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IPSAS®

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ACCOUNTING STANDARDS**

IPSAS[®]

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IPSAS 41—FINANCIAL INSTRUMENTS

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Financial Reporting Standard (IFRS) 9, *Financial Instruments*, IFRIC 16, *Hedges of a Net Investment in a Foreign Operation*, and IFRIC 19, *Extinguishing Financial Liabilities with Equity Instruments* published by the International Accounting Standards Board (IASB). Extracts from IFRS 9, IFRIC 16 and IFRIC 19 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards Foundation.

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IPSAS 41—FINANCIAL INSTRUMENTS

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2022.

IPSAS 41, *Financial Instruments* was issued in August 2018.

Since then, IPSAS 36 has been amended by the following IPSASs:

- IPSAS 43, *Leases* (issued January 2022)
- *Improvements to IPSAS 2021* (issued January 2022)
- Non-Authoritative Amendments to IPSAS 41, *Financial Instruments* (issued December 2020)
- *COVID-19: Deferral of Effective Dates* (issued November 2020)
- *Long-term Interests in Associates and Joint Ventures* (Amendments to IPSAS 36) and *Prepayment Features with Negative Compensation* (Amendments to IPSAS 41) (issued January 2019)

Table of Amended Paragraphs in IPSAS 41

Paragraph Affected	How Affected	Affected By
2	Amended	IPSAS 43 January 2022
Heading above paragraph 72A	New	Improvements to IPSAS January 2022
72A	New	Improvements to IPSAS January 2022
72B	New	Improvements to IPSAS January 2022
72C	New	Improvements to IPSAS January 2022
72D	New	Improvements to IPSAS January 2022
72E	New	Improvements to IPSAS January 2022
87	Amended	IPSAS 43 January 2022
Heading above paragraph 155A	New	Improvements to IPSAS January 2022
155A	New	Improvements to IPSAS January 2022
155B	New	Improvements to IPSAS January 2022
155C	New	Improvements to IPSAS January 2022
Heading above paragraph 155D	New	Improvements to IPSAS January 2022
155D	New	Improvements to IPSAS January 2022
Heading above paragraph 155E	New	Improvements to IPSAS January 2022
155E	New	Improvements to IPSAS January 2022
Heading above paragraph 155F	New	Improvements to IPSAS January 2022
155F	New	Improvements to IPSAS January 2022
Heading above paragraph 155G	New	Improvements to IPSAS January 2022
155G	New	Improvements to IPSAS January 2022
155H	New	Improvements to IPSAS January 2022
Heading above paragraph 155I	New	Improvements to IPSAS January 2022

Paragraph Affected	How Affected	Affected By
155I	New	Improvements to IPSAS January 2022
155J	New	Improvements to IPSAS January 2022
155K	New	Improvements to IPSAS January 2022
155L	New	Improvements to IPSAS January 2022
155M	New	Improvements to IPSAS January 2022
Heading above paragraph 155N	New	Improvements to IPSAS January 2022
155N	New	Improvements to IPSAS January 2022
155O	New	Improvements to IPSAS January 2022
155P	New	Improvements to IPSAS January 2022
155Q	New	Improvements to IPSAS January 2022
155R	New	Improvements to IPSAS January 2022
155S	New	Improvements to IPSAS January 2022
Headings above paragraph 155T	New	Improvements to IPSAS January 2022
155T	New	Improvements to IPSAS January 2022
155U	New	Improvements to IPSAS January 2022
Heading above paragraph 155V	New	Improvements to IPSAS January 2022
155V	New	Improvements to IPSAS January 2022
155W	New	Improvements to IPSAS January 2022
Heading above paragraph 155X	New	Improvements to IPSAS January 2022
155X	New	Improvements to IPSAS January 2022
155Y	New	Improvements to IPSAS January 2022
155Z	New	Improvements to IPSAS January 2022
156	Amended	COVID-19: Deferral of Effective Dates November 2020
156A	Amended	COVID-19: Deferral of Effective Dates November 2020
156B	New	Improvements to IPSAS January 2022
156C	New	Improvements to IPSAS January 2022
156D	New	Improvements to IPSAS January 2022
156E	New	IPSAS 43 January 2022
Heading above paragraph 184	New	Long-term Interests in Associates and Joint Ventures (Amendments to IPSAS 36) and Prepayment Features with Negative Compensation (Amendments to IPSAS 41) January 2019
184	Amended	Long-term Interests in Associates and Joint Ventures (Amendments to IPSAS 36) and Prepayment Features with Negative Compensation (Amendments to IPSAS 41) January 2019 Improvements to IPSAS January 2022
185	New	Long-term Interests in Associates and Joint Ventures (Amendments to IPSAS 36) and Prepayment Features with Negative Compensation (Amendments to IPSAS 41) January 2019
186	New	Long-term Interests in Associates and Joint Ventures (Amendments to IPSAS 36) and Prepayment Features with Negative Compensation (Amendments to IPSAS 41) January 2019

Paragraph Affected	How Affected	Affected By
187	New	Long-term Interests in Associates and Joint Ventures (Amendments to IPSAS 36) and Prepayment Features with Negative Compensation (Amendments to IPSAS 41) January 2019
188	New	Long-term Interests in Associates and Joint Ventures (Amendments to IPSAS 36) and Prepayment Features with Negative Compensation (Amendments to IPSAS 41) January 2019
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191	New	Improvements to IPSAS January 2022
192	New	Improvements to IPSAS January 2022
193	New	Improvements to IPSAS January 2022
194	New	Improvements to IPSAS January 2022
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AG74A	New	Long-term Interests in Associates and Joint Ventures (Amendments to IPSAS 36) and Prepayment Features with Negative Compensation (Amendments to IPSAS 41) January 2019
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AG210	Amended	IPSAS 43 January 2022
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B1	New	Non-Authoritative Amendments to IPSAS 41, Financial Instruments December 2020
B11	New	Non-Authoritative Amendments to IPSAS 41, Financial Instruments December 2020
B12	New	Non-Authoritative Amendments to IPSAS 41, Financial Instruments December 2020
B121	New	Non-Authoritative Amendments to IPSAS 41, Financial Instruments December 2020
B122	New	Non-Authoritative Amendments to IPSAS 41, Financial Instruments December 2020
B123	New	Non-Authoritative Amendments to IPSAS 41, Financial Instruments December 2020

IPSAS 41—FINANCIAL INSTRUMENTS

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Objective

1. The objective of this Standard is to establish principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows.

Scope

2. **This Standard shall be applied by all entities to all types of financial instruments except:**
 - (a) **Those interests in controlled entities, associates and joint ventures that are accounted for in accordance with IPSAS 34, *Separate Financial Statements*, IPSAS 35, *Consolidated Financial Statements*, or IPSAS 36, *Investments in Associates and Joint Ventures*. However, in some cases, IPSAS 34, IPSAS 35 or IPSAS 36 require or permit an entity to account for an interest in a controlled entity, associate or joint venture in accordance with some or all of the requirements of this Standard. Entities shall also apply this Standard to derivatives on an interest in a controlled entity, associate or joint venture unless the derivative meets the definition of an equity instrument of the entity in IPSAS 28, *Financial Instruments: Presentation*.**
 - (b) **Rights and obligations under leases to which IPSAS 43, *Leases* applies. However:**
 - (i) **Finance lease receivables (i.e., net investments in finance leases) and operating lease receivables recognized by a lessor are subject to the derecognition and impairment requirements of this Standard;**
 - (ii) **Lease liabilities recognized by a lessee are subject to the derecognition requirements in paragraph 35 of this Standard; and**
 - (iii) **Derivatives that are embedded in leases are subject to the embedded derivatives requirements of this Standard.**
 - (c) **Employers' rights and obligations under employee benefit plans, to which IPSAS 39, *Employee Benefits* applies.**
 - (d) **Financial instruments issued by the entity that meet the definition of an equity instrument in IPSAS 28 (including options and warrants) or that are required to be classified as an equity instrument in accordance with paragraphs 15 and 16 or paragraphs 17 and 18 of IPSAS 28. However, the holder of such equity instruments shall apply this Standard to those instruments, unless they meet the exception in (a).**
 - (e) **Rights and obligations arising under:**
 - (i) **An insurance contract, other than an issuer's rights and obligations arising under an insurance contract that meets the definition of a financial guarantee contract in paragraph 9; or**
 - (ii) **A contract that is within the scope of relevant international or national accounting standard dealing with insurance contracts because it contains a discretionary participation feature.**

This Standard applies to a derivative that is embedded in a contract if the derivative is not itself an insurance contract (see paragraphs 47–53 and Appendix A paragraphs AG99–AG110 of this Standard). An entity applies this Standard to financial guarantee contracts, but shall apply the relevant international or national accounting standard dealing with insurance contracts if the issuer elects to apply that standard in recognizing and measuring them. Notwithstanding (i) above, an entity may apply this Standard to other insurance contracts which involve the transfer of financial risk.
 - (f) **Any forward contract between an acquirer and a selling shareholder to buy or sell an acquired operation that will result in a public sector combination to which IPSAS 40 applies at a future acquisition date. The term of the forward contract should not exceed a reasonable period normally necessary to obtain any required approvals and to complete the transaction.**
 - (g) **Loan commitments other than those loan commitments described in paragraph 4. However, an issuer of loan commitments shall apply the impairment requirements of this Standard to loan commitments that are not otherwise within the scope of this Standard. Also, all loan commitments are subject to the derecognition requirements of this Standard.**
 - (h) **Financial instruments, contracts and obligations under share-based payment transactions to which the relevant international or national accounting standard dealing with share based payment applies, except for contracts within the scope of paragraphs 5–8 of this Standard to which this Standard applies.**

- (i) **Rights to payments to reimburse the entity for expenditure that it is required to make to settle a liability that it recognizes as a provision in accordance with IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*, or for which, in an earlier period, it recognized a provision in accordance with IPSAS 19.**
 - (j) **The initial recognition and initial measurement of rights and obligations arising from non-exchange revenue transactions to which IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)* applies; except as described in paragraph AG6.**
 - (k) **Rights and obligations under service concession arrangements to which IPSAS 32, *Service Concession Arrangements: Grantor* applies. However, financial liabilities recognized by a grantor under the financial liability model are subject to the derecognition provisions of this Standard (see paragraphs 35–38 and Appendix A paragraphs AG39–AG47).**
3. **The impairment requirements of this Standard shall be applied to those rights arising from IPSAS 9, *Revenue from Exchange Transactions* and IPSAS 23 transactions which give rise to financial instruments for the purposes of recognizing impairment gains or losses.**
4. **The following loan commitments are within the scope of this Standard:**
- (a) **Loan commitments that the entity designates as financial liabilities at fair value through surplus or deficit (see paragraph 46). An entity that has a past practice of selling the assets resulting from its loan commitments shortly after origination shall apply this Standard to all its loan commitments in the same class.**
 - (b) **Loan commitments that can be settled net in cash or by delivering or issuing another financial instrument. These loan commitments are derivatives. A loan commitment is not regarded as settled net merely because the loan is paid out in installments (for example, a mortgage construction loan that is paid out in installments in line with the progress of construction).**
 - (c) **Commitments to provide a loan at a below-market interest rate (see paragraph 45(d)).**
5. **This Standard shall be applied to those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements. However, this Standard shall be applied to those contracts that an entity designates as measured at fair value through surplus or deficit in accordance with paragraph 6.**
6. **A contract to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contract was a financial instrument, may be irrevocably designated as measured at fair value through surplus or deficit even if it was entered into for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements. This designation is available only at inception of the contract and only if it eliminates or significantly reduces a recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise from not recognizing that contract because it is excluded from the scope of this Standard (see paragraph 5).**
7. **There are various ways in which a contract to buy or sell a non-financial item can be settled net in cash or another financial instrument or by exchanging financial instruments. These include:**
- (a) **When the terms of the contract permit either party to settle it net in cash or another financial instrument or by exchanging financial instruments;**
 - (b) **When the ability to settle net in cash or another financial instrument, or by exchanging financial instruments, is not explicit in the terms of the contract, but the entity has a practice of settling similar contracts net in cash or another financial instrument or by exchanging financial instruments (whether with the counterparty, by entering into offsetting contracts or by selling the contract before its exercise or lapse);**
 - (c) **When, for similar contracts, the entity has a practice of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin; and**
 - (d) **When the non-financial item that is the subject of the contract is readily convertible to cash.**

A contract to which (b) or (c) applies is not entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements and, accordingly, is within the scope

of this Standard. Other contracts to which paragraph 5 applies are evaluated to determine whether they were entered into and continue to be held for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements and, accordingly, whether they are within the scope of this Standard.

8. A written option to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, in accordance with paragraph 7(a) or 7(d) is within the scope of this Standard. Such a contract cannot be entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements.

Definitions

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

12-month expected credit losses are the portion of lifetime expected credit losses that represent the expected credit losses that result from default events on a financial instrument that are possible within the 12 months after the reporting date.

The amortized cost of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any loss allowance.

A **credit-impaired financial asset** is a financial asset that is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred. Evidence that a financial asset is credit-impaired include observable data about the following events:

- (a) Significant financial difficulty of the issuer or the borrower;
- (b) A breach of contract, such as a default or past due event;
- (c) The lender(s) of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession(s) that the lender(s) would not otherwise consider;
- (d) It is becoming probable that the borrower will enter bankruptcy or other financial reorganization;
- (e) The disappearance of an active market for that financial asset because of financial difficulties; or
- (f) The purchase or origination of a financial asset at a deep discount that reflects the incurred credit losses.

It may not be possible to identify a single discrete event—instead, the combined effect of several events may have caused financial assets to become credit-impaired.

Credit loss is the difference between all contractual cash flows that are due to an entity in accordance with the contract and all the cash flows that the entity expects to receive (i.e., all cash shortfalls), discounted at the original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets). An entity shall estimate cash flows by considering all contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) through the expected life of that financial instrument. The cash flows that are considered shall include cash flows from the sale of collateral held or other credit enhancements that are integral to the contractual terms. There is a presumption that the expected life of a financial instrument can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the expected life of a financial instrument, the entity shall use the remaining contractual term of the financial instrument.

Credit-adjusted effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts through the expected life of the financial asset to the amortized cost of a financial asset that is a purchased or originated credit-impaired financial asset. When calculating the credit-adjusted effective interest rate, an entity shall estimate the expected cash flows by considering all contractual terms of the financial asset (for example, prepayment, extension, call and similar options) and expected credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate (see paragraphs AG156–AG158), transaction costs, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the cash flows or the remaining life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments).

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

A **derivative** is a financial instrument or other contract within the scope of this Standard with all three of the following characteristics.

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

Dividends or similar distributions are distributions to holders of equity instruments in proportion to their holdings of a particular class of capital.

The **effective interest method** is the method that is used in the calculation of the amortized cost of a financial asset or a financial liability and in the allocation and recognition of the interest revenue or interest expense in surplus or deficit over the relevant period.

The **effective interest rate** is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset or to the amortized cost of a financial liability. When calculating the effective interest rate, an entity shall estimate the expected cash flows by considering all the contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) but shall not consider the expected credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate (see paragraphs AG156–AG158), transaction costs, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the cash flows or the expected life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments).

An **expected credit loss** is the weighted average of credit losses with the respective risks of a default occurring as the weights.

A **financial guarantee contract** is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

A **financial liability at fair value through surplus or deficit** is a financial liability that meets one of the following conditions:

- (a) It meets the definition of held for trading.
- (b) Upon initial recognition it is designated by the entity as at fair value through surplus or deficit in accordance with paragraph 46 or 51.
- (c) It is designated either upon initial recognition or subsequently as at fair value through surplus or deficit in accordance with paragraph 152.

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

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

The **gross carrying amount of a financial asset** is the amortized cost of a financial asset, before adjusting for any loss allowance.

The **hedge ratio** is the relationship between the quantity of the hedging instrument and the quantity of the hedged item in terms of their relative weighting.

A **held for trading** financial instrument is a financial asset or financial liability that:

- (a) Is acquired or incurred principally for the purpose of selling or repurchasing it in the near term;
- (b) On initial recognition is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or
- (c) Is a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).

An **impairment gain or loss** is recognized in surplus or deficit in accordance with paragraph 80 and arises from applying the impairment requirements in paragraphs 73–93.

Lifetime expected credit losses are the expected credit losses that result from all possible default events over the expected life of a financial instrument.

A **loss allowance** is the allowance for expected credit losses on financial assets measured in accordance with paragraph 40, lease receivables, the accumulated impairment amount for financial assets measured in accordance with paragraph 41 and the provision for expected credit losses on loan commitments and financial guarantee contracts.

A **modification gain or loss** is the amount arising from adjusting the gross carrying amount of a financial asset to reflect the renegotiated or modified contractual cash flows. The entity recalculates the gross carrying amount of a financial asset as the present value of the estimated future cash payments or receipts through the expected life of the renegotiated or modified financial asset that are discounted at the financial asset's original effective interest rate (or the original credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets) or, when applicable, the revised effective interest rate calculated in accordance with paragraph 139. When estimating the expected cash flows of a financial asset, an entity shall consider all contractual terms of the financial asset (for example, prepayment, call and similar options) but shall not consider the expected credit losses, unless the financial asset is a purchased or originated credit-impaired financial asset, in which case an entity shall also consider the initial expected credit losses that were considered when calculating the original credit-adjusted effective interest rate.

A financial asset is **past due** when a counterparty has failed to make a payment when that payment was contractually due.

A **purchased or originated credit-impaired financial asset** is credit-impaired on initial recognition.

The **reclassification date** is the first day of the first reporting period following the change in management model that results in an entity reclassifying financial assets.

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

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability (see paragraph AG163). An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.

Terms defined in other IPSAS are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately. The following terms are defined in either IPSAS 28 or IPSAS 30, *Financial Instruments: Disclosures*: credit risk¹, currency risk, liquidity risk, market risk, equity instrument, financial asset, financial instrument, financial liability and puttable instrument.

Recognition and Derecognition

Initial Recognition

10. An entity shall recognize a financial asset or a financial liability in its statement of financial position when, and only when, the entity becomes party to the contractual provisions of the instrument (see paragraphs AG15 and AG16). When an entity first recognizes a financial asset, it shall classify it in accordance with paragraphs 39–44 and measure it in accordance with paragraphs 57 and 59. When an entity first recognizes a financial liability, it shall classify it in accordance with paragraphs 45 and 46 and measure it in accordance with paragraph 57.

¹ This term (as defined in IPSAS 30) is used in the requirements for presenting the effects of changes in credit risk on liabilities designated as at fair value through surplus or deficit (see paragraph 108).

Regular Way Purchase or Sale of Financial Assets

11. **A regular way purchase or sale of financial assets shall be recognized and derecognized, as applicable, using trade date accounting or settlement date accounting (see paragraphs AG17–AG20).**

Derecognition of Financial Assets

12. In consolidated financial statements, paragraphs 13–20, AG15, AG16 and AG21–AG38 are applied at a consolidated level. Hence, an entity first consolidates all controlled entities in accordance with IPSAS 35 and then applies those paragraphs to the resulting economic entity.
13. **Before evaluating whether, and to what extent, derecognition is appropriate under paragraphs 14–20, an entity determines whether those paragraphs should be applied to a part of a financial asset (or a part of a group of similar financial assets) or a financial asset (or a group of similar financial assets) in its entirety, as follows.**
- (a) **Paragraphs 14–20 are applied to a part of a financial asset (or a part of a group of similar financial assets) if, and only if, the part being considered for derecognition meets one of the following three conditions.**
- (i) **The part comprises only specifically identified cash flows from a financial asset (or a group of similar financial assets). For example, when an entity enters into an interest rate strip whereby the counterparty obtains the right to the interest cash flows, but not the principal cash flows from a debt instrument, paragraphs 14–20 are applied to the interest cash flows.**
- (ii) **The part comprises only a fully proportionate (pro rata) share of the cash flows from a financial asset (or a group of similar financial assets). For example, when an entity enters into an arrangement whereby the counterparty obtains the rights to a 90 percent share of all cash flows of a debt instrument, paragraphs 14–20 are applied to 90 percent of those cash flows. If there is more than one counterparty, each counterparty is not required to have a proportionate share of the cash flows provided that the transferring entity has a fully proportionate share.**
- (iii) **The part comprises only a fully proportionate (pro rata) share of specifically identified cash flows from a financial asset (or a group of similar financial assets). For example, when an entity enters into an arrangement whereby the counterparty obtains the rights to a 90 percent share of interest cash flows from a financial asset, paragraphs 14–20 are applied to 90 percent of those interest cash flows. If there is more than one counterparty, each counterparty is not required to have a proportionate share of the specifically identified cash flows provided that the transferring entity has a fully proportionate share.**
- (b) **In all other cases, paragraphs 14–20 are applied to the financial asset in its entirety (or to the group of similar financial assets in their entirety). For example, when an entity transfers (i) the rights to the first or the last 90 percent of cash collections from a financial asset (or a group of financial assets), or (ii) the rights to 90 percent of the cash flows from a group of receivables, but provides a guarantee to compensate the buyer for any credit losses up to 8 percent of the principal amount of the receivables, paragraphs 14–20 are applied to the financial asset (or a group of similar financial assets) in its entirety.**

In paragraphs 14–23, the term ‘financial asset’ refers to either a part of a financial asset (or a part of a group of similar financial assets) as identified in (a) above or, otherwise, a financial asset (or a group of similar financial assets) in its entirety.

14. **An entity shall derecognize a financial asset when, and only when:**
- (a) **The contractual rights to the cash flows from the financial asset expire or are waived, or**
- (b) **It transfers the financial asset as set out in paragraphs 15 and 16 and the transfer qualifies for derecognition in accordance with paragraph 17.**
- (See paragraph 11 for regular way sales of financial assets.)**
15. **An entity transfers a financial asset if, and only if, it either:**
- (a) **Transfers the contractual rights to receive the cash flows of the financial asset, or**
- (b) **Retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients in an arrangement that meets the conditions in paragraph 16.**

16. **When an entity retains the contractual rights to receive the cash flows of a financial asset (the ‘original asset’), but assumes a contractual obligation to pay those cash flows to one or more entities (the ‘eventual recipients’), the entity treats the transaction as a transfer of a financial asset if, and only if, all of the following three conditions are met.**
- (a) **The entity has no obligation to pay amounts to the eventual recipients unless it collects equivalent amounts from the original asset. Short-term advances by the entity with the right of full recovery of the amount lent plus accrued interest at market rates do not violate this condition.**
 - (b) **The entity is prohibited by the terms of the transfer contract from selling or pledging the original asset other than as security to the eventual recipients for the obligation to pay them cash flows.**
 - (c) **The entity has an obligation to remit any cash flows it collects on behalf of the eventual recipients without material delay. In addition, the entity is not entitled to reinvest such cash flows, except for investments in cash or cash equivalents (as defined in IPSAS 2, *Cash Flow Statements*) during the short settlement period from the collection date to the date of required remittance to the eventual recipients, and interest earned on such investments is passed to the eventual recipients.**
17. **When an entity transfers a financial asset (see paragraph 15), it shall evaluate the extent to which it retains the risks and rewards of ownership of the financial asset. In this case:**
- (a) **If the entity transfers substantially all the risks and rewards of ownership of the financial asset, the entity shall derecognize the financial asset and recognize separately as assets or liabilities any rights and obligations created or retained in the transfer.**
 - (b) **If the entity retains substantially all the risks and rewards of ownership of the financial asset, the entity shall continue to recognize the financial asset.**
 - (c) **If the entity neither transfers nor retains substantially all the risks and rewards of ownership of the financial asset, the entity shall determine whether it has retained control of the financial asset. In this case:**
 - (i) **If the entity has not retained control, it shall derecognize the financial asset and recognize separately as assets or liabilities any rights and obligations created or retained in the transfer.**
 - (ii) **If the entity has retained control, it shall continue to recognize the financial asset to the extent of its continuing involvement in the financial asset (see paragraph 27).**
18. The transfer of risks and rewards (see paragraph 17) is evaluated by comparing the entity’s exposure, before and after the transfer, with the variability in the amounts and timing of the net cash flows of the transferred asset. An entity has retained substantially all the risks and rewards of ownership of a financial asset if its exposure to the variability in the present value of the future net cash flows from the financial asset does not change significantly as a result of the transfer (e.g., because the entity has sold a financial asset subject to an agreement to buy it back at a fixed price or the sale price plus a lender’s return). An entity has transferred substantially all the risks and rewards of ownership of a financial asset if its exposure to such variability is no longer significant in relation to the total variability in the present value of the future net cash flows associated with the financial asset (e.g., because the entity has sold a financial asset subject only to an option to buy it back at its *fair value* at the time of repurchase or has transferred a fully proportionate share of the cash flows from a larger financial asset in an arrangement, such as a loan sub-participation, that meets the conditions in paragraph 16).
19. Often it will be obvious whether the entity has transferred or retained substantially all risks and rewards of ownership and there will be no need to perform any computations. In other cases, it will be necessary to compute and compare the entity’s exposure to the variability in the present value of the future net cash flows before and after the transfer. The computation and comparison are made using as the discount rate an appropriate current market interest rate. All reasonably possible variability in net cash flows is considered, with greater weight being given to those outcomes that are more likely to occur.
20. Whether the entity has retained control (see paragraph 17(c)) of the transferred asset depends on the transferee’s ability to sell the asset. If the transferee has the practical ability to sell the asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without needing to impose additional restrictions on the transfer, the entity has not retained control. In all other cases, the entity has retained control.

Transfers that Qualify for Derecognition

21. **If an entity transfers a financial asset in a transfer that qualifies for derecognition in its entirety and retains the right to service the financial asset for a fee, it shall recognize either a servicing asset or a servicing liability for that servicing contract. If the fee to be received is not expected to compensate the entity adequately for performing the servicing, a servicing liability for the servicing obligation shall be recognized at its fair value. If the fee to be received**

is expected to be more than adequate compensation for the servicing, a servicing asset shall be recognized for the servicing right at an amount determined on the basis of an allocation of the carrying amount of the larger financial asset in accordance with paragraph 24.

22. **If, as a result of a transfer, a financial asset is derecognized in its entirety but the transfer results in the entity obtaining a new financial asset or assuming a new financial liability, or a servicing liability, the entity shall recognize the new financial asset, financial liability or servicing liability at fair value.**
23. **On derecognition of a financial asset in its entirety, the difference between:**
- (a) **The carrying amount (measured at the date of derecognition); and**
 - (b) **The consideration received (including any new asset obtained less any new liability assumed)**
- shall be recognized in surplus or deficit.**
24. **If the transferred asset is part of a larger financial asset (e.g., when an entity transfers interest cash flows that are part of a debt instrument, see paragraph 13(a)) and the part transferred qualifies for derecognition in its entirety, the previous carrying amount of the larger financial asset shall be allocated between the part that continues to be recognized and the part that is derecognized, on the basis of the relative fair values of those parts on the date of the transfer. For this purpose, a retained servicing asset shall be treated as a part that continues to be recognized. The difference between:**
- (a) **The carrying amount (measured at the date of derecognition) allocated to the part derecognized; and**
 - (b) **The consideration received for the part derecognized (including any new asset obtained less any new liability assumed)**
- shall be recognized in surplus or deficit.**
25. When an entity allocates the previous carrying amount of a larger financial asset between the part that continues to be recognized and the part that is derecognized, the fair value of the part that continues to be recognized needs to be measured. When the entity has a history of selling parts similar to the part that continues to be recognized or other market transactions exist for such parts, recent prices of actual transactions provide the best estimate of its fair value. When there are no price quotes or recent market transactions to support the fair value of the part that continues to be recognized, the best estimate of the fair value is the difference between the fair value of the larger financial asset as a whole and the consideration received from the transferee for the part that is derecognized.

Transfers that do not Qualify for Derecognition

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

Continuing Involvement in Transferred Assets

27. **If an entity neither transfers nor retains substantially all the risks and rewards of ownership of a transferred asset, and retains control of the transferred asset, the entity continues to recognize the transferred asset to the extent of its continuing involvement. The extent of the entity's continuing involvement in the transferred asset is the extent to which it is exposed to changes in the value of the transferred asset. For example:**
- (a) **When the entity's continuing involvement takes the form of guaranteeing the transferred asset, the extent of the entity's continuing involvement is the lower of (i) the amount of the asset and (ii) the maximum amount of the consideration received that the entity could be required to repay ('the guarantee amount').**
 - (b) **When the entity's continuing involvement takes the form of a written or purchased option (or both) on the transferred asset, the extent of the entity's continuing involvement is the amount of the transferred asset that the entity may repurchase. However, in the case of a written put option on an asset that is measured at fair value, the extent of the entity's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price (see paragraph AG34).**
 - (c) **When the entity's continuing involvement takes the form of a cash-settled option or similar provision on the transferred asset, the extent of the entity's continuing involvement is measured in the same way as that which results from non-cash settled options as set out in (b) above.**

28. **When an entity continues to recognize an asset to the extent of its continuing involvement, the entity also recognizes an associated liability. Despite the other measurement requirements in this Standard, the transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the entity has retained. The associated liability is measured in such a way that the net carrying amount of the transferred asset and the associated liability is:**
- (a) **The amortized cost of the rights and obligations retained by the entity, if the transferred asset is measured at amortized cost; or**
 - (b) **Equal to the fair value of the rights and obligations retained by the entity when measured on a stand-alone basis, if the transferred asset is measured at fair value.**
29. **The entity shall continue to recognize any revenue arising on the transferred asset to the extent of its continuing involvement and shall recognize any expense incurred on the associated liability.**
30. **For the purpose of subsequent measurement, recognized changes in the fair value of the transferred asset and the associated liability are accounted for consistently with each other in accordance with paragraph 101, and shall not be offset.**
31. **If an entity's continuing involvement is in only a part of a financial asset (e.g., when an entity retains an option to repurchase part of a transferred asset, or retains a residual interest that does not result in the retention of substantially all the risks and rewards of ownership and the entity retains control), the entity allocates the previous carrying amount of the financial asset between the part it continues to recognize under continuing involvement, and the part it no longer recognizes on the basis of the relative fair values of those parts on the date of the transfer. For this purpose, the requirements of paragraph 25 apply. The difference between:**
- (a) **The carrying amount (measured at the date of derecognition) allocated to the part that is no longer recognized; and**
 - (b) **The consideration received for the part no longer recognized**
- shall be recognized in surplus or deficit.**
32. **If the transferred asset is measured at amortized cost, the option in this Standard to designate a financial liability as at fair value through surplus or deficit is not applicable to the associated liability.**

All Transfers

33. **If a transferred asset continues to be recognized, the asset and the associated liability shall not be offset. Similarly, the entity shall not offset any revenue arising from the transferred asset with any expense incurred on the associated liability (see paragraph 47 of IPSAS 28).**
34. **If a transferor provides non-cash collateral (such as debt or equity instruments) to the transferee, the accounting for the collateral by the transferor and the transferee depends on whether the transferee has the right to sell or repledge the collateral and on whether the transferor has defaulted. The transferor and transferee shall account for the collateral as follows:**
- (a) **If the transferee has the right by contract or custom to sell or repledge the collateral, then the transferor shall reclassify that asset in its statement of financial position (e.g., as a loaned asset, pledged equity instruments or repurchase receivable) separately from other assets.**
 - (b) **If the transferee sells collateral pledged to it, it shall recognize the proceeds from the sale and a liability measured at fair value for its obligation to return the collateral.**
 - (c) **If the transferor defaults under the terms of the contract and is no longer entitled to redeem the collateral, it shall derecognize the collateral, and the transferee shall recognize the collateral as its asset initially measured at fair value or, if it has already sold the collateral, derecognize its obligation to return the collateral.**
 - (d) **Except as provided in (c), the transferor shall continue to carry the collateral as its asset, and the transferee shall not recognize the collateral as an asset.**

Derecognition of Financial Liabilities

35. **An entity shall remove a financial liability (or a part of a financial liability) from its statement of financial position when, and only when, it is extinguished—i.e., when the obligation specified in the contract is discharged, waived, canceled or expires.**

36. **An exchange between an existing borrower and lender of debt instruments with substantially different terms shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. Similarly, a substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.**
37. **The difference between the carrying amount of a financial liability (or part of a financial liability) extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, shall be recognized in surplus or deficit. Where an obligation is waived by the lender or assumed by a third party as part of a non-exchange transaction, an entity applies IPSAS 23.**
38. **If an entity repurchases a part of a financial liability, the entity shall allocate the previous carrying amount of the financial liability between the part that continues to be recognized and the part that is derecognized based on the relative fair values of those parts on the date of the repurchase. The difference between (a) the carrying amount allocated to the part derecognized and (b) the consideration paid, including any non-cash assets transferred or liabilities assumed, for the part derecognized shall be recognized in surplus or deficit.**

Classification

Classification of Financial Assets

39. **Unless paragraph 44 applies, an entity shall classify financial assets as subsequently measured at amortized cost, fair value through net assets/equity or fair value through surplus or deficit on the basis of both:**
- (a) **The entity's management model for financial assets and**
 - (b) **The contractual cash flow characteristics of the financial asset.**
40. **A financial asset shall be measured at amortized cost if both of the following conditions are met:**
- (a) **The financial asset is held within a management model whose objective is to hold financial assets in order to collect contractual cash flows and**
 - (b) **The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.**

Paragraphs AG48–AG88 provide guidance on how to apply these conditions.

41. **A financial asset shall be measured at fair value through net assets/equity if both of the following conditions are met:**
- (a) **The financial asset is held within a management model whose objective is achieved by both collecting contractual cash flows and selling financial assets and**
 - (b) **The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.**

Paragraphs AG48–AG88 provide guidance on how to apply these conditions.

42. **For the purpose of applying paragraphs 40(b) and 41(b):**
- (a) **Principal is the fair value of the financial asset at initial recognition. Paragraph AG64 provides additional guidance on the meaning of principal.**
 - (b) **Interest consists of consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs, as well as a profit margin. Paragraphs AG63 and AG67–AG71 provide additional guidance on the meaning of interest, including the meaning of the time value of money.**
43. **A financial asset shall be measured at fair value through surplus or deficit unless it is measured at amortized cost in accordance with paragraph 40 or at fair value through net assets/equity in accordance with paragraph 41. However an entity may make an irrevocable election at initial recognition for particular investments in equity instruments that would otherwise be measured at fair value through surplus or deficit to present subsequent changes in fair value in net assets/equity (see paragraphs 106–107).**

Option to Designate a Financial Asset at Fair Value through Surplus or Deficit

44. **Despite paragraphs 39–43, an entity may, at initial recognition, irrevocably designate a financial asset as measured at fair value through surplus or deficit if doing so eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an ‘accounting mismatch’) that would otherwise arise from measuring assets or liabilities or recognizing the gains and losses on them on different bases (see paragraphs AG91–AG94).**

Classification of Financial Liabilities

45. **An entity shall classify all financial liabilities as subsequently measured at amortized cost, except for:**
- (a) **Financial liabilities at fair value through surplus or deficit. Such liabilities, including derivatives that are liabilities, shall be subsequently measured at fair value.**
 - (b) **Financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies. Paragraphs 26 and 28 apply to the measurement of such financial liabilities.**
 - (c) **Financial guarantee contracts. After initial recognition, an issuer of such a contract shall (unless paragraph 45(a) or (b) applies) subsequently measure it at the higher of:**
 - (i) **The amount of the loss allowance determined in accordance with paragraphs 73–93; and**
 - (ii) **The amount initially recognized (see paragraph 57) less, when appropriate, the cumulative amount of amortization recognized in accordance with the principles of IPSAS 9.**
 - (d) **Commitments to provide a loan at a below-market interest rate. An issuer of such a commitment shall (unless paragraph 45(a) applies) subsequently measure it at the higher of:**
 - (i) **The amount of the loss allowance determined in accordance with paragraphs 73–93; and**
 - (ii) **The amount initially recognized (see paragraph 57) less, when appropriate, the cumulative amount of amortization recognized in accordance with the principles of IPSAS 9.**
 - (e) **Contingent consideration recognized by an acquirer in a public sector combination to which IPSAS 40 applies. Such contingent consideration shall subsequently be measured at fair value with changes recognized in surplus or deficit.**

Option to Designate a Financial Liability at Fair Value through Surplus or Deficit

46. **An entity may, at initial recognition, irrevocably designate a financial liability as measured at fair value through surplus or deficit when permitted by paragraph 51, or when doing so results in more relevant information, because either:**
- (a) **It eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as ‘an accounting mismatch’) that would otherwise arise from measuring assets or liabilities or recognizing the gains and losses on them on different bases (see paragraphs AG91–AG94); or**
 - (b) **A group of financial liabilities or financial assets and financial liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity’s key management personnel (as defined in IPSAS 20, *Related Party Disclosures*), for example, the entity’s governing body and chief executive officer (see paragraphs AG95–AG98).**

Embedded Derivatives

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

Hybrid Contracts with Financial Asset Hosts

48. **If a hybrid contract contains a host that is an asset within the scope of this Standard, an entity shall apply the requirements in paragraphs 39–44 to the entire hybrid contract.**

Other Hybrid Contracts

49. **If a hybrid contract contains a host that is not an asset within the scope of this Standard, an embedded derivative shall be separated from the host and accounted for as a derivative under this Standard if, and only if:**
- (a) **The economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host (see paragraphs AG103 and AG106);**
 - (b) **A separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and**
 - (c) **The hybrid contract is not measured at fair value with changes in fair value recognized in surplus or deficit (i.e., a derivative that is embedded in a financial liability at fair value through surplus or deficit is not separated).**
50. **If an embedded derivative is separated, the host contract shall be accounted for in accordance with the appropriate Standards. This Standard does not address whether an embedded derivative shall be presented separately in the statement of financial position.**
51. **Despite paragraphs 49 and 50, if a contract contains one or more embedded derivatives and the host is not an asset within the scope of this Standard, an entity may designate the entire hybrid contract as at fair value through surplus or deficit unless:**
- (a) **The embedded derivative(s) do(es) not significantly modify the cash flows that otherwise would be required by the contract; or**
 - (b) **It is clear with little or no analysis when a similar hybrid instrument is first considered that separation of the embedded derivative(s) is prohibited, such as a prepayment option embedded in a loan that permits the holder to prepay the loan for approximately its amortized cost.**
52. **If an entity is required by this Standard to separate an embedded derivative from its host, but is unable to measure the embedded derivative separately either at acquisition or at the end of a subsequent financial reporting period, it shall designate the entire hybrid contract as at fair value through surplus or deficit.**
53. **If an entity is unable to measure reliably the fair value of an embedded derivative on the basis of its terms and conditions, the fair value of the embedded derivative is the difference between the fair value of the hybrid contract and the fair value of the host. If the entity is unable to measure the fair value of the embedded derivative using this method, paragraph 52 applies and the hybrid contract is designated as at fair value through surplus or deficit.**

Reclassification

54. **When, and only when, an entity changes its management model for financial assets it shall reclassify all affected financial assets in accordance with paragraphs 39–43. See paragraphs 94–100, AG111–AG113 and AG220–AG221 for additional guidance on reclassifying financial assets.**
55. **An entity shall not reclassify any financial liability.**
56. **The following changes in circumstances are not reclassifications for the purposes of paragraphs 54–55:**
- (a) **An item that was previously a designated and effective hedging instrument in a cash flow hedge or net investment hedge no longer qualifies as such;**
 - (b) **An item becomes a designated and effective hedging instrument in a cash flow hedge or net investment hedge; and**
 - (c) **Changes in measurement in accordance with paragraphs 152–155.**

Measurement**Initial Measurement**

57. **Except for short-term receivables and payables within the scope of paragraph 60, at initial recognition, an entity shall measure a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or**

financial liability not at fair value through surplus or deficit, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

58. **However, if the fair value of the financial asset or financial liability at initial recognition differs from the transaction price, an entity shall apply paragraph AG117.**
59. When an entity uses settlement date accounting for an asset that is subsequently measured at amortized cost, the asset is recognized initially at its fair value on the trade date (see paragraphs AG17–AG20).
60. Despite the requirement in paragraph 57, at initial recognition, an entity may measure short-term receivables and payables at the original invoice amount if the effect of discounting is immaterial.

Subsequent Measurement of Financial Assets

61. **After initial recognition, an entity shall measure a financial asset in accordance with paragraphs 39–44 at:**
- (a) **Amortized cost;**
 - (b) **Fair value through net assets/equity; or**
 - (c) **Fair value through surplus or deficit.**
62. **An entity shall apply the impairment requirements in paragraphs 73–93 to financial assets that are measured at amortized cost in accordance with paragraph 40 and to financial assets that are measured at fair value through net assets/equity in accordance with paragraph 41.**
63. **An entity shall apply the hedge accounting requirements in paragraphs 137–143 (and, if applicable, paragraphs 99–105 of IPSAS 29, *Financial Instruments: Recognition and Measurement*) for the fair value hedge accounting for a portfolio hedge of interest rate risk) to a financial asset that is designated as a hedged item.²**

Subsequent Measurement of Financial Liabilities

64. **After initial recognition, an entity shall measure a financial liability in accordance with paragraphs 45–46.**
65. **An entity shall apply the hedge accounting requirements in paragraphs 137–143 (and, if applicable, paragraphs 99–105 of IPSAS 29 for the fair value hedge accounting for a portfolio hedge of interest rate risk) to a financial liability that is designated as a hedged item.**

Fair Value Measurement Considerations

66. In determining the fair value of a financial asset or a financial liability for the purpose of applying this Standard, IPSAS 28 or IPSAS 30, an entity shall apply paragraphs AG144–AG155 of Appendix A.
67. The best evidence of fair value is quoted prices in an active market. If the market for a financial instrument is not active, an entity establishes fair value by using a valuation technique. The objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal operating considerations. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, if available, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the entity uses that technique. The chosen valuation technique makes maximum use of market inputs and relies as little as possible on entity-specific inputs. It incorporates all factors that market participants would consider in setting a price and is consistent with accepted economic methodologies for pricing financial instruments. Periodically, an entity calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on any available observable market data.
68. The fair value of a financial liability with a demand feature (e.g., a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

² In accordance with paragraph 179, an entity may choose as its accounting policy to continue to apply the hedge accounting requirements in IPSAS 29 instead of the requirements in paragraphs 113-155 of this Standard. If an entity has made this election, the references in this Standard to particular hedge accounting requirements in paragraphs 113-155 are not relevant. Instead the entity applies the relevant hedge accounting requirements in IPSAS 29.

Amortized Cost Measurement*Financial Assets*

Effective Interest Method

69. **Interest revenue shall be calculated by using the effective interest method (see paragraphs 9 and AG156–AG162). This shall be calculated by applying the effective interest rate to the gross carrying amount of a financial asset except for:**
- (a) **Purchased or originated credit-impaired financial assets. For those financial assets, the entity shall apply the credit-adjusted effective interest rate to the amortized cost of the financial asset from initial recognition.**
 - (b) **Financial assets that are not purchased or originated credit-impaired financial assets but subsequently have become credit-impaired financial assets. For those financial assets, the entity shall apply the effective interest rate to the amortized cost of the financial asset in subsequent reporting periods.**
70. An entity that, in a reporting period, calculates interest revenue by applying the effective interest method to the amortized cost of a financial asset in accordance with paragraph 69(b), shall, in subsequent reporting periods, calculate the interest revenue by applying the effective interest rate to the gross carrying amount if the credit risk on the financial instrument improves so that the financial asset is no longer credit-impaired and the improvement can be related objectively to an event occurring after the requirements in paragraph 69(b) were applied (such as an improvement in the borrower's credit rating).

Modification of Contractual Cash Flows

71. When the contractual cash flows of a financial asset are renegotiated or otherwise modified and the renegotiation or modification does not result in the derecognition of that financial asset in accordance with this Standard, an entity shall recalculate the gross carrying amount of the financial asset and shall recognize a modification gain or loss in surplus or deficit. The gross carrying amount of the financial asset shall be recalculated as the present value of the renegotiated or modified contractual cash flows that are discounted at the financial asset's original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets) or, when applicable, the revised effective interest rate calculated in accordance with paragraph 139. Any costs or fees incurred adjust the carrying amount of the modified financial asset and are amortized over the remaining term of the modified financial asset.

Write-off

72. An entity shall directly reduce the gross carrying amount of a financial asset when the entity has no reasonable expectations of recovering a financial asset in its entirety or a portion thereof. A write-off constitutes a derecognition event (see paragraph AG37(r)).

Changes in the Basis for Determining the Contractual Cash Flows as a Result of Interest Rate Benchmark Reform

- 72A. An entity shall apply paragraphs 72B–72E to a financial asset or financial liability if, and only if, the basis for determining the contractual cash flows of that financial asset or financial liability changes as a result of interest rate benchmark reform. For this purpose, the term 'interest rate benchmark reform' refers to the market-wide reform of an interest rate benchmark as described in paragraph 155B.
- 72B. The basis for determining the contractual cash flows of a financial asset or financial liability can change:
- (a) By amending the contractual terms specified at the initial recognition of the financial instrument (for example, the contractual terms are amended to replace the referenced interest rate benchmark with an alternative benchmark rate);
 - (b) In a way that was not considered by—or contemplated in—the contractual terms at the initial recognition of the financial instrument, without amending the contractual terms (for example, the method for calculating the interest rate benchmark is altered without amending the contractual terms); and/or
 - (c) Because of the activation of an existing contractual term (for example, an existing fallback clause is triggered).
- 72C. As a practical expedient, an entity shall apply paragraph AG160 to account for a change in the basis for determining the contractual cash flows of a financial asset or financial liability that is required by interest rate benchmark reform. This practical expedient applies only to such changes and only to the extent the change is required by interest rate benchmark reform (see also paragraph 72E). For this purpose, a change in the basis for determining the contractual cash flows is required by interest rate benchmark reform if, and only if, both these conditions are met:

- (a) The change is necessary as a direct consequence of interest rate benchmark reform; and
 - (b) The new basis for determining the contractual cash flows is economically equivalent to the previous basis (i.e., the basis immediately preceding the change).
- 72D. Examples of changes that give rise to a new basis for determining the contractual cash flows that is economically equivalent to the previous basis (i.e., the basis immediately preceding the change) are:
- (a) The replacement of an existing interest rate benchmark used to determine the contractual cash flows of a financial asset or financial liability with an alternative benchmark rate—or the implementation of such a reform of an interest rate benchmark by altering the method used to calculate the interest rate benchmark—with the addition of a fixed spread necessary to compensate for the basis difference between the existing interest rate benchmark and the alternative benchmark rate;
 - (b) Changes to the reset period, reset dates or the number of days between coupon payment dates in order to implement the reform of an interest rate benchmark; and
 - (c) The addition of a fallback provision to the contractual terms of a financial asset or financial liability to enable any change described in (a) and (b) above to be implemented.
- 72E. If changes are made to a financial asset or financial liability in addition to changes to the basis for determining the contractual cash flows required by interest rate benchmark reform, an entity shall first apply the practical expedient in paragraph 72C to the changes required by interest rate benchmark reform. The entity shall then apply the applicable requirements in this Standard to any additional changes to which the practical expedient does not apply. If the additional change does not result in the derecognition of the financial asset or financial liability, the entity shall apply paragraph 71 or paragraph AG161, as applicable, to account for that additional change. If the additional change results in the derecognition of the financial asset or financial liability, the entity shall apply the derecognition requirements.

Impairment

Recognition of Expected Credit Losses

General Approach

73. **An entity shall recognize a loss allowance for *expected credit losses* on a financial asset that is measured in accordance with paragraphs 40 or 41, a lease receivable, or a loan commitment and a financial guarantee contract to which the impairment requirements apply in accordance with paragraphs 2(g), 45(c) or 45(d).**
74. An entity shall apply the impairment requirements for the recognition and measurement of a loss allowance for financial assets that are measured at fair value through net assets/equity in accordance with paragraph 41. However, the loss allowance shall be recognized in net assets/equity and shall not reduce the carrying amount of the financial asset in the statement of financial position.
75. **Subject to paragraphs 85–88, at each reporting date, an entity shall measure the loss allowance for a financial instrument at an amount equal to the lifetime expected credit losses if the credit risk on that financial instrument has increased significantly since initial recognition.**
76. The objective of the impairment requirements is to recognize lifetime expected credit losses for all financial instruments for which there have been significant increases in credit risk since initial recognition — whether assessed on an individual or collective basis — considering all reasonable and supportable information, including that which is forward-looking.
77. **Subject to paragraphs 85–88, if, at the reporting date, the credit risk on a financial instrument has not increased significantly since initial recognition, an entity shall measure the loss allowance for that financial instrument at an amount equal to 12-month expected credit losses.**
78. For loan commitments and financial guarantee contracts, the date that the entity becomes a party to the irrevocable commitment shall be considered to be the date of initial recognition for the purposes of applying the impairment requirements.
79. If an entity has measured the loss allowance for a financial instrument at an amount equal to lifetime expected credit losses in the previous reporting period, but determines at the current reporting date that paragraph 75 is no longer met, the entity shall measure the loss allowance at an amount equal to 12-month expected credit losses at the current reporting date.

80. An entity shall recognize in surplus or deficit, as an *impairment gain or loss*, the amount of expected credit losses (or reversal) that is required to adjust the loss allowance at the reporting date to the amount that is required to be recognized in accordance with this Standard.

Determining Significant Increases in Credit Risk

81. At each reporting date, an entity shall assess whether the credit risk on a financial instrument has increased significantly since initial recognition. When making the assessment, an entity shall use the change in the risk of a default occurring over the expected life of the financial instrument instead of the change in the amount of expected credit losses. To make that assessment, an entity shall compare the risk of a default occurring on the financial instrument as at the reporting date with the risk of a default occurring on the financial instrument as at the date of initial recognition and consider reasonable and supportable information, that is available without undue cost or effort, that is indicative of significant increases in credit risk since initial recognition.
82. An entity may assume that the credit risk on a financial instrument has not increased significantly since initial recognition if the financial instrument is determined to have low credit risk at the reporting date (see paragraphs AG186–AG188).
83. If reasonable and supportable forward-looking information is available without undue cost or effort, an entity cannot rely solely on past due information when determining whether credit risk has increased significantly since initial recognition. However, when information that is more forward-looking than past due status (either on an individual or a collective basis) is not available without undue cost or effort, an entity may use past due information to determine whether there have been significant increases in credit risk since initial recognition. Regardless of the way in which an entity assesses significant increases in credit risk, there is a rebuttable presumption that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due. An entity can rebut this presumption if the entity has reasonable and supportable information that is available without undue cost or effort, that demonstrates that the credit risk has not increased significantly since initial recognition even though the contractual payments are more than 30 days past due. When an entity determines that there have been significant increases in credit risk before contractual payments are more than 30 days past due, the rebuttable presumption does not apply.

Modified Financial Assets

84. If the contractual cash flows on a financial asset have been renegotiated or modified and the financial asset was not derecognized, an entity shall assess whether there has been a significant increase in the credit risk of the financial instrument in accordance with paragraph 75 by comparing:
- The risk of a default occurring at the reporting date (based on the modified contractual terms); and
 - The risk of a default occurring at initial recognition (based on the original, unmodified contractual terms).

Purchased or Originated Credit-Impaired Financial Assets

85. **Despite paragraphs 75 and 77, at the reporting date, an entity shall only recognize the cumulative changes in lifetime expected credit losses since initial recognition as a loss allowance for purchased or originated credit-impaired financial assets.**
86. At each reporting date, an entity shall recognize in surplus or deficit the amount of the change in lifetime expected credit losses as an impairment gain or loss. An entity shall recognize favorable changes in lifetime expected credit losses as an impairment gain, even if the lifetime expected credit losses are less than the amount of expected credit losses that were included in the estimated cash flows on initial recognition.

Simplified Approach for Receivables

87. **Despite paragraphs 75 and 77, an entity shall always measure the loss allowance at an amount equal to lifetime expected credit losses for:**
- Receivables that result from exchange transactions that are within the scope of IPSAS 9 and non-exchange transactions within the scope of IPSAS 23.**
 - Lease receivables that result from transactions that are within the scope of IPSAS 43, if the entity chooses as its accounting policy to measure the loss allowance at an amount equal to lifetime expected credit losses. That accounting policy shall be applied to all lease receivables but may be applied separately to finance and operating lease receivables.**

88. An entity may select its accounting policy for trade receivables and lease receivables independently of each other.
89. The requirements for purchased or originated credit-impaired financial assets (see paragraphs 9 and 85 to 86) do not apply to short-term receivables.

Measurement of Expected Credit Losses

90. **An entity shall measure expected credit losses of a financial instrument in a way that reflects:**
- (a) **An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;**
 - (b) **The time value of money; and**
 - (c) **Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.**
91. When measuring expected credit losses, an entity need not necessarily identify every possible scenario. However, it shall consider the risk or probability that a credit loss occurs by reflecting the possibility that a credit loss occurs and the possibility that no credit loss occurs, even if the possibility of a credit loss occurring is very low.
92. The maximum period to consider when measuring expected credit losses is the maximum contractual period (including extension options) over which the entity is exposed to credit risk and not a longer period, even if that longer period is consistent with business practice.
93. However, some financial instruments include both a loan and an undrawn commitment component and the entity's contractual ability to demand repayment and cancel the undrawn commitment does not limit the entity's exposure to credit losses to the contractual notice period. For such financial instruments, and only those financial instruments, the entity shall measure expected credit losses over the period that the entity is exposed to credit risk and expected credit losses would not be mitigated by credit risk management actions, even if that period extends beyond the maximum contractual period.

Reclassification of Financial Assets

94. **If an entity reclassifies financial assets in accordance with paragraph 54, it shall apply the reclassification prospectively from the reclassification date. The entity shall not restate any previously recognized gains, losses (including impairment gains or losses) or interest. Paragraphs 95–100 set out the requirements for reclassifications.**
95. **If an entity reclassifies a financial asset out of the amortized cost measurement category and into the fair value through surplus or deficit measurement category, its fair value is measured at the reclassification date. Any gain or loss arising from a difference between the previous amortized cost of the financial asset and fair value is recognized in surplus or deficit.**
96. **If an entity reclassifies a financial asset out of the fair value through surplus or deficit measurement category and into the amortized cost measurement category, its fair value at the reclassification date becomes its new gross carrying amount. (See paragraph AG221 for guidance on determining an effective interest rate and a loss allowance at the reclassification date.)**
97. **If an entity reclassifies a financial asset out of the amortized cost measurement category and into the fair value through net assets/equity measurement category, its fair value is measured at the reclassification date. Any gain or loss arising from a difference between the previous amortized cost of the financial asset and fair value is recognized in net assets/equity. The effective interest rate and the measurement of expected credit losses are not adjusted as a result of the reclassification. (See paragraph AG220.)**
98. **If an entity reclassifies a financial asset out of the fair value through net assets/equity measurement category and into the amortized cost measurement category, the financial asset is reclassified at its fair value at the reclassification date. However, the cumulative gain or loss previously recognized in net assets/equity is removed from net assets/equity and adjusted against the fair value of the financial asset at the reclassification date. As a result, the financial asset is measured at the reclassification date as if it had always been measured at amortized cost. This adjustment affects net assets/equity but does not affect surplus or deficit and therefore is not a reclassification adjustment (see IPSAS 1, *Presentation of Financial Statements*). The effective interest rate and the measurement of expected credit losses are not adjusted as a result of the reclassification. (See paragraph AG220.)**
99. **If an entity reclassifies a financial asset out of the fair value through surplus or deficit measurement category and into the fair value through net assets/equity measurement category, the financial asset continues to be measured at**

fair value. (See paragraph AG221 for guidance on determining an effective interest rate and a loss allowance at the reclassification date.)

100. **If an entity reclassifies a financial asset out of the fair value through net assets/equity measurement category and into the fair value through surplus or deficit measurement category, the financial asset continues to be measured at fair value. The cumulative gain or loss previously recognized in net assets/equity is reclassified from net assets/equity to surplus or deficit as a reclassification adjustment (see IPSAS 1) at the reclassification date.**

Gains and Losses

101. **A gain or loss on a financial asset or financial liability that is measured at fair value shall be recognized in surplus or deficit unless:**
- (a) **It is part of a hedging relationship (see paragraphs 137–143 and, if applicable, paragraphs 99–105 of IPSAS 29 for the fair value hedge accounting for a portfolio hedge of interest rate risk);**
 - (b) **It is an investment in an equity instrument and the entity has elected to present gains and losses on that investment in net assets/equity in accordance with paragraph 106;**
 - (c) **It is a financial liability designated as at fair value through surplus or deficit and the entity is required to present the effects of changes in the liability's credit risk in net assets/equity in accordance with paragraph 108; or**
 - (d) **It is a financial asset measured at fair value through net assets/equity in accordance with paragraph 41 and the entity is required to recognize some changes in fair value in net assets/equity in accordance with paragraph 111.**
102. Dividends or similar distributions are recognized in surplus or deficit only when:
- (a) The entity's right to receive payment of the dividend is established;
 - (b) It is probable that the economic benefits associated with the dividend will flow to the entity; and
 - (c) The amount of the dividend can be measured reliably.
103. **A gain or loss on a financial asset that is measured at amortized cost and is not part of a hedging relationship (see paragraphs 137–143 and, if applicable, paragraphs 99–105 of IPSAS 29 for the fair value hedge accounting for a portfolio hedge of interest rate risk) shall be recognized in surplus or deficit when the financial asset is derecognized, reclassified in accordance with paragraph 95, through the amortization process or in order to recognize impairment gains or losses. An entity shall apply paragraphs 95 and 97 if it reclassifies financial assets out of the amortized cost measurement category. A gain or loss on a financial liability that is measured at amortized cost and is not part of a hedging relationship (see paragraphs 137–143 and, if applicable, paragraphs 99–105 of IPSAS 29 for the fair value hedge accounting for a portfolio hedge of interest rate risk) shall be recognized in surplus or deficit when the financial liability is derecognized and through the amortization process. (See paragraph AG224 for guidance on foreign exchange gains or losses.)**
104. **A gain or loss on financial assets or financial liabilities that are hedged items in a hedging relationship shall be recognized in accordance with paragraphs 137–143 and, if applicable, paragraphs 99–105 of IPSAS 29 for the fair value hedge accounting for a portfolio hedge of interest rate risk.**
105. **If an entity recognizes financial assets using settlement date accounting (see paragraphs 11, AG17 and AG20), any change in the fair value of the asset to be received during the period between the trade date and the settlement date is not recognized for assets measured at amortized cost. For assets measured at fair value, however, the change in fair value shall be recognized in surplus or deficit or in net assets/equity, as appropriate in accordance with paragraph 101. The trade date shall be considered the date of initial recognition for the purposes of applying the impairment requirements.**

Investments in Equity Instruments

106. **At initial recognition, an entity may make an irrevocable election to present in net assets/equity subsequent changes in the fair value of an investment in an equity instrument within the scope of this Standard that is neither held for trading nor contingent consideration recognized by an acquirer in a public sector combination. (See paragraph AG226 for guidance on foreign exchange gains or losses.)**
107. If an entity makes the election in paragraph 106, it shall recognize in surplus or deficit dividends or similar distributions from that investment in accordance with paragraph 102.

Liabilities Designated as at Fair Value through Surplus or Deficit

108. **An entity shall present a gain or loss on a financial liability that is designated as at fair value through surplus or deficit in accordance with paragraph 46 or paragraph 51 as follows:**
- (a) **The amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability shall be presented in net assets/equity (see paragraphs AG236–AG243), and**
 - (b) **The remaining amount of change in the fair value of the liability shall be presented in surplus or deficit unless the treatment of the effects of changes in the liability’s credit risk described in (a) would create or enlarge an accounting mismatch in surplus or deficit (in which case paragraph 109 applies). Paragraphs AG228–AG230 and AG233–AG235 provide guidance on determining whether an accounting mismatch would be created or enlarged.**
109. **If the requirements in paragraph 108 would create or enlarge an accounting mismatch in surplus or deficit, an entity shall present all gains or losses on that liability (including the effects of changes in the credit risk of that liability) in surplus or deficit.**
110. Despite the requirements in paragraphs 108 and 109, an entity shall present in surplus or deficit all gains and losses on loan commitments and financial guarantee contracts that are designated as at fair value through surplus or deficit.

Assets Measured at Fair Value through Net Assets/Equity

111. **A gain or loss on a financial asset measured at fair value through net assets/equity in accordance with paragraph 41 shall be recognized in net assets/equity, except for impairment gains or losses (see paragraphs 73–93) and foreign exchange gains and losses (see paragraphs AG224–AG225), until the financial asset is derecognized or reclassified. When the financial asset is derecognized the cumulative gain or loss previously recognized in net assets/equity is reclassified from net assets/equity to surplus or deficit as a reclassification adjustment (see paragraphs 125A–125C of IPSAS 1). If the financial asset is reclassified out of the fair value through net assets/equity measurement category, the entity shall account for the cumulative gain or loss that was previously recognized in net assets/equity in accordance with paragraphs 98 and 100. Interest calculated using the effective interest method is recognized in surplus or deficit.**
112. **As described in paragraph 111, if a financial asset is measured at fair value through net assets/equity in accordance with paragraph 41, the amounts that are recognized in surplus or deficit are the same as the amounts that would have been recognized in surplus or deficit if the financial asset had been measured at amortized cost.**

Hedge Accounting**Objective and Scope of Hedge Accounting**

113. The objective of hedge accounting is to represent, in the financial statements, the effect of an entity’s risk management activities that use financial instruments to manage exposures arising from particular risks that could affect surplus or deficit (or net assets/equity, in the case of investments in equity instruments for which an entity has elected to present changes in fair value in net assets/equity in accordance with paragraph 106). This approach aims to convey the context of hedging instruments for which hedge accounting is applied in order to allow insight into their purpose and effect.
114. An entity may choose to designate a hedging relationship between a hedging instrument and a hedged item in accordance with paragraphs 116–128 and AG244–AG274. For hedging relationships that meet the qualifying criteria, an entity shall account for the gain or loss on the hedging instrument and the hedged item in accordance with paragraphs 130–143 and AG294–AG321. When the hedged item is a group of items, an entity shall comply with the additional requirements in paragraphs 146–151 and AG333–AG348.
115. For a fair value hedge of the interest rate exposure of a portfolio of financial assets or financial liabilities (and only for such a hedge), an entity may apply the hedge accounting requirements in IPSAS 29 instead of those in this Standard. In that case, the entity must also apply the specific requirements for the fair value hedge accounting for a portfolio hedge of interest rate risk and designate as the hedged item a portion that is a currency amount (see paragraphs 91, 100 and AG157–AG175 of IPSAS 29).

Hedging Instruments*Qualifying Instruments*

116. **A derivative measured at fair value through surplus or deficit may be designated as a hedging instrument, except for some written options (see paragraph AG247).**

117. **A non-derivative financial asset or a non-derivative financial liability measured at fair value through surplus or deficit may be designated as a hedging instrument unless it is a financial liability designated as at fair value through surplus or deficit for which the amount of its change in fair value that is attributable to changes in the credit risk of that liability is presented in net assets/equity in accordance with paragraph 108. For a hedge of foreign currency risk, the foreign currency risk component of a non-derivative financial asset or a non-derivative financial liability may be designated as a hedging instrument provided that it is not an investment in an equity instrument for which an entity has elected to present changes in fair value in net assets/equity in accordance with paragraph 106.**
118. **For hedge accounting purposes, only contracts with a party external to the reporting entity (i.e., external to the economic entity or individual entity that is being reported on) can be designated as hedging instruments.**

Designation of Hedging Instruments

119. A qualifying instrument must be designated in its entirety as a hedging instrument. The only exceptions permitted are:
- Separating the intrinsic value and time value of an option contract and designating as the hedging instrument only the change in intrinsic value of an option and not the change in its time value (see paragraphs 144 and AG322–AG326);
 - Separating the forward element and the spot element of a forward contract and designating as the hedging instrument only the change in the value of the spot element of a forward contract and not the forward element; similarly, the foreign currency basis spread may be separated and excluded from the designation of a financial instrument as the hedging instrument (see paragraphs 145 and AG327–AG332); and
 - A proportion of the entire hedging instrument, such as 50 percent of the nominal amount, may be designated as the hedging instrument in a hedging relationship. However, a hedging instrument may not be designated for a part of its change in fair value that results from only a portion of the time period during which the hedging instrument remains outstanding.
120. An entity may view in combination, and jointly designate as the hedging instrument, any combination of the following (including those circumstances in which the risk or risks arising from some hedging instruments offset those arising from others):
- Derivatives or a proportion of them; and
 - Non-derivatives or a proportion of them.
121. However, a derivative instrument that combines a written option and a purchased option (for example, an interest rate collar) does not qualify as a hedging instrument if it is, in effect, a net written option at the date of designation (unless it qualifies in accordance with paragraph AG247). Similarly, two or more instruments (or proportions of them) may be jointly designated as the hedging instrument only if, in combination, they are not, in effect, a net written option at the date of designation (unless it qualifies in accordance with paragraph AG247).

Hedged Items

Qualifying Items

122. **A hedged item can be a recognized asset or liability, an unrecognized firm commitment, a forecast transaction or a net investment in a foreign operation. The hedged item can be:**
- A single item; or**
 - A group of items (subject to paragraphs 146–151 and AG333–AG348).**
- A hedged item can also be a component of such an item or group of items (see paragraphs 128 and AG256–AG274).**
123. **The hedged item must be reliably measurable.**
124. **If a hedged item is a forecast transaction (or a component thereof), that transaction must be highly probable.**
125. **An aggregated exposure that is a combination of an exposure that could qualify as a hedged item in accordance with paragraph 122 and a derivative may be designated as a hedged item (see paragraphs AG252–AG253). This includes a forecast transaction of an aggregated exposure (i.e., uncommitted but anticipated future transactions that would give rise to an exposure and a derivative) if that aggregated exposure is highly probable and, once it has occurred and is therefore no longer forecast, is eligible as a hedged item.**

126. **For hedge accounting purposes, only assets, liabilities, firm commitments or highly probable forecast transactions with a party external to the reporting entity can be designated as hedged items. Hedge accounting can be applied to transactions between entities in the same economic entity only in the individual or separate financial statements of those entities and not in the consolidated financial statements of the economic entity, except for:**
- (a) **The consolidated financial statements of an investment entity, as defined in IPSAS 35, where transactions between an investment entity and its controlled entities measured at fair value through surplus or deficit will not be eliminated in the consolidated financial statements; or**
 - (b) **The consolidated financial statements of a controlling entity of an investment entity, as defined in IPSAS 35 that is not itself an investment entity, where transactions between a controlled investment entity and the investments of a controlled investment entity measured at fair value through surplus or deficit will not be eliminated in the consolidated financial statements.**
127. However, as an exception to paragraph 126, the foreign currency risk of a monetary item within an economic entity (for example, a payable/receivable between two controlled entities) may qualify as a hedged item in the consolidated financial statements if it results in an exposure to foreign exchange rate gains or losses that are not fully eliminated on consolidation in accordance with IPSAS 4, *The Effects of Changes in Foreign Exchange Rates*. In accordance with IPSAS 4, foreign exchange rate gains and losses on monetary items within an economic entity are not fully eliminated on consolidation when the monetary item is transacted between two entities within the economic entity that have different functional currencies. In addition, the foreign currency risk of a highly probable forecast transaction within the economic entity may qualify as a hedged item in consolidated financial statements provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated surplus or deficit.

Designation of Hedged Items

128. An entity may designate an item in its entirety or a component of an item as the hedged item in a hedging relationship. An entire item comprises all changes in the cash flows or fair value of an item. A component comprises less than the entire fair value change or cash flow variability of an item. In that case, an entity may designate only the following types of components (including combinations) as hedged items:
- (a) Only changes in the cash flows or fair value of an item attributable to a specific risk or risks (risk component), provided that, based on an assessment within the context of the particular market structure, the risk component is separately identifiable and reliably measurable (see paragraphs AG257–AG264). Risk components include a designation of only changes in the cash flows or the fair value of a hedged item above or below a specified price or other variable (a one-sided risk).
 - (b) One or more selected contractual cash flows.
 - (c) Components of a nominal amount, i.e., a specified part of the amount of an item (see paragraphs AG265–AG269).

Qualifying Criteria for Hedge Accounting

129. **A hedging relationship qualifies for hedge accounting only if all of the following criteria are met:**
- (a) **The hedging relationship consists only of eligible hedging instruments and eligible hedged items.**
 - (b) **At the inception of the hedging relationship there is formal designation and documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge. That documentation shall include identification of the hedging instrument, the hedged item, the nature of the risk being hedged and how the entity will assess whether the hedging relationship meets the hedge effectiveness requirements (including its analysis of the sources of hedge ineffectiveness and how it determines the *hedge ratio*).**
 - (c) **The hedging relationship meets all of the following hedge effectiveness requirements:**
 - (i) **There is an economic relationship between the hedged item and the hedging instrument (see paragraphs AG278–AG280);**
 - (ii) **The effect of credit risk does not dominate the value changes that result from that economic relationship (see paragraphs AG281–AG282); and**
 - (iii) **The hedge ratio of the hedging relationship is the same as that resulting from the quantity of the hedged item that the entity actually hedges and the quantity of the hedging instrument that the entity actually uses to hedge that quantity of hedged item. However, that designation shall not reflect an**

imbalance between the weightings of the hedged item and the hedging instrument that would create hedge ineffectiveness (irrespective of whether recognized or not) that could result in an accounting outcome that would be inconsistent with the purpose of hedge accounting (see paragraphs AG283–AG285).

Accounting for Qualifying Hedging Relationships

130. An entity applies hedge accounting to hedging relationships that meet the qualifying criteria in paragraph 129 (which include the entity's decision to designate the hedging relationship).
131. There are three types of hedging relationships:
- (a) **Fair value hedge:** a hedge of the exposure to changes in fair value of a recognized asset or liability or an unrecognized firm commitment, or a component of any such item, that is attributable to a particular risk and could affect surplus or deficit.
 - (b) **Cash flow hedge:** a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with all, or a component of, a recognized asset or liability (such as all or some future interest payments on variable-rate debt) or a highly probable forecast transaction, and could affect surplus or deficit.
 - (c) **Hedge of a net investment in a foreign operation as defined in IPSAS 4.**
132. If the hedged item is an equity instrument for which an entity has elected to present changes in fair value in net assets/equity in accordance with paragraph 106, the hedged exposure referred to in paragraph 131(a) must be one that could affect net assets/equity. In that case, and only in that case, the recognized hedge ineffectiveness is presented in net assets/equity.
133. A hedge of the foreign currency risk of a firm commitment may be accounted for as a fair value hedge or a cash flow hedge.
134. **If a hedging relationship ceases to meet the hedge effectiveness requirement relating to the hedge ratio (see paragraph 129(c)(iii)) but the risk management objective for that designated hedging relationship remains the same, an entity shall adjust the hedge ratio of the hedging relationship so that it meets the qualifying criteria again (this is referred to in this Standard as 'rebalancing'—see paragraphs AG300–AG314).**
135. An entity shall discontinue hedge accounting prospectively only when the hedging relationship (or a part of a hedging relationship) ceases to meet the qualifying criteria (after taking into account any rebalancing of the hedging relationship, if applicable). This includes instances when the hedging instrument expires or is sold, terminated or exercised. For this purpose, the replacement or rollover of a hedging instrument into another hedging instrument is not an expiration or termination if such a replacement or rollover is part of, and consistent with, the entity's documented risk management objective. Additionally, for this purpose there is not an expiration or termination of the hedging instrument if:
- (a) As a consequence of laws or regulations or the introduction of laws or regulations, the parties to the hedging instrument agree that one or more clearing counterparties replace their original counterparty to become the new counterparty to each of the parties. For this purpose, a clearing counterparty is a central counterparty (sometimes called a 'clearing organization' or 'clearing agency') or an entity or entities, for example, a clearing member of a clearing organization or a client of a clearing member of a clearing organization, that are acting as a counterparty in order to effect clearing by a central counterparty. However, when the parties to the hedging instrument replace their original counterparties with different counterparties the requirement in this subparagraph is met only if each of those parties effects clearing with the same central counterparty.
 - (b) Other changes, if any, to the hedging instrument are limited to those that are necessary to effect such a replacement of the counterparty. Such changes are limited to those that are consistent with the terms that would be expected if the hedging instrument were originally cleared with the clearing counterparty. These changes include changes in the collateral requirements, rights to offset receivables and payables balances, and charges levied.

Discontinuing hedge accounting can either affect a hedging relationship in its entirety or only a part of it (in which case hedge accounting continues for the remainder of the hedging relationship).

136. An entity shall apply:
- (a) Paragraph 139 when it discontinues hedge accounting for a fair value hedge for which the hedged item is (or is a component of) a financial instrument measured at amortized cost; and
 - (b) Paragraph 141 when it discontinues hedge accounting for cash flow hedges.

Fair Value Hedges

137. **As long as a fair value hedge meets the qualifying criteria in paragraph 129, the hedging relationship shall be accounted for as follows:**
- (a) **The gain or loss on the hedging instrument shall be recognized in surplus or deficit (or net assets/equity, if the hedging instrument hedges an equity instrument for which an entity has elected to present changes in fair value in net assets/equity in accordance with paragraph 106).**
 - (b) **The hedging gain or loss on the hedged item shall adjust the carrying amount of the hedged item (if applicable) and be recognized in surplus or deficit. If the hedged item is a financial asset (or a component thereof) that is measured at fair value through net assets/equity in accordance with paragraph 41, the hedging gain or loss on the hedged item shall be recognized in surplus or deficit. However, if the hedged item is an equity instrument for which an entity has elected to present changes in fair value in net assets/equity in accordance with paragraph 106, those amounts shall remain in net assets/equity. When a hedged item is an unrecognized firm commitment (or a component thereof), the cumulative change in the fair value of the hedged item subsequent to its designation is recognized as an asset or a liability with a corresponding gain or loss recognized in surplus or deficit.**
138. When a hedged item in a fair value hedge is a firm commitment (or a component thereof) to acquire an asset or assume a liability, the initial carrying amount of the asset or the liability that results from the entity meeting the firm commitment is adjusted to include the cumulative change in the fair value of the hedged item that was recognized in the statement of financial position.
139. Any adjustment arising from paragraph 137(b) shall be amortized to surplus or deficit if the hedged item is a financial instrument (or a component thereof) measured at amortized cost. Amortization may begin as soon as an adjustment exists and shall begin no later than when the hedged item ceases to be adjusted for hedging gains and losses. The amortization is based on a recalculated effective interest rate at the date that amortization begins. In the case of a financial asset (or a component thereof) that is a hedged item and that is measured at fair value through net assets/equity in accordance with paragraph 41, amortization applies in the same manner but to the amount that represents the cumulative gain or loss previously recognized in accordance with paragraph 137(b) instead of by adjusting the carrying amount.

Cash Flow Hedges

140. **As long as a cash flow hedge meets the qualifying criteria in paragraph 129, the hedging relationship shall be accounted for as follows:**
- (a) **The separate component of net assets/equity associated with the hedged item (cash flow hedge reserve) is adjusted to the lower of the following (in absolute amounts):**
 - (i) **The cumulative gain or loss on the hedging instrument from inception of the hedge; and**
 - (ii) **The cumulative change in fair value (present value) of the hedged item (i.e., the present value of the cumulative change in the hedged expected future cash flows) from inception of the hedge.**
 - (b) **The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge (i.e., the portion that is offset by the change in the cash flow hedge reserve calculated in accordance with (a)) shall be recognized in net assets/equity.**
 - (c) **Any remaining gain or loss on the hedging instrument (or any gain or loss required to balance the change in the cash flow hedge reserve calculated in accordance with (a)) is hedge ineffectiveness that shall be recognized in surplus or deficit.**
 - (d) **The amount that has been accumulated in the cash flow hedge reserve in accordance with (a) shall be accounted for as follows:**
 - (i) **If a hedged forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, or a hedged forecast transaction for a non-financial asset or a non-financial liability becomes a firm commitment for which fair value hedge accounting is applied, the entity shall remove that amount from the cash flow hedge reserve and include it directly in the initial cost or other carrying amount of the asset or the liability. This is not a reclassification adjustment (see IPSAS 1) and hence it does not affect net assets/equity.**

- (ii) **For cash flow hedges other than those covered by (i), that amount shall be reclassified from the cash flow hedge reserve to surplus or deficit as a reclassification adjustment (see paragraphs 125A–125C of IPSAS 1) in the same period or periods during which the hedged expected future cash flows affect surplus or deficit (for example, in the periods that interest revenue or interest expense is recognized or when a forecast sale occurs).**
 - (iii) **However, if that amount is a loss and an entity expects that all or a portion of that loss will not be recovered in one or more future periods, it shall immediately reclassify the amount that is not expected to be recovered into surplus or deficit as a reclassification adjustment (see paragraphs 125A–125C of IPSAS 1).**
141. When an entity discontinues hedge accounting for a cash flow hedge (see paragraphs 135 and 136(b)) it shall account for the amount that has been accumulated in the cash flow hedge reserve in accordance with paragraph 140(a) as follows:
- (a) If the hedged future cash flows are still expected to occur, that amount shall remain in the cash flow hedge reserve until the future cash flows occur or until paragraph 140(d)(iii) applies. When the future cash flows occur, paragraph 140(d) applies.
 - (b) If the hedged future cash flows are no longer expected to occur, that amount shall be immediately reclassified from the cash flow hedge reserve to surplus or deficit as a reclassification adjustment (see IPSAS 1). A hedged future cash flow that is no longer highly probable to occur may still be expected to occur.

Hedges of a Net Investment in a Foreign Operation

142. **Hedges of a net investment in a foreign operation, including a hedge of a monetary item that is accounted for as part of the net investment (see IPSAS 4), shall be accounted for similarly to cash flow hedges:**
- (a) **The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge shall be recognized in net assets/equity (see paragraph 140); and**
 - (b) **The ineffective portion shall be recognized in surplus or deficit.**
143. **The cumulative gain or loss on the hedging instrument relating to the effective portion of the hedge that has been accumulated in the foreign currency translation reserve shall be reclassified from net assets/equity to surplus or deficit as a reclassification adjustment (see IPSAS 1) in accordance with paragraphs 57–58 of IPSAS 4 on the disposal or partial disposal of the foreign operation.**

Accounting for the Time Value of Options

144. When an entity separates the intrinsic value and time value of an option contract and designates as the hedging instrument only the change in intrinsic value of the option (see paragraph 119(a)), it shall account for the time value of the option as follows (see paragraphs AG322–AG326):
- (a) An entity shall distinguish the time value of options by the type of hedged item that the option hedges (see paragraph AG322):
 - (i) A transaction related hedged item; or
 - (ii) A time-period related hedged item.
 - (b) The change in fair value of the time value of an option that hedges a transaction related hedged item shall be recognized in net assets/equity to the extent that it relates to the hedged item and shall be accumulated in a separate component of net assets/equity. The cumulative change in fair value arising from the time value of the option that has been accumulated in a separate component of net assets/equity (the ‘amount’) shall be accounted for as follows:
 - (i) If the hedged item subsequently results in the recognition of a non-financial asset or a non-financial liability, or a firm commitment for a non-financial asset or a non-financial liability for which fair value hedge accounting is applied, the entity shall remove the amount from the separate component of net assets/equity and include it directly in the initial cost or other carrying amount of the asset or the liability. This is not a reclassification adjustment (see IPSAS 1) and hence does not affect net assets/equity.
 - (ii) For hedging relationships other than those covered by (i), the amount shall be reclassified from the separate component of net assets/equity to surplus or deficit as a reclassification adjustment (see IPSAS 1) in the same period or periods during which the hedged expected future cash flows affect surplus or deficit (for example, when a forecast sale occurs).

- (iii) However, if all or a portion of that amount is not expected to be recovered in one or more future periods, the amount that is not expected to be recovered shall be immediately reclassified into surplus or deficit as a reclassification adjustment (see IPSAS 1).
- (c) The change in fair value of the time value of an option that hedges a time-period related hedged item shall be recognized in net assets/equity to the extent that it relates to the hedged item and shall be accumulated in a separate component of net assets/equity. The time value at the date of designation of the option as a hedging instrument, to the extent that it relates to the hedged item, shall be amortized on a systematic and rational basis over the period during which the hedge adjustment for the option's intrinsic value could affect surplus or deficit (or net assets/equity, if the hedged item is an equity instrument for which an entity has elected to present changes in fair value in net assets/equity in accordance with paragraph 106). Hence, in each reporting period, the amortization amount shall be reclassified from the separate component of net assets/equity to surplus or deficit as a reclassification adjustment (see IPSAS 1). However, if hedge accounting is discontinued for the hedging relationship that includes the change in intrinsic value of the option as the hedging instrument, the net amount (i.e., including cumulative amortization) that has been accumulated in the separate component of net assets/equity shall be immediately reclassified into surplus or deficit as a reclassification adjustment (see IPSAS 1).

Accounting for the Forward Element of Forward Contracts and Foreign Currency Basis Spreads of Financial Instruments

145. When an entity separates the forward element and the spot element of a forward contract and designates as the hedging instrument only the change in the value of the spot element of the forward contract, or when an entity separates the foreign currency basis spread from a financial instrument and excludes it from the designation of that financial instrument as the hedging instrument (see paragraph 119(b)), the entity may apply paragraph 144 to the forward element of the forward contract or to the foreign currency basis spread in the same manner as it is applied to the time value of an option. In that case, the entity shall apply the application guidance in paragraphs AG327–AG332.

Hedges of a Group of Items

Eligibility of a Group of Items as the Hedged Item

146. **A group of items (including a group of items that constitute a net position; see paragraphs AG333–AG340) is an eligible hedged item only if:**
- (a) **It consists of items (including components of items) that are, individually, eligible hedged items;**
 - (b) **The items in the group are managed together on a group basis for risk management purposes; and**
 - (c) **In the case of a cash flow hedge of a group of items whose variabilities in cash flows are not expected to be approximately proportional to the overall variability in cash flows of the group so that offsetting risk positions arise:**
 - (i) **It is a hedge of foreign currency risk; and**
 - (ii) **The designation of that net position specifies the reporting period in which the forecast transactions are expected to affect surplus or deficit, as well as their nature and volume (see paragraphs AG339–AG340).**

Designation of a Component of a Nominal Amount

147. A component that is a proportion of an eligible group of items is an eligible hedged item provided that designation is consistent with the entity's risk management objective.
148. A layer component of an overall group of items (for example, a bottom layer) is eligible for hedge accounting only if:
- (a) It is separately identifiable and reliably measurable;
 - (b) The risk management objective is to hedge a layer component;
 - (c) The items in the overall group from which the layer is identified are exposed to the same hedged risk (so that the measurement of the hedged layer is not significantly affected by which particular items from the overall group form part of the hedged layer);
 - (d) For a hedge of existing items (for example, an unrecognized firm commitment or a recognized asset) an entity can identify and track the overall group of items from which the hedged layer is defined (so that the entity is able to comply with the requirements for the accounting for qualifying hedging relationships); and

- (e) Any items in the group that contain prepayment options meet the requirements for components of a nominal amount (see paragraph AG269).

Presentation

149. For a hedge of a group of items with offsetting risk positions (i.e., in a hedge of a net position) whose hedged risk affects different line items in the statement of financial performance and statement of changes in net assets/equity, any hedging gains or losses in that statement shall be presented in a separate line from those affected by the hedged items. Hence, in that statement the amount in the line item that relates to the hedged item itself (for example, revenue or expenses) remains unaffected.
150. For assets and liabilities that are hedged together as a group in a fair value hedge, the gain or loss in the statement of financial position on the individual assets and liabilities shall be recognized as an adjustment of the carrying amount of the respective individual items comprising the group in accordance with paragraph 137(b).

Nil Net Positions

151. When the hedged item is a group that is a nil net position (i.e., the hedged items among themselves fully offset the risk that is managed on a group basis), an entity is permitted to designate it in a hedging relationship that does not include a hedging instrument, provided that:
- The hedge is part of a rolling net risk hedging strategy, whereby the entity routinely hedges new positions of the same type as time moves on (for example, when transactions move into the time horizon for which the entity hedges);
 - The hedged net position changes in size over the life of the rolling net risk hedging strategy and the entity uses eligible hedging instruments to hedge the net risk (i.e., when the net position is not nil);
 - Hedge accounting is normally applied to such net positions when the net position is not nil and it is hedged with eligible hedging instruments; and
 - Not applying hedge accounting to the nil net position would give rise to inconsistent accounting outcomes, because the accounting would not recognize the offsetting risk positions that would otherwise be recognized in a hedge of a net position.

Option to Designate a Credit Exposure as Measured at Fair Value through Surplus or Deficit

Eligibility of Credit Exposures for Designation at Fair Value through Surplus or Deficit

152. **If an entity uses a credit derivative that is measured at fair value through surplus or deficit to manage the credit risk of all, or a part of, a financial instrument (credit exposure) it may designate that financial instrument to the extent that it is so managed (i.e., all or a proportion of it) as measured at fair value through surplus or deficit if:**
- The name of the credit exposure (for example, the borrower, or the holder of a loan commitment) matches the reference entity of the credit derivative ('name matching'); and**
 - The seniority of the financial instrument matches that of the instruments that can be delivered in accordance with the credit derivative.**

An entity may make this designation irrespective of whether the financial instrument that is managed for credit risk is within the scope of this Standard (for example, an entity may designate loan commitments that are outside the scope of this Standard). The entity may designate that financial instrument at, or subsequent to, initial recognition, or while it is unrecognized. The entity shall document the designation concurrently.

Accounting for Credit Exposures Designated at Fair Value through Surplus or Deficit

153. If a financial instrument is designated in accordance with paragraph 152 as measured at fair value through surplus or deficit after its initial recognition, or was previously not recognized, the difference at the time of designation between the carrying amount, if any, and the fair value shall immediately be recognized in surplus or deficit. For financial assets measured at fair value through net assets/equity in accordance with paragraph 41, the cumulative gain or loss previously recognized in net assets/equity shall immediately be reclassified from net assets/equity to surplus or deficit as a reclassification adjustment (see IPSAS 1).
154. An entity shall discontinue measuring the financial instrument that gave rise to the credit risk, or a proportion of that financial instrument, at fair value through surplus or deficit if:

- (a) The qualifying criteria in paragraph 152 are no longer met, for example:
 - (i) The credit derivative or the related financial instrument that gives rise to the credit risk expires or is sold, terminated or settled; or
 - (ii) The credit risk of the financial instrument is no longer managed using credit derivatives. For example, this could occur because of improvements in the credit quality of the borrower or the loan commitment holder or changes to capital requirements imposed on an entity; and
 - (b) The financial instrument that gives rise to the credit risk is not otherwise required to be measured at fair value through surplus or deficit (i.e., the entity's management model has not changed in the meantime so that a reclassification in accordance with paragraph 54 was required).
155. When an entity discontinues measuring the financial instrument that gives rise to the credit risk, or a proportion of that financial instrument, at fair value through surplus or deficit, that financial instrument's fair value at the date of discontinuation becomes its new carrying amount. Subsequently, the same measurement that was used before designating the financial instrument at fair value through surplus or deficit shall be applied (including amortization that results from the new carrying amount). For example, a financial asset that had originally been classified as measured at amortized cost would revert to that measurement and its effective interest rate would be recalculated based on its new gross carrying amount on the date of discontinuing measurement at fair value through surplus or deficit.

Temporary Exceptions from Applying Specific Hedge Accounting Requirements

- 155A. An entity shall apply paragraphs 155D–155L and paragraphs 156E and 184(d) to all hedging relationships directly affected by interest rate benchmark reform. These paragraphs apply only to such hedging relationships. A hedging relationship is directly affected by interest rate benchmark reform only if the reform gives rise to uncertainties about:
- (a) The interest rate benchmark (contractually or non-contractually specified) designated as a hedged risk; and/or
 - (b) The timing or the amount of interest rate benchmark-based cash flows of the hedged item or of the hedging instrument.
- 155B. For the purpose of applying paragraphs 155D–155L, the term 'interest rate benchmark reform' refers to the market-wide reform of an interest rate benchmark, including the replacement of an interest rate benchmark with an alternative benchmark rate such as that resulting from the recommendations set out in the Financial Stability Board's July 2014 report, 'Reforming Major Interest Rate Benchmarks'.³
- 155C. Paragraphs 155D–155L provide exceptions only to the requirements specified in these paragraphs. An entity shall continue to apply all other hedge accounting requirements to hedging relationships directly affected by interest rate benchmark reform.

Highly Probable Requirement for Cash Flow Hedges

- 155D. For the purpose of determining whether a forecast transaction (or a component thereof) is highly probable as required by paragraph 124, an entity shall assume that the interest rate benchmark on which the hedged cash flows (contractually or non-contractually specified) are based is not altered as a result of interest rate benchmark reform.

Reclassifying the Amount Accumulated in the Cash Flow Hedge Reserve

- 155E. For the purpose of applying the requirement in paragraph 141 in order to determine whether the hedged future cash flows are expected to occur, an entity shall assume that the interest rate benchmark on which the hedged cash flows (contractually or non-contractually specified) are based is not altered as a result of interest rate benchmark reform.

Assessing the Economic Relationship between the Hedged Item and the Hedging Instrument

- 155F. For the purpose of applying the requirements in paragraphs 129(c)(i) and AG278–AG280, an entity shall assume that the interest rate benchmark on which the hedged cash flows and/or the hedged risk (contractually or non-contractually specified) are based, or the interest rate benchmark on which the cash flows of the hedging instrument are based, is not altered as a result of interest rate benchmark reform.

Designating a Component of an Item as a Hedged Item

- 155G. Unless paragraph 155H applies, for a hedge of a non-contractually specified benchmark component of interest rate risk, an entity shall apply the requirement in paragraphs 128(a) and AG257—that the risk component shall be separately identifiable—only at the inception of the hedging relationship.

³ The report, 'Reforming Major Interest Rate Benchmarks', is available at http://www.fsb.org/wp-content/uploads/r_140722.pdf.

155H. When an entity, consistent with its hedge documentation, frequently resets (i.e., discontinues and restarts) a hedging relationship because both the hedging instrument and the hedged item frequently change (i.e., the entity uses a dynamic process in which both the hedged items and the hedging instruments used to manage that exposure do not remain the same for long), the entity shall apply the requirement in paragraphs 128(a) and AG257—that the risk component is separately identifiable—only when it initially designates a hedged item in that hedging relationship. A hedged item that has been assessed at the time of its initial designation in the hedging relationship, whether it was at the time of the hedge inception or subsequently, is not reassessed at any subsequent redesignation in the same hedging relationship.

End of Application

155I. An entity shall prospectively cease applying paragraph 155D to a hedged item at the earlier of:

- (a) When the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and the amount of the interest rate benchmark-based cash flows of the hedged item; and
- (b) When the hedging relationship that the hedged item is part of is discontinued.

155J. An entity shall prospectively cease applying paragraph 155E at the earlier of:

- (a) When the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and the amount of the interest rate benchmark-based future cash flows of the hedged item; and
- (b) When the entire amount accumulated in the cash flow hedge reserve with respect to that discontinued hedging relationship has been reclassified to surplus or deficit.

155K. An entity shall prospectively cease applying paragraph 155F:

- (a) To a hedged item, when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the hedged risk or the timing and the amount of the interest rate benchmark-based cash flows of the hedged item; and
- (b) To a hedging instrument, when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and the amount of the interest rate benchmark-based cash flows of the hedging instrument.

If the hedging relationship that the hedged item and the hedging instrument are part of is discontinued earlier than the date specified in paragraph 155K(a) or the date specified in paragraph 155K(b), the entity shall prospectively cease applying paragraph 155F to that hedging relationship at the date of discontinuation.

155L. When designating a group of items as the hedged item, or a combination of financial instruments as the hedging instrument, an entity shall prospectively cease applying paragraphs 155D–155F to an individual item or financial instrument in accordance with paragraphs 155I, 155J, or 155K, as relevant, when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the hedged risk and/or the timing and the amount of the interest rate benchmark-based cash flows of that item or financial instrument.

155M. An entity shall prospectively cease applying paragraphs 155G and 155H at the earlier of:

- (a) When changes required by interest rate benchmark reform are made to the non-contractually specified risk component applying paragraph 155N; or
- (b) When the hedging relationship in which the non-contractually specified risk component is designated is discontinued.

Additional Temporary Exceptions Arising from Interest Rate Benchmark Reform

155N. As and when the requirements in paragraphs 155D–155H cease to apply to a hedging relationship (see paragraphs 155I–155M), an entity shall amend the formal designation of that hedging relationship as previously documented to reflect the changes required by interest rate benchmark reform, i.e., the changes are consistent with the requirements in paragraphs 72B–72D. In this context, the hedge designation shall be amended only to make one or more of these changes:

- (a) Designating an alternative benchmark rate (contractually or non-contractually specified) as a hedged risk;
- (b) Amending the description of the hedged item, including the description of the designated portion of the cash flows or fair value being hedged; or
- (c) Amending the description of the hedging instrument.

155O. An entity also shall apply the requirement in paragraph 155N(c) if these three conditions are met:

- (a) The entity makes a change required by interest rate benchmark reform using an approach other than changing the basis for determining the contractual cash flows of the hedging instrument (as described in paragraph 72B);

- (b) The original hedging instrument is not derecognized; and
 - (c) The chosen approach is economically equivalent to changing the basis for determining the contractual cash flows of the original hedging instrument (as described in paragraphs 72C and 72D).
- 155P. The requirements in paragraphs 155D–155H may cease to apply at different times. Therefore, in applying paragraph 155N, an entity may be required to amend the formal designation of its hedging relationships at different times, or may be required to amend the formal designation of a hedging relationship more than once. When, and only when, such a change is made to the hedge designation, an entity shall apply paragraphs 155T–155Y as applicable. An entity also shall apply paragraph 137 (for a fair value hedge) or paragraph 140 (for a cash flow hedge) to account for any changes in the fair value of the hedged item or the hedging instrument.
- 155Q. An entity shall amend a hedging relationship as required in paragraph 155N by the end of the reporting period during which a change required by interest rate benchmark reform is made to the hedged risk, hedged item or hedging instrument. For the avoidance of doubt, such an amendment to the formal designation of a hedging relationship constitutes neither the discontinuation of the hedging relationship nor the designation of a new hedging relationship.
- 155R. If changes are made in addition to those changes required by interest rate benchmark reform to the financial asset or financial liability designated in a hedging relationship (as described in paragraphs 72B–72D) or to the designation of the hedging relationship (as required by paragraph 155N), an entity shall first apply the applicable requirements in this Standard to determine if those additional changes result in the discontinuation of hedge accounting. If the additional changes do not result in the discontinuation of hedge accounting, an entity shall amend the formal designation of the hedging relationship as specified in paragraph 155N.
- 155S. Paragraphs 155T–155Z provide exceptions to the requirements specified in those paragraphs only. An entity shall apply all other hedge accounting requirements in this Standard, including the qualifying criteria in paragraph 129, to hedging relationships that were directly affected by interest rate benchmark reform.

Accounting for Qualifying Hedging Relationships

Cash Flow Hedges

- 155T. For the purpose of applying paragraph 140, at the point when an entity amends the description of a hedged item as required in paragraph 155N(b), the amount accumulated in the cash flow hedge reserve shall be deemed to be based on the alternative benchmark rate on which the hedged future cash flows are determined.
- 155U. For a discontinued hedging relationship, when the interest rate benchmark on which the hedged future cash flows had been based is changed as required by interest rate benchmark reform, for the purpose of applying paragraph 141 in order to determine whether the hedged future cash flows are expected to occur, the amount accumulated in the cash flow hedge reserve for that hedging relationship shall be deemed to be based on the alternative benchmark rate on which the hedged future cash flows will be based.

Groups of Items

- 155V. When an entity applies paragraph 155N to groups of items designated as hedged items in a fair value or cash flow hedge, the entity shall allocate the hedged items to subgroups based on the benchmark rate being hedged and designate the benchmark rate as the hedged risk for each subgroup. For example, in a hedging relationship in which a group of items is hedged for changes in an interest rate benchmark subject to interest rate benchmark reform, the hedged cash flows or fair value of some items in the group could be changed to reference an alternative benchmark rate before other items in the group are changed. In this example, in applying paragraph 155N, the entity would designate the alternative benchmark rate as the hedged risk for that relevant subgroup of hedged items. The entity would continue to designate the existing interest rate benchmark as the hedged risk for the other subgroup of hedged items until the hedged cash flows or fair value of those items are changed to reference the alternative benchmark rate or the items expire and are replaced with hedged items that reference the alternative benchmark rate.
- 155W. An entity shall assess separately whether each subgroup meets the requirements in paragraph 146 to be an eligible hedged item. If any subgroup fails to meet the requirements in paragraph 146, the entity shall discontinue hedge accounting prospectively for the hedging relationship in its entirety. An entity also shall apply the requirements in paragraphs 137 and 140 to account for ineffectiveness related to the hedging relationship in its entirety.

Designation of Risk Components

- 155X. An alternative benchmark rate designated as a non-contractually specified risk component that is not separately identifiable (see paragraphs 128(a) and AG257) at the date it is designated shall be deemed to have met that requirement at that date, if, and only if, the entity reasonably expects the alternative benchmark rate will be separately identifiable within 24 months.

The 24-month period applies to each alternative benchmark rate separately and starts from the date the entity designates the alternative benchmark rate as a non-contractually specified risk component for the first time (ie the 24-month period applies on a rate-by-rate basis).

- 155Y. If subsequently an entity reasonably expects that the alternative benchmark rate will not be separately identifiable within 24 months from the date the entity designated it as a non-contractually specified risk component for the first time, the entity shall cease applying the requirement in paragraph 155X to that alternative benchmark rate and discontinue hedge accounting prospectively from the date of that reassessment for all hedging relationships in which the alternative benchmark rate was designated as a non-contractually specified risk component.
- 155Z. In addition to those hedging relationships specified in paragraph 155N, an entity shall apply the requirements in paragraphs 155X and 155Y to new hedging relationships in which an alternative benchmark rate is designated as a non-contractually specified risk component (see paragraphs 128(a) and AG257) when, because of interest rate benchmark reform, that risk component is not separately identifiable at the date it is designated.

Effective Date and Transition

Effective Date

156. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is permitted. If an entity elects to apply this Standard early, it must disclose that fact and apply all of the requirements in this Standard at the same time (but see also paragraph 179). It shall also, at the same time, apply the amendments in Appendix D.**
- 156A. ***Long-term Interests in Associates and Joint Ventures* (Amendments to IPSAS 36) and *Prepayment Features with Negative Compensation* (Amendments to IPSAS 41), issued in January 2019, added paragraphs 185–190 and AG74A and amended paragraphs AG73(b) and AG74(b). An entity shall apply these amendments for annual periods beginning on or after January 1, 2023. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact.**
- 156B. **Paragraphs 155A–155L were added and paragraph 184 was amended by *Improvements to IPSAS, 2021*, issued in January 2022. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact.**
- 156C. **Paragraphs 72A–72E, 155M–155Z, and 191–194 were added by *Improvements to IPSAS, 2021*, issued in January 2022. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact.**
- 156D. **Paragraph AG46 was amended and paragraphs AG46A and 195 were added by *Improvements to IPSAS, 2021*, issued in January 2022. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact.**
- 156E. **Paragraphs 2, 87, AG198 and AG210 were amended by IPSAS 43 issued in January 2022. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted. If an entity applies the amendments for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 43 at the same time.**
157. When an entity adopts the accrual basis IPSASs of accounting as defined in IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of IPSASs.

Transition

158. An entity shall apply this Standard retrospectively, in accordance with IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, except as specified in paragraphs 161–184. This Standard shall not be applied to items that have already been derecognized at the date of initial application.
159. For the purposes of the transition provisions in paragraphs 158, 160–184, the date of initial application is the date when an entity first applies those requirements of this Standard and must be the beginning of a reporting period after the issue of this Standard.

Transition for Classification and Measurement

160. At the date of initial application, an entity shall assess whether a financial asset meets the condition in paragraphs 40(a) or 41(a) on the basis of the facts and circumstances that exist at that date. The resulting classification shall be applied retrospectively irrespective of the entity's management model in prior reporting periods.
161. If, at the date of initial application, it is impracticable (as defined in IPSAS 3) for an entity to assess a modified time value of money element in accordance with paragraphs AG68–AG70 on the basis of the facts and circumstances that existed at the initial recognition of the financial asset, an entity shall assess the contractual cash flow characteristics of that financial asset on the basis of the facts and circumstances that existed at the initial recognition of the financial asset without taking into account the requirements related to the modification of the time value of money element in paragraphs AG68–AG70. (See also paragraph 49R of IPSAS 30.)
162. If, at the date of initial application, it is impracticable (as defined in IPSAS 3) for an entity to assess whether the fair value of a prepayment feature was insignificant in accordance with paragraph AG74(c) on the basis of the facts and circumstances that existed at the initial recognition of the financial asset, an entity shall assess the contractual cash flow characteristics of that financial asset on the basis of the facts and circumstances that existed at the initial recognition of the financial asset without taking into account the exception for prepayment features in paragraph AG74. (See also paragraph 49S of IPSAS 30.)
163. If an entity measures a hybrid contract at fair value in accordance with paragraphs 41, 43 or 44 but the fair value of the hybrid contract had not been measured in comparative reporting periods, the fair value of the hybrid contract in the comparative reporting periods shall be the sum of the fair values of the components (i.e., the non-derivative host and the embedded derivative) at the end of each comparative reporting period if the entity restates prior periods (see paragraph 173).
164. If an entity has applied paragraph 163 then at the date of initial application the entity shall recognize any difference between the fair value of the entire hybrid contract at the date of initial application and the sum of the fair values of the components of the hybrid contract at the date of initial application in the opening accumulated surplus or deficit (or other component of net assets/equity, as appropriate) of the reporting period that includes the date of initial application.
165. At the date of initial application an entity may designate:
- (a) A financial asset as measured at fair value through surplus or deficit in accordance with paragraph 44; or
 - (b) An investment in an equity instrument as at fair value through net assets/equity in accordance with paragraph 106.
- Such a designation shall be made on the basis of the facts and circumstances that exist at the date of initial application. That classification shall be applied retrospectively.
166. At the date of initial application an entity:
- (a) Shall revoke its previous designation of a financial asset as measured at fair value through surplus or deficit if that financial asset does not meet the condition in paragraph 44.
 - (b) May revoke its previous designation of a financial asset as measured at fair value through surplus or deficit if that financial asset meets the condition in paragraph 44.
- Such a revocation shall be made on the basis of the facts and circumstances that exist at the date of initial application. That classification shall be applied retrospectively.
167. At the date of initial application, an entity:
- (a) May designate a financial liability as measured at fair value through surplus or deficit in accordance with paragraph 46(a).
 - (b) Shall revoke its previous designation of a financial liability as measured at fair value through surplus or deficit if such designation was made at initial recognition in accordance with the condition now in paragraph 46(a) and such designation does not satisfy that condition at the date of initial application.
 - (c) May revoke its previous designation of a financial liability as measured at fair value through surplus or deficit if such designation was made at initial recognition in accordance with the condition now in paragraph 46(a) and such designation satisfies that condition at the date of initial application.
- Such a designation and revocation shall be made on the basis of the facts and circumstances that exist at the date of initial application. That classification shall be applied retrospectively.

168. If it is impracticable (as defined in IPSAS 3) for an entity to apply retrospectively the effective interest method, the entity shall treat:
- (a) The fair value of the financial asset or the financial liability at the end of each comparative period presented as the gross carrying amount of that financial asset or the amortized cost of that financial liability if the entity restates prior periods; and
 - (b) The fair value of the financial asset or the financial liability at the date of initial application as the new gross carrying amount of that financial asset or the new amortized cost of that financial liability at the date of initial application of this Standard.
169. If an entity previously accounted at cost (in accordance with IPSAS 29), for an investment in an equity instrument that does not have a quoted price in an active market for an identical instrument (i.e., a Level 1 input) (or for a derivative asset that is linked to and must be settled by delivery of such an equity instrument) it shall measure that instrument at fair value at the date of initial application. Any difference between the previous carrying amount and the fair value shall be recognized in the opening accumulated surplus or deficit (or other component of net assets/equity, as appropriate) of the reporting period that includes the date of initial application.
170. If an entity previously accounted for a derivative liability that is linked to, and must be settled by, delivery of an equity instrument that does not have a quoted price in an active market for an identical instrument (i.e., a Level 1 input) at cost in accordance with IPSAS 29, it shall measure that derivative liability at fair value at the date of initial application. Any difference between the previous carrying amount and the fair value shall be recognized in the opening net assets/equity of the reporting period that includes the date of initial application.
171. At the date of initial application, an entity shall determine whether the treatment in paragraph 108 would create or enlarge an accounting mismatch in surplus or deficit on the basis of the facts and circumstances that exist at the date of initial application. This Standard shall be applied retrospectively on the basis of that determination.
172. At the date of initial application, an entity is permitted to make the designation in paragraph 6 for contracts that already exist on the date but only if it designates all similar contracts. The change in the net assets resulting from such designations shall be recognized in net assets/equity at the date of initial application.
173. Despite the requirement in paragraph 158, an entity that adopts the classification and measurement requirements of this Standard (which include the requirements related to amortized cost measurement for financial assets and impairment in paragraphs 69–72 and paragraphs 73–93) shall provide the disclosures set out in paragraphs 49L–49O of IPSAS 30 but need not restate prior periods. The entity may restate prior periods if, and only if, it is possible without the use of hindsight. If an entity does not restate prior periods, the entity shall recognize any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the date of initial application in the opening accumulated surplus or deficit (or other component of net assets/equity, as appropriate) of the annual reporting period that includes the date of initial application. However, if an entity restates prior periods, the restated financial statements must reflect all of the requirements in this Standard.
174. If an entity prepares interim financial reports, the entity need not apply the requirements in this Standard to interim periods prior to the date of initial application if it is impracticable (as defined in IPSAS 3).

Impairment

175. An entity shall apply the impairment requirements in paragraphs 73–93 retrospectively in accordance with IPSAS 3 subject to paragraphs 173 and 176–178.
176. At the date of initial application, an entity shall use reasonable and supportable information that is available without undue cost or effort to determine the credit risk at the date that a financial instrument was initially recognized (or for loan commitments and financial guarantee contracts at the date that the entity became a party to the irrevocable commitment in accordance with paragraph 78) and compare that to the credit risk at the date of initial application of this Standard.
177. When determining whether there has been a significant increase in credit risk since initial recognition, an entity may apply:
- (a) The requirements in paragraphs 82 and AG186–AG188; and
 - (b) The rebuttable presumption in paragraph 83 for contractual payments that are more than 30 days past due if an entity will apply the impairment requirements by identifying significant increases in credit risk since initial recognition for those financial instruments on the basis of past due information.

178. If, at the date of initial application, determining whether there has been a significant increase in credit risk since initial recognition would require undue cost or effort, an entity shall recognize a loss allowance at an amount equal to lifetime expected credit losses at each reporting date until that financial instrument is derecognized (unless that financial instrument is low credit risk at a reporting date, in which case paragraph 177(a) applies).

Transition for Hedge Accounting

179. When an entity first applies this Standard, it may choose as its accounting policy to continue to apply the hedge accounting requirements of IPSAS 29 instead of the requirements in paragraphs 113–155 of this Standard. An entity shall apply that policy to all of its hedging relationships. An entity that chooses that policy shall also apply Appendix C of IPSAS 29.
180. Except as provided in paragraph 184, an entity shall apply the hedge accounting requirements of this Standard prospectively.
181. To apply hedge accounting from the date of initial application of the hedge accounting requirements of this Standard, all qualifying criteria must be met as at that date.
182. Hedging relationships that qualified for hedge accounting in accordance with IPSAS 29 that also qualify for hedge accounting in accordance with the criteria of this Standard (see paragraph 129), after taking into account any rebalancing of the hedging relationship on transition (see paragraph 183(b)), shall be regarded as continuing hedging relationships.
183. On initial application of the hedge accounting requirements of this Standard, an entity:
- (a) May start to apply those requirements from the same point in time as it ceases to apply the hedge accounting requirements of IPSAS 29; and
 - (b) Shall consider the hedge ratio in accordance with IPSAS 29 as the starting point for rebalancing the hedge ratio of a continuing hedging relationship, if applicable. Any gain or loss from such a rebalancing shall be recognized in surplus or deficit.
184. As an exception to prospective application of the hedge accounting requirements of this Standard, an entity:
- (a) Shall apply the accounting for the time value of options in accordance with paragraph 144 retrospectively if, in accordance with IPSAS 29, only the change in an option's intrinsic value was designated as a hedging instrument in a hedging relationship. This retrospective application applies only to those hedging relationships that existed at the beginning of the earliest comparative period or were designated thereafter.
 - (b) May apply the accounting for the forward element of forward contracts in accordance with paragraph 145 retrospectively if, in accordance with IPSAS 29, only the change in the spot element of a forward contract was designated as a hedging instrument in a hedging relationship. This retrospective application applies only to those hedging relationships that existed at the beginning of the earliest comparative period or were designated thereafter. In addition, if an entity elects retrospective application of this accounting, it shall be applied to all hedging relationships that qualify for this election (i.e., on transition this election is not available on a hedging-relationship-by-hedging-relationship basis). The accounting for foreign currency basis spreads (see paragraph 145) may be applied retrospectively for those hedging relationships that existed at the beginning of the earliest comparative period or were designated thereafter.
 - (c) Shall apply retrospectively the requirement of paragraph 135 that there is not an expiration or termination of the hedging instrument if:
 - (i) As a consequence of laws or regulations, or the introduction of laws or regulations, the parties to the hedging instrument agree that one or more clearing counterparties replace their original counterparty to become the new counterparty to each of the parties; and
 - (ii) Other changes, if any, to the hedging instrument are limited to those that are necessary to effect such a replacement of the counterparty.
 - (d) Shall apply the requirements in paragraphs 155A–155L retrospectively. This retrospective application applies only to those hedging relationships that existed at the beginning of the reporting period in which an entity first applies those requirements or were designated thereafter, and to the amount accumulated in the cash flow hedge reserve that existed at the beginning of the reporting period in which an entity first applies those requirements.

Transition for Prepayment Features with Negative Compensation

185. An entity shall apply *Long-term Interests in Associates and Joint Ventures* (Amendments to IPSAS 36) and *Prepayment Features with Negative Compensation* (Amendments to IPSAS 41) retrospectively in accordance with IPSAS 3, except as specified in paragraphs 186–190.
186. An entity that first applies these amendments at the same time it first applies this Standard shall apply paragraphs 157–183 instead of paragraphs 187–190.
187. An entity that first applies these amendments after it first applies this Standard shall apply paragraphs 188–190. The entity shall also apply the other transition requirements in this Standard necessary for applying these amendments. For that purpose, references to the date of initial application shall be read as referring to the beginning of the reporting period in which an entity first applies these amendments (date of initial application of these amendments).
188. With regard to designating a financial asset or financial liability as measured at fair value through surplus or deficit, an entity:
- (a) Shall revoke its previous designation of a financial asset as measured at fair value through surplus or deficit if that designation was previously made in accordance with the condition in paragraph 44 but that condition is no longer satisfied as a result of the application of these amendments;
 - (b) May designate a financial asset as measured at fair value through surplus or deficit if that designation would not have previously satisfied the condition in paragraph 44 but that condition is now satisfied as a result of the application of these amendments;
 - (c) Shall revoke its previous designation of a financial liability as measured at fair value through surplus or deficit if that designation was previously made in accordance with the condition in paragraph 46(a) but that condition is no longer satisfied as a result of the application of these amendments; and
 - (d) May designate a financial liability as measured at fair value through surplus or deficit if that designation would not have previously satisfied the condition in paragraph 46(a) but that condition is now satisfied as a result of the application of these amendments.

Such a designation and revocation shall be made on the basis of the facts and circumstances that exist at the date of initial application of these amendments. That classification shall be applied retrospectively.

189. An entity is not required to restate prior periods to reflect the application of these amendments. The entity may restate prior periods if, and only if, it is possible without the use of hindsight and the restated financial statements reflect all the requirements in this Standard. If an entity does not restate prior periods, the entity shall recognize any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the date of initial application of these amendments in the opening accumulated surplus or deficit (or other component of net assets/equity, as appropriate) of the annual reporting period that includes the date of initial application of these amendments.
190. In the reporting period that includes the date of initial application of these amendments, the entity shall disclose the following information as at that date of initial application for each class of financial assets and financial liabilities that were affected by these amendments:
- (a) The previous measurement category and carrying amount determined immediately before applying these amendments;
 - (b) The new measurement category and carrying amount determined after applying these amendments;
 - (c) The carrying amount of any financial assets and financial liabilities in the statement of financial position that were previously designated as measured at fair value through surplus or deficit but are no longer so designated; and
 - (d) The reasons for any designation or de-designation of financial assets or financial liabilities as measured at fair value through surplus or deficit.

Transition for Interest Rate Benchmark Reform—Phase 2

191. An entity shall apply *Interest Rate Benchmark Reform—Phase 2* amendments retrospectively in accordance with IPSAS 3, except as specified in paragraphs 192–194.

192. An entity shall designate a new hedging relationship (for example, as described in paragraph 155Z) only prospectively (i.e., an entity is prohibited from designating a new hedge accounting relationship in prior periods). However, an entity shall reinstate a discontinued hedging relationship if, and only if, these conditions are met:
- (a) The entity had discontinued that hedging relationship solely due to changes required by interest rate benchmark reform and the entity would not have been required to discontinue that hedging relationship if these amendments had been applied at that time; and
 - (b) At the beginning of the reporting period in which an entity first applies these amendments (date of initial application of these amendments), that discontinued hedging relationship meets the qualifying criteria for hedge accounting (after taking into account these amendments).
193. If, in applying paragraph 192, an entity reinstates a discontinued hedging relationship, the entity shall read references in paragraphs 155X and 155Y to the date the alternative benchmark rate is designated as a non-contractually specified risk component for the first time as referring to the date of initial application of these amendments (i.e., the 24-month period for that alternative benchmark rate designated as a non-contractually specified risk component begins from the date of initial application of these amendments).
194. An entity is not required to restate prior periods to reflect the application of these amendments. The entity may restate prior periods if, and only if, it is possible without the use of hindsight. If an entity does not restate prior periods, the entity shall recognize any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the date of initial application of these amendments in the opening net assets/equity (or other component of net assets/equity, as appropriate) of the annual reporting period that includes the date of initial application of these amendments.

Transition for *Improvements to IPSAS, 2021*

195. An entity shall apply *Improvements to IPSAS, 2021* to financial liabilities that are modified or exchanged on or after the beginning of the annual reporting period in which the entity first applies the amendment.

Application Guidance

This Appendix is an integral part of IPSAS 41.

Scope

- AG1. Some contracts require a payment based on climatic, geological or other physical variables. (Those based on climatic variables are sometimes referred to as ‘weather derivatives’.) If those contracts are not insurance contracts, they are within the scope of this Standard.
- AG2. This Standard does not change the requirements relating to employee benefit plans that comply with the relevant international or national accounting standard on accounting and reporting by retirement benefit plans and royalty agreements based on the volume of sales or service revenues that are accounted for under IPSAS 9, *Revenue from Exchange Transactions*.
- AG3. Sometimes, an entity makes what it views as a ‘strategic investment’ in equity instruments issued by another entity, with the management model of establishing or maintaining a long-term operating relationship with the entity in which the investment is made. The investor or joint venturer entity uses IPSAS 36, *Investments in Associates and Joint Ventures* to determine whether the equity method of accounting shall be applied to such an investment.
- AG4. This Standard applies to the financial assets and financial liabilities of insurers, other than rights and obligations that paragraph 2(e) excludes because they arise from insurance contracts. An entity does however apply this Standard to:
- (a) Financial guarantee contracts, except those where the issuer elects to treat such contracts as insurance contracts in accordance with IPSAS 28; and
 - (b) Embedded derivatives included in insurance contracts.

An entity may, but is not required to, apply this Standard to other insurance contracts that involve the transfer of financial risk.

- AG5. Financial guarantee contracts may have various legal forms, such as a guarantee, some types of letter of credit, a credit default contract or an insurance contract. Their accounting treatment does not depend on their legal form. The following are examples of the appropriate treatment (see paragraph 2(e)):
- (a) Although a financial guarantee contract meets the definition of an insurance contract in IFRS 4 if the risk transferred is significant, the issuer applies this Standard. Nevertheless, an entity may elect, under certain circumstances, to treat financial guarantee contracts as insurance contracts of financial instruments using IPSAS 28 if the issuer has previously adopted an accounting policy that treated financial guarantee contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either this Standard or the relevant international or national accounting standard on insurance contracts to such financial guarantee contracts. If this Standard applies, paragraph 57 requires the issuer to recognize a financial guarantee contract initially at fair value. If the financial guarantee contract was issued to an unrelated party in a stand-alone arm’s length transaction, its fair value at inception is likely to equal the premium received, unless there is evidence to the contrary. Subsequently, unless the financial guarantee contract was designated at inception as at fair value through surplus or deficit or unless paragraphs 26–34 and AG32–AG38 apply (when a transfer of a financial asset does not qualify for derecognition or the continuing involvement approach applies), the issuer measures it at the higher of:
 - (i) The amount determined in accordance with paragraphs 73–93; and
 - (ii) The amount initially recognized less, when appropriate, the cumulative amortization recognized in accordance with the principles of IPSAS 9 (see paragraph 45(c)).
 - (b) Some credit-related guarantees do not, as a precondition for payment, require that the holder is exposed to, and has incurred a loss on, the failure of the debtor to make payments on the guaranteed asset when due. An example of such a guarantee is one that requires payments in response to changes in a specified credit rating or credit index. Such guarantees are not financial guarantee contracts as defined in this Standard, and are not insurance contracts. Such guarantees are derivatives and the issuer applies this Standard to them.
 - (c) If a financial guarantee contract was issued in connection with the sale of goods, the issuer applies IPSAS 9 in determining when it recognizes the revenue from the guarantee and from the sale of goods.

- AG6. Rights and obligations (assets and liabilities) may arise from non-exchange revenue transactions, for example, an entity may receive cash from a multi-lateral agency to perform certain activities. Where the performance of those activities is subject

to conditions, an asset and a liability is recognized simultaneously. Where the asset is a financial asset, it is recognized in accordance with IPSAS 23, and initially measured in accordance with IPSAS 23 and this Standard. A liability that is initially recognized as a result of conditions imposed on the use of an asset is outside the scope of this Standard and is dealt with in IPSAS 23. After initial recognition, if circumstances indicate that recognition of a liability in accordance with IPSAS 23 is no longer appropriate, an entity considers whether a financial liability should be recognized in accordance with this Standard. Other liabilities that may arise from non-exchange revenue transactions are recognized and measured in accordance with this Standard if they meet the definition of a financial liability in IPSAS 28.

Definitions

Derivatives

- AG7. Typical examples of derivatives are futures and forward, swap and option contracts. A derivative usually has a notional amount, which is an amount of currency, a number of shares, a number of units of weight or volume or other units specified in the contract. However, a derivative instrument does not require the holder or writer to invest or receive the notional amount at the inception of the contract. Alternatively, a derivative could require a fixed payment or payment of an amount that can change (but not proportionally with a change in the underlying) as a result of some future event that is unrelated to a notional amount. For example, a contract may require a fixed payment of CU1,000 if the six-month interbank offered rate increases by 100 basis points. Such a contract is a derivative even though a notional amount is not specified.
- AG8. The definition of a derivative in this Standard includes contracts that are settled gross by delivery of the underlying item (e.g., a forward contract to purchase a fixed rate debt instrument). An entity may have a contract to buy or sell a non-financial item that can be settled net in cash or another financial instrument or by exchanging financial instruments (e.g., a contract to buy or sell a commodity at a fixed price at a future date). Such a contract is within the scope of this Standard unless it was entered into and continues to be held for the purpose of delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements. However, this Standard applies to such contracts for an entity's expected purchase, sale or usage requirements if the entity makes a designation in accordance with paragraph 6 (see paragraphs 5–8).
- AG9. One of the defining characteristics of a derivative is that it has an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors. An option contract meets that definition because the premium is less than the investment that would be required to obtain the underlying financial instrument to which the option is linked. A currency swap that requires an initial exchange of different currencies of equal fair values meets the definition because it has a zero initial net investment.
- AG10. A regular way purchase or sale gives rise to a fixed price commitment between trade date and settlement date that meets the definition of a derivative. However, because of the short duration of the commitment it is not recognized as a derivative financial instrument. Instead, this Standard provides for special accounting for such regular way contracts (see paragraphs 11 and AG17–AG20).
- AG11. The definition of a derivative refers to non-financial variables that are not specific to a party to the contract. These include an index of earthquake losses in a particular region and an index of temperatures in a particular city. Non-financial variables specific to a party to the contract include the occurrence or non-occurrence of a fire that damages or destroys an asset of a party to the contract. A change in the fair value of a non-financial asset is specific to the owner if the fair value reflects not only changes in market prices for such assets (a financial variable) but also the condition of the specific non-financial asset held (a non-financial variable). For example, if a guarantee of the residual value of a specific car exposes the guarantor to the risk of changes in the car's physical condition, the change in that residual value is specific to the owner of the car.

Financial Assets and Liabilities Held for Trading

- AG12. Trading generally reflects active and frequent buying and selling, and financial instruments held for trading generally are used with the objective of generating a profit from short-term fluctuations in price or dealer's margin.
- AG13. Financial liabilities held for trading include:
- (a) Derivative liabilities that are not accounted for as hedging instruments;
 - (b) Obligations to deliver financial assets borrowed by a short seller (i.e., an entity that sells financial assets it has borrowed and does not yet own);
 - (c) Financial liabilities that are incurred with a management model to repurchase them in the near term (e.g., a quoted debt instrument that the issuer may buy back in the near term depending on changes in its fair value); and
 - (d) Financial liabilities that are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking.

AG14. The fact that a liability is used to fund trading activities does not in itself make that liability one that is held for trading.

Recognition and Derecognition

Initial Recognition

AG15. As a consequence of the principle in paragraph 10, an entity recognizes all of its contractual rights and obligations under derivatives in its statement of financial position as assets and liabilities, respectively, except for derivatives that prevent a transfer of financial assets from being accounted for as a sale (see paragraph AG35). If a transfer of a financial asset does not qualify for derecognition, the transferee does not recognize the transferred asset as its asset (see paragraph AG36).

AG16. The following are examples of applying the principle in paragraph 10:

- (a) Unconditional receivables and payables are recognized as assets or liabilities when the entity becomes a party to the contract and, as a consequence, has a legal right to receive or a legal obligation to pay cash.
- (b) Assets to be acquired and liabilities to be incurred as a result of a firm commitment to purchase or sell goods or services are generally not recognized until at least one of the parties has performed under the agreement. For example, an entity that receives a firm order does not generally recognize an asset (and the entity that places the order does not recognize a liability) at the time of the commitment but, instead, delays recognition until the ordered goods or services have been shipped, delivered or rendered. If a firm commitment to buy or sell non-financial items is within the scope of this Standard in accordance with paragraphs 5–8, its net fair value is recognized as an asset or a liability on the commitment date (see paragraph AG92(c)). In addition, if a previously unrecognized firm commitment is designated as a hedged item in a fair value hedge, any change in the net fair value attributable to the hedged risk is recognized as an asset or a liability after the inception of the hedge (see paragraphs 137(b) and 138).
- (c) A forward contract that is within the scope of this Standard (see paragraph 2) is recognized as an asset or a liability on the commitment date, instead of on the date on which settlement takes place. When an entity becomes a party to a forward contract, the fair values of the right and obligation are often equal, so that the net fair value of the forward is zero. If the net fair value of the right and obligation is not zero, the contract is recognized as an asset or liability.
- (d) Option contracts that are within the scope of this Standard (see paragraph 2) are recognized as assets or liabilities when the holder or writer becomes a party to the contract.
- (e) Planned future transactions, no matter how likely, are not assets and liabilities because the entity has not become a party to a contract.

Regular Way Purchase or Sale of Financial Assets

AG17. A regular way purchase or sale of financial assets is recognized using either trade date accounting or settlement date accounting as described in paragraphs AG19 and AG20. An entity shall apply the same method consistently for all purchases and sales of financial assets that are classified in the same way in accordance with this Standard. For this purpose assets that are mandatorily measured at fair value through surplus or deficit form a separate classification from assets designated as measured at fair value through surplus or deficit. In addition, investments in equity instruments accounted for using the option provided in paragraph 106 form a separate classification.

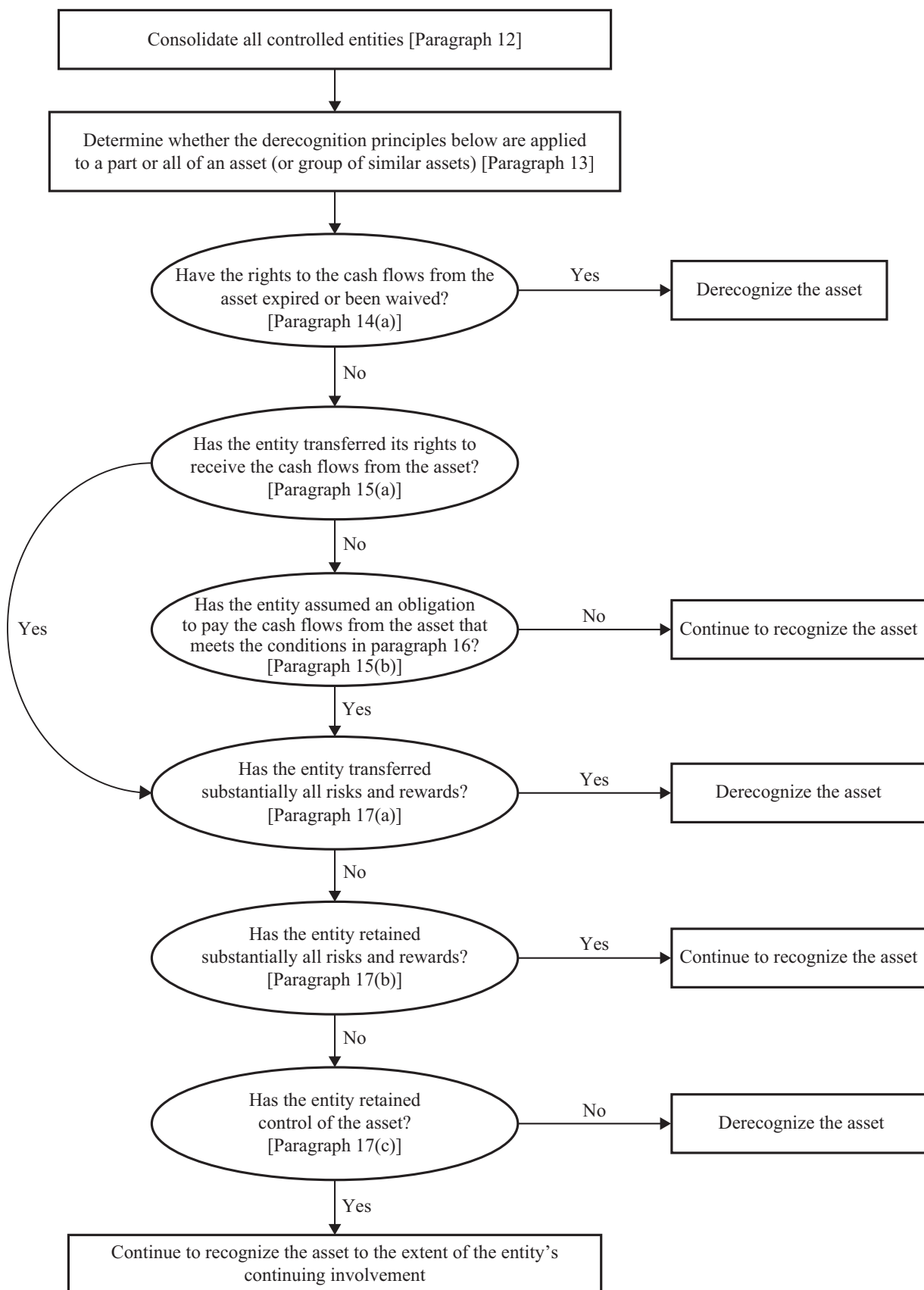
AG18. A contract that requires or permits net settlement of the change in the value of the contract is not a regular way contract. Instead, such a contract is accounted for as a derivative in the period between the trade date and the settlement date.

AG19. The trade date is the date that an entity commits itself to purchase or sell an asset. Trade date accounting refers to (a) the recognition of an asset to be received and the liability to pay for it on the trade date, and (b) derecognition of an asset that is sold, recognition of any gain or loss on disposal and the recognition of a receivable from the buyer for payment on the trade date. Generally, interest does not start to accrue on the asset and corresponding liability until the settlement date when title passes.

AG20. The settlement date is the date that an asset is delivered to or by an entity. Settlement date accounting refers to (a) the recognition of an asset on the day it is received by the entity, and (b) the derecognition of an asset and recognition of any gain or loss on disposal on the day that it is delivered by the entity. When settlement date accounting is applied an entity accounts for any change in the fair value of the asset to be received during the period between the trade date and the settlement date in the same way as it accounts for the acquired asset. In other words, the change in value is not recognized for assets measured at amortized cost; it is recognized in surplus or deficit for assets classified as financial assets measured at fair value through surplus or deficit; and it is recognized in net assets/equity for financial assets measured at fair value through net assets/equity in accordance with paragraph 41 and for investments in equity instruments accounted for in accordance with paragraph 106.

Derecognition of Financial Assets

AG21. The following flow chart illustrates the evaluation of whether and to what extent a financial asset is derecognized.



Arrangements Under which an Entity Retains the Contractual Rights to Receive the Cash Flows of a Financial Asset, but Assumes a Contractual Obligation to Pay the Cash Flows to One or More Recipients (paragraph 15(b))

- AG22. The situation described in paragraph 15(b) (when an entity retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients) occurs, for example, if the entity is a trust, and issues to investors beneficial interests in the underlying financial assets that it owns and provides servicing of those financial assets. In that case, the financial assets qualify for derecognition if the conditions in paragraphs 16 and 17 are met.
- AG23. In applying paragraph 16, the entity could be, for example, the originator of the financial asset, or it could be an economic entity that includes a controlled entity that has acquired the financial asset and passes on cash flows to unrelated third party investors.

Evaluation of the Transfer of Risks and Rewards of Ownership (paragraph 17)

- AG24. Examples of when an entity has transferred substantially all the risks and rewards of ownership are:
- (a) An unconditional sale of a financial asset;
 - (b) A sale of a financial asset together with an option to repurchase the financial asset at its fair value at the time of repurchase; and
 - (c) A sale of a financial asset together with a put or call option that is deeply out of the money (i.e., an option that is so far out of the money it is highly unlikely to go into the money before expiry).
- AG25. Examples of when an entity has retained substantially all the risks and rewards of ownership are:
- (a) A sale and repurchase transaction where the repurchase price is a fixed price or the sale price plus a lender's return;
 - (b) A securities lending agreement;
 - (c) A sale of a financial asset together with a total return swap that transfers the market risk exposure back to the entity;
 - (d) A sale of a financial asset together with a deep in-the-money put or call option (i.e., an option that is so far in the money that it is highly unlikely to go out of the money before expiry); and
 - (e) A sale of short-term receivables in which the entity guarantees to compensate the transferee for credit losses that are likely to occur.
- AG26. If an entity determines that as a result of the transfer, it has transferred substantially all the risks and rewards of ownership of the transferred asset, it does not recognize the transferred asset again in a future period, unless it reacquires the transferred asset in a new transaction.

Evaluation of the Transfer of Control

- AG27. An entity has not retained control of a transferred asset if the transferee has the practical ability to sell the transferred asset. An entity has retained control of a transferred asset if the transferee does not have the practical ability to sell the transferred asset. A transferee has the practical ability to sell the transferred asset if it is traded in an active market because the transferee could repurchase the transferred asset in the market if it needs to return the asset to the entity. For example, a transferee may have the practical ability to sell a transferred asset if the transferred asset is subject to an option that allows the entity to repurchase it, but the transferee can readily obtain the transferred asset in the market if the option is exercised. A transferee does not have the practical ability to sell the transferred asset if the entity retains such an option and the transferee cannot readily obtain the transferred asset in the market if the entity exercises its option.
- AG28. The transferee has the practical ability to sell the transferred asset only if the transferee can sell the transferred asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without imposing additional restrictions on the transfer. The critical question is what the transferee is able to do in practice, not what contractual rights the transferee has concerning what it can do with the transferred asset or what contractual prohibitions exist. In particular:
- (a) A contractual right to dispose of the transferred asset has little practical effect if there is no market for the transferred asset, and
 - (b) An ability to dispose of the transferred asset has little practical effect if it cannot be exercised freely. For that reason:
 - (i) The transferee's ability to dispose of the transferred asset must be independent of the actions of others (i.e., it must be a unilateral ability), and

- (ii) The transferee must be able to dispose of the transferred asset without needing to attach restrictive conditions or “strings” to the transfer (e.g., conditions about how a loan asset is serviced or an option giving the transferee the right to repurchase the asset).

AG29. That the transferee is unlikely to sell the transferred asset does not, of itself, mean that the transferor has retained control of the transferred asset. However, if a put option or guarantee constrains the transferee from selling the transferred asset, then the transferor has retained control of the transferred asset. For example, if a put option or guarantee is sufficiently valuable it constrains the transferee from selling the transferred asset because the transferee would, in practice, not sell the transferred asset to a third party without attaching a similar option or other restrictive conditions. Instead, the transferee would hold the transferred asset so as to obtain payments under the guarantee or put option. Under these circumstances the transferor has retained control of the transferred asset.

Transfers that Qualify for Derecognition

- AG30. An entity may retain the right to a part of the interest payments on transferred assets as compensation for servicing those assets. The part of the interest payments that the entity would give up upon termination or transfer of the servicing contract is allocated to the servicing asset or servicing liability. The part of the interest payments that the entity would not give up is an interest-only strip receivable. For example, if the entity would not give up any interest upon termination or transfer of the servicing contract, the entire interest spread is an interest-only strip receivable. For the purposes of applying paragraph 24, the fair values of the servicing asset and interest-only strip receivable are used to allocate the carrying amount of the receivable between the part of the asset that is derecognized and the part that continues to be recognized. If there is no servicing fee specified or the fee to be received is not expected to compensate the entity adequately for performing the servicing, a liability for the servicing obligation is recognized at fair value.
- AG31. When measuring the fair values of the part that continues to be recognized and the part that is derecognized for the purposes of applying paragraph 24, an entity applies the fair value measurement requirements in paragraphs 66–68 and AG144–AG155.

Transfers that do not Qualify for Derecognition

- AG32. The following is an application of the principle outlined in paragraph 26. If a guarantee provided by the entity for default losses on the transferred asset prevents a transferred asset from being derecognized because the entity has retained substantially all the risks and rewards of ownership of the transferred asset, the transferred asset continues to be recognized in its entirety and the consideration received is recognized as a liability.

Sale of Future Flows Arising from a Sovereign Right

- AG33. In the public sector, securitization schemes may involve a sale of future flows arising from a sovereign right, such as a right to taxation, that have not previously been recognized as assets. An entity recognizes the revenue arising from such transactions in accordance with the relevant revenue standard (see IPSAS 9 and IPSAS 23). Such transactions may give rise to financial liabilities as defined in IPSAS 28. Examples of such financial liabilities may include but are not limited to borrowings, financial guarantees, liabilities arising from a servicing or administrative contract, or payables relating to cash collected on behalf of the purchasing entity. Financial liabilities shall be recognized when the entity becomes party to the contractual provisions of the instrument in accordance with paragraph 10 and classified in accordance with paragraphs 45 and 46. The financial liabilities shall be initially recognized in accordance with paragraph 57, and subsequently measured in accordance with paragraphs 62 and 63.

Continuing Involvement in Transferred Assets

- AG34. The following are examples of how an entity measures a transferred asset and the associated liability under paragraph 27.

All Assets

- (a) If a guarantee provided by an entity to pay for default losses on a transferred asset prevents the transferred asset from being derecognized to the extent of the continuing involvement, the transferred asset at the date of the transfer is measured at the lower of (i) the carrying amount of the asset and (ii) the maximum amount of the consideration received in the transfer that the entity could be required to repay (‘the guarantee amount’). The associated liability is initially measured at the guarantee amount plus the fair value of the guarantee (which is normally the consideration received for the guarantee). Subsequently, the initial fair value of the guarantee is recognized in surplus or deficit on a time proportion basis (see IPSAS 9) and the carrying value of the asset is reduced by any loss allowance.

Assets Measured at Amortized Cost

- (b) If a put option obligation written by an entity or call option right held by an entity prevents a transferred asset from being derecognized and the entity measures the transferred asset at amortized cost, the associated liability is measured at its cost (i.e., the consideration received) adjusted for the amortization of any difference between that cost and the gross carrying amount of the transferred asset at the expiration date of the option. For example, assume that the gross carrying amount of the asset on the date of the transfer is CU98 and that the consideration received is CU95. The gross carrying amount of the asset on the option exercise date will be CU100. The initial carrying amount of the associated liability is CU95 and the difference between CU95 and CU100 is recognized in surplus or deficit using the effective interest method. If the option is exercised, any difference between the carrying amount of the associated liability and the exercise price is recognized in surplus or deficit.

Assets Measured at Fair Value

- (c) If a call option right retained by an entity prevents a transferred asset from being derecognized and the entity measures the transferred asset at fair value, the asset continues to be measured at its fair value. The associated liability is measured at (i) the option exercise price less the time value of the option if the option is in or at the money, or (ii) the fair value of the transferred asset less the time value of the option if the option is out of the money. The adjustment to the measurement of the associated liability ensures that the net carrying amount of the asset and the associated liability is the fair value of the call option right. For example, if the fair value of the underlying asset is CU80, the option exercise price is CU95 and the time value of the option is CU5, the carrying amount of the associated liability is CU75 (CU80 – CU5) and the carrying amount of the transferred asset is CU80 (i.e., its fair value).
- (d) If a put option written by an entity prevents a transferred asset from being derecognized and the entity measures the transferred asset at fair value, the associated liability is measured at the option exercise price plus the time value of the option. The measurement of the asset at fair value is limited to the lower of the fair value and the option exercise price because the entity has no right to increases in the fair value of the transferred asset above the exercise price of the option. This ensures that the net carrying amount of the asset and the associated liability is the fair value of the put option obligation. For example, if the fair value of the underlying asset is CU120, the option exercise price is CU100 and the time value of the option is CU5, the carrying amount of the associated liability is CU105 (CU100 + CU5) and the carrying amount of the asset is CU100 (in this case the option exercise price).
- (e) If a collar, in the form of a purchased call and written put, prevents a transferred asset from being derecognized and the entity measures the asset at fair value, it continues to measure the asset at fair value. The associated liability is measured at (i) the sum of the call exercise price and fair value of the put option less the time value of the call option, if the call option is in or at the money, or (ii) the sum of the fair value of the asset and the fair value of the put option less the time value of the call option if the call option is out of the money. The adjustment to the associated liability ensures that the net carrying amount of the asset and the associated liability is the fair value of the options held and written by the entity. For example, assume an entity transfers a financial asset that is measured at fair value while simultaneously purchasing a call with an exercise price of CU120 and writing a put with an exercise price of CU80. Assume also that the fair value of the asset is CU100 at the date of the transfer. The time value of the put and call are CU1 and CU5 respectively. In this case, the entity recognizes an asset of CU100 (the fair value of the asset) and a liability of CU96 [(CU100 + CU1) – CU5]. This gives a net asset value of CU4, which is the fair value of the options held and written by the entity.

All Transfers

- AG35. To the extent that a transfer of a financial asset does not qualify for derecognition, the transferor's contractual rights or obligations related to the transfer are not accounted for separately as derivatives if recognizing both the derivative and either the transferred asset or the liability arising from the transfer would result in recognizing the same rights or obligations twice. For example, a call option retained by the transferor may prevent a transfer of financial assets from being accounted for as a sale. In that case, the call option is not separately recognized as a derivative asset.
- AG36. To the extent that a transfer of a financial asset does not qualify for derecognition, the transferee does not recognize the transferred asset as its asset. The transferee derecognizes the cash or other consideration paid and recognizes a receivable from the transferor. If the transferor has both a right and an obligation to reacquire control of the entire transferred asset for a fixed amount (such as under a repurchase agreement), the transferee may measure its receivable at amortized cost if it meets the criteria in paragraph 40.

Examples

AG37. The following examples illustrate the application of the derecognition principles of this Standard.

- (a) Repurchase agreements and securities lending. If a financial asset is sold under an agreement to repurchase it at a fixed price or at the sale price plus a lender's return or if it is loaned under an agreement to return it to the transferor, it is not derecognized because the transferor retains substantially all the risks and rewards of ownership. If the transferee obtains the right to sell or pledge the asset, the transferor reclassifies the asset in its statement of financial position, for example, as a loaned asset or repurchase receivable.
- (b) Repurchase agreements and securities lending—assets that are substantially the same. If a financial asset is sold under an agreement to repurchase the same or substantially the same asset at a fixed price or at the sale price plus a lender's return or if a financial asset is borrowed or loaned under an agreement to return the same or substantially the same asset to the transferor, it is not derecognized because the transferor retains substantially all the risks and rewards of ownership.
- (c) Repurchase agreements and securities lending—right of substitution. If a repurchase agreement at a fixed repurchase price or a price equal to the sale price plus a lender's return, or a similar securities lending transaction, provides the transferee with a right to substitute assets that are similar and of equal fair value to the transferred asset at the repurchase date, the asset sold or lent under a repurchase or securities lending transaction is not derecognized because the transferor retains substantially all the risks and rewards of ownership.
- (d) Repurchase right of first refusal at fair value. If an entity sells a financial asset and retains only a right of first refusal to repurchase the transferred asset at fair value if the transferee subsequently sells it, the entity derecognizes the asset because it has transferred substantially all the risks and rewards of ownership.
- (e) Wash sale transaction. The repurchase of a financial asset shortly after it has been sold is sometimes referred to as a wash sale. Such a repurchase does not preclude derecognition provided that the original transaction met the derecognition requirements. However, if an agreement to sell a financial asset is entered into concurrently with an agreement to repurchase the same asset at a fixed price or the sale price plus a lender's return, then the asset is not derecognized.
- (f) Put options and call options that are deeply in the money. If a transferred financial asset can be called back by the transferor and the call option is deeply in the money, the transfer does not qualify for derecognition because the transferor has retained substantially all the risks and rewards of ownership. Similarly, if the financial asset can be put back by the transferee and the put option is deeply in the money, the transfer does not qualify for derecognition because the transferor has retained substantially all the risks and rewards of ownership.
- (g) Put options and call options that are deeply out of the money. A financial asset that is transferred subject only to a deep out-of-the-money put option held by the transferee or a deep out-of-the-money call option held by the transferor is derecognized. This is because the transferor has transferred substantially all the risks and rewards of ownership.
- (h) Readily obtainable assets subject to a call option that is neither deeply in the money nor deeply out of the money. If an entity holds a call option on an asset that is readily obtainable in the market and the option is neither deeply in the money nor deeply out of the money, the asset is derecognized. This is because the entity (i) has neither retained nor transferred substantially all the risks and rewards of ownership, and (ii) has not retained control. However, if the asset is not readily obtainable in the market, derecognition is precluded to the extent of the amount of the asset that is subject to the call option because the entity has retained control of the asset.
- (i) A not readily obtainable asset subject to a put option written by an entity that is neither deeply in the money nor deeply out of the money. If an entity transfers a financial asset that is not readily obtainable in the market, and writes a put option that is not deeply out of the money, the entity neither retains nor transfers substantially all the risks and rewards of ownership because of the written put option. The entity retains control of the asset if the put option is sufficiently valuable to prevent the transferee from selling the asset, in which case the asset continues to be recognized to the extent of the transferor's continuing involvement (see paragraph AG29). The entity transfers control of the asset if the put option is not sufficiently valuable to prevent the transferee from selling the asset, in which case the asset is derecognized.
- (j) Assets subject to a fair value put or call option or a forward repurchase agreement. A transfer of a financial asset that is subject only to a put or call option or a forward repurchase agreement that has an exercise or repurchase price equal to the fair value of the financial asset at the time of repurchase results in derecognition because of the transfer of substantially all the risks and rewards of ownership.

- (k) Cash-settled call or put options. An entity evaluates the transfer of a financial asset that is subject to a put or call option or a forward repurchase agreement that will be settled net in cash to determine whether it has retained or transferred substantially all the risks and rewards of ownership. If the entity has not retained substantially all the risks and rewards of ownership of the transferred asset, it determines whether it has retained control of the transferred asset. That the put or the call or the forward repurchase agreement is settled net in cash does not automatically mean that the entity has transferred control (see paragraphs AG29 and (g), (h) and (i) above).
- (l) Removal of accounts provision. A removal of accounts provision is an unconditional repurchase (call) option that gives an entity the right to reclaim assets transferred subject to some restrictions. Provided that such an option results in the entity neither retaining nor transferring substantially all the risks and rewards of ownership, it precludes derecognition only to the extent of the amount subject to repurchase (assuming that the transferee cannot sell the assets). For example, if the carrying amount and proceeds from the transfer of loan assets are CU100,000 and any individual loan could be called back but the aggregate amount of loans that could be repurchased could not exceed CU10,000, CU90,000 of the loans would qualify for derecognition.
- (m) Clean-up calls. An entity, which may be a transferor, that services transferred assets may hold a clean-up call to purchase remaining transferred assets when the amount of outstanding assets falls to a specified level at which the cost of servicing those assets becomes burdensome in relation to the benefits of servicing. Provided that such a clean-up call results in the entity neither retaining nor transferring substantially all the risks and rewards of ownership and the transferee cannot sell the assets, it precludes derecognition only to the extent of the amount of the assets that is subject to the call option.
- (n) Subordinated retained interests and credit guarantees. An entity may provide the transferee with credit enhancement by subordinating some or all of its interest retained in the transferred asset. Alternatively, an entity may provide the transferee with credit enhancement in the form of a credit guarantee that could be unlimited or limited to a specified amount. If the entity retains substantially all the risks and rewards of ownership of the transferred asset, the asset continues to be recognized in its entirety. If the entity retains some, but not substantially all, of the risks and rewards of ownership and has retained control, derecognition is precluded to the extent of the amount of cash or other assets that the entity could be required to pay.
- (o) Total return swaps. An entity may sell a financial asset to a transferee and enter into a total return swap with the transferee, whereby all of the interest payment cash flows from the underlying asset are remitted to the entity in exchange for a fixed payment or variable rate payment and any increases or declines in the fair value of the underlying asset are absorbed by the entity. In such a case, derecognition of all of the asset is prohibited.
- (p) Interest rate swaps. An entity may transfer to a transferee a fixed rate financial asset and enter into an interest rate swap with the transferee to receive a fixed interest rate and pay a variable interest rate based on a notional amount that is equal to the principal amount of the transferred financial asset. The interest rate swap does not preclude derecognition of the transferred asset provided the payments on the swap are not conditional on payments being made on the transferred asset.
- (q) Amortizing interest rate swaps. An entity may transfer to a transferee a fixed rate financial asset that is paid off over time, and enter into an amortizing interest rate swap with the transferee to receive a fixed interest rate and pay a variable interest rate based on a notional amount. If the notional amount of the swap amortizes so that it equals the principal amount of the transferred financial asset outstanding at any point in time, the swap would generally result in the entity retaining substantial prepayment risk, in which case the entity either continues to recognize all of the transferred asset or continues to recognize the transferred asset to the extent of its continuing involvement. Conversely, if the amortization of the notional amount of the swap is not linked to the principal amount outstanding of the transferred asset, such a swap would not result in the entity retaining prepayment risk on the asset. Hence, it would not preclude derecognition of the transferred asset provided the payments on the swap are not conditional on interest payments being made on the transferred asset and the swap does not result in the entity retaining any other significant risks and rewards of ownership on the transferred asset.
- (r) Write-off. An entity has no reasonable expectations of recovering the contractual cash flows on a financial asset in its entirety or a portion thereof.

AG38. This paragraph illustrates the application of the continuing involvement approach when the entity's continuing involvement is in a part of a financial asset.

Assume an entity has a portfolio of prepayable loans whose coupon and effective interest rate is 10 percent and whose principal amount and amortized cost is CU10,000. It enters into a transaction in which, in return for a payment of CU9,115, the transferee obtains the right to CU9,000 of any collections of principal plus interest thereon at 9.5 percent. The entity retains rights to CU1,000 of any collections of principal plus interest thereon at 10 percent, plus the excess spread of 0.5 percent on the remaining CU9,000 of principal. Collections from prepayments are allocated between the entity and the transferee proportionately in the ratio of 1:9, but any defaults are deducted from the entity's interest of CU1,000 until that interest is exhausted. The fair value of the loans at the date of the transaction is CU10,100 and the estimated fair value of the excess spread of 0.5 percent is CU40.

The entity determines that it has transferred some significant risks and rewards of ownership (for example, significant prepayment risk) but has also retained some significant risks and rewards of ownership (because of its subordinated retained interest) and has retained control. It therefore applies the continuing involvement approach.

To apply this Standard, the entity analyzes the transaction as (a) a retention of a fully proportionate retained interest of CU1,000, plus (b) the subordination of that retained interest to provide credit enhancement to the transferee for credit losses.

The entity calculates that CU9,090 (90 percent \times CU10,100) of the consideration received of CU9,115 represents the consideration for a fully proportionate 90 percent share. The remainder of the consideration received (CU25) represents consideration received for subordinating its retained interest to provide credit enhancement to the transferee for credit losses. In addition, the excess spread of 0.5 percent represents consideration received for the credit enhancement. Accordingly, the total consideration received for the credit enhancement is CU65 (CU25 + CU40).

The entity calculates the gain or loss on the sale of the 90 percent share of cash flows. Assuming that separate fair values of the 90 percent part transferred and the 10 percent part retained are not available at the date of the transfer, the entity allocates the carrying amount of the asset in accordance with paragraph 25 as follows:

	<i>Estimated fair value</i>	<i>Percentage</i>	<i>Allocated carrying amount</i>
Portion transferred	9,090	90 percent	9,000
Portion retained	<u>1,010</u>	10 percent	<u>1,000</u>
Total	<u>10,100</u>		<u>10,000</u>

The entity computes its gain or loss on the sale of the 90 percent share of the cash flows by deducting the allocated carrying amount of the portion transferred from the consideration received, i.e., CU90 (CU9,090 – CU9,000). The carrying amount of the portion retained by the entity is CU1,000.

In addition, the entity recognizes the continuing involvement that results from the subordination of its retained interest for credit losses. Accordingly, it recognizes an asset of CU1,000 (the maximum amount of the cash flows it would not receive under the subordination), and an associated liability of CU1,065 (which is the maximum amount of the cash flows it would not receive under the subordination, i.e., CU1,000 plus the fair value of the subordination of CU65).

The entity uses all of the above information to account for the transaction as follows:

	<i>Debit</i>	<i>Credit</i>
Original asset	—	9,000
Asset recognized for subordination or the residual interest	1,000	—
Asset for the consideration received in the form of excess spread	40	—
Surplus or deficit (gain on transfer)	—	90
Liability	—	1,065
Cash received	<u>9,115</u>	<u>—</u>
Total	<u>10,155</u>	<u>10,155</u>

Immediately following the transaction, the carrying amount of the asset is CU2,040 comprising CU1,000, representing the allocated cost of the portion retained, and CU1,040, representing the entity's additional continuing involvement from the subordination of its retained interest for credit losses (which includes the excess spread of CU40).

In subsequent periods, the entity recognizes the consideration received for the credit enhancement (CU65) on a time proportion basis, accrues interest on the recognized asset using the effective interest method and recognizes any impairment losses on the recognized assets. As an example of the latter, assume that in the following year there is an impairment loss on the underlying loans of CU300. The entity reduces its recognized asset by CU600 (CU300 relating to its retained interest and CU300 relating to the additional continuing involvement that arises from the subordination of its retained interest for impairment losses), and reduces its recognized liability by CU300. The net result is a charge to surplus or deficit for impairment losses of CU300.

Derecognition of Financial Liabilities

- AG39. A financial liability (or part of it) is extinguished when the debtor either:
- (a) Discharges the liability (or part of it) by paying the creditor, normally with cash, other financial assets, goods or services; or
 - (b) Is legally released from primary responsibility for the liability (or part of it) either by process of law or by the creditor. (If the debtor has given a guarantee this condition may still be met.)
- AG40. If an issuer of a debt instrument repurchases that instrument, the debt is extinguished even if the issuer is a market maker in that instrument or intends to resell it in the near term.
- AG41. Payment to a third party, including a trust (sometimes called 'in-substance defeasance'), does not, by itself, relieve the debtor of its primary obligation to the creditor, in the absence of legal release.
- AG42. If a debtor pays a third party to assume an obligation and notifies its creditor that the third party has assumed its debt obligation, the debtor does not derecognize the debt obligation unless the condition in paragraph AG39(b) is met. If the debtor pays a third party to assume an obligation and obtains a legal release from its creditor, the debtor has extinguished the debt. However, if the debtor agrees to make payments on the debt to the third party or direct to its original creditor, the debtor recognizes a new debt obligation to the third party.
- AG43. If a third party assumes an obligation of an entity, and the entity provides either no or only nominal consideration to that third party in return, an entity applies the derecognition requirements of this Standard as well as paragraphs 84 to 87 of IPSAS 23.
- AG44. Lenders will sometimes waive their right to collect debt owed by a public sector entity, for example, a national government may cancel a loan owed by a local government. This waiver of debt would constitute a legal release of the debt owing by the borrower to the lender. Where an entity's obligations have been waived as part of a non-exchange transaction it applies the derecognition requirements of this Standard as well as paragraphs 84–87 of IPSAS 23.
- AG45. Although legal release, whether judicially or by the creditor, results in derecognition of a liability, the entity may recognize a new liability if the derecognition criteria in paragraphs 12–34 are not met for the financial assets transferred. If those criteria are not met, the transferred assets are not derecognized, and the entity recognizes a new liability relating to the transferred assets.
- AG46. For the purpose of paragraph 36, the terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10 percent different from the discounted present value of the remaining cash flows of the original financial liability. In determining those fees paid net of fees received, a borrower includes only fees paid or received between the borrower and the lender, including fees paid or received by either the borrower or lender on the other's behalf.
- AG46A. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognized as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortized over the remaining term of the modified liability.
- AG47. In some cases, a creditor releases a debtor from its present obligation to make payments, but the debtor assumes a guarantee obligation to pay if the party assuming primary responsibility defaults. In these circumstances the debtor:
- (a) Recognizes a new financial liability based on the fair value of its obligation for the guarantee; and

- (b) Recognizes a gain or loss based on the difference between (i) any proceeds paid and (ii) the carrying amount of the original financial liability less the fair value of the new financial liability.

Classification

Classification of Financial Assets

The Entity's Management Model for Financial Assets

- AG48. Paragraph 39(a) requires an entity to classify financial assets on the basis of the entity's management model for the financial assets, unless paragraph 44 applies. An entity assesses whether its financial assets meet the condition in paragraph 40(a) or the condition in paragraph 41(a) on the basis of the management model as determined by the entity's key management personnel (as defined in IPSAS 20, *Related Party Disclosures*).
- AG49. An entity's management model is determined at a level that reflects how groups of financial assets are managed together to achieve a particular objective. The entity's management model does not depend on management's intentions for an individual instrument. Accordingly, this condition is not an instrument-by-instrument approach to classification and should be determined on a higher level of aggregation. However, a single entity may have more than one management model for its financial instruments. Consequently, classification need not be determined at the reporting entity level. For example, an entity may hold a portfolio of investments that it manages in order to collect contractual cash flows and another portfolio of investments that it manages in order to trade to realize fair value changes. Similarly, in some circumstances, it may be appropriate to separate a portfolio of financial assets into sub-portfolios in order to reflect the level at which an entity manages those financial assets. For example, that may be the case if an entity originates or purchases a portfolio of mortgage loans and manages some of the loans with an objective of collecting contractual cash flows and manages the other loans with an objective of selling them.
- AG50. An entity's management model refers to how an entity manages its financial assets in order to generate cash flows. That is, the entity's management model determines whether cash flows will result from collecting contractual cash flows, selling financial assets or both. Consequently, this assessment is not performed on the basis of scenarios that the entity does not reasonably expect to occur, such as so-called 'worst case' or 'stress case' scenarios. For example, if an entity expects that it will sell a particular portfolio of financial assets only in a stress case scenario, that scenario would not affect the entity's assessment of the management model for those assets if the entity reasonably expects that such a scenario will not occur. If cash flows are realized in a way that is different from the entity's expectations at the date that the entity assessed the management model (for example, if the entity sells more or fewer financial assets than it expected when it classified the assets), that does not give rise to a prior period error in the entity's financial statements (see IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*) nor does it change the classification of the remaining financial assets held in that management model (i.e., those assets that the entity recognized in prior periods and still holds) as long as the entity considered all relevant information that was available at the time that it made the management model assessment. However, when an entity assesses the management model for newly originated or newly purchased financial assets, it must consider information about how cash flows were realized in the past, along with all other relevant information.
- AG51. An entity's management model for financial assets is a matter of fact and not merely an assertion. It is typically observable through the activities that the entity undertakes to achieve the objective of the management model. An entity will need to use judgment when it assesses its management model for financial assets and that assessment is not determined by a single factor or activity. Instead, the entity must consider all relevant evidence that is available at the date of the assessment. Such relevant evidence includes, but is not limited to:
- (a) How the performance of the management model and the financial assets held within that management model are evaluated and reported to the entity's key management personnel;
 - (b) The risks that affect the performance of the management model (and the financial assets held within that management model) and, in particular, the way in which those risks are managed; and
 - (c) How management is compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected).

A Management Model Whose Objective is to Hold Assets in Order to Collect Contractual Cash Flows

- AG52. Financial assets that are held within a management model whose objective is to hold assets in order to collect contractual cash flows are managed to realize cash flows by collecting contractual payments over the life of the instrument. That is, the entity manages the assets held within the portfolio to collect those particular contractual cash flows (instead of managing the overall return on the portfolio by both holding and selling assets). In determining whether cash flows are going to be

realized by collecting the financial assets' contractual cash flows, it is necessary to consider the frequency, value and timing of sales in prior periods, the reasons for those sales and expectations about future sales activity. However sales in themselves do not determine the management model and therefore cannot be considered in isolation. Instead, information about past sales and expectations about future sales provide evidence related to how the entity's stated objective for managing the financial assets is achieved and, specifically, how cash flows are realized. An entity must consider information about past sales within the context of the reasons for those sales and the conditions that existed at that time as compared to current conditions.

- AG53. Although the objective of an entity's management model may be to hold financial assets in order to collect contractual cash flows, the entity need not hold all of those instruments until maturity. Thus an entity's management model can be to hold financial assets to collect contractual cash flows even when sales of financial assets occur or are expected to occur in the future.
- AG54. The management model may be to hold assets to collect contractual cash flows even if the entity sells financial assets when there is an increase in the assets' credit risk. To determine whether there has been an increase in the assets' credit risk, the entity considers reasonable and supportable information, including forward looking information. Irrespective of their frequency and value, sales due to an increase in the assets' credit risk are not inconsistent with a management model whose objective is to hold financial assets to collect contractual cash flows because the credit quality of financial assets is relevant to the entity's ability to collect contractual cash flows. Credit risk management activities that are aimed at minimizing potential credit losses due to credit deterioration are integral to such a management model. Selling a financial asset because it no longer meets the credit criteria specified in the entity's documented investment policy is an example of a sale that has occurred due to an increase in credit risk. However, in the absence of such a policy, the entity may demonstrate in other ways that the sale occurred due to an increase in credit risk.
- AG55. Sales that occur for other reasons, such as sales made to manage credit concentration risk (without an increase in the assets' credit risk), may also be consistent with a management model whose objective is to hold financial assets in order to collect contractual cash flows. In particular, such sales may be consistent with a management model whose objective is to hold financial assets in order to collect contractual cash flows if those sales are infrequent (even if significant in value) or insignificant in value both individually and in aggregate (even if frequent). If more than an infrequent number of such sales are made out of a portfolio and those sales are more than insignificant in value (either individually or in aggregate), the entity needs to assess whether and how such sales are consistent with an objective of collecting contractual cash flows. Whether a third party imposes the requirement to sell the financial assets, or that activity is at the entity's discretion, is not relevant to this assessment. An increase in the frequency or value of sales in a particular period is not necessarily inconsistent with an objective to hold financial assets in order to collect contractual cash flows, if an entity can explain the reasons for those sales and demonstrate why those sales do not reflect a change in the entity's management model. In addition, sales may be consistent with the objective of holding financial assets in order to collect contractual cash flows if the sales are made close to the maturity of the financial assets and the proceeds from the sales approximate the collection of the remaining contractual cash flows.
- AG56. The following are examples of when the objective of an entity's management model may be to hold financial assets to collect the contractual cash flows. This list of examples is not exhaustive. Furthermore, the examples are not intended to discuss all factors that may be relevant to the assessment of the entity's management model nor specify the relative importance of the factors.

Example	Analysis
<p>Example 1</p> <p>An entity holds investments to collect their contractual cash flows. The funding needs of the entity are predictable and the maturity of its financial assets is matched to the entity’s estimated funding needs.</p> <p>The entity performs credit risk management activities with the objective of minimizing credit losses. In the past, sales have typically occurred when the financial assets’ credit risk has increased such that the assets no longer meet the credit criteria specified in the entity’s documented investment policy. In addition, infrequent sales have occurred as a result of unanticipated funding needs.</p> <p>Reports to key management personnel focus on the credit quality of the financial assets and the contractual return. The entity also monitors fair values of the financial assets, among other information.</p>	<p>Although the entity considers, among other information, the financial assets’ fair values from a liquidity perspective (i.e., the cash amount that would be realized if the entity needs to sell assets), the entity’s objective is to hold the financial assets in order to collect the contractual cash flows. Sales would not contradict that objective if they were in response to an increase in the assets’ credit risk, for example if the assets no longer meet the credit criteria specified in the entity’s documented investment policy. Infrequent sales resulting from unanticipated funding needs (e.g., in a stress case scenario) also would not contradict that objective, even if such sales are significant in value.</p>
<p>Example 2</p> <p>An entity’s management model is to purchase portfolios of financial assets, such as loans. Those portfolios may or may not include financial assets that are credit-impaired.</p> <p>If payment on the loans is not made on a timely basis, the entity attempts to realize the contractual cash flows through various means—for example, by contacting the debtor by mail, telephone or other methods. The entity’s objective is to collect the contractual cash flows and the entity does not manage any of the loans in this portfolio with an objective of realizing cash flows by selling them.</p> <p>In some cases, the entity enters into interest rate swaps to change the interest rate on particular financial assets in a portfolio from a floating interest rate to a fixed interest rate.</p>	<p>The objective of the entity’s management model is to hold the financial assets in order to collect the contractual cash flows.</p> <p>The same analysis would apply even if the entity does not expect to receive all of the contractual cash flows (e.g., some of the financial assets are credit-impaired at initial recognition).</p> <p>Moreover, the fact that the entity enters into derivatives to modify the cash flows of the portfolio does not in itself change the entity’s management model.</p>
<p>Example 3</p> <p>An entity has a management model with the objective of originating student loans and subsequently selling those loans to a securitization vehicle. The securitization vehicle issues instruments to investors.</p> <p>The originating entity controls the securitization vehicle and thus consolidates it.</p> <p>The securitization vehicle collects the contractual cash flows from the loans and passes them on to its investors.</p> <p>It is assumed for the purposes of this example that the loans continue to be recognized in the consolidated statement of financial position because they are not derecognized by the securitization vehicle.</p>	<p>The consolidated economic entity originated the loans with the objective of holding them to collect the contractual cash flows.</p> <p>However, the originating entity has an objective of realizing cash flows on the loan portfolio by selling the loans to the securitization vehicle, so for the purposes of its separate financial statements it would not be considered to be managing this portfolio in order to collect the contractual cash flows.</p>

Example	Analysis
<p>Example 4</p> <p>A local government entity that issues bonds holds financial assets to meet redemption needs in a ‘stress case’ scenario (e.g., a run on the government’s issued securities). The entity does not anticipate selling these assets except in such scenarios.</p> <p>The entity monitors the credit quality of the financial assets and its objective in managing the financial assets is to collect the contractual cash flows. The entity evaluates the performance of the assets on the basis of interest revenue earned and credit losses realized.</p> <p>However, the entity also monitors the fair value of the financial assets from a liquidity perspective to ensure that the cash amount that would be realized if the entity needed to sell the assets in a stress case scenario would be sufficient to meet the entity’s liquidity needs. Periodically, the entity makes sales that are insignificant in value to demonstrate liquidity.</p>	<p>The objective of the entity’s management model is to hold the financial assets to collect contractual cash flows.</p> <p>The analysis would not change even if during a previous stress case scenario the entity had sales that were significant in value in order to meet its redemption needs. Similarly, recurring sales activity that is insignificant in value is not inconsistent with holding financial assets to collect contractual cash flows.</p> <p>In contrast, if an entity holds financial assets to meet its everyday redemption needs and meeting that objective involves frequent sales that are significant in value, the objective of the entity’s management model is not to hold the financial assets to collect contractual cash flows.</p> <p>Similarly, if the entity is required by law or regulation to routinely sell financial assets to demonstrate that the assets are liquid, and the value of the assets sold is significant, the entity’s management model is not to hold financial assets to collect contractual cash flows. Whether a third party imposes the requirement to sell the financial assets, or that activity is at the entity’s discretion, is not relevant to the analysis.</p>

A Management Model Whose Objective is Achieved by Both Collecting Contractual Cash Flows and Selling Financial Assets

- AG57. An entity may hold financial assets in a management model whose objective is achieved by both collecting contractual cash flows and selling financial assets. In this type of management model, the entity’s key management personnel have made a decision that both collecting contractual cash flows and selling financial assets are integral to achieving the objective of the management model. There are various objectives that may be consistent with this type of management model. For example, the objective of the management model may be to manage everyday liquidity needs, to maintain a particular interest yield profile or to match the duration of the financial assets to the duration of the liabilities that those assets are funding. To achieve such an objective, the entity will both collect contractual cash flows and sell financial assets.
- AG58. Compared to a management model whose objective is to hold financial assets to collect contractual cash flows, this management model will typically involve greater frequency and value of sales. This is because selling financial assets is integral to achieving the management model’s objective instead of being only incidental to it. However, there is no threshold for the frequency or value of sales that must occur in this management model because both collecting contractual cash flows and selling financial assets are integral to achieving its objective.
- AG59. The following are examples of when the objective of the entity’s management model may be achieved by both collecting contractual cash flows and selling financial assets. This list of examples is not exhaustive. Furthermore, the examples are not intended to describe all the factors that may be relevant to the assessment of the entity’s management model nor specify the relative importance of the factors.

Example	Analysis
<p>Example 5</p> <p>An entity anticipates capital expenditure in a few years. The entity invests its excess cash in short and long-term financial assets so that it can fund the expenditure when the need arises. Many of the financial assets have contractual lives that exceed the entity's anticipated investment period.</p> <p>The entity will hold financial assets to collect the contractual cash flows and, when an opportunity arises, it will sell financial assets to re-invest the cash in financial assets with a higher return.</p> <p>The managers responsible for the portfolio are remunerated based on the overall return generated by the portfolio.</p>	<p>The objective of the management model is achieved by both collecting contractual cash flows and selling financial assets. The entity will make decisions on an ongoing basis about whether collecting contractual cash flows or selling financial assets will maximize the return on the portfolio until the need arises for the invested cash.</p> <p>In contrast, consider an entity that anticipates a cash outflow in five years to fund capital expenditure and invests excess cash in short-term financial assets. When the investments mature, the entity reinvests the cash in new short-term financial assets. The entity maintains this strategy until the funds are needed, at which time the entity uses the proceeds from the maturing financial assets to fund the capital expenditure. Only sales that are insignificant in value occur before maturity (unless there is an increase in credit risk). The objective of this contrasting management model is to hold financial assets to collect contractual cash flows.</p>
<p>Example 6</p> <p>An entity holds financial assets to meet its everyday liquidity needs. The entity seeks to minimize the costs of managing those liquidity needs and therefore actively manages the return on the portfolio. That return consists of collecting contractual payments as well as gains and losses from the sale of financial assets.</p> <p>As a result, the entity holds financial assets to collect contractual cash flows and sells financial assets to reinvest in higher yielding financial assets or to better match the duration of its liabilities. In the past, this strategy has resulted in frequent sales activity and such sales have been significant in value. This activity is expected to continue in the future.</p>	<p>The objective of the management model is to maximize the return on the portfolio to meet everyday liquidity needs and the entity achieves that objective by both collecting contractual cash flows and selling financial assets. In other words, both collecting contractual cash flows and selling financial assets are integral to achieving the management model's objective.</p>
<p>Example 7</p> <p>A social security fund holds financial assets in order to fund social security liabilities. The fund uses the proceeds from the contractual cash flows on the financial assets to settle social security liabilities as they come due. To ensure that the contractual cash flows from the financial assets are sufficient to settle those liabilities, the fund undertakes significant buying and selling activity on a regular basis to rebalance its portfolio of assets and to meet cash flow needs as they arise.</p>	<p>The objective of the management model is to fund the social security liabilities. To achieve this objective, the entity collects contractual cash flows as they come due and sells financial assets to maintain the desired profile of the asset portfolio. Thus both collecting contractual cash flows and selling financial assets are integral to achieving the management model's objective.</p>

Other Management Models

- AG60. Financial assets are measured at fair value through surplus or deficit if they are not held within a management model whose objective is to hold assets to collect contractual cash flows or within a management model whose objective is achieved by both collecting contractual cash flows and selling financial assets (but see also paragraph 106). One management model that results in measurement at fair value through surplus or deficit is one in which an entity manages the financial assets with the objective of realizing cash flows through the sale of the assets. The entity makes decisions based on the assets' fair values and manages the assets to realize those fair values. In this case, the entity's objective will typically result in active buying and selling. Even though the entity will collect contractual cash flows while it holds the financial assets, the objective of such a management model is not achieved by both collecting contractual cash flows and selling financial assets. This is because the collection of contractual cash flows is not integral to achieving the management model's objective; instead, it is incidental to it.
- AG61. A portfolio of financial assets that is managed and whose performance is evaluated on a fair value basis (as described in paragraph 46(b)) is neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets. The entity is primarily focused on fair value information and uses that information to assess the assets' performance and to make decisions. In addition, a portfolio of financial assets that meets the definition of held for trading

is not held to collect contractual cash flows or held both to collect contractual cash flows and to sell financial assets. For such portfolios, the collection of contractual cash flows is only incidental to achieving the management model's objective. Consequently, such portfolios of financial assets must be measured at fair value through surplus or deficit.

Contractual Cash Flows that are Solely Payments of Principal and Interest on the Principal Amount Outstanding

- AG62. Paragraph 39(b) requires an entity to classify a financial asset on the basis of its contractual cash flow characteristics if the financial asset is held within a management model whose objective is to hold assets to collect contractual cash flows or within a management model whose objective is achieved by both collecting contractual cash flows and selling financial assets, unless paragraph 44 applies. To do so, the condition in paragraphs 40(b) and 41(b) requires an entity to determine whether the asset's contractual cash flows are solely payments of principal and interest on the principal amount outstanding.
- AG63. Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding are consistent with a basic lending arrangement. In a basic lending arrangement, consideration for the time value of money (see paragraphs AG67–AG71) and credit risk are typically the most significant elements of interest. However, in such an arrangement, interest can also include consideration for other basic lending risks (for example, liquidity risk) and costs (for example, administrative costs) associated with holding the financial asset for a particular period of time. In addition, interest can include a profit margin that is consistent with a basic lending arrangement. In extreme economic circumstances, interest can be negative if, for example, the holder of a financial asset either explicitly or implicitly pays for the deposit of its money for a particular period of time (and that fee exceeds the consideration that the holder receives for the time value of money, credit risk and other basic lending risks and costs). However, contractual terms that introduce exposure to risks or volatility in the contractual cash flows that is unrelated to a basic lending arrangement, such as exposure to changes in equity prices, commodity prices, a specific profitability or income threshold being reached by the borrower or lender, or the achievement (or otherwise) of specific financial or other ratios, do not give rise to contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. An originated or a purchased financial asset can be a basic lending arrangement irrespective of whether it is a loan in its legal form.
- AG64. In accordance with paragraph 42(a), principal is the fair value of the financial asset at initial recognition. However that principal amount may change over the life of the financial asset (for example, if there are repayments of principal).
- AG65. An entity shall assess whether contractual cash flows are solely payments of principal and interest on the principal amount outstanding for the currency in which the financial asset is denominated.
- AG66. Leverage is a contractual cash flow characteristic of some financial assets. Leverage increases the variability of the contractual cash flows with the result that they do not have the economic characteristics of interest. Stand-alone option, forward and swap contracts are examples of financial assets that include such leverage. Thus, such contracts do not meet the condition in paragraphs 40(b) and 41(b) and cannot be subsequently measured at amortized cost or fair value through net assets/equity.

Consideration for the Time Value of Money

- AG67. Time value of money is the element of interest that provides consideration for only the passage of time. That is, the time value of money element does not provide consideration for other risks or costs associated with holding the financial asset. In order to assess whether the element provides consideration for only the passage of time, an entity applies judgment and considers relevant factors such as the currency in which the financial asset is denominated and the period for which the interest rate is set.
- AG68. However, in some cases, the time value of money element may be modified (i.e., imperfect). That would be the case, for example, if a financial asset's interest rate is periodically reset but the frequency of that reset does not match the tenor of the interest rate (for example, the interest rate resets every month to a one-year rate) or if a financial asset's interest rate is periodically reset to an average of particular short and long-term interest rates. In such cases, an entity must assess the modification to determine whether the contractual cash flows represent solely payments of principal and interest on the principal amount outstanding. In some circumstances, the entity may be able to make that determination by performing a qualitative assessment of the time value of money element whereas, in other circumstances, it may be necessary to perform a quantitative assessment.
- AG69. When assessing a modified time value of money element, the objective is to determine how different the contractual (undiscounted) cash flows could be from the (undiscounted) cash flows that would arise if the time value of money element was not modified (the benchmark cash flows). For example, if the financial asset under assessment contains a variable interest rate that is reset every month to a one-year interest rate, the entity would compare that financial asset to a financial instrument with identical contractual terms and the identical credit risk except the variable interest rate is reset monthly

to a one-month interest rate. If the modified time value of money element could result in contractual (undiscounted) cash flows that are significantly different from the (undiscounted) benchmark cash flows, the financial asset does not meet the condition in paragraphs 40(b) and 41(b). To make this determination, the entity must consider the effect of the modified time value of money element in each reporting period and cumulatively over the life of the financial instrument. The reason for the interest rate being set in this way is not relevant to the analysis. If it is clear, with little or no analysis, whether the contractual (undiscounted) cash flows on the financial asset under the assessment could (or could not) be significantly different from the (undiscounted) benchmark cash flows, an entity need not perform a detailed assessment.

- AG70. When assessing a modified time value of money element, an entity must consider factors that could affect future contractual cash flows. For example, if an entity is assessing a bond with a five-year term and the variable interest rate is reset every six months to a five-year rate, the entity cannot conclude that the contractual cash flows are solely payments of principal and interest on the principal amount outstanding simply because the interest rate curve at the time of the assessment is such that the difference between a five-year interest rate and a six-month interest rate is not significant. Instead, the entity must also consider whether the relationship between the five-year interest rate and the six-month interest rate could change over the life of the instrument such that the contractual (undiscounted) cash flows over the life of the instrument could be significantly different from the (undiscounted) benchmark cash flows. However, an entity must consider only reasonably possible scenarios instead of every possible scenario. If an entity concludes that the contractual (undiscounted) cash flows could be significantly different from the (undiscounted) benchmark cash flows, the financial asset does not meet the condition in paragraphs 40(b) and 41(b) and therefore cannot be measured at amortized cost or fair value through net assets/equity.
- AG71. In some jurisdictions, the government or a regulatory authority sets interest rates. For example, such government regulation of interest rates may be part of a broad macroeconomic policy or it may be introduced to encourage entities to invest in a particular sector of the economy. In some of these cases, the objective of the time value of money element is not to provide consideration for only the passage of time. However, despite paragraphs AG67–AG70, a regulated interest rate shall be considered a proxy for the time value of money element for the purpose of applying the condition in paragraphs 40(b) and 41(b) if that regulated interest rate provides consideration that is broadly consistent with the passage of time and does not provide exposure to risks or volatility in the contractual cash flows that are inconsistent with a basic lending arrangement.

Contractual Terms that Change the Timing or Amount of Contractual Cash Flows

- AG72. If a financial asset contains a contractual term that could change the timing or amount of contractual cash flows (for example, if the asset can be prepaid before maturity or its term can be extended), the entity must determine whether the contractual cash flows that could arise over the life of the instrument due to that contractual term are solely payments of principal and interest on the principal amount outstanding. To make this determination, the entity must assess the contractual cash flows that could arise both before, and after, the change in contractual cash flows. The entity may also need to assess the nature of any contingent event (i.e., the trigger) that would change the timing or amount of the contractual cash flows. While the nature of the contingent event in itself is not a determinative factor in assessing whether the contractual cash flows are solely payments of principal and interest, it may be an indicator. For example, compare a financial instrument with an interest rate that is reset to a higher rate if the debtor misses a particular number of payments to a financial instrument with an interest rate that is reset to a higher rate if a specified equity index reaches a particular level. It is more likely in the former case that the contractual cash flows over the life of the instrument will be solely payments of principal and interest on the principal amount outstanding because of the relationship between missed payments and an increase in credit risk. (See also paragraph AG80.)
- AG73. The following are examples of contractual terms that result in contractual cash flows that are solely payments of principal and interest on the principal amount outstanding:
- (a) A variable interest rate that consists of consideration for the time value of money, the credit risk associated with the principal amount outstanding during a particular period of time (the consideration for credit risk may be determined at initial recognition only, and so may be fixed) and other basic lending risks and costs, as well as a profit margin;
 - (b) A contractual term that permits the issuer (i.e., the debtor) to prepay a debt instrument or permits the holder (i.e., the creditor) to put a debt instrument back to the issuer before maturity and the prepayment amount substantially represents unpaid amounts of principal and interest on the principal amount outstanding, which may include reasonable compensation for the early termination of the contract; and
 - (c) A contractual term that permits the issuer or the holder to extend the contractual term of a debt instrument (i.e., an extension option) and the terms of the extension option result in contractual cash flows during the extension period that are solely payments of principal and interest on the principal amount outstanding, which may include reasonable compensation for the extension of the contract.

AG74. Despite paragraph AG72, a financial asset that would otherwise meet the condition in paragraphs 40(b) and 41(b) but does not do so only as a result of a contractual term that permits (or requires) the issuer to prepay a debt instrument or permits (or requires) the holder to put a debt instrument back to the issuer before maturity is eligible to be measured at amortized cost or fair value through net assets/equity (subject to meeting the condition in paragraph 40(a) or the condition in paragraph 41(a)) if:

- (a) The entity acquires or originates the financial asset at a premium or discount to the contractual par amount;
- (b) The prepayment amount substantially represents the contractual par amount and accrued (but unpaid) contractual interest, which may include reasonable compensation for the early termination of the contract; and
- (c) When the entity initially recognizes the financial asset, the fair value of the prepayment feature is insignificant.

AG74A. For the purpose of applying paragraphs AG73(b) and AG74(b), irrespective of the event or circumstance that causes the early termination of the contract, a party may pay or receive reasonable compensation for that early termination. For example, a party may pay or receive reasonable compensation when it chooses to terminate the contract early (or otherwise causes the early termination to occur).

AG75. The following examples illustrate contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. This list of examples is not exhaustive.

Instrument	Analysis
<p>Instrument A</p> <p>Instrument A is a bond with a stated maturity date. Payments of principal and interest on the principal amount outstanding are linked to an inflation index of the currency in which the instrument is issued. The inflation link is not leveraged and the principal is protected.</p>	<p>The contractual cash flows are solely payments of principal and interest on the principal amount outstanding. Linking payments of principal and interest on the principal amount outstanding to an unleveraged inflation index resets the time value of money to a current level. In other words, the interest rate on the instrument reflects ‘real’ interest. Thus, the interest amounts are consideration for the time value of money on the principal amount outstanding.</p> <p>However, if the interest payments were indexed to another variable such as the debtor’s performance (e.g., the debtor’s surplus or deficit) or an equity index, the contractual cash flows are not payments of principal and interest on the principal amount outstanding (unless the indexing to the debtor’s performance results in an adjustment that only compensates the holder for changes in the credit risk of the instrument, such that contractual cash flows are solely payments of principal and interest). That is because the contractual cash flows reflect a return that is inconsistent with a basic lending arrangement (see paragraph AG63).</p>

Instrument	Analysis
<p>Instrument B</p> <p>Instrument B is a variable interest rate instrument with a stated maturity date that permits the borrower to choose the market interest rate on an ongoing basis. For example, at each interest rate reset date, the borrower can choose to pay the three-month interbank offered rate for a three-month term or one-month interbank offered rate for a one-month term.</p>	<p>The contractual cash flows are solely payments of principal and interest on the principal amount outstanding as long as the interest paid over the life of the instrument reflects consideration for the time value of money, for the credit risk associated with the instrument and for other basic lending risks and costs, as well as a profit margin (see paragraph AG63). The fact that the interbank offered rate interest rate is reset during the life of the instrument does not in itself disqualify the instrument.</p> <p>However, if the borrower is able to choose to pay a one-month interest rate that is reset every three months, the interest rate is reset with a frequency that does not match the tenor of the interest rate. Consequently, the time value of money element is modified. Similarly, if an instrument has a contractual interest rate that is based on a term that can exceed the instrument's remaining life (for example, if an instrument with a five-year maturity pays a variable rate that is reset periodically but always reflects a five-year maturity), the time value of money element is modified. That is because the interest payable in each period is disconnected from the interest period.</p> <p>In such cases, the entity must qualitatively or quantitatively assess the contractual cash flows against those on an instrument that is identical in all respects except the tenor of the interest rate matches the interest period to determine if the cash flows are solely payments of principal and interest on the principal amount outstanding. (But see paragraph AG71 for guidance on regulated interest rates.)</p> <p>For example, in assessing a bond with a five-year term that pays a variable rate that is reset every six months but always reflects a five-year maturity, an entity considers the contractual cash flows on an instrument that resets every six months to a six-month interest rate but is otherwise identical.</p> <p>The same analysis would apply if the borrower is able to choose between the lender's various published interest rates (e.g., the borrower can choose between the lender's published one-month variable interest rate and the lender's published three-month variable interest rate).</p>
<p>Instrument C</p> <p>Instrument C is a bond with a stated maturity date and pays a variable market interest rate. That variable interest rate is capped.</p>	<p>The contractual cash flows of both:</p> <ul style="list-style-type: none"> (a) an instrument that has a fixed interest rate and (b) an instrument that has a variable interest rate <p>are payments of principal and interest on the principal amount outstanding as long as the interest reflects consideration for the time value of money, for the credit risk associated with the instrument during the term of the instrument and for other basic lending risks and costs, as well as a profit margin. (See paragraph AG63)</p> <p>Consequently, an instrument that is a combination of (a) and (b) (e.g., a bond with an interest rate cap) can have cash flows that are solely payments of principal and interest on the principal amount outstanding. Such a contractual term may reduce cash flow variability by setting a limit on a variable interest rate (e.g., an interest rate cap or floor) or increase the cash flow variability because a fixed rate becomes variable.</p>

Instrument	Analysis
<p>Instrument D</p> <p>Instrument D is a full recourse loan and is secured by collateral.</p>	<p>The fact that a full recourse loan is collateralized does not in itself affect the analysis of whether the contractual cash flows are solely payments of principal and interest on the principal amount outstanding.</p>
<p>Instrument E</p> <p>Instrument E is issued by a regulated bank and has a stated maturity date. The instrument pays a fixed interest rate and all contractual cash flows are non-discretionary.</p>	<p>The holder would analyze the contractual terms of the financial instrument to determine whether they give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding and thus are consistent with a basic lending arrangement.</p> <p>That analysis would not consider the payments that arise only as a result of the national resolving authority's power to impose losses on the holders of Instrument E. That is because that power, and the resulting payments, are not contractual terms of the financial instrument.</p>
<p>However, the issuer is subject to legislation that permits or requires a national resolving authority to impose losses on holders of particular instruments, including Instrument E, in particular circumstances. For example, the national resolving authority has the power to write down the par amount of Instrument E or to convert it into a fixed number of the issuer's ordinary shares if the national resolving authority determines that the issuer is having severe financial difficulties, needs additional regulatory capital or is 'failing'.</p>	<p>In contrast, the contractual cash flows would not be solely payments of principal and interest on the principal amount outstanding if the contractual terms of the financial instrument permit or require the issuer or another entity to impose losses on the holder (e.g., by writing down the par amount or by converting the instrument into a fixed number of the issuer's ordinary shares) as long as those contractual terms are genuine, even if the probability is remote that such a loss will be imposed.</p>

AG76. The following examples illustrate contractual cash flows that are not solely payments of principal and interest on the principal amount outstanding. This list of examples is not exhaustive.

Instrument	Analysis
<p>Instrument F</p> <p>Instrument F is a bond that is convertible into a fixed number of equity instruments of the issuer.</p>	<p>The holder would analyze the convertible bond in its entirety.</p> <p>The contractual cash flows are not payments of principal and interest on the principal amount outstanding because they reflect a return that is inconsistent with a basic lending arrangement (see paragraph AG63); i.e., the return is linked to the value of the equity of the issuer.</p>
<p>Instrument G</p> <p>Instrument G is a loan that pays an inverse floating interest rate (i.e., the interest rate has an inverse relationship to market interest rates).</p>	<p>The contractual cash flows are not solely payments of principal and interest on the principal amount outstanding.</p> <p>The interest amounts are not consideration for the time value of money on the principal amount outstanding.</p>
<p>Instrument H</p> <p>Instrument H is a perpetual instrument but the issuer may call the instrument at any point and pay the holder the par amount plus accrued interest due.</p> <p>Instrument H pays a market interest rate but payment of interest cannot be made unless the issuer is able to remain solvent immediately afterwards.</p> <p>Deferred interest does not accrue additional interest.</p>	<p>The contractual cash flows are not payments of principal and interest on the principal amount outstanding. That is because the issuer may be required to defer interest payments and additional interest does not accrue on those deferred interest amounts. As a result, interest amounts are not consideration for the time value of money on the principal amount outstanding.</p> <p>If interest accrued on the deferred amounts, the contractual cash flows could be payments of principal and interest on the principal amount outstanding.</p>

Instrument	Analysis
	<p>The fact that Instrument H is perpetual does not in itself mean that the contractual cash flows are not payments of principal and interest on the principal amount outstanding. In effect, a perpetual instrument has continuous (multiple) extension options. Such options may result in contractual cash flows that are payments of principal and interest on the principal amount outstanding if interest payments are mandatory and must be paid in perpetuity.</p> <p>Also, the fact that Instrument H is callable does not mean that the contractual cash flows are not payments of principal and interest on the principal amount outstanding unless it is callable at an amount that does not substantially reflect payment of outstanding principal and interest on that principal amount outstanding. Even if the callable amount includes an amount that reasonably compensates the holder for the early termination of the instrument, the contractual cash flows could be payments of principal and interest on the principal amount outstanding. (See also paragraph AG74.)</p>

- AG77. In some cases a financial asset may have contractual cash flows that are described as principal and interest but those cash flows do not represent the payment of principal and interest on the principal amount outstanding as described in paragraphs 40(b), 41(b) and 42 of this Standard.
- AG78. This may be the case if the financial asset represents an investment in particular assets or cash flows and hence the contractual cash flows are not solely payments of principal and interest on the principal amount outstanding. For example, if the contractual terms stipulate that the financial asset's cash flows increase as more automobiles use a particular toll road, those contractual cash flows are inconsistent with a basic lending arrangement. As a result, the instrument would not satisfy the condition in paragraphs 40(b) and 41(b). This could be the case when a creditor's claim is limited to specified assets of the debtor or the cash flows from specified assets (for example, a 'non-recourse' financial asset).
- AG79. However, the fact that a financial asset is non-recourse does not in itself necessarily preclude the financial asset from meeting the condition in paragraphs 40(b) and 41(b). In such situations, the creditor is required to assess ('look through to') the particular underlying assets or cash flows to determine whether the contractual cash flows of the financial asset being classified are payments of principal and interest on the principal amount outstanding. If the terms of the financial asset give rise to any other cash flows or limit the cash flows in a manner inconsistent with payments representing principal and interest, the financial asset does not meet the condition in paragraphs 40(b) and 41(b). Whether the underlying assets are financial assets or non-financial assets does not in itself affect this assessment.
- AG80. A contractual cash flow characteristic does not affect the classification of the financial asset if it could have only a de minimis effect on the contractual cash flows of the financial asset. To make this determination, an entity must consider the possible effect of the contractual cash flow characteristic in each reporting period and cumulatively over the life of the financial instrument. In addition, if a contractual cash flow characteristic could have an effect on the contractual cash flows that is more than de minimis (either in a single reporting period or cumulatively) but that cash flow characteristic is not genuine, it does not affect the classification of a financial asset. A cash flow characteristic is not genuine if it affects the instrument's contractual cash flows only on the occurrence of an event that is extremely rare, highly abnormal and very unlikely to occur.
- AG81. In almost every lending transaction the creditor's instrument is ranked relative to the instruments of the debtor's other creditors. An instrument that is subordinated to other instruments may have contractual cash flows that are payments of principal and interest on the principal amount outstanding if the debtor's non-payment is a breach of contract and the holder has a contractual right to unpaid amounts of principal and interest on the principal amount outstanding even in the event of the debtor's bankruptcy. For example, a trade receivable that ranks its creditor as a general creditor would qualify as having payments of principal and interest on the principal amount outstanding. This is the case even if the debtor issued loans that are collateralized, which in the event of bankruptcy would give that loan holder priority over the claims of the general creditor in respect of the collateral but does not affect the contractual right of the general creditor to unpaid principal and other amounts due.

Contractually Linked Instruments

- AG82. In some types of transactions, an issuer may prioritize payments to the holders of financial assets using multiple contractually linked instruments that create concentrations of credit risk (tranches). Each tranche has a subordination ranking that specifies the order in which any cash flows generated by the issuer are allocated to the tranche. In such situations, the holders of a tranche have the right to payments of principal and interest on the principal amount outstanding only if the issuer generates sufficient cash flows to satisfy higher-ranking tranches.
- AG83. In such transactions, a tranche has cash flow characteristics that are payments of principal and interest on the principal amount outstanding only if:
- (a) The contractual terms of the tranche being assessed for classification (without looking through to the underlying pool of financial instruments) give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding (e.g., the interest rate on the tranche is not linked to a commodity index);
 - (b) The underlying pool of financial instruments has the cash flow characteristics set out in paragraphs AG85 and AG86; and
 - (c) The exposure to credit risk in the underlying pool of financial instruments inherent in the tranche is equal to or lower than the exposure to credit risk of the underlying pool of financial instruments (for example, the credit rating of the tranche being assessed for classification is equal to or higher than the credit rating that would apply to a single tranche that funded the underlying pool of financial instruments).
- AG84. An entity must look through until it can identify the underlying pool of instruments that are creating (instead of passing through) the cash flows. This is the underlying pool of financial instruments.
- AG85. The underlying pool must contain one or more instruments that have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.
- AG86. The underlying pool of instruments may also include instruments that:
- (a) Reduce the cash flow variability of the instruments in paragraph AG85 and, when combined with the instruments in paragraph AG85, result in cash flows that are solely payments of principal and interest on the principal amount outstanding (e.g., an interest rate cap or floor or a contract that reduces the credit risk on some or all of the instruments in paragraph AG85); or
 - (b) Align the cash flows of the tranches with the cash flows of the pool of underlying instruments in paragraph AG85 to address differences in and only in:
 - (i) Whether the interest rate is fixed or floating;
 - (ii) The currency in which the cash flows are denominated, including inflation in that currency; or
 - (iii) The timing of the cash flows.
- AG87. If any instrument in the pool does not meet the conditions in either paragraph AG85 or paragraph AG86, the condition in paragraph AG83(b) is not met. In performing this assessment, a detailed instrument-by-instrument analysis of the pool may not be necessary. However, an entity must use judgment and perform sufficient analysis to determine whether the instruments in the pool meet the conditions in paragraphs AG85–AG86. (See also paragraph AG80 for guidance on contractual cash flow characteristics that have only a de minimis effect.)
- AG88. If the holder cannot assess the conditions in paragraph AG83 at initial recognition, the tranche must be measured at fair value through surplus or deficit. If the underlying pool of instruments can change after initial recognition in such a way that the pool may not meet the conditions in paragraphs AG85–AG86, the tranche does not meet the conditions in paragraph AG83 and must be measured at fair value through surplus or deficit. However, if the underlying pool includes instruments that are collateralized by assets that do not meet the conditions in paragraphs AG85–AG86, the ability to take possession of such assets shall be disregarded for the purposes of applying this paragraph unless the entity acquired the tranche with the management model of controlling the collateral.

Option to Designate a Financial Asset or Financial Liability as at Fair Value through Surplus or Deficit

- AG89. Subject to the conditions in paragraphs 44 and 46, this Standard allows an entity to designate a financial asset, a financial liability, or a group of financial instruments (financial assets, financial liabilities or both) as at fair value through surplus or deficit provided that doing so results in more relevant information.
- AG90. The decision of an entity to designate a financial asset or financial liability as at fair value through surplus or deficit is similar to an accounting policy choice (although, unlike an accounting policy choice, it is not required to be applied

consistently to all similar transactions). When an entity has such a choice, paragraph 12 of IPSAS 3 requires the chosen policy to result in the financial statements providing faithfully representative and more relevant information about the effects of transactions, other events and conditions on the entity's financial position, financial performance or cash flows. For example, in the case of designation of a financial liability as at fair value through surplus or deficit, paragraph 46 sets out the two circumstances when the requirement for more relevant information will be met. Accordingly, to choose such designation in accordance with paragraph 46, the entity needs to demonstrate that it falls within one (or both) of these two circumstances.

Designation Eliminates or Significantly Reduces an Accounting Mismatch

- AG91. Measurement of a financial asset or financial liability and classification of recognized changes in its value are determined by the item's classification and whether the item is part of a designated hedging relationship. Those requirements can create a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') when, for example, in the absence of designation as at fair value through surplus or deficit, a financial asset would be classified as subsequently measured at fair value through surplus or deficit and a liability the entity considers related would be subsequently measured at amortized cost (with changes in fair value not recognized). In such circumstances, an entity may conclude that its financial statements would provide more relevant information if both the asset and the liability were measured as at fair value through surplus or deficit.
- AG92. The following examples show when this condition could be met. In all cases, an entity may use this condition to designate financial assets or financial liabilities as at fair value through surplus or deficit only if it meets the principle in paragraph 44 or 46(a):
- (a) An entity has liabilities under insurance contracts whose measurement incorporates current information and financial assets that it considers to be related and that would otherwise be measured at either fair value through net assets/equity or amortized cost.
 - (b) An entity has financial assets, financial liabilities or both that share a risk, such as interest rate risk, and that gives rise to opposite changes in fair value that tend to offset each other. However, only some of the instruments would be measured at fair value through surplus or deficit (for example, those that are derivatives, or are classified as held for trading). It may also be the case that the requirements for hedge accounting are not met because, for example, the requirements for hedge effectiveness in paragraph 129 are not met.
 - (c) An entity has financial assets, financial liabilities or both that share a risk, such as interest rate risk, that gives rise to opposite changes in fair value that tend to offset each other and none of the financial assets or financial liabilities qualifies for designation as a hedging instrument because they are not measured at fair value through surplus or deficit. Furthermore, in the absence of hedge accounting there is a significant inconsistency in the recognition of gains and losses. For example, the entity has financed a specified group of loans by issuing traded bonds whose changes in fair value tend to offset each other. If, in addition, the entity regularly buys and sells the bonds but rarely, if ever, buys and sells the loans, reporting both the loans and the bonds at fair value through surplus or deficit eliminates the inconsistency in the timing of the recognition of the gains and losses that would otherwise result from measuring them both at amortized cost and recognizing a gain or loss each time a bond is repurchased.
- AG93. In cases such as those described in the preceding paragraph, to designate, at initial recognition, the financial assets and financial liabilities not otherwise so measured as at fair value through surplus or deficit may eliminate or significantly reduce the measurement or recognition inconsistency and produce more relevant information. For practical purposes, the entity need not enter into all of the assets and liabilities giving rise to the measurement or recognition inconsistency at exactly the same time. A reasonable delay is permitted provided that each transaction is designated as at fair value through surplus or deficit at its initial recognition and, at that time, any remaining transactions are expected to occur.
- AG94. It would not be acceptable to designate only some of the financial assets and financial liabilities giving rise to the inconsistency as at fair value through surplus or deficit if to do so would not eliminate or significantly reduce the inconsistency and would therefore not result in more relevant information. However, it would be acceptable to designate only some of a number of similar financial assets or similar financial liabilities if doing so achieves a significant reduction (and possibly a greater reduction than other allowable designations) in the inconsistency. For example, assume an entity has a number of similar financial liabilities that sum to CU100 and a number of similar financial assets that sum to CU50 but are measured on a different basis. The entity may significantly reduce the measurement inconsistency by designating at initial recognition all of the assets but only some of the liabilities (for example, individual liabilities with a combined total of CU45) as at fair value through surplus or deficit. However, because designation as at fair value through surplus or deficit can be applied only to the whole of a financial instrument, the entity in this example must designate one or more liabilities in their entirety. It could not designate either a component of a liability (e.g., changes in value attributable to only one risk, such as changes in a benchmark interest rate) or a proportion (i.e., percentage) of a liability.

A Group of Financial Liabilities or Financial Assets and Financial Liabilities is Managed and its Performance is Evaluated on a Fair Value Basis

- AG95. An entity may manage and evaluate the performance of a group of financial liabilities or financial assets and financial liabilities in such a way that measuring that group at fair value through surplus or deficit results in more relevant information. The focus in this instance is on the way the entity manages and evaluates performance, instead of on the nature of its financial instruments.
- AG96. For example, an entity may use this condition to designate financial liabilities as at fair value through surplus or deficit if it meets the principle in paragraph 46(b) and the entity has financial assets and financial liabilities that share one or more risks and those risks are managed and evaluated on a fair value basis in accordance with a documented policy of asset and liability management. An example could be an entity that has issued ‘structured products’ containing multiple embedded derivatives and manages the resulting risks on a fair value basis using a mix of derivative and non-derivative financial instruments.
- AG97. As noted above, this condition relies on the way the entity manages and evaluates performance of the group of financial instruments under consideration. Accordingly, (subject to the requirement of designation at initial recognition) an entity that designates financial liabilities as at fair value through surplus or deficit on the basis of this condition shall so designate all eligible financial liabilities that are managed and evaluated together.
- AG98. Documentation of the entity’s strategy need not be extensive but should be sufficient to demonstrate compliance with paragraph 46(b). Such documentation is not required for each individual item, but may be on a portfolio basis. For example, if the performance management system for a department—as approved by the entity’s key management personnel—clearly demonstrates that its performance is evaluated on this basis, no further documentation is required to demonstrate compliance with paragraph 46(b).

Embedded Derivatives

- AG99. When an entity becomes a party to a hybrid contract with a host that is not an asset within the scope of this Standard, paragraph 49 requires the entity to identify any embedded derivative, assess whether it is required to be separated from the host contract and, for those that are required to be separated, measure the derivatives at fair value at initial recognition and subsequently at fair value through surplus or deficit.
- AG100. If a host contract has no stated or predetermined maturity and represents a residual interest in the net assets of an entity, then its economic characteristics and risks are those of an equity instrument, and an embedded derivative would need to possess equity characteristics related to the same entity to be regarded as closely related. If the host contract is not an equity instrument and meets the definition of a financial instrument, then its economic characteristics and risks are those of a debt instrument.
- AG101. An embedded non-option derivative (such as an embedded forward or swap) is separated from its host contract on the basis of its stated or implied substantive terms, so as to result in it having a fair value of zero at initial recognition. An embedded option-based derivative (such as an embedded put, call, cap, floor or swaption) is separated from its host contract on the basis of the stated terms of the option feature. The initial carrying amount of the host instrument is the residual amount after separating the embedded derivative.
- AG102. Generally, multiple embedded derivatives in a single hybrid contract are treated as a single compound embedded derivative. However, embedded derivatives that are classified as equity (see IPSAS 28) are accounted for separately from those classified as assets or liabilities. In addition, if a hybrid contract has more than one embedded derivative and those derivatives relate to different risk exposures and are readily separable and independent of each other, they are accounted for separately from each other.
- AG103. The economic characteristics and risks of an embedded derivative are not closely related to the host contract (paragraph 49(a)) in the following examples. In these examples, assuming the conditions in paragraph 49(b) and 49(c) are met, an entity accounts for the embedded derivative separately from the host contract.
- (a) A put option embedded in an instrument that enables the holder to require the issuer to reacquire the instrument for an amount of cash or other assets that varies on the basis of the change in an equity or commodity price or index is not closely related to a host debt instrument.
 - (b) An option or automatic provision to extend the remaining term to maturity of a debt instrument is not closely related to the host debt instrument unless there is a concurrent adjustment to the approximate current market rate of interest at the time of the extension. If an entity issues a debt instrument and the holder of that debt instrument writes a call option on the debt instrument to a third party, the issuer regards the call option as extending the term to maturity

of the debt instrument provided the issuer can be required to participate in or facilitate the remarketing of the debt instrument as a result of the call option being exercised.

- (c) Equity-indexed interest or principal payments embedded in a host debt instrument or insurance contract—by which the amount of interest or principal is indexed to the value of equity instruments—are not closely related to the host instrument because the risks inherent in the host and the embedded derivative are dissimilar.
- (d) Commodity-indexed interest or principal payments embedded in a host debt instrument or insurance contract—by which the amount of interest or principal is indexed to the price of a commodity (such as gold)—are not closely related to the host instrument because the risks inherent in the host and the embedded derivative are dissimilar.
- (e) A call, put, or prepayment option embedded in a host debt contract or host insurance contract is not closely related to the host contract unless:
 - (i) The option's exercise price is approximately equal on each exercise date to the amortized cost of the host debt instrument or the carrying amount of the host insurance contract; or
 - (ii) The exercise price of a prepayment option reimburses the lender for an amount up to the approximate present value of lost interest for the remaining term of the host contract. Lost interest is the product of the principal amount prepaid multiplied by the interest rate differential. The interest rate differential is the excess of the effective interest rate of the host contract over the effective interest rate the entity would receive at the prepayment date if it reinvested the principal amount prepaid in a similar contract for the remaining term of the host contract.

The assessment of whether the call or put option is closely related to the host debt contract is made before separating the equity element of a convertible debt instrument in accordance with IPSAS 28.

- (f) Credit derivatives that are embedded in a host debt instrument and allow one party (the 'beneficiary') to transfer the credit risk of a particular reference asset, which it may not own, to another party (the 'guarantor') are not closely related to the host debt instrument. Such credit derivatives allow the guarantor to assume the credit risk associated with the reference asset without directly owning it.

AG104. An example of a hybrid contract is a financial instrument that gives the holder a right to put the financial instrument back to the issuer in exchange for an amount of cash or other financial assets that varies on the basis of the change in an equity or commodity index that may increase or decrease (a 'puttable instrument'). Unless the issuer on initial recognition designates the puttable instrument as a financial liability at fair value through surplus or deficit, it is required to separate an embedded derivative (i.e., the indexed principal payment) under paragraph 49 because the host contract is a debt instrument under paragraph AG100 and the indexed principal payment is not closely related to a host debt instrument under paragraph AG103(a). Because the principal payment can increase and decrease, the embedded derivative is a non-option derivative whose value is indexed to the underlying variable.

AG105. In the case of a puttable instrument that can be put back at any time for cash equal to a proportionate share of the net asset value of an entity (such as units of an open-ended mutual fund or some unit-linked investment products), the effect of separating an embedded derivative and accounting for each component is to measure the hybrid contract at the redemption amount that is payable at the end of the reporting period if the holder exercised its right to put the instrument back to the issuer.

AG106. The economic characteristics and risks of an embedded derivative are closely related to the economic characteristics and risks of the host contract in the following examples. In these examples, an entity does not account for the embedded derivative separately from the host contract.

- (a) An embedded derivative in which the underlying is an interest rate or interest rate index that can change the amount of interest that would otherwise be paid or received on an interest-bearing host debt contract or insurance contract is closely related to the host contract unless the hybrid contract can be settled in such a way that the holder would not recover substantially all of its recognized investment or the embedded derivative could at least double the holder's initial rate of return on the host contract and could result in a rate of return that is at least twice what the market return would be for a contract with the same terms as the host contract.
- (b) An embedded floor or cap on the interest rate on a debt contract or insurance contract is closely related to the host contract, provided the cap is at or above the market rate of interest and the floor is at or below the market rate of interest when the contract is issued, and the cap or floor is not leveraged in relation to the host contract. Similarly, provisions included in a contract to purchase or sell an asset (e.g., a commodity) that establish a cap and a floor on the price to be paid or received for the asset are closely related to the host contract if both the cap and floor were out of the money at inception and are not leveraged.

- (c) An embedded foreign currency derivative that provides a stream of principal or interest payments that are denominated in a foreign currency and is embedded in a host debt instrument (for example, a dual currency bond) is closely related to the host debt instrument. Such a derivative is not separated from the host instrument because IPSAS 4, *The Effects of Changes in Foreign Exchange Rates* requires foreign currency gains and losses on monetary items to be recognized in surplus or deficit.
- (d) An embedded foreign currency derivative in a host contract that is an insurance contract or not a financial instrument (such as a contract for the purchase or sale of a non-financial item where the price is denominated in a foreign currency) is closely related to the host contract provided it is not leveraged, does not contain an option feature, and requires payments denominated in one of the following currencies:
 - (i) The functional currency of any substantial party to that contract;
 - (ii) The currency in which the price of the related good or service that is acquired or delivered is routinely denominated in commercial transactions around the world (such as the US dollar for crude oil transactions); or
 - (iii) A currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place (e.g., a relatively stable and liquid currency that is commonly used in local business transactions or external trade).
- (e) An embedded prepayment option in an interest-only or principal-only strip is closely related to the host contract provided the host contract (i) initially resulted from separating the right to receive contractual cash flows of a financial instrument that, in and of itself, did not contain an embedded derivative, and (ii) does not contain any terms not present in the original host debt contract.
- (f) An embedded derivative in a host lease contract is closely related to the host contract if the embedded derivative is (i) an inflation-related index such as an index of lease payments to a consumer price index (provided that the lease is not leveraged and the index relates to inflation in the entity's own economic environment), (ii) variable lease payments based on related sales or (iii) variable lease payments based on variable interest rates.
- (g) A unit-linking feature embedded in a host financial instrument or host insurance contract is closely related to the host instrument or host contract if the unit-denominated payments are measured at current unit values that reflect the fair values of the assets of the fund. A unit-linking feature is a contractual term that requires payments denominated in units of an internal or external investment fund.
- (h) A derivative embedded in an insurance contract is closely related to the host insurance contract if the embedded derivative and host insurance contract are so interdependent that an entity cannot measure the embedded derivative separately (i.e., without considering the host contract).

Instruments Containing Embedded Derivatives

AG107. As noted in paragraph AG99, when an entity becomes a party to a hybrid contract with a host that is not an asset within the scope of this Standard and with one or more embedded derivatives, paragraph 49 requires the entity to identify any such embedded derivative, assess whether it is required to be separated from the host contract and, for those that are required to be separated, measure the derivatives at fair value at initial recognition and subsequently. These requirements can be more complex, or result in less reliable measures, than measuring the entire instrument at fair value through surplus or deficit. For that reason this Standard permits the entire hybrid contract to be designated as at fair value through surplus or deficit.

AG108. Such designation may be used whether paragraph 49 requires the embedded derivatives to be separated from the host contract or prohibits such separation. However, paragraph 51 would not justify designating the hybrid contract as at fair value through surplus or deficit in the cases set out in paragraph 51(a) and 51(b) because doing so would not reduce complexity or increase reliability.

Reassessment of Embedded Derivatives

AG109. In accordance with paragraph 49, an entity shall assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required. An entity determines whether a modification to cash flows is significant by considering the extent to which the expected future cash flows associated with the embedded derivative, the host contract or both have changed and whether the change is significant relative to the previously expected cash flows on the contract.

AG110. Paragraph AG109 does not apply to embedded derivatives in contracts acquired in:

- (a) A public sector combination;
- (b) A combination of entities under common control; or
- (c) The formation of a joint venture as defined in IPSAS 37, *Joint Arrangements* or their possible reassessment at the date of acquisition.

Reclassification of Financial Assets

AG111. Paragraph 54 requires an entity to reclassify financial assets if the entity changes its management model for managing those financial assets. Such changes are expected to be very infrequent. Such changes are determined by the entity's senior management as a result of external or internal changes and must be significant to the entity's operations and demonstrable to external parties. Accordingly, a change in an entity's management model will occur only when an entity either begins or ceases to perform an activity that is significant to its operations; for example, when the entity has acquired, disposed of or terminated a business line. Examples of a change in management model include the following:

- (a) A government agency extends loans to small business owners and has a management model to sell the loan portfolios to private entities at a discount due to the long collection cycle of these loans. The entity enters into a long term contract with a third party collection service provider. The loan portfolios are no longer for sale, as they are held to collect the contractual cash flows with the aid of the collections service provider.
- (b) A department of government decides to end its support for its national auto manufacturing industry by no longer providing favorable loans. That department no longer issues new loans and the department is actively marketing its loan portfolio for sale.

AG112. A change in the objective of the entity's management model must be effected before the reclassification date. For example, if a federal mortgage and housing corporation decides on February 15 to shut down its retail mortgage business and hence must reclassify all affected financial assets on April 1 (i.e., the first day of the entity's next reporting period), the entity must not accept new retail mortgage business or otherwise engage in activities consistent with its former management model after February 15.

AG113. The following are not changes in management model:

- (a) A change in intention related to particular financial assets (even in circumstances of significant changes in market conditions).
- (b) The temporary disappearance of a particular market for financial assets.
- (c) A transfer of financial assets between parts of the entity with different management models.

Measurement

Non-Exchange Revenue Transactions

AG114. The initial recognition and measurement of assets and liabilities resulting from non-exchange revenue transactions is dealt with in IPSAS 23. Assets resulting from non-exchange revenue transactions can arise out of both contractual and non-contractual arrangements (see IPSAS 28 paragraphs AG20 and AG21). Where these assets arise out of contractual arrangements and otherwise meet the definition of a financial instrument, they are:

- (a) Initially recognized in accordance with IPSAS 23;
- (b) Initially measured:
 - (i) At fair value using the principles in IPSAS 23; and
 - (ii) Taking account of transaction costs that are directly attributable to the acquisition of the financial asset in accordance with paragraph 57 of this Standard, where the asset is subsequently measured other than at fair value through surplus or deficit.

Initial measurement

Initial Measurement of Financial Assets and Financial Liabilities (Paragraphs 57–59)

AG115. The fair value of a financial instrument at initial recognition is normally the transaction price (i.e., the fair value of the consideration given or received, see also paragraph AG117). However, if part of the consideration given or received is

for something other than the financial instrument, the fair value of the financial instrument is estimated, using a valuation technique (see paragraphs AG149–AG154). For example, the fair value of a long-term loan or receivable that carries no interest can be measured as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating. Any additional amount lent is an expense or a reduction of revenue unless it qualifies for recognition as some other type of asset.

AG116. If an entity originates a loan that bears an off-market interest rate (e.g., 5 percent when the market rate for similar loans is 8 percent), and receives an upfront fee as compensation, the entity recognizes the loan at its fair value, i.e., net of the fee it receives.

AG117. The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price. If an entity determines that the fair value at initial recognition differs from the transaction price as mentioned in paragraph 58, the entity shall account for that instrument at that date as follows:

- (a) At the measurement required by paragraph 57 if that fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e., a Level 1 input) or based on a valuation technique that uses only data from observable markets. An entity shall recognize the difference between the fair value at initial recognition and the transaction price as a gain or loss.
- (b) In all other cases, at the measurement required by paragraph 57, adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the entity shall recognize that deferred difference as a gain or loss only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the asset or liability.

The requirements of this paragraph do not apply to concessionary loans or equity instruments arising from non-exchange transactions as outlined in paragraphs AG118 to AG130.

Concessionary Loans

AG118. Concessionary loans are granted to or received by an entity at below market terms. Below market terms can result from interest and/or principal concessions. Examples of concessionary loans that commonly have below market terms include loans to developing countries, small farms, student loans granted to qualifying students for university or college education and housing loans granted to low income families. Entities may receive concessionary loans, for example, from development agencies and other government entities.

AG119. The granting or receiving of a concessionary loan is distinguished from the waiver of debt owing to or by an entity. This distinction is important because it affects whether the below market conditions are considered in the initial recognition or measurement of the loan rather than as part of the subsequent measurement or derecognition.

AG120. The intention of a concessionary loan at the outset is to provide or receive resources at below market terms. A waiver of debt results from loans initially granted or received at market related terms where the intention of either party to the loan has changed subsequent to its initial issue or receipt. For example, a government may lend money to a not-for-profit entity with the intention that the loan be repaid in full on market terms. However, the government may subsequently write-off part of the loan. This is not a concessionary loan as the intention of the loan at the outset was to provide credit to an entity at market related rates. An entity would treat the subsequent write-off of the loan as a waiver of debt and apply the derecognition requirements of IPSAS 41 (see paragraphs 12–34).

AG121. Concessionary loans also share many characteristics with originated credit-impaired loans. Whether a loan is classified as concessionary or originated credit-impaired determines whether the difference between the transaction price and the fair value of the loan is recognized as a concession or as a credit loss in the statement of financial performance.

AG122. Whether a loan is concessionary or originated credit-impaired depends on its substance. An intention to incorporate a non-exchange component into the transaction, such as a transfer of resources, indicates the loan is concessionary. The non-exchange component is incorporated into the transaction by granting the loan at below market terms. By contrast, originated credit-impaired loans are loans where one or more events, that have a detrimental impact on the estimated future cash flows of the financial asset, have occurred.

AG123. As concessionary loans are granted or received at below market terms, the transaction price on initial recognition of the loan may not be its fair value. At initial recognition, an entity therefore analyzes the substance of the loan granted or received into its component parts, and accounts for those components using the principles in paragraphs AG124 and AG126 below.

AG124. An entity firstly assesses whether the substance of the concessionary loan is in fact a loan, a non-exchange transaction, a contribution from owners or a combination thereof, by applying the principles in IPSAS 28 and paragraphs 42–58 of IPSAS 23. If an entity has determined that the transaction, or part of the transaction, is a loan, it assesses whether the transaction price represents the fair value of the loan on initial recognition. An entity determines the fair value of the loan by using the principles in paragraphs AG144–AG155. Where an entity cannot determine fair value by reference to an active market, it uses a valuation technique. Fair value using a valuation technique could be determined by discounting all future cash receipts using a market related rate of interest for a similar loan (see paragraph AG115).

AG125. Any difference between the fair value of the loan and the transaction price (the loan proceeds) is treated as follows:

- (a) Where the loan is received by an entity, the difference is accounted for in accordance with IPSAS 23.
- (b) Where the loan is granted by an entity, the difference is treated as an expense in surplus or deficit at initial recognition, except where the loan is a transaction with owners, in their capacity as owners. Where the loan is a transaction with owners in their capacity as owners, for example, where a controlling entity provides a concessionary loan to a controlled entity, the difference may represent a capital contribution, i.e., an investment in an entity, rather than an expense.

Illustrative Examples are provided in paragraph IG54 of IPSAS 23 as well as paragraphs IE153 to IE161 accompanying this Standard.

AG126. After evaluating the substance of the concessionary loan and measuring the loan component at fair value, an entity subsequently assesses the classification of concessionary loans in accordance with paragraphs 39–44 and measures concessionary loans in accordance with paragraphs 61–65.

AG127. In some circumstances a concessionary loan may be granted that is also originated credit-impaired. For example, a government may provide loans with concessionary terms on a recurring basis to a borrower that historically has not been able to repay in full. If the concessionary loan is credit-impaired, an entity measures the instrument at the fair value including the expected credit losses over the life of the instrument. An entity applies paragraph AG125(b) to account for the component parts and recognizes the credit losses and concessionary element in its entirety as a concession.

Equity Instruments Arising from Non-Exchange Transactions

AG128. In the public sector, equity investment can be used as a way for an entity to provide financing or subsidized funding to another public sector entity. In such a transaction, there is generally a lack of an active market for such investments (i.e., the equity instrument is unquoted), and there are no or minimal future cash flow expectations from the investment besides a potential redemption by the issuing entity. Cash is provided by the investing entity to the investee generally to further the investee’s economic or social objectives. Examples of such investments could include membership shares in a development bank, or equity investment in another public sector entity that provides certain social programs or services (e.g., shelters, subsidized housing, small business assistance...etc.)

AG129. At initial recognition of such transactions, an entity shall analyze the substance of the arrangement and assess whether the intention at the outset is the provision or receipt of resources by way of a non-exchange transaction. To the extent that the transaction, or component of the transaction, is a non-exchange transaction, any assets or revenues arising from the transaction are accounted for in accordance with IPSAS 23. The entity providing the resources shall recognize the amount as an expense in surplus or deficit at initial recognition.

AG130. To the extent an equity instrument arises from the transaction, or component of the transaction, that is within the scope of this Standard, it is to be recognized initially at fair value in accordance with paragraph 57. The equity instrument is to be measured subsequently in accordance with paragraphs 61–63. If the instrument does not have an active market, the entity shall consider valuation techniques and inputs in paragraphs AG149–AG155) in determining its fair value.

Valuing Financial Guarantees Issued through a Non-Exchange Transaction

AG131. Only contractual financial guarantees (or guarantees that are in substance, contractual) are within the scope of this Standard (See paragraphs AG3 and AG4 of IPSAS 28). Non-contractual guarantees are not within the scope of this Standard as they do not meet the definition of a financial instrument. This Standard prescribes recognition and measurement requirements only for the issuer of financial guarantee contracts.

AG132. In paragraph 9, “financial guarantee contract” is defined as “a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.” Under the requirements of this Standard, financial guarantee contracts, like other financial assets and financial liabilities, are required to be initially recognized at fair value. Paragraphs 66–68

of this Standard provide commentary and guidance on determining fair value and this is complemented by Application Guidance in paragraphs AG144–AG155. Subsequent measurement for financial guarantee contracts is at the higher of the amount of the loss allowance determined in accordance with paragraphs 73–93 and the amount initially recognized less, when appropriate, cumulative amortization in accordance with IPSAS 9, *Revenue from Exchange Transactions*.

- AG133. In the public sector, guarantees are frequently provided by way of non-exchange transactions, i.e., at no or nominal consideration. This type of guarantee is provided generally to further the entity's economic and social objectives. Such purposes include supporting infrastructure projects, supporting corporate entities at times of economic distress, guaranteeing the bond issues of entities in other tiers of governments and the loans of employees to finance motor vehicles that are to be used for performance of their duties as employees. Where there is consideration for a financial guarantee, an entity should determine whether that consideration arises from an exchange transaction and whether the consideration represents a fair value. If the consideration does represent a fair value, entities should recognize the financial guarantee at the amount of the consideration. Subsequent measurement should be at the higher of the amount of the loss allowance determined in accordance with paragraphs 73–93 and the amount initially recognized, less, when appropriate, cumulative amortization recognized in accordance with IPSAS 9. Where the entity concludes that the consideration is not a fair value, an entity determines the carrying value at initial recognition in the same way as if no consideration had been paid.
- AG134. At initial recognition, where no fee is charged or where the consideration is not fair value, an entity firstly considers whether there are quoted prices available in an active market for financial guarantee contracts directly equivalent to that entered into. Evidence of an active market includes recent arm's length market transactions between knowledgeable willing parties, and reference to the current fair value of another financial guarantee contract that is substantially the same as that provided at nil or nominal consideration by the issuer. The fact that a financial guarantee contract has been entered into at no consideration by the debtor to the issuer is not, of itself, conclusive evidence of the absence of an active market. Guarantees may be available from commercial issuers, but a public sector entity may agree to enter into a financial guarantee contract for a number of non-commercial reasons. For example, if a debtor is unable to afford a commercial fee, and initiation of a project in fulfillment of one of the entity's social or policy objectives would be put at risk unless a financial guarantee contract is issued, it may approach a public sector entity or government to issue a financial guarantee contract.
- AG135. Where there is no active market for a directly equivalent guarantee contract; the entity considers whether a valuation technique other than observation of an active market is available and provides a reliable measure of fair value. Such a valuation technique may rely on mathematical models which consider financial risk. For example, National Government W guarantees a bond issue of Municipality X. As Municipality X has a government guarantee backing its bond issue, its bonds have a lower coupon than if they were not secured by a government guarantee. This is because the guarantee lowers the risk profile of the bonds for investors. The guarantee fee could be determined by using the credit spread between what the coupon rate would have been had the issue not been backed by a government guarantee and the rate with the guarantee in place. Where a fair value is obtainable either by observation of an active market or through another valuation technique, the entity recognizes the financial guarantee at that fair value in the statement of financial position and recognizes an expense of an equivalent amount in the statement of financial performance. When using a valuation technique that is not based on observation of an active market an entity needs to satisfy itself that the output of any model is reliable and understandable.
- AG136. If no reliable measure of fair value can be determined, either by direct observation of an active market or through another valuation technique, an entity is required to measure the financial guarantee contract at the amount of the loss allowance determined in accordance with paragraphs 73 to 93.

Subsequent Measurement

- AG137. If a financial instrument that was previously recognized as a financial asset is measured at fair value through surplus or deficit and its fair value decreases below zero, it is a financial liability measured in accordance with paragraph 45. However, hybrid contracts with hosts that are assets within the scope of this Standard are always measured in accordance with paragraph 48.
- AG138. The following example illustrates the accounting for transaction costs on the initial and subsequent measurement of a financial asset measured at fair value with changes through net assets/equity in accordance with either paragraph 106 or 41. An entity acquires a financial asset for CU100 plus a purchase commission of CU2. Initially, the entity recognizes the asset at CU102. The reporting period ends one day later, when the quoted market price of the asset is CU100. If the asset were sold, a commission of CU3 would be paid. On that date, the entity measures the asset at CU100 (without regard to the possible commission on sale) and recognizes a loss of CU2 in net assets/equity. If the financial asset is measured at fair value through net assets/equity in accordance with paragraph 41, the transaction costs are amortized to surplus or deficit using the effective interest method.

AG139. The subsequent measurement of a financial asset or financial liability and the subsequent recognition of gains and losses described in paragraph AG117 shall be consistent with the requirements of this Standard.

Investments in Equity Instruments and Contracts on those Investments

AG140. All investments in equity instruments and contracts on those instruments must be measured at fair value. However, in limited circumstances, cost may be an appropriate estimate of fair value. That may be the case if insufficient more recent information is available to measure fair value, or if there is a wide range of possible fair value measurements and cost represents the best estimate of fair value within that range.

AG141. Indicators that cost might not be representative of fair value include:

- (a) A significant change in the performance of the investee compared with budgets, plans or milestones.
- (b) Changes in expectation that the investee's technical product milestones will be achieved.
- (c) A significant change in the market for the investee's equity or its products or potential products.
- (d) A significant change in the global economy or the economic environment in which the investee operates.
- (e) A significant change in the performance of comparable entities, or in the valuations implied by the overall market.
- (f) Internal matters of the investee such as fraud, commercial disputes, litigation, changes in management or strategy.
- (g) Evidence from external transactions in the investee's equity, either by the investee (such as a fresh issue of equity), or by transfers of equity instruments between third parties.

AG142. The list in paragraph AG141 is not exhaustive. An entity shall use all information about the performance and operations of the investee that becomes available after the date of initial recognition. To the extent that any such relevant factors exist, they may indicate that cost might not be representative of fair value. In such cases, the entity must measure fair value.

AG143. Cost is never the best estimate of fair value for investments in quoted equity instruments (or contracts on quoted equity instruments).

Fair Value Measurement Considerations

AG144. Underlying the definition of fair value is a presumption that an entity is a going concern without any intention or need to liquidate, to curtail materially the scale of its operations or to undertake a transaction on adverse terms. Fair value is not, therefore, the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale. However, fair value reflects the credit quality of the instrument.

AG145. This Standard uses the terms "bid price" and "asking price" (sometimes referred to as "current offer price") in the context of quoted market prices, and the term "the bid-ask spread" to include only transaction costs. Other adjustments to arrive at fair value (e.g., for counterparty credit risk) are not included in the term "bid-ask spread."

Active Market: Quoted Price

AG146. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. Fair value is defined in terms of a price agreed by a willing buyer and a willing seller in an arm's length transaction. The objective of determining fair value for a financial instrument that is traded in an active market is to arrive at the price at which a transaction would occur at the end of the reporting period in that instrument (i.e., without modifying or repackaging the instrument) in the most advantageous active market to which the entity has immediate access. However, the entity adjusts the price in the more advantageous market to reflect any differences in counterparty credit risk between instruments traded in that market and the one being valued. The existence of published price quotations in an active market is the best evidence of fair value and when they exist they are used to measure the financial asset or financial liability.

AG147. The appropriate quoted market price for an asset held or liability to be issued is usually the current bid price and, for an asset to be acquired or liability held, the asking price. When an entity has assets and liabilities with offsetting market risks, it may use mid-market prices as a basis for establishing fair values for the offsetting risk positions and apply the bid or asking price to the net open position as appropriate. When current bid and asking prices are unavailable, the price of the most recent transaction provides evidence of the current fair value as long as there has not been a significant change in economic circumstances since the time of the transaction. If conditions have changed since the time of the transaction (e.g., a change in the risk-free interest rate following the most recent price quote for a government bond), the fair value reflects

the change in conditions by reference to current prices or rates for similar financial instruments, as appropriate. Similarly, if the entity can demonstrate that the last transaction price is not fair value (e.g., because it reflected the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale), that price is adjusted. The fair value of a portfolio of financial instruments is the product of the number of units of the instrument and its quoted market price. If a published price quotation in an active market does not exist for a financial instrument in its entirety, but active markets exist for its component parts, fair value is determined on the basis of the relevant market prices for the component parts.

AG148. If a rate (rather than a price) is quoted in an active market, the entity uses that market-quoted rate as an input into a valuation technique to determine fair value. If the market-quoted rate does not include credit risk or other factors that market participants would include in valuing the instrument, the entity adjusts for those factors.

No Active Market: Valuation Technique

AG149. If the market for a financial instrument is not active, an entity establishes fair value by using a valuation technique. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, if available, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the entity uses that technique.

AG150. The objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal operating considerations. Fair value is estimated on the basis of the results of a valuation technique that makes maximum use of market inputs, and relies as little as possible on entity-specific inputs. A valuation technique would be expected to arrive at a realistic estimate of the fair value if (a) it reasonably reflects how the market could be expected to price the instrument and (b) the inputs to the valuation technique reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument.

AG151. Therefore, a valuation technique (a) incorporates all factors that market participants would consider in setting a price and (b) is consistent with accepted economic methodologies for pricing financial instruments. Periodically, an entity calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on any available observable market data. An entity obtains market data consistently in the same market where the instrument was originated or purchased.

AG152. The initial acquisition or origination of a financial asset or incurrence of a financial liability is a market transaction that provides a foundation for estimating the fair value of the financial instrument. In particular, if the financial instrument is a debt instrument (such as a loan), its fair value can be determined by reference to the market conditions that existed at its acquisition or origination date and current market conditions or interest rates currently charged by the entity or by others for similar debt instruments (i.e., similar remaining maturity, cash flow pattern, currency, credit risk, collateral and interest basis). Alternatively, provided there is no change in the credit risk of the debtor and applicable credit spreads after the origination of the debt instrument, an estimate of the current market interest rate may be derived by using a benchmark interest rate reflecting a better credit quality than the underlying debt instrument, holding the credit spread constant, and adjusting for the change in the benchmark interest rate from the origination date. If conditions have changed since the most recent market transaction, the corresponding change in the fair value of the financial instrument being valued is determined by reference to current prices or rates for similar financial instruments, adjusted as appropriate, for any differences from the instrument being valued.

AG153. The same information may not be available at each measurement date. For example, at the date that an entity makes a loan or acquires a debt instrument that is not actively traded, the entity has a transaction price that is also a market price. However, no new transaction information may be available at the next measurement date and, although the entity can determine the general level of market interest rates, it may not know what level of credit or other risk market participants would consider in pricing the instrument on that date. An entity may not have information from recent transactions to determine the appropriate credit spread over the basic interest rate to use in determining a discount rate for a present value computation. It would be reasonable to assume, in the absence of evidence to the contrary, that no changes have taken place in the spread that existed at the date the loan was made. However, the entity would be expected to make reasonable efforts to determine whether there is evidence that there has been a change in such factors. When evidence of a change exists, the entity would consider the effects of the change in determining the fair value of the financial instrument.

AG154. In applying discounted cash flow analysis, an entity uses one or more discount rates equal to the prevailing rates of return for financial instruments having substantially the same terms and characteristics, including the credit quality of the instrument, the remaining term over which the contractual interest rate is fixed, the remaining term to repayment of the principal and the currency in which payments are to be made.

Inputs to Valuation Techniques

AG155. An appropriate technique for estimating the fair value of a particular financial instrument would incorporate observable market data about the market conditions and other factors that are likely to affect the instrument's fair value. The fair value of a financial instrument will be based on one or more of the following factors (and perhaps others).

- (a) The time value of money (i.e., interest at the basic or risk-free rate). Basic interest rates can usually be derived from observable government bond prices and are often quoted in financial publications. These rates typically vary with the expected dates of the projected cash flows along a yield curve of interest rates for different time horizons. For practical reasons, an entity may use a well-accepted and readily observable general market rate, such as a swap rate, as the benchmark rate. (If the rate used is not the risk-free interest rate, the credit risk adjustment appropriate to the particular financial instrument is determined on the basis of its credit risk in relation to the credit risk in this benchmark rate). In some countries, the central government's bonds may carry a significant credit risk and may not provide a stable benchmark basic interest rate for instruments denominated in that currency. Some entities in these countries may have a better credit standing and a lower borrowing rate than the central government. In such a case, basic interest rates may be more appropriately determined by reference to interest rates for the highest rated corporate bonds issued in the currency of that jurisdiction.
- (b) Credit risk. The effect on fair value of credit risk (i.e., the premium over the basic interest rate for credit risk) may be derived from observable market prices for traded instruments of different credit quality or from observable interest rates charged by lenders for loans of various credit ratings.
- (c) Foreign currency exchange prices. Active currency exchange markets exist for most major currencies, and prices are quoted daily in financial publications.
- (d) Commodity prices. There are observable market prices for many commodities.
- (e) Equity prices. Prices (and indexes of prices) of traded equity instruments are readily observable in some markets. Present value based techniques may be used to estimate the current market price of equity instruments for which there are no observable prices.
- (f) Volatility (i.e., magnitude of future changes in price of the financial instrument or other item). Measures of the volatility of actively traded items can normally be reasonably estimated on the basis of historical market data or by using volatilities implied in current market prices.
- (g) Prepayment risk and surrender risk. Expected prepayment patterns for financial assets and expected surrender patterns for financial liabilities can be estimated on the basis of historical data. (The fair value of a financial liability that can be surrendered by the counterparty cannot be less than the present value of the surrender amount – see paragraph 68).
- (h) Servicing costs for a financial asset or a financial liability. Costs of servicing can be estimated using comparisons with current fees charged by other market participants. If the costs of servicing a financial asset or financial liability are significant and other market participants would face comparable costs, the issuer would consider them in determining the fair value of that financial asset or financial liability. It is likely that the fair value at inception of a contractual right to future fees equals the origination costs paid for them, unless future fees and related costs are out of line with market comparables.

Amortized Cost Measurement

Effective Interest Method

AG156. In applying the effective interest method, an entity identifies fees that are an integral part of the effective interest rate of a financial instrument. The description of fees for financial services may not be indicative of the nature and substance of the services provided. Fees that are an integral part of the effective interest rate of a financial instrument are treated as an adjustment to the effective interest rate, unless the financial instrument is measured at fair value, with the change in fair value being recognized in surplus or deficit. In those cases, the fees are recognized as revenue or expense when the instrument is initially recognized.

AG157. Fees that are an integral part of the effective interest rate of a financial instrument include:

- (a) Origination fees received by the entity relating to the creation or acquisition of a financial asset. Such fees may include compensation for activities such as evaluating the borrower's financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and

processing documents and closing the transaction. These fees are an integral part of generating an involvement with the resulting financial instrument.

- (b) Commitment fees received by the entity to originate a loan when the loan commitment is not measured in accordance with paragraph 45(a) and it is probable that the entity will enter into a specific lending arrangement. These fees are regarded as compensation for an ongoing involvement with the acquisition of a financial instrument. If the commitment expires without the entity making the loan, the fee is recognized as revenue on expiry.
- (c) Origination fees paid on issuing financial liabilities measured at amortized cost. These fees are an integral part of generating an involvement with a financial liability. An entity distinguishes fees and costs that are an integral part of the effective interest rate for the financial liability from origination fees and transaction costs relating to the right to provide services, such as investment management services.

AG158. Fees that are not an integral part of the effective interest rate of a financial instrument and are accounted for in accordance with IPSAS 9 include:

- (a) Fees charged for servicing a loan;
- (b) Commitment fees to originate a loan when the loan commitment is not measured in accordance with paragraph 45(a) and it is unlikely that a specific lending arrangement will be entered into; and
- (c) Loan syndication fees received by an entity that arranges a loan and retains no part of the loan package for itself (or retains a part at the same effective interest rate for comparable risk as other participants).

AG159. When applying the effective interest method, an entity generally amortizes any fees, points paid or received, transaction costs and other premiums or discounts that are included in the calculation of the effective interest rate over the expected life of the financial instrument. However, a shorter period is used if this is the period to which the fees, points paid or received, transaction costs, premiums or discounts relate. This will be the case when the variable to which the fees, points paid or received, transaction costs, premiums or discounts relate is repriced to market rates before the expected maturity of the financial instrument. In such a case, the appropriate amortization period is the period to the next such repricing date. For example, if a premium or discount on a floating-rate financial instrument reflects the interest that has accrued on that financial instrument since the interest was last paid, or changes in the market rates since the floating interest rate was reset to the market rates, it will be amortized to the next date when the floating interest is reset to market rates. This is because the premium or discount relates to the period to the next interest reset date because, at that date, the variable to which the premium or discount relates (i.e., interest rates) is reset to the market rates. If, however, the premium or discount results from a change in the credit spread over the floating rate specified in the financial instrument, or other variables that are not reset to the market rates, it is amortized over the expected life of the financial instrument.

AG160. For floating-rate financial assets and floating-rate financial liabilities, periodic re-estimation of cash flows to reflect the movements in the market rates of interest alters the effective interest rate. If a floating-rate financial asset or a floating-rate financial liability is recognized initially at an amount equal to the principal receivable or payable on maturity, re-estimating the future interest payments normally has no significant effect on the carrying amount of the asset or the liability.

AG161. If an entity revises its estimates of payments or receipts (excluding modifications in accordance with paragraph 71 and changes in estimates of expected credit losses), it shall adjust the gross carrying amount of the financial asset or amortized cost of a financial liability (or group of financial instruments) to reflect actual and revised estimated contractual cash flows. The entity recalculates the gross carrying amount of the financial asset or amortized cost of the financial liability as the present value of the estimated future contractual cash flows that are discounted at the financial instrument's original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets) or, when applicable, the revised effective interest rate calculated in accordance with paragraph 139. The adjustment is recognized in surplus or deficit as revenue or expense.

AG162. In some cases a financial asset is considered credit-impaired at initial recognition because the credit risk is very high, and in the case of a purchase it is acquired at a deep discount. An entity is required to include the initial expected credit losses in the estimated cash flows when calculating the credit-adjusted effective interest rate for financial assets that are considered to be purchased or originated credit-impaired at initial recognition. However, this does not mean that a credit-adjusted effective interest rate should be applied solely because the financial asset has high credit risk at initial recognition.

Transaction Costs

AG163. Transaction costs include fees and commission paid to agents (including employees acting as selling agents), advisers, brokers and dealers, levies by regulatory agencies and security exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

Write-off

AG164. Write-offs can relate to a financial asset in its entirety or to a portion of it. For example, an entity plans to enforce the collateral on a financial asset and expects to recover no more than 30 percent of the financial asset from the collateral. If the entity has no reasonable prospects of recovering any further cash flows from the financial asset, it should write off the remaining 70 percent of the financial asset.

Impairment

Collective and Individual Assessment Basis

AG165. In order to meet the objective of recognizing lifetime expected credit losses for significant increases in credit risk since initial recognition, it may be necessary to perform the assessment of significant increases in credit risk on a collective basis by considering information that is indicative of significant increases in credit risk on, for example, a group or subgroup of financial instruments. This is to ensure that an entity meets the objective of recognizing lifetime expected credit losses when there are significant increases in credit risk, even if evidence of such significant increases in credit risk at the individual instrument level is not yet available.

AG166. Lifetime expected credit losses are generally expected to be recognized before a financial instrument becomes past due. Typically, credit risk increases significantly before a financial instrument becomes past due or other lagging borrower-specific factors (for example, a modification or restructuring) are observed. Consequently when reasonable and supportable information that is more forward-looking than past due information is available without undue cost or effort, it must be used to assess changes in credit risk.

AG167. However, depending on the nature of the financial instruments and the credit risk information available for particular groups of financial instruments, an entity may not be able to identify significant changes in credit risk for individual financial instruments before the financial instrument becomes past due. This may be the case for financial instruments such as student loans for which there is little or no updated credit risk information that is routinely obtained and monitored on an individual instrument until a borrower breaches the contractual terms. If changes in the credit risk for individual financial instruments are not captured before they become past due, a loss allowance based only on credit information at an individual financial instrument level would not faithfully represent the changes in credit risk since initial recognition.

AG168. In some circumstances an entity does not have reasonable and supportable information that is available without undue cost or effort to measure lifetime expected credit losses on an individual instrument basis. In that case, lifetime expected credit losses shall be recognized on a collective basis that considers comprehensive credit risk information. This comprehensive credit risk information must incorporate not only past due information but also all relevant credit information, including forward-looking macroeconomic information, in order to approximate the result of recognizing lifetime expected credit losses when there has been a significant increase in credit risk since initial recognition on an individual instrument level.

AG169. For the purpose of determining significant increases in credit risk and recognizing a loss allowance on a collective basis, an entity can group financial instruments on the basis of shared credit risk characteristics with the objective of facilitating an analysis that is designed to enable significant increases in credit risk to be identified on a timely basis. The entity should not obscure this information by grouping financial instruments with different risk characteristics. Examples of shared credit risk characteristics may include, but are not limited to, the:

- (a) Instrument type;
- (b) Credit risk ratings;
- (c) Collateral type;
- (d) Date of initial recognition;
- (e) Remaining term to maturity;
- (f) Industry;
- (g) Geographical location of the borrower; and
- (h) The value of collateral relative to the financial asset if it has an impact on the probability of a default occurring (for example, non-recourse loans in some jurisdictions or loan-to-value ratios).

AG170. Paragraph 76 requires that lifetime expected credit losses are recognized on all financial instruments for which there has been significant increases in credit risk since initial recognition. In order to meet this objective, if an entity is not able to group financial instruments for which the credit risk is considered to have increased significantly since initial recognition

based on shared credit risk characteristics, the entity should recognize lifetime expected credit losses on a portion of the financial assets for which credit risk is deemed to have increased significantly. The aggregation of financial instruments to assess whether there are changes in credit risk on a collective basis may change over time as new information becomes available on groups of, or individual, financial instruments.

Timing of Recognizing Lifetime Expected Credit Losses

- AG171. The assessment of whether lifetime expected credit losses should be recognized is based on significant increases in the likelihood or risk of a default occurring since initial recognition (irrespective of whether a financial instrument has been repriced to reflect an increase in credit risk) instead of on evidence of a financial asset being credit-impaired at the reporting date or an actual default occurring. Generally, there will be a significant increase in credit risk before a financial asset becomes credit-impaired or an actual default occurs.
- AG172. For loan commitments, an entity considers changes in the risk of a default occurring on the loan to which a loan commitment relates. For financial guarantee contracts, an entity considers the changes in the risk that the specified debtor will default on the contract.
- AG173. The significance of a change in the credit risk since initial recognition depends on the risk of a default occurring as at initial recognition. Thus, a given change, in absolute terms, in the risk of a default occurring will be more significant for a financial instrument with a lower initial risk of a default occurring compared to a financial instrument with a higher initial risk of a default occurring.
- AG174. The risk of a default occurring on financial instruments that have comparable credit risk is higher the longer the expected life of the instrument; for example, the risk of a default occurring on an AAA-rated bond with an expected life of 10 years is higher than that on an AAA-rated bond with an expected life of five years.
- AG175. Because of the relationship between the expected life and the risk of a default occurring, the change in credit risk cannot be assessed simply by comparing the change in the absolute risk of a default occurring over time. For example, if the risk of a default occurring for a financial instrument with an expected life of 10 years at initial recognition is identical to the risk of a default occurring on that financial instrument when its expected life in a subsequent period is only five years, that may indicate an increase in credit risk. This is because the risk of a default occurring over the expected life usually decreases as time passes if the credit risk is unchanged and the financial instrument is closer to maturity. However, for financial instruments that only have significant payment obligations close to the maturity of the financial instrument the risk of a default occurring may not necessarily decrease as time passes. In such a case, an entity should also consider other qualitative factors that would demonstrate whether credit risk has increased significantly since initial recognition.
- AG176. An entity may apply various approaches when assessing whether the credit risk on a financial instrument has increased significantly since initial recognition or when measuring expected credit losses. An entity may apply different approaches for different financial instruments. An approach that does not include an explicit probability of default as an input per se, such as a credit loss rate approach, can be consistent with the requirements in this Standard, provided that an entity is able to separate the changes in the risk of a default occurring from changes in other drivers of expected credit losses, such as collateral, and considers the following when making the assessment:
- (a) The change in the risk of a default occurring since initial recognition;
 - (b) The expected life of the financial instrument; and
 - (c) Reasonable and supportable information that is available without undue cost or effort that may affect credit risk.
- AG177. The methods used to determine whether credit risk has increased significantly on a financial instrument since initial recognition should consider the characteristics of the financial instrument (or group of financial instruments) and the default patterns in the past for comparable financial instruments. Despite the requirement in paragraph 81, for financial instruments for which default patterns are not concentrated at a specific point during the expected life of the financial instrument, changes in the risk of a default occurring over the next 12 months may be a reasonable approximation of the changes in the lifetime risk of a default occurring. In such cases, an entity may use changes in the risk of a default occurring over the next 12 months to determine whether credit risk has increased significantly since initial recognition, unless circumstances indicate that a lifetime assessment is necessary.
- AG178. However, for some financial instruments, or in some circumstances, it may not be appropriate to use changes in the risk of a default occurring over the next 12 months to determine whether lifetime expected credit losses should be recognized. For example, the change in the risk of a default occurring in the next 12 months may not be a suitable basis for determining whether credit risk has increased on a financial instrument with a maturity of more than 12 months when:

- (a) The financial instrument only has significant payment obligations beyond the next 12 months;
- (b) Changes in relevant macroeconomic or other credit-related factors occur that are not adequately reflected in the risk of a default occurring in the next 12 months; or
- (c) Changes in credit-related factors only have an impact on the credit risk of the financial instrument (or have a more pronounced effect) beyond 12 months.

Determining Whether Credit Risk has Increased Significantly since Initial Recognition

AG179. When determining whether the recognition of lifetime expected credit losses is required, an entity shall consider reasonable and supportable information that is available without undue cost or effort and that may affect the credit risk on a financial instrument in accordance with paragraph 90(c). An entity need not undertake an exhaustive search for information when determining whether credit risk has increased significantly since initial recognition.

AG180. Credit risk analysis is a multifactor and holistic analysis; whether a specific factor is relevant, and its weight compared to other factors, will depend on the type of product, characteristics of the financial instruments and the borrower as well as the geographical region. An entity shall consider reasonable and supportable information that is available without undue cost or effort and that is relevant for the particular financial instrument being assessed. However, some factors or indicators may not be identifiable on an individual financial instrument level. In such a case, the factors or indicators should be assessed for appropriate portfolios, groups of portfolios or portions of a portfolio of financial instruments to determine whether the requirement in paragraph 75 for the recognition of lifetime expected credit losses has been met.

AG181. The following non-exhaustive list of information may be relevant in assessing changes in credit risk:

- (a) Significant changes in internal price indicators of credit risk as a result of a change in credit risk since inception, including, but not limited to, the credit spread that would result if a particular financial instrument or similar financial instrument with the same terms and the same counterparty were newly originated or issued at the reporting date.
- (b) Other changes in the rates or terms of an existing financial instrument that would be significantly different if the instrument was newly originated or issued at the reporting date (such as more stringent covenants, increased amounts of collateral or guarantees, or higher revenue coverage) because of changes in the credit risk of the financial instrument since initial recognition.
- (c) Significant changes in external market indicators of credit risk for a particular financial instrument or similar financial instruments with the same expected life. Changes in market indicators of credit risk include, but are not limited to:
 - (i) The credit spread;
 - (ii) The credit default swap prices for the borrower;
 - (iii) The length of time or the extent to which the fair value of a financial asset has been less than its amortized cost; and
 - (iv) Other market information related to the borrower, such as changes in the price of a borrower's debt and equity instruments.
- (d) An actual or expected significant change in the financial instrument's external credit rating.
- (e) An actual or expected internal credit rating downgrade for the borrower or decrease in behavioral scoring used to assess credit risk internally. Internal credit ratings and internal behavioral scoring are more reliable when they are mapped to external ratings or supported by default studies.
- (f) Existing or forecast adverse changes in business, financial or economic conditions that are expected to cause a significant change in the borrower's ability to meet its debt obligations, such as an actual or expected increase in interest rates or an actual or expected significant increase in unemployment rates.
- (g) An actual or expected significant change in the operating results of the borrower. Examples include actual or expected declining revenues or margins, increasing operating risks, working capital deficiencies, decreasing asset quality, increased balance sheet leverage, liquidity, management problems or changes in the scope of operation or organizational structure (such as the discontinuance of a segment of the entity) that results in a significant change in the borrower's ability to meet its debt obligations.
- (h) Significant increases in credit risk on other financial instruments of the same borrower.

- (i) An actual or expected significant adverse change in the regulatory, economic, or technological environment of the borrower that results in a significant change in the borrower's ability to meet its debt obligations, such as a decline in the demand for the borrower's sales product because of a shift in technology.
- (j) Significant changes in the value of the collateral supporting the obligation or in the quality of third-party guarantees or credit enhancements, which are expected to reduce the borrower's economic incentive to make scheduled contractual payments or to otherwise have an effect on the probability of a default occurring. For example, if the value of collateral declines because house prices decline, borrowers in some jurisdictions have a greater incentive to default on their mortgages.
- (k) A significant change in the quality of the guarantee provided by an entity's owners (or an individual's guarantors) if the shareholder (or guarantors) have an incentive and financial ability to prevent default by capital or cash infusion.
- (l) Significant changes, such as reductions in financial support from a controlling entity or other affiliate or an actual or expected significant change in the quality of credit enhancement, that are expected to reduce the borrower's economic incentive to make scheduled contractual payments. Credit quality enhancements or support include the consideration of the financial condition of the guarantor and/or, for interests issued in securitizations, whether subordinated interests are expected to be capable of absorbing expected credit losses (for example, on the loans underlying the security).
- (m) Expected changes in the loan documentation including an expected breach of contract that may lead to covenant waivers or amendments, interest payment holidays, interest rate step-ups, requiring additional collateral or guarantees, or other changes to the contractual framework of the instrument.
- (n) Significant changes in the expected performance and behavior of the borrower, including changes in the payment status of borrowers in the economic entity (for example, an increase in the expected number or extent of delayed contractual payments).
- (o) Changes in the entity's credit management approach in relation to the financial instrument; i.e., based on emerging indicators of changes in the credit risk of the financial instrument, the entity's credit risk management practice is expected to become more active or to be focused on managing the instrument, including the instrument becoming more closely monitored or controlled, or the entity specifically intervening with the borrower.
- (p) Past due information, including the rebuttable presumption as set out in paragraph 83.

AG182. In some cases, the qualitative and non-statistical quantitative information available may be sufficient to determine that a financial instrument has met the criterion for the recognition of a loss allowance at an amount equal to lifetime expected credit losses. That is, the information does not need to flow through a statistical model or credit ratings process in order to determine whether there has been a significant increase in the credit risk of the financial instrument. In other cases, an entity may need to consider other information, including information from its statistical models or credit ratings processes. Alternatively, the entity may base the assessment on both types of information, i.e., qualitative factors that are not captured through the internal ratings process and a specific internal rating category at the reporting date, taking into consideration the credit risk characteristics at initial recognition, if both types of information are relevant.

More than 30 Days Past Due Rebuttable Presumption

AG183. The rebuttable presumption in paragraph 83 is not an absolute indicator that lifetime expected credit losses should be recognized, but is presumed to be the latest point at which lifetime expected credit losses should be recognized even when using forward-looking information (including macroeconomic factors on a portfolio level).

AG184. An entity can rebut this presumption. However, it can do so only when it has reasonable and supportable information available that demonstrates that even if contractual payments become more than 30 days past due, this does not represent a significant increase in the credit risk of a financial instrument. For example when non-payment was an administrative oversight, instead of resulting from financial difficulty of the borrower, or the entity has access to historical evidence that demonstrates that there is no correlation between significant increases in the risk of a default occurring and financial assets on which payments are more than 30 days past due, but that evidence does identify such a correlation when payments are more than 60 days past due.

AG185. An entity cannot align the timing of significant increases in credit risk and the recognition of lifetime expected credit losses to when a financial asset is regarded as credit-impaired or an entity's internal definition of default.

Financial Instruments that have Low Credit Risk at the Reporting Date

- AG186. The credit risk on a financial instrument is considered low for the purposes of paragraph 82, if the financial instrument has a low risk of default, the borrower has a strong capacity to meet its contractual cash flow obligations in the near term and adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil its contractual cash flow obligations. Financial instruments are not considered to have low credit risk when they are regarded as having a low risk of loss simply because of the value of collateral and the financial instrument without that collateral would not be considered low credit risk. Financial instruments are also not considered to have low credit risk simply because they have a lower risk of default than the entity's other financial instruments or relative to the credit risk of the jurisdiction within which an entity operates.
- AG187. To determine whether a financial instrument has low credit risk, an entity may use its internal credit risk ratings or other methodologies that are consistent with a globally understood definition of low credit risk and that consider the risks and the type of financial instruments that are being assessed. An external rating of 'investment grade' is an example of a financial instrument that may be considered as having low credit risk. However, financial instruments are not required to be externally rated to be considered to have low credit risk. They should, however, be considered to have low credit risk from a market participant perspective taking into account all of the terms and conditions of the financial instrument.
- AG188. Lifetime expected credit losses are not recognized on a financial instrument simply because it was considered to have low credit risk in the previous reporting period and is not considered to have low credit risk at the reporting date. In such a case, an entity shall determine whether there has been a significant increase in credit risk since initial recognition and thus whether lifetime expected credit losses are required to be recognized in accordance with paragraph 75.

Modifications

- AG189. In some circumstances, the renegotiation or modification of the contractual cash flows of a financial asset can lead to the derecognition of the existing financial asset in accordance with this Standard. When the modification of a financial asset results in the derecognition of the existing financial asset and the subsequent recognition of the modified financial asset, the modified asset is considered a 'new' financial asset for the purposes of this Standard.
- AG190. Accordingly the date of the modification shall be treated as the date of initial recognition of that financial asset when applying the impairment requirements to the modified financial asset. This typically means measuring the loss allowance at an amount equal to 12-month expected credit losses until the requirements for the recognition of lifetime expected credit losses in paragraph 75 are met. However, in some unusual circumstances following a modification that results in derecognition of the original financial asset, there may be evidence that the modified financial asset is credit-impaired at initial recognition, and thus, the financial asset should be recognized as an originated credit-impaired financial asset. This might occur, for example, in a situation in which there was a substantial modification of a distressed asset that resulted in the derecognition of the original financial asset. In such a case, it may be possible for the modification to result in a new financial asset which is credit-impaired at initial recognition.
- AG191. If the contractual cash flows on a financial asset have been renegotiated or otherwise modified, but the financial asset is not derecognized, that financial asset is not automatically considered to have lower credit risk. An entity shall assess whether there has been a significant increase in credit risk since initial recognition on the basis of all reasonable and supportable information that is available without undue cost or effort. This includes historical and forward-looking information and an assessment of the credit risk over the expected life of the financial asset, which includes information about the circumstances that led to the modification. Evidence that the criteria for the recognition of lifetime expected credit losses are no longer met may include a history of up-to-date and timely payment performance against the modified contractual terms. Typically a borrower would need to demonstrate consistently good payment behavior over a period of time before the credit risk is considered to have decreased. For example, a history of missed or incomplete payments would not typically be erased by simply making one payment on time following a modification of the contractual terms.

Measurement of Expected Credit Losses**Expected Credit Losses**

- AG192. Expected credit losses are a probability-weighted estimate of credit losses (i.e., the present value of all cash shortfalls) over the expected life of the financial instrument. A cash shortfall is the difference between the cash flows that are due to an entity in accordance with the contract and the cash flows that the entity expects to receive. Because expected credit losses consider the amount and timing of payments, a credit loss arises even if the entity expects to be paid in full but later than when contractually due.
- AG193. For financial assets, a credit loss is the present value of the difference between:

- (a) The contractual cash flows that are due to an entity under the contract; and
- (b) The cash flows that the entity expects to receive.

AG194. For undrawn loan commitments, a credit loss is the present value of the difference between:

- (a) The contractual cash flows that are due to the entity if the holder of the loan commitment draws down the loan; and
- (b) The cash flows that the entity expects to receive if the loan is drawn down.

AG195. An entity's estimate of expected credit losses on loan commitments shall be consistent with its expectations of drawdowns on that loan commitment, i.e., it shall consider the expected portion of the loan commitment that will be drawn down within 12 months of the reporting date when estimating 12-month expected credit losses, and the expected portion of the loan commitment that will be drawn down over the expected life of the loan commitment when estimating lifetime expected credit losses.

AG196. For a financial guarantee contract, the entity is required to make payments only in the event of a default by the debtor in accordance with the terms of the instrument that is guaranteed. Accordingly, cash shortfalls are the expected payments to reimburse the holder for a credit loss that it incurs less any amounts that the entity expects to receive from the holder, the debtor or any other party. If the asset is fully guaranteed, the estimation of cash shortfalls for a financial guarantee contract would be consistent with the estimations of cash shortfalls for the asset subject to the guarantee.

AG197. For a financial asset that is credit-impaired at the reporting date, but that is not a purchased or originated credit-impaired financial asset, an entity shall measure the expected credit losses as the difference between the asset's gross carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. Any adjustment is recognized in surplus or deficit as an impairment gain or loss.

AG198. When measuring a loss allowance for a lease receivable, the cash flows used for determining the expected credit losses should be consistent with the cash flows used in measuring the lease receivable in accordance with IPSAS 43, *Leases*.

AG199. An entity may use practical expedients when measuring expected credit losses if they are consistent with the principles in paragraph 90. An example of a practical expedient is the calculation of the expected credit losses on receivables using a provision matrix. The entity would use its historical credit loss experience (adjusted as appropriate in accordance with paragraphs AG215–AG216) for receivables to estimate the 12-month expected credit losses or the lifetime expected credit losses on the financial assets as relevant. A provision matrix might, for example, specify fixed provision rates depending on the number of days that a trade receivable is past due (for example, 1 percent if not past due, 2 percent if less than 30 days past due, 3 percent if more than 30 days but less than 90 days past due, 20 percent if 90-180 days past due etc.). Depending on the diversity of its customer base, the entity would use appropriate groupings if its historical credit loss experience shows significantly different loss patterns for different customer segments. Examples of criteria that might be used to group assets include geographical region, product type, customer rating, collateral or trade credit insurance and type of customer (such as other government entities or individuals).

Definition of Default

AG200. Paragraph 81 requires that when determining whether the credit risk on a financial instrument has increased significantly, an entity shall consider the change in the risk of a default occurring since initial recognition.

AG201. When defining default for the purposes of determining the risk of a default occurring, an entity shall apply a default definition that is consistent with the definition used for internal credit risk management purposes for the relevant financial instrument and consider qualitative indicators (for example, financial covenants) when appropriate. However, there is a rebuttable presumption that default does not occur later than when a financial asset is 90 days past due unless an entity has reasonable and supportable information to demonstrate that a more lagging default criterion is more appropriate. The definition of default used for these purposes shall be applied consistently to all financial instruments unless information becomes available that demonstrates that another default definition is more appropriate for a particular financial instrument.

Period Over Which to Estimate Expected Credit Losses

AG202. In accordance with paragraph 92, the maximum period over which expected credit losses shall be measured is the maximum contractual period over which the entity is exposed to credit risk. For loan commitments and financial guarantee contracts, this is the maximum contractual period over which an entity has a present contractual obligation to extend credit.

AG203. However, in accordance with paragraph 93, some financial instruments include both a loan and an undrawn commitment component and the entity's contractual ability to demand repayment and cancel the undrawn commitment does not limit the entity's exposure to credit losses to the contractual notice period. For example, revolving credit facilities, such as line of credit provided by a government owned bank, can be contractually withdrawn by the lender with as little as one day's notice. However, in practice lenders continue to extend credit for a longer period and may only withdraw the facility after the credit risk of the borrower increases, which could be too late to prevent some or all of the expected credit losses. These financial instruments generally have the following characteristics as a result of the nature of the financial instrument, the way in which the financial instruments are managed, and the nature of the available information about significant increases in credit risk:

- (a) The financial instruments do not have a fixed term or repayment structure and usually have a short contractual cancellation period (for example, one day);
- (b) The contractual ability to cancel the contract is not enforced in the normal day-to-day management of the financial instrument and the contract may only be canceled when the entity becomes aware of an increase in credit risk at the facility level; and
- (c) The financial instruments are managed on a collective basis.

AG204. When determining the period over which the entity is expected to be exposed to credit risk, but for which expected credit losses would not be mitigated by the entity's normal credit risk management actions, an entity should consider factors such as historical information and experience about:

- (a) The period over which the entity was exposed to credit risk on similar financial instruments;
- (b) The length of time for related defaults to occur on similar financial instruments following a significant increase in credit risk; and
- (c) The credit risk management actions that an entity expects to take once the credit risk on the financial instrument has increased, such as the reduction or removal of undrawn limits.

Probability-weighted Outcome

AG205. The purpose of estimating expected credit losses is neither to estimate a worst-case scenario nor to estimate the best-case scenario. Instead, an estimate of expected credit losses shall always reflect the possibility that a credit loss occurs and the possibility that no credit loss occurs even if the most likely outcome is no credit loss.

AG206. Paragraph 90(a) requires the estimate of expected credit losses to reflect an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes. In practice, this may not need to be a complex analysis. In some cases, relatively simple modelling may be sufficient, without the need for a large number of detailed simulations of scenarios. For example, the average credit losses of a large group of financial instruments with shared risk characteristics may be a reasonable estimate of the probability-weighted amount. In other situations, the identification of scenarios that specify the amount and timing of the cash flows for particular outcomes and the estimated probability of those outcomes will probably be needed. In those situations, the expected credit losses shall reflect at least two outcomes in accordance with paragraph 91.

AG207. For lifetime expected credit losses, an entity shall estimate the risk of a default occurring on the financial instrument during its expected life. 12-month expected credit losses are a portion of the lifetime expected credit losses and represent the lifetime cash shortfalls that will result if a default occurs in the 12 months after the reporting date (or a shorter period if the expected life of a financial instrument is less than 12 months), weighted by the probability of that default occurring. Thus, 12-month expected credit losses are neither the lifetime expected credit losses that an entity will incur on financial instruments that it predicts will default in the next 12 months nor the cash shortfalls that are predicted over the next 12 months.

Time Value of Money

AG208. Expected credit losses shall be discounted to the reporting date, not to the expected default or some other date, using the effective interest rate determined at initial recognition or an approximation thereof. If a financial instrument has a variable interest rate, expected credit losses shall be discounted using the current effective interest rate determined in accordance with paragraph AG160.

AG209. For purchased or originated credit-impaired financial assets, expected credit losses shall be discounted using the credit-adjusted effective interest rate determined at initial recognition.

- AG210. Expected credit losses on lease receivables shall be discounted using the same discount rate used in the measurement of the lease receivable in accordance with IPSAS 43, *Leases*.
- AG211. The expected credit losses on a loan commitment shall be discounted using the effective interest rate, or an approximation thereof, that will be applied when recognizing the financial asset resulting from the loan commitment. This is because for the purpose of applying the impairment requirements, a financial asset that is recognized following a draw down on a loan commitment shall be treated as a continuation of that commitment instead of as a new financial instrument. The expected credit losses on the financial asset shall therefore be measured considering the initial credit risk of the loan commitment from the date that the entity became a party to the irrevocable commitment.
- AG212. Expected credit losses on financial guarantee contracts or on loan commitments for which the effective interest rate cannot be determined shall be discounted by applying a discount rate that reflects the current market assessment of the time value of money and the risks that are specific to the cash flows but only if, and to the extent that, the risks are taken into account by adjusting the discount rate instead of adjusting the cash shortfalls being discounted.

Reasonable and Supportable Information

- AG213. For the purpose of this Standard, reasonable and supportable information is that which is reasonably available at the reporting date without undue cost or effort, including information about past events, current conditions and forecasts of future economic conditions. Information that is available for financial reporting purposes is considered to be available without undue cost or effort.
- AG214. An entity is not required to incorporate forecasts of future conditions over the entire expected life of a financial instrument. The degree of judgment that is required to estimate expected credit losses depends on the availability of detailed information. As the forecast horizon increases, the availability of detailed information decreases and the degree of judgment required to estimate expected credit losses increases. The estimate of expected credit losses does not require a detailed estimate for periods that are far in the future—for such periods, an entity may extrapolate projections from available, detailed information.
- AG215. An entity need not undertake an exhaustive search for information but shall consider all reasonable and supportable information that is available without undue cost or effort and that is relevant to the estimate of expected credit losses, including the effect of expected prepayments. The information used shall include factors that are specific to the borrower, general economic conditions and an assessment of both the current as well as the forecast direction of conditions at the reporting date. An entity may use various sources of data that may be both internal (entity-specific) and external. Possible data sources include internal historical credit loss experience, internal ratings, credit loss experience of other entities and external ratings, reports and statistics. Entities that have no, or insufficient, sources of entity-specific data may use peer group experience for the comparable financial instrument (or groups of financial instruments).
- AG216. Historical information is an important anchor or base from which to measure expected credit losses. However, an entity shall adjust historical data, such as credit loss experience, on the basis of current observable data to reflect the effects of the current conditions and its forecasts of future conditions that did not affect the period on which the historical data is based, and to remove the effects of the conditions in the historical period that are not relevant to the future contractual cash flows. In some cases, the best reasonable and supportable information could be the unadjusted historical information, depending on the nature of the historical information and when it was calculated, compared to circumstances at the reporting date and the characteristics of the financial instrument being considered. Estimates of changes in expected credit losses should reflect, and be directionally consistent with, changes in related observable data from period to period (such as changes in unemployment rates, property prices, commodity prices, payment status or other factors that are indicative of credit losses on the financial instrument or in the group of financial instruments and in the magnitude of those changes). An entity shall regularly review the methodology and assumptions used for estimating expected credit losses to reduce any differences between estimates and actual credit loss experience.
- AG217. When using historical credit loss experience in estimating expected credit losses, it is important that information about historical credit loss rates is applied to groups that are defined in a manner that is consistent with the groups for which the historical credit loss rates were observed. Consequently, the method used shall enable each group of financial assets to be associated with information about past credit loss experience in groups of financial assets with similar risk characteristics and with relevant observable data that reflects current conditions.
- AG218. Expected credit losses reflect an entity's own expectations of credit losses. However, when considering all reasonable and supportable information that is available without undue cost or effort in estimating expected credit losses, an entity should also consider observable market information about the credit risk of the particular financial instrument or similar financial instruments.

Collateral

AG219. For the purposes of measuring expected credit losses, the estimate of expected cash shortfalls shall reflect the cash flows expected from collateral and other credit enhancements that are part of the contractual terms and are not recognized separately by the entity. The estimate of expected cash shortfalls on a collateralized financial instrument reflects the amount and timing of cash flows that are expected from foreclosure on the collateral less the costs of obtaining and selling the collateral, irrespective of whether foreclosure is probable (i.e., the estimate of expected cash flows considers the probability of a foreclosure and the cash flows that would result from it). Consequently, any cash flows that are expected from the realization of the collateral beyond the contractual maturity of the contract should be included in this analysis. Any collateral obtained as a result of foreclosure is not recognized as an asset that is separate from the collateralized financial instrument unless it meets the relevant recognition criteria for an asset in this or other Standards.

Reclassification of Financial Assets

AG220. If an entity reclassifies financial assets in accordance with paragraph 54, paragraph 94 requires that the reclassification is applied prospectively from the reclassification date. Both the amortized cost measurement category and the fair value through net assets/equity measurement category require that the effective interest rate is determined at initial recognition. Both of those measurement categories also require that the impairment requirements are applied in the same way. Consequently, when an entity reclassifies a financial asset between the amortized cost measurement category and the fair value through net assets/equity measurement category:

- (a) The recognition of interest revenue will not change and therefore the entity continues to use the same effective interest rate.
- (b) The measurement of expected credit losses will not change because both measurement categories apply the same impairment approach. However if a financial asset is reclassified out of the fair value through net assets/equity measurement category and into the amortized cost measurement category, a loss allowance would be recognized as an adjustment to the gross carrying amount of the financial asset from the reclassification date. If a financial asset is reclassified out of the amortized cost measurement category and into the fair value through net assets/equity measurement category, the loss allowance would be derecognized (and thus would no longer be recognized as an adjustment to the gross carrying amount) but instead would be recognized as an accumulated impairment amount (of an equal amount) in net assets/equity and would be disclosed from the reclassification date.

AG221. However, an entity is not required to separately recognize interest revenue or impairment gains or losses for a financial asset measured at fair value through surplus or deficit. Consequently, when an entity reclassifies a financial asset out of the fair value through surplus or deficit measurement category, the effective interest rate is determined on the basis of the fair value of the asset at the reclassification date. In addition, for the purposes of applying paragraphs 73–93 to the financial asset from the reclassification date, the date of the reclassification is treated as the date of initial recognition.

Gains and Losses

AG222. Paragraph 106 permits an entity to make an irrevocable election to present in net assets/equity changes in the fair value of an investment in an equity instrument that is not held for trading. This election is made on an instrument-by-instrument (i.e., share-by-share) basis. Amounts presented in net assets/equity shall not be subsequently transferred to surplus or deficit. However, the entity may transfer the cumulative gain or loss within net assets/equity. Dividends or similar distributions on such investments are recognized in surplus or deficit in accordance with paragraph 107 unless the dividend clearly represents a recovery of part of the cost of the investment.

AG223. Unless paragraph 44 applies, paragraph 41 requires that a financial asset is measured at fair value through net assets/equity if the contractual terms of the financial asset give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding and the asset is held in a management model whose objective is achieved by both collecting contractual cash flows and selling financial assets. This measurement category recognizes information in surplus or deficit as if the financial asset is measured at amortized cost, while the financial asset is measured in the statement of financial position at fair value. Gains or losses, other than those that are recognized in surplus or deficit in accordance with paragraphs 111–112, are recognized in net assets/equity. When these financial assets are derecognized, cumulative gains or losses previously recognized in net assets/equity are reclassified to surplus or deficit. This reflects the gain or loss that would have been recognized in surplus or deficit upon derecognition if the financial asset had been measured at amortized cost.

AG224. An entity applies IPSAS 4 to financial assets and financial liabilities that are monetary items in accordance with IPSAS 4 and denominated in a foreign currency. IPSAS 4 requires any foreign exchange gains and losses on monetary assets and

monetary liabilities to be recognized in surplus or deficit. An exception is a monetary item that is designated as a hedging instrument in a cash flow hedge (see paragraph 140), a hedge of a net investment (see paragraph 142) or a fair value hedge of an equity instrument for which an entity has elected to present changes in fair value in net assets/equity in accordance with paragraph 106 (see paragraph 137).

- AG225. For the purpose of recognizing foreign exchange gains and losses under IPSAS 4, a financial asset measured at fair value through net assets/equity in accordance with paragraph 41 is treated as a monetary item. Accordingly, such a financial asset is treated as an asset measured at amortized cost in the foreign currency. Exchange differences on the amortized cost are recognized in surplus or deficit and other changes in the carrying amount are recognized in accordance with paragraph 111.
- AG226. Paragraph 106 permits an entity to make an irrevocable election to present in net assets/equity subsequent changes in the fair value of particular investments in equity instruments. Such an investment is not a monetary item. Accordingly, the gain or loss that is presented in net assets/equity in accordance with paragraph 106 includes any related foreign exchange component.
- AG227. If there is a hedging relationship between a non-derivative monetary asset and a non-derivative monetary liability, changes in the foreign currency component of those financial instruments are presented in surplus or deficit.

Liabilities Designated as at Fair Value through Surplus or Deficit

- AG228. When an entity designates a financial liability as at fair value through surplus or deficit, it must determine whether presenting in net assets/equity the effects of changes in the liability's credit risk would create or enlarge an accounting mismatch in surplus or deficit. An accounting mismatch would be created or enlarged if presenting the effects of changes in the liability's credit risk in net assets/equity would result in a greater mismatch in surplus or deficit than if those amounts were presented in surplus or deficit.
- AG229. To make that determination, an entity must assess whether it expects that the effects of changes in the liability's credit risk will be offset in surplus or deficit by a change in the fair value of another financial instrument measured at fair value through surplus or deficit. Such an expectation must be based on an economic relationship between the characteristics of the liability and the characteristics of the other financial instrument.
- AG230. That determination is made at initial recognition and is not reassessed. For practical purposes the entity need not enter into all of the assets and liabilities giving rise to an accounting mismatch at exactly the same time. A reasonable delay is permitted provided that any remaining transactions are expected to occur. An entity must apply consistently its methodology for determining whether presenting in net assets/equity the effects of changes in the liability's credit risk would create or enlarge an accounting mismatch in surplus or deficit. However, an entity may use different methodologies when there are different economic relationships between the characteristics of the liabilities designated as at fair value through surplus or deficit and the characteristics of the other financial instruments. IPSAS 30 requires an entity to provide qualitative disclosures in the notes to the financial statements about its methodology for making that determination.
- AG231. If such a mismatch would be created or enlarged, the entity is required to present all changes in fair value (including the effects of changes in the credit risk of the liability) in surplus or deficit. If such a mismatch would not be created or enlarged, the entity is required to present the effects of changes in the liability's credit risk in net assets/equity.
- AG232. Amounts presented in net assets/equity shall not be subsequently transferred to surplus or deficit. However, the entity may transfer the cumulative gain or loss within equity.
- AG233. The following example describes a situation in which an accounting mismatch would be created in surplus or deficit if the effects of changes in the credit risk of the liability were presented in net assets/equity. A Federal Mortgage and Housing Corporation provides loans to customers and funds those loans by selling bonds with matching characteristics (e.g., amount outstanding, repayment profile, term and currency) in the market. The contractual terms of the loan permit the mortgage customer to prepay its loan (i.e., satisfy its obligation to the bank) by buying the corresponding bond at fair value in the market and delivering that bond to the Mortgage and Housing Corporation. As a result of that contractual prepayment right, if the credit quality of the bond worsens (and, thus, the fair value of the Mortgage and Housing Corporation's liability decreases), the fair value of the Mortgage and Housing Corporation's loan asset also decreases. The change in the fair value of the asset reflects the mortgage customer's contractual right to prepay the mortgage loan by buying the underlying bond at fair value (which, in this example, has decreased) and delivering the bond to the Mortgage and Housing Corporation. Consequently, the effects of changes in the credit risk of the liability (the bond) will be offset in surplus or deficit by a corresponding change in the fair value of a financial asset (the loan). If the effects of changes in the liability's credit risk were presented in net assets/equity there would be an accounting mismatch in surplus or deficit. Consequently, the Mortgage and Housing Corporation is required to present all changes in fair value of the liability (including the effects of changes in the liability's credit risk) in surplus or deficit.

- AG234. In the example in paragraph AG233, there is a contractual linkage between the effects of changes in the credit risk of the liability and changes in the fair value of the financial asset (i.e., as a result of the mortgage customer's contractual right to prepay the loan by buying the bond at fair value and delivering the bond to the Mortgage and Housing Corporation). However, an accounting mismatch may also occur in the absence of a contractual linkage.
- AG235. For the purposes of applying the requirements in paragraphs 108 and 109, an accounting mismatch is not caused solely by the measurement method that an entity uses to determine the effects of changes in a liability's credit risk. An accounting mismatch in surplus or deficit would arise only when the effects of changes in the liability's credit risk (as defined in IPSAS 30) are expected to be offset by changes in the fair value of another financial instrument. A mismatch that arises solely as a result of the measurement method (i.e., because an entity does not isolate changes in a liability's credit risk from some other changes in its fair value) does not affect the determination required by paragraphs 108 and 109. For example, an entity may not isolate changes in a liability's credit risk from changes in liquidity risk. If the entity presents the combined effect of both factors in net assets/equity, a mismatch may occur because changes in liquidity risk may be included in the fair value measurement of the entity's financial assets and the entire fair value change of those assets is presented in surplus or deficit. However, such a mismatch is caused by measurement imprecision, not the offsetting relationship described in paragraph AG229 and, therefore, does not affect the determination required by paragraphs 108 and 109.

The Meaning of 'Credit Risk' (paragraphs 108 and 109)

- AG236. IPSAS 30 defines credit risk as 'the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation'. The requirement in paragraph 108(a) relates to the risk that the issuer will fail to perform on that particular liability. It does not necessarily relate to the creditworthiness of the issuer. For example, if an entity issues a collateralized liability and a non-collateralized liability that are otherwise identical, the credit risk of those two liabilities will be different, even though they are issued by the same entity. The credit risk on the collateralized liability will be less than the credit risk of the non-collateralized liability. The credit risk for a collateralized liability may be close to zero.
- AG237. For the purposes of applying the requirement in paragraph 108(a), credit risk is different from asset-specific performance risk. Asset-specific performance risk is not related to the risk that an entity will fail to discharge a particular obligation but instead it is related to the risk that a single asset or a group of assets will perform poorly (or not at all).
- AG238. The following are examples of asset-specific performance risk:
- (a) A liability with a unit-linking feature whereby the amount due to investors is contractually determined on the basis of the performance of specified assets. The effect of that unit-linking feature on the fair value of the liability is asset-specific performance risk, not credit risk.
 - (b) A liability issued by a structured entity with the following characteristics. The entity is legally isolated so the assets in the entity are ring-fenced solely for the benefit of its investors, even in the event of bankruptcy. The entity enters into no other transactions and the assets in the entity cannot be hypothecated. Amounts are due to the entity's investors only if the ring-fenced assets generate cash flows. Thus, changes in the fair value of the liability primarily reflect changes in the fair value of the assets. The effect of the performance of the assets on the fair value of the liability is asset-specific performance risk, not credit risk.

Determining the Effects of Changes in Credit Risk

- AG239. For the purposes of applying the requirement in paragraph 108(a), an entity shall determine the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability either:
- (a) As the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk (see paragraphs AG240 and AG241); or
 - (b) Using an alternative method the entity believes more faithfully represents the amount of change in the liability's fair value that is attributable to changes in its credit risk.
- AG240. Changes in market conditions that give rise to market risk include changes in a benchmark interest rate, the price of another entity's financial instrument, a commodity price, a foreign exchange rate or an index of prices or rates.
- AG241. If the only significant relevant changes in market conditions for a liability are changes in an observed (benchmark) interest rate, the amount in paragraph AG239(a) can be estimated as follows:
- (a) First, the entity computes the liability's internal rate of return at the start of the period using the fair value of the liability and the liability's contractual cash flows at the start of the period. It deducts from this rate of return the

observed (benchmark) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.

- (b) Next, the entity calculates the present value of the cash flows associated with the liability using the liability's contractual cash flows at the end of the period and a discount rate equal to the sum of (i) the observed (benchmark) interest rate at the end of the period and (ii) the instrument-specific component of the internal rate of return as determined in (a).
- (c) The difference between the fair value of the liability at the end of the period and the amount determined in (b) is the change in fair value that is not attributable to changes in the observed (benchmark) interest rate. This is the amount to be presented in net assets/equity in accordance with paragraph 108(a).

AG242. The example in paragraph AG241 assumes that changes in fair value arising from factors other than changes in the instrument's credit risk or changes in observed (benchmark) interest rates are not significant. This method would not be appropriate if changes in fair value arising from other factors are significant. In those cases, an entity is required to use an alternative method that more faithfully measures the effects of changes in the liability's credit risk (see paragraph AG239(b)). For example, if the instrument in the example contains an embedded derivative, the change in fair value of the embedded derivative is excluded in determining the amount to be presented in net assets/equity in accordance with paragraph 108(a).

AG243. As with all fair value measurements, an entity's measurement method for determining the portion of the change in the liability's fair value that is attributable to changes in its credit risk must make maximum use of relevant observable inputs and minimum use of unobservable inputs.

Hedge Accounting

Hedging Instruments

Qualifying Instruments

AG244. Derivatives that are embedded in hybrid contracts, but that are not separately accounted for, cannot be designated as separate hedging instruments.

AG245. An entity's own equity instruments are not financial assets or financial liabilities of the entity and therefore cannot be designated as hedging instruments.

AG246. For hedges of foreign currency risk, the foreign currency risk component of a non-derivative financial instrument is determined in accordance with IPSAS 4.

Written Options

AG247. This Standard does not restrict the circumstances in which a derivative that is measured at fair value through surplus or deficit may be designated as a hedging instrument, except for some written options. A written option does not qualify as a hedging instrument unless it is designated as an offset to a purchased option, including one that is embedded in another financial instrument (for example, a written call option used to hedge a callable liability).

Designation of Hedging Instruments

AG248. For hedges other than hedges of foreign currency risk, when an entity designates a non-derivative financial asset or a non-derivative financial liability measured at fair value through surplus or deficit as a hedging instrument, it may only designate the non-derivative financial instrument in its entirety or a proportion of it.

AG249. A single hedging instrument may be designated as a hedging instrument of more than one type of risk, provided that there is a specific designation of the hedging instrument and of the different risk positions as hedged items. Those hedged items can be in different hedging relationships.

Hedged Items

Qualifying Items

AG250. A firm commitment to acquire an operation in a public sector combination cannot be a hedged item, except for foreign currency risk, because the other risks being hedged cannot be specifically identified and measured. Those other risks are general business risks.

AG251. An equity method investment cannot be a hedged item in a fair value hedge. This is because the equity method recognizes in surplus or deficit the investor's share of the investee's surplus or deficit, instead of changes in the investment's fair value.

For a similar reason, an investment in a consolidated controlled entity cannot be a hedged item in a fair value hedge. This is because consolidation recognizes in surplus or deficit the controlled entity's surplus or deficit, instead of changes in the investment's fair value. A hedge of a net investment in a foreign operation is different because it is a hedge of the foreign currency exposure, not a fair value hedge of the change in the value of the investment.

AG252. Paragraph 125 permits an entity to designate as hedged items aggregated exposures that are a combination of an exposure and a derivative. When designating such a hedged item, an entity assesses whether the aggregated exposure combines an exposure with a derivative so that it creates a different aggregated exposure that is managed as one exposure for a particular risk (or risks). In that case, the entity may designate the hedged item on the basis of the aggregated exposure. For example:

- (a) An entity may hedge a given quantity of highly probable oil purchases in 15 months' time against price risk (based on US dollars) using a 15-month futures contract for oil. The highly probable oil purchases and the futures contract for oil in combination can be viewed as a 15-month fixed-amount US dollar foreign currency risk exposure for risk management purposes (i.e., like any fixed-amount US dollar cash outflow in 15 months' time).
- (b) An entity may hedge the foreign currency risk for the entire term of a 10-year fixed-rate debt denominated in a foreign currency. However, the entity requires fixed-rate exposure in its functional currency only for a short to medium-term (say two years) and floating rate exposure in its functional currency for the remaining term to maturity. At the end of each of the two-year intervals (i.e., on a two-year rolling basis) the entity fixes the next two years' interest rate exposure (if the interest level is such that the entity wants to fix interest rates). In such a situation an entity may enter into a 10-year fixed-to-floating cross-currency interest rate swap that swaps the fixed-rate foreign currency debt into a variable-rate functional currency exposure. This is overlaid with a two-year interest rate swap that—on the basis of the functional currency—swaps variable-rate debt into fixed-rate debt. In effect, the fixed-rate foreign currency debt and the 10-year fixed-to-floating cross-currency interest rate swap in combination are viewed as a 10-year variable-rate debt functional currency exposure for risk management purposes.

AG253. When designating the hedged item on the basis of the aggregated exposure, an entity considers the combined effect of the items that constitute the aggregated exposure for the purpose of assessing hedge effectiveness and measuring hedge ineffectiveness. However, the items that constitute the aggregated exposure remain accounted for separately. This means that, for example:

- (a) Derivatives that are part of an aggregated exposure are recognized as separate assets or liabilities measured at fair value; and
- (b) If a hedging relationship is designated between the items that constitute the aggregated exposure, the way in which a derivative is included as part of an aggregated exposure must be consistent with the designation of that derivative as the hedging instrument at the level of the aggregated exposure. For example, if an entity excludes the forward element of a derivative from its designation as the hedging instrument for the hedging relationship between the items that constitute the aggregated exposure, it must also exclude the forward element when including that derivative as a hedged item as part of the aggregated exposure. Otherwise, the aggregated exposure shall include a derivative, either in its entirety or a proportion of it.

AG254. Paragraph 127 states that in consolidated financial statements the foreign currency risk of a highly probable forecast transaction within an economic entity may qualify as a hedged item in a cash flow hedge, provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and that the foreign currency risk will affect consolidated surplus or deficit. For this purpose an entity can be a controlling entity, controlled entity, associate, joint arrangement or branch. If the foreign currency risk of a forecast transaction within the economic entity does not affect consolidated surplus or deficit, the transaction cannot qualify as a hedged item. This is usually the case for royalty payments, interest payments or management charges between members of the same economic entity, unless there is a related external transaction. However, when the foreign currency risk of a forecast transaction within an economic entity will affect consolidated surplus or deficit, the transaction within the economic entity can qualify as a hedged item. An example is forecast sales or purchases of inventories between members of the same economic entity if there is an onward sale of the inventory to a party external to the economic entity. Similarly, a forecast sale of plant and equipment within the economic entity from the entity that manufactured it to an entity that will use the plant and equipment in its operations may affect consolidated surplus or deficit. This could occur, for example, because the plant and equipment will be depreciated by the purchasing entity and the amount initially recognized for the plant and equipment may change if the forecast transaction within the economic entity is denominated in a currency other than the functional currency of the purchasing entity.

AG255. If a hedge of a forecast transaction within an economic entity qualifies for hedge accounting, any gain or loss is recognized in, and taken out of, net assets/equity in accordance with paragraph 140. The relevant period or periods during which the foreign currency risk of the hedged transaction affects surplus or deficit is when it affects consolidated surplus or deficit.

Designation of Hedged Items

AG256. A component is a hedged item that is less than the entire item. Consequently, a component reflects only some of the risks of the item of which it is a part or reflects the risks only to some extent (for example, when designating a proportion of an item).

Risk Components

AG257. To be eligible for designation as a hedged item, a risk component must be a separately identifiable component of the financial or the non-financial item, and the changes in the cash flows or the fair value of the item attributable to changes in that risk component must be reliably measurable.

AG258. When identifying what risk components qualify for designation as a hedged item, an entity assesses such risk components within the context of the particular market structure to which the risk or risks relate and in which the hedging activity takes place. Such a determination requires an evaluation of the relevant facts and circumstances, which differ by risk and market.

AG259. When designating risk components as hedged items, an entity considers whether the risk components are explicitly specified in a contract (contractually specified risk components) or whether they are implicit in the fair value or the cash flows of an item of which they are a part (non-contractually specified risk components). Non-contractually specified risk components can relate to items that are not a contract (for example, forecast transactions) or contracts that do not explicitly specify the component (for example, a firm commitment that includes only one single price instead of a pricing formula that references different underlyings). For example:

- (a) Entity A has a long-term supply contract for natural gas that is priced using a contractually specified formula that references commodities and other factors (for example, gas oil, fuel oil and other components such as transport charges). Entity A hedges the gas oil component in that supply contract using a gas oil forward contract. Because the gas oil component is specified by the terms and conditions of the supply contract it is a contractually specified risk component. Hence, because of the pricing formula, Entity A concludes that the gas oil price exposure is separately identifiable. At the same time, there is a market for gas oil forward contracts. Hence, Entity A concludes that the gas oil price exposure is reliably measurable. Consequently, the gas oil price exposure in the supply contract is a risk component that is eligible for designation as a hedged item.
- (b) Entity B hedges its future coffee purchases based on its production forecast. Hedging starts up to 15 months before delivery for part of the forecast purchase volume. Entity B increases the hedged volume over time (as the delivery date approaches). Entity B uses two different types of contracts to manage its coffee price risk:
 - (i) Exchange-traded coffee futures contracts; and
 - (ii) Coffee supply contracts for Arabica coffee from Colombia delivered to a specific manufacturing site. These contracts price a tonne of coffee based on the exchange-traded coffee futures contract price plus a fixed price differential plus a variable logistics services charge using a pricing formula. The coffee supply contract is an executory contract in accordance with which Entity B takes actual delivery of coffee.

For deliveries that relate to the current harvest, entering into the coffee supply contracts allows Entity B to fix the price differential between the actual coffee quality purchased (Arabica coffee from Colombia) and the benchmark quality that is the underlying of the exchange-traded futures contract. However, for deliveries that relate to the next harvest, the coffee supply contracts are not yet available, so the price differential cannot be fixed. Entity B uses exchange-traded coffee futures contracts to hedge the benchmark quality component of its coffee price risk for deliveries that relate to the current harvest as well as the next harvest. Entity B determines that it is exposed to three different risks: coffee price risk reflecting the benchmark quality, coffee price risk reflecting the difference (spread) between the price for the benchmark quality coffee and the particular Arabica coffee from Colombia that it actually receives, and the variable logistics costs. For deliveries related to the current harvest, after Entity B enters into a coffee supply contract, the coffee price risk reflecting the benchmark quality is a contractually specified risk component because the pricing formula includes an indexation to the exchange-traded coffee futures contract price. Entity B concludes that this risk component is separately identifiable and reliably measurable. For deliveries related to the next harvest, Entity B has not yet entered into any coffee supply contracts (i.e., those deliveries are forecast transactions). Hence, the coffee price risk reflecting the benchmark quality is a non-contractually specified risk component. Entity B's analysis of the market structure takes into account how eventual deliveries of the particular coffee that it receives are priced. Hence, on the basis of this analysis of the market structure, Entity B concludes that the forecast transactions also involve the coffee price risk that reflects the benchmark quality as a risk component that is separately identifiable and reliably measurable even though it is not contractually specified.

Consequently, Entity B may designate hedging relationships on a risk components basis (for the coffee price risk that reflects the benchmark quality) for coffee supply contracts as well as forecast transactions.

- (c) Entity C hedges part of its future jet fuel purchases on the basis of its consumption forecast up to 24 months before delivery and increases the volume that it hedges over time. Entity C hedges this exposure using different types of contracts depending on the time horizon of the hedge, which affects the market liquidity of the derivatives. For the longer time horizons (12–24 months) Entity C uses crude oil contracts because only these have sufficient market liquidity. For time horizons of 6–12 months Entity C uses gas oil derivatives because they are sufficiently liquid. For time horizons up to six months Entity C uses jet fuel contracts. Entity C’s analysis of the market structure for oil and oil products and its evaluation of the relevant facts and circumstances is as follows:
- (i) Entity C operates in a geographical area in which Brent is the crude oil benchmark. Crude oil is a raw material benchmark that affects the price of various refined oil products as their most basic input. Gas oil is a benchmark for refined oil products, which is used as a pricing reference for oil distillates more generally. This is also reflected in the types of derivative financial instruments for the crude oil and refined oil products markets of the environment in which Entity C operates, such as:
 - The benchmark crude oil futures contract, which is for Brent crude oil;
 - The benchmark gas oil futures contract, which is used as the pricing reference for distillates—for example, jet fuel spread derivatives cover the price differential between jet fuel and that benchmark gas oil; and
 - The benchmark gas oil crack spread derivative (i.e., the derivative for the price differential between crude oil and gas oil—a refining margin), which is indexed to Brent crude oil.
 - (ii) The pricing of refined oil products does not depend on which particular crude oil is processed by a particular refinery because those refined oil products (such as gas oil or jet fuel) are standardized products.

Hence, Entity C concludes that the price risk of its jet fuel purchases includes a crude oil price risk component based on Brent crude oil and a gas oil price risk component, even though crude oil and gas oil are not specified in any contractual arrangement. Entity C concludes that these two risk components are separately identifiable and reliably measurable even though they are not contractually specified. Consequently, Entity C may designate hedging relationships for forecast jet fuel purchases on a risk components basis (for crude oil or gas oil). This analysis also means that if, for example, Entity C used crude oil derivatives based on West Texas Intermediate (WTI) crude oil, changes in the price differential between Brent crude oil and WTI crude oil would cause hedge ineffectiveness.

- (d) Entity D holds a fixed-rate debt instrument. This instrument is issued in an environment with a market in which a large variety of similar debt instruments are compared by their spreads to a benchmark rate (for example, an interbank offered rate) and variable-rate instruments in that environment are typically indexed to that benchmark rate. Interest rate swaps are frequently used to manage interest rate risk on the basis of that benchmark rate, irrespective of the spread of debt instruments to that benchmark rate. The price of fixed-rate debt instruments varies directly in response to changes in the benchmark rate as they happen. Entity D concludes that the benchmark rate is a component that can be separately identified and reliably measured. Consequently, Entity D may designate hedging relationships for the fixed-rate debt instrument on a risk component basis for the benchmark interest rate risk.

AG260. When designating a risk component as a hedged item, the hedge accounting requirements apply to that risk component in the same way as they apply to other hedged items that are not risk components. For example, the qualifying criteria apply, including that the hedging relationship must meet the hedge effectiveness requirements, and any hedge ineffectiveness must be measured and recognized.

AG261. An entity can also designate only changes in the cash flows or fair value of a hedged item above or below a specified price or other variable (a ‘one-sided risk’). The intrinsic value of a purchased option hedging instrument (assuming that it has the same principal terms as the designated risk), but not its time value, reflects a one-sided risk in a hedged item. For example, an entity can designate the variability of future cash flow outcomes resulting from a price increase of a forecast commodity purchase. In such a situation, the entity designates only cash flow losses that result from an increase in the price above the specified level. The hedged risk does not include the time value of a purchased option, because the time value is not a component of the forecast transaction that affects surplus or deficit.

AG262. There is a rebuttable presumption that unless inflation risk is contractually specified, it is not separately identifiable and reliably measurable and hence cannot be designated as a risk component of a financial instrument. However, in limited

cases, it is possible to identify a risk component for inflation risk that is separately identifiable and reliably measurable because of the particular circumstances of the inflation environment and the relevant debt market.

AG263. For example, an entity issues debt in an environment in which inflation-linked bonds have a volume and term structure that results in a sufficiently liquid market that allows constructing a term structure of zero-coupon real interest rates. This means that for the respective currency, inflation is a relevant factor that is separately considered by the debt markets. In those circumstances the inflation risk component could be determined by discounting the cash flows of the hedged debt instrument using the term structure of zero-coupon real interest rates (i.e., in a manner similar to how a risk-free (nominal) interest rate component can be determined). Conversely, in many cases an inflation risk component is not separately identifiable and reliably measurable. For example, an entity issues only nominal interest rate debt in an environment with a market for inflation-linked bonds that is not sufficiently liquid to allow a term structure of zero-coupon real interest rates to be constructed. In this case the analysis of the market structure and of the facts and circumstances does not support the entity concluding that inflation is a relevant factor that is separately considered by the debt markets. Hence, the entity cannot overcome the rebuttable presumption that inflation risk that is not contractually specified is not separately identifiable and reliably measurable. Consequently, an inflation risk component would not be eligible for designation as the hedged item. This applies irrespective of any inflation hedging instrument that the entity has actually entered into. In particular, the entity cannot simply impute the terms and conditions of the actual inflation hedging instrument by projecting its terms and conditions onto the nominal interest rate debt.

AG264. A contractually specified inflation risk component of the cash flows of a recognized inflation-linked bond (assuming that there is no requirement to account for an embedded derivative separately) is separately identifiable and reliably measurable, as long as other cash flows of the instrument are not affected by the inflation risk component.

Components of a Nominal Amount

AG265. There are two types of components of nominal amounts that can be designated as the hedged item in a hedging relationship: a component that is a proportion of an entire item or a layer component. The type of component changes the accounting outcome. An entity shall designate the component for accounting purposes consistently with its risk management objective.

AG266. An example of a component that is a proportion is 50 percent of the contractual cash flows of a loan.

AG267. A layer component may be specified from a defined, but open, population, or from a defined nominal amount. Examples include:

- (a) Part of a monetary transaction volume, for example, the next FC10 cash flows from sales denominated in a foreign currency after the first FC20 in March 201X;⁴
- (b) A part of a physical volume, for example, the bottom layer, measuring 5 million cubic meters, of the natural gas stored in location XYZ;
- (c) A part of a physical or other transaction volume, for example, the first 100 barrels of the oil purchases in June 201X or the first 100 MWh of electricity sales in June 201X; or
- (d) A layer from the nominal amount of the hedged item, for example, the last CU80 million of a CU100 million firm commitment, the bottom layer of CU20 million of a CU100 million fixed-rate bond or the top layer of CU30 million from a total amount of CU100 million of fixed-rate debt that can be prepaid at fair value (the defined nominal amount is CU100 million).

AG268. If a layer component is designated in a fair value hedge, an entity shall specify it from a defined nominal amount. To comply with the requirements for qualifying fair value hedges, an entity shall remeasure the hedged item for fair value changes (i.e., remeasure the item for fair value changes attributable to the hedged risk). The fair value hedge adjustment must be recognized in surplus or deficit no later than when the item is derecognized. Consequently, it is necessary to track the item to which the fair value hedge adjustment relates. For a layer component in a fair value hedge, this requires an entity to track the nominal amount from which it is defined. For example, in paragraph AG267(d), the total defined nominal amount of CU100 million must be tracked in order to track the bottom layer of CU20 million or the top layer of CU30 million.

AG269. A layer component that includes a prepayment option is not eligible to be designated as a hedged item in a fair value hedge if the prepayment option's fair value is affected by changes in the hedged risk, unless the designated layer includes the effect of the related prepayment option when determining the change in the fair value of the hedged item.

⁴ In this Standard monetary amounts are denominated in 'currency units' (CU) and 'foreign currency units' (FC).

Relationship Between Components and the Total Cash Flows of an Item

- AG270. If a component of the cash flows of a financial or a non-financial item is designated as the hedged item, that component must be less than or equal to the total cash flows of the entire item. However, all of the cash flows of the entire item may be designated as the hedged item and hedged for only one particular risk (for example, only for those changes that are attributable to changes in a market related interest rate or a benchmark commodity price).
- AG271. For example, in the case of a financial liability whose effective interest rate is below a market related interest rate, an entity cannot designate:
- (a) A component of the liability equal to interest at the market rate (plus the principal amount in case of a fair value hedge); and
 - (b) A negative residual component.
- AG272. However, in the case of a fixed-rate financial liability whose effective interest rate is (for example) 100 basis points below the market rate, an entity can designate as the hedged item the change in the value of that entire liability (i.e., principal plus interest at the market rate minus 100 basis points) that is attributable to changes in the market rate. If a fixed-rate financial instrument is hedged some time after its origination and interest rates have changed in the meantime, the entity can designate a risk component equal to a benchmark rate that is higher than the contractual rate paid on the item. The entity can do so provided that the benchmark rate is less than the effective interest rate calculated on the assumption that the entity had purchased the instrument on the day when it first designates the hedged item. For example, assume that an entity originates a fixed-rate financial asset of CU100 that has an effective interest rate of 6 percent at a time when the market rate is 4 percent. It begins to hedge that asset some time later when the market rate has increased to 8 percent and the fair value of the asset has decreased to CU90. The entity calculates that if it had purchased the asset on the date it first designates the related the market rate interest rate risk as the hedged item, the effective yield of the asset based on its then fair value of CU90 would have been 9.5 percent. Because the market rate is less than this effective yield, the entity can designate a the market rate component of 8 percent that consists partly of the contractual interest cash flows and partly of the difference between the current fair value (i.e., CU90) and the amount repayable on maturity (i.e., CU100).
- AG273. If a variable-rate financial liability bears interest of (for example) the three-month interbank offered rate minus 20 basis points (with a floor at zero basis points), an entity can designate as the hedged item the change in the cash flows of that entire liability (i.e., the three-month interbank offered rate minus 20 basis points—including the floor) that is attributable to changes in the interbank offered rate. Hence, as long as the three-month interbank offered rate forward curve for the remaining life of that liability does not fall below 20 basis points, the hedged item has the same cash flow variability as a liability that bears interest at the three-month interbank offered rate with a zero or positive spread. However, if the three-month interbank offered rate forward curve for the remaining life of that liability (or a part of it) falls below 20 basis points, the hedged item has a lower cash flow variability than a liability that bears interest at three-month interbank offered rate with a zero or positive spread.
- AG274. A similar example of a non-financial item is a specific type of crude oil from a particular oil field that is priced off the relevant benchmark crude oil. If an entity sells that crude oil under a contract using a contractual pricing formula that sets the price per barrel at the benchmark crude oil price minus CU10 with a floor of CU15, the entity can designate as the hedged item the entire cash flow variability under the sales contract that is attributable to the change in the benchmark crude oil price. However, the entity cannot designate a component that is equal to the full change in the benchmark crude oil price. Hence, as long as the forward price (for each delivery) does not fall below CU25, the hedged item has the same cash flow variability as a crude oil sale at the benchmark crude oil price (or with a positive spread). However, if the forward price for any delivery falls below CU25, the hedged item has a lower cash flow variability than a crude oil sale at the benchmark crude oil price (or with a positive spread).

Qualifying Criteria for Hedge Accounting

Hedge Effectiveness

- AG275. Hedge effectiveness is the extent to which changes in the fair value or the cash flows of the hedging instrument offset changes in the fair value or the cash flows of the hedged item (for example, when the hedged item is a risk component, the relevant change in fair value or cash flows of an item is the one that is attributable to the hedged risk). Hedge ineffectiveness is the extent to which the changes in the fair value or the cash flows of the hedging instrument are greater or less than those on the hedged item.
- AG276. When designating a hedging relationship and on an ongoing basis, an entity shall analyze the sources of hedge ineffectiveness that are expected to affect the hedging relationship during its term. This analysis (including any updates in accordance with

paragraph AG314 arising from rebalancing a hedging relationship) is the basis for the entity's assessment of meeting the hedge effectiveness requirements.

AG277. For the avoidance of doubt, the effects of replacing the original counterparty with a clearing counterparty and making the associated changes as described in paragraph 135 shall be reflected in the measurement of the hedging instrument and therefore in the assessment of hedge effectiveness and the measurement of hedge effectiveness.

Economic Relationship Between the Hedged Item and the Hedging Instrument

AG278. The requirement that an economic relationship exists means that the hedging instrument and the hedged item have values that generally move in the opposite direction because of the same risk, which is the hedged risk. Hence, there must be an expectation that the value of the hedging instrument and the value of the hedged item will systematically change in response to movements in either the same underlying or underlyings that are economically related in such a way that they respond in a similar way to the risk that is being hedged (for example, Brent and WTI crude oil).

AG279. If the underlyings are not the same but are economically related, there can be situations in which the values of the hedging instrument and the hedged item move in the same direction, for example, because the price differential between the two related underlyings changes while the underlyings themselves do not move significantly. That is still consistent with an economic relationship between the hedging instrument and the hedged item if the values of the hedging instrument and the hedged item are still expected to typically move in the opposite direction when the underlyings move.

AG280. The assessment of whether an economic relationship exists includes an analysis of the possible behavior of the hedging relationship during its term to ascertain whether it can be expected to meet the risk management objective. The mere existence of a statistical correlation between two variables does not, by itself, support a valid conclusion that an economic relationship exists.

The Effect of Credit Risk

AG281. Because the hedge accounting model is based on a general notion of offset between gains and losses on the hedging instrument and the hedged item, hedge effectiveness is determined not only by the economic relationship between those items (i.e., the changes in their underlyings) but also by the effect of credit risk on the value of both the hedging instrument and the hedged item. The effect of credit risk means that even if there is an economic relationship between the hedging instrument and the hedged item, the level of offset might become erratic. This can result from a change in the credit risk of either the hedging instrument or the hedged item that is of such a magnitude that the credit risk dominates the value changes that result from the economic relationship (i.e., the effect of the changes in the underlyings). A level of magnitude that gives rise to dominance is one that would result in the loss (or gain) from credit risk frustrating the effect of changes in the underlyings on the value of the hedging instrument or the hedged item, even if those changes were significant. Conversely, if during a particular period there is little change in the underlyings, the fact that even small credit risk-related changes in the value of the hedging instrument or the hedged item might affect the value more than the underlyings does not create dominance.

AG282. An example of credit risk dominating a hedging relationship is when an entity hedges an exposure to commodity price risk using an uncollateralized derivative. If the counterparty to that derivative experiences a severe deterioration in its credit standing, the effect of the changes in the counterparty's credit standing might outweigh the effect of changes in the commodity price on the fair value of the hedging instrument, whereas changes in the value of the hedged item depend largely on the commodity price changes.

Hedge Ratio

AG283. In accordance with the hedge effectiveness requirements, the hedge ratio of the hedging relationship must be the same as that resulting from the quantity of the hedged item that the entity actually hedges and the quantity of the hedging instrument that the entity actually uses to hedge that quantity of hedged item. Hence, if an entity hedges less than 100 percent of the exposure on an item, such as 85 percent, it shall designate the hedging relationship using a hedge ratio that is the same as that resulting from 85 percent of the exposure and the quantity of the hedging instrument that the entity actually uses to hedge those 85 percent. Similarly, if, for example, an entity hedges an exposure using a nominal amount of 40 units of a financial instrument, it shall designate the hedging relationship using a hedge ratio that is the same as that resulting from that quantity of 40 units (i.e., the entity must not use a hedge ratio based on a higher quantity of units that it might hold in total or a lower quantity of units) and the quantity of the hedged item that it actually hedges with those 40 units.

AG284. However, the designation of the hedging relationship using the same hedge ratio as that resulting from the quantities of the hedged item and the hedging instrument that the entity actually uses shall not reflect an imbalance between the weightings of the hedged item and the hedging instrument that would in turn create hedge ineffectiveness (irrespective

of whether recognized or not) that could result in an accounting outcome that would be inconsistent with the purpose of hedge accounting. Hence, for the purpose of designating a hedging relationship, an entity must adjust the hedge ratio that results from the quantities of the hedged item and the hedging instrument that the entity actually uses if that is needed to avoid such an imbalance.

AG285. Examples of relevant considerations in assessing whether an accounting outcome is inconsistent with the purpose of hedge accounting are:

- (a) Whether the intended hedge ratio is established to avoid recognizing hedge ineffectiveness for cash flow hedges, or to achieve fair value hedge adjustments for more hedged items with the aim of increasing the use of fair value accounting, but without offsetting fair value changes of the hedging instrument; and
- (b) Whether there is a commercial reason for the particular weightings of the hedged item and the hedging instrument, even though that creates hedge ineffectiveness. For example, an entity enters into and designates a quantity of the hedging instrument that is not the quantity that it determined as the best hedge of the hedged item because the standard volume of the hedging instruments does not allow it to enter into that exact quantity of hedging instrument (a 'lot size issue'). An example is an entity that hedges 1,000 tonnes of oil purchases with standard oil futures contracts that have a contract size of 1,000 barrels. The entity could only use either seven or eight contracts (equivalent to 980 tonnes and 1,120 tonnes respectively) to hedge the purchase volume of 1,000 tonnes. In that case, the entity designates the hedging relationship using the hedge ratio that results from the number of oil futures contracts that it actually uses, because the hedge ineffectiveness resulting from the mismatch in the weightings of the hedged item and the hedging instrument would not result in an accounting outcome that is inconsistent with the purpose of hedge accounting.

Frequency of Assessing Whether the Hedge Effectiveness Requirements are Met

AG286. An entity shall assess at the inception of the hedging relationship, and on an ongoing basis, whether a hedging relationship meets the hedge effectiveness requirements. At a minimum, an entity shall perform the ongoing assessment at each reporting date or upon a significant change in the circumstances affecting the hedge effectiveness requirements, whichever comes first. The assessment relates to expectations about hedge effectiveness and is therefore only forward-looking.

Methods for Assessing Whether the Hedge Effectiveness Requirements are Met

AG287. This Standard does not specify a method for assessing whether a hedging relationship meets the hedge effectiveness requirements. However, an entity shall use a method that captures the relevant characteristics of the hedging relationship including the sources of hedge ineffectiveness. Depending on those factors, the method can be a qualitative or a quantitative assessment.

AG288. For example, when the critical terms (such as the nominal amount, maturity and underlying) of the hedging instrument and the hedged item match or are closely aligned, it might be possible for an entity to conclude on the basis of a qualitative assessment of those critical terms that the hedging instrument and the hedged item have values that will generally move in the opposite direction because of the same risk and hence that an economic relationship exists between the hedged item and the hedging instrument (see paragraphs AG278–AG280).

AG289. The fact that a derivative is in or out of the money when it is designated as a hedging instrument does not in itself mean that a qualitative assessment is inappropriate. It depends on the circumstances whether hedge ineffectiveness arising from that fact could have a magnitude that a qualitative assessment would not adequately capture.

AG290. Conversely, if the critical terms of the hedging instrument and the hedged item are not closely aligned, there is an increased level of uncertainty about the extent of offset. Consequently, the hedge effectiveness during the term of the hedging relationship is more difficult to predict. In such a situation it might only be possible for an entity to conclude on the basis of a quantitative assessment that an economic relationship exists between the hedged item and the hedging instrument (see paragraphs AG278–AG280). In some situations a quantitative assessment might also be needed to assess whether the hedge ratio used for designating the hedging relationship meets the hedge effectiveness requirements (see paragraphs AG283–AG285). An entity can use the same or different methods for those two different purposes.

AG291. If there are changes in circumstances that affect hedge effectiveness, an entity may have to change the method for assessing whether a hedging relationship meets the hedge effectiveness requirements in order to ensure that the relevant characteristics of the hedging relationship, including the sources of hedge ineffectiveness, are still captured.

AG292. An entity's risk management is the main source of information to perform the assessment of whether a hedging relationship meets the hedge effectiveness requirements. This means that the management information (or analysis) used for decision-

making purposes can be used as a basis for assessing whether a hedging relationship meets the hedge effectiveness requirements.

AG293. An entity's documentation of the hedging relationship includes how it will assess the hedge effectiveness requirements, including the method or methods used. The documentation of the hedging relationship shall be updated for any changes to the methods (see paragraph AG291).

Accounting for Qualifying Hedging Relationships

AG294. An example of a fair value hedge is a hedge of exposure to changes in the fair value of a fixed-rate debt instrument arising from changes in interest rates. Such a hedge could be entered into by the issuer or by the holder.

AG295. The purpose of a cash flow hedge is to defer the gain or loss on the hedging instrument to a period or periods in which the hedged expected future cash flows affect surplus or deficit. An example of a cash flow hedge is the use of a swap to change floating rate debt (whether measured at amortized cost or fair value) to fixed-rate debt (i.e., a hedge of a future transaction in which the future cash flows being hedged are the future interest payments). Conversely, a forecast purchase of an equity instrument that, once acquired, will be accounted for at fair value through surplus or deficit, is an example of an item that cannot be the hedged item in a cash flow hedge, because any gain or loss on the hedging instrument that would be deferred could not be appropriately reclassified to surplus or deficit during a period in which it would achieve offset. For the same reason, a forecast purchase of an equity instrument that, once acquired, will be accounted for at fair value with changes in fair value presented in net assets/equity also cannot be the hedged item in a cash flow hedge.

AG296. A hedge of a firm commitment (for example, a hedge of the change in fuel price relating to an unrecognized contractual commitment by an electric utility to purchase fuel at a fixed price) is a hedge of an exposure to a change in fair value. Accordingly, such a hedge is a fair value hedge. However, in accordance with paragraph 133, a hedge of the foreign currency risk of a firm commitment could alternatively be accounted for as a cash flow hedge.

Measurement of Hedge Ineffectiveness

AG297. When measuring hedge ineffectiveness, an entity shall consider the time value of money. Consequently, the entity determines the value of the hedged item on a present value basis and therefore the change in the value of the hedged item also includes the effect of the time value of money.

AG298. To calculate the change in the value of the hedged item for the purpose of measuring hedge ineffectiveness, an entity may use a derivative that would have terms that match the critical terms of the hedged item (this is commonly referred to as a 'hypothetical derivative'), and, for example for a hedge of a forecast transaction, would be calibrated using the hedged price (or rate) level. For example, if the hedge was for a two-sided risk at the current market level, the hypothetical derivative would represent a hypothetical forward contract that is calibrated to a value of nil at the time of designation of the hedging relationship. If the hedge was for example for a one-sided risk, the hypothetical derivative would represent the intrinsic value of a hypothetical option that at the time of designation of the hedging relationship is at the money if the hedged price level is the current market level, or out of the money if the hedged price level is above (or, for a hedge of a long position, below) the current market level. Using a hypothetical derivative is one possible way of calculating the change in the value of the hedged item. The hypothetical derivative replicates the hedged item and hence results in the same outcome as if that change in value was determined by a different approach. Hence, using a 'hypothetical derivative' is not a method in its own right but a mathematical expedient that can only be used to calculate the value of the hedged item. Consequently, a 'hypothetical derivative' cannot be used to include features in the value of the hedged item that only exist in the hedging instrument (but not in the hedged item). An example is debt denominated in a foreign currency (irrespective of whether it is fixed-rate or variable-rate debt). When using a hypothetical derivative to calculate the change in the value of such debt or the present value of the cumulative change in its cash flows, the hypothetical derivative cannot simply impute a charge for exchanging different currencies even though actual derivatives under which different currencies are exchanged might include such a charge (for example, cross-currency interest rate swaps).

AG299. The change in the value of the hedged item determined using a hypothetical derivative may also be used for the purpose of assessing whether a hedging relationship meets the hedge effectiveness requirements.

Rebalancing the Hedging Relationship and Changes to the Hedge Ratio

AG300. Rebalancing refers to the adjustments made to the designated quantities of the hedged item or the hedging instrument of an already existing hedging relationship for the purpose of maintaining a hedge ratio that complies with the hedge effectiveness requirements. Changes to designated quantities of a hedged item or of a hedging instrument for a different purpose do not constitute rebalancing for the purpose of this Standard.

- AG301. Rebalancing is accounted for as a continuation of the hedging relationship in accordance with paragraphs AG302–AG314. On rebalancing, the hedge ineffectiveness of the hedging relationship is determined and recognized immediately before adjusting the hedging relationship.
- AG302. Adjusting the hedge ratio allows an entity to respond to changes in the relationship between the hedging instrument and the hedged item that arise from their underlyings or risk variables. For example, a hedging relationship in which the hedging instrument and the hedged item have different but related underlyings changes in response to a change in the relationship between those two underlyings (for example, different but related reference indices, rates or prices). Hence, rebalancing allows the continuation of a hedging relationship in situations in which the relationship between the hedging instrument and the hedged item changes in a way that can be compensated for by adjusting the hedge ratio.
- AG303. For example, an entity hedges an exposure to Foreign Currency A using a currency derivative that references Foreign Currency B and Foreign Currencies A and B are pegged (i.e., their exchange rate is maintained within a band or at an exchange rate set by a central bank or other authority). If the exchange rate between Foreign Currency A and Foreign Currency B were changed (i.e., a new band or rate was set), rebalancing the hedging relationship to reflect the new exchange rate would ensure that the hedging relationship would continue to meet the hedge effectiveness requirement for the hedge ratio in the new circumstances. In contrast, if there was a default on the currency derivative, changing the hedge ratio could not ensure that the hedging relationship would continue to meet that hedge effectiveness requirement. Hence, rebalancing does not facilitate the continuation of a hedging relationship in situations in which the relationship between the hedging instrument and the hedged item changes in a way that cannot be compensated for by adjusting the hedge ratio.
- AG304. Not every change in the extent of offset between the changes in the fair value of the hedging instrument and the hedged item's fair value or cash flows constitutes a change in the relationship between the hedging instrument and the hedged item. An entity analyzes the sources of hedge ineffectiveness that it expected to affect the hedging relationship during its term and evaluates whether changes in the extent of offset are:
- (a) Fluctuations around the hedge ratio, which remains valid (i.e., continues to appropriately reflect the relationship between the hedging instrument and the hedged item); or
 - (b) An indication that the hedge ratio no longer appropriately reflects the relationship between the hedging instrument and the hedged item.

An entity performs this evaluation against the hedge effectiveness requirement for the hedge ratio, i.e., to ensure that the hedging relationship does not reflect an imbalance between the weightings of the hedged item and the hedging instrument that would create hedge ineffectiveness (irrespective of whether recognized or not) that could result in an accounting outcome that would be inconsistent with the purpose of hedge accounting. Hence, this evaluation requires judgment.

- AG305. Fluctuation around a constant hedge ratio (and hence the related hedge ineffectiveness) cannot be reduced by adjusting the hedge ratio in response to each particular outcome. Hence, in such circumstances, the change in the extent of offset is a matter of measuring and recognizing hedge ineffectiveness but does not require rebalancing.
- AG306. Conversely, if changes in the extent of offset indicate that the fluctuation is around a hedge ratio that is different from the hedge ratio that is currently used for that hedging relationship, or that there is a trend leading away from that hedge ratio, hedge ineffectiveness can be reduced by adjusting the hedge ratio, whereas retaining the hedge ratio would increasingly produce hedge ineffectiveness. Hence, in such circumstances, an entity must evaluate whether the hedging relationship reflects an imbalance between the weightings of the hedged item and the hedging instrument that would create hedge ineffectiveness (irrespective of whether recognized or not) that could result in an accounting outcome that would be inconsistent with the purpose of hedge accounting. If the hedge ratio is adjusted, it also affects the measurement and recognition of hedge ineffectiveness because, on rebalancing, the hedge ineffectiveness of the hedging relationship must be determined and recognized immediately before adjusting the hedging relationship in accordance with paragraph AG301.
- AG307. Rebalancing means that, for hedge accounting purposes, after the start of a hedging relationship an entity adjusts the quantities of the hedging instrument or the hedged item in response to changes in circumstances that affect the hedge ratio of that hedging relationship. Typically, that adjustment should reflect adjustments in the quantities of the hedging instrument and the hedged item that it actually uses. However, an entity must adjust the hedge ratio that results from the quantities of the hedged item or the hedging instrument that it actually uses if:
- (a) The hedge ratio that results from changes to the quantities of the hedging instrument or the hedged item that the entity actually uses would reflect an imbalance that would create hedge ineffectiveness that could result in an accounting outcome that would be inconsistent with the purpose of hedge accounting; or

- (b) An entity would retain quantities of the hedging instrument and the hedged item that it actually uses, resulting in a hedge ratio that, in new circumstances, would reflect an imbalance that would create hedge ineffectiveness that could result in an accounting outcome that would be inconsistent with the purpose of hedge accounting (i.e., an entity must not create an imbalance by omitting to adjust the hedge ratio).

AG308. Rebalancing does not apply if the risk management objective for a hedging relationship has changed. Instead, hedge accounting for that hedging relationship shall be discontinued (despite that an entity might designate a new hedging relationship that involves the hedging instrument or hedged item of the previous hedging relationship as described in paragraph AG321).

AG309. If a hedging relationship is rebalanced, the adjustment to the hedge ratio can be effected in different ways:

- (a) The weighting of the hedged item can be increased (which at the same time reduces the weighting of the hedging instrument) by:
 - (i) Increasing the volume of the hedged item; or
 - (ii) Decreasing the volume of the hedging instrument.
- (b) The weighting of the hedging instrument can be increased (which at the same time reduces the weighting of the hedged item) by:
 - (i) Increasing the volume of the hedging instrument; or
 - (ii) Decreasing the volume of the hedged item.

Changes in volume refer to the quantities that are part of the hedging relationship. Hence, decreases in volumes do not necessarily mean that the items or transactions no longer exist, or are no longer expected to occur, but that they are not part of the hedging relationship. For example, decreasing the volume of the hedging instrument can result in the entity retaining a derivative, but only part of it might remain a hedging instrument of the hedging relationship. This could occur if the rebalancing could be effected only by reducing the volume of the hedging instrument in the hedging relationship, but with the entity retaining the volume that is no longer needed. In that case, the undesignated part of the derivative would be accounted for at fair value through surplus or deficit (unless it was designated as a hedging instrument in a different hedging relationship).

AG310. Adjusting the hedge ratio by increasing the volume of the hedged item does not affect how the changes in the fair value of the hedging instrument are measured. The measurement of the changes in the value of the hedged item related to the previously designated volume also remains unaffected. However, from the date of rebalancing, the changes in the value of the hedged item also include the change in the value of the additional volume of the hedged item. These changes are measured starting from, and by reference to, the date of rebalancing instead of the date on which the hedging relationship was designated. For example, if an entity originally hedged a volume of 100 tonnes of a commodity at a forward price of CU80 (the forward price at inception of the hedging relationship) and added a volume of 10 tonnes on rebalancing when the forward price was CU90, the hedged item after rebalancing would comprise two layers: 100 tonnes hedged at CU80 and 10 tonnes hedged at CU90.

AG311. Adjusting the hedge ratio by decreasing the volume of the hedging instrument does not affect how the changes in the value of the hedged item are measured. The measurement of the changes in the fair value of the hedging instrument related to the volume that continues to be designated also remains unaffected. However, from the date of rebalancing, the volume by which the hedging instrument was decreased is no longer part of the hedging relationship. For example, if an entity originally hedged the price risk of a commodity using a derivative volume of 100 tonnes as the hedging instrument and reduces that volume by 10 tonnes on rebalancing, a nominal amount of 90 tonnes of the hedging instrument volume would remain (see paragraph AG309 for the consequences for the derivative volume (i.e., the 10 tonnes) that is no longer a part of the hedging relationship).

AG312. Adjusting the hedge ratio by increasing the volume of the hedging instrument does not affect how the changes in the value of the hedged item are measured. The measurement of the changes in the fair value of the hedging instrument related to the previously designated volume also remains unaffected. However, from the date of rebalancing, the changes in the fair value of the hedging instrument also include the changes in the value of the additional volume of the hedging instrument. The changes are measured starting from, and by reference to, the date of rebalancing instead of the date on which the hedging relationship was designated. For example, if an entity originally hedged the price risk of a commodity using a derivative volume of 100 tonnes as the hedging instrument and added a volume of 10 tonnes on rebalancing, the hedging instrument after rebalancing would comprise a total derivative volume of 110 tonnes. The change in the fair value of the hedging instrument is the total change in the fair value of the derivatives that make up the total volume of 110 tonnes.

These derivatives could (and probably would) have different critical terms, such as their forward rates, because they were entered into at different points in time (including the possibility of designating derivatives into hedging relationships after their initial recognition).

AG313. Adjusting the hedge ratio by decreasing the volume of the hedged item does not affect how the changes in the fair value of the hedging instrument are measured. The measurement of the changes in the value of the hedged item related to the volume that continues to be designated also remains unaffected. However, from the date of rebalancing, the volume by which the hedged item was decreased is no longer part of the hedging relationship. For example, if an entity originally hedged a volume of 100 tonnes of a commodity at a forward price of CU80 and reduces that volume by 10 tonnes on rebalancing, the hedged item after rebalancing would be 90 tonnes hedged at CU80. The 10 tonnes of the hedged item that are no longer part of the hedging relationship would be accounted for in accordance with the requirements for the discontinuation of hedge accounting (see paragraphs 135–136 and AG315–AG321).

AG314. When rebalancing a hedging relationship, an entity shall update its analysis of the sources of hedge ineffectiveness that are expected to affect the hedging relationship during its (remaining) term (see paragraph AG276). The documentation of the hedging relationship shall be updated accordingly.

Discontinuation of Hedge Accounting

AG315. Discontinuation of hedge accounting applies prospectively from the date on which the qualifying criteria are no longer met.

AG316. An entity shall not de-designate and thereby discontinue a hedging relationship that:

- (a) Still meets the risk management objective on the basis of which it qualified for hedge accounting (i.e., the entity still pursues that risk management objective); and
- (b) Continues to meet all other qualifying criteria (after taking into account any rebalancing of the hedging relationship, if applicable).

AG317. For the purposes of this Standard, an entity's risk management strategy is distinguished from its risk management objectives. The risk management strategy is established at the highest level at which an entity determines how it manages its risk. Risk management strategies typically identify the risks to which the entity is exposed and set out how the entity responds to them. A risk management strategy is typically in place for a longer period and may include some flexibility to react to changes in circumstances that occur while that strategy is in place (for example, different interest rate or commodity price levels that result in a different extent of hedging). This is normally set out in a general document that is cascaded down through an entity through policies containing more specific guidelines. In contrast, the risk management objective for a hedging relationship applies at the level of a particular hedging relationship. It relates to how the particular hedging instrument that has been designated is used to hedge the particular exposure that has been designated as the hedged item. Hence, a risk management strategy can involve many different hedging relationships whose risk management objectives relate to executing that overall risk management strategy. For example:

- (a) An entity has a strategy of managing its interest rate exposure on debt funding that sets ranges for the overall entity for the mix between variable-rate and fixed-rate funding. The strategy is to maintain between 20 percent and 40 percent of the debt at fixed rates. The entity decides from time to time how to execute this strategy (i.e., where it positions itself within the 20 percent to 40 percent range for fixed-rate interest exposure) depending on the level of interest rates. If interest rates are low the entity fixes the interest for more debt than when interest rates are high. The entity's debt is CU100 of variable-rate debt of which CU30 is swapped into a fixed-rate exposure. The entity takes advantage of low interest rates to issue an additional CU50 of debt to finance a major investment, which the entity does by issuing a fixed-rate bond. In the light of the low interest rates, the entity decides to set its fixed interest-rate exposure to 40 percent of the total debt by reducing by CU20 the extent to which it previously hedged its variable-rate exposure, resulting in CU60 of fixed-rate exposure. In this situation the risk management strategy itself remains unchanged. However, in contrast the entity's execution of that strategy has changed and this means that, for CU20 of variable-rate exposure that was previously hedged, the risk management objective has changed (i.e., at the hedging relationship level). Consequently, in this situation hedge accounting must be discontinued for CU20 of the previously hedged variable-rate exposure. This could involve reducing the swap position by a CU20 nominal amount but, depending on the circumstances, an entity might retain that swap volume and, for example, use it for hedging a different exposure or it might become part of a trading book. Conversely, if an entity instead swapped a part of its new fixed-rate debt into a variable-rate exposure, hedge accounting would have to be continued for its previously hedged variable-rate exposure.
- (b) Some exposures result from positions that frequently change, for example, the interest rate risk of an open portfolio of debt instruments. The addition of new debt instruments and the derecognition of debt instruments continuously

change that exposure (i.e., it is different from simply running off a position that matures). This is a dynamic process in which both the exposure and the hedging instruments used to manage it do not remain the same for long. Consequently, an entity with such an exposure frequently adjusts the hedging instruments used to manage the interest rate risk as the exposure changes. For example, debt instruments with 24 months' remaining maturity are designated as the hedged item for interest rate risk for 24 months. The same procedure is applied to other time buckets or maturity periods. After a short period of time, the entity discontinues all, some or a part of the previously designated hedging relationships for maturity periods and designates new hedging relationships for maturity periods on the basis of their size and the hedging instruments that exist at that time. The discontinuation of hedge accounting in this situation reflects that those hedging relationships are established in such a way that the entity looks at a new hedging instrument and a new hedged item instead of the hedging instrument and the hedged item that were designated previously. The risk management strategy remains the same, but there is no risk management objective that continues for those previously designated hedging relationships, which as such no longer exist. In such a situation, the discontinuation of hedge accounting applies to the extent to which the risk management objective has changed. This depends on the situation of an entity and could, for example, affect all or only some hedging relationships of a maturity period, or only part of a hedging relationship.

- (c) An entity has a risk management strategy whereby it manages the foreign currency risk of forecast sales and the resulting receivables. Within that strategy the entity manages the foreign currency risk as a particular hedging relationship only up to the point of the recognition of the receivable. Thereafter, the entity no longer manages the foreign currency risk on the basis of that particular hedging relationship. Instead, it manages together the foreign currency risk from receivables, payables and derivatives (that do not relate to forecast transactions that are still pending) denominated in the same foreign currency. For accounting purposes, this works as a 'natural' hedge because the gains and losses from the foreign currency risk on all of those items are immediately recognized in surplus or deficit. Consequently, for accounting purposes, if the hedging relationship is designated for the period up to the payment date, it must be discontinued when the receivable is recognized, because the risk management objective of the original hedging relationship no longer applies. The foreign currency risk is now managed within the same strategy but on a different basis. Conversely, if an entity had a different risk management objective and managed the foreign currency risk as one continuous hedging relationship specifically for that forecast sales amount and the resulting receivable until the settlement date, hedge accounting would continue until that date.

AG318. The discontinuation of hedge accounting can affect:

- (a) A hedging relationship in its entirety; or
 (b) A part of a hedging relationship (which means that hedge accounting continues for the remainder of the hedging relationship).

AG319. A hedging relationship is discontinued in its entirety when, as a whole, it ceases to meet the qualifying criteria. For example:

- (a) The hedging relationship no longer meets the risk management objective on the basis of which it qualified for hedge accounting (i.e., the entity no longer pursues that risk management objective);
 (b) The hedging instrument or instruments have been sold or terminated (in relation to the entire volume that was part of the hedging relationship); or
 (c) There is no longer an economic relationship between the hedged item and the hedging instrument or the effect of credit risk starts to dominate the value changes that result from that economic relationship.

AG320. A part of a hedging relationship is discontinued (and hedge accounting continues for its remainder) when only a part of the hedging relationship ceases to meet the qualifying criteria. For example:

- (a) On rebalancing of the hedging relationship, the hedge ratio might be adjusted in such a way that some of the volume of the hedged item is no longer part of the hedging relationship (see paragraph AG313); hence, hedge accounting is discontinued only for the volume of the hedged item that is no longer part of the hedging relationship; or
 (b) When the occurrence of some of the volume of the hedged item that is (or is a component of) a forecast transaction is no longer highly probable, hedge accounting is discontinued only for the volume of the hedged item whose occurrence is no longer highly probable. However, if an entity has a history of having designated hedges of forecast transactions and having subsequently determined that the forecast transactions are no longer expected to occur, the entity's ability to predict forecast transactions accurately is called into question when predicting similar

forecast transactions. This affects the assessment of whether similar forecast transactions are highly probable (see paragraph 124) and hence whether they are eligible as hedged items.

AG321. An entity can designate a new hedging relationship that involves the hedging instrument or hedged item of a previous hedging relationship for which hedge accounting was (in part or in its entirety) discontinued. This does not constitute a continuation of a hedging relationship but is a restart. For example:

- (a) A hedging instrument experiences such a severe credit deterioration that the entity replaces it with a new hedging instrument. This means that the original hedging relationship failed to achieve the risk management objective and is hence discontinued in its entirety. The new hedging instrument is designated as the hedge of the same exposure that was hedged previously and forms a new hedging relationship. Hence, the changes in the fair value or the cash flows of the hedged item are measured starting from, and by reference to, the date of designation of the new hedging relationship instead of the date on which the original hedging relationship was designated.
- (b) A hedging relationship is discontinued before the end of its term. The hedging instrument in that hedging relationship can be designated as the hedging instrument in another hedging relationship (for example, when adjusting the hedge ratio on rebalancing by increasing the volume of the hedging instrument or when designating a whole new hedging relationship).

Accounting for the Time Value of Options

AG322. An option can be considered as being related to a time period because its time value represents a charge for providing protection for the option holder over a period of time. However, the relevant aspect for the purpose of assessing whether an option hedges a transaction or time-period related hedged item are the characteristics of that hedged item, including how and when it affects surplus or deficit. Hence, an entity shall assess the type of hedged item (see paragraph 144(a)) on the basis of the nature of the hedged item (regardless of whether the hedging relationship is a cash flow hedge or a fair value hedge):

- (a) The time value of an option relates to a transaction related hedged item if the nature of the hedged item is a transaction for which the time value has the character of costs of that transaction. An example is when the time value of an option relates to a hedged item that results in the recognition of an item whose initial measurement includes transaction costs (for example, an entity hedges a commodity purchase, whether it is a forecast transaction or a firm commitment, against the commodity price risk and includes the transaction costs in the initial measurement of the inventory). As a consequence of including the time value of the option in the initial measurement of the particular hedged item, the time value affects surplus or deficit at the same time as that hedged item. Similarly, an entity that hedges a sale of a commodity, whether it is a forecast transaction or a firm commitment, would include the time value of the option as part of the cost related to that sale (hence, the time value would be recognized in surplus or deficit in the same period as the revenue from the hedged sale).
- (b) The time value of an option relates to a time-period related hedged item if the nature of the hedged item is such that the time value has the character of a cost for obtaining protection against a risk over a particular period of time (but the hedged item does not result in a transaction that involves the notion of a transaction cost in accordance with (a)). For example, if commodity inventory is hedged against a fair value decrease for six months using a commodity option with a corresponding life, the time value of the option would be allocated to surplus or deficit (i.e., amortized on a systematic and rational basis) over that six-month period. Another example is a hedge of a net investment in a foreign operation that is hedged for 18 months using a foreign-exchange option, which would result in allocating the time value of the option over that 18-month period.

AG323. The characteristics of the hedged item, including how and when the hedged item affects surplus or deficit, also affect the period over which the time value of an option that hedges a time-period related hedged item is amortized, which is consistent with the period over which the option's intrinsic value can affect surplus or deficit in accordance with hedge accounting. For example, if an interest rate option (a cap) is used to provide protection against increases in the interest expense on a floating rate bond, the time value of that cap is amortized to surplus or deficit over the same period over which any intrinsic value of the cap would affect surplus or deficit:

- (a) If the cap hedges increases in interest rates for the first three years out of a total life of the floating rate bond of five years, the time value of that cap is amortized over the first three years; or
- (b) If the cap is a forward start option that hedges increases in interest rates for years two and three out of a total life of the floating rate bond of five years, the time value of that cap is amortized during years two and three.

AG324. The accounting for the time value of options in accordance with paragraph 144 also applies to a combination of a purchased and a written option (one being a put option and one being a call option) that at the date of designation as a hedging

instrument has a net nil time value (commonly referred to as a 'zero-cost collar'). In that case, an entity shall recognize any changes in time value in net assets/equity, even though the cumulative change in time value over the total period of the hedging relationship is nil. Hence, if the time value of the option relates to:

- (a) A transaction related hedged item, the amount of time value at the end of the hedging relationship that adjusts the hedged item or that is reclassified to surplus or deficit (see paragraph 144(b)) would be nil.
- (b) A time-period related hedged item, the amortization expense related to the time value is nil.

AG325. The accounting for the time value of options in accordance with paragraph 144 applies only to the extent that the time value relates to the hedged item (aligned time value). The time value of an option relates to the hedged item if the critical terms of the option (such as the nominal amount, life and underlying) are aligned with the hedged item. Hence, if the critical terms of the option and the hedged item are not fully aligned, an entity shall determine the aligned time value, i.e., how much of the time value included in the premium (actual time value) relates to the hedged item (and therefore should be treated in accordance with paragraph 144). An entity determines the aligned time value using the valuation of the option that would have critical terms that perfectly match the hedged item.

AG326. If the actual time value and the aligned time value differ, an entity shall determine the amount that is accumulated in a separate component of net assets/equity in accordance with paragraph 144 as follows:

- (a) If, at inception of the hedging relationship, the actual time value is higher than the aligned time value, the entity shall:
 - (i) Determine the amount that is accumulated in a separate component of net assets/equity on the basis of the aligned time value; and
 - (ii) Account for the differences in the fair value changes between the two time values in surplus or deficit.
- (b) If, at inception of the hedging relationship, the actual time value is lower than the aligned time value, the entity shall determine the amount that is accumulated in a separate component of net assets/equity by reference to the lower of the cumulative change in fair value of:
 - (i) The actual time value; and
 - (ii) The aligned time value.

Any remainder of the change in fair value of the actual time value shall be recognized in surplus or deficit.

Accounting for the Forward Element of Forward Contracts and Foreign Currency Basis Spreads of Financial Instruments

AG327. A forward contract can be considered as being related to a time period because its forward element represents charges for a period of time (which is the tenor for which it is determined). However, the relevant aspect for the purpose of assessing whether a hedging instrument hedges a transaction or time-period related hedged item are the characteristics of that hedged item, including how and when it affects surplus or deficit. Hence, an entity shall assess the type of hedged item (see paragraphs 144(a) and 145) on the basis of the nature of the hedged item (regardless of whether the hedging relationship is a cash flow hedge or a fair value hedge):

- (a) The forward element of a forward contract relates to a transaction related hedged item if the nature of the hedged item is a transaction for which the forward element has the character of costs of that transaction. An example is when the forward element relates to a hedged item that results in the recognition of an item whose initial measurement includes transaction costs (for example, an entity hedges an inventory purchase denominated in a foreign currency, whether it is a forecast transaction or a firm commitment, against foreign currency risk and includes the transaction costs in the initial measurement of the inventory). As a consequence of including the forward element in the initial measurement of the particular hedged item, the forward element affects surplus or deficit at the same time as that hedged item. Similarly, an entity that hedges a sale of a commodity denominated in a foreign currency against foreign currency risk, whether it is a forecast transaction or a firm commitment, would include the forward element as part of the cost that is related to that sale (hence, the forward element would be recognized in surplus or deficit in the same period as the revenue from the hedged sale).
- (b) The forward element of a forward contract relates to a time-period related hedged item if the nature of the hedged item is such that the forward element has the character of a cost for obtaining protection against a risk over a particular period of time (but the hedged item does not result in a transaction that involves the notion of a transaction cost in accordance with (a)). For example, if commodity inventory is hedged against changes in fair value for six months using a commodity forward contract with a corresponding life, the forward element of the forward contract

would be allocated to surplus or deficit (i.e., amortized on a systematic and rational basis) over that six-month period. Another example is a hedge of a net investment in a foreign operation that is hedged for 18 months using a foreign-exchange forward contract, which would result in allocating the forward element of the forward contract over that 18-month period.

- AG328. The characteristics of the hedged item, including how and when the hedged item affects surplus or deficit, also affect the period over which the forward element of a forward contract that hedges a time-period related hedged item is amortized, which is over the period to which the forward element relates. For example, if a forward contract hedges the exposure to variability in three-month interest rates for a three-month period that starts in six months' time, the forward element is amortized during the period that spans months seven to nine.
- AG329. The accounting for the forward element of a forward contract in accordance with paragraph 145 also applies if, at the date on which the forward contract is designated as a hedging instrument, the forward element is nil. In that case, an entity shall recognize any fair value changes attributable to the forward element in net assets/equity, even though the cumulative fair value change attributable to the forward element over the total period of the hedging relationship is nil. Hence, if the forward element of a forward contract relates to:
- (a) A transaction related hedged item, the amount in respect of the forward element at the end of the hedging relationship that adjusts the hedged item or that is reclassified to surplus or deficit (see paragraphs 144(b) and 145) would be nil.
 - (b) A time-period related hedged item, the amortization amount related to the forward element is nil.
- AG330. The accounting for the forward element of forward contracts in accordance with paragraph 145 applies only to the extent that the forward element relates to the hedged item (aligned forward element). The forward element of a forward contract relates to the hedged item if the critical terms of the forward contract (such as the nominal amount, life and underlying) are aligned with the hedged item. Hence, if the critical terms of the forward contract and the hedged item are not fully aligned, an entity shall determine the aligned forward element, i.e., how much of the forward element included in the forward contract (actual forward element) relates to the hedged item (and therefore should be treated in accordance with paragraph 145). An entity determines the aligned forward element using the valuation of the forward contract that would have critical terms that perfectly match the hedged item.
- AG331. If the actual forward element and the aligned forward element differ, an entity shall determine the amount that is accumulated in a separate component of net assets/equity in accordance with paragraph 145 as follows:
- (a) If, at inception of the hedging relationship, the absolute amount of the actual forward element is higher than that of the aligned forward element the entity shall:
 - (i) Determine the amount that is accumulated in a separate component of net assets/equity on the basis of the aligned forward element; and
 - (ii) Account for the differences in the fair value changes between the two forward elements in surplus or deficit.
 - (b) If, at inception of the hedging relationship, the absolute amount of the actual forward element is lower than that of the aligned forward element, the entity shall determine the amount that is accumulated in a separate component of net assets/equity by reference to the lower of the cumulative change in fair value of:
 - (i) The absolute amount of the actual forward element; and
 - (ii) The absolute amount of the aligned forward element.

Any remainder of the change in fair value of the actual forward element shall be recognized in surplus or deficit.

- AG332. When an entity separates the foreign currency basis spread from a financial instrument and excludes it from the designation of that financial instrument as the hedging instrument (see paragraph 119(b)), the application guidance in paragraphs AG327–AG331 applies to the foreign currency basis spread in the same manner as it is applied to the forward element of a forward contract.

Hedge of a Group of Items

Hedge of a Net Position

Eligibility for Hedge Accounting and Designation of a Net Position

- AG333. A net position is eligible for hedge accounting only if an entity hedges on a net basis for risk management purposes. Whether an entity hedges in this way is a matter of fact (not merely of assertion or documentation). Hence, an entity cannot

apply hedge accounting on a net basis solely to achieve a particular accounting outcome if that would not reflect its risk management approach. Net position hedging must form part of an established risk management strategy. Normally this would be approved by key management personnel as defined in IPSAS 20.

- AG334. For example, Entity A, whose functional currency is its local currency, has a firm commitment to pay FC150,000 for advertising expenses in nine months' time and a firm commitment to sell finished goods for FC150,000 in 15 months' time. Entity A enters into a foreign currency derivative that settles in nine months' time under which it receives FC100 and pays CU70. Entity A has no other exposures to FC. Entity A does not manage foreign currency risk on a net basis. Hence, Entity A cannot apply hedge accounting for a hedging relationship between the foreign currency derivative and a net position of FC100 (consisting of FC150,000 of the firm purchase commitment—i.e., advertising services—and FC149,900 (of the FC150,000) of the firm sale commitment) for a nine-month period.
- AG335. If Entity A did manage foreign currency risk on a net basis and did not enter into the foreign currency derivative (because it increases its foreign currency risk exposure instead of reducing it), then the entity would be in a natural hedged position for nine months. Normally, this hedged position would not be reflected in the financial statements because the transactions are recognized in different reporting periods in the future. The nil net position would be eligible for hedge accounting only if the conditions in paragraph 151 are met.
- AG336. When a group of items that constitute a net position is designated as a hedged item, an entity shall designate the overall group of items that includes the items that can make up the net position. An entity is not permitted to designate a non-specific abstract amount of a net position. For example, an entity has a group of firm sale commitments in nine months' time for FC100 and a group of firm purchase commitments in 18 months' time for FC120. The entity cannot designate an abstract amount of a net position up to FC20. Instead, it must designate a gross amount of purchases and a gross amount of sales that together give rise to the hedged net position. An entity shall designate gross positions that give rise to the net position so that the entity is able to comply with the requirements for the accounting for qualifying hedging relationships.

Application of the Hedge Effectiveness Requirements to a Hedge of a Net Position

- AG337. When an entity determines whether the hedge effectiveness requirements of paragraph 129(c) are met when it hedges a net position, it shall consider the changes in the value of the items in the net position that have a similar effect as the hedging instrument in conjunction with the fair value change on the hedging instrument. For example, an entity has a group of firm sale commitments in nine months' time for FC100 and a group of firm purchase commitments in 18 months' time for FC120. It hedges the foreign currency risk of the net position of FC20 using a forward exchange contract for FC20. When determining whether the hedge effectiveness requirements of paragraph 129(c) are met, the entity shall consider the relationship between:
- (a) The fair value change on the forward exchange contract together with the foreign currency risk related changes in the value of the firm sale commitments; and
 - (b) The foreign currency risk related changes in the value of the firm purchase commitments.
- AG338. Similarly, if in the example in paragraph AG337 the entity had a nil net position it would consider the relationship between the foreign currency risk related changes in the value of the firm sale commitments and the foreign currency risk related changes in the value of the firm purchase commitments when determining whether the hedge effectiveness requirements of paragraph 129(c) are met.

Cash Flow Hedges that Constitute a Net Position

- AG339. When an entity hedges a group of items with offsetting risk positions (i.e., a net position), the eligibility for hedge accounting depends on the type of hedge. If the hedge is a fair value hedge, then the net position may be eligible as a hedged item. If, however, the hedge is a cash flow hedge, then the net position can only be eligible as a hedged item if it is a hedge of foreign currency risk and the designation of that net position specifies the reporting period in which the forecast transactions are expected to affect surplus or deficit and also specifies their nature and volume.
- AG340. For example, an entity has a net position that consists of a bottom layer of FC100 of sales and a bottom layer of FC150 of purchases. Both sales and purchases are denominated in the same foreign currency. In order to sufficiently specify the designation of the hedged net position, the entity specifies in the original documentation of the hedging relationship that sales can be of Product A or Product B and purchases can be of Machinery Type A, Machinery Type B and Raw Material A. The entity also specifies the volumes of the transactions by each nature. The entity documents that the bottom layer of sales (FC100) is made up of a forecast sales volume of the first FC70 of Product A and the first FC30 of Product B. If those sales volumes are expected to affect surplus or deficit in different reporting periods, the entity would include that in the documentation, for example, the first FC70 from sales of Product A that are expected to affect surplus or deficit in the

first reporting period and the first FC30 from sales of Product B that are expected to affect surplus or deficit in the second reporting period. The entity also documents that the bottom layer of the purchases (FC150) is made up of purchases of the first FC60 of Machinery Type A, the first FC40 of Machinery Type B and the first FC50 of Raw Material A. If those purchase volumes are expected to affect surplus or deficit in different reporting periods, the entity would include in the documentation a disaggregation of the purchase volumes by the reporting periods in which they are expected to affect surplus or deficit (similarly to how it documents the sales volumes). For example, the forecast transaction would be specified as:

- (a) The first FC60 of purchases of Machinery Type A that are expected to affect surplus or deficit from the third reporting period over the next ten reporting periods;
- (b) The first FC40 of purchases of Machinery Type B that are expected to affect surplus or deficit from the fourth reporting period over the next 20 reporting periods; and
- (c) The first FC50 of purchases of Raw Material A that are expected to be received in the third reporting period and sold, i.e., affect surplus or deficit, in that and the next reporting period.

Specifying the nature of the forecast transaction volumes would include aspects such as the depreciation pattern for items of property, plant and equipment of the same kind, if the nature of those items is such that the depreciation pattern could vary depending on how the entity uses those items. For example, if the entity uses items of Machinery Type A in two different production processes that result in straight-line depreciation over ten reporting periods and the units of production method respectively, its documentation of the forecast purchase volume for Machinery Type A would disaggregate that volume by which of those depreciation patterns will apply.

AG341. For a cash flow hedge of a net position, the amounts determined in accordance with paragraph 140 shall include the changes in the value of the items in the net position that have a similar effect as the hedging instrument in conjunction with the fair value change on the hedging instrument. However, the changes in the value of the items in the net position that have a similar effect as the hedging instrument are recognized only once the transactions that they relate to are recognized, such as when a forecast sale is recognized as revenue. For example, an entity has a group of highly probable forecast sales in nine months' time for FC100 and a group of highly probable forecast purchases in 18 months' time for FC120. It hedges the foreign currency risk of the net position of FC20 using a forward exchange contract for FC20. When determining the amounts that are recognized in the cash flow hedge reserve in accordance with paragraph 140(a)–140(b), the entity compares:

- (a) The fair value change on the forward exchange contract together with the foreign currency risk related changes in the value of the highly probable forecast sales; with
- (b) The foreign currency risk related changes in the value of the highly probable forecast purchases.

However, the entity recognizes only amounts related to the forward exchange contract until the highly probable forecast sales transactions are recognized in the financial statements, at which time the gains or losses on those forecast transactions are recognized (i.e., the change in the value attributable to the change in the foreign exchange rate between the designation of the hedging relationship and the recognition of revenue).

AG342. Similarly, if in the example the entity had a nil net position it would compare the foreign currency risk related changes in the value of the highly probable forecast sales with the foreign currency risk related changes in the value of the highly probable forecast purchases. However, those amounts are recognized only once the related forecast transactions are recognized in the financial statements.

Layers of Groups of Items Designated as the Hedged Item

AG343. For the same reasons noted in paragraph AG268, designating layer components of groups of existing items requires the specific identification of the nominal amount of the group of items from which the hedged layer component is defined.

AG344. A hedging relationship can include layers from several different groups of items. For example, in a hedge of a net position of a group of assets and a group of liabilities, the hedging relationship can comprise, in combination, a layer component of the group of assets and a layer component of the group of liabilities.

Presentation of Hedging Instrument Gains or Losses

AG345. If items are hedged together as a group in a cash flow hedge, they might affect different line items in the statement of surplus or deficit and net assets/equity. The presentation of hedging gains or losses in that statement depends on the group of items.

- AG346. If the group of items does not have any offsetting risk positions (for example, a group of foreign currency expenses that affect different line items in the statement of financial performance and the statement of changes in net assets/equity that are hedged for foreign currency risk) then the reclassified hedging instrument gains or losses shall be apportioned to the line items affected by the hedged items. This apportionment shall be done on a systematic and rational basis and shall not result in the grossing up of the net gains or losses arising from a single hedging instrument.
- AG347. If the group of items does have offsetting risk positions (for example, a group of sales and expenses denominated in a foreign currency hedged together for foreign currency risk) then an entity shall present the hedging gains or losses in a separate line item in the statement of financial performance and the statement of changes in net assets/equity. Consider, for example, a hedge of the foreign currency risk of a net position of foreign currency sales of FC100 and foreign currency expenses of FC80 using a forward exchange contract for FC20. The gain or loss on the forward exchange contract that is reclassified from the cash flow hedge reserve to surplus or deficit (when the net position affects surplus or deficit) shall be presented in a separate line item from the hedged sales and expenses. Moreover, if the sales occur in an earlier period than the expenses, the sales revenue is still measured at the spot exchange rate in accordance with IPSAS 4. The related hedging gain or loss is presented in a separate line item, so that surplus or deficit reflects the effect of hedging the net position, with a corresponding adjustment to the cash flow hedge reserve. When the hedged expenses affect surplus or deficit in a later period, the hedging gain or loss previously recognized in the cash flow hedge reserve on the sales is reclassified to surplus or deficit and presented as a separate line item from those that include the hedged expenses, which are measured at the spot exchange rate in accordance with IPSAS 4.
- AG348. For some types of fair value hedges, the objective of the hedge is not primarily to offset the fair value change of the hedged item but instead to transform the cash flows of the hedged item. For example, an entity hedges the fair value interest rate risk of a fixed-rate debt instrument using an interest rate swap. The entity's hedge objective is to transform the fixed-interest cash flows into floating interest cash flows. This objective is reflected in the accounting for the hedging relationship by accruing the net interest accrual on the interest rate swap in surplus or deficit. In the case of a hedge of a net position (for example, a net position of a fixed-rate asset and a fixed-rate liability), this net interest accrual must be presented in a separate line item in the statement of financial performance and the statement of changes in net assets/equity. This is to avoid the grossing up of a single instrument's net gains or losses into offsetting gross amounts and recognizing them in different line items (for example, this avoids grossing up a net interest receipt on a single interest rate swap into gross interest revenue and gross interest expense).

Effective Date and Transition

Transition

Financial Assets Held for Trading

- AG349. At the date of initial application of this Standard, an entity must determine whether the objective of the entity's management model for managing any of its financial assets meets the condition in paragraph 40(a) or the condition in paragraph 41(a) or if a financial asset is eligible for the election in paragraph 106. For that purpose, an entity shall determine whether financial assets meet the definition of held for trading as if the entity had purchased the assets at the date of initial application.

Impairment

- AG350. On transition, an entity should seek to approximate the credit risk on initial recognition by considering all reasonable and supportable information that is available without undue cost or effort. An entity is not required to undertake an exhaustive search for information when determining, at the date of transition, whether there have been significant increases in credit risk since initial recognition. If an entity is unable to make this determination without undue cost or effort paragraph 178 applies.
- AG351. In order to determine the loss allowance on financial instruments initially recognized (or loan commitments or financial guarantee contracts to which the entity became a party to the contract) prior to the date of initial application, both on transition and until the derecognition of those items an entity shall consider information that is relevant in determining or approximating the credit risk at initial recognition. In order to determine or approximate the initial credit risk, an entity may consider internal and external information, including portfolio information, in accordance with paragraphs AG165–AG170.
- AG352. An entity with little historical information may use information from internal reports and statistics (that may have been generated when deciding whether to launch a new product), information about similar products or peer group experience for comparable financial instruments, if relevant.

Appendix B – Hedges of a Net Investment in a Foreign Operation

This Appendix is an integral part of IPSAS 41.

Introduction

- B1. Many reporting entities have investments in foreign operations (as defined in IPSAS 4, paragraph 10). Such foreign operations may be controlled entities, associates, joint ventures or branches. IPSAS 4 requires an entity to determine the functional currency of each of its foreign operations as the currency of the primary economic environment of that operation. When translating the results and financial position of a foreign operation into a presentation currency, the entity is required to recognize foreign exchange differences directly in net assets/equity until it disposes of the foreign operation.
- B2. Hedge accounting of the foreign currency risk arising from a net investment in a foreign operation will apply only when the net assets of that foreign operation are included in the financial statements. This will be the case for consolidated financial statements, financial statements in which investments such as associates or joint ventures are accounted for using the equity method and financial statements that include a branch or joint operations as defined in IPSAS 37. The item being hedged with respect to the foreign currency risk arising from the net investment in a foreign operation may be an amount of net assets equal to or less than the carrying amount of the net assets of the foreign operation.
- B3. IPSAS 41 requires the designation of an eligible hedged item and eligible hedging instruments in a hedge accounting relationship. If there is a designated hedging relationship, in the case of a net investment hedge, the gain or loss on the hedging instrument that is determined to be an effective hedge of the net investment is recognized directly in net assets/equity and is included with the foreign exchange differences arising on translation of the results and financial position of the foreign operation.
- B4. This Appendix applies to an entity that hedges the foreign currency risk arising from its net investments in foreign operations and wishes to qualify for hedge accounting in accordance with IPSAS 41. It should not be applied by analogy to other types of hedge accounting. This Appendix refers to such an entity as a controlling entity and to the financial statements in which the net assets of foreign operations are included as consolidated financial statements. All references to a controlling entity apply equally to an entity that has a net investment in a foreign operation that is a joint venture, an associate or a branch.
- B5. This Appendix provides guidance on:
- (a) Identifying the foreign currency risks that qualify as a hedged risk in the hedge of a net investment in a foreign operation, given that an entity with many foreign operations may be exposed to a number of foreign currency risks. It specifically addresses:
 - (i) Whether the controlling entity may designate as a hedged risk only the foreign exchange differences arising from a difference between the functional currencies of the controlling entity and its foreign operation, or whether it may also designate as the hedged risk the foreign exchange differences arising from the difference between the presentation currency of the controlling entity's consolidated financial statements and the functional currency of the foreign operation; and
 - (ii) If the controlling entity holds the foreign operation indirectly, whether the hedged risk may include only the foreign exchange differences arising from differences in functional currencies between the foreign operation and its immediate controlling entity, or whether the hedged risk may also include any foreign exchange differences between the functional currency of the foreign operation and any intermediate or ultimate controlling entity (i.e., whether the fact that the net investment in the foreign operation is held through an intermediate controlling entity affects the economic risk to the ultimate controlling entity).
 - (b) Where in an economic entity the hedging instrument can be held. It specifically addresses:
 - (i) IPSAS 41 allows an entity to designate either a derivative or a non-derivative financial instrument (or a combination of derivative and non-derivative financial instruments) as hedging instruments for foreign currency risk. This Appendix addresses whether the nature of the hedging instrument (derivative or non-derivative) or the method of consolidation affects the assessment of hedge effectiveness.
 - (ii) This Appendix also addresses where, within an economic entity, hedging instruments that are hedges of a net investment in a foreign operation can be held to qualify for hedge accounting i.e., whether a qualifying hedge accounting relationship can be established only if the entity hedging its net investment is a party to the hedging instrument or whether any entity within the economic entity, regardless of its functional currency, can hold the hedging instrument.

- (c) How an entity should determine what amount of the gain or loss recognized in net assets/equity should be recognized directly in surplus or deficit for both the hedging instrument and the hedged item as IPSAS 4 and IPSAS 41 require cumulative amounts recognized directly in net assets/equity relating to both the foreign exchange differences arising on translation of the results and financial position of the foreign operation and the gain or loss on the hedging instrument that is determined to be an effective hedge of the net investment to be recognized directly when the controlling entity disposes of the foreign operation. It specifically addresses:
- (i) When a foreign operation that was hedged is disposed of, what amounts from the controlling entity's foreign currency translation reserve in respect of the hedging instrument and of that foreign operation should be recognized in surplus or deficit in the controlling entity's consolidated financial statements; and
 - (ii) Whether the method of consolidation affects the determination of the amounts to be recognized in surplus or deficit.

Application of IPSAS 41 to Hedges of a Net Investment in a Foreign Operation

Nature of the Hedged Risk and Amount of the Hedged Item for which a Hedging Relationship may be Designated

- B6. Hedge accounting may be applied only to the foreign exchange differences arising between the functional currency of the foreign operation and the controlling entity's functional currency.
- B7. In a hedge of the foreign currency risks arising from a net investment in a foreign operation, the hedged item can be an amount of net assets equal to or less than the carrying amount of the net assets of the foreign operation in the consolidated financial statements of the controlling entity. The carrying amount of the net assets of a foreign operation that may be designated as the hedged item in the consolidated financial statements of a controlling entity depends on whether any lower level controlling entity of the foreign operation has applied hedge accounting for all or part of the net assets of that foreign operation and that accounting has been maintained in the controlling entity's consolidated financial statements.
- B8. The hedged risk may be designated as the foreign currency exposure arising between the functional currency of the foreign operation and the functional currency of any controlling entity (the immediate, intermediate or ultimate controlling entity) of that foreign operation. The fact that the net investment is held through an intermediate controlling entity does not affect the nature of the economic risk arising from the foreign currency exposure to the ultimate controlling entity.
- B9. An exposure to foreign currency risk arising from a net investment in a foreign operation may qualify for hedge accounting only once in the consolidated financial statements. Therefore, if the same net assets of a foreign operation are hedged by more than one controlling entity within the economic entity (e.g., both a direct and an indirect controlling entity) for the same risk, only one hedging relationship will qualify for hedge accounting in the consolidated financial statements of the ultimate controlling entity. A hedging relationship designated by one controlling entity in its consolidated financial statements need not be maintained by another higher level controlling entity. However, if it is not maintained by the higher level controlling entity, the hedge accounting applied by the lower level controlling entity must be reversed before the higher level controlling entity's hedge accounting is recognized.

Where the Hedging Instrument can be Held

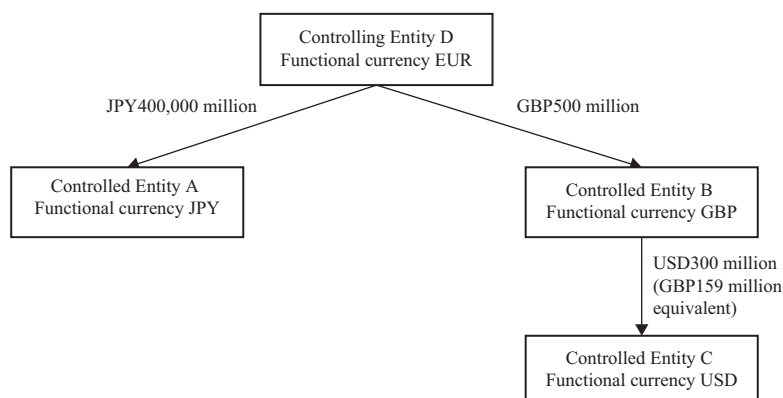
- B10. A derivative or a non-derivative instrument (or a combination of derivative and non-derivative instruments) may be designated as a hedging instrument in a hedge of a net investment in a foreign operation. The hedging instrument(s) may be held by any entity or entities within the economic entity, as long as the designation, documentation and effectiveness requirements of IPSAS 41 paragraph 129 that relate to a net investment hedge are satisfied. In particular, the hedging strategy of the economic entity should be clearly documented because of the possibility of different designations at different levels of the economic entity.
- B11. For the purpose of assessing effectiveness, the change in value of the hedging instrument in respect of foreign exchange risk is computed by reference to the functional currency of the controlling entity against whose functional currency the hedged risk is measured, in accordance with the hedge accounting documentation. Depending on where the hedging instrument is held, in the absence of hedge accounting the total change in value might be recognized in surplus or deficit, directly in net assets/equity, or both. However, the assessment of effectiveness is not affected by whether the change in value of the hedging instrument is recognized in surplus or deficit or directly in net assets/equity. As part of the application of hedge accounting, the total effective portion of the change is included directly in net assets/equity. The assessment of effectiveness is not affected by whether the hedging instrument is a derivative or a non-derivative instrument or by the method of consolidation.

Disposal of a Hedged Foreign Operation

- B12. When a foreign operation that was hedged is disposed of, the amount reclassified to surplus or deficit from the foreign currency translation reserve in the consolidated financial statements of the controlling entity in respect of the hedging instrument is the amount that IPSAS 41 paragraph 143 requires to be identified. That amount is the cumulative gain or loss on the hedging instrument that was determined to be an effective hedge.
- B13. The amount recognized in surplus or deficit upon transfer from the foreign currency translation reserve in the consolidated financial statements of a controlling entity in respect of the net investment in that foreign operation in accordance with IPSAS 4 paragraph 57 is the amount included in that controlling entity's foreign currency translation reserve in respect of that foreign operation. In the ultimate controlling entity's consolidated financial statements, the aggregate net amount recognized in the foreign currency translation reserve in respect of all foreign operations is not affected by the consolidation method. However, whether the ultimate controlling entity uses the direct or the step-by-step method of consolidation, may affect the amount included in its foreign currency translation reserve in respect of an individual foreign operation.
- B14. The direct method is the method of consolidation in which the financial statements of the foreign operation are translated directly into the functional currency of the ultimate controlling entity. The step-by-step method is the method of consolidation in which the financial statements of the foreign operation are first translated into the functional currency of any intermediate controlling entity(ies) and then translated into the functional currency of the ultimate controlling entity (or the presentation currency if different).
- B15. The use of the step-by-step method of consolidation may result in a different amount being recognized in surplus or deficit from that used to determine hedge effectiveness. This difference may be eliminated by determining the amount relating to that foreign operation that would have arisen if the direct method of consolidation had been used. Making this adjustment is not required by IPSAS 4. However, it is an accounting policy choice that should be followed consistently for all net investments.

Example

- B16. The following example illustrates the application of the preceding paragraphs using the entity structure illustrated below. In all cases the hedging relationships described would be tested for effectiveness in accordance with IPSAS 41, although this testing is not discussed. Controlling Entity D, being the ultimate controlling entity, presents its consolidated financial statements in its functional currency of euro (EUR). Each of the controlled entities i.e., Controlled Entity A, Controlled Entity B and Controlled Entity C, is wholly owned. Controlling Entity D's £500 million net investment in Controlled Entity B (functional currency pounds sterling (GBP)) includes the £159 million equivalent of Controlled Entity B's US\$300 million net investment in Controlled Entity C (functional currency US dollars (USD)). In other words, Controlled Entity B's net assets other than its investment in Controlled Entity C are £341 million.

*Nature of Hedged Risk for which a Hedging Relationship may be Designated (paragraphs B6–B9)*

- B17. Controlling Entity D can hedge its net investment in each of Controlled Entities A, B and C for the foreign exchange risk between their respective functional currencies (Japanese yen (JPY), pounds sterling and US dollars) and euro. In addition, Controlling Entity D can hedge the USD/GBP foreign exchange risk between the functional currencies of Controlled Entity B and Controlled Entity C. In its consolidated financial statements, Controlled Entity B can hedge its net investment in Controlled Entity C for the foreign exchange risk between their functional currencies of US dollars and pounds sterling. In the following examples the designated risk is the spot foreign exchange risk because the hedging instruments are not

derivatives. If the hedging instruments were forward contracts, Controlling Entity D could designate the forward foreign exchange risk.

Amount of Hedged Item for which a Hedging Relationship may be Designated (paragraphs B6–B9)

B18. Controlling Entity D wishes to hedge the foreign exchange risk from its net investment in Controlled Entity C. Assume that Controlled Entity A has an external borrowing of US\$300 million. The net assets of Controlled Entity A at the start of the reporting period are ¥400,000 million including the proceeds of the external borrowing of US\$300 million.

B19. The hedged item can be an amount of net assets equal to or less than the carrying amount of Controlling Entity D's net investment in Controlled Entity C (US\$300 million) in its consolidated financial statements. In its consolidated financial statements Controlling Entity D can designate the US\$300 million external borrowing in Controlled Entity A as a hedge of the EUR/USD spot foreign exchange risk associated with its net investment in the US\$300 million net assets of Controlled Entity C. In this case, both the EUR/USD foreign exchange difference on the US\$300 million external borrowing in Controlled Entity A and the EUR/USD foreign exchange difference on the US\$300 million net investment in Controlled Entity C are included in the foreign currency translation reserve in Controlling Entity D's consolidated financial statements after the application of hedge accounting.

B20. In the absence of hedge accounting, the total USD/EUR foreign exchange difference on the US\$300 million external borrowing in Controlled Entity A would be recognized in Controlling Entity D's consolidated financial statements as follows:

- USD/JPY spot foreign exchange rate change, translated to euro, in surplus or deficit; and
- JPY/EUR spot foreign exchange rate change directly in net assets/equity.

Instead of the designation in paragraph B19, in its consolidated financial statements Controlling Entity D can designate the US\$300 million external borrowing in Controlled Entity A as a hedge of the GBP/USD spot foreign exchange risk between Controlled Entity C and Controlled Entity B. In this case, the total USD/EUR foreign exchange difference on the US\$300 million external borrowing in Entity A would instead be recognized in Controlled Entity D's consolidated financial statements as follows:

- The GBP/USD spot foreign exchange rate change in the foreign currency translation reserve relating to Controlled Entity C;
- GBP/JPY spot foreign exchange rate change, translated to euro, in surplus or deficit; and
- JPY/EUR spot foreign exchange rate change directly in net assets/equity.

B21. Controlling Entity D cannot designate the US\$300 million external borrowing in Controlled Entity A as a hedge of both the EUR/USD spot foreign exchange risk and the GBP/USD spot foreign exchange risk in its consolidated financial statements. A single hedging instrument can hedge the same designated risk only once. Controlled Entity B cannot apply hedge accounting in its consolidated financial statements because the hedging instrument is held outside the economic entity comprising Controlled Entity B and Controlled Entity C.

Where in an Economic Entity can the Hedging Instrument be Held (paragraphs B10 and B11)?

B22. As noted in paragraph B20, the total change in value in respect of foreign exchange risk of the US\$300 million external borrowing in Controlled Entity A would be recorded in both surplus or deficit (USD/JPY spot risk) and directly in net assets/equity (EUR/JPY spot risk) in Controlling Entity D's consolidated financial statements in the absence of hedge accounting. Both amounts are included for the purpose of assessing the effectiveness of the hedge designated in paragraph B19 because the change in value of both the hedging instrument and the hedged item are computed by reference to the euro functional currency of Controlling Entity D against the US dollar functional currency of Controlled Entity C, in accordance with the hedge documentation. The method of consolidation (i.e., direct method or step-by-step method) does not affect the assessment of the effectiveness of the hedge.

Amounts Recognized in Surplus or Deficit on Disposal of a Foreign Operation (paragraphs B12 and B13)

B23. When Controlled Entity C is disposed of, the amounts are recognized in surplus or deficit in Controlling Entity D's consolidated financial statements upon transfer from its foreign currency translation reserve (FCTR) are:

- (a) In respect of the US\$300 million external borrowing of Controlled Entity A, the amount that IPSAS 41 requires to be identified, i.e., the total change in value in respect of foreign exchange risk that was recognized directly in net assets/equity as the effective portion of the hedge; and

- (b) In respect of the US\$300 million net investment in Controlled Entity C, the amount determined by the entity's consolidation method. If Controlling Entity D uses the direct method, its FCTR in respect of Controlled Entity C will be determined directly by the EUR/USD foreign exchange rate. If Controlling Entity D uses the step-by-step method, its FCTR in respect of Controlled Entity C will be determined by the FCTR recognized by Controlled Entity B reflecting the GBP/USD foreign exchange rate, translated to Controlling Entity D's functional currency using the EUR/GBP foreign exchange rate. Controlling Entity D's use of the step-by-step method of consolidation in prior periods does not require it to or preclude it from determining the amount of FCTR to be recognized in surplus or deficit when it disposes of Controlled Entity C to be the amount that it would have recognized if it had always used the direct method, depending on its accounting policy.

Hedging More Than One Foreign Operation (paragraphs B7, B9, and B11)

- B24. The following examples illustrate that in the consolidated financial statements of Controlling Entity D, the risk that can be hedged is always the risk between its functional currency (euro) and the functional currencies of Controlled Entities B and C. No matter how the hedges are designated, the maximum amounts that can be effective hedges to be included in the foreign currency translation reserve in Controlling Entity D's consolidated financial statements when both foreign operations are hedged are US\$300 million for EUR/USD risk and £341 million for EUR/GBP risk. Other changes in value due to changes in foreign exchange rates are included in Controlling Entity D's consolidated surplus or deficit. Of course, it would be possible for Controlling Entity D to designate US\$300 million only for changes in the USD/GBP spot foreign exchange rate or £500 million only for changes in the GBP/EUR spot foreign exchange rate.

Entity D Holds Both USD and GBP Hedging Instruments

- B25. Controlling Entity D may wish to hedge the foreign exchange risk in relation to its net investment in Controlled Entity B as well as that in relation to Controlled Entity C. Assume that Controlling Entity D holds suitable hedging instruments denominated in US dollars and pounds sterling that it could designate as hedges of its net investments in Controlled Entity B and Controlled Entity C. The designations Controlling Entity D can make in its consolidated financial statements include, but are not limited to, the following:
- (a) US\$300 million hedging instrument designated as a hedge of the US\$300 million of net investment in Controlled Entity C with the risk being the spot foreign exchange exposure (EUR/USD) between Controlling Entity D and Controlled Entity C and up to £341 million hedging instrument designated as a hedge of £341 million of the net investment in Controlled Entity B with the risk being the spot foreign exchange exposure (EUR/GBP) between Controlling Entity D and Controlled Entity B.
- (b) US\$300 million hedging instrument designated as a hedge of the US\$300 million of net investment in Controlled Entity C with the risk being the spot foreign exchange exposure (GBP/USD) between Controlled Entity B and Controlled Entity C and up to £500 million hedging instrument designated as a hedge of £500 million of the net investment in Controlled Entity B with the risk being the spot foreign exchange exposure (EUR/GBP) between Controlling Entity D and Controlled Entity B.
- B26. The EUR/USD risk from Controlling Entity D's net investment in Controlled Entity C is a different risk from the EUR/GBP risk from Controlling Entity D's net investment in Controlled Entity B. However, in the case described in paragraph B25(a), by its designation of the USD hedging instrument it holds, Controlling Entity D has already fully hedged the EUR/USD risk from its net investment in Controlled Entity C. If Controlling Entity D also designated a GBP instrument it holds as a hedge of its £500 million net investment in Controlled Entity B, £159 million of that net investment, representing the GBP equivalent of its USD net investment in Controlled Entity C, would be hedged twice for GBP/EUR risk in Controlling Entity D's consolidated financial statements.
- B27. In the case described in paragraph B25(b), if Controlling Entity D designates the hedged risk as the spot foreign exchange exposure (GBP/USD) between Controlled Entity B and Controlled Entity C, only the GBP/USD part of the change in the value of its US\$300 million hedging instrument is included in Controlling Entity D's foreign currency translation reserve relating to Controlled Entity C. The remainder of the change (equivalent to the GBP/EUR change on £159 million) is included in Controlling Entity D's consolidated surplus or deficit, as in paragraph B20. Because the designation of the USD/GBP risk between Controlled entities B and C does not include the GBP/EUR risk, Controlling Entity D is also able to designate up to £500 million of its net investment in Controlled Entity B with the risk being the spot foreign exchange exposure (GBP/EUR) between Controlling Entity D and Controlled Entity B.

Entity B Holds the USD Hedging Instrument

- B28. Assume that Controlled Entity B holds US\$300 million of external debt, the proceeds of which were transferred to Controlling Entity D by an inter-entity loan denominated in pounds sterling. Because both its assets and liabilities increased by £159 million, Controlled Entity B's net assets are unchanged. Controlled Entity B could designate the external debt as a hedge of the GBP/USD risk of its net investment in Controlled Entity C in its consolidated financial statements. Controlling Entity D could maintain Controlled Entity B's designation of that hedging instrument as a hedge of its US\$300 million net investment in Controlled Entity C for the GBP/USD risk (see paragraph B9) and Controlling Entity D could designate the GBP hedging instrument it holds as a hedge of its entire £500 million net investment in Controlled Entity B. The first hedge, designated by Controlled Entity B, would be assessed by reference to Controlled Entity B's functional currency (pounds sterling) and the second hedge, designated by Controlling Entity D, would be assessed by reference to Controlling Entity D's functional currency (euro). In this case, only the GBP/USD risk from Controlling Entity D's net investment in Controlled Entity C has been hedged in Controlling Entity D's consolidated financial statements by the USD hedging instrument, not the entire EUR/USD risk. Therefore, the entire EUR/GBP risk from Controlling Entity D's £500 million net investment in Controlled Entity B may be hedged in the consolidated financial statements of Controlling Entity D.
- B29. However, the accounting for Controlling Entity D's £159 million loan payable to Controlled Entity B must also be considered. If Controlling Entity D's loan payable is not considered part of its net investment in Controlled Entity B because it does not satisfy the conditions in IPSAS 4 paragraph 18, the GBP/EUR foreign exchange difference arising on translating it would be included in Controlling Entity D's consolidated surplus or deficit. If the £159 million loan payable to Controlled Entity B is considered part of Controlling Entity D's net investment, that net investment would be only £341 million and the amount Controlling Entity D could designate as the hedged item for GBP/EUR risk would be reduced from £500 million to £341 million accordingly.
- B30. If Controlling Entity D reversed the hedging relationship designated by Controlled Entity B, Controlling Entity D could designate the US\$300 million external borrowing held by Controlled Entity B as a hedge of its US\$300 million net investment in Controlled Entity C for the EUR/USD risk and designate the GBP hedging instrument it holds itself as a hedge of only up to £341 million of the net investment in Controlled Entity B. In this case the effectiveness of both hedges would be computed by reference to Controlling Entity D's functional currency (euro). Consequently, both the USD/GBP change in value of the external borrowing held by Controlled Entity B and the GBP/EUR change in value of Controlling Entity D's loan payable to Controlled Entity B (equivalent to USD/EUR in total) would be included in the foreign currency translation reserve in Controlling Entity D's consolidated financial statements. Because Controlling Entity D has already fully hedged the EUR/USD risk from its net investment in Controlled Entity C, it can hedge only up to £341 million for the EUR/GBP risk of its net investment in Controlled Entity B.

Appendix C: Extinguishing Financial Liabilities with Equity Instruments

This Appendix is an integral part of IPSAS 41.

Introduction

- C1. A debtor and creditor might renegotiate the terms of a financial liability with the result that the debtor extinguishes the liability fully or partially by issuing equity instruments to the creditor. These transactions are sometimes referred to as ‘debt for equity swaps’.

Scope

- C2. This Appendix addresses the accounting by an entity when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to a creditor of the entity to extinguish all or part of the financial liability. It does not address the accounting by the creditor.
- C3. An entity shall not apply this Appendix to transactions in situations where:
- The creditor is also a direct or indirect shareholder and is acting in its capacity as a direct or indirect existing shareholder.
 - The creditor and the entity are controlled by the same party or parties before and after the transaction and the substance of the transaction includes an equity distribution by, or contribution to, the entity.
 - Extinguishing the financial liability by issuing equity shares is in accordance with the original terms of the financial liability.
- C4. This Appendix addresses the following issues:
- Are an entity’s equity instruments issued to extinguish all or part of a financial liability ‘consideration paid’ in accordance with paragraph 37 of IPSAS 41?
 - How should an entity initially measure the equity instruments issued to extinguish such a financial liability?
 - How should an entity account for any difference between the carrying amount of the financial liability extinguished and the initial measurement amount of the equity instruments issued?

Consensus

- C5. The issue of an entity’s equity instruments to a creditor to extinguish all or part of a financial liability is consideration paid in accordance with paragraph 37 of IPSAS 41. An entity shall remove a financial liability (or part of a financial liability) from its statement of financial position when, and only when, it is extinguished in accordance with paragraph 35 of IPSAS 41.
- C6. When equity instruments issued to a creditor to extinguish all or part of a financial liability are recognized initially, an entity shall measure them at the fair value of the equity instruments issued, unless that fair value cannot be reliably measured.
- C7. If the fair value of the equity instruments issued cannot be reliably measured then the equity instruments shall be measured to reflect the fair value of the financial liability extinguished. In measuring the fair value of a financial liability extinguished that includes a demand feature (e.g., a demand deposit), paragraph 68 of IPSAS 41 is not applied.
- C8. If only part of the financial liability is extinguished, the entity shall assess whether some of the consideration paid relates to a modification of the terms of the liability that remains outstanding. If part of the consideration paid does relate to a modification of the terms of the remaining part of the liability, the entity shall allocate the consideration paid between the part of the liability extinguished and the part of the liability that remains outstanding. The entity shall consider all relevant facts and circumstances relating to the transaction in making this allocation.
- C9. The difference between the carrying amount of the financial liability (or part of a financial liability) extinguished, and the consideration paid, shall be recognized in surplus or deficit, in accordance with paragraph 37 of IPSAS 41. The equity instruments issued shall be recognized initially and measured at the date the financial liability (or part of that liability) is extinguished.
- C10. When only part of the financial liability is extinguished, consideration shall be allocated in accordance with paragraph C8. The consideration allocated to the remaining liability shall form part of the assessment of whether the terms of that

remaining liability have been substantially modified. If the remaining liability has been substantially modified, the entity shall account for the modification as the extinguishment of the original liability and the recognition of a new liability as required by paragraph 36 of IPSAS 41.

- C11. An entity shall disclose a gain or loss recognized in accordance with paragraphs C9 and C10 as a separate line item in surplus or deficit or in the notes.

Amendments to Other IPSASs

Amendments to IPSAS 1, *Presentation of Financial Statements*

Paragraphs 7, 79, 82, 101, 102 and 138 are amended and paragraphs 125A, 125B, 125C and 153L are added. New text is underlined and deleted text is struck through.

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Definitions

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

The components of net assets/equity are contributed capital, accumulated surpluses or deficits, reserves, and non-controlling interests. Types of reserves include:

- (a) Changes in revaluation surplus (see IPSAS 17, *Property, Plant, and Equipment* and IPSAS 31, *Intangible Assets*);
- (b) Remeasurements of defined benefit plans (see IPSAS 39, *Employee Benefits*);
- (c) Gains and losses arising from translating the financial statements of a foreign operation (see IPSAS 4, *The Effects of Changes in Foreign Exchange Rates*);
- (d) Gains and losses from investments in equity instruments designated at fair value through net assets/equity in accordance with paragraph 106 of IPSAS 41, *Financial Instruments*;
- (e) Gains and losses on financial assets measured at fair value through net assets/equity in accordance with paragraph 41 of IPSAS 41;
- (f) The effective portion of gains and losses on hedging instruments in a cash flow hedge and the gains and losses on hedging instruments that hedge investments in equity instruments measured at fair value through net assets/equity in accordance with paragraph 106 of IPSAS 41 (see paragraphs 113–155 of IPSAS 41);
- (g) For particular liabilities designated as at fair value through surplus or deficit, the amount of the change in fair value that is attributable to changes in the liability's credit risk (see paragraph 108 of IPSAS 41);
- (h) Changes in the value of the time value of options when separating the intrinsic value and time value of an option contract and designating as the hedging instrument only the changes in the intrinsic value (see paragraphs 113–155 of IPSAS 41); and
- (i) Changes in the value of the forward elements of forward contracts when separating the forward element and spot element of a forward contract and designating as the hedging instrument only the changes in the spot element, and changes in the value of the foreign currency basis spread of a financial instrument when excluding it from the designation of that financial instrument as the hedging instrument (see paragraphs 113–155 of IPSAS 41).

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Statement of Financial Position

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Current Assets

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79. Current assets include assets (such as taxes receivable, user charges receivable, fines and regulatory fees receivable, inventories and accrued investment revenue) that are either realized, consumed or sold, as part of the normal operating cycle even when they are not expected to be realized within twelve months after the reporting date. Current assets also include assets held primarily for the purpose of trading (examples include some financial assets that meet the definition of classified as held for trading in accordance with IPSAS 41 *IPSAS 29, Financial Instruments: Recognition and Measurement*) and the current portion of non-current financial assets.

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Current Liabilities

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82. Other current liabilities are not settled as part of the normal operating cycle, but are due for settlement within twelve months after the reporting date or held primarily for the purpose of being traded. Examples are some financial liabilities that meet the definition of classified as held for trading in accordance with IPSAS 41 IPSAS 29, bank overdrafts, and the current portion of non-current financial liabilities, dividends or similar distributions payable, income taxes and other non-trade payables. Financial liabilities that provide financing on a long-term basis (i.e., are not part of the working capital used in the entity's normal operating cycle) and are not due for settlement within twelve months after the reporting date are non-current liabilities, subject to paragraphs 85 and 86.

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Statement of Financial Performance

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101. Other IPSASs deal with items that may meet definitions of revenue or expense set out in this Standard, but are usually excluded from surplus or deficit. Examples include revaluation surpluses (see IPSAS 17), particular (a) gains and losses arising on translating the financial statements of a foreign operation (see IPSAS 4), and (b) gains or losses on remeasuring ~~available-for-sale~~ financial assets measured at fair value through net assets/equity (guidance on measurement of financial assets can be found in IPSAS 41 IPSAS 29).

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Information to be Presented on the Face of the Statement Financial Performance

102. **As a minimum, the face of the statement of financial performance shall include line items that present the following amounts for the period:**
- (a) **Revenue, presenting separately:**
 - (i) Interest revenue calculated using the effective interest method; and**
 - (ii) Gains and losses arising from the derecognition of financial assets measured at amortized cost;**
 - (b) **Finance costs;**
 - (ba) **Impairment losses (including reversals of impairment losses or impairment gains) determined in accordance with paragraphs 73–93 of IPSAS 41;**
 - (c) **Share of the surplus or deficit of associates and joint ventures accounted for using the equity method;**
 - (ca) **If a financial asset is reclassified out of the amortized cost measurement category so that it is measured at fair value through surplus or deficit, any gain or loss arising from a difference between the previous amortized cost of the financial asset and its fair value at the reclassification date (as defined in IPSAS 41);**
 - (cb) **If a financial asset is reclassified out of the fair value through net asset/equity measurement category so that it is measured at fair value through surplus or deficit, any cumulative gain or loss previously recognized in net assets/equity that is reclassified to surplus or deficit;**
 - (d) **Pre-tax gain or loss recognized on the disposal of assets or settlement of liabilities attributable to discontinuing operations; and**
 - (e) **Surplus or deficit.**

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Statement of Changes in Net Assets/Equity

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- 125A. Other IPSASs specify whether and when amounts previously recognized in net assets/equity are reclassified to surplus or deficit. Such reclassifications are referred to in this Standard as reclassification adjustments. A reclassification adjustment is included with the related component of net assets/equity in the period that the adjustment is reclassified to surplus or deficit. These amounts may have been recognized in net assets/equity as unrealized gains in the current or previous periods.

Those unrealized gains must be deducted from net assets/equity in the period in which the realized gains are reclassified to surplus or deficit to avoid including them in the statement of changes in net assets/equity twice.

125B. Reclassification adjustments arise, for example, on disposal of a foreign operation (see IPSAS 4) and when some hedged forecast cash flows affect surplus or deficit (see paragraph 140(d) of IPSAS 41 in relation to cash flow hedges).

125C. Reclassification adjustments do not arise on changes in revaluation surplus recognized in accordance with IPSAS 17 or IPSAS 31 or on remeasurements of defined benefit plans recognized in accordance with IPSAS 39. These components are recognized in net assets/equity and are not reclassified to surplus or deficit in subsequent periods. Changes in revaluation surplus may be transferred to accumulated surpluses or deficits in subsequent periods as the asset is used or when it is derecognized (see IPSAS 17 or IPSAS 31). In accordance with IPSAS 41, reclassification adjustments do not arise if a cash flow hedge or the accounting for the time value of an option (or the forward element of a forward contract or the foreign currency basis spread of a financial instrument) result in amounts that are removed from the cash flow hedge reserve or a separate component of net assets/equity, respectively, and included directly in the initial cost or other carrying amount of an asset or a liability. These amounts are directly transferred to assets or liabilities.

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Disclosure of Accounting Policies

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138. In the process of applying the entity's accounting policies, management makes various judgments, apart from those involving estimations, that can significantly affect the amounts recognized in the financial statements. For example, management makes judgments in determining:

- Whether assets are investment properties;
- Whether agreements for the provision of goods and/or services that involve the use of dedicated assets are leases;
- Whether, in substance, particular sales of goods are financing arrangements and therefore do not give rise to revenue; ~~and~~
- Whether the substance of the relationship between the reporting entity and other entities indicates that these other entities are controlled by the reporting entity; and,
- Whether the contractual terms of a financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

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Effective Date

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153L. Paragraphs 7, 79, 82, 101, 102 and 138 were amended and paragraphs 125A, 125B and 125C were added by IPSAS 41, issued in August 2018. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2022. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2022 it shall disclose that fact and apply IPSAS 41 at the same time.

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Amendments to IPSAS 4, *The Effects of Changes in Foreign Exchange Rates*

Paragraphs 3, 4, 5, 31 and 61 are amended and paragraph 71D is added. New text is underlined and deleted text is struck through.

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Scope

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3. An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard:

- (a) **In accounting for transactions and balances in foreign currencies, except for those derivative transactions and balances that are within the scope of IPSAS 41, *Financial Instruments* ~~IPSAS 29, *Financial Instruments: Recognition and Measurement*~~;**
 - (b) **In translating the financial performance and financial position of foreign operations that are included in the financial statements of the entity by consolidation, or by the equity method; and**
 - (c) **In translating an entity's financial performance and financial position into a presentation currency.**
4. IPSAS 41 ~~IPSAS 29~~ applies to many foreign currency derivatives and, accordingly, these are excluded from the scope of this Standard. However, those foreign currency derivatives that are not within the scope of IPSAS 41 ~~IPSAS 29~~ (e.g., some foreign currency derivatives that are embedded in other contracts) are within the scope of this Standard. In addition, this Standard applies when an entity translates amounts relating to derivatives from its functional currency to its presentation currency.
5. This Standard does not apply to hedge accounting for foreign currency items, including the hedging of a net investment in a foreign operation. IPSAS 41 ~~IPSAS 29~~ applies to hedge accounting.

Recognition of Exchange Differences

31. As noted in paragraph 5, this Standard does not deal with hedge accounting for foreign currency items. Guidance in relation to hedge accounting, including the criteria for when to use hedge accounting, can be found in IPSAS 41 ~~IPSAS 29~~.

Disclosure

61. The entity shall disclose:

- (a) **The amount of exchange differences recognized in surplus or deficit, except for those arising on financial instruments measured at fair value through surplus or deficit in accordance with IPSAS 41 ~~IPSAS 29~~; and**
- (b) **Net exchange differences classified in a separate component of net assets/equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.**

Effective Date

71D. Paragraphs 3, 4, 5, 31 and 61 were amended by IPSAS 41, issued in August 2018. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2022. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2022 it shall disclose that fact and apply IPSAS 41 at the same time.

Amendments to IPSAS 9, *Revenue from Exchange Transactions*

Paragraph 10 is amended and paragraph 41D is added. New text is underlined and deleted text is struck through.

Scope

10. This Standard does not deal with revenues arising from:

- (a) Lease agreements (see IPSAS 13, *Leases*);
- (b) Dividends or similar distributions arising from investments that are accounted for under the equity method (see IPSAS 36, *Investments in Associates and Joint Ventures*);

- (c) Gains from the sale of property, plant, and equipment (which are dealt with in IPSAS 17, *Property, Plant, and Equipment*);
- (d) Insurance contracts within the scope of the relevant international or national accounting standard dealing with insurance contracts;
- (e) Changes in the fair value of financial assets and financial liabilities or their disposal (~~see IPSAS 41, *Financial Instruments* guidance on the recognition and measurement of financial instruments can be found in IPSAS 29, *Financial Instruments: Recognition and Measurement*~~);
- (f) Changes in the value of other current assets;
- (g) Initial recognition, and from changes in the fair value of biological assets related to agricultural activity (see IPSAS 27, *Agriculture*);
- (h) Initial recognition of agricultural produce (see IPSAS 27); and
- (i) The extraction of mineral ores.

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Effective Date

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41D. Paragraph 10 was amended by IPSAS 41, issued in August 2018. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2022. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2022 it shall disclose that fact and apply IPSAS 41 at the same time.

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Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 9.

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Rendering of Services

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Financial Service Fees

IG12. The recognition of revenue for financial service fees depends on (a) the purposes for which the fees are assessed, and (b) the basis of accounting for any associated financial instrument. The description of fees for financial services may not be indicative of the nature and substance of the services provided. Therefore, it is necessary to distinguish between fees that are an integral part of the effective yield of a financial instrument, fees that are earned as services are provided, and fees that are earned on the execution of a significant act.

(a) **Fees that are an integral part of the effective interest rate of a financial instrument**

Such fees are generally treated as an adjustment to the effective interest rate. However, when the financial instrument is measured at fair value with the change in fair value recognized in surplus or deficit, the fees are recognized as revenue when the instrument is initially recognized.

- (i) *Origination fees received by the entity relating to the creation or acquisition of a financial asset other than one that under IPSAS 41 ~~IPSAS 29~~ is classified as a financial asset “at fair value through surplus or deficit”*

Such fees may include compensation for activities such as evaluating the borrower’s financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction. These fees are an integral part of generating an involvement with the resulting financial instrument and, together with the related transaction costs (as defined in IPSAS 41 ~~IPSAS 29~~), are deferred and recognized as an adjustment to the effective interest rate.

- (ii) *Commitment fees received by the entity to originate a loan when the loan commitment is outside the scope of IPSAS 41 HPSAS 29*

If it is probable that the entity will enter into a specific lending arrangement and the loan commitment is not within the scope of IPSAS 41 HPSAS 29, the commitment fee received is regarded as compensation for an ongoing involvement with the acquisition of a financial instrument and, together with the related transaction costs (as defined in IPSAS 41 HPSAS 29), is deferred and recognized as an adjustment to the effective interest rate. If the commitment expires without the entity making the loan, the fee is recognized as revenue on expiry. Loan commitments that are within the scope of IPSAS 41 HPSAS 29 are accounted for as derivatives and measured at fair value.

- (iii) *Origination fees received on issuing financial liabilities measured at amortized cost*

These fees are an integral part of generating an involvement with a financial liability. When a financial liability is not classified as “at fair value through surplus or deficit,” the origination fees received are included, with the related transaction costs (as defined in IPSAS 41 HPSAS 29) incurred, in the initial carrying amount of the financial liability and recognized as an adjustment to the effective interest rate. An entity distinguishes fees and costs that are an integral part of the effective interest rate for the financial liability from origination fees and transaction costs relating to the right to provide services, such as investment management services.

(b) **Fees earned as services are provided**

- (i) *Fees charged for servicing a loan*

Fees charged by an entity for servicing a loan are recognized as revenue as the services are provided.

- (ii) *Commitment fees to originate a loan when the loan commitment is outside the scope of IPSAS 41 HPSAS 29*

If it is unlikely that a specific lending arrangement will be entered into and the loan commitment is outside the scope of IPSAS 41 HPSAS 29, the commitment fee is recognized as revenue on a time proportion basis over the commitment period. Loan commitments that are within the scope of IPSAS 41 HPSAS 29 are accounted for as derivatives and measured at fair value.

- (iii) *Investment management fees*

Fees charged for managing investments are recognized as revenue as the services are provided.

Incremental costs that are directly attributable to securing an investment management contract are recognized as an asset if they can be identified separately and measured reliably and if it is probable that they will be recovered. As in IPSAS 41 HPSAS 29, an incremental cost is one that would not have been incurred if the entity had not secured the investment management contract. The asset represents the entity’s contractual right to benefit from providing investment management services, and is amortized as the entity recognizes the related revenue. If the entity has a portfolio of investment management contracts, it may assess their recoverability on a portfolio basis.

Some financial services contracts involve both the origination of one or more financial instruments and the provision of investment management services. An example is a long-term monthly saving contract linked to the management of a pool of equity securities. The provider of the contract distinguishes the transaction costs relating to the origination of the financial instrument from the costs of securing the right to provide investment management services.

(c) **Fees that are earned on the execution of a significant act**

The fees are recognized as revenue when the significant act has been completed, as in the examples below.

- (i) *Commission on the allotment of shares to a client*

The commission is recognized as revenue when the shares have been allotted.

- (ii) *Placement fees for arranging a loan between a borrower and an investor*

The fee is recognized as revenue when the loan has been arranged.

- (iii) *Loan syndication fees*

A syndication fee received by an entity that arranges a loan and retains no part of the loan package for itself (or retains a part at the same effective interest rate for comparable risk as other participants) is compensation for the service of syndication. Such a fee is recognized as revenue when the syndication has been completed.

...

Amendments to IPSAS 12, *Inventories*

Paragraph 2 is amended and paragraph 51E is added. New text is underlined and deleted text is struck through.

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Scope

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2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for all inventories except:**
 - (a) **Work-in-progress arising under construction contracts, including directly related service contracts (see IPSAS 11, *Construction Contracts*);**
 - (b) **Financial instruments (see IPSAS 28, *Financial Instruments: Presentation* and IPSAS 41, *Financial Instruments*, ~~IPSAS 29, *Financial Instruments: Recognition and Measurement*~~);**
 - (c) **Biological assets related to agricultural activity and agricultural produce at the point of harvest (see IPSAS 27, *Agriculture*); and**
 - (d) **Work-in-progress of services to be provided for no or nominal consideration directly in return from the recipients.**

...

Effective Date

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51E. Paragraph 2 was amended by IPSAS 41, issued in August 2018. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2022. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2022 it shall disclose that fact and apply IPSAS 41 at the same time.

...

Amendments to IPSAS 14, *Events After the Reporting Date*

Paragraph 11 is amended and paragraph 32F is added. New text is underlined and deleted text is struck through.

...

Adjusting Events after the Reporting Date

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11. The following are examples of adjusting events after the reporting date that require an entity to adjust the amounts recognized in its financial statements, or to recognize items that were not previously recognized:
 - (a) The settlement after the reporting date of a court case that confirms that the entity had a present obligation at the reporting date. The entity adjusts any previously recognized provision related to this court case in accordance with IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, or recognizes a new provision. The entity does not merely disclose a contingent liability because the settlement provides additional evidence that would be considered in accordance with paragraph 24 in IPSAS 19.
 - (b) The receipt of information after the reporting date indicating that an asset was impaired at the reporting date, or that the amount of a previously recognized impairment loss for that asset needs to be adjusted. For example:

- (i) The bankruptcy of a debtor that occurs after the reporting date usually confirms that the debtor was credit-impaired at the end ~~a loss already existed at the reporting date on a receivable account, and that the entity needs to adjust the carrying amount of the reporting period receivable account;~~ and
- (ii) The sale of inventories after the reporting date may give evidence about their net realizable value at the reporting date;
- (c) The determination after the reporting date of the cost of assets purchased, or the proceeds from assets sold, before the reporting date;
- (d) The determination after the reporting date of the amount of revenue collected during the reporting period to be shared with another government under a revenue-sharing agreement in place during the reporting period;
- (e) The determination after the reporting date of performance bonus payments to be made to staff if the entity had a present legal or constructive obligation at the reporting date to make such payments as a result of events before that date; and
- (f) The discovery of fraud or errors that show that the financial statements were incorrect.

...

Effective Date

...

32F. Paragraph 11 was amended by IPSAS 41, *Financial Instruments* issued in August 2018. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2022. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2022 it shall disclose that fact and apply IPSAS 41 at the same time.

...

Amendments to IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*

Paragraph 4 is amended and paragraph 111H is added. New text is underlined and deleted text is struck through.

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Scope

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4. **This Standard does not apply to financial instruments (including guarantees) that are within the scope of IPSAS 41, *Financial Instruments*, ~~IPSAS 29, *Financial Instruments: Recognition and Measurement*~~.**

...

Effective Date

...

111H. Paragraph 4 was amended by IPSAS 41, issued in August 2018. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2022. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2022 it shall disclose that fact and apply IPSAS 41 at the same time.

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Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 19.

...

A Single Guarantee

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- IG 14. During 2004, a provincial government gives a guarantee of certain borrowings of a private sector operator providing public services for a fee, whose financial condition at that time is sound. During 2005, the financial condition of the operator deteriorates and, at June 30, 2005, the operator files for protection from its creditors.

This contract meets the definition of a financial guarantee contract in IPSAS 29, except those where the issuer elects to treat such contracts as insurance contracts in accordance with the relevant international or national accounting standard dealing with insurance contracts. The following is an example of an accounting policy that complies with the requirements in IPSAS 29 for financial guarantee contracts within the scope of IPSAS 29:

Analysis

- (a) At December 31, 2004

Present obligation as a result of a past obligating event — The obligating event is the giving of the guarantee, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits or service potential in settlement — No outflow of benefits is probable at December 31, 2004.

Conclusion

The guarantee is recognized at fair value.

Analysis

- (b) At December 31, 2005

Present obligation as a result of a past obligating event — The obligating event is the giving of the guarantee, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits or service potential in settlement — At December 31, 2005, it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation.

Conclusion

The guarantee is subsequently measured at the higher of (a) the best estimate of the obligation (see paragraphs 22, 31 and 109), and (b) the amount initially recognized less, when appropriate, cumulative amortization in accordance with IPSAS 9, *Revenue from Exchange Transactions*.

...

Amendments to IPSAS 21, *Impairment of Non-Cash-Generating Assets*

Paragraphs 2, 9 and 13 are amended and paragraph 82I is added. New text is underlined and deleted text is struck through.

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Scope

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2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for impairment of non-cash-generating assets, except:**
- (a) **Inventories (see IPSAS 12, *Inventories*);**
 - (b) **Assets arising from construction contracts (see IPSAS 11, *Construction Contracts*);**
 - (c) **Financial assets that are included in the scope of IPSAS 41, *Financial Instruments*, ~~IPSAS 29, *Financial Instruments: Recognition and Measurement*~~;**
 - (d) **Investment property that is measured using the fair value model (see IPSAS 16, *Investment Property*);**
 - (e) [Deleted]
 - (f) [Deleted]
 - (g) **Other assets in respect of which accounting requirements for impairment are included in another IPSAS.**

9. This Standard does not apply to financial assets that are included in the scope of IPSAS 28, *Financial Instruments: Presentation*. Impairment of these assets is dealt with in IPSAS 41 ~~IPSAS 29~~.

13. Investments in:

- (a) Controlled entities, as defined in IPSAS 35, *Consolidated Financial Statements*;
- (b) Associates, as defined in IPSAS 36, *Investments in Associates and Joint Ventures*; and
- (c) Joint arrangements, as defined in IPSAS 37, *Joint Arrangements*;

are financial assets that are excluded from the scope of IPSAS 41 ~~IPSAS 29~~. Where such investments are classified as cash-generating assets, they are dealt with under IPSAS 26. Where these assets are non-cash-generating assets, they are dealt with under this Standard.

Effective Date

82I. Paragraphs 2, 9 and 13 were amended by IPSAS 41, issued in August 2018. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2022. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2022 it shall disclose that fact and apply IPSAS 41 at the same time.

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

Paragraphs 43 and 105A are amended and paragraph 124F is added. New text is underlined and deleted text is struck through.

Measurement of Assets on Initial Recognition

43. Consistent with IPSAS 12, *Inventories*, IPSAS 16, *Investment Property*, ~~and~~ IPSAS 17, ~~and~~ IPSAS 41, *Financial Instruments*, assets acquired through non-exchange transactions are measured at their fair value as at the date of acquisition.

Concessionary Loans

105A. Concessionary loans are loans received by an entity at below market terms. The portion of the loan that is repayable, along with any interest payments, is an exchange transaction and is accounted for in accordance with IPSAS 41 ~~IPSAS 29, *Financial Instruments: Recognition and Measurement*~~. An entity considers whether any difference between the transaction price (loan proceeds) and the fair value of the loan on initial recognition (see IPSAS 41 ~~IPSAS 29~~) is non-exchange revenue that should be accounted for in accordance with this Standard.

Effective Date

124F. Paragraphs 43, 105A was amended by IPSAS 41, issued in August 2018. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2022. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2022 it shall disclose that fact and apply IPSAS 41 at the same time.

Implementation Guidance

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

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Concessionary Loans (paragraphs 105A to 105B)

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IG54. An entity receives CU6 million funding from a multi-lateral development agency to build 10 schools over the next 5 years. The funding is provided on the following conditions:

- CU1 million of the funding need not be repaid, provided that the schools are built.
- CU5 million of the funding is to be repaid as follows:
 - Year 1: no capital to be repaid
 - Year 2: 10% of the capital to be repaid
 - Year 3: 20% of the capital to be repaid
 - Year 4: 30% of the capital to be repaid
 - Year 5: 40% of the capital to be repaid
- Interest is charged at 5% per annum over the period of the loan (assume interest is paid annually in arrears). The market rate of interest for a similar loan is 10%.
- To the extent that schools have not been built, the funding provided should be returned to the donor (assume that the donor has effective monitoring systems in place and has a past history of requiring any unspent funds to be returned).
- The entity built the following schools over the period of the loan:
 - Year 1: 1 school completed
 - Year 2: 3 schools completed
 - Year 3: 5 schools completed
 - Year 4: 10 schools completed

Analysis

The entity has effectively received a grant of CU1 million and a loan of CU5 million (Note: An entity would consider whether the substance of the CU1 million is a contribution from owners or revenue; assume for purposes of this example that the CU1 million is revenue). It has also received an additional grant of CU784,550 (which is the difference between the proceeds of the loan of CU5 million and the present value of the contractual cash flows of the loan, discounted using the market related rate of interest of 10%).

The grant of CU1 million + CU784,550 is accounted for in accordance with this Standard and, the loan with its related contractual interest and capital payments, in accordance with [IPSAS 41 IPSAS 29](#).

1. On initial recognition, the entity will recognize the following:

Dr	Bank	CU6,000,000	
	Cr	Loan	CU4,215,450
	Cr	Liability	CU1,784,550

2. Year 1: the entity will recognize the following:

Dr	Liability	CU178,455	
	Cr	Non-exchange revenue	CU178,455

(1/10 of the schools built X CU1,784,550)

(Note: The journal entries for the repayment of interest and capital and interest accruals, have not been reflected in this example as it is intended to illustrate the recognition of revenue arising from concessionary loans. Comprehensive examples are included in the Illustrative Examples to [IPSAS 41 IPSAS 29](#)).

3. Year 2: the entity will recognize the following (assuming that the entity subsequently measures the concessionary loan at amortized cost):

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Dr	Liability	CU356,910	
	Cr	Non-exchange revenue	CU356,910

3/10 schools built X CU1,784,500 – CU178,455 already recognized)

4. Year 3: the entity will recognize the following:

Dr	Liability	CU356,910	
	Cr	Non-exchange revenue	CU356,910

(5/10 schools built X CU1,784,550 – CU535,365 already recognized)

5. Year 4: the entity will recognize the following:

Dr	Liability	CU892,275	
	Cr	Non-exchange revenue	CU892,275

(All schools built, CU1,784,550 – CU892,275)

If the concessionary loan was granted with no conditions, the entity would recognize the following on initial recognition:

Dr	Bank	CU6,000,000	
	Cr	Loan	CU4,215,450
	Cr	Non-exchange revenue	CU1,784,550

Interaction Between Measurement Requirements of IPSAS 23 and IPSAS 41

Background

IG55. An individual donates shares in listed Entity X to public sector Entity A on January 1, 20X8. At that date, the shares in Entity X have a fair value of CU1,000,000. At December 31, 20X8, the fair value of the shares is CU900,000. As part of the arrangement, Entity A incurs the transfer duty to have the shares transferred into its name. These costs amount to CU10,000.

IG56. Listed Entity X provides telecommunications infrastructure and related services to the public. During 20X9, new technology was introduced into the telecommunications industry, making the infrastructure and equipment used by Entity X almost obsolete. This resulted in a permanent decline in the value of listed Entity X. The value of the impairment loss as at December 31, 20X9 is CU700,000. Entity A measures investments in shares at fair value through net assets/equity when the shares are not held for trading. Assume that the arrangement is a contractual arrangement, no present obligations arise from the donation and that the entity’s reporting period ends on December 31, 20X8.

Analysis

IG57. As Entity A received the shares as a donation, it uses IPSAS 23 to initially recognize the shares acquired and the related non-exchange revenue. However, because Entity A has acquired a financial asset, it considers the initial measurement requirements of IPSAS 23 and IPSAS 41.

IG58. IPSAS 23 prescribes that assets acquired as part of a non-exchange revenue transaction are initially measured at fair value, while IPSAS 41 prescribes that financial assets are initially measured at fair value and, depending on their classification, transaction costs may or may not be included. As the entity has a policy of measuring investments in shares at fair value through net assets/equity, the transaction costs of CU10,000 are added to the value of the shares of CU1,000,000 on initial measurement.

IG59. The subsequent measurement and derecognition of the shares is addressed in IPSAS 41. The entity measures investments in shares at fair value through net assets/equity which means that the shares are measured at a fair value with any subsequent changes in fair value recognized in net assets/equity. Dividends are however recognized in surplus or deficit.

The journal entries at initial acquisition and at the reporting dates are as follows:

1. Acquisition of shares through donation

Dr	Investment in Entity X	CU1,010,000	-
	Cr	Non-exchange revenue	CU1,000,000
	Cr	Bank (Transfer costs paid)	CU10,000

2. Subsequent measurement at December 31, 20X8

<u>Dr</u>	<u>Net assets/equity (fair value adjustment of investment)</u>	<u>CU110,000</u>	-
	<u>Cr</u>	<u>Investment in Entity X</u>	-
			<u>CU110,000</u>

3. Subsequent measurement at December 31, 20X9

<u>Dr</u>	<u>Impairment loss (net assets/equity)</u>	<u>CU700,000</u>	-
	<u>Cr</u>	<u>Investment in Entity X</u>	-
			<u>CU700,000</u>

Amendments to IPSAS 26, *Impairment of Cash Generating Assets*

Paragraphs 2, 9 and 12 are amended and paragraph 126K is added. New text is underlined and deleted text is struck through.

Scope

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

- (a) **Inventories (see IPSAS 12, *Inventories*);**
- (b) **Assets arising from construction contracts (see IPSAS 11, *Construction Contracts*);**
- (c) **Financial assets that are within the scope of IPSAS 41, *Financial Instruments* ~~IPSAS 29, *Financial Instruments: Recognition and Measurement*~~;**
- (d) ...

9. This Standard does not apply to any financial assets that are included in the scope of IPSAS 28, *Financial Instruments: Presentation*. Impairment of these assets is dealt with in IPSAS 41 ~~IPSAS 29~~.

12. Investments in:

- (a) Controlled entities, as defined in IPSAS 35, *Consolidated Financial Statements*;
- (b) Associates, as defined in IPSAS 36, *Investments in Associates and Joint Ventures*; and
- (c) Joint arrangements, as defined in IPSAS 37, *Joint Arrangements*,

are financial assets that are excluded from the scope of IPSAS 41 ~~IPSAS 29~~. Where such investments are in the nature of cash-generating assets, they are dealt with under this Standard. Where these assets are in the nature of non-cash-generating assets, they are dealt with under IPSAS 21.

Effective Date

126K. Paragraphs 2, 9 and 12 were amended by IPSAS 41, issued in August 2018. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2022. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2022 it shall disclose that fact and apply IPSAS 41 at the same time.

Amendments to IPSAS 28, *Financial Instruments: Presentation*

Paragraphs 2, 3, 4, 9, 10, 14, 28, 36, 47, 48, AG2 and AG55 are amended, paragraph AG63 was deleted and paragraphs 60F, AG63A, AG63B, AG63C, AG63D, AG63E and AG63F were added. New text is underlined and deleted text is struck through.

Objective

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2. The principles in this Standard complement the principles for recognizing and measuring financial assets and financial liabilities in IPSAS 41, *Financial Instruments*, ~~29, *Financial Instruments: Recognition and Measurement*~~, and for disclosing information about them in IPSAS 30, *Financial Instruments: Disclosures*.

...

Scope

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3. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard to all types of financial instruments except:**

- (a) **Those interests in controlled entities, associates or joint ventures that are accounted for in accordance with IPSAS 35, *Consolidated Financial Statements*, IPSAS 34, *Separate Financial Statements*, IPSAS 36, *Investments in Associates and Joint Ventures*. However, in some cases, IPSAS 34, IPSAS 35, or IPSAS 36 require or permits an entity to account for an interest in a controlled entity, associate, or joint venture using IPSAS 41 ~~IPSAS 29~~; in those cases, entities shall apply the requirements of this Standard. Entities shall also apply this Standard to all derivatives linked to interests in controlled entities, associates, or joint ventures.**
- (b) **Employers' rights and obligations under employee benefit plans, to which IPSAS 39, *Employee Benefits* applies.**
- (c) **Obligations arising from insurance contracts. However, this Standard applies to:**
 - (i) **Derivatives that are embedded in insurance contracts if IPSAS 41 ~~IPSAS 29~~ requires the entity to account for them separately; and**
 - (ii) **Financial guarantee contracts, if the issuer applies IPSAS 41 ~~IPSAS 29~~ in recognizing and measuring the contracts, but shall apply the relevant international or national accounting standard dealing with insurance contracts if the issuer elects to apply that standard in recognizing and measuring them.**

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

- (d) **Financial instruments that are within the scope of the international or national accounting standard dealing with insurance contracts because they contain a discretionary participation feature. The issuer of these instruments is exempt from applying to these features paragraphs 13–37 and AG49–AG60 of this Standard regarding the distinction between financial liabilities and equity instruments. However, these instruments are subject to all other requirements of this Standard. Furthermore, this Standard applies to derivatives that are embedded in these instruments (see IPSAS 41 ~~IPSAS 29~~).**
- (e) **Financial instruments, contracts and obligations under share-based payment transactions to which the relevant international or national accounting standard dealing with share-based payments applies, except for:**
 - (i) **Contracts within the scope of paragraphs 4–6 of this Standard, to which this Standard applies; or**
 - (ii) **Paragraphs 38 and 39 of this Standard, which shall be applied to treasury shares purchased, sold, issued, or canceled in connection with employee share option plans, employee share purchase plans, and all other share-based payment arrangements.**

4. **This Standard shall be applied to those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale, or usage requirements. However, this Standard shall be applied to those contracts that an entity designates as measured at fair value through surplus or deficit in accordance with paragraph 6 of IPSAS 41.**

...

Definitions

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

...

A **financial liability** is any liability that is:

- (a) A contractual obligation:
 - (i) To deliver cash or another financial asset to another entity; or
 - (ii) To exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the entity; or
- (b) A contract that will or may be settled in the entity's own equity instruments and is:
 - (i) A non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or
 - (ii) A derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose, **rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. Also, for these purposes the entity's own equity instruments do not include puttable financial instruments classified as equity instruments in accordance with paragraphs 15 and 16, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 17 and 18, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.**

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

10. The following terms are defined in paragraph 9 of IPSAS 41 or paragraph 10 of IPSAS 29, *Financial Instruments: Recognition and Measurement*, and are used in this Standard with the meaning specified in those that Standards.

- Amortized cost of a financial asset or financial liability;
- Available-for-sale financial assets;
- ~~Derecognition~~ ~~Derecognizing~~;
- Derivative;
- Effective interest method;
- Financial guarantee contract;
- Financial asset or financial liability at fair value through surplus or deficit;
- Firm commitment;
- Forecast transaction;
- Hedge effectiveness;
- Hedged item;
- Hedging instrument;
- Held-to-maturity investments;
- ~~Loans and receivables~~;
- ~~Held for trading~~;
- Regular way purchase or sale; and
- Transaction costs.

...

14. When an issuer applies the definitions in paragraph 9 to determine whether a financial instrument is an equity instrument rather than a financial liability, the instrument is an equity instrument if, and only if, both conditions (a) and (b) below are met.

- (a) The instrument includes no contractual obligation:
 - (i) To deliver cash or another financial asset to another entity; or
 - (ii) To exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the issuer.
- (b) If the instrument will or may be settled in the issuer's own equity instruments, it is:
 - (i) A non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or
 - (ii) A derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose, rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. Also, for these purposes the issuer's own equity instruments do not include instruments that have all the features and meet the conditions described in paragraphs 15 and 16 or paragraphs 17 and 18, or instruments that are contracts for the future receipt or delivery of the issuer's own equity instruments.

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

...

28. With the exception of the circumstances described in paragraphs 15 and 16 or paragraphs 17 and 18, a contract that contains an obligation for an entity to purchase its own equity instruments for cash or another financial asset gives rise to a financial liability for the present value of the redemption amount (e.g., for the present value of the forward repurchase price, option exercise price, or other redemption amount). This is the case even if the contract itself is an equity instrument. One example is an entity's obligation under a forward contract to purchase its own equity instruments for cash. ~~When the~~ The financial liability is recognized initially at the present value of the redemption amount, and under IPSAS 29, its fair value (the present value of the redemption amount) is reclassified from net assets/equity. Subsequently, the financial liability is measured in accordance with IPSAS 41 ~~IPSAS 29~~. If the contract expires without delivery, the carrying amount of the financial liability is reclassified to net assets/equity. An entity's contractual obligation to purchase its own equity instruments gives rise to a financial liability for the present value of the redemption amount even if the obligation to purchase is conditional on the counterparty exercising a right to redeem (e.g., a written put option that gives the counterparty the right to sell an entity's own equity instruments to the entity for a fixed price).

...

36. IPSAS 41 ~~IPSAS 29~~ deals with the measurement of financial assets and financial liabilities. Equity instruments evidence a residual interest in the assets of an entity after deducting all of its liabilities. Therefore, when the initial carrying amount of a compound financial instrument is allocated into its components, the net assets/equity component is assigned the residual amount after deducting from the fair value of the instrument as a whole the amount separately determined for the liability component. The value of any derivative features (such as a call option) embedded in the compound financial instrument is included in the liability component unless it forms part of the component of net assets/equity (such as an equity conversion option). The sum of the carrying amounts assigned to the liability and the net assets/equity components on initial recognition is always equal to the fair value that would be ascribed to the instrument as a whole. No gain or loss arises from initially recognizing the components of the instrument separately.

...

Offsetting a Financial Asset and a Financial Liability (see also paragraphs AG63A–AG63F and AG64)

47. **A financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position when, and only when, an entity:**

- (a) **Currently has a legally enforceable right to set off the recognized amounts; and**
- (b) **Intends either to settle on a net basis, or to realize the asset and settle the liability simultaneously.**

In accounting for a transfer of a financial asset that does not qualify for derecognition, the entity shall not offset the transferred asset and the associated liability (see IPSAS 41 ~~IPSAS 29~~, paragraph 33 ~~38~~).

48. This Standard requires the presentation of financial assets and financial liabilities on a net basis when doing so reflects an entity's expected future cash flows from settling two or more separate financial instruments. When an entity has the right to receive or pay a single net amount and intends to do so, it has, in effect, only a single financial asset or financial liability. In other circumstances, financial assets and financial liabilities are presented separately from each other consistently with their characteristics as resources or obligations of the entity. An entity shall disclose the information required in paragraphs 17B–17E in IPSAS 30 for recognized financial instruments that are within the scope of paragraph 17A of IPSAS 30.

...

Effective Date

...

- 60F. Paragraphs 2, 3, 4, 9, 10, 14, 28, 36, 47, 48, AG2 and AG55 were amended, paragraph AG63 was deleted and paragraphs AG63A, AG63B, AG63C, AG63D, AG63E and AG63F were added by IPSAS 41, issued in August 2018. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2022. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2022 it shall disclose that fact and apply IPSAS 41 at the same time.

...

Application Guidance

This Appendix is an integral part of IPSAS 28.

...

- AG2. The Standard does not deal with the recognition or measurement of financial instruments. Requirements about the recognition and measurement of financial assets and financial liabilities are set out in IPSAS 41 ~~IPSAS 29~~.

...

Compound Financial Instruments (paragraphs 33–37)

- AG55. Paragraph 33 applies only to issuers of non-derivative compound financial instruments. Paragraph 33 does not deal with compound financial instruments from the perspective of holders. IPSAS 41 ~~IPSAS 29~~ deals with the classification and measurement separation of financial assets that are embedded derivatives from the perspective of holders of compound financial instruments from the holder's perspective that contain the features of both debt and equity instruments.

...

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

- AG63. To offset a financial asset and a financial liability, an entity must have a currently enforceable legal right to set off the recognized amounts. An entity may have a conditional right to set off recognized amounts, such as in a master netting agreement or in some forms of non-recourse debt, but such rights are enforceable only on the occurrence of some future event, usually a default of the counterparty. Thus, such an arrangement does not meet the conditions for offset.

Criterion that an Entity 'Currently has a Legally Enforceable Right to Set Off the Recognized Amounts' (paragraph 47(a))

- AG63A. A right of set-off may be currently available or it may be contingent on a future event (for example, the right may be triggered or exercisable only on the occurrence of some future event, such as the default, insolvency or bankruptcy of one of the counterparties). Even if the right of set-off is not contingent on a future event, it may only be legally enforceable in the normal course of operations, or in the event of default, or in the event of insolvency or bankruptcy, of one or all of the counterparties.

AG63B. To meet the criterion in paragraph 47(a), an entity must currently have a legally enforceable right of set-off. This means that the right of set-off:

- (a) Must not be contingent on a future event; and
- (b) Must be legally enforceable in all of the following circumstances:
 - (i) The normal course of operations;
 - (ii) The event of default; and
 - (iii) The event of insolvency or bankruptcy
of the entity and all of the counterparties.

AG63C. The nature and extent of the right of set-off, including any conditions attached to its exercise and whether it would remain in the event of default or insolvency or bankruptcy, may vary from one legal jurisdiction to another. Consequently, it cannot be assumed that the right of set-off is automatically available outside of the normal course of operations. For example, the bankruptcy or insolvency laws of a jurisdiction may prohibit, or restrict, the right of set-off in the event of bankruptcy or insolvency in some circumstances.

AG63D. The laws applicable to the relationships between the parties (for example, contractual provisions, the laws governing the contract, or the default, insolvency or bankruptcy laws applicable to the parties) need to be considered to ascertain whether the right of set-off is enforceable in the normal course of operations, in an event of default, and in the event of insolvency or bankruptcy, of the entity and all of the counterparties (as specified in paragraph AG63B(b)).

Criterion that an Entity ‘Intends Either to Settle on a Net Basis, or to Realize the Asset and Settle the Liability Simultaneously’ (paragraph 47(b))

AG63E. To meet the criterion in paragraph 47(b) an entity must intend either to settle on a net basis or to realize the asset and settle the liability simultaneously. Although the entity may have a right to settle net, it may still realize the asset and settle the liability separately.

AG63F. If an entity can settle amounts in a manner such that the outcome is, in effect, equivalent to net settlement, the entity will meet the net settlement criterion in paragraph 47(b). This will occur if, and only if, the gross settlement mechanism has features that eliminate or result in insignificant credit and liquidity risk, and that will process receivables and payables in a single settlement process or cycle. For example, a gross settlement system that has all of the following characteristics would meet the net settlement criterion in paragraph 47(b):

- (a) Financial assets and financial liabilities eligible for set-off are submitted at the same point in time for processing;
- (b) Once the financial assets and financial liabilities are submitted for processing, the parties are committed to fulfil the settlement obligation;
- (c) There is no potential for the cash flows arising from the assets and liabilities to change once they have been submitted for processing (unless the processing fails—see (d) below);
- (d) Assets and liabilities that are collateralized with securities will be settled on a securities transfer or similar system (for example, delivery versus payment), so that if the transfer of securities fails, the processing of the related receivable or payable for which the securities are collateral will also fail (and vice versa);
- (e) Any transactions that fail, as outlined in (d), will be re-entered for processing until they are settled;
- (f) Settlement is carried out through the same settlement institution (for example, a settlement bank, a central bank or a central securities depository); and
- (g) An intraday credit facility is in place that will provide sufficient overdraft amounts to enable the processing of payments at the settlement date for each of the parties, and it is virtually certain that the intraday credit facility will be honored if called upon.

...

In Appendix B paragraphs B19 and B21 are amended to read as follows:

...

Appendix B – Members’ Shares in Co-operative Entities and Similar Instruments

...

Before the Governing Charter is Amended

B19. Members’ shares in excess of the prohibition against redemption are financial liabilities. The co-operative entity measures this financial liability at fair value at initial recognition. Because these shares are redeemable on demand, the co-operative entity measures ~~determines~~ the fair value of such financial liabilities in accordance with ~~as required by~~ paragraph 68 of IPSAS 41 ~~52 of IPSAS 29~~, which states: “The fair value of a financial liability with a demand feature (e.g., a demand deposit) is not less than the amount payable on demand ...” Accordingly, the co-operative entity classifies as financial liabilities the maximum amount payable on demand under the redemption provisions.

...

After the Governing Charter is Amended

B21. Following the change in its governing charter the co-operative entity can now be required to redeem a maximum of 25 percent of its outstanding shares or a maximum of 50,000 shares at CU20 each. Accordingly, on January 1, 20X3 the co-operative entity classifies as financial liabilities an amount of CU1,000,000 being the maximum amount payable on demand under the redemption provisions, as determined in accordance with paragraph 68 of IPSAS 41 ~~52 of IPSAS 28~~. It therefore transfers on January 1, 20X3 from net assets/equity to financial liabilities an amount of CU200,000, leaving CU2,000,000 classified as equity instruments. In this example the entity does not recognize a gain or loss on the transfer.

...

Basis for Conclusions

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

...

Scope

BC5. IAS 32 excludes all insurance contracts from the scope of IAS 32, except for financial guarantee contracts where the issuer applies IFRS 9, Financial Instruments ~~IAS 39, Financial Instruments: Recognition and Measurement~~ in recognizing and measuring such contracts. The scope of IPSAS 28 also excludes all insurance contracts, except that:

- Financial guarantee contracts are to be treated as financial instruments unless an entity elects to treat such contracts as insurance contracts in accordance with the relevant international or national accounting standard dealing with insurance contracts; and
- Contracts that are insurance contracts but involve the transfer of financial risk may be treated as financial instruments in accordance with IPSAS 28, ~~IPSAS 29~~ and IPSAS 30 and IPSAS 41.

...

Illustrative Examples

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

Accounting for Contracts on Equity Instruments of an Entity

IE1. The following examples illustrate the application of paragraphs 13–32 and IPSAS 41 ~~IPSAS 29~~ to the accounting for contracts on an entity’s own equity instruments. In these examples, monetary amounts are denominated in “currency units” (CU).

...

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

February 1, 20X2

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

To record the obligation to deliver CU104,000 in one year at its present value of CU100,000 discounted using an appropriate interest rate (see *IPSAS 41 IPSAS 29*, paragraph *AG115 AG82*).

December 31, 20X2

Dr	Interest expense	CU3,660	
	Cr	Liability	CU3,660

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

January 31, 20X3

Dr	Interest expense	CU340	
	Cr	Liability	CU340

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

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

Dr	Liability	CU104,000	
	Cr	Cash	CU104,000

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

...

Amendments to IPSAS 29, *Financial Instruments: Recognition and Measurement*

Paragraphs 2, 9, 10, 80, 98, 99, 101, 102, 107, 108, 109, 111, 112, 113, AG128, AG157 and AG161 are amended, paragraphs 1, 3, 4, 5, 6, 11–79, 88, AG1–AG126 and AG129 are deleted and paragraphs 125H and AG156A are added.

Objective

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

Scope

- This Standard shall be applied by all entities to all ~~types of~~ financial instruments within the scope of IPSAS 41, *Financial Instruments* if, and to the extent that, except:
 - ~~IPSAS 41 permits the hedge accounting requirements of this Standard to be applied; and Those interests in controlled entities, associates and joint ventures that are accounted for in accordance with IPSAS 34, *Separate Financial Statements*, IPSAS 35, *Consolidated Financial Statements* IPSAS 36, *Investments in Associates and Joint Ventures*. However, in some cases, IPSAS 34, IPSAS 35 or IPSAS 36 require or permit an entity to account for an interest in a controlled entity, associate, or joint venture in accordance with some or all of the requirements of this Standard. Entities shall also apply this Standard to derivatives on an interest in a controlled entity, associate, or joint venture unless the derivative meets the definition of an equity instrument of the entity in IPSAS 28.~~
 - The financial instrument is part of a hedging relationship that qualifies for hedge accounting in accordance with this Standard. Rights and obligations under leases to which IPSAS 13, *Leases* applies. However:
 - ~~Lease receivables recognized by a lessor are subject to the derecognition and impairment provisions of this Standard (see paragraphs 17–39, 67, 68, 72, and Appendix A paragraphs AG51–AG67 and AG117–AG126);~~
 - ~~Finance lease payables recognized by a lessee are subject to the derecognition provisions of this Standard (see paragraphs 41–44 and Appendix A paragraphs AG72–AG80); and~~

- (iii) ~~Derivatives that are embedded in leases are subject to the embedded derivatives provisions of this Standard (see paragraphs 11–15 and Appendix A paragraphs AG40–AG46).~~
- (c) ~~Employers’ rights and obligations under employee benefit plans, to which IPSAS 39, *Employee Benefits* applies.~~
- (d) ~~Financial instruments issued by the entity that meet the definition of an equity instrument in IPSAS 28 (including options and warrants) or that are required to be classified as an equity instrument in accordance with paragraphs 15 and 16 or 17 and 18 of IPSAS 28. However, the holder of such equity instruments shall apply this Standard to those instruments, unless they meet the exception in (a) above.~~
- (e) ~~Rights and obligations arising under:~~
 - (i) ~~An insurance contract, other than an issuer’s rights and obligations arising under an insurance contract that meets the definition of a financial guarantee contract in paragraph 10; or~~
 - (ii) ~~A contract that is within the scope of the relevant international or national accounting standard dealing with insurance contracts because it contains a discretionary participation feature.~~

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

- (f) ~~Any forward contracts between an acquirer and seller to buy or sell an acquired operation that will result in a public sector combination at a future acquisition date. The term of the forward contract should not exceed a reasonable period normally necessary to obtain any required approvals and to complete the transaction.~~
- (g) ~~Loan commitments other than those loan commitments described in paragraph 4. An issuer of loan commitments shall apply IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets* to loan commitments that are not within the scope of this Standard. However, all loan commitments are subject to the derecognition provisions of this Standard (see paragraphs 17–44 and Appendix A paragraphs AG51–AG80).~~
- (h) ~~Financial instruments, contracts and obligations under share-based payment transactions to which the relevant international or national accounting standard dealing with share based payment applies, except for contracts within the scope of paragraphs 4–6 of this Standard, to which this Standard applies.~~
- (i) ~~Rights to payments to reimburse the entity for expenditure it is required to make to settle a liability that it recognizes as a provision in accordance with IPSAS 19, or for which, in an earlier period, it recognized a provision in accordance with IPSAS 19.~~
- (j) ~~The initial recognition and initial measurement of rights and obligations arising from non-exchange revenue transactions, to which IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)* applies.~~
- (k) ~~Rights and obligations under service concession arrangements to which IPSAS 32, *Service Concession Assets: Grantor* applies. However, financial liabilities recognized by a grantor under the financial liability model are subject to the derecognition provisions of this Standard (see paragraphs 41–44 and Appendix A paragraphs AG72–AG80).~~

3. ~~The following loan commitments are within the scope of this Standard:~~

- (a) ~~Loan commitments that the entity designates as financial liabilities at fair value through surplus or deficit. An entity that has a past practice of selling the assets resulting from its loan commitments shortly after origination shall apply this Standard to all its loan commitments in the same class.~~
- (b) ~~Loan commitments that can be settled net in cash or by delivering or issuing another financial instrument. These loan commitments are derivatives. A loan commitment is not regarded as settled net merely because the loan is paid out in installments (e.g., a mortgage construction loan that is paid out in installments in line with the progress of construction).~~
- (c) ~~Commitments to provide a loan at a below-market interest rate. Paragraph 49(d) specifies the subsequent measurement of liabilities arising from these loan commitments.~~

4. ~~This Standard shall be applied to those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale, or usage requirements.~~

5. There are various ways in which a contract to buy or sell a non-financial item can be settled net in cash or another financial instrument or by exchanging financial instruments. These include:

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

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

6. ~~A written option to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, in accordance with paragraph 5(a) or (d) is within the scope of this Standard. Such a contract cannot be entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements.~~

...

Definitions

9. The terms defined in IPSAS 28 ~~and IPSAS 41~~ are used in this Standard with the meanings specified in paragraph 9 of IPSAS 28 ~~and paragraph 9 of IPSAS 41~~. IPSAS 28 ~~and IPSAS 41~~ defines the following terms:

- Amortized cost of a financial asset or financial liability;
- Derecognition;
- Derivative;
- Effective interest method;
- Effective interest rate;
- Equity instrument;
- Financial asset;
- Financial instrument;
- Financial liability;
- Firm commitment;
- Forecast transaction;

and provides guidance on applying those definitions.

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

Definition of a derivative

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

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

Definitions of four categories of financial instruments

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

- (a) It is classified as held for trading. A financial asset or financial liability is classified as held for trading if:
 - (i) It is acquired or incurred principally for the purpose of selling or repurchasing it in the near term;
 - (ii) On initial recognition it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or
 - (iii) It is a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument);
- (b) Upon initial recognition it is designated by the entity as at fair value through surplus or deficit. An entity may use this designation only when permitted by paragraph 13 or when doing so results in more relevant information, because either:
 - (i) It eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as “an accounting mismatch”) that would otherwise arise from measuring assets or liabilities or recognizing the gains and losses on them on different bases; or
 - (ii) A group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; and information about the group is provided internally on that basis to the entity’s key management personnel (as defined in IPSAS 20, *Related Party Disclosures*), for example the entity’s governing body and chief executive officer.

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

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

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

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

- (a) Those that the entity upon initial recognition designates as at fair value through surplus or deficit;
- (b) Those that the entity designates as available for sale; and
- (c) Those that meet the definition of loans and receivables.

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

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

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

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

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

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

Definition of a financial guarantee contract

~~A financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.~~

Definitions relating to recognition and measurement

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

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

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

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

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

Definitions relating to hedge accounting

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

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

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

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

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

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

Embedded Derivatives

11–79. [Deleted]

Hedging

80. ~~**If an entity applies IPSAS 41 and has not chosen as its accounting policy to continue to apply the hedge accounting requirements of this Standard (see paragraph 177 of IPSAS 41), it shall apply the hedge accounting requirements in paragraphs 113–155 of IPSAS 41. However, for a fair value hedge of the interest rate exposure of a portion of a portfolio of financial assets or financial liabilities, an entity may, in accordance with paragraph 115 of IPSAS 41, apply the hedge accounting requirements in this Standard instead of those in IPSAS 41. In that case the entity must also apply the specific requirements for fair value hedge accounting for a portfolio hedge of interest rate risk (see paragraphs 91, 100 and AG157–AG175). If there is a designated hedging relationship between a hedging instrument and a hedged item as described in paragraphs 95–98 and Appendix A paragraphs AG142–AG144, accounting for the gain or loss on the hedging instrument and the hedged item shall follow paragraphs 99–113.**~~

...

88. ~~Unlike loans and receivables, a held-to-maturity investment cannot be a hedged item with respect to interest-rate risk or prepayment risk because designation of an investment as held to maturity requires an intention to hold the investment until maturity without regard to changes in the fair value or cash flows of such an investment attributable to changes in interest rates. However, a held-to-maturity investment can be a hedged item with respect to risks from changes in foreign currency exchange rates and credit risk.~~

...

98. A hedging relationship qualifies for hedge accounting under paragraphs 99–113 if, and only if, all of the following conditions are met.

- (a) At the inception of the hedge there is formal designation and documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge. That documentation shall include identification of the hedging instrument, the hedged item or transaction, the nature of the risk being

hedged and how the entity will assess the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk.

- (b) The hedge is expected to be highly effective (see Appendix A paragraphs AG145–AG156) in achieving offsetting changes in fair value or cash flows attributable to the hedged risk, consistently with the originally documented risk management strategy for that particular hedging relationship.
- (c) For cash flow hedges, a forecast transaction that is the subject of the hedge must be highly probable and must present an exposure to variations in cash flows that could ultimately affect surplus or deficit.
- (d) The effectiveness of the hedge can be reliably measured, i.e., the fair value or cash flows of the hedged item that are attributable to the hedged risk and the fair value of the hedging instrument can be reliably measured (~~see paragraphs 50 and 51 and Appendix A paragraphs AG139–AG151 for guidance on determining fair value~~).
- (e) The hedge is assessed on an ongoing basis and determined actually to have been highly effective throughout the financial reporting periods for which the hedge was designated.

Fair Value Hedges

99. If a fair value hedge meets the conditions in paragraph 98 during the period, it shall be accounted for as follows:

- (a) The gain or loss from remeasuring the hedging instrument at fair value (for a derivative hedging instrument) or the foreign currency component of its carrying amount measured in accordance with IPSAS 4 (for a non-derivative hedging instrument) shall be recognized in surplus or deficit; and
- (b) The gain or loss on the hedged item attributable to the hedged risk shall adjust the carrying amount of the hedged item and be recognized in surplus or deficit. This applies if the hedged item is otherwise measured at cost. Recognition of the gain or loss attributable to the hedged risk in surplus or deficit applies if the hedged item is a an available-for-sale financial asset measured at fair value through net assets/equity in accordance with paragraph 41 of IPSAS 41.

...

101. If only particular risks attributable to a hedged item are hedged, recognized changes in the fair value of the hedged item unrelated to the hedged risk are recognized as set out in paragraph 101 of IPSAS 41 64.

102. An entity shall discontinue prospectively the hedge accounting specified in paragraph 99 if:

- (a) The hedging instrument expires or is sold, terminated or exercised. ~~For (for this purpose, the replacement or rollover of a hedging instrument into another hedging instrument is not an expiration or termination if such replacement or rollover is part of the entity's documented hedging strategy.);~~ Additionally, for this purpose there is not an expiration or termination of the hedging instrument if:
 - (i) As a consequence of laws or regulations or the introduction of laws or regulations, the parties to the hedging instrument agree that one or more clearing counterparties replace their original counterparty to become the new counterparty to each of the parties. For this purpose, a clearing counterparty is a central counterparty (sometimes called a 'clearing organization' or 'clearing agency') or an entity or entities, for example, a clearing member of a clearing organization or a client of a clearing member of a clearing organization, that are acting as counterparty in order to effect clearing by a central counterparty. However, when the parties to the hedging instrument replace their original counterparties with different counterparties this paragraph shall apply only if each of those parties effects clearing with the same central counterparty.
 - (ii) Other changes, if any, to the hedging instrument are limited to those that are necessary to effect such a replacement of the counterparty. Such changes are limited to those that are consistent with the terms that would be expected if the hedging instrument were originally cleared with the clearing counterparty. These changes include changes in the collateral requirements, rights to offset receivables and payables balances, and charges levied.
- (b) The hedge no longer meets the criteria for hedge accounting in paragraph 98; or
- (c) The entity revokes the designation.

...

Cash Flow Hedges

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107. More specifically, a cash flow hedge is accounted for as follows:
- (a) The separate component of net assets/equity associated with the hedged item is adjusted to the lesser of the following (in absolute amounts):
 - (i) The cumulative gain or loss on the hedging instrument from inception of the hedge; and
 - (ii) The cumulative change in fair value (present value) of the expected future cash flows on the hedged item from inception of the hedge;
 - (b) Any remaining gain or loss on the hedging instrument or designated component of it (that is not an effective hedge) is recognized in surplus or deficit; and
 - (c) If an entity's documented risk management strategy for a particular hedging relationship excludes from the assessment of hedge effectiveness a specific component of the gain or loss or related cash flows on the hedging instrument (see paragraphs 83, 84, and 98(a)), that excluded component of gain or loss is recognized in accordance with paragraph 101 of IPSAS 41 64.

108. **If a hedge of a forecast transaction subsequently results in the recognition of a financial asset or a financial liability, the associated gains or losses that were recognized directly in net assets/equity in accordance with paragraph 106 shall be reclassified into surplus or deficit as a reclassification adjustment in the same period or periods during which the hedged forecast cash flows affect surplus or deficit (such as in the periods that interest revenue or interest expense is recognized). However, if an entity expects that all or a portion of a loss recognized directly in net assets/equity will not be recovered in one or more future periods, it shall reclassify into surplus or deficit as a reclassification adjustment the amount that is not expected to be recovered.**

109. **If a hedge of a forecast transaction subsequently results in the recognition of a non-financial asset or a non-financial liability, or a forecast transaction for a non-financial asset or non-financial liability becomes a firm commitment for which fair value hedge accounting is applied, then the entity shall adopt (a) or (b) below:**

- (a) **It reclassifies the associated gains and losses that were recognized directly in net assets/equity in accordance with paragraph 106 into surplus or deficit as a reclassification adjustment in the same period or periods during which the asset acquired or liability assumed affects surplus or deficit (such as in the periods that depreciation or inventories are recognized as an expense). However, if an entity expects that all or a portion of a loss recognized directly in net assets/equity will not be recovered in one or more future periods, it shall reclassify from net assets/equity into surplus or deficit as a reclassification adjustment the amount that is not expected to be recovered.**
- (b) **It removes the associated gains and losses that were recognized directly in net assets/equity in accordance with paragraph 106, and includes them in the initial cost or other carrying amount of the asset or liability.**

...

111. **For cash flow hedges other than those covered by paragraphs 108 and 109, amounts that had been recognized directly in net assets/equity shall be recognized in surplus or deficit as a reclassification adjustment in the same period or periods during which the hedged forecast cash flows affects surplus or deficit (e.g., when a forecast sale occurs).**

112. **In any of the following circumstances an entity shall discontinue prospectively the hedge accounting specified in paragraphs 106–111:**

- (a) **The hedging instrument expires or is sold, terminated or exercised (~~for this purpose, the replacement or rollover of a hedging instrument into another hedging instrument is not an expiration or termination if such replacement or rollover is part of the entity's documented hedging strategy~~). In this case, the cumulative gain or loss on the hedging instrument that remains recognized directly in net assets/equity from the period when the hedge was effective (see paragraph 106(a)) shall remain separately recognized in net assets/equity until the forecast transaction occurs. When the transaction occurs, paragraph 108, 109, or 111 applies. For the purpose of this subparagraph, the replacement or rollover of a hedging instrument into another hedging instrument is not an expiration or termination if such replacement or rollover is part of the entity's documented hedging**

strategy. Additionally, for the purpose of this subparagraph there is not an expiration or termination of the hedging instrument if:

- (i) As a consequence of laws or regulations or the introduction of laws or regulations, the parties to the hedging instrument agree that one or more clearing counterparties replace their original counterparty to become the new counterparty to each of the parties. For this purpose, a clearing counterparty is a central counterparty (sometimes called a ‘clearing organization’ or ‘clearing agency’) or an entity or entities, for example, a clearing member of a clearing organization or a client of a clearing member of a clearing organization, that are acting as counterparty in order to effect clearing by a central counterparty. However, when the parties to the hedging instrument replace their original counterparties with different counterparties this paragraph shall apply only if each of those parties effects clearing with the same central counterparty.
 - (ii) Other changes, if any, to the hedging instrument are limited to those that are necessary to effect such a replacement of the counterparty. Such changes are limited to those that are consistent with the terms that would be expected if the hedging instrument were originally cleared with the clearing counterparty. These changes include changes in the collateral requirements, rights to offset receivables and payables balances, and charges levied.
- (b) The hedge no longer meets the criteria for hedge accounting in paragraph 98. In this case, the cumulative gain or loss on the hedging instrument that remains recognized directly in net assets/equity from the period when the hedge was effective (see paragraph 106(a)) shall remain separately recognized in net assets/equity until the forecast transaction occurs. When the transaction occurs, paragraph 108, 109, or 111 applies.
 - (c) The forecast transaction is no longer expected to occur, in which case any related cumulative gain or loss on the hedging instrument that has been recognized directly in net assets/equity from the period when the hedge was effective (see paragraph 106(a)) shall be recognized in surplus or deficit as a reclassification adjustment. A forecast transaction that is no longer highly probable (see paragraph 98(c)) may still be expected to occur.
 - (d) The entity revokes the designation. For hedges of a forecast transaction, the cumulative gain or loss on the hedging instrument that remains recognized directly in net assets/equity from the period when the hedge was effective (see paragraph 106(a)) shall remain separately recognized in net assets/equity until the forecast transaction occurs or is no longer expected to occur. When the transaction occurs, paragraph 108, 109, or 111 applies. If the transaction is no longer expected to occur, the cumulative gain or loss that had been recognized directly in net assets/equity shall be recognized in surplus or deficit as a reclassification adjustment.

Hedges of a Net Investment

113. Hedges of a net investment in a foreign operation, including a hedge of a monetary item that is accounted for as part of the net investment (see IPSAS 4), shall be accounted for similarly to cash flow hedges:
- (a) The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge (see paragraph 98) shall be recognized directly in net assets/equity through the statement of changes in net assets/equity (see IPSAS 1); and
 - (b) The ineffective portion shall be recognized in surplus or deficit.

The gain or loss on the hedging instrument relating to the effective portion of the hedge that has been recognized directly in net assets/equity shall be recognized in surplus or deficit as a reclassification adjustment in accordance with paragraphs 56–57 of IPSAS 4 on disposal of the foreign operation.

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Effective Date

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125H. Paragraphs 2, 9, 10, 80, 98, 99, 101, 102, 107, 108, 109, 111, 112, 113, AG128, AG157 and AG161 were amended, paragraph AG156A was added and paragraphs 1, 3, 4, 5, 6, 11–79, 88, AG1–AG126 and AG129 were deleted by IPSAS 41, issued in August 2018. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2022. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2022 it shall disclose that fact and apply IPSAS 41 at the same time.

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Application Guidance

This Appendix is an integral part of IPSAS 29.

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AG1–AG126. [Deleted] ...

Qualifying Instruments (paragraphs 81 and 82)

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AG128. A financial asset measured held-to-maturity investment carried at amortized cost may be designated as a hedging instrument in a hedge of foreign currency risk.

AG129. ~~An investment in an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured or a derivative that is linked to and must be settled by delivery of such an unquoted equity instrument (see paragraphs 48(c) and 49) cannot be designated as a hedging instrument.~~

Qualifying Items (paragraphs 87–89)

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AG134. If a hedge of a forecast transaction within the economic entity qualifies for hedge accounting, any gain or loss that is recognized directly in net assets/equity in accordance with paragraph 106(a) shall be reclassified into surplus or deficit as a reclassification adjustment in the same period or periods during which the foreign currency risk of the hedged transaction affects consolidated surplus or deficit.

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Assessing Hedge Effectiveness

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AG156A. For the avoidance of doubt, the effects of replacing the original counterparty with a clearing counterparty and making the associated changes as described in paragraphs 102(a)(ii) and 112(a)(ii) shall be reflected in the measurement of the hedging instrument and therefore in the assessment of hedge effectiveness and the measurement of hedge effectiveness.

Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk

AG157. For a fair value hedge of interest rate risk associated with a portfolio of financial assets or financial liabilities, an entity would meet the requirements of this Standard if it complies with the procedures set out in (a)–(i) and paragraphs AG158–AG175 below.

- (a) As part of its risk management process the entity identifies a portfolio of items whose interest rate risk it wishes to hedge. The portfolio may comprise only assets, only liabilities or both assets and liabilities. The entity may identify two or more portfolios (e.g., ~~the entity may group its available-for-sale assets into a separate portfolio~~), in which case it applies the guidance below to each portfolio separately.
- (b) The entity analyses the portfolio into repricing time periods based on expected, rather than contractual, repricing dates. The analysis into repricing time periods may be performed in various ways including scheduling cash flows into the periods in which they are expected to occur, or scheduling notional principal amounts into all periods until repricing is expected to occur.
- (c) On the basis of this analysis, the entity decides the amount it wishes to hedge. The entity designates as the hedged item an amount of assets or liabilities (but not a net amount) from the identified portfolio equal to the amount it wishes to designate as being hedged. This amount also determines the percentage measure that is used for testing effectiveness in accordance with paragraph AG169(b).
- (d) The entity designates the interest rate risk it is hedging. This risk could be a portion of the interest rate risk in each of the items in the hedged position, such as a benchmark interest rate (e.g., a swap rate).
- (e) The entity designates one or more hedging instruments for each repricing time period.
- (f) Using the designations made in (c)–(e) above, the entity assesses at inception and in subsequent periods, whether the hedge is expected to be highly effective during the period for which the hedge is designated.

- (g) Periodically, the entity measures the change in the fair value of the hedged item (as designated in (c)) that is attributable to the hedged risk (as designated in (d)), on the basis of the expected repricing dates determined in (b). Provided that the hedge is determined actually to have been highly effective when assessed using the entity's documented method of assessing effectiveness, the entity recognizes the change in fair value of the hedged item as a gain or loss in surplus or deficit and in one of two line items in the statement of financial position as described in paragraph 100. The change in fair value need not be allocated to individual assets or liabilities.
- (h) The entity measures the change in fair value of the hedging instrument(s) (as designated in (e)) and recognizes it as a gain or loss in surplus or deficit. The fair value of the hedging instrument(s) is recognized as an asset or liability in the statement of financial position.
- (i) Any ineffectiveness will be recognized in surplus or deficit as the difference between the change in fair value referred to in (g) and that referred to in (h) (effectiveness is measured using the same materiality considerations as in other IPSASs).

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AG161. As an example of the designation set out in paragraph AG157(c), if in a particular repricing time period an entity estimates that it has fixed rate assets of CU100 and fixed rate liabilities of CU80 and decides to hedge all of the net position of CU20, it designates as the hedged item assets in the amount of CU20 (a portion of the assets is designated as the Standard permits an entity to designate any amount of the available qualifying assets or liabilities, i.e., in this example any amount of the assets between CU0 and CU100). The designation is expressed as an "amount of a currency" (e.g., an amount of dollars, euro, pounds or rand) rather than as individual assets. It follows that all of the assets (or liabilities) from which the hedged amount is drawn – i.e., all of the CU100 of assets in the above example – must be:

- (a) Items whose fair value changes in response to changes in the interest rate being hedged; and
- (b) Items that could have qualified for fair value hedge accounting if they had been designated as hedged individually. In particular, because ~~IPSAS 41 paragraph 52 of the Standard~~ specifies that the fair value of a financial liability with a demand feature (such as demand deposits and some types of time deposits) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid, such an item cannot qualify for fair value hedge accounting for any time period beyond the shortest period in which the holder can demand payment. In the above example, the hedged position is an amount of assets. Hence, such liabilities are not a part of the designated hedged item, but are used by the entity to determine the amount of the asset that is designated as being hedged. If the position the entity wished to hedge was an amount of liabilities, the amount representing the designated hedged item must be drawn from fixed rate liabilities other than liabilities that the entity can be required to repay in an earlier time period, and the percentage measure used for assessing hedge effectiveness in accordance with paragraph AG169(b) would be calculated as a percentage of these other liabilities. For example, assume that an entity estimates that in a particular repricing time period it has fixed rate liabilities of CU100, comprising CU40 of demand deposits and CU60 of liabilities with no demand feature, and CU70 of fixed rate assets. If the entity decides to hedge all of the net position of CU30, it designates as the hedged item liabilities of CU30 or 50 percent ($(CU30 / (CU100 - CU40) = 50$ percent) of the liabilities with no demand feature.

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Appendix B is removed. Guidance is included in paragraphs AG109 and AG110 of IPSAS 41.

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Appendix B: Reassessment of Embedded Derivatives

B1–B7. [Deleted]

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~~Implementation Guidance~~

This guidance accompanies, but is not part of, IPSAS 29.

Sections A–G

[Deleted]

...

Illustrative Examples

These examples accompany, but are not part of, IPSAS 29.

IE32–IE50. [Deleted]

...

Amendments to IPSAS 30, *Financial Instruments: Disclosures*

Paragraphs 2, 3, 4, 5, 8, 11, 12, 13, 14, 18, 24, 34, 35, 36, 37, 41, 43, 45, AG1, AG5, AG9, AG10, AG24, and AG29 are amended, several headings and paragraphs 16, 17, 20, 26, 27, 28 and 44 are deleted and several headings and paragraphs 5A, 13A, 14A, 14B, 15A, 15B, 15C, 17A, 17B, 17C, 17D, 17E, 17F, 20A, 24A, 25A, 25B, 25C, 25D, 26A, 26B, 26C, 27A, 27B, 27C, 27D, 27E, 27F, 28A, 28B, 28C, 28D, 28E, 28F, 28G, 37A, 39A, 42A, 42B, 42C, 42D, 42E, 42F, 42G, 42H, 42I, 42J, 42K, 42L, 42M, 42N, 49A, 49B, 49C, 49D, 49E, 49F, 49G, 49H, 49I, 49J, 42K, 49L, 49M, 49N, 49O, 49P, 49Q, 49R, 49S, 52F, AG8A, AG8B, AG8C, AG8D, AG8E, AG8F, AG8G, AG8H, AG8I, AG8J, AG31, AG32, AG32A, AG33, AG34, AG35, AG36, AG37, AG38, AG39, AG40, AG41, AG42, AG43, AG44, AG45, AG46, AG47, AG48, AG49, AG50, AG51, AG52, AG53, AG54 and AG55 are added.

Objective

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2. The principles in this Standard complement the principles for recognizing, measuring, and presenting financial assets and financial liabilities in IPSAS 28, *Financial Instruments: Presentation* and IPSAS 41, *Financial Instruments*, ~~IPSAS 29, *Financial Instruments: Recognition and Measurement*~~.

...

Scope

3. **This Standard shall be applied by all entities to all types of financial instruments, except:**
 - (a) **Those interests in controlled entities, associates, or joint ventures that are accounted for in accordance with IPSAS 34, *Separate Financial Statements*, IPSAS 35, *Consolidated Financial Statements* or IPSAS 36, *Investments in Associates and Joint Ventures*. However, in some cases, IPSAS 34, IPSAS 35, or IPSAS 37 require or permit an entity to account for an interest in a controlled entity, associate, or joint venture using IPSAS 41 ~~IPSAS 29~~; in those cases, entities shall apply the requirements of this Standard. Entities shall also apply this Standard to all derivatives linked to interests in controlled entities, associates, or joint ventures unless the derivative meets the definition of an equity instrument in IPSAS 28.**
 - (b) **Employers' rights and obligations arising from employee benefit plans, to which IPSAS 39, *Employee Benefits* applies.**
 - (c) **Rights and obligations arising under insurance contracts. However, this Standard applies to:**
 - (i) **Derivatives that are embedded in insurance contracts if IPSAS 41 ~~IPSAS 29~~ requires the entity to account for them separately; and**
 - (ii) **An issuer of financial guarantee contracts if the issuer applies IPSAS 41 ~~IPSAS 29~~ in recognizing and measuring the contracts, but shall apply the relevant international or national accounting standard dealing with insurance contracts if the issuer elects to apply those standards in recognizing and measuring them.**

In addition to (i) and (ii) above, an entity may apply this Standard to insurance contracts which involve the transfer of financial risk.
 - (d) **Financial instruments, contracts, and obligations under share-based payment transactions to which the relevant international or national accounting standard dealing with share-based payment applies, except for contracts within the scope of paragraphs 6-8 of IPSAS 41 ~~4-6 of IPSAS 29~~, to which that Standard applies.**
 - (e) **Instruments that are required to be classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18 of IPSAS 28.**

...

4. This Standard applies to recognized and unrecognized financial instruments. Recognized financial instruments include financial assets and financial liabilities that are within the scope of IPSAS 41 ~~IPSAS 29~~. Unrecognized financial instruments include some financial instruments that, although outside the scope of IPSAS 41 ~~IPSAS 29~~, are within the scope of this Standard (such as some loan commitments).

5. This Standard applies to contracts to buy or sell a non-financial item that are within the scope of IPSAS 41 ~~IPSAS 29~~ (see paragraphs 6–8 of IPSAS 41 ~~IPSAS 29~~).

- 5A. The credit risk disclosure requirements in paragraphs 42A–42N apply to those rights for receivables that result from exchange transactions that are within the scope of IPSAS 9 and non-exchange transactions within the scope of IPSAS 23 which give rise to financial instruments for the purpose of recognizing impairment gains or losses in accordance with paragraph 3 of IPSAS 41. Any reference to financial assets or financial instruments in these paragraphs shall include those rights unless otherwise specified.

Definitions

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

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

Credit risk rating grades is a rating of credit risk based on the risk of a default occurring on the financial instrument.

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

Loans payable are financial liabilities, other than short-term trade payables on normal credit terms.

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk, and other price risk.

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.

~~A financial asset is past due when a counterparty has failed to make a payment when contractually due.~~

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

Significance of Financial Instruments for Financial Position and Financial Performance

Statement of Financial Position

Categories of Financial Assets and Financial Liabilities

11. The carrying amounts of each of the following categories, as defined in IPSAS 41 ~~IPSAS 29~~, shall be disclosed either in the statement of financial position or in the notes:

- (a) Financial assets measured at fair value through surplus or deficit, showing separately (i) those designated as such upon initial recognition or subsequently in accordance with paragraph 152 of IPSAS 41, and (ii) ~~those classified as held-for-trading in accordance with IPSAS 29~~ those mandatorily measured at fair value through surplus or deficit in accordance with IPSAS 41;
- (b) ~~Held-to-maturity investments;~~
- (c) ~~Loans and receivables;~~
- (d) ~~Available-for-sale financial assets;~~
- (e) Financial liabilities at fair value through surplus or deficit, showing separately (i) those designated as such upon initial recognition or subsequently in accordance with paragraph 152 of IPSAS 41, and (ii) ~~those classified as held-for-trading in accordance with IPSAS 29~~ those that meet the definition of held for trading in IPSAS 41; and
- (f) ~~Financial assets liabilities~~ measured at amortized cost;-
- (g) Financial liabilities measured at amortized cost; and
- (h) Financial assets measured at fair value through net assets/equity, showing separately (i) financial assets that are measured at fair value through net assets/equity in accordance with paragraph 41 of IPSAS 41; and (ii) investments in equity instruments designated as such upon initial recognition in accordance with paragraph 106 of IPSAS 41.

Financial Assets or Financial Liabilities at Fair Value through Surplus or Deficit

12. If the entity has designated as measured at fair value through surplus or deficit a financial asset (or group of financial assets) that would otherwise be measured at fair value through net assets/equity or amortized cost ~~a loan or receivable (or group of loans or receivables)~~ as at fair value through surplus or deficit, it shall disclose:
- (a) The maximum exposure to credit risk (see paragraph 43(a)) of the financial asset (or group of financial assets) ~~loan or receivable (or group of loans or receivables)~~ at the end of the reporting period.
 - (b) The amount by which any related credit derivatives or similar instruments mitigate that maximum exposure to credit risk (see paragraph 43(b)).
 - (c) The amount of change, during the period and cumulatively, in the fair value of the financial asset (or group of financial assets) ~~loan or receivable (or group of loans or receivables)~~ that is attributable to changes in the credit risk of the financial asset determined either:
 - (i) As the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk; or
 - (ii) Using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the asset.

Changes in market conditions that give rise to market risk include changes in an observed (benchmark) interest rate, commodity price, foreign exchange rate, or index of prices or rates.
 - (d) The amount of the change in the fair value of any related credit derivatives or similar instruments that has occurred during the period and cumulatively since the financial asset ~~loan or receivable~~ was designated.
13. If the entity has designated a financial liability as at fair value through surplus or deficit in accordance with paragraph 46 of IPSAS 41 and is required to present the effects of changes in that liability's credit risk in net assets/equity (see paragraph 108 of IPSAS 41) of IPSAS 29, it shall disclose:
- (a) The amount of change, ~~during the period and~~ cumulatively, in the fair value of the financial liability that is attributable to changes in the credit risk of that liability (see paragraphs AG236–AG243 of IPSAS 41 for guidance on determining the effects of changes in a liability's credit risk); ~~determined either:~~
 - (i) As the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk (see Appendix A, paragraph AG4); or
 - (ii) ~~Using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the liability.~~

~~Changes in market conditions that give rise to market risk include changes in a benchmark interest rate, the price of another entity's financial instrument, a commodity price, a foreign exchange rate, or an index of prices or rates. For~~

~~contracts that include a unit-linking feature, changes in market conditions include changes in the performance of the related internal or external investment fund.~~

- (b) ~~The difference between the financial liability's carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation.~~
- (c) ~~Any transfers of the cumulative gain or loss within net assets/equity during the period including the reason for such transfers.~~
- (d) ~~If a liability is derecognized during the period, the amount (if any) presented in net assets/equity that was realized at derecognition.~~

13A. If an entity has designated a financial liability as at fair value through surplus or deficit in accordance with paragraph 46 of IPSAS 41 and is required to present all changes in the fair value of that liability (including the effects of changes in the credit risk of the liability) in surplus or deficit (see paragraphs 108 and 109 of IPSAS 41), it shall disclose:

- (a) The amount of change, during the period and cumulatively, in the fair value of the financial liability that is attributable to changes in the credit risk of that liability (see paragraphs AG236–AG243 of IPSAS 41 for guidance on determining the effects of changes in a liability's credit risk); and
- (b) The difference between the financial liability's carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation.

14. The entity shall also disclose:

- (a) A detailed description of the ~~The~~ methods used to comply with the requirements in paragraphs 12(c), ~~and~~ 13(a) and 13A(a) and paragraph 108(a) of IPSAS 41, including an explanation of why the method is appropriate.
- (b) If the entity believes that the disclosure it has given, either in the statement of financial position or in the notes, to comply with the requirements in paragraph 12(c), ~~or~~ 13(a) or 13A(a) or paragraph 108(a) of IPSAS 41 does not faithfully represent the change in the fair value of the financial asset or financial liability attributable to changes in its credit risk, the reasons for reaching this conclusion and the factors it believes are relevant.
- (c) A detailed description of the methodology or methodologies used to determine whether presenting the effects of changes in a liability's credit risk in net assets/equity would create or enlarge an accounting mismatch in surplus or deficit (see paragraphs 108 and 109 of IPSAS 41). If an entity is required to present the effects of changes in a liability's credit risk in surplus or deficit (see paragraph 109 of IPSAS 41), the disclosure must include a detailed description of the economic relationship described in paragraph AG229 of IPSAS 41.

Investments in Equity Instruments Designated at Fair Value through Net Assets/Equity

14A. If an entity has designated investments in equity instruments to be measured at fair value through net assets/equity, as permitted by paragraph 106 of IPSAS 41, it shall disclose:

- (a) Which investments in equity instruments have been designated to be measured at fair value through net assets/equity.
- (b) The reasons for using this presentation alternative.
- (c) The fair value of each such investment at the end of the reporting period.
- (d) Dividends recognized during the period, showing separately those related to investments derecognized during the reporting period and those related to investments held at the end of the reporting period.
- (e) Any transfers of the cumulative gain or loss within net assets/equity during the period including the reason for such transfers.

14B. If an entity derecognized investments in equity instruments measured at fair value through net assets/equity during the reporting period, it shall disclose:

- (a) The reasons for disposing of the investments.
- (b) The fair value of the investments at the date of derecognition.
- (c) The cumulative gain or loss on disposal.

Reclassification

15. If the entity has reclassified a financial asset (in accordance with paragraphs 60–63 of IPSAS 29) as one measured:
- (a) ~~At cost or amortized cost, rather than at fair value; or~~
 - (b) ~~At fair value, rather than at cost or amortized cost;~~
- it shall disclose the amount reclassified into and out of each category and the reason for that reclassification.
- ~~15A. An entity shall disclose if, in the current or previous reporting periods, it has reclassified any financial assets in accordance with paragraph 54 of IPSAS 41. For each such event, an entity shall disclose:~~
- ~~(a) The date of reclassification.~~
 - ~~(b) A detailed explanation of the change in management model and a qualitative description of its effect on the entity's financial statements.~~
 - ~~(c) The amount reclassified into and out of each category.~~
- ~~15B. For each reporting period following reclassification until derecognition, an entity shall disclose for assets reclassified out of the fair value through surplus or deficit category so that they are measured at amortized cost or fair value through net assets/equity in accordance with paragraph 54 of IPSAS 41:~~
- ~~(a) The effective interest rate determined on the date of reclassification; and~~
 - ~~(b) The interest revenue recognized.~~
- ~~15C. If, since its last reporting date, an entity has reclassified financial assets out of the fair value through net assets/equity category so that they are measured at amortized cost or out of the fair value through surplus or deficit category so that they are measured at amortized cost or fair value through net assets/equity it shall disclose:~~
- ~~(a) The fair value of the financial assets at the end of the reporting period; and~~
 - ~~(b) The fair value gain or loss that would have been recognized in surplus or deficit or net assets/equity during the reporting period if the financial assets had not been reclassified.~~
16. If the entity has reclassified a financial asset out of the fair value through surplus or deficit category in accordance with paragraph 55 or 57 of IPSAS 29 or out of the available-for-sale category in accordance with paragraph 58 of IPSAS 29, it shall disclose:
- (a) ~~The amount reclassified into and out of each category;~~
 - (b) ~~For each reporting period until derecognition, the carrying amounts and fair values of all financial assets that have been reclassified in the current and previous reporting periods;~~
 - (c) ~~If a financial asset was reclassified in accordance with paragraph 55 of IPSAS 29, the rare situation, and the facts and circumstances indicating that the situation was rare;~~
 - (d) ~~For the reporting period when the financial asset was reclassified, the fair value gain or loss on the financial asset recognized in surplus or deficit or in net assets/equity in that reporting period and in the previous reporting period;~~
 - (e) ~~For each reporting period following the reclassification (including the reporting period in which the financial asset was reclassified) until derecognition of the financial asset, the fair value gain or loss that would have been recognized in surplus or deficit or in net assets/equity if the financial asset had not been reclassified, and the gain, loss, revenue, and expense recognized in surplus or deficit; and~~
 - (f) ~~The effective interest rate and estimated amounts of cash flows the entity expects to recover, as at the date of reclassification of the financial asset.~~

Derecognition

17. ~~An entity may have transferred financial assets in such a way that part or all of the financial assets do not qualify for derecognition (see paragraphs 17–39 of IPSAS 29). The entity shall disclose for each class of such financial assets:-~~
- ~~(a) The nature of the assets;~~
 - ~~(b) The nature of the risks and rewards of ownership to which the entity remains exposed;~~

- (c) ~~When the entity continues to recognize all of the assets, the carrying amounts of the assets, and of the associated liabilities; and~~
- (d) ~~When the entity continues to recognize the assets to the extent of its continuing involvement, the total carrying amount of the original assets, the amount of the assets that the entity continues to recognize, and the carrying amount of the associated liabilities.~~

Offsetting Financial Assets and Financial Liabilities

17A. The disclosures in paragraphs 17B–17E supplement the other disclosure requirements of this Standard and are required for all recognized financial instruments that are set off in accordance with paragraph 47 of IPSAS 28. These disclosures also apply to recognized financial instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are set off in accordance with paragraph 47 of IPSAS 28.

17B. An entity shall disclose information to enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on the entity's financial position. This includes the effect or potential effect of rights of set-off associated with the entity's recognized financial assets and recognized financial liabilities that are within the scope of paragraph 17A.

17C. To meet the objective in paragraph 17B, an entity shall disclose, at the end of the reporting period, the following quantitative information separately for recognized financial assets and recognized financial liabilities that are within the scope of paragraph 17A:

- (a) The gross amounts of those recognized financial assets and recognized financial liabilities;
- (b) The amounts that are set off in accordance with the criteria in paragraph 47 of IPSAS 28 when determining the net amounts presented in the statement of financial position;
- (c) The net amounts presented in the statement of financial position;
- (d) The amounts subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in paragraph 17C(b), including:
 - (i) Amounts related to recognized financial instruments that do not meet some or all of the offsetting criteria in paragraph 47 of IPSAS 28; and
 - (ii) Amounts related to financial collateral (including cash collateral); and
- (e) The net amount after deducting the amounts in (d) from the amounts in (c) above.

The information required by this paragraph shall be presented in a tabular format, separately for financial assets and financial liabilities, unless another format is more appropriate.

17D. The total amount disclosed in accordance with paragraph 17C(d) for an instrument shall be limited to the amount in paragraph 17C(c) for that instrument.

17E. An entity shall include a description in the disclosures of the rights of set-off associated with the entity's recognized financial assets and recognized financial liabilities subject to enforceable master netting arrangements and similar agreements that are disclosed in accordance with paragraph 17C(d), including the nature of those rights.

17F. If the information required by paragraphs 17B–17E is disclosed in more than one note to the financial statements, an entity shall cross-refer between those notes.

Collateral

18. An entity shall disclose:

- (a) The carrying amount of financial assets it has pledged as collateral for liabilities or contingent liabilities, including amounts that have been reclassified in accordance with paragraph 34(a) of IPSAS 41 ~~39(a) of IPSAS 29~~; and
- (b) The terms and conditions relating to its pledge.

...

Allowance Account for Credit Losses

20. ~~When financial assets are impaired by credit losses and the entity records the impairment in a separate account (e.g., an allowance account used to record individual impairments or a similar account used to record a collective impairment of~~

assets) rather than directly reducing the carrying amount of the asset, it shall disclose a reconciliation of changes in that account during the period for each class of financial assets:

- 20A. The carrying amount of financial assets measured at fair value through net assets/equity in accordance with paragraph 41 of IPSAS 41 is not reduced by a loss allowance and an entity shall not present the loss allowance separately in the statement of financial position as a reduction of the carrying amount of the financial asset. However, an entity shall disclose the loss allowance in the notes to the financial statements.

...

Statement of Financial Performance

Items of Revenue, Expense, Gains, or Losses

24. An entity shall disclose the following items of revenue, expense, gains, or losses either in the statement of financial performance or in the notes:
- (a) Net gains or net losses on:
 - (i) Financial assets or financial liabilities measured at fair value through surplus or deficit, showing separately those on financial assets or financial liabilities designated as such upon initial recognition or subsequently in accordance with paragraph 152 of IPSAS 41, and those on financial assets or financial liabilities that are mandatorily measured at fair value through surplus or deficit in accordance with IPSAS 41 (e.g., financial liabilities that meet the definition of held for trading in IPSAS 41). For financial liabilities designated as at fair value through surplus or deficit, an entity shall show separately the amount of gain or loss recognized in net assets/equity and the amount recognized in surplus or deficit classified as held for trading in accordance with IPSAS 29;
 - (ii) ~~Available-for-sale financial assets, showing separately the amount of gain or loss recognized in net assets/equity during the period and the amount reclassified from net assets/equity and recognized directly in surplus or deficit for the period;~~
 - (iii) ~~Held-to-maturity investments;~~
 - (iv) ~~Loans and receivables; and~~
 - (v) ~~Financial liabilities measured at amortized cost;~~
 - (vi) Financial assets measured at amortized cost;
 - (vii) Investments in equity instruments designated at fair value through net assets/equity in accordance with paragraph 106 of IPSAS 41; and
 - (viii) Financial assets measured at fair value through net assets/equity in accordance with paragraph 41 of IPSAS 41, showing separately the amount of gain or loss recognized in net assets/equity during the period and the amount reclassified upon derecognition from accumulated net assets/equity to surplus or deficit for the period.
 - (b) Total interest revenue and total interest expense (calculated using the effective interest method) for financial assets or financial liabilities that are measured at amortized cost or that are measured at fair value through net assets/equity in accordance with paragraph 41 of IPSAS 41 (showing these amounts separately); or financial liabilities that are not measured at fair value through surplus or deficit not at fair value through surplus or deficit;
 - (c) Fee revenue and expense (other than amounts included in determining the effective interest rate) arising from:
 - (i) ~~Financial assets or financial liabilities that are not at fair value through surplus or deficit; and~~
 - (ii) ~~Trust and other fiduciary activities that result in the holding or investing of assets on behalf of individuals, trusts, retirement benefit plans, and other institutions;~~
 - (d) ~~Interest revenue on impaired financial assets accrued in accordance with paragraph AG126 of IPSAS 29; and~~
 - (e) ~~The amount of any impairment loss for each class of financial asset.~~
- 24A. An entity shall disclose an analysis of the gain or loss recognized in the statement of financial performance arising from the derecognition of financial assets measured at amortized cost, showing separately gains and losses arising from derecognition of those financial assets. This disclosure shall include the reasons for derecognizing those financial assets.

...

Hedge Accounting

25A. An entity shall apply the disclosure requirements in paragraphs 25B–28F for those risk exposures that an entity hedges and for which it elects to apply hedge accounting. Hedge accounting disclosures shall provide information about:

- (a) An entity’s risk management strategy and how it is applied to manage risk;
- (b) How the entity’s hedging activities may affect the amount, timing and uncertainty of its future cash flows; and
- (c) The effect that hedge accounting has had on the entity’s statement of financial position, statement of financial performance and statement of changes in net assets/equity.

25B. An entity shall present the required disclosures in a single note or separate section in its financial statements. However, an entity need not duplicate information that is already presented elsewhere, provided that the information is incorporated by cross-reference from the financial statements to some other statement, such as a management commentary or risk report that is available to users of the financial statements on the same terms as the financial statements and at the same time. Without the information incorporated by cross-reference, the financial statements are incomplete.

25C. When paragraphs 26A–28F require the entity to separate by risk category the information disclosed, the entity shall determine each risk category on the basis of the risk exposures an entity decides to hedge and for which hedge accounting is applied. An entity shall determine risk categories consistently for all hedge accounting disclosures.

25D. To meet the objectives in paragraph 25A, an entity shall (except as otherwise specified below) determine how much detail to disclose, how much emphasis to place on different aspects of the disclosure requirements, the appropriate level of aggregation or disaggregation, and whether users of financial statements need additional explanations to evaluate the quantitative information disclosed. However, an entity shall use the same level of aggregation or disaggregation it uses for disclosure requirements of related information in this Standard.

26. ~~An entity shall disclose the following separately for each type of hedge described in IPSAS 29 (i.e., fair value hedges, cash flow hedges, and hedges of net investments in foreign operations):-~~

- ~~(a) A description of each type of hedge;~~
- ~~(b) A description of the financial instruments designated as hedging instruments and their fair values at the end of the reporting period; and~~
- ~~(c) The nature of the risks being hedged.~~

The Risk Management Strategy

26A. An entity shall explain its risk management strategy for each risk category of risk exposures that it decides to hedge and for which hedge accounting is applied. This explanation should enable users of financial statements to evaluate (for example):

- (a) How each risk arises.
- (b) How the entity manages each risk; this includes whether the entity hedges an item in its entirety for all risks or hedges a risk component (or components) of an item and why.
- (c) The extent of risk exposures that the entity manages.

26B. To meet the requirements in paragraph 26A, the information should include (but is not limited to) a description of:

- (a) The hedging instruments that are used (and how they are used) to hedge risk exposures;
- (b) How the entity determines the economic relationship between the hedged item and the hedging instrument for the purpose of assessing hedge effectiveness; and
- (c) How the entity establishes the hedge ratio and what the sources of hedge ineffectiveness are.

26C. When an entity designates a specific risk component as a hedged item (see paragraph 128 of IPSAS 41) it shall provide, in addition to the disclosures required by paragraphs 26A and 26B, qualitative or quantitative information about:

- (a) How the entity determined the risk component that is designated as the hedged item (including a description of the nature of the relationship between the risk component and the item as a whole); and

- (b) How the risk component relates to the item in its entirety (for example, the designated risk component historically covered on average 80 percent of the changes in fair value of the item as a whole).

The Amount, Timing and Uncertainty of Future Cash Flows

27. ~~For cash flow hedges, an entity shall disclose:~~

- (a) ~~The periods when the cash flows are expected to occur and when they are expected to affect surplus or deficit;~~
- (b) ~~A description of any forecast transaction for which hedge accounting had previously been used, but which is no longer expected to occur;~~
- (c) ~~The amount that was recognized in net assets/equity during the period;~~
- (d) ~~The amount that was reclassified from net assets/equity and included in surplus or deficit for the period, showing the amount included in each line item in the statement of financial performance; and~~
- (e) ~~The amount that was removed from net assets/equity during the period and included in the initial cost or other carrying amount of a non-financial asset or non-financial liability whose acquisition or incurrence was a hedged highly probable forecast transaction.~~

27A. Unless exempted by paragraph 27C, an entity shall disclose by risk category quantitative information to allow users of its financial statements to evaluate the terms and conditions of hedging instruments and how they affect the amount, timing and uncertainty of future cash flows of the entity.

27B. To meet the requirement in paragraph 27A, an entity shall provide a breakdown that discloses:

- (a) A profile of the timing of the nominal amount of the hedging instrument; and
- (b) If applicable, the average price or rate (for example strike or forward prices etc.) of the hedging instrument.

27C. In situations in which an entity frequently resets (i.e., discontinues and restarts) hedging relationships because both the hedging instrument and the hedged item frequently change (i.e., the entity uses a dynamic process in which both the exposure and the hedging instruments used to manage that exposure do not remain the same for long—such as in the example in paragraph AG317(b) of IPSAS 41) the entity:

- (a) Is exempt from providing the disclosures required by paragraphs 27A and 27B.
- (b) Shall disclose:
 - (i) Information about what the ultimate risk management strategy is in relation to those hedging relationships;
 - (ii) A description of how it reflects its risk management strategy by using hedge accounting and designating those particular hedging relationships; and
 - (iii) An indication of how frequently the hedging relationships are discontinued and restarted as part of the entity's process in relation to those hedging relationships.

27D. An entity shall disclose by risk category a description of the sources of hedge ineffectiveness that are expected to affect the hedging relationship during its term.

27E. If other sources of hedge ineffectiveness emerge in a hedging relationship, an entity shall disclose those sources by risk category and explain the resulting hedge ineffectiveness.

27F. For cash flow hedges, an entity shall disclose a description of any forecast transaction for which hedge accounting had been used in the previous period, but which is no longer expected to occur.

The Effects of Hedge Accounting on Financial Position and Performance

28. An entity shall disclose separately:

- (a) In fair value hedges, gains or losses:
 - (i) On the hedging instrument; and
 - (ii) On the hedged item attributable to the hedged risk.
- (b) The ineffectiveness recognized in surplus or deficit that arises from cash flow hedges; and
- (c) The ineffectiveness recognized in surplus or deficit that arises from hedges of net investments in foreign operations.

28A. An entity shall disclose, in a tabular format, the following amounts related to items designated as hedging instruments separately by risk category for each type of hedge (fair value hedge, cash flow hedge or hedge of a net investment in a foreign operation):

- (a) The carrying amount of the hedging instruments (financial assets separately from financial liabilities);
- (b) The line item in the statement of financial position that includes the hedging instrument;
- (c) The change in fair value of the hedging instrument used as the basis for recognizing hedge ineffectiveness for the period; and
- (d) The nominal amounts (including quantities such as tonnes or cubic meters) of the hedging instruments.

28B. An entity shall disclose, in a tabular format, the following amounts related to hedged items separately by risk category for the types of hedges as follows:

- (a) For fair value hedges:
 - (i) The carrying amount of the hedged item recognized in the statement of financial position (presenting assets separately from liabilities);
 - (ii) The accumulated amount of fair value hedge adjustments on the hedged item included in the carrying amount of the hedged item recognized in the statement of financial position (presenting assets separately from liabilities);
 - (iii) The line item in the statement of financial position that includes the hedged item;
 - (iv) The change in value of the hedged item used as the basis for recognizing hedge ineffectiveness for the period; and
 - (v) The accumulated amount of fair value hedge adjustments remaining in the statement of financial position for any hedged items that have ceased to be adjusted for hedging gains and losses in accordance with paragraph 139 of IPSAS 41.
- (b) For cash flow hedges and hedges of a net investment in a foreign operation:
 - (i) The change in value of the hedged item used as the basis for recognizing hedge ineffectiveness for the period (i.e., for cash flow hedges the change in value used to determine the recognized hedge ineffectiveness in accordance with paragraph 140(c) of IPSAS 41);
 - (ii) The balances in the cash flow hedge reserve and the foreign currency translation reserve for continuing hedges that are accounted for in accordance with paragraphs 140 and 142(a) of IPSAS 41; and
 - (iii) The balances remaining in the cash flow hedge reserve and the foreign currency translation reserve from any hedging relationships for which hedge accounting is no longer applied.

28C. An entity shall disclose, in a tabular format, the following amounts separately by risk category for the types of hedges as follows:

- (a) For fair value hedges:
 - (i) Hedge ineffectiveness—i.e., the difference between the hedging gains or losses of the hedging instrument and the hedged item—recognized in surplus or deficit (or net assets/equity for hedges of an equity instrument for which an entity has elected to present changes in fair value in net assets/equity in accordance with paragraph 106 of IPSAS 41); and
 - (ii) The line item in the statement of financial performance that includes the recognized hedge ineffectiveness.
- (b) For cash flow hedges and hedges of a net investment in a foreign operation:
 - (i) Hedging gains or losses of the reporting period that were recognized in net assets/equity;
 - (ii) Hedge ineffectiveness recognized in surplus or deficit;
 - (iii) The line item in the statement of financial performance that includes the recognized hedge ineffectiveness;
 - (iv) The amount reclassified from the cash flow hedge reserve or the foreign currency translation reserve into surplus or deficit as a reclassification adjustment (see IPSAS 1) (differentiating between amounts for which

hedge accounting had previously been used, but for which the hedged future cash flows are no longer expected to occur, and amounts that have been transferred because the hedged item has affected surplus or deficit);

- (v) The line item in the statement of financial performance that includes the reclassification adjustment (see IPSAS 1); and
- (vi) For hedges of net positions, the hedging gains or losses recognized in a separate line item in the statement of financial performance (see paragraph 149 of IPSAS 41).

28D. When the volume of hedging relationships to which the exemption in paragraph 27C applies is unrepresentative of normal volumes during the period (i.e., the volume at the reporting date does not reflect the volumes during the period) an entity shall disclose that fact and the reason it believes the volumes are unrepresentative.

28E. An entity shall provide a reconciliation of each component of net assets/equity and an analysis of net assets/equity in accordance with IPSAS 1 that, taken together:

- (a) Differentiates, at a minimum, between the amounts that relate to the disclosures in paragraph 28C(b)(i) and (b)(iv) as well as the amounts accounted for in accordance with paragraph 140(d)(i) and (iii) of IPSAS 41;
- (b) Differentiates between the amounts associated with the time value of options that hedge transaction related hedged items and the amounts associated with the time value of options that hedge time-period related hedged items when an entity accounts for the time value of an option in accordance with paragraph 144 of IPSAS 41; and
- (c) Differentiates between the amounts associated with forward elements of forward contracts and the foreign currency basis spreads of financial instruments that hedge transaction related hedged items, and the amounts associated with forward elements of forward contracts and the foreign currency basis spreads of financial instruments that hedge time-period related hedged items when an entity accounts for those amounts in accordance with paragraph 145 of IPSAS 41.

28F. An entity shall disclose the information required in paragraph 28E separately by risk category. This disaggregation by risk may be provided in the notes to the financial statements.

Option to Designate a Credit Exposure as Measured at Fair Value Through Surplus or Deficit

28G. If an entity designated a financial instrument, or a proportion of it, as measured at fair value through surplus or deficit because it uses a credit derivative to manage the credit risk of that financial instrument it shall disclose:

- (a) For credit derivatives that have been used to manage the credit risk of financial instruments designated as measured at fair value through surplus or deficit in accordance with paragraph 152 of IPSAS 41, a reconciliation of each of the nominal amount and the fair value at the beginning and at the end of the period;
- (b) The gain or loss recognized in surplus or deficit on designation of a financial instrument, or a proportion of it, as measured at fair value through surplus or deficit in accordance with paragraph 152 of IPSAS 41; and
- (c) On discontinuation of measuring a financial instrument, or a proportion of it, at fair value through surplus or deficit, that financial instrument's fair value that has become the new carrying amount in accordance with paragraph 155 of IPSAS 41 and the related nominal or principal amount (except for providing comparative information in accordance with IPSAS 1, an entity does not need to continue this disclosure in subsequent periods).

...

34. If the market for a financial instrument is not active, an entity establishes its fair value using a valuation technique (see paragraphs ~~AG149–AG154 of IPSAS 41~~ ~~AG106–AG112 of IPSAS 29~~). Nevertheless, the best evidence of fair value at initial recognition is the transaction price (i.e., the fair value of the consideration given or received), unless conditions described in paragraph ~~AG151 of IPSAS 41~~ ~~AG108 of IPSAS 29~~ are met. It follows that there could be a difference between the fair value at initial recognition and the amount that would be determined at that date using the valuation technique. If such a difference exists, an entity shall disclose, by class of financial instrument:

- (a) Its accounting policy for recognizing that difference in surplus or deficit to reflect a change in factors (including time) that market participants would consider in setting a price (see paragraph ~~AG117(b) of IPSAS 41~~ ~~AG109 of IPSAS 29~~); and
- (b) The aggregate difference yet to be recognized in surplus or deficit at the beginning and end of the period and a reconciliation of changes in the balance of this difference.

35. Disclosures of fair value are not required:
- (a) When the carrying amount is a reasonable approximation of fair value, for example, for financial instruments such as short-term trade receivables and payables; and
 - (b) ~~For an investment in equity instruments that do not have a quoted market price in an active market, or derivatives linked to such equity instruments, that is measured at cost in accordance with IPSAS 29 because its fair value cannot be measured reliably; and~~
 - (c) For a contract containing a discretionary participation feature if the fair value of that feature cannot be measured reliably.
36. In the case cases described in paragraph 35(b) ~~and~~ (c), an entity shall disclose information to help users of the financial statements make their own judgments about the extent of possible differences between the carrying amount of those contracts ~~financial assets or financial liabilities~~ and their fair value, including:
- (a) The fact that fair value information has not been disclosed for these instruments because their fair value cannot be measured reliably;
 - (b) A description of the financial instruments, their carrying amount, and an explanation of why fair value cannot be measured reliably;
 - (c) Information about the market for the instruments;
 - (d) Information about whether and how the entity intends to dispose of the financial instruments; and
 - (e) If financial instruments whose fair value previously could not be reliably measured are derecognized, that fact, their carrying amount at the time of derecognition, and the amount of gain or loss recognized.

Concessionary Loans

37. Concessionary loans are granted by entities on below market terms. Examples of concessionary loans that commonly have below market terms include loans to developing countries, small farms, student loans granted to qualifying students for university or college education, and housing loans granted to low income families. For concessionary loans granted and measured at amortized cost in accordance with paragraph 40 of IPSAS 41, an entity shall disclose:
- (a) A reconciliation between the opening and closing carrying amounts of the loans, including:
 - (i) Nominal value of new loans granted during the period;
 - (ii) The fair value adjustment on initial recognition;
 - (iii) Loans repaid during the period;
 - (iv) Impairment losses recognized;
 - (v) Any increase during the period in the discounted amount arising from the passage of time; and
 - (vi) Other changes.
 - (b) Nominal value of the loans at the end of the period;
 - (c) The purpose and terms of the various types of loans, including the nature of the concession; and
 - (d) Valuation assumptions.
- 37A. For concessionary loans measured at fair value in accordance with paragraph 41 or 43 of IPSAS 41 an entity shall disclose:
- (a) A reconciliation between the opening and closing carrying amounts of the loans, including:
 - (i) Nominal value of new loans granted during the period;
 - (ii) The fair value adjustment on initial recognition;
 - (iii) Loans repaid during the period;
 - (iv) The fair value adjustment during the period (separate from initial recognition); and
 - (v) Other changes.

- (b) Nominal value of the loans at the end of the period;
- (c) The purpose and terms of the various types of loans, including the nature of the concession; and
- (d) Valuation assumptions.

...

Nature and Extent of Risks Arising from Financial Instruments

...

39A. Providing qualitative disclosures in the context of quantitative disclosures enables users to link related disclosures and hence form an overall picture of the nature and extent of risks arising from financial instruments. The interaction between qualitative and quantitative disclosures contributes to disclosure of information in a way that better enables users to evaluate an entity's exposure to risks.

...

Quantitative Disclosures

41. For each type of risk arising from financial instruments, an entity shall disclose:

- (a) Summary quantitative data about its exposure to that risk at the end of the reporting period. This disclosure shall be based on the information provided internally to key management personnel of the entity (as defined in IPSAS 20, *Related Party Disclosures*), for example, the entity's governing body or chief executive officer.
- (b) The disclosures required by paragraphs 43–49, to the extent not provided in accordance with (a), ~~unless the risk is not material (see paragraphs 45–47 of IPSAS 1 for a discussion of materiality).~~
- (c) Concentrations of risk if not apparent from the disclosures made in accordance with (a) and (b).

...

Credit Risk

Scope and Objectives

42A. An entity shall apply the disclosure requirements in paragraphs 42F–42N to financial instruments to which the impairment requirements in IPSAS 41 are applied. However:

- (a) For receivables that result from exchange transactions that are within the scope of IPSAS 9 and non-exchange transactions within the scope of IPSAS 23 and lease receivables, paragraph 42J(a) applies to those receivables or lease receivables on which lifetime expected credit losses are recognized in accordance with paragraph 87 of IPSAS 41, if those financial assets are modified while more than 30 days past due; and
- (b) Paragraph 42K(b) does not apply to lease receivables.

42B. The credit risk disclosures made in accordance with paragraphs 42F–42N shall enable users of financial statements to understand the effect of credit risk on the amount, timing and uncertainty of future cash flows. To achieve this objective, credit risk disclosures shall provide:

- (a) Information about an entity's credit risk management practices and how they relate to the recognition and measurement of expected credit losses, including the methods, assumptions and information used to measure expected credit losses;
- (b) Quantitative and qualitative information that allows users of financial statements to evaluate the amounts in the financial statements arising from expected credit losses, including changes in the amount of expected credit losses and the reasons for those changes; and
- (c) Information about an entity's credit risk exposure (i.e., the credit risk inherent in an entity's financial assets and commitments to extend credit) including significant credit risk concentrations.

42C. An entity need not duplicate information that is already presented elsewhere, provided that the information is incorporated by cross-reference from the financial statements to other statements, such as a management commentary or risk report that is available to users of the financial statements on the same terms as the financial statements and at the same time. Without the information incorporated by cross-reference, the financial statements are incomplete.

42D. To meet the objectives in paragraph 42B, an entity shall (except as otherwise specified) consider how much detail to disclose, how much emphasis to place on different aspects of the disclosure requirements, the appropriate level of aggregation or disaggregation, and whether users of financial statements need additional explanations to evaluate the quantitative information disclosed.

42E. If the disclosures provided in accordance with paragraphs 42F–42N are insufficient to meet the objectives in paragraph 42B, an entity shall disclose additional information that is necessary to meet those objectives.

The Credit Risk Management Practices

42F. An entity shall explain its credit risk management practices and how they relate to the recognition and measurement of expected credit losses. To meet this objective an entity shall disclose information that enables users of financial statements to understand and evaluate:

- (a) How an entity determined whether the credit risk of financial instruments has increased significantly since initial recognition, including, if and how:
 - (i) Financial instruments are considered to have low credit risk in accordance with paragraph 82 of IPSAS 41, including the classes of financial instruments to which it applies; and
 - (ii) The presumption in paragraph 83 of IPSAS 41, that there have been significant increases in credit risk since initial recognition when financial assets are more than 30 days past due, has been rebutted;
- (b) An entity's definitions of default, including the reasons for selecting those definitions;
- (c) How the instruments were grouped if expected credit losses were measured on a collective basis;
- (d) How an entity determined that financial assets are credit-impaired financial assets;
- (e) An entity's write-off policy, including the indicators that there is no reasonable expectation of recovery and information about the policy for financial assets that are written-off but are still subject to enforcement activity; and
- (f) How the requirements in paragraph 84 of IPSAS 41 for the modification of contractual cash flows of financial assets have been applied, including how an entity:
 - (i) Determines whether the credit risk on a financial asset that has been modified while the loss allowance was measured at an amount equal to lifetime expected credit losses, has improved to the extent that the loss allowance reverts to being measured at an amount equal to 12-month expected credit losses in accordance with paragraph 77 of IPSAS 41; and
 - (ii) Monitors the extent to which the loss allowance on financial assets meeting the criteria in (i) is subsequently remeasured at an amount equal to lifetime expected credit losses in accordance with paragraph 75 of IPSAS 41.

42G. An entity shall explain the inputs, assumptions and estimation techniques used to apply the requirements in paragraphs 73–93 of IPSAS 41. For this purpose an entity shall disclose:

- (a) The basis of inputs and assumptions and the estimation techniques used to:
 - (i) Measure the 12-month and lifetime expected credit losses;
 - (ii) Determine whether the credit risk of financial instruments has increased significantly since initial recognition; and
 - (iii) Determine whether a financial asset is a credit-impaired financial asset.
- (b) How forward-looking information has been incorporated into the determination of expected credit losses, including the use of macroeconomic information; and
- (c) Changes in the estimation techniques or significant assumptions made during the reporting period and the reasons for those changes.

Quantitative and Qualitative Information about Amounts Arising from Expected Credit Losses

42H. To explain the changes in the loss allowance and the reasons for those changes, an entity shall provide, by class of financial instrument, a reconciliation from the opening balance to the closing balance of the loss allowance, in a table, showing separately the changes during the period for:

- (a) The loss allowance measured at an amount equal to 12-month expected credit losses;
- (b) The loss allowance measured at an amount equal to lifetime expected credit losses for:
 - (i) Financial instruments for which credit risk has increased significantly since initial recognition but that are not credit-impaired financial assets;
 - (ii) Financial assets that are credit-impaired at the reporting date (but that are not purchased or originated credit-impaired); and
 - (iii) Receivables that result from exchange transactions that are within the scope of IPSAS 9 or non-exchange transactions that are within the scope of IPSAS 23 or lease receivables for which the loss allowances are measured in accordance with paragraph 87 of IPSAS 41.
- (c) Financial assets that are purchased or originated credit-impaired. In addition to the reconciliation, an entity shall disclose the total amount of undiscounted expected credit losses at initial recognition on financial assets initially recognized during the reporting period.

42I. To enable users of financial statements to understand the changes in the loss allowance disclosed in accordance with paragraph 42H, an entity shall provide an explanation of how significant changes in the gross carrying amount of financial instruments during the period contributed to changes in the loss allowance. The information shall be provided separately for financial instruments that represent the loss allowance as listed in paragraph 42H(a)–(c) and shall include relevant qualitative and quantitative information. Examples of changes in the gross carrying amount of financial instruments that contributed to the changes in the loss allowance may include:

- (a) Changes because of financial instruments originated or acquired during the reporting period;
- (b) The modification of contractual cash flows on financial assets that do not result in a derecognition of those financial assets in accordance with IPSAS 41;
- (c) Changes because of financial instruments that were derecognized (including those that were written-off) during the reporting period; and
- (d) Changes arising from whether the loss allowance is measured at an amount equal to 12-month or lifetime expected credit losses.

42J. To enable users of financial statements to understand the nature and effect of modifications of contractual cash flows on financial assets that have not resulted in derecognition and the effect of such modifications on the measurement of expected credit losses, an entity shall disclose:

- (a) The amortized cost before the modification and the net modification gain or loss recognized for financial assets for which the contractual cash flows have been modified during the reporting period while they had a loss allowance measured at an amount equal to lifetime expected credit losses; and
- (b) The gross carrying amount at the end of the reporting period of financial assets that have been modified since initial recognition at a time when the loss allowance was measured at an amount equal to lifetime expected credit losses and for which the loss allowance has changed during the reporting period to an amount equal to 12-month expected credit losses.

42K. To enable users of financial statements to understand the effect of collateral and other credit enhancements on the amounts arising from expected credit losses, an entity shall disclose by class of financial instrument:

- (a) The amount that best represents its maximum exposure to credit risk at the end of the reporting period without taking account of any collateral held or other credit enhancements (e.g., netting agreements that do not qualify for offset in accordance with IPSAS 28).
- (b) A narrative description of collateral held as security and other credit enhancements, including:
 - (i) A description of the nature and quality of the collateral held;
 - (ii) An explanation of any significant changes in the quality of that collateral or credit enhancements as a result of deterioration or changes in the collateral policies of the entity during the reporting period; and
 - (iii) Information about financial instruments for which an entity has not recognized a loss allowance because of the collateral.

- (c) Quantitative information about the collateral held as security and other credit enhancements (for example, quantification of the extent to which collateral and other credit enhancements mitigate credit risk) for financial assets that are credit-impaired at the reporting date.

42L. An entity shall disclose the contractual amount outstanding on financial assets that were written off during the reporting period and are still subject to enforcement activity.

Credit Risk Exposure

42M. To enable users of financial statements to assess an entity's credit risk exposure and understand its significant credit risk concentrations, an entity shall disclose, by credit risk rating grades, the gross carrying amount of financial assets and the exposure to credit risk on loan commitments and financial guarantee contracts. This information shall be provided separately for financial instruments:

- (a) For which the loss allowance is measured at an amount equal to 12-month expected credit losses;
- (b) For which the loss allowance is measured at an amount equal to lifetime expected credit losses and that are:
- (i) Financial instruments for which credit risk has increased significantly since initial recognition but that are not credit-impaired financial assets;
- (ii) Financial assets that are credit-impaired at the reporting date (but that are not purchased or originated credit-impaired); and
- (iii) Receivables that result from exchange transactions that are within the scope of IPSAS 9 or non-exchange transactions that are within the scope of IPSAS 23 or lease receivables for which the loss allowances are measured in accordance with paragraph 87 of IPSAS 41.
- (c) That are purchased or originated credit-impaired financial assets.

42N. For receivables that result from exchange transactions that are within the scope of IPSAS 9 or non-exchange transactions that are within the scope of IPSAS 23 or lease receivables to which an entity applies paragraph 87 of IPSAS 41, the information provided in accordance with paragraph 42M may be based on a provision matrix (see paragraph AG199 of IPSAS 41).

...

43. For all financial instruments within the scope of this Standard, but to which the impairment requirements in IPSAS 41 are not applied, an ~~An~~ entity shall disclose by class of financial instrument:

- (a) The amount that best represents its maximum exposure to credit risk at the end of the reporting period without taking account of any collateral held or other credit enhancements (e.g., netting agreements that do not qualify for offset in accordance with IPSAS 28); ~~this disclosure is not required for financial instruments whose carrying amount best represents the maximum exposure to credit risk;~~
- (b) ~~In respect of the amount disclosed in (a);~~ A description of collateral held as security and other credit enhancements, and their financial effect (e.g., quantification of the extent to which collateral and other credit enhancements mitigate credit risk) in respect of the amount that best represents the maximum exposure to credit risk (whether disclosed in accordance with (a) or represented by the carrying amount of a financial instrument);
- (c) ~~Information about the credit quality of financial assets that are neither past due nor impaired; and~~
- (d) ~~The carrying amount of financial assets that would otherwise be past due or impaired whose terms have been renegotiated.~~

~~Financial Assets that are Either Past Due or Impaired~~

44. An entity shall disclose by class of financial asset:

- (a) An analysis of the age of financial assets that are past due as at the end of the reporting period but not impaired;
- (b) An analysis of financial assets that are individually determined to be impaired as at the end of the reporting period, including the factors the entity considered in determining that they are impaired; and
- (c) For the amounts disclosed in (a) and (b), a description of collateral held by the entity as security and other credit enhancements and, unless impracticable, an estimate of their fair value.

Collateral and Other Credit Enhancements Obtained

45. When an entity obtains financial or non-financial assets during the period by taking possession of collateral it holds as security or calling on other credit enhancements (e.g., guarantees), and such assets meet the recognition criteria in other Standards, an entity shall disclose for such assets held at the reporting date:
- (a) The nature and carrying amount of the assets ~~obtained~~; and
 - (b) When the assets are not readily convertible into cash, its policies for disposing of such assets or for using them in its operations.

...

Transfers of Financial Assets

- 49A. The disclosure requirements in paragraphs 49B–49H relating to transfers of financial assets supplement the other disclosure requirements of this Standard. An entity shall present the disclosures required by paragraphs 49B–49H in a single note in its financial statements. An entity shall provide the required disclosures for all transferred financial assets that are not derecognized and for any continuing involvement in a transferred asset, existing at the reporting date, irrespective of when the related transfer transaction occurred. For the purposes of applying the disclosure requirements in those paragraphs, an entity transfers all or a part of a financial asset (the transferred financial asset) if, and only if, it either:
- (a) Transfers the contractual rights to receive the cash flows of that financial asset; or
 - (b) Retains the contractual rights to receive the cash flows of that financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients in an arrangement.
- 49B. An entity shall disclose information that enables users of its financial statements:
- (a) To understand the relationship between transferred financial assets that are not derecognized in their entirety and the associated liabilities; and
 - (b) To evaluate the nature of, and risks associated with, the entity’s continuing involvement in derecognized financial assets.
- 49C. For the purposes of applying the disclosure requirements in paragraphs 49E–49H, an entity has continuing involvement in a transferred financial asset if, as part of the transfer, the entity retains any of the contractual rights or obligations inherent in the transferred financial asset or obtains any new contractual rights or obligations relating to the transferred financial asset. For the purposes of applying the disclosure requirements in paragraphs 49E–49H, the following do not constitute continuing involvement:
- (a) Normal representations and warranties relating to fraudulent transfer and concepts of reasonableness, good faith and fair dealings that could invalidate a transfer as a result of legal action;
 - (b) Forward, option and other contracts to reacquire the transferred financial asset for which the contract price (or exercise price) is the fair value of the transferred financial asset; or
 - (c) An arrangement whereby an entity retains the contractual rights to receive the cash flows of a financial asset but assumes a contractual obligation to pay the cash flows to one or more entities and the conditions in paragraph 16(a)–(c) of IPSAS 41 are met.

Transferred Financial Assets that are Not Derecognized in Their Entirety

- 49D. An entity may have transferred financial assets in such a way that part or all of the transferred financial assets do not qualify for derecognition. To meet the objectives set out in paragraph 49B(a), the entity shall disclose at each reporting date for each class of transferred financial assets that are not derecognized in their entirety:
- (a) The nature of the transferred assets.
 - (b) The nature of the risks and rewards of ownership to which the entity is exposed.
 - (c) A description of the nature of the relationship between the transferred assets and the associated liabilities, including restrictions arising from the transfer on the reporting entity’s use of the transferred assets.

- (d) When the counterparty (counterparties) to the associated liabilities has (have) recourse only to the transferred assets, a schedule that sets out the fair value of the transferred assets, the fair value of the associated liabilities and the net position (the difference between the fair value of the transferred assets and the associated liabilities).
- (e) When the entity continues to recognize all of the transferred assets, the carrying amounts of the transferred assets and the associated liabilities.
- (f) When the entity continues to recognize the assets to the extent of its continuing involvement (see paragraphs 17(c)(ii) and 27 of IPSAS 41), the total carrying amount of the original assets before the transfer, the carrying amount of the assets that the entity continues to recognize, and the carrying amount of the associated liabilities.

Transferred Financial Assets that are Derecognized in Their Entirety

49E. To meet the objectives set out in paragraph 49B(b), when an entity derecognizes transferred financial assets in their entirety (see paragraph 17(a) and 17(c)(i) of IPSAS 41) but has continuing involvement in them, the entity shall disclose, as a minimum, for each type of continuing involvement at each reporting date:

- (a) The carrying amount of the assets and liabilities that are recognized in the entity's statement of financial position and represent the entity's continuing involvement in the derecognized financial assets, and the line items in which the carrying amount of those assets and liabilities are recognized.
- (b) The fair value of the assets and liabilities that represent the entity's continuing involvement in the derecognized financial assets.
- (c) The amount that best represents the entity's maximum exposure to loss from its continuing involvement in the derecognized financial assets, and information showing how the maximum exposure to loss is determined.
- (d) The undiscounted cash outflows that would or may be required to repurchase derecognized financial assets (e.g., the strike price in an option agreement) or other amounts payable to the transferee in respect of the transferred assets. If the cash outflow is variable then the amount disclosed should be based on the conditions that exist at each reporting date.
- (e) A maturity analysis of the undiscounted cash outflows that would or may be required to repurchase the derecognized financial assets or other amounts payable to the transferee in respect of the transferred assets, showing the remaining contractual maturities of the entity's continuing involvement.
- (f) Qualitative information that explains and supports the quantitative disclosures required in (a)–(e).

49F. An entity may aggregate the information required by paragraph 49E in respect of a particular asset if the entity has more than one type of continuing involvement in that derecognized financial asset, and report it under one type of continuing involvement.

49G. In addition, an entity shall disclose for each type of continuing involvement:

- (a) The gain or loss recognized at the date of transfer of the assets.
- (b) Revenue and expenses recognized, both in the reporting period and cumulatively, from the entity's continuing involvement in the derecognized financial assets (e.g., fair value changes in derivative instruments).
- (c) If the total amount of proceeds from transfer activity (that qualifies for derecognition) in a reporting period is not evenly distributed throughout the reporting period (e.g., if a substantial proportion of the total amount of transfer activity takes place in the closing days of a reporting period):
 - (i) When the greatest transfer activity took place within that reporting period (e.g., the last five days before the end of the reporting period),
 - (ii) The amount (e.g., related gains or losses) recognized from transfer activity in that part of the reporting period, and
 - (iii) The total amount of proceeds from transfer activity in that part of the reporting period.

An entity shall provide this information for each period for which a statement of net assets/equity is presented.

Supplementary Information

49H. An entity shall disclose any additional information that it considers necessary to meet the disclosure objectives in paragraph 49B.

Initial Application of IPSAS 41

49I. In the reporting period that includes the date of initial application of IPSAS 41, the entity shall disclose the following information for each class of financial assets and financial liabilities as at the date of initial application:

- (a) The original measurement category and carrying amount determined in accordance with IPSAS 29 or in accordance with a previous version of IPSAS 41 (if the entity's chosen approach to applying IPSAS 41 involves more than one date of initial application for different requirements);
- (b) The new measurement category and carrying amount determined in accordance with IPSAS 41;
- (c) The amount of any financial assets and financial liabilities in the statement of financial position that were previously designated as measured at fair value through surplus or deficit but are no longer so designated, distinguishing between those that IPSAS 41 requires an entity to reclassify and those that an entity elects to reclassify at the date of initial application.

49J. In the reporting period that includes the date of initial application of IPSAS 41, an entity shall disclose qualitative information to enable users to understand:

- (a) How it applied the classification requirements in IPSAS 41 to those financial assets whose classification has changed as a result of applying IPSAS 41.
- (b) The reasons for any designation or de-designation of financial assets or financial liabilities as measured at fair value through surplus or deficit at the date of initial application.

49K. In the reporting period that an entity first applies the classification and measurement requirements for financial assets in IPSAS 41 (i.e., when the entity transitions from IPSAS 29 to IPSAS 41 for financial assets), it shall present the disclosures set out in paragraphs 49L–49O of this Standard as required by paragraph 173 of IPSAS 41.

49L. When required by paragraph 49K, an entity shall disclose the changes in the classifications of financial assets and financial liabilities as at the date of initial application of IPSAS 41, showing separately:

- (a) The changes in the carrying amounts on the basis of their measurement categories in accordance with IPSAS 29 (i.e., not resulting from a change in measurement attribute on transition to IPSAS 41); and
- (b) The changes in the carrying amounts arising from a change in measurement attribute on transition to IPSAS 41.

The disclosures in this paragraph need not be made after the reporting period in which the entity initially applies the classification and measurement requirements for financial assets in IPSAS 41.

49M. When required by paragraph 49K, an entity shall disclose the following for financial assets and financial liabilities that have been reclassified so that they are measured at amortized cost and, in the case of financial assets, that have been reclassified out of fair value through surplus or deficit so that they are measured at fair value through net assets/equity, as a result of the transition to IPSAS 41:

- (a) The fair value of the financial assets or financial liabilities at the end of the reporting period; and
- (b) The fair value gain or loss that would have been recognized in surplus or deficit or net assets/equity during the reporting period if the financial assets or financial liabilities had not been reclassified.

The disclosures in this paragraph need not be made after the reporting period in which the entity initially applies the classification and measurement requirements for financial assets in IPSAS 41.

49N. When required by paragraph 49K, an entity shall disclose the following for financial assets and financial liabilities that have been reclassified out of the fair value through surplus or deficit category as a result of the transition to IPSAS 41:

- (a) The effective interest rate determined on the date of initial application; and
- (b) The interest revenue or expense recognized.

If an entity treats the fair value of a financial asset or a financial liability as the new gross carrying amount at the date of initial application (see paragraph 168 of IPSAS 41), the disclosures in this paragraph shall be made for each reporting

period until derecognition. Otherwise, the disclosures in this paragraph need not be made after the reporting period in which the entity initially applies the classification and measurement requirements for financial assets in IPSAS 41.

49O. When an entity presents the disclosures set out in paragraphs 49K–49N, those disclosures, and the disclosures in paragraph 29 of this Standard, must permit reconciliation between:

- (a) The measurement categories presented in accordance with IPSAS 29 and IPSAS 41; and
- (b) The class of financial instrument

as at the date of initial application.

49P. On the date of initial application of paragraphs 73–93 of IPSAS 41, an entity is required to disclose information that would permit the reconciliation of the ending impairment allowances in accordance with IPSAS 29 and the provisions in accordance with IPSAS 19 to the opening loss allowances determined in accordance with IPSAS 41. For financial assets, this disclosure shall be provided by the related financial assets' measurement categories in accordance with IPSAS 29 and IPSAS 41, and shall show separately the effect of the changes in the measurement category on the loss allowance at that date.

49Q. In the reporting period that includes the date of initial application of IPSAS 41, an entity is not required to disclose the line item amounts that would have been reported in accordance with the classification and measurement requirements (which includes the requirements related to amortized cost measurement of financial assets and impairment in paragraphs 69–72 and 73–93 of IPSAS 41) of:

- (a) IPSAS 41 for prior periods; and
- (b) IPSAS 29 for the current period.

49R. In accordance with paragraph 161 of IPSAS 41, if it is impracticable (as defined in IPSAS 3) at the date of initial application of IPSAS 41 for an entity to assess a modified time value of money element in accordance with paragraphs AG68–AG70 of IPSAS 41 based on the facts and circumstances that existed at the initial recognition of the financial asset, an entity shall assess the contractual cash flow characteristics of that financial asset based on the facts and circumstances that existed at the initial recognition of the financial asset without taking into account the requirements related to the modification of the time value of money element in paragraphs AG68–AG70 of IPSAS 41. An entity shall disclose the carrying amount at the reporting date of the financial assets whose contractual cash flow characteristics have been assessed based on the facts and circumstances that existed at the initial recognition of the financial asset without taking into account the requirements related to the modification of the time value of money element in paragraphs AG68–AG70 of IPSAS 41 until those financial assets are derecognized.

49S. In accordance with paragraph 162 of IPSAS 41, if it is impracticable (as defined in IPSAS 3) at the date of initial application for an entity to assess whether the fair value of a prepayment feature was insignificant in accordance with paragraphs AG74(c) of IPSAS 41 based on the facts and circumstances that existed at the initial recognition of the financial asset, an entity shall assess the contractual cash flow characteristics of that financial asset based on the facts and circumstances that existed at the initial recognition of the financial asset without taking into account the exception for prepayment features in paragraph AG74 of IPSAS 41. An entity shall disclose the carrying amount at the reporting date of the financial assets whose contractual cash flow characteristics have been assessed based on the facts and circumstances that existed at the initial recognition of the financial asset without taking into account the exception for prepayment features in paragraph AG74 of IPSAS 41 until those financial assets are derecognized.

Effective Date and Transition

52F. Paragraphs 2, 3, 4, 5, 8, 11, 12, 13, 14, 18, 24, 34, 35, 36, 37, 41, 43, 45, AG1, AG5, AG9, AG10, AG24, and AG29 were amended, paragraphs 16, 17, 20, 26, 27, 28 and 44 were deleted and several headings and paragraphs 5A, 13A, 14A, 14B, 15A, 15B, 15C, 17A, 17B, 17C, 17D, 17E, 17F, 20A, 24A, 25A, 25B, 25C, 25D, 26A, 26B, 26C, 27A, 27B, 27C, 27D, 27E, 27F, 28A, 28B, 28C, 28D, 28E, 28F, 28G, 37A, 39A, 42A, 42B, 42C, 42D, 42E, 42F, 42G, 42H, 42I, 42J, 42K, 42L, 42M, 42N, 49A, 49B, 49C, 49D, 49E, 49F, 49G, 49H, 49I, 49J, 49K, 49L, 49M, 49N, 49O, 49P, 49Q, 49R, 49S, 52C, 52D, AG8A, AG8B, AG8C, AG8D, AG8E, AG8F, AG8G, AG8H, AG8I, AG8J, AG31, AG32, AG32A, AG33, AG34, AG35, AG36, AG37, AG38, AG39, AG40, AG41, AG42, AG43, AG44, AG45, AG46, AG47, AG48, AG49, AG50, AG51, AG52, AG53, AG54 and AG55 are added by IPSAS 41, issued in August 2018. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2022. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2022 it shall disclose that fact and apply IPSAS 41 at the same time.

Application Guidance

This Appendix is an integral part of IPSAS 30.

...

Classes of Financial Instruments and Level of Disclosure (paragraph 9)

AG1. Paragraph 9 requires an entity to group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. The classes described in paragraph 9 are determined by the entity and are, thus, distinct from the categories of financial instruments specified in IPSAS 41 IPSAS 29 (which determine how financial instruments are measured and where changes in fair value are recognized).

...

Significance of Financial Instruments for Financial Position and Financial Performance

Financial Liabilities at Fair Value through Surplus or Deficit (paragraphs 13 and 14)

AG4. If an entity designates a financial liability as at fair value through surplus or deficit, paragraph 13(a) requires it to disclose the amount of change in the fair value of the financial liability that is attributable to changes in the liability's credit risk. Paragraph 13(a)(i) permits an entity to determine this amount as the amount of change in the liability's fair value that is not attributable to changes in market conditions that give rise to market risk. If the only relevant changes in market conditions for a liability are changes in an observed (benchmark) interest rate, this amount can be estimated as follows:

- (a) First, the entity computes the liability's internal rate of return at the start of the period using the observed market price of the liability and the liability's contractual cash flows at the start of the period. It deducts from this rate of return the observed (benchmark) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.
- (b) Next, the entity calculates the present value of the cash flows associated with the liability using the liability's contractual cash flows at the end of the period and a discount rate equal to the sum of (i) the observed (benchmark) interest rate at the end of the period, and (ii) the instrument-specific component of the internal rate of return as determined in (a).
- (c) The difference between the observed market price of the liability at the end of the period and the amount determined in (b) is the change in fair value that is not attributable to changes in the observed (benchmark) interest rate. This is the amount to be disclosed.

This example assumes that changes in fair value arising from factors other than changes in the instrument's credit risk or changes in interest rates are not significant. If the instrument in the example contains an embedded derivative, the change in fair value of the embedded derivative is excluded in determining the amount to be disclosed in accordance with paragraph 13(a):

Other Disclosure—Accounting Policies (paragraph 25)

AG5. Paragraph 25 requires disclosure of the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements. For financial instruments, such disclosure may include:

- (a) For financial ~~assets or financial~~ liabilities designated as at fair value through surplus or deficit:
 - (i) The nature of the financial ~~assets or financial~~ liabilities the entity has designated as at fair value through surplus or deficit;
 - (ii) The criteria for so designating such financial ~~assets or financial~~ liabilities on initial recognition; and
 - (iii) How the entity has satisfied the conditions in paragraph ~~46 10, 13, or 14~~ of IPSAS 41 IPSAS 29 for such designation. For instruments designated in accordance with paragraph (b)(i) of the definition of a financial asset or financial liability at fair value through surplus or deficit in IPSAS 29, that disclosure includes a narrative description of the circumstances underlying the measurement or recognition inconsistency that would otherwise arise. For instruments designated in accordance with paragraph (b)(ii) of the definition of a financial asset or financial liability at fair value through surplus or deficit in IPSAS 29, that disclosure includes a narrative description of how designation at fair value through surplus or deficit is consistent with the entity's documented risk management or investment strategy.

- (b) For financial assets designated as measured at fair value through surplus or deficit:
 - (i) The nature of the financial assets the entity has designated as measured at fair value through surplus or deficit; and
 - (ii) How the entity has satisfied the criteria in paragraph 44 of IPSAS 41 for such designation.
- (b) ~~The criteria for designating financial assets as available for sale.~~
- (c) Whether regular way purchases and sales of financial assets are accounted for at trade date or at settlement date (see paragraph 11 40 of IPSAS 41 IPSAS 29).
- (d) ~~When an allowance account is used to reduce the carrying amount of financial assets impaired by credit losses:~~
 - (i) ~~The criteria for determining when the carrying amount of impaired financial assets is reduced directly (or, in the case of a reversal of a write-down, increased directly) and when the allowance account is used; and~~
 - (ii) ~~The criteria for writing off amounts charged to the allowance account against the carrying amount of impaired financial assets (see paragraph 20).~~
- (e) How net gains or net losses on each category of financial instrument are determined (see paragraph 24(a)), for example, whether the net gains or net losses on items at fair value through surplus or deficit include interest or revenue from dividends or similar distributions.
- (f) ~~The criteria the entity uses to determine that there is objective evidence that an impairment loss has occurred (see paragraph 24(e)).~~
- (g) ~~When the terms of financial assets that would otherwise be past due or impaired have been renegotiated, the accounting policy for financial assets that are the subject of renegotiated terms (see paragraph 43(d)).~~
- (h) For financial guarantee contracts issued through a non-exchange transaction, where no fair value can be determined and a provision is recognized in accordance with IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, disclosure of the circumstances that result in a provision being recognized.

Paragraph 137 of IPSAS 1 also requires entities to disclose, in the summary of significant accounting policies or other notes, the judgments, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognized in the financial statements.

...
Credit Risk Management Practices (paragraphs 42F–42G)

AG8A. Paragraph 42F(b) requires the disclosure of information about how an entity has defined default for different financial instruments and the reasons for selecting those definitions. In accordance with paragraph 81 of IPSAS 41, the determination of whether lifetime expected credit losses should be recognized is based on the increase in the risk of a default occurring since initial recognition. Information about an entity's definitions of default that will assist users of financial statements in understanding how an entity has applied the expected credit loss requirements in IPSAS 41 may include:

- (a) The qualitative and quantitative factors considered in defining default;
- (b) Whether different definitions have been applied to different types of financial instruments; and
- (c) Assumptions about the cure rate (i.e., the number of financial assets that return to a performing status) after a default occurred on the financial asset.

AG8B. To assist users of financial statements in evaluating an entity's restructuring and modification policies, paragraph 42F(f) (i) requires the disclosure of information about how an entity monitors the extent to which the loss allowance on financial assets previously disclosed in accordance with paragraph 42F(f)(i) are subsequently measured at an amount equal to lifetime expected credit losses in accordance with paragraph 75 of IPSAS 41. Quantitative information that will assist users in understanding the subsequent increase in credit risk of modified financial assets may include information about modified financial assets meeting the criteria in paragraph 42F(f)(i) for which the loss allowance has reverted to being measured at an amount equal to lifetime expected credit losses (i.e., a deterioration rate).

AG8C. Paragraph 42G(a) requires the disclosure of information about the basis of inputs and assumptions and the estimation techniques used to apply the impairment requirements in IPSAS 41. An entity's assumptions and inputs used to measure expected credit losses or determine the extent of increases in credit risk since initial recognition may include information

obtained from internal historical information or rating reports and assumptions about the expected life of financial instruments and the timing of the sale of collateral.

Changes in the Loss Allowance (paragraph 42H)

AG8D. In accordance with paragraph 42H, an entity is required to explain the reasons for the changes in the loss allowance during the period. In addition to the reconciliation from the opening balance to the closing balance of the loss allowance, it may be necessary to provide a narrative explanation of the changes. This narrative explanation may include an analysis of the reasons for changes in the loss allowance during the period, including:

- (a) The portfolio composition;
- (b) The volume of financial instruments purchased or originated; and
- (c) The severity of the expected credit losses

AG8E. For loan commitments and financial guarantee contracts the loss allowance is recognized as a provision. An entity should disclose information about the changes in the loss allowance for financial assets separately from those for loan commitments and financial guarantee contracts. However, if a financial instrument includes both a loan (i.e., financial asset) and an undrawn commitment (i.e., loan commitment) component and the entity cannot separately identify the expected credit losses on the loan commitment component from those on the financial asset component, the expected credit losses on the loan commitment should be recognized together with the loss allowance for the financial asset. To the extent that the combined expected credit losses exceed the gross carrying amount of the financial asset, the expected credit losses should be recognized as a provision.

Collateral (paragraph 42K)

AG8F. Paragraph 42K requires the disclosure of information that will enable users of financial statements to understand the effect of collateral and other credit enhancements on the amount of expected credit losses. An entity is neither required to disclose information about the fair value of collateral and other credit enhancements nor is it required to quantify the exact value of the collateral that was included in the calculation of expected credit losses (i.e., the loss given default).

AG8G. A narrative description of collateral and its effect on amounts of expected credit losses might include information about:

- (a) The main types of collateral held as security and other credit enhancements (examples of the latter being guarantees, credit derivatives and netting agreements that do not qualify for offset in accordance with IPSAS 28);
- (b) The volume of collateral held and other credit enhancements and its significance in terms of the loss allowance;
- (c) The policies and processes for valuing and managing collateral and other credit enhancements;
- (d) The main types of counterparties to collateral and other credit enhancements and their creditworthiness; and
- (e) Information about risk concentrations within the collateral and other credit enhancements.

Credit Risk Exposure (paragraphs 42M–42N)

AG8H. Paragraph 42M requires the disclosure of information about an entity's credit risk exposure and significant concentrations of credit risk at the reporting date. A concentration of credit risk exists when a number of counterparties are located in a geographical region or are engaged in similar activities and have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. An entity should provide information that enables users of financial statements to understand whether there are groups or portfolios of financial instruments with particular features that could affect a large portion of that group of financial instruments such as concentration to particular risks. This could include, for example, loan-to-value groupings, geographical, industry or issuer-type concentrations.

AG8I. The number of credit risk rating grades used to disclose the information in accordance with paragraph 42M shall be consistent with the number that the entity reports to key management personnel for credit risk management purposes. If past due information is the only borrower-specific information available and an entity uses past due information to assess whether credit risk has increased significantly since initial recognition in accordance with paragraph 82 of IPSAS 41, an entity shall provide an analysis by past due status for those financial assets.

AG8J. When an entity has measured expected credit losses on a collective basis, the entity may not be able to allocate the gross carrying amount of individual financial assets or the exposure to credit risk on loan commitments and financial guarantee contracts to the credit risk rating grades for which lifetime expected credit losses are recognized. In that case, an entity

should apply the requirement in paragraph 42M to those financial instruments that can be directly allocated to a credit risk rating grade and disclose separately the gross carrying amount of financial instruments for which lifetime expected credit losses have been measured on a collective basis.

Maximum Credit Risk Exposure (paragraph 43(a))

AG9. Paragraphs 42K(a) and 43(a) requires disclosure of the amount that best represents the entity's maximum exposure to credit risk. For a financial asset, this is typically the gross carrying amount, net of:

- (a) Any amounts offset in accordance with IPSAS 28; and
- (b) Any loss allowance ~~impairment losses~~ recognized in accordance with IPSAS 41 ~~IPSAS 29~~.

AG10. Activities that give rise to credit risk and the associated maximum exposure to credit risk include, but are not limited to:

- (a) Granting loans ~~and receivables~~ to customers and placing deposits with other entities. In these cases, the maximum exposure to credit risk is the carrying amount of the related financial assets.
- (b) Entering into derivative contracts (e.g., foreign exchange contracts, interest rate swaps, and credit derivatives). When the resulting asset is measured at fair value, the maximum exposure to credit risk at the end of the reporting period will equal the carrying amount.
- (c) Granting financial guarantees. In this case, the maximum exposure to credit risk is the maximum amount the entity could have to pay if the guarantee is called on, which may be significantly greater than the amount recognized as a liability.
- (d) Making a loan commitment that is irrevocable over the life of the facility or is revocable only in response to a material adverse change. If the issuer cannot settle the loan commitment net in cash or another financial instrument, the maximum credit exposure is the full amount of the commitment. This is because it is uncertain whether the amount of any undrawn portion may be drawn upon in the future. This may be significantly greater than the amount recognized as a liability.

...

Interest Rate Risk

AG24. Interest rate risk arises on interest-bearing financial instruments recognized in the statement of financial position (e.g., ~~loans and receivables and~~ debt instruments acquired or issued) and on some financial instruments not recognized in the statement of financial position (e.g., some loan commitments).

...

Other Price Risk

...

AG29. In accordance with paragraph 47(a), the sensitivity of surplus or deficit (that arises, for example, from instruments measured classified as at fair value through surplus or deficit and impairments of available-for-sale financial assets) is disclosed separately from the sensitivity of net assets/equity (that arises, for example, from investments in equity instruments whose changes in fair value are presented in net assets/equity classified as available for sale).

...

Derecognition (paragraphs 49C–49H)

Continuing Involvement (paragraph 49C)

AG31. The assessment of continuing involvement in a transferred financial asset for the purposes of the disclosure requirements in paragraphs 49E–49H is made at the level of the reporting entity. For example, if a controlled entity transfers to an unrelated third party a financial asset in which the controlling entity of the controlled entity has continuing involvement, the controlled entity does not include the controlling entity's involvement in the assessment of whether it has continuing involvement in the transferred asset in its separate or individual financial statements (i.e., when the controlled entity is the reporting entity). However, a controlling entity would include its continuing involvement (or that of another member of the group) in a financial asset transferred by its controlling entity in determining whether it has continuing involvement in the transferred asset in its consolidated financial statements (i.e., when the reporting entity is the group).

AG32. An entity does not have a continuing involvement in a transferred financial asset if, as part of the transfer, it neither retains any of the contractual rights or obligations inherent in the transferred financial asset nor acquires any new contractual rights or obligations relating to the transferred financial asset. An entity does not have continuing involvement in a transferred financial asset if it has neither an interest in the future performance of the transferred financial asset nor a responsibility under any circumstances to make payments in respect of the transferred financial asset in the future. The term ‘payment’ in this context does not include cash flows of the transferred financial asset that an entity collects and is required to remit to the transferee.

AG32A. When an entity transfers a financial asset, the entity may retain the right to service that financial asset for a fee that is included in, for example, a servicing contract. The entity assesses the servicing contract in accordance with the guidance in paragraphs 49C and AG32 to decide whether the entity has continuing involvement as a result of the servicing contract for the purposes of the disclosure requirements. For example, a servicer will have continuing involvement in the transferred financial asset for the purposes of the disclosure requirements if the servicing fee is dependent on the amount or timing of the cash flows collected from the transferred financial asset. Similarly, a servicer has continuing involvement for the purposes of the disclosure requirements if a fixed fee would not be paid in full because of non-performance of the transferred financial asset. In these examples, the servicer has an interest in the future performance of the transferred financial asset. This assessment is independent of whether the fee to be received is expected to compensate the entity adequately for performing the servicing.

AG33. Continuing involvement in a transferred financial asset may result from contractual provisions in the transfer agreement or in a separate agreement with the transferee or a third party entered into in connection with the transfer.

Transferred Financial Assets that are Not Derecognized in Their Entirety (paragraph 49D)

AG34. Paragraph 49D requires disclosures when part or all of the transferred financial assets do not qualify for derecognition. Those disclosures are required at each reporting date at which the entity continues to recognize the transferred financial assets, regardless of when the transfers occurred.

Types of Continuing Involvement (paragraphs 49E–49H)

AG35. Paragraphs 49E–49H require qualitative and quantitative disclosures for each type of continuing involvement in derecognized financial assets. An entity shall aggregate its continuing involvement into types that are representative of the entity’s exposure to risks. For example, an entity may aggregate its continuing involvement by type of financial instrument (e.g., guarantees or call options) or by type of transfer (e.g., factoring of receivables, securitizations and securities lending).

Maturity Analysis for Undiscounted Cash Outflows to Repurchase Transferred Assets (paragraph 49E(e))

AG36. Paragraph 49E(e) requires an entity to disclose a maturity analysis of the undiscounted cash outflows to repurchase derecognized financial assets or other amounts payable to the transferee in respect of the derecognized financial assets, showing the remaining contractual maturities of the entity’s continuing involvement. This analysis distinguishes cash flows that are required to be paid (e.g., forward contracts), cash flows that the entity may be required to pay (e.g., written put options) and cash flows that the entity might choose to pay (e.g., purchased call options).

AG37. An entity shall use its judgment to determine an appropriate number of time bands in preparing the maturity analysis required by paragraph 49E(e). For example, an entity might determine that the following maturity time bands are appropriate:

- (a) Not later than one month;
- (b) Later than one month and not later than three months;
- (c) Later than three months and not later than six months;
- (d) Later than six months and not later than one year;
- (e) Later than one year and not later than three years;
- (f) Later than three years and not later than five years; and
- (g) More than five years.

AG38. If there is a range of possible maturities, the cash flows are included on the basis of the earliest date on which the entity can be required or is permitted to pay.

Qualitative Information (paragraph 49E(f))

AG39. The qualitative information required by paragraph 49E(f) includes a description of the derecognized financial assets and the nature and purpose of the continuing involvement retained after transferring those assets. It also includes a description of the risks to which an entity is exposed, including:

- (a) A description of how the entity manages the risk inherent in its continuing involvement in the derecognized financial assets.
- (b) Whether the entity is required to bear losses before other parties, and the ranking and amounts of losses borne by parties whose interests rank lower than the entity's interest in the asset (i.e., its continuing involvement in the asset).
- (c) A description of any triggers associated with obligations to provide financial support or to repurchase a transferred financial asset.

Gain or Loss on Derecognition (paragraph 49G(a))

AG40. Paragraph 49G(a) requires an entity to disclose the gain or loss on derecognition relating to financial assets in which the entity has continuing involvement. The entity shall disclose if a gain or loss on derecognition arose because the fair values of the components of the previously recognized asset (i.e., the interest in the asset derecognized and the interest retained by the entity) were different from the fair value of the previously recognized asset as a whole. In that situation, the entity shall also disclose whether the fair value measurements included significant inputs that were not based on observable market data, as described in paragraph 32.

Supplementary Information (paragraph 49H)

AG41. The disclosures required in paragraphs 49D–49G may not be sufficient to meet the disclosure objectives in paragraph 49B. If this is the case, the entity shall disclose whatever additional information is necessary to meet the disclosure objectives. The entity shall decide, in the light of its circumstances, how much additional information it needs to provide to satisfy the information needs of users and how much emphasis it places on different aspects of the additional information. It is necessary to strike a balance between burdening financial statements with excessive detail that may not assist users of financial statements and obscuring information as a result of too much aggregation.

...

Offsetting Financial Assets and Financial Liabilities (paragraphs 17A–17F)*Scope (paragraph 17A)*

AG42. The disclosures in paragraphs 17B–17E are required for all recognized financial instruments that are set off in accordance with paragraph 47 of IPSAS 28. In addition, financial instruments are within the scope of the disclosure requirements in paragraphs 17B–17E if they are subject to an enforceable master netting arrangement or similar agreement that covers similar financial instruments and transactions, irrespective of whether the financial instruments are set off in accordance with paragraph 47 of IPSAS 28.

AG43. The similar agreements referred to in paragraphs 17A and AG42 include derivative clearing agreements, global master repurchase agreements, global master securities lending agreements, and any related rights to financial collateral. The similar financial instruments and transactions referred to in paragraph AG31 include derivatives, sale and repurchase agreements, reverse sale and repurchase agreements, securities borrowing, and securities lending agreements. Examples of financial instruments that are not within the scope of paragraph 17A are loans and customer deposits at the same institution (unless they are set off in the statement of financial position), and financial instruments that are subject only to a collateral agreement.

Disclosure of Quantitative Information for Recognized Financial Assets and Recognized Financial Liabilities within the Scope of Paragraph 17A (paragraph 17C)

AG44. Financial instruments disclosed in accordance with paragraph 17C may be subject to different measurement requirements (for example, a payable related to a repurchase agreement may be measured at amortized cost, while a derivative will be measured at fair value). An entity shall include instruments at their recognized amounts and describe any resulting measurement differences in the related disclosures.

Disclosure of the Gross Amounts of Recognized Financial Assets and Recognized Financial Liabilities within the Scope of Paragraph 17A (paragraph 17C(a))

AG45. The amounts required by paragraph 17C(a) relate to recognized financial instruments that are set off in accordance with paragraph 47 of IPSAS 28. The amounts required by paragraph 17C(a) also relate to recognized financial instruments that are subject to an enforceable master netting arrangement or similar agreement irrespective of whether they meet the offsetting criteria. However, the disclosures required by paragraph 17C(a) do not relate to any amounts recognized as a result of collateral agreements that do not meet the offsetting criteria in paragraph 47 of IPSAS 28. Instead, such amounts are required to be disclosed in accordance with paragraph 17C(d).

Disclosure of the Amounts that are Set Off in Accordance with the Criteria in Paragraph 47 of IPSAS 28 (paragraph 17C(b))

AG46. Paragraph 17C(b) requires that entities disclose the amounts set off in accordance with paragraph 47 of IPSAS 28 when determining the net amounts presented in the statement of financial position. The amounts of both the recognized financial assets and the recognized financial liabilities that are subject to set-off under the same arrangement will be disclosed in both the financial asset and financial liability disclosures. However, the amounts disclosed (in, for example, a table) are limited to the amounts that are subject to set-off. For example, an entity may have a recognized derivative asset and a recognized derivative liability that meet the offsetting criteria in paragraph 47 of IPSAS 28. If the gross amount of the derivative asset is larger than the gross amount of the derivative liability, the financial asset disclosure table will include the entire amount of the derivative asset (in accordance with paragraph 17C(a)) and the entire amount of the derivative liability (in accordance with paragraph 17C(b)). However, while the financial liability disclosure table will include the entire amount of the derivative liability (in accordance with paragraph 17C(a)), it will only include the amount of the derivative asset (in accordance with paragraph 17C(b)) that is equal to the amount of the derivative liability.

Disclosure of the Net Amounts Presented in the Statement of Financial Position (paragraph 17C(c))

AG47. If an entity has instruments that meet the scope of these disclosures (as specified in paragraph 17A), but that do not meet the offsetting criteria in paragraph 47 of IPSAS 28, the amounts required to be disclosed by paragraph 17C(c) would equal the amounts required to be disclosed by paragraph 17C(a).

AG48. The amounts required to be disclosed by paragraph 17C(c) must be reconciled to the individual line item amounts presented in the statement of financial position. For example, if an entity determines that the aggregation or disaggregation of individual financial statement line item amounts provides more relevant information, it must reconcile the aggregated or disaggregated amounts disclosed in paragraph 17C(c) back to the individual line item amounts presented in the statement of financial position.

Disclosure of the Amounts Subject to an Enforceable Master Netting Arrangement or Similar Agreement that are not Otherwise Included in Paragraph 17C(b) (paragraph 17C(d))

AG49. Paragraph 17C(d) requires that entities disclose amounts that are subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in paragraph 17C(b). Paragraph 17C(d)(i) refers to amounts related to recognized financial instruments that do not meet some or all of the offsetting criteria in paragraph 47 of IPSAS 28 (for example, current rights of set-off that do not meet the criterion in paragraph 47(b) of IPSAS 28, or conditional rights of set-off that are enforceable and exercisable only in the event of default, or only in the event of insolvency or bankruptcy of any of the counterparties).

AG50. Paragraph 17C(d)(ii) refers to amounts related to financial collateral, including cash collateral, both received and pledged. An entity shall disclose the fair value of those financial instruments that have been pledged or received as collateral. The amounts disclosed in accordance with paragraph 17C(d)(ii) should relate to the actual collateral received or pledged and not to any resulting payables or receivables recognized to return or receive back such collateral.

Limits on the Amounts Disclosed in Paragraph 17C(d) (paragraph 17D)

AG51. When disclosing amounts in accordance with paragraph 17C(d), an entity must take into account the effects of over-collateralization by financial instrument. To do so, the entity must first deduct the amounts disclosed in accordance with paragraph 17C(d)(i) from the amount disclosed in accordance with paragraph 17C(c). The entity shall then limit the amounts disclosed in accordance with paragraph 17C(d)(ii) to the remaining amount in paragraph 17C(c) for the related financial instrument. However, if rights to collateral can be enforced across financial instruments, such rights can be included in the disclosure provided in accordance with paragraph 17D.

Description of the Rights of Set-Off Subject to Enforceable Master Netting Arrangements and Similar Agreements (paragraph 17E)

AG52. An entity shall describe the types of rights of set-off and similar arrangements disclosed in accordance with paragraph 17C(d), including the nature of those rights. For example, an entity shall describe its conditional rights. For instruments subject to rights of set-off that are not contingent on a future event but that do not meet the remaining criteria in paragraph 47 of IPSAS 28, the entity shall describe the reason(s) why the criteria are not met. For any financial collateral received or pledged, the entity shall describe the terms of the collateral agreement (for example, when the collateral is restricted).

Disclosure by Type of Financial Instrument or by Counterparty

AG53. The quantitative disclosures required by paragraph 17C(a)–(e) may be grouped by type of financial instrument or transaction (for example, derivatives, repurchase and reverse repurchase agreements or securities borrowing and securities lending agreements).

AG54. Alternatively, an entity may group the quantitative disclosures required by paragraph 17C(a)–(c) by type of financial instrument, and the quantitative disclosures required by paragraph 17C(c)–(e) by counterparty. If an entity provides the required information by counterparty, the entity is not required to identify the counterparties by name. However, designation of counterparties (Counterparty A, Counterparty B, Counterparty C, etc.) shall remain consistent from year to year for the years presented to maintain comparability. Qualitative disclosures shall be considered so that further information can be given about the types of counterparties. When disclosure of the amounts in paragraph 17C(c)–(e) is provided by counterparty, amounts that are individually significant in terms of total counterparty amounts shall be separately disclosed and the remaining individually insignificant counterparty amounts shall be aggregated into one line item.

Other

AG55. The specific disclosures required by paragraphs 17C–17E are minimum requirements. To meet the objective in paragraph 17B an entity may need to supplement them with additional (qualitative) disclosures, depending on the terms of the enforceable master netting arrangements and related agreements, including the nature of the rights of set-off, and their effect or potential effect on the entity's financial position.

...

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 30.

...

Materiality

IG3. — IPSAS 1 notes that a specific disclosure requirement in an IPSAS need not be satisfied if the information is not material. IPSAS 1 defines materiality as follows:

Omissions or misstatements of items are material if they could, individually or collectively, influence the decisions or assessments made on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The nature or size of the item, or a combination of both, could be the determining factor.

IG4. — IPSAS 1 also explains that definition as follows:

Assessing whether an omission or misstatement could influence decisions of users, and so be material, requires consideration of the characteristics of those users. Users are assumed to have a reasonable knowledge of the public sector and economic activities and accounting and a willingness to study the information with reasonable diligence. Therefore, the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making and evaluating decisions:

...

Significance of Financial Instruments for Financial Position and Financial Performance (paragraphs 10–36, AG4 and AG5)⁵

Financial Liabilities at Fair Value through Surplus or Deficit (paragraphs 13(a)(i) and AG4)

- IG7. The following example illustrates the calculation that an entity might perform in accordance with paragraph AG4 of Appendix A of the Standard.
- IG8. On January 1, 20X1, an entity issues a 10-year bond with a par value of CU150,000⁶ and an annual fixed coupon rate of 8 percent, which is consistent with market rates for bonds with similar characteristics.
- IG9. The entity uses the London Interbank Offered Rate (LIBOR) as its observable (benchmark) interest rate. At the date of inception of the bond, LIBOR is 5 percent. At the end of the first year:
- LIBOR has decreased to 4.75 percent.
 - The fair value for the bond is CU153,811, consistent with an interest rate of 7.6 percent.⁷
- IG10. The entity assumes a flat yield curve, all changes in interest rates result from a parallel shift in the yield curve, and the changes in LIBOR are the only relevant changes in market conditions.
- IG11. The entity estimates the amount of change in the fair value of the bond that is not attributable to changes in market conditions that give rise to market risk as follows:

<p>[paragraph AG4(a)]</p> <p>First, the entity computes the liability's internal rate of return at the start of the period using the observed market price of the liability and the liability's contractual cash flows at the start of the period:</p> <p>It deducts from this rate of return the observed (benchmark) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return:</p>	<p>At the start of the period of a 10-year bond with a coupon of 8 percent, the bond's internal rate of return is 8 percent.</p> <p>Because the observed (benchmark) interest rate (LIBOR) is 5 percent, the instrument-specific component of the internal rate of return is 3 percent.</p>
<p>[paragraph AG4(b)]</p> <p>Next, the entity calculates the present value of the cash flows associated with the liability using the liability's contractual cash flows at the end of the period and a discount rate equal to the sum of (i) the observed (benchmark) interest rate at the end of the period, and (ii) the instrument-specific component of the internal rate of return as determined in accordance with paragraph AG4(a):</p>	<p>The contractual cash flows of the instrument at the end of the period are:</p> <ul style="list-style-type: none"> Interest: CU12,000^(a) per year for each of years 2–10. Principal: CU150,000 in year 10. <p>The discount rate to be used to calculate the present value of the bond is thus 7.75 percent, which is 4.75 percent end-of-period LIBOR rate, plus the 3 percent instrument-specific component.</p> <p>This gives a present value of CU152,367.^(b)</p>
<p>[paragraph AG4(c)]</p> <p>The difference between the observed market price of the liability at the end of the period and the amount determined in accordance with paragraph AG4(b) is the change in fair value that is not attributable to changes in the observed (benchmark) interest rate. This is the amount to be disclosed:</p>	<p>The market price of the liability at the end of the period is CU153,811.^(c)</p> <p>Thus, the entity discloses CU1,444, which is CU153,811 – CU152,367, as the increase in fair value of the bond that is not attributable to changes in market conditions that give rise to market risk:</p>
<p>(a) — $CU150,000 \times 8\% = CU12,000$</p> <p>(b) — $PV = [CU12,000 \times (1 - (1 + 0.0775)^{-9}) / 0.0775] + CU150,000 \times (1 + 0.0775)^{-10}$</p> <p>(c) — market price = $[CU12,000 \times (1 - (1 + 0.076)^{-9}) / 0.076] + CU150,000 \times (1 + 0.076)^{-10}$</p>	

...

Fair Value (paragraphs 31–34)

- IG14. IPSAS 30 requires disclosures about the level in the fair value hierarchy in which fair value measurements are categorized for assets and liabilities measured in the statement of financial position. A tabular format is required unless another format is more appropriate. An entity might disclose the following for assets to comply with paragraph 33(a). (Disclosure of comparative information is also required, but is not included in the following example)

⁵ IPSAS 41, *Financial Instruments* deleted paragraph AG4 of IPSAS 30.

⁶ In this guidance monetary amounts are denominated in “currency units (CU).”

⁷ This reflects a shift in LIBOR from 5 percent to 4.75 percent and a movement of 0.15 percent which, in the absence of other relevant changes in market conditions, is assumed to reflect changes in credit risk of the instrument.

FINANCIAL INSTRUMENTS

Assets Measured at Fair Value		Fair value measurement at end of the reporting period using:		
		Level 1	Level 2	Level 3
Description	Dec 31, 20X2	CU million	CU million	CU million
Financial assets at fair value through surplus or deficit				
Trading securities	100	40	55	5
Trading derivatives	39	17	20	2
<u>Available-for-sale financial assets at fair value through net assets/equity</u>				
Equity investments	75	30	40	5
Total	<u>214</u>	<u>87</u>	<u>115</u>	<u>12</u>

Note: For liabilities, a similar table might be presented.

- IG15. IPSAS 30 requires a reconciliation from beginning to ending balances for those assets and liabilities that are measured in the statement of financial position at fair value based on a valuation technique for which any significant input is not based on observable market data (Level 3). A tabular format is required unless another format is more appropriate. An entity might disclose the following for assets to comply with paragraph 33(b). (Disclosure of comparative information is also required, but is not included in the following example).

Assets Measured at Fair Value Based on Level 3				
	Fair value measurement at the end of the reporting period			
	Financial assets at fair value through surplus or deficit		Available-for-sale financial assets at fair value through net assets/equity	Total
	Trading securities	Trading derivatives	Equity investments	
	CU million	CU million	CU million	CU million
Opening balance	6	5	4	15
Total gains or losses				
in surplus or deficit	(2)	(2)	-	(4)
in net assets/ equity	-	-	(1)	(1)
Purchases	1	2	2	5
Issues	-	-	-	-
Settlements	-	(1)	-	(1)
Transfers out of Level 3	-	(2)	-	(2)
Closing balance	<u>5</u>	<u>2</u>	<u>5</u>	<u>12</u>
Total gains or losses for the period included in surplus or deficit for assets held at the end of the reporting period	<u>(1)</u>	<u>(1)</u>	<u>-</u>	<u>(2)</u>

(Note: For liabilities, a similar table might be presented.)

Gains or losses included in surplus or deficit for the period (above) are presented in revenue as follows:		Revenue
Total gains or losses included in surplus or deficit for the period		(4)
Total gains or losses for the period included in surplus or deficit for assets held at the end of the reporting period		<u>(2)</u>

(Note: For liabilities, a similar table might be presented.)

- IG16. The fair value at initial recognition of financial instruments that are not traded in active markets is determined in accordance with paragraph AG151 AG108 of IPSAS 41 IPSAS-29. However, when, after initial recognition, an entity will use a valuation technique that incorporates data not obtained from observable markets, there may be a difference between the transaction price at initial recognition and the amount determined at initial recognition using that valuation technique. In these circumstances, the difference will be recognized in surplus or deficit in subsequent periods in accordance with IPSAS 41 IPSAS-29 and the entity's accounting policy. Such recognition reflects changes in factors (including time) that market participants would consider in setting a price (see paragraph AG151 AG108 of IPSAS 41 IPSAS-29). Paragraph 33 requires disclosures in these circumstances. An entity might disclose the following to comply with paragraph 34:

Background		
On January 1, 20X1 an entity purchases for CU15 million financial assets that are not traded in an active market. The entity has only one class of such financial assets.		
The transaction price of CU15 million is the fair value at initial recognition.		
After initial recognition, the entity will apply a valuation technique to establish the financial assets' fair value. This valuation technique includes variables other than data from observable markets.		
At initial recognition, the same valuation technique would have resulted in an amount of CU14 million, which differs from fair value by CU1 million.		
The entity has existing differences of CU5 million at January 1, 20X1.		
Application of Requirements		
The entity's 20X2 disclosure would include the following:		
<i>Accounting Policies</i>		
The entity uses the following valuation technique to determine the fair value of financial instruments that are not traded in an active market: [description of technique not included in this example]. Differences may arise between the fair value at initial recognition (which, in accordance with <u>IPSAS 41 IPSAS-29</u> , is generally the transaction price) and the amount determined at initial recognition using the valuation technique. Any such differences are [description of the entity's accounting policy].		
<i>In the Notes to the Financial Statements</i>		
As discussed in note X, the entity uses [name of valuation technique] to measure the fair value of the following financial instruments that are not traded in an active market. However, in accordance with <u>IPSAS 41 IPSAS-29</u> , the fair value of an instrument at inception is generally the transaction price. If the transaction price differs from the amount determined at inception using the valuation technique, that difference is [description of the entity's accounting policy].		
The differences yet to be recognized in surplus or deficit are as follows:		
	Dec 31, X2	Dec 31, X1
	CU million	CU million
Balance at beginning of year	5.3	5.0
New transactions	–	1.0
Amounts recognized in surplus or deficit during the year	(0.7)	(0.8)
Other increases	–	0.2
Other decreases	(0.1)	(0.1)
Balance at end of year	<u>4.5</u>	<u>5.3</u>

...

Credit Quality (paragraph 43(c))

- IG25. ~~Paragraph 43(c) requires an entity to disclose information about the credit quality of financial assets with credit risk that are neither past due nor impaired. In doing so, an entity might disclose the following information:-~~

- ~~(a) An analysis of credit exposures using an external or internal credit grading system;~~
- ~~(b) The nature of the counterparty;~~
- ~~(c) Historical information about counterparty default rates; and~~
- ~~(d) Any other information used to assess credit quality.~~

~~IG26. When the entity considers external ratings when managing and monitoring credit quality, the entity might disclose information about:~~

- ~~(a) The amounts of credit exposures for each external credit grade;~~
- ~~(b) The rating agencies used;~~
- ~~(c) The amount of an entity's rated and unrated credit exposures; and~~
- ~~(d) The relationship between internal and external ratings.~~

~~IG27. When the entity considers internal credit ratings when managing and monitoring credit quality, the entity might disclose information about:~~

- ~~(a) The internal credit ratings process;~~
- ~~(b) The amounts of credit exposures for each internal credit grade; and~~
- ~~(c) The relationship between internal and external ratings.~~

Financial Assets that are either Past Due or Impaired (paragraph 44)

~~IG28. A financial asset is past due when the counterparty has failed to make a payment when contractually due. As an example, an entity enters into a lending agreement that requires interest to be paid every month. On the first day of the next month, if interest has not been paid, the loan is past due. Past due does not mean that a counterparty will never pay, but it can trigger various actions such as renegotiation, enforcement of covenants, or legal proceedings.~~

~~IG29. When the terms and conditions of financial assets that have been classified as past due are renegotiated, the terms and conditions of the new contractual arrangement apply in determining whether the financial asset remains past due.~~

~~IG30. Paragraph 44(a) requires an analysis by class of the age of financial assets that are past due but not impaired. An entity uses its judgment to determine an appropriate number of time bands. For example, an entity might determine that the following time bands are appropriate:~~

- ~~(a) Not more than three months;~~
- ~~(b) More than three months and not more than six months;~~
- ~~(c) More than six months and not more than one year; and~~
- ~~(d) More than one year.~~

~~IG31. Paragraph 44(b) requires an analysis of impaired financial assets by class. This analysis might include:~~

- ~~(a) The carrying amount, before deducting any impairment loss;~~
- ~~(b) The amount of any related impairment loss; and~~
- ~~(c) The nature and fair value of collateral available and other credit enhancements obtained.~~

Market Risk (paragraphs 47–49 and AG19–AG30)

...

IG36. The following example illustrates the application of the disclosure requirement in paragraph 47(a):

Interest Rate Risk

At December 31, 20X2, if interest rates at that date had been 10 basis points lower with all other variables held constant, surplus for the year would have been CU1.7 million (20X1—CU2.4 million) higher, arising mainly as a result of lower interest expense on variable borrowings, and other revenue would have been CU2.8 million (20X1—CU3.2 million) higher, arising mainly as a result of an increase in the fair value of fixed rate financial assets classified as available for sale. If interest rates had been 10 basis points higher, with all other variables held constant, surplus would have been CU1.5 million (20X1—CU2.1 million) lower, arising mainly as a result of higher interest expense on variable borrowings, revenue would have been CU3.0 million (20X1—CU3.4 million) lower, arising mainly as a result of a decrease in the fair value of fixed rate financial assets classified as available for sale. Surplus is more sensitive to interest rate decreases than increases because of borrowings with capped interest rates. The sensitivity is lower in 20X2 than in 20X1 because of a reduction in outstanding borrowings that has occurred as the entity's debt has matured (see note X).^(a)

Foreign Currency Exchange Rate Risk

At December 31, 20X2, if the CU had weakened 10 percent against the US dollar with all other variables held constant, surplus for the year would have been CU2.8 million (20X1—CU6.4 million) lower, revenue would have been CU1.2 million (20X1—CU1.1 million) higher. Conversely, if the CU had strengthened 10 percent against the US dollar with all other variables held constant, surplus would have been CU2.8 million (20X1—CU6.4 million) higher, revenue would have been CU1.2 million (20X1—CU1.1 million) lower. The lower foreign currency exchange rate sensitivity in surplus in 20X2 compared with 20X1 is attributable to a reduction in foreign currency denominated debt. Revenue is more sensitive in 20X2 than in 20X1 because of the increased use of hedges of foreign currency purchases, offset by the reduction in foreign currency debt.

(a) Paragraph 46 requires disclosure of a maturity analysis of liabilities.

...

Derecognition (paragraphs 49D and 49E)

IG41 The following examples illustrate some possible ways to meet the quantitative disclosure requirements in paragraphs 49D and 49E.

IG42 The following examples illustrate how an entity that has adopted IPSAS 41 might meet the quantitative disclosure requirements in paragraphs 49D and 49E.

Transferred financial assets that are not derecognized in their entirety

Illustrating the application of paragraph 49D(d) and (e)

	<u>Financial assets at fair value through surplus or deficit</u>		<u>Financial assets at amortized cost</u>		<u>Financial assets at fair value through net assets/equity</u>
	<u>CU million</u>		<u>CU million</u>		<u>CU million</u>
	<u>Trading assets</u>	<u>Derivatives</u>	<u>Mortgages</u>	<u>Consumer loans</u>	<u>Equity investments</u>
Carrying amount of assets	X	X	X	X	X
Carrying amount of associated liabilities	(X)	(X)	(X)	(X)	(X)
For those liabilities that have recourse only to the transferred assets:					
Fair value of assets	X	X	X	X	X
Fair value of associated liabilities	(X)	(X)	(X)	(X)	(X)
Net position	X	X	X	X	X

Transferred financial assets that are derecognized in their entirety

Illustrating the application of paragraph 49E(a)–(d)

<u>Type of continuing involvement</u>	<u>Cash outflows to repurchase transferred (derecognized) assets</u>	<u>Carrying amount of continuing involvement in statement of financial position</u>			<u>Fair value of continuing involvement</u>		<u>Maximum exposure to loss</u>
	<u>CU million</u>	<u>CU million</u>			<u>CU million</u>		<u>CU million</u>
		<u>Financial assets at fair value through surplus or deficit</u>	<u>Financial assets at fair value through net assets/equity</u>	<u>Financial liabilities at fair value through surplus or deficit</u>	<u>Assets</u>	<u>Liabilities</u>	
Written put options	(X)			(X)		(X)	X
Purchased call options	(X)	X			X		X
Securities lending	(X)			(X)	X	(X)	X
Total		X		(X)	X	(X)	X

Illustrating the Application of Paragraph 49E(e)

<u>Undiscounted cash flows to repurchase transferred assets</u>								
<u>Type of continuing involvement</u>	<u>Maturity of continuing involvement CU million</u>							
	<u>Total</u>	<u>less than 1 month</u>	<u>1–3 months</u>	<u>3–6 months</u>	<u>6 months – 1 year</u>	<u>1–3 years</u>	<u>3–5 years</u>	<u>more than 5 years</u>
Written put options	X		X	X	X	X		
Purchased call options	X			X	X	X		X
Securities lending	X	X	X					

IG43 The following examples illustrate how an entity that has not adopted IPSAS 41 might meet the quantitative disclosure requirements in paragraphs 49D and 49E.

Transferred financial assets that are not derecognized in their entirety

Illustrating the application of paragraph 49D(d) and (e)

	<u>Financial assets at fair value through surplus or deficit</u>		<u>Loans and receivables</u>		<u>Available-for-sale financial assets</u>
	CU million		CU million		CU million
	Trading securities	Derivatives	Mortgages	Consumer loans	Equity investments
Carrying amount of assets	X	X	X	X	X
Carrying amount of associated liabilities	(X)	(X)	(X)	(X)	(X)
For those liabilities that have recourse only to the transferred assets:					
Fair value of assets	X	X	X	X	X
Fair value of associated liabilities	(X)	(X)	(X)	(X)	(X)
Net position	X	X	X	X	X

Transferred financial assets that are derecognized in their entirety

Illustrating the application of paragraph 49E(a)–(d)

<u>Type of continuing involvement</u>	<u>Cash outflows to repurchase transferred (derecognized) assets</u>	<u>Carrying amount of continuing involvement in statement of financial position</u>			<u>Fair value of continuing involvement</u>		<u>Maximum exposure to loss</u>
	CU million	CU million			CU million		CU million
		<u>Held for trading</u>	<u>Available-for-sale financial assets</u>	<u>Financial liabilities at fair value through surplus or deficit</u>	<u>Assets</u>	<u>Liabilities</u>	
Written put options	(X)			(X)		(X)	X
Purchased call options	(X)	X			X		X
Securities lending	(X)		X	(X)	X	(X)	X
Total		X	X	(X)	X	(X)	X

Illustrating the application of paragraph 49E(e)

<u>Undiscounted cash flows to repurchase transferred assets</u>								
<u>Maturity of continuing involvement CU million</u>								
<u>Type of continuing involvement</u>	<u>Total</u>	<u>less than 1 month</u>	<u>1–3 months</u>	<u>3–6 months</u>	<u>6 months–1 year</u>	<u>1–3 years</u>	<u>3–5 years</u>	<u>more than 5 years</u>
Written put options	X		X	X	X	X		
Purchased call options	X			X	X	X		X
Securities lending	X	X	X					

...

Disclosures (paragraphs 17A–17F and AG42–55)

IG44 The following examples illustrate ways in which an entity might provide the quantitative disclosures required by paragraph 17C. However, these illustrations do not address all possible ways of applying the disclosure requirements as set out in paragraphs 17B–17E.

Background

An entity has entered into transactions subject to an enforceable master netting arrangement or similar agreement with the following counterparties. The entity has the following recognized financial assets and financial liabilities resulting from those transactions that meet the scope of the disclosure requirements in paragraph 17A.

Counterparty A:

The entity has a derivative asset (fair value of CU100 million) and a derivative liability (fair value of CU80 million) with Counterparty A that meet the offsetting criteria in paragraph 47 of IPSAS 28. Consequently, the gross derivative liability is set off against the gross derivative asset, resulting in the presentation of a net derivative asset of CU20 million in the entity's statement of financial position. Cash collateral has also been received from Counterparty A for a portion of the net derivative asset (CU10 million). The cash collateral of CU10 million does not meet the offsetting criteria in paragraph 47 of IPSAS 28, but it can be set off against the net amount of the derivative asset and derivative liability in the case of default and insolvency or bankruptcy, in accordance with an associated collateral arrangement.

Counterparty B:

The entity has a derivative asset (fair value of CU100 million) and a derivative liability (fair value of CU80 million) with Counterparty B that do not meet the offsetting criteria in paragraph 47 of IPSAS 28, but which the entity has the right to set off in the case of default and insolvency or bankruptcy. Consequently, the gross amount of the derivative asset (CU100 million) and the gross amount of the derivative liability (CU80 million) are presented separately in the entity's statement of financial position. Cash collateral has also been received from Counterparty B for the net amount of the derivative asset and derivative liability (CU20 million). The cash collateral of CU20 million does not meet the offsetting criteria in paragraph 47 of IPSAS 28, but it can be set off against the net amount of the derivative asset and derivative liability in the case of default and insolvency or bankruptcy, in accordance with an associated collateral arrangement.

Counterparty C:

The entity has entered into a sale and repurchase agreement with Counterparty C that is accounted for as a collateralized borrowing. The carrying amount of the financial assets (bonds) used as collateral and posted by the entity for the transaction is CU79 million and their fair value is CU85 million. The carrying amount of the collateralized borrowing (repo payable) is CU80 million.

The entity has also entered into a reverse sale and repurchase agreement with Counterparty C that is accounted for as a collateralized lending. The fair value of the financial assets (bonds) received as collateral (and not recognized in the entity's statement of financial position) is CU105 million. The carrying amount of the collateralized lending (reverse repo receivable) is CU90 million.

The transactions are subject to a global master repurchase agreement with a right of set-off only in default and insolvency or bankruptcy and therefore do not meet the offsetting criteria in paragraph 47 of IPSAS 28. Consequently, the related repo payable and repo receivable are presented separately in the entity's statement of financial position.

Illustrating the Application of Paragraph 17C(a)–(e) by Type of Financial Instrument*Financial assets subject to offsetting, enforceable master netting arrangements and similar agreements*

<u>CU million</u>						
<u>As at December 31,</u> <u>20XX</u>	<u>(a)</u>	<u>(b)</u>	<u>(c)=(a)-(b)</u>	<u>(d)</u>		<u>(e)=(c)-(d)</u>
				<u>Related amounts not set off in the statement of financial position</u>		
<u>Description</u>	<u>Gross amounts of recognized financial assets</u>	<u>Gross amounts of recognized financial liabilities set off in the statement of financial position</u>	<u>Net amounts of financial assets presented in the statement of financial position</u>	<u>(d)(i), (d)(ii) Financial instruments</u>	<u>(d)(ii) Cash collateral received</u>	<u>Net amount</u>
Derivatives	200	(80)	120	(80)	(30)	10
Reverse repurchase, securities borrowing and similar agreements	90	=	90	(90)	=	=
Other financial instruments	=	=	=	=	=	=
Total	290	(80)	210	(170)	(30)	10

Financial liabilities subject to offsetting, enforceable master netting arrangements and similar agreements

<u>CU million</u>						
<u>As at December</u> <u>31, 20XX</u>	<u>(a)</u>	<u>(b)</u>	<u>(c)=(a)-(b)</u>	<u>(d)</u>		<u>(e)=(c)-(d)</u>
				<u>Related amounts not set off in the statement of financial position</u>		
<u>Description</u>	<u>Gross amounts of recognized financial liabilities</u>	<u>Gross amounts of recognized financial assets set off in the statement of financial position</u>	<u>Net amounts of financial liabilities presented in the statement of financial position</u>	<u>(d)(i), (d)(ii) Financial instruments</u>	<u>(d)(ii) Cash collateral pledged</u>	<u>Net amount</u>
Derivatives	160	(80)	80	(80)	=	=
Repurchase, securities lending and similar agreements	80	=	80	(80)	=	=
Other financial instruments	=	=	=	=	=	=
Total	240	(80)	160	(160)	=	=

Illustrating the Application of Paragraph 17C(a)–(c) by Type of Financial Instrument and Paragraph 17C(c)–(e) by Counterparty

Financial assets subject to offsetting, enforceable master netting arrangements and similar agreements

<u>CU million</u>			
<u>As at December 31, 20XX</u>	<u>(a)</u>	<u>(b)</u>	<u>(c)=(a)-(b)</u>
<u>Description</u>	<u>Gross amounts of recognized financial assets</u>	<u>Gross amounts of recognized financial liabilities set off in the statement of financial position</u>	<u>Net amounts of financial assets presented in the statement of financial position</u>
Derivatives	200	(80)	120
Reverse repurchase, securities borrowing and similar agreements	90	=	90
Other financial instruments	=	=	=
Total	290	(80)	210

Net financial assets subject to enforceable master netting arrangements and similar agreements, by counterparty

<u>CU million</u>				
<u>As at December 31, 20XX</u>	<u>(c)</u>	<u>(d)</u>		<u>(e)=(c)-(d)</u>
		<u>Related amounts not set off in the statement of financial position</u>		
	<u>Net amounts of financial assets presented in the statement of financial position</u>	<u>(d)(i). (d)(ii) Financial instruments</u>	<u>(d)(ii) Cash collateral received</u>	<u>Net amount</u>
Counterparty A	20	=	(10)	10
Counterparty B	100	(80)	(20)	=
Counterparty C	90	(90)	=	=
Other	=	=	=	=
Total	210	(170)	(30)	10

Financial liabilities subject to offsetting, enforceable master netting arrangements and similar agreements

<u>CU million</u>			
<u>As at December 31, 20XX</u>	<u>(a)</u>	<u>(b)</u>	<u>(c)=(a)-(b)</u>
<u>Description</u>	<u>Gross amounts of recognized financial liabilities</u>	<u>Gross amounts of recognized financial assets set off in the statement of financial position</u>	<u>Net amounts of financial liabilities presented in the statement of financial position</u>
Derivatives	160	(80)	80
Repurchase, securities lending and similar agreements	80	=	80
Other financial instruments	=	=	=
Total	240	(80)	160

Net financial liabilities subject to enforceable master netting arrangements and similar agreements, by counterparty

CU million				
As at December 31, 20XX	(c)	(d)		(e)=(c)-(d)
		Related amounts not set off in the statement of financial position		
	Net amounts of financial liabilities presented in the statement of financial position	(d)(i). Financial instruments	(d)(ii) Cash collateral pledged	Net amount
Counterparty A	=	=	=	=
Counterparty B	80	(80)	=	=
Counterparty C	80	(80)	=	=
Other	=	=	=	=
Total	160	(160)	=	=

...

Transition from IPSAS 29 to IPSAS 41 (paragraphs 49K–49O)

IG45 The following illustration is an example of one possible way to meet the quantitative disclosure requirements in paragraphs 49K–49O of IPSAS 30 at the date of initial application of IPSAS 41. However, this illustration does not address all possible ways of applying the disclosure requirements of this Standard.

Reconciliation of statement of financial position balances from IPSAS 29 to IPSAS 41 at January 1, 2022

Financial assets	(i)	(ii)	(iii)	(iv) = (i) + (ii) + (iii)	(v) = (iii)
	IPSAS 29 carrying amount December 31, 2021 (1)	Reclassifications	Remeasurements	IPSAS 41 carrying amount January 1, 2022	Accumulated surplus or deficit effect on January 1, 2022 (2), (3)
Fair value through surplus or deficit					
Additions:					
From available for sale (IPSAS 29)		(a)			(c)
From amortized cost (IPSAS 29) – required reclassification		(b)			
From amortized cost (IPSAS 29) – fair value option elected at January 1, 2022					
Subtractions:					
To amortized cost (IPSAS 41)					
To fair value through net assets/equity – debt instruments (IPSAS 41)					
To fair value through net assets/equity – equity instruments (IPSAS 41)					
Total change to fair value through surplus or deficit					
Fair value through net assets/equity					
Additions – debt instruments:					
From available for sale (IPSAS 29)					(g)
From amortized cost (IPSAS 29)					(h)
From fair value through surplus or deficit (IPSAS 29) – required reclassification based on classification criteria					(i)

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Reconciliation of statement of financial position balances from IPSAS 29 to IPSAS 41 at January 1, 2022

Financial assets	(i)	(ii)	(iii)	(iv) = (i) + (ii) + (iii)	(v) = (iii)
	<u>IPSAS 29 carrying amount December 31, 2021 (1)</u>	<u>Reclassifications</u>	<u>Remeasurements</u>	<u>IPSAS 41 carrying amount January 1, 2022</u>	<u>Accumulated surplus or deficit effect on January 1, 2022 (2), (3)</u>
From fair value through surplus or deficit (fair value option under IPSAS 29) – fair value option criteria not met at January 1, 2022					(j)
From fair value through surplus or deficit (IPSAS 29) – fair value option revoked at January 1, 2022 by choice					(k)
<u>Additions – equity instruments:</u>					
From available-for-sale (IPSAS 29)					
From fair value through surplus or deficit (fair value option under IPSAS 29) – fair value through net assets/equity elected at January 1, 2022					
From cost (IPSAS 29)					
<u>Subtractions – debt and equity instruments:</u>					
Available for sale (IPSAS 29) to fair value through surplus or deficit (IPSAS 41) – required reclassification based on classification criteria					(d)
Available for sale (IPSAS 29) to fair value through surplus or deficit (IPSAS 41) – fair value option elected at January 1, 2022					
Available for sale (IPSAS 29) to amortized cost (IPSAS 41)					(e)
<u>Total change to fair value through net assets/equity</u>					
<u>Amortized cost</u>					
<u>Additions:</u>					
From available for sale (IPSAS 29)					(f)
From fair value through surplus or deficit (IPSAS 29) – required reclassification					
From fair value through surplus or deficit (fair value option under IPSAS 29) – fair value option criteria not met at January 1, 2022					
From fair value through surplus or deficit (IPSAS 29) – fair value option revoked at January 1, 2022 by choice					
<u>Subtractions:</u>					

Reconciliation of statement of financial position balances from IPSAS 29 to IPSAS 41 at January 1, 2022

Financial assets	(i)	(ii)	(iii)	(iv) = (i) + (ii) + (iii)	(v) = (iii)
	<u>IPSAS 29 carrying amount</u>	<u>Reclassifications</u>	<u>Remeasurements</u>	<u>IPSAS 41 carrying</u>	<u>Accumulated surplus</u>
	<u>December 31, 2021 (1)</u>			<u>amount January 1, 2022</u>	<u>or deficit effect on</u>
					<u>January 1, 2022 (2), (3)</u>
<u>To fair value through net assets/equity</u> <u>(IPSAS 41)</u>					(1)
<u>To fair value through surplus or deficit</u> <u>(IPSAS 41) – required reclassification</u> <u>based on classification criteria</u>					
<u>To fair value through surplus or deficit</u> <u>(IPSAS 41) – fair value option elected at</u> <u>January 1, 2022</u>					
Total change to amortized cost					
Total financial asset balances, reclassifications and remeasurements at January 1, 2022	(i)	Total (ii) = 0	(iii)	(iv) = (i) + (ii) + (iii)	

1 Includes the effect of reclassifying hybrid instruments that were bifurcated under IPSAS 29 with host contract components of (a), which had associated embedded derivatives with a fair value of X at December 31, 2021, and (b), which had associated embedded derivatives with a fair value of Y at December 31, 2021.

2 Includes (c), (d), (e) and (f), which are amounts reclassified from net assets/equity to accumulated surplus or deficit at the date of initial application.

3 Includes (g), (h), (i), (j), (k) and (l), which are amounts reclassified from accumulated surplus or deficit to net assets/equity at the date of initial application.

...

Amendments to IPSAS 32, *Service Concession Arrangements*

Paragraphs 20, 29, AG37, AG45, AG52 and AG53 are amended and paragraph 36D is added. New text is underlined and deleted text is struck through.

...

Financial Liability Model (see paragraphs AG37–AG46)

...

20. IPSAS 28, *Financial Instruments: Presentation*, the derecognition requirements in IPSAS 29, *Financial Instruments: Recognition and Measurement*, and IPSAS 30, *Financial Instruments: Disclosures* and the derecognition requirements in IPSAS 41, *Financial Instruments* apply to the financial liability recognized under paragraph 14, except where this Standard provides requirements and guidance.

...

Other Liabilities, Commitments, Contingent Liabilities and Contingent Assets (see paragraphs AG51–AG54)

...

29. **The grantor shall account for other liabilities, commitments, contingent liabilities, and contingent assets arising from a service concession arrangement in accordance with IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, IPSAS 28, ~~IPSAS 29~~, and IPSAS 30, and IPSAS 41.**

...

Effective Date

...

36D. Paragraphs 20, 29, AG37, AG45, AG52 and AG53 were amended by IPSAS 41, issued in August 2018. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2022. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2022 it shall disclose that fact and apply IPSAS 41 at the same time.

...

Application Guidance

This Appendix is an integral part of IPSAS 32.

...

Recognition and Measurement of Liabilities

...

AG37. When the grantor has an unconditional obligation to make a predetermined series of payments to the operator, the liability is a financial liability as defined in IPSAS 41 ~~IPSAS 29~~. The grantor has an unconditional obligation if it has little, if any, discretion to avoid the obligation usually because of the binding arrangement with the operator being enforceable by law.

...

AG45. The finance charge related to the liability in a service concession arrangement is presented consistently with other finance charges in accordance with IPSAS 28, ~~IPSAS 29~~, and IPSAS 30, and IPSAS 41.

...

AG52. Certain guarantees made by a grantor may meet the definition of a financial guarantee contract. The grantor determines whether guarantees made by the grantor as part of a service concession arrangement meet the definition of a financial guarantee contract and applies IPSAS 28, ~~IPSAS 29~~, and IPSAS 30, and IPSAS 41 in accounting for the guarantee. Where the guarantee is an insurance contract, the grantor can elect to apply the relevant international or national accounting standard dealing with insurance contracts. See IPSAS 28, paragraphs AG3–AG9, for further guidance.

AG53. Guarantees and commitments that do not meet the requirements in IPSAS 28 and IPSAS 41 ~~IPSAS 29~~ relating to financial guarantee contracts or are not insurance contracts are accounted for in accordance with IPSAS 19.

...

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 32.

...

The Financial Liability Model

...

BC26. Service concession arrangements are concluded by way of a binding arrangement, which may include contracts or similar arrangements that confer similar rights and obligations on the parties as if they were in the form of a contract. The IPSASB concluded that, if similar arrangements exist that confer the same rights and obligations on either party as if they were in the form of a contract, IPSAS 28, *Financial Instruments: Presentation*, ~~IPSAS 29, *Financial Instruments: Recognition and Measurement*~~, and IPSAS 30, *Financial Instruments: Disclosures*, and IPSAS 41, *Financial Instruments* should be applied by analogy to such arrangements.

...

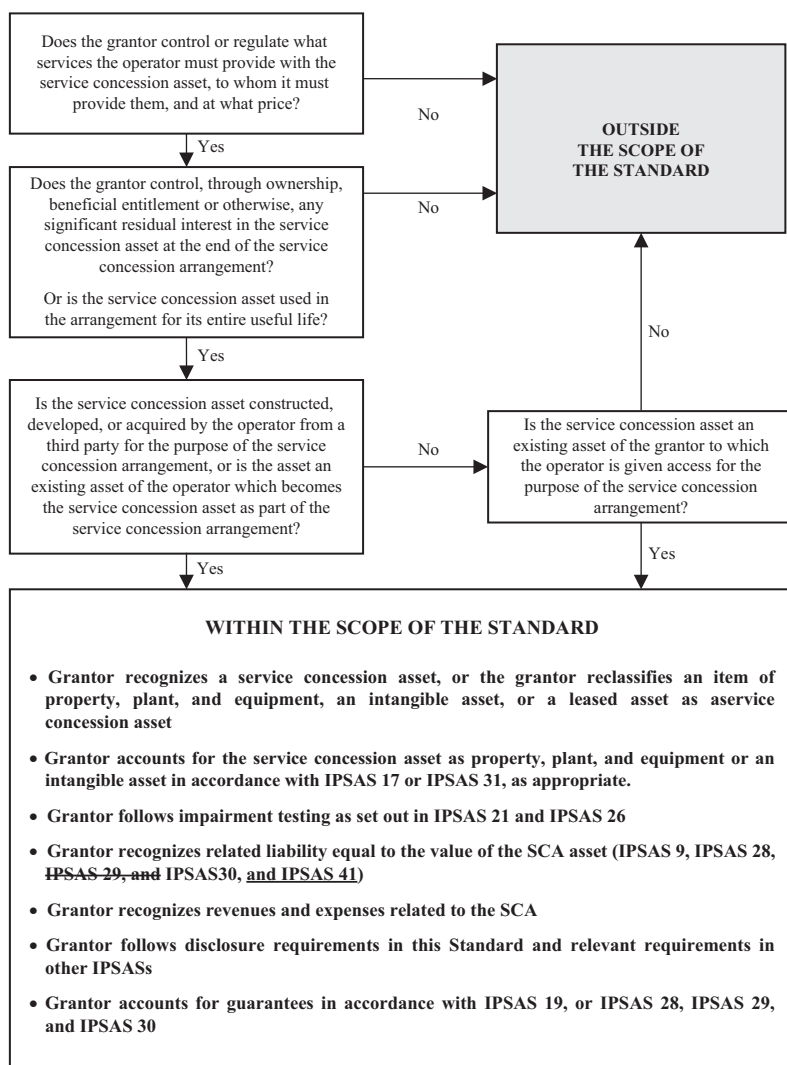
Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 32.

...

Accounting Framework for Service Concession Arrangements

IG2. The diagram below summarizes the accounting for service concession arrangements established by IPSAS 32.



Amendments to IPSAS 33, *First-Time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)*

Paragraphs 36, 64, 72, 113, 114, 115, 116, 117, 118, 119, 120, 121, 122 and 124 are amended and paragraphs 114A, 119A, 119B, 119C, 119D, 122A, 122B, 122C, 122D, and 154D are added. New text is underlined and deleted text is struck through.

Recognition and/or Measurement of Assets and/or Liabilities

36. **Where a first-time adopter has not recognized assets and/or liabilities under its previous basis of accounting, it is not required to recognize and/or measure the following assets and/or liabilities for reporting periods beginning on a date within three years following the date of adoption of IPSASs:**

- Inventories (see IPSAS 12, *Inventories*);**
- Investment property (see IPSAS 16, *Investment Property*);**
- Property, plant and equipment (see IPSAS 17, *Property, Plant and Equipment*);**
- Defined benefit plans and other long-term employee benefits (see IPSAS 39, *Employee Benefits*);**
- Biological assets and agricultural produce (see IPSAS 27, *Agriculture*);**

- (f) Intangible assets (see IPSAS 31, *Intangible Assets*);
- (g) Service concession assets and the related liabilities, either under the financial liability model or the grant of a right to the operator model (see IPSAS 32, *Service Concession Arrangements: Grantor*); and
- (h) Financial instruments (see IPSAS 41, *Financial Instruments* ~~IPSAS 29, *Financial Instruments; Recognition and Measurement*~~).

...

Using Deemed Cost to Measure Assets and/or Liabilities

64. A first-time adopter may elect to measure the following assets and/or liabilities at their fair value when reliable cost information about the assets and liabilities is not available, and use that fair value as the deemed cost for:
- (a) Inventory (see IPSAS 12);
 - (b) Investment property, if the first-time adopter elects to use the cost model in IPSAS 16;
 - (c) Property, plant and equipment (see IPSAS 17);
 - (d) Intangible assets, other than internally generated intangible assets (see IPSAS 31) that meets:
 - (i) The recognition criteria in IPSAS 31 (excluding the reliable measurement criterion); and
 - (ii) The criteria in IPSAS 31 for revaluation (including the existence of an active market);
 - (e) Financial instruments (see IPSAS 41 ~~IPSAS 29~~); or
 - (f) Service concession assets (see IPSAS 32).

...

Using Deemed Cost for Investments in Controlled Entities, Joint Ventures and Associates (IPSAS 34)

72. Where a first-time adopter measures an investment in a controlled entity, joint venture or associate at cost in its separate financial statements, it may, on the date of adoption of IPSASs, elect to measure that investment at one of the following amounts in its separate opening statement of financial position:
- (a) Cost; or
 - (b) Deemed cost. The deemed cost of such an investment shall be its fair value (determined in accordance with IPSAS 41 ~~IPSAS 29~~) at the first-time adopter's date of adoption of IPSASs in its separate financial statements.

...

IPSAS 41, *Financial Instruments* ~~IPSAS 29, *Financial Instruments; Recognition and Measurement*~~

Designation of Financial Instruments on the Date of Adoption of IPSAS or During the Period of Transition

113. A first-time adopter may designate a financial asset or financial liability as a financial asset or financial liability at fair value through surplus or deficit that meet the criteria for designation in IPSAS 41 ~~IPSAS 29~~, in accordance with paragraph 114. A first-time adopter shall disclose the fair value of financial assets and financial liabilities designated into each category at the date of designation, their classification and carrying amount.
114. IPSAS 41 ~~IPSAS 29~~ permits a financial asset to be designated on initial recognition as ~~available for sale~~ or a financial instrument (provide it meets certain criteria) to be designated as a financial asset or financial liability at fair value through surplus or deficit. Despite this requirement, exceptions apply in the following circumstances:
- (a) ~~A first-time adopter is permitted to make an available-for-sale designation at the date of adoption of IPSASs.~~
 - (b) A first-time adopter is permitted to designate, at the date of adoption of IPSASs, any financial asset or financial liability as at fair value through surplus or deficit provided the asset or liability meets the criteria in paragraph 44, 46(a) or 46(b) of IPSAS 41 ~~10(b)(i), 10(b)(ii) or 13 of IPSAS 29~~ at that date.
- 114A. An entity may designate an investment in an equity instrument as at fair value through net assets/equity in accordance with paragraph 106 of IPSAS 41 on the basis of the facts and circumstances that exist at the date of adoption of IPSASs.

Derecognition of Financial Assets and Financial Liabilities

115. Except as permitted by paragraph 116 a first-time adopter shall apply the derecognition requirements in IPSAS 41 ~~IPSAS 29~~ prospectively for transactions occurring on or after the date of adoption of IPSASs, or where a first-time adopter takes advantage of the exemptions not to recognize financial instruments, the date on which the exemptions that provided the relief have expired and/or the financial instruments are recognized (whichever is earlier). For example, if a first-time adopter derecognized non-derivative financial assets or non-derivative financial liabilities in accordance with its previous basis of accounting as a result of a transaction that occurred before the date of adoption of IPSASs, it shall not recognize those assets and liabilities in accordance with IPSAS 41 ~~IPSAS 29~~, unless they qualify for recognition as a result of a later transaction or event.
116. Notwithstanding the provision in paragraph 115, a first-time adopter may apply the derecognition requirements in IPSAS 41 ~~IPSAS 29~~ retrospectively from a date of the first-time adopter choosing, provided that the information needed to apply IPSAS 41 ~~IPSAS 29~~ to financial assets and financial liabilities derecognized as a result of past transactions was obtained at the time of initially accounting for these transactions.

Hedge Accounting

117. As required by IPSAS 41 ~~IPSAS 29~~, a first-time adopter shall at the date of adoption of IPSASs, or where a first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure financial instruments, the date when the exemption that provided the relief has expired and/or the relevant financial instruments are recognized and/or measured in accordance with the applicable IPSASs (whichever is earlier):
- (a) Measure all derivatives at fair value; and
 - (b) Eliminate all deferred losses and gains arising on derivatives that were reported in accordance with its previous basis of accounting as if they were assets or liabilities.
118. A first-time adopter shall not reflect in its opening statement of financial position a hedging relationship of a type that does not qualify for hedge accounting in accordance with IPSAS 41 ~~IPSAS 29~~ (for example, many hedging relationships where the hedging instrument is a stand-alone cash instrument or written option; or where the hedged item is a net position in a cash flow hedge for another risk than foreign currency risk). However, if a first-time adopter designated a net position as a hedged item in accordance with its previous basis of accounting, it may designate as a hedged item in accordance with IPSASs an individual item within that net position, or a net position if that meets the requirements in paragraph 146 of IPSAS 41 ~~as a hedged item in accordance with IPSASs~~, provided that it does so no later than the date of adoption of IPSASs or where it takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure financial instruments, the date when the exemption that provided the relief has expired, and/or the relevant financial instruments are recognized and/or measured in accordance with the applicable IPSASs (whichever is earlier).
119. If, before the date of adoption of IPSASs, or where a first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure financial instruments the date on which the exemption that provided the relief has expired, and/or the relevant financial instruments are recognized and/or measured in accordance with the applicable IPSASs (whichever is earlier), a first-time adopter had designated a transaction as a hedge but the hedge does not meet the conditions for hedge accounting in IPSAS 41 ~~IPSAS 29~~, the first-time adopter shall apply paragraphs 135 and 136 of IPSAS 41 ~~102 and 112 of IPSAS 29~~ to discontinue hedge accounting. Transactions entered into before the date of adoption of IPSASs, or where a first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure financial instruments, the date when the transitional exemption expires and/or the relevant financial instruments are recognized and/or measured in accordance with IPSAS 41 ~~IPSAS 29~~ (whichever is earlier), shall not be retrospectively designated as hedges.

Classification and Measurement of Financial Instruments

- 119A. An entity shall assess whether a financial asset meets the conditions in paragraph 40 or the conditions in paragraph 41 of IPSAS 41 on the basis of the facts and circumstances that exist at the date of adoption of IPSASs.
- 119B. If it is impracticable to assess a modified time value of money element in accordance with paragraphs AG68–AG70 of IPSAS 41 on the basis of the facts and circumstances that exist at the date of transition to IPSASs, an entity shall assess the contractual cash flow characteristics of that financial asset on the basis of the facts and circumstances that existed at

the date of adoption of IPSASs without taking into account the requirements related to the modification of the time value of money element in paragraphs AG68–AG70 of IPSAS 41. (In this case, the entity shall also apply paragraph 49J of IPSAS 30 but references to ‘paragraph 161 of IPSAS 41’ shall be read to mean this paragraph and references to ‘initial recognition of the financial asset’ shall be read to mean ‘at the date of adoption of IPSASs’.)

- 119C. If it is impracticable to assess whether the fair value of a prepayment feature is insignificant in accordance with paragraph AG74(c) of IPSAS 41 on the basis of the facts and circumstances that exist at the date of adoption of IPSASs, an entity shall assess the contractual cash flow characteristics of that financial asset on the basis of the facts and circumstances that existed at the date of adoption of IPSASs without taking into account the exception for prepayment features in paragraph AG74 of IPSAS 41. (In this case, the entity shall also apply paragraph 49K of IPSAS 30 but references to ‘paragraph 162 of IPSAS 41’ shall be read to mean this paragraph and references to ‘initial recognition of the financial asset’ shall be read to mean ‘at the date of adoption of IPSASs’.)
- 119D. If it is impracticable (as defined in IPSAS 3) for an entity to apply retrospectively the effective interest method in IPSAS 41, the fair value of the financial asset or the financial liability at the date of adoption of IPSASs shall be the new gross carrying amount of that financial asset or the new amortized cost of that financial liability at the date of adoption of IPSASs.

Impairment of Financial Assets

120. **A first-time adopter shall apply the impairment requirements prospectively from the date of adoption of IPSASs, except in relation to those financial assets where it takes advantage of the exemptions in paragraphs 36, 38 and 42 which allow a three-year transitional relief period to not recognize and/or measure financial instruments. When a first-time adopter adopts the three year transitional relief period provided, it applies the impairment provisions when exemption that provided the relief has expired, and/or the relevant financial instruments are recognized and/or measured in accordance with IPSAS 41 IPSAS 29 (whichever is earlier).**

...

122. A first-time adopter shall apply the impairment requirements prospectively. This means that on the date of adoption of IPSAS 41 IPSAS 29, when the exemptions that provided the relief have expired, and/ or when the relevant financial instruments are recognized and/or measured, a first-time adopter shall be required to assess whether there is an indication that the financial instrument is impaired. Any impairment loss shall be recognized in opening accumulated surplus or deficit on the date of adoption of IPSASs, or in the opening accumulated surplus or deficit of the reporting period in which the exemptions that provided the relief have expired, and/or the relevant financial instruments are recognized and/or measured (whichever is earlier).
- 122A. At the date of adoption of IPSAS 41, when the exemptions that provided the relief have expired, and/ or when the relevant financial instruments are recognized and/or measured, a first-time adopter shall use reasonable and supportable information that is available without undue cost or effort to determine the credit risk at the date that financial instruments were initially recognized (or for loan commitments and financial guarantee contracts the date that the entity became a party to the irrevocable commitment in accordance with paragraph 78 of IPSAS 41) and compare that to the credit risk at the date of adoption of IPSASs (also see paragraphs AG350–AG351 of IPSAS 41).
- 122B. When determining whether there has been a significant increase in credit risk since initial recognition, an entity may apply:
- (a) The requirements in paragraph 82 and AG179–AG182 of IPSAS 41; and
 - (b) The rebuttable presumption in paragraph 83 of IPSAS 41 for contractual payments that are more than 30 days past due if an entity will apply the impairment requirements by identifying significant increases in credit risk since initial recognition for those financial instruments on the basis of past due information.
- 122C. If, at the date of adoption of IPSASs, determining whether there has been a significant increase in credit risk since the initial recognition of a financial instrument would require undue cost or effort, an entity shall recognize a loss allowance at an amount equal to lifetime expected credit losses at each reporting date until that financial instrument is derecognized (unless that financial instrument is low credit risk at a reporting date, in which case paragraph 122B(a) applies).

Embedded Derivatives

- 122E. A first-time adopter shall assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative on the basis of the conditions that existed at the later of the date it first became a party to the contract and the date a reassessment is required by paragraph AG109 of IPSAS 41.

IPSAS 30, Financial Instruments: Disclosures

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124. **A first-time adopter shall apply the requirements in IPSAS 30 prospectively from the date of adoption of IPSASs, or when the exemptions that provided the relief have expired, and/or when the relevant financial instrument is recognized and/or measured in accordance with IPSAS 41 ~~IPSAS 29~~ (whichever is earlier).**

...

Effective Date

...

- 154D. Paragraphs 36, 64, 72, 113, 114, 115, 116, 117, 118, 119, 120, 121, 122 and 124 were amended and paragraphs 114A, 119A, 119B, 119C, 119D, 122A, 122B, 122C, and 122D were added by IPSAS 41, issued in August 2018. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2022. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2022 it shall disclose that fact and apply IPSAS 41 at the same time.

...

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 33.

...

IPSAS 41, Financial Instruments ~~IPSAS 29, Financial Instruments: Recognition and Measurement~~

BC61. The existing transitional provisions in IPSAS 41 ~~IPSAS 29~~ do not provide any relief to a first-time adopter for the recognition and/or measurement of financial instruments. Because many public sector entities will need some time to identify and appropriately classify their financial instruments, the IPSASB agreed that a transitional relief period should be provided to a first-time adopter for the recognition and/or measurement of financial instruments. A transitional relief period of three years was granted in line with the relief period provided for the recognition and/or measurement of other items.

...

BC63. As with non-monetary assets, the IPSASB agreed that the same principle should be applied to the recognition and/or measurement of monetary assets and/or liabilities, i.e., to the extent that a first-time adopter has recognized financial instruments under its previous basis of accounting, the IPSASB agreed that a three-year relief period should be granted for the measurement and classification of financial instruments following the date of adoption of IPSASs. During this transitional period, a first-time adopter will be able to develop reliable models for applying the principles in IPSAS 41 ~~IPSAS 29~~. It would also be allowed to apply accounting policies for the measurement of financial instruments that differs from the requirements in IPSAS 41 ~~IPSAS 29~~ during the period of transition.

...

Deemed Cost for Investments in Controlled Entities, Joint Ventures or Associates

BC85. The IPSASB also agreed that a first-time adopter may elect to measure an investment in a controlled entity, joint venture or associate at cost in its separate financial statements on the date of adoption of IPSASs at either cost as determined in accordance with IPSAS 6, or deemed cost. Deemed cost is determined as fair value in accordance with IPSAS 41, Financial Instruments ~~IPSAS 29, Financial Instruments: Recognition and Measurement~~.

...

IPSAS 41, Financial Instruments ~~IPSAS 29, Financial Instruments: Recognition and Measurement~~

BC111. The IPSASB concluded that, as it is in most instances impracticable to apply impairment principles retrospectively, the impairment of financial instruments should be applied prospectively. This exemption is consistent with the exemption provided for non-cash-generating assets and cash-generating assets in accordance with IPSAS 21 and 26.

...

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 33.

...

IPSAS 41, Financial Instruments ~~IPSAS 29, Financial Instruments: Recognition and Measurement~~

Recognition

IG67. A first-time adopter recognizes all financial assets and financial liabilities (including all derivatives) that qualify for recognition in accordance with IPSAS 41 ~~IPSAS 29~~ and have not yet qualified for derecognition in accordance with IPSAS 41 ~~IPSAS 29~~, except non-derivative financial assets and non-derivative financial liabilities derecognized in accordance with its previous basis of accounting before the date of adoption of IPSASs, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition of financial instruments, the date on which the exemptions expire or when the financial instruments are recognized and/or measured in accordance with the applicable IPSAS (whichever is earlier), to which the first-time adopter does not choose to apply paragraph 116 of IPSAS 33 (see paragraphs 115 and 116 of IPSAS 33).

IG68. For example, a first-time adopter that does not apply paragraph 116 of IPSAS 33 does not recognize assets transferred in a securitization, transfer or other derecognition transaction that occurred before the date of adoption of IPSASs if those transactions qualified for derecognition in accordance with its previous basis of accounting. However, if the first-time adopter uses the same securitization arrangement or other derecognition arrangement for further transfers after the date

of transition to IPSASs, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition and/or measurement of financial instruments, the date on which the exemptions expire or when the financial instruments are recognized and/or measured in accordance with the applicable IPSAS (whichever is earlier), those further transfers qualify for derecognition only if they meet the derecognition criteria of IPSAS 41 IPSAS 29.

Embedded Derivatives

IG69. When IPSAS 41 IPSAS 29 requires a first-time adopter to separate an embedded derivative from a host contract, the initial carrying amounts of the components at the date when the instrument first satisfies the recognition criteria in IPSAS 41 IPSAS 29 reflect circumstances at that date (IPSAS 41 IPSAS 29 paragraph 49). If the first-time adopter cannot determine the initial carrying amounts of the embedded derivative and host contract reliably, it measures the entire combined contract as at fair value through surplus or deficit (IPSAS 41 IPSAS 29 paragraph 52).

Measurement

IG70. In preparing its opening statement of financial position, a first-time adopter applies the criteria in IPSAS 41 IPSAS 29 to identify those financial assets and financial liabilities that are measured at fair value and those that are measured at amortized ~~amortised~~ cost.

Adjusting the Carrying Amount of Financial Instruments on the Date of Adoption of Accrual Basis IPSASs or During the Period of Transition

IG71. A first-time adopter shall treat an adjustment to the carrying amount of a financial asset or financial liability as an adjustment to be recognized in the opening balance of accumulated surplus or deficit at the date of adoption of IPSASs, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition and/or measurement of financial instruments, the date on which the exemptions expire or when the financial instruments are recognized and/or measured in accordance with the applicable IPSAS (whichever is earlier), only to the extent that it results from adopting IPSAS 41 IPSAS 29. Because all derivatives, other than those that are financial guarantee contracts or are designated and effective hedging instruments, are classified as held for trading, the differences between the previous carrying amount (which may have been zero) and the fair value of the derivatives are recognized as an adjustment of the balance of accumulated surplus or deficit at the beginning of the financial year in which IPSAS 41 IPSAS 29 is initially applied, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition and/or measurement of financial instruments, the date on which the exemptions expire or when the financial instruments are recognized and/or measured in accordance with the applicable IPSAS (whichever is earlier).

Hedge Accounting

...

IG74. A first-time adopter may, in accordance with its previous basis of accounting, have deferred gains and losses on a cash flow hedge of a forecast transaction. If, at the date of adoption of IPSAS, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition and/or measurement of financial instruments, the date on which the exemptions expire or when the financial instruments are recognized and/or measured in accordance with the applicable IPSAS (whichever is earlier), the hedged forecast transaction is not highly probable, but is expected to occur, the entire deferred gain or loss is recognized in net assets/equity. Any net cumulative gain or loss that has been reclassified to net assets/equity on initial application of IPSAS 41 IPSAS 29 or where the first-time adopter takes advantage of the exemption that provides relief from the recognition and/or measurement of financial instruments, the date on which the exemptions expire or when the financial instruments are recognized and/or measured in accordance with the applicable IPSAS (whichever is earlier) remains in net assets/equity until (a) the forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, (b) the forecast transaction affects surplus or deficit or (c) subsequently circumstances change and the forecast transaction is no longer expected to occur, in which case any related net cumulative gain or loss is reclassified from net assets/equity to surplus or deficit. If the hedging instrument is still held, but the hedge does not qualify as a cash flow hedge in accordance with IPSAS 41 IPSAS 29, hedge accounting is no longer appropriate starting from the date of adoption of IPSASs, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition and/or measurement of financial instruments, the date on which the exemptions expire or when the financial instruments are recognized and/or measured in accordance with the applicable IPSAS (whichever is earlier).

...

Summary of Transitional Exemptions and Provisions Included in IPSAS 33, *First-time Adoption of Accrual Basis IPSASs*

IG91. The diagram below summarizes the transitional exemptions and provisions included in other accrual basis IPSASs

IPSAS	Transitional exemption provided									
	NO	YES								
		Deemed cost	3 year transitional relief for recognition	3 year transitional relief for measurement	3 year transitional relief for recognition and/or measurement	3 year transitional relief for disclosure	Elimination of transactions, balances, revenue and expenses	Other		
IPSAS 1, <i>Presentation of Financial Statements</i>						√ To extent that 3 year relief period was adopted		<ul style="list-style-type: none"> Presenting comparative info encouraged 		
IPSAS 2, <i>Cash Flow Statements</i>	√									
IPSAS 3, <i>Accounting Policies, Changes in Accounting Estimates and Errors</i>	√									
IPSAS 4, <i>The Effects of Changes in Foreign Exchange Rates</i>								<ul style="list-style-type: none"> Exemption to comply with requirements for cumulative translation 		
IPSAS 5, <i>Borrowing Costs</i>			√ When allowed alternative is elected as accounting policy					<ul style="list-style-type: none"> Encouraged to apply benchmark treatment retrospectively Allowed alternative must be applied retrospectively 		
IPSAS 6, <i>Consolidated and Separate Financial Statements</i>		√			√ To appropriately classify and identify interests in other entities		√	<ul style="list-style-type: none"> Provisions when controlling and/or controlled entity adopts IPSAS at different time Exemption to not prepare financial statements as consolidated financial statements (Assess if investment entity on date of adoption and measure at fair value at that date) 		
(IPSAS 35 <i>Consolidated Financial Statements</i>)										
IPSAS 7, <i>Investments in Associates</i>		√			√ To appropriately classify and identify interests in other entities		√	<ul style="list-style-type: none"> Provisions when controlling entity and associate adopts IPSAS at different time Exemption to not include investment in associate in consolidated financial statements 		
(IPSAS 36 <i>Investments in Associates and Joint Ventures</i>)										

IPSAS	Transitional exemption provided									
	NO	Deemed cost	3 year transitional relief for recognition	3 year transitional relief for measurement	3 year transitional relief and/or measurement	3 year transitional relief for disclosure	Elimination of transactions, balances, revenue and expenses	Other		
IPSAS 8, <i>Interests in Joint Venture</i> (IPSAS 36 <i>Investments in Associates and Joint Ventures</i>)		√			√ To appropriately classify and identify interests in other entities		√	<ul style="list-style-type: none"> Provisions when controlling entity and associate and jointly controlled entities adopt IPSAS at different time Exemption to not include interests in joint venture in consolidated financial statements 		
(IPSAS 37 <i>Joint Arrangements</i>)								<ul style="list-style-type: none"> Provision on how to measure investment in joint venture previously accounted for using proportionate consolidation 		
IPSAS 9, <i>Revenue from Exchange Transactions</i>	√				√ To extent that 3 year relief period was adopted for assets and/or liabilities					
IPSAS 10, <i>Financial Reporting In Hyperinflationary Economies</i>								<ul style="list-style-type: none"> Provisions around severe hyperinflation 		
IPSAS 11, <i>Construction Contracts</i>	√									
IPSAS 12, <i>Inventories</i>		√	√ Inventory not recognized under previous basis of accounting	√ Inventory recognized under previous basis of accounting						
IPSAS 13, <i>Leases</i>			√ Leased assets and/or liabilities not recognized under previous basis of accounting	√ Leased assets and/or liabilities recognized under previous basis of accounting						
IPSAS 14, <i>Events After the Reporting Date</i>	√									

FINANCIAL INSTRUMENTS

IPSAS	Transitional exemption provided									
	NO					YES				
	Deemed cost	3 year transitional relief for recognition	3 year transitional relief for measurement	3 year transitional relief for recognition and/or measurement	3 year transitional relief for disclosure	Elimination of transactions, balances, revenue and expenses				
IPSAS, 16 <i>Investment Property</i>	√	√ Investment property not recognized under previous basis of accounting	√ Investment property recognized under previous basis of accounting							
IPSAS 17, <i>Property, Plant and Equipment</i>	√	√ Property, plant and equipment not recognized under previous basis of accounting	√ Property, plant and equipment recognized under previous basis of accounting							
IPSAS 18, <i>Segment Reporting</i>	√ No segment report to the extent that 3 year relief period was adopted									
IPSAS 19, <i>Provisions, Contingent Liabilities and Contingent Assets</i>		√ Only liabilities related to assets not recognized under previous basis of accounting to be included initial estimate of cost of dismantling/removing item/restoring site	√ Only liabilities related to assets recognized under previous basis of accounting to be included initial estimate of cost of dismantling/removing item/restoring site							
IPSAS 20, <i>Related Party Disclosures</i>					√					
IPSAS 21, <i>Impairment of Non-Cash-Generating Assets</i>										• Prospective application
IPSAS 22, <i>Disclosure of Information About the General Government Sector</i>	√									

IPSAS	Transitional exemption provided									
	NO	YES								
	Deemed cost	3 year transitional relief for recognition	3 year transitional relief for measurement	3 year transitional relief and/or measurement	3 year transitional relief for disclosure	Elimination of transactions, balances, revenue and expenses	Other			
IPSAS 23, Revenue from Non-Exchange Transactions		√ All non-exchange revenue not recognized under previous basis of accounting	√ All non-exchange revenue recognized under previous basis of accounting	√ To extent that 3 year relief period was adopted for assets and/or liabilities						
IPSAS 19, Provisions, Contingent Liabilities and Contingent Assets		√ Only liabilities related to assets not recognized under previous basis of accounting to be included initial estimate of cost of dismantling/removing item/restoring site	√ Only liabilities related to assets recognized under previous basis of accounting to be included initial estimate of cost of dismantling/removing item/restoring site							
IPSAS 20, Related Party Disclosures					√					
IPSAS 21, Impairment of Non-Cash-Generating Assets										• Prospective application
IPSAS 22, Disclosure of Information About the General Government Sector	√									
IPSAS 23, Revenue from Non-Exchange Transactions		√ All non-exchange revenue not recognized under previous basis of accounting	√ All non-exchange revenue recognized under previous basis of accounting	√ To extent that 3 year relief period was adopted for assets and/or liabilities						

FINANCIAL INSTRUMENTS

IPSAS	Transitional exemption provided							Other
	NO	Deemed cost	3 year transitional relief for recognition	3 year transitional relief for measurement	3 year transitional relief for recognition and/or measurement	3 year transitional relief for disclosure	Elimination of transactions, balances, revenue and expenses	
IPSAS 19, Provisions, Contingent Liabilities and Contingent Assets			√ Only liabilities related to assets not recognized under previous basis of accounting to be included initial estimate of cost of dismantling/ removing item/ restoring site	√ Only liabilities related to assets recognized under previous basis of accounting to be included initial estimate of cost of dismantling/ removing item/ restoring site				
IPSAS 20, Related Party Disclosures						√		
IPSAS 21, Impairment of Non-Cash-Generating Assets								• Prospective application
IPSAS 22, Disclosure of Information About the General Government Sector	√							
IPSAS 23, Revenue from Non-Exchange Transactions			√ All non-exchange revenue not recognized under previous basis of accounting	√ All non-exchange revenue recognized under previous basis of accounting	√ To extent that 3 year relief period was adopted for assets and/ or liabilities			
IPSAS 24, Presentation of Budget Information in Financial Statements	√							
IPSAS 25, Employee Benefits (IPSAS 39, Employee Benefits)			√ defined benefit plans and other long-term employee benefits not recognized under previous basis of accounting	√ for defined benefit and other long-term employee benefits recognized under previous basis of accounting				<ul style="list-style-type: none"> • Provisions on how to determine initial liability • Provision to not separate cumulative actuarial gains and losses • Prospective disclosure on experience adjustments
IPSAS 26, Impairment of Cash-Generating Assets			√					• Prospective application

IPSAS	Transitional exemption provided								Other
	NO	YES							
		Deemed cost	3 year transitional relief for recognition	3 year transitional relief for measurement	3 year transitional relief for recognition and/or measurement	3 year transitional relief for disclosure	Elimination of transactions, balances, revenue and expenses		
IPSAS 27, <i>Agriculture</i>			√ Biological and agricultural activities not recognized under previous basis of accounting	√ Biological and agricultural activities recognized under previous basis of accounting					
IPSAS 28, <i>Financial Instruments: Presentation</i>									<ul style="list-style-type: none"> Provisions not to separate liability and net asset/equity component under specific circumstances
IPSAS 29, <i>Financial Instruments: Recognition and Measurement</i>		√	For financial instruments not recognized under previous basis of accounting	√ For financial instruments recognized under previous basis of accounting					<ul style="list-style-type: none"> Provisions around designation/derecognition/hedge accounting Apply impairment principles prospectively
IPSAS 30, <i>Financial Instruments: Disclosures</i>									<ul style="list-style-type: none"> No comparative info about nature and extent of risks
IPSAS 31, <i>Intangible Assets</i>		√	Intangible assets not recognized under previous basis of accounting	√ Intangible assets recognized under previous basis of accounting					<ul style="list-style-type: none"> Provision to recognize previously expensed internally generated intangible assets
IPSAS 32, <i>Service Concession Arrangements: Grantor</i>		√	Service concession asset and related liability not recognized under previous basis of accounting	√ Service concession asset related liability recognized under previous basis of accounting					<ul style="list-style-type: none"> Provision on how to recognize related liability
IPSAS 41, <i>Financial Instruments</i>		√	For financial instruments not recognized under previous basis of accounting	√ For financial instruments recognized under previous basis of accounting					<ul style="list-style-type: none"> Provisions around designation/derecognition/hedge accounting Apply impairment principles prospectively

Appendix

Differentiation between transitional exemptions and provisions that a first-time adopter is required to apply and/or can elect to apply on adoption of accrual basis IPSASs

Transitional exemption or provision	Transitional exemptions or provisions that have to be applied	Transitional exemptions or provisions that may be applied or elected	
		Do not affect fair presentation and compliance with accrual basis IPSAS	Affect fair presentation and compliance with accrual basis IPSAS
IPSAS 1			
<ul style="list-style-type: none"> Present comparative information 		√	
IPSAS 4			
<ul style="list-style-type: none"> Cumulative transitional differences at the date of adoption 		√	
IPSAS 5			
<ul style="list-style-type: none"> Allowed alternative treatment and has taken advantage of relief period 	√		√
<ul style="list-style-type: none"> Adopt allowed alternative treatment on date of adoption – retrospective application 			
<ul style="list-style-type: none"> Adopt bench mark treatment on the date of adoption – retrospective application of costs incurred before and after date of adoption 		√	
IPSAS 6 (IPSAS 35)			
<ul style="list-style-type: none"> Relief to recognize and/or measure interests in controlled entity 			√
<ul style="list-style-type: none"> Elect to not eliminate inter-entity balances, transactions, revenue and expenses 			√
<ul style="list-style-type: none"> Controlled entity becomes first-time adopter later or earlier than its controlling entity 	√		
<ul style="list-style-type: none"> Not present financial statements as consolidated financial statements if three year relief for recognition and/or measurement and/or elimination option was adopted 	√		√
<ul style="list-style-type: none"> <i>Assess if investment entity on date of adoption and determine fair value at that date)</i> 			
IPSAS 7 (IPSAS 36)			
<ul style="list-style-type: none"> Relief to recognize and/or measure interest in associate 			√
<ul style="list-style-type: none"> Elect to not eliminate share in associate’s surplus and deficit 			√
<ul style="list-style-type: none"> Associate becomes first-time adopter later or earlier than its controlling entity 	√		
<ul style="list-style-type: none"> Not present investment in associates in consolidated financial statements if three year relief for recognition and/or measurement and/or elimination option was adopted 			√

FINANCIAL INSTRUMENTS

Transitional exemption or provision	Transitional exemptions or provisions that have to be applied	Transitional exemptions or provisions that may be applied or elected	
		Do not affect fair presentation and compliance with accrual basis IPSAS	Affect fair presentation and compliance with accrual basis IPSAS
IPSAS 8 (<i>IPSAS 36</i>) <ul style="list-style-type: none"> Relief to recognize and/or measure interest in joint venture Elect to not eliminate balances and transactions with jointly controlled entities Joint venture becomes first-time adopter later or earlier than its controlling entity Not present interest in joint venture in consolidated financial statements if three year relief for recognition and/or measurement and/or elimination option was adopted 	√		√
IPSAS 37 <ul style="list-style-type: none"> Measure investment in joint venture previously accounted for using proportionate consolidation 	√		
IPSAS 9 <ul style="list-style-type: none"> Relief for recognition and/or measurement of revenue related to adoption of three year relief period for recognition and/or measurement of financial instruments 			√
IPSAS 10 <ul style="list-style-type: none"> Determine if hyperinflationary economy is subject to severe hyperinflation at the date of adoption Measure assets and liabilities if date of adoption is on or after normalization date 	√		
IPSAS 12 <ul style="list-style-type: none"> Three year relief for recognition and/or measurement of assets and changing the accounting policy to measure assets 			√
IPSAS 13 <ul style="list-style-type: none"> No recognition and/or measurement of finance lease liability and finance lease asset if relief period for recognition and/or measurement of assets is adopted Classification of lease based on circumstances at adoption of accrual basis IPSAS 	√		√
IPSAS 16 <ul style="list-style-type: none"> Three year relief for recognition and/or measurement of assets and changing the accounting policy to measure assets 			√
IPSAS 17 <ul style="list-style-type: none"> Three year relief for recognition and/or measurement of assets and changing the accounting policy to measure assets 			√
IPSAS 18 <ul style="list-style-type: none"> No preparation of segment report within three years of adoption 		√	

FINANCIAL INSTRUMENTS

Transitional exemption or provision	Transitional exemptions or provisions that have to be applied	Transitional exemptions or provisions that may be applied or elected	
		Do not affect fair presentation and compliance with accrual basis IPSAS	Affect fair presentation and compliance with accrual basis IPSAS
IPSAS 19			
<ul style="list-style-type: none"> No recognition and measurement of liability relating to initial estimate of costs of dismantling and removing item if relief for recognition and/or measurement of assets are adopted 			√
IPSAS 20			
<ul style="list-style-type: none"> No disclosure of related party relationships, related party transactions and information about key management personnel 			√
IPSAS 21			
<ul style="list-style-type: none"> Apply impairment provisions prospectively on date of adoption or when assets are recognized when relief period was applied 	√		
IPSAS 25 (IPSAS 39)			
<ul style="list-style-type: none"> Three year relief for recognition and/or measurement of assets and/or liabilities and changing the accounting policy to measure assets and/or liabilities Determine initial liability for defined benefit and other long-term employee benefit plans on date of adoption or when relief period expired Recognize increase/decrease on date of adoption or when relief period expires in opening accumulated surplus/deficit 	√ √		√
IPSAS 26			
<ul style="list-style-type: none"> Apply impairment provisions prospectively on date of adoption or when assets are recognized when relief period was applied 	√		
IPSAS 27			
<ul style="list-style-type: none"> Three year relief for recognition and/or measurement of assets and changing the accounting policy to measure assets 			√
IPSAS 28			
<ul style="list-style-type: none"> Determine if financial instrument has liability and net asset/equity component on date of adoption Do not separate compound financial instrument if no liability exists on date of adoption 	√ √		
IPSAS 29			
<ul style="list-style-type: none"> Three-year relief for recognition and/or measurement of assets and/or liabilities and changing the accounting policy to measure assets and/or liabilities <p><i>Designation</i></p> <ul style="list-style-type: none"> Designate financial asset or liability at fair value through surplus or deficit on date of adoption <p><i>Impairment</i></p> <ul style="list-style-type: none"> Apply impairment provisions prospectively on date of adoption 	√ √		√

FINANCIAL INSTRUMENTS

Transitional exemption or provision	Transitional exemptions or provisions that have to be applied	Transitional exemptions or provisions that may be applied or elected	
		Do not affect fair presentation and compliance with accrual basis IPSAS	Affect fair presentation and compliance with accrual basis IPSAS
IPSAS 29 <i>Derecognition</i>			
<ul style="list-style-type: none"> Apply derecognition provisions prospectively on date of adoption Apply derecognition provisions retrospectively if information is available as at the date of initial accounting 	√	√	
IPSAS 29 <i>Hedge accounting</i>			
<ul style="list-style-type: none"> Measure derivatives at fair value Eliminate all deferred losses and gains Only reflect hedges that qualify for hedge accounting on date of adoption Discontinue hedge transaction if conditions of hedge accounting on date of adoption are not met 	√ √ √ √		
IPSAS 30			
<ul style="list-style-type: none"> No disclosure of information about nature and extent of risks 		√	
IPSAS 31			
<ul style="list-style-type: none"> Three year relief for recognition and/or measurement of assets and changing the accounting policy to measure assets Recognize all internally generated intangible assets 	√		√
IPSAS 32			
<ul style="list-style-type: none"> Three year relief for recognition and/or measurement of assets and/or liabilities and changing the accounting policy to measure assets and/or liabilities Measure liability either under financial liability model or grant of a right to the operator model on date of adoption or when asset is recognized if relief period is adopted. 	√		√
Applying deemed cost to assets and/or liabilities		√	
Applying deemed cost to assets acquired in a non-exchange transaction		√	
Using deemed cost for investments in controlled entities, jointly controlled entities and associates		√	
Preparing reconciliations during transitional period	√		

FINANCIAL INSTRUMENTS

Transitional exemption or provision	Transitional exemptions or provisions that have to be applied	Transitional exemptions or provisions that may be applied or elected	
		Do not affect fair presentation and compliance with accrual basis IPSAS	Affect fair presentation and compliance with accrual basis IPSAS
<p>IPSAS 41</p> <ul style="list-style-type: none"> • <u>Three-year relief for recognition and/or measurement of assets and/or liabilities and changing the accounting policy to measure assets and/or liabilities</u> <p><i>Designation</i></p> <ul style="list-style-type: none"> • <u>Designate financial asset or liability at fair value through surplus or deficit on date of adoption</u> <p><i>Impairment</i></p> <ul style="list-style-type: none"> • <u>Apply impairment provisions prospectively on date of adoption</u> 	<p>√</p> <p>√</p>		<p>√</p>
<p>IPSAS 41</p> <p><i>Derecognition</i></p> <ul style="list-style-type: none"> • <u>Apply derecognition provisions prospectively on date of adoption</u> • <u>Apply derecognition provisions retrospectively if information is available as at the date of initial accounting</u> 	<p>√</p>	<p>√</p>	
<p><i>Hedge accounting</i></p> <ul style="list-style-type: none"> • <u>Measure derivatives at fair value</u> • <u>Eliminate all deferred losses and gains</u> • <u>Only reflect hedges that qualify for hedge accounting on date of adoption</u> • <u>Discontinue hedge transaction if conditions of hedge accounting on date of adoption are not met</u> 	<p>√</p> <p>√</p> <p>√</p> <p>√</p>		

...

IPSAS 34, Separate Financial Statements

Paragraphs 6, 12, 13, 14, 15, 22, 26 and 30 are amended and paragraph 32B is added. New text is underlined and deleted text is struck through.

...

Definitions

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

Consolidated financial statements are the financial statements of an economic entity in which the assets, liabilities, net assets/equity, revenue, expenses and cash flows of the controlling entity and its controlled entities are presented as those of a single economic entity.

Separate financial statements are those presented by an entity, in which the entity could elect, subject to the requirements in this Standard, to account for its investments in controlled entities, joint ventures and associates either at cost, in accordance with IPSAS 41, *Financial Instruments* ~~IPSAS 29, *Financial Instruments: Recognition and Measurement*~~ or using the equity method as described in IPSAS 36, *Investments in Associates and Joint Ventures*.

Terms defined in other IPSASs are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately. The following terms are defined in IPSAS 35, *Consolidated Financial Statements*, IPSAS 36, *Investments in Associates and Joint Ventures* or IPSAS 37, *Joint Arrangements*: associate, control, controlled entity, controlling entity, economic entity, equity method, investment entity, joint control, joint operation, joint venture, joint venturer and significant influence.

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Preparation of Separate Financial Statements

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12. When an entity prepares separate financial statements, it shall account for similar investments in controlled entities, joint ventures and associates either:

- (a) At cost;
- (b) In accordance with IPSAS 41 ~~IPSAS 29~~; or
- (c) Using the equity method as described in IPSAS 36.

13. If an entity elects, in accordance with paragraph 24 of IPSAS 36, to measure its investments in associates or joint ventures at fair value through surplus or deficit in accordance with IPSAS 41 ~~IPSAS 29~~, it shall also account for those investments in the same way in its separate financial statements.

14. If a controlling entity is required, in accordance with paragraph 56 of IPSAS 35, to measure its investment in a controlled entity at fair value through surplus or deficit in accordance with IPSAS 41 ~~IPSAS 29~~, it shall also account for that investment in the same way in its separate financial statements. If a controlling entity that is not itself an investment entity is required, in accordance with paragraph 58 of IPSAS 35, to measure the investments of a controlled investment entity at fair value through surplus or deficit in accordance with IPSAS 41 ~~IPSAS 29~~ and consolidate the other assets and liabilities and revenue and expenses of the controlled investment entity, it shall also account for that investment in the controlled investment entity in the same way in its separate financial statements.

15. When a controlling entity ceases to be an investment entity, or becomes an investment entity, it shall account for the change from the date when the change in status occurred, as follows:

- (a) When an entity ceases to be an investment entity, the entity shall account for an investment in a controlled entity in accordance with paragraph 12. The date of the change of status shall be the deemed acquisition date. The fair value of the controlled entity at the deemed acquisition date shall represent the transferred deemed consideration when accounting for the investment in accordance with paragraph 12.
- (b) When an entity becomes an investment entity, it shall account for an investment in a controlled entity at fair value through surplus or deficit in accordance with IPSAS 41 ~~IPSAS 29~~. The difference between the previous carrying amount of the controlled entity and its fair value at the date of the change of status of the

investor shall be recognized as a gain or loss in surplus or deficit. The cumulative amount of any gain or loss previously recognized directly in net assets/equity in respect of those controlled entities shall be treated as if the investment entity had disposed of those controlled entities at the date of change in status.

...

Disclosure

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22. If a controlling entity that is not itself an investment entity is required, in accordance with paragraph 56 of IPSAS 35, to measure the investments of a controlled investment entity at fair value through surplus or deficit in accordance with IPSAS 41 ~~IPSAS 29~~ and consolidate the other assets and liabilities and revenue and expenses of the controlled investment entity, it shall disclose that fact. The entity shall also present the disclosures relating to investment entities required by IPSAS 38, *Disclosure of Interests in Other Entities*.

...

Transitional Provisions

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26. At the date of initial application, an investment entity shall not make adjustments to the previous accounting for an interest in a controlled entity that it had previously elected to measure at fair value through surplus or deficit in accordance with IPSAS 41 ~~IPSAS 29~~, as permitted in paragraph 12.

...

30. At the date of initial application, a controlling entity that is not itself an investment entity but which is required, in accordance with paragraph 56 of IPSAS 35, to measure the investments of a controlled investment entity at fair value through surplus or deficit in accordance with IPSAS 41 ~~IPSAS 29~~ and consolidate the other assets and liabilities and revenue and expenses of the controlled investment entity, shall use the transitional provisions in paragraphs 24–29 in accounting for its investment in the controlled investment entity in its separate financial statements.

...

Effective Date

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- 32B. Paragraphs 6, 12, 13, 14, 15, 22, 26 and 30 were amended by IPSAS 41, issued in August 2018. An entity shall apply these amendment for annual financial statements covering periods beginning on or after January 1, 2022. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2022 it shall disclose that fact and apply IPSAS 41 at the same time.

...

~~Basis for Conclusions~~

This Basis for Conclusions accompanies, but is not part of, IPSAS 34.

...

Use of the Equity Method in Separate Statements

- BC3. IPSAS 6 permitted an entity, in its separate financial statements, to measure investments in controlled entities, jointly controlled entities and associates:
- (a) Using the equity method;
 - (b) At cost; or
 - (c) As a financial instrument in accordance with IPSAS 41 ~~IPSAS 29~~.

...

- BC6. The IPSASB decided to continue to permit the use of the equity method in separate financial statements for the following reasons:

- (a) The equity method is a well-established method of accounting for certain investments in the public sector. In many circumstances where investments are held by public sector entities, the equity method can provide information that is reliable and useful, and possibly at a lower cost than either the cost method or the fair value method. In the public sector, investment entities are often used more as “instruments” to enable service provision, rather than as a holding for investment purposes, as might generally be the case in the private sector. The equity method may therefore, in some circumstances, be better suited to meeting user needs in the public sector, as it allows the financial statements to portray the fluctuations in the equity of, and performance by, an investment over time, in a cost effective and easily understood manner.
- (b) Although application of the cost method is often relatively straightforward, where investments have been held for some time, using the cost method may result in outdated and less relevant information, in which case, it would not meet user needs.
- (c) In the public sector there is likely to be a higher proportion of investments for which there are no active markets and in respect of which fair values are not readily observable. Although the guidance in IPSAS 41 ~~IPSAS 29~~ can be used to derive a value for such investments, the IPSASB considered that this approach would generally result in information that did not faithfully represent the underlying circumstances.

...

Separate Financial Statements of Investment Entities

- BC8. In developing IPSAS 35 the IPSASB decided to introduce the concept of investment entities and to require that a controlling entity that is an investment entity measure its investments in most controlled entities at fair value through surplus or deficit in accordance with IPSAS 41 ~~IPSAS 29~~. Consequently, the IPSASB decided to require that an investment entity measure its investments in controlled entities at fair value through surplus or deficit in its separate financial statements. The IPSASB also decided that an investment entity preparing separate financial statements as its only financial statements, should also make the disclosures required in IPSAS 38 about its interests in controlled entities.
- BC9. The IPSASB also decided to require a controlling entity of an investment entity that is not itself an investment entity to present consolidated financial statements in which it (i) measures the investments of a controlled investment entity at fair value through surplus or deficit in accordance with IPSAS 41 ~~IPSAS 29~~ and (ii) consolidates the other assets and liabilities and revenue and expenses of the controlled investment entity. Consequently, the IPSASB decided to require that a non-investment controlling entity should measure its investment in a controlled investment entity in the same way in its separate financial statements.

...

IPSAS 35, Consolidated Financial Statements

Paragraphs 22, 45, 52, 55A, 56, 58 and AG105 are amended and paragraph 79E is added. New text is underlined and deleted text is struck through.

...

Control

...

22. Two or more entities collectively control another entity when they must act together to direct the relevant activities. In such cases, because no single entity can direct the activities without the co-operation of the others, no single entity controls the other entity. Each entity would account for its interest in the other entity in accordance with the relevant IPSASs, such as IPSAS 36, IPSAS 37, or the IPSASs dealing with financial instruments (IPSAS 28, *Financial Instruments: Presentation*, ~~IPSAS 29, *Financial Instruments: Recognition and Measurement*, and~~ IPSAS 30, *Financial Instruments: Disclosures*, and IPSAS 41, *Financial Instruments*).

...

Potential Voting Rights

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45. IPSAS 28 and IPSAS 41 ~~IPSAS 29~~ do not apply to interests in controlled entities that are consolidated. When instruments containing potential voting rights in substance currently give access to the benefits associated with an ownership interest in a controlled entity, the instruments are not subject to the requirements of IPSAS 28 and IPSAS 41 ~~IPSAS 29~~. In all other

cases, instruments containing potential voting rights in a controlled entity are accounted for in accordance with IPSAS 28 and IPSAS 41 ~~IPSAS 29~~.

...

Loss of Control

52. **If a controlling entity loses control of a controlled entity, the controlling entity:**
- (a) **Derecognizes the assets and liabilities of the former controlled entity from the consolidated statement of financial position;**
 - (b) **Recognizes any investment retained in the former controlled entity and subsequently accounts for it and for any amounts owed by or to the former controlled entity in accordance with relevant IPSASs. That retained interest is remeasured, as described in paragraphs 54(b)(iii) and 55A. The remeasured value at the date that control is lost shall be regarded as the fair value on initial recognition of a financial asset in accordance with IPSAS 41 ~~IPSAS 29~~ or the cost on initial recognition of an investment in an associate or joint venture, if applicable; and**
 - (c) **Recognizes the gain or loss associated with the loss of control attributable to the former controlling interest, as specified in paragraphs 54–55A.**

...

- 55A. **If a controlling entity loses control of a controlled entity that does not contain an operation, as defined in IPSAS 40, as a result of a transaction involving an associate or a joint venture that is accounted for using the equity method, the controlling entity determines the gain or loss in accordance with paragraphs 54–55. The gain or loss resulting from the transaction is recognized in the controlling entity’s surplus or deficit only to the extent of the unrelated investors’ interests in that associate or joint venture. The remaining part of the gain is eliminated against the carrying amount of the investment in that associate or joint venture. In addition, if the controlling entity retains an investment in the former controlled entity and the former controlled entity is now an associate or a joint venture that is accounted for using the equity method, the controlling entity recognizes the part of the gain or loss resulting from the remeasurement at fair value of the investment retained in that former controlled entity in its surplus or deficit only to the extent of the unrelated investors’ interests in the new associate or joint venture. The remaining part of that gain is eliminated against the carrying amount of the investment retained in the former controlled entity. If the controlling entity retains an investment in the former controlled entity that is now accounted for in accordance with IPSAS 41 ~~IPSAS 29~~, the part of the gain or loss resulting from the remeasurement at fair value of the investment retained in the former controlled entity is recognized in full in the controlling entity’s surplus or deficit.**

Investment Entities: Fair Value Requirement

56. **Except as described in paragraph 57, an investment entity shall not consolidate its controlled entities or apply IPSAS 40 when it obtains control of another entity. Instead, an investment entity shall measure an investment in a controlled entity at fair value through surplus or deficit in accordance with IPSAS 41 ~~IPSAS 29~~.**

...

58. **A controlling entity of an investment entity that is not itself an investment entity shall present consolidated financial statements in which it (i) measures the investments of a controlled investment entity at fair value through surplus or deficit in accordance with IPSAS 41 ~~IPSAS 29~~ and (ii) consolidates the other assets and liabilities and revenue and expenses of the controlled investment entity in accordance with paragraphs 38–55 of this Standard.**

...

Effective Date

...

- 79E. Paragraphs 22, 45, 52, 55A, 56, 58 and AG105 were amended by IPSAS 41, issued in August 2018. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2022. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2022 it shall disclose that fact and apply IPSAS 41 at the same time.

...

Application Guidance

This Appendix is an integral part of IPSAS 35.

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Fair Value Measurement

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AG105. In order to meet the requirement in AG104(a), an investment entity would:

- (a) Elect to account for any investment property using the fair value model in IPSAS 16, Investment Property;
- (b) Elect the exemption from applying the equity method in IPSAS 36 for its investments in associates and joint ventures; an
- (c) Measure its financial assets at fair value using the requirements in IPSAS 41 ~~IPSAS 29~~.

...

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 35.

...

Investment Entities

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BC29. The IPSASB considered what type of information users would find most useful about a controlled investment entity. The IPSASB considered that users would find it most useful if the accounting for investments applied in a controlled investment entity's financial statements were extended to its controlling entity's financial statements. The IPSASB therefore proposed that a controlling entity with a controlled investment entity should be required to present consolidated financial statements in which it (i) measures the investments of the controlled investment entity at fair value through surplus or deficit in accordance with IPSAS 41 ~~IPSAS 29~~ and (ii) consolidates the other assets and liabilities and revenue and expenses of the controlled investment entity in accordance with the usual consolidation accounting policies required by the Standard. The IPSASB considered that its proposals reflect the fact that a controlling entity does not manage an investment entity itself on a fair value basis. Rather, it manages the investments of the investment entity on a fair value basis. This approach is also consistent with the accounting by an investment entity for its investments in other entities.

...

Amendments to IPSAS 36, *Investments in Associates and Joint Ventures*

Paragraphs 20, 24, 25, 26, 43, 44 and 45 are amended and paragraphs 44A, 44B, 44C and 51D are added. New text is underlined and deleted text is struck through.

...

Equity Method

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20. IPSAS 41, *Financial Instruments* ~~IPSAS 29, *Financial Instruments: Recognition and Measurement*~~ does not apply to interests in associates and joint ventures that are accounted for using the equity method. When instruments containing potential voting rights in substance currently give access to the benefits associated with an ownership interest in an associate or a joint venture, the instruments are not subject to IPSAS 41 ~~IPSAS 29~~. In all other cases, instruments containing potential voting rights in an associate or a joint venture are accounted for in accordance with IPSAS 41 ~~IPSAS 29~~.

...

Application of the Equity Method

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24. When an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organization, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure investments in those associates and joint ventures at fair value through surplus or deficit in accordance with IPSAS 41 ~~IPSAS 29~~. An investment entity will, by definition, have made this election.
25. When an entity has an investment in an associate, a portion of which is held indirectly through a venture capital organization, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure that portion of the investment in the associate at fair value through surplus or deficit in accordance with IPSAS 41 ~~IPSAS 29~~ regardless of whether the venture capital organization, or the mutual fund, unit trust and similar entities including investment-linked insurance funds, has significant influence over that portion of the investment. If the entity makes that election, the entity shall apply the equity method to any remaining portion of its investment in an associate that is not held through a venture capital organization, or a mutual fund, unit trust and similar entities including investment-linked insurance funds. When an entity has an investment in an associate, a portion of which is held indirectly through an investment entity, the entity shall measure that portion of the investment at fair value through surplus or deficit in accordance with IPSAS 41 ~~IPSAS 29~~.

Discontinuing the Use of the Equity Method

26. **An entity shall discontinue the use of the equity method from the date when its investment ceases to be an associate or a joint venture as follows:**
- (a) **If the investment becomes a controlled entity, the entity shall account for its investment in accordance with the relevant national or international pronouncement dealing with public sector combinations and IPSAS 35.**
 - (b) **If the retained interest in the former associate or joint venture is a financial asset, the entity shall measure the retained interest at fair value. The fair value of the retained interest shall be regarded as its fair value on initial recognition as a financial asset in accordance with IPSAS 41 ~~IPSAS 29~~. ~~If an entity is precluded by IPSAS 29, paragraphs AG113 and AG114 from measuring the retained interest at fair value, the entity shall measure the retained interest at the carrying amount of the investment at the date that it ceases to be an associate or joint venture and that carrying amount shall be regarded as its cost on initial recognition as a financial asset in accordance with IPSAS 29.~~ The entity shall recognize in surplus or deficit any difference between:

 - (i) ~~The fair value (or, where relevant, the carrying amount)~~ of any retained interest and any proceeds from disposing of a part interest in the associate or joint venture; and
 - (ii) The carrying amount of the investment at the date the equity method was discontinued.**
 - (c) **When an entity discontinues the use of the equity method, the entity shall account for all amounts previously recognized directly in the entity's net assets/equity in relation to that investment on the same basis as would have been required if the investee had directly disposed of the related assets or liabilities.**

...

Impairment Losses

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43. After application of the equity method, including recognizing the associate's or joint venture's deficits in accordance with paragraph 41, the entity applies paragraphs 44A–44C ~~IPSAS 29~~ to determine whether there ~~it is necessary to recognize any objective evidence that~~ additional impairment loss with respect to its net investment in the associate or joint venture is impaired.
44. ~~The entity also applies IPSAS 29 to determine whether any additional impairment loss is recognized with respect to the impairment requirements in IPSAS 41 to its other interests~~ interest in the associate or joint venture that are in scope of IPSAS 41 and that do ~~does not constitute part of the net investment and the amount of that impairment loss.~~
- 44A. The net investment in an associate or joint venture is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the net investment (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows from the net investment that can be reliably estimated. It may not be possible to identify a single, discrete event that caused the impairment. Rather the combined effect of several events may have caused the impairment. Losses expected as a result of future events, no matter how likely, are not recognized. Objective evidence that the net investment is impaired includes observable data that comes to the attention of the entity about the following loss events:

- (a) Significant financial difficulty of the associate or joint venture;
- (b) A breach of contract, such as a default or delinquency in payments by the associate or joint venture;
- (c) The entity, for economic or legal reasons relating to its associate's or joint venture's financial difficulty, granting to the associate or joint venture a concession that the entity would not otherwise consider;
- (d) It becoming probable that the associate or joint venture will enter bankruptcy or other financial reorganization; or
- (e) The disappearance of an active market for the net investment because of financial difficulties of the associate or joint venture.

44B. The disappearance of an active market because the associate's or joint venture's equity or financial instruments are no longer publicly traded is not evidence of impairment. A downgrade of an associate's or joint venture's credit rating or a decline in the fair value of the associate or joint venture, is not of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information.

44C. In addition to the types of events in paragraph 44A, objective evidence of impairment for the net investment in the equity instruments of the associate or joint venture includes information about significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the associate or joint venture operates, and indicates that the cost of the investment in the equity instrument may not be recovered. A significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is also objective evidence of impairment.

45. Whenever application of paragraphs 44A–44C IPSAS 29 indicates that the investment in an associate or a joint venture may be impaired, an entity applies IPSAS 26, *Impairment of Cash-Generating Assets*, and possibly, IPSAS 21, *Impairment of Non-Cash-Generating Assets*.

...

Effective Date

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51D. Paragraphs 20, 24, 25, 26, 43, 44 and 45 were amended and paragraphs 44A, 44B and 44C were added by IPSAS 41, issued in August 2018. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2022. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2022 it shall disclose that fact and apply IPSAS 41 at the same time.

...

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 36.

...

Investment Entities

BC11. Some respondents to ED 50 requested that the IPSASB clarify the application of the equity method by investment entities and by investors with investments in an associate or a joint venture that is an investment entity. Accordingly the IPSASB:

- (a) Clarified that an investment entity will, by definition, have elected to account for investments in associates and joint ventures at fair value through surplus or deficit in accordance with IPSAS 41 IPSAS 29; and
- (b) Required that an entity with an interest in an investment entity associate or an investment entity joint venture, shall, when applying the equity method, retain the fair value measurement applied by that investment entity associate or investment entity joint venture to its interests in controlled entities.

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Amendments to IPSAS 37, Joint Arrangements

Paragraphs 28, 30, 41, AG11 and AG33A are amended and 42D is added. New text is underlined and deleted text is struck through.

...

Joint Ventures

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28. A party that participates in, but does not have joint control of, a joint venture shall account for its interest in the arrangement in accordance with the IPSASs dealing with financial instruments, being IPSAS 28, *Financial Instruments: Presentation*, ~~IPSAS 29, *Financial Instruments: Recognition and Measurement*~~, and IPSAS 30, *Financial Instruments: Disclosures*, and IPSAS 41, *Financial Instruments* unless it has significant influence over the joint venture, in which case it shall account for it in accordance with IPSAS 36.

...

Separate Financial Statements

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30. In its separate financial statements, a party that participates in, but does not have joint control of, a joint arrangement shall account for its interest in:
- (a) A joint operation in accordance with paragraph 26; and
 - (b) A joint venture in accordance with IPSAS 41 ~~IPSAS 29~~, unless the entity has significant influence over the joint venture, in which case it shall apply paragraph 12 of IPSAS 34.

...

Transitional Provisions in an Entity's Separate Financial Statement

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41. An entity that, in accordance with paragraph 58 of IPSAS 6, *Consolidated and Separate Financial Statements*, was previously accounting in its separate financial statements for its interest in a joint operation as an investment using the equity method, at cost or in accordance with IPSAS 41 ~~IPSAS 29~~ shall:
- (a) Derecognize the investment and recognize the assets and the liabilities in respect of its interest in the joint operation at the amounts determined in accordance with paragraphs 37–39.
 - (b) Provide a reconciliation between the investment derecognized, and the assets and liabilities recognized, together with any remaining difference adjusted in accumulated surplus or deficit, at the beginning of the immediately preceding period.

...

Effective Date

...

- 42D. Paragraphs 28, 30, 41, AG11 and AG33A were amended by IPSAS 41, issued in August 2018. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2022. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2022 it shall disclose that fact and apply IPSAS 41 at the same time.

...

Application Guidance

This Appendix accompanies, but is not part of, IPSAS 37.

...

Joint Control (paragraphs 12–18)

...

- AG11. When an arrangement is outside the scope of IPSAS 37, *Joint Arrangements*, an entity accounts for its interest in the arrangement in accordance with relevant IPSASs, such as IPSAS 35, IPSAS 36, *Investments in Associates and Joint Ventures* or IPSAS 41, *Financial Instruments* ~~IPSAS 29, *Financial Instruments: Recognition and Measurement*~~.

...

Financial Statements of Parties to a Joint Arrangement (paragraphs 23–28)

Accounting for acquisitions of interests in joint operations

AG33A. When an entity acquires an interest in a joint operation in which the activity of the joint operation constitutes an operation, as defined in IPSAS 40, it shall apply, to the extent of its share in accordance with paragraph 23, all of the principles on acquisition accounting in IPSAS 40, and other IPSASs, that do not conflict with the guidance in this Standard and disclose the information required by those IPSASs in relation to acquisitions. The principles on acquisition accounting that do not conflict with the guidance in this Standard include but are not limited to:

- (a) Measuring identifiable assets and liabilities at fair value, other than items for which exceptions are given in IPSAS 40 and other IPSASs;
- (b) Recognizing acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with the exception that the costs to issue debt or equity securities are recognized in accordance with IPSAS 28 and IPSAS 41 ~~IPSAS 29~~;
- (c) Recognizing the excess of the consideration transferred over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed, if any, as goodwill; and
- (d) Testing for impairment a cash-generating unit to which goodwill has been allocated at least annually, and whenever there is an indication that the unit may be impaired, as required by IPSAS 26, *Impairment of Cash-Generating Assets*, for goodwill acquired in an acquisition.

...

Amendments to IPSAS 38, *Disclosure of Interests in Other Entities*

Paragraph 4 is amended and paragraphs 61C is added. New text is underlined and deleted text is struck through.

...

Scope

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4. This Standard does not apply to:

- (a) **Post-employment benefit plans or other long-term employee benefit plans to which IPSAS 39, *Employee Benefits* applies.**
- (b) **An entity's separate financial statements to which IPSAS 34, *Separate Financial Statements*, applies. However:**
 - (i) **If an entity has interests in structured entities that are not consolidated and prepares separate financial statements as its only financial statements, it shall apply the requirements in paragraphs 40–48 when preparing those separate financial statements.**
 - (ii) **An investment entity that prepares financial statements in which all of its controlled entities are measured at fair value through surplus or deficit in accordance with paragraph 56 of IPSAS 35 shall present the disclosures relating to investment entities required by this Standard.**
- (c) **An interest held by an entity that participates in, but does not have joint control of, a joint arrangement unless that interest results in significant influence over the arrangement or is an interest in a structured entity.**
- (d) **An interest in another entity that is accounted for in accordance with IPSAS 41, *Financial Instruments* ~~IPSAS 29, *Financial Instruments: Recognition and Measurement*~~. However, an entity shall apply this Standard:**
 - (i) **When that interest is an interest in an associate or a joint venture that, in accordance with IPSAS 36, *Investments in Associates and Joint Ventures*, is measured at fair value through surplus or deficit; or**
 - (ii) **When that interest is an interest in a structured entity that is not consolidated.**

...

Effective Date

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61C. Paragraph 4 was amended by IPSAS 41, in August 2018. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2022. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2022 it shall disclose that fact and apply IPSAS 41 at the same time.

...

Amendments to IPSAS 40, *Public Sector Combinations*

Paragraphs 25, 45, 70, 111, 115, 117 and AG88 are amended and paragraph 126A is added. New text is underlined and deleted text is struck through.

...

Classifying or Designating Assets and Liabilities in an Amalgamation

...

25. In some situations, IPSASs provide for different accounting depending on how an entity classifies or designates a particular asset or liability. Examples of classifications or designations that the resulting entity shall make on the basis of the classifications or designations previously applied by the combining operations include but are not limited to:

- (a) Classification of particular financial assets and liabilities as measured at fair value through surplus or deficit or at amortized cost, or measured at fair value through net assets/equity in accordance with IPSAS 41, *Financial Instruments* ~~IPSAS 29, *Financial Instruments: Recognition and Measurement*~~;
- (b) Designation of a derivative instrument as a hedging instrument in accordance with IPSAS 41 ~~IPSAS 29~~; and
- (c) Assessment of whether an embedded derivative should be separated from a host contract in accordance with IPSAS 41 ~~IPSAS 29~~ (which is a matter of ‘classification’ as this Standard uses that term).

...

Amalgamation-Related Costs

...

45. Amalgamation-related costs are costs the resulting entity or combining operations incur to effect an amalgamation. Those costs include advisory, legal, accounting, valuation and other professional or consulting fees; general administrative costs; and any costs of registering and issuing debt and equity securities. The resulting entity and combining operations shall account for amalgamation-related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception. The costs to issue debt or equity securities shall be recognized in accordance with IPSAS 28, *Financial Instruments: Presentation*, and IPSAS 41, *Financial Instruments* ~~IPSAS 29~~.

...

Classifying or Designating Identifiable Assets Acquired and Liabilities Assumed in an Acquisition

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70. In some situations, IPSASs provide for different accounting depending on how an entity classifies or designates a particular asset or liability. Examples of classifications or designations that the acquirer shall make on the basis of the pertinent conditions as they exist at the acquisition date include but are not limited to:

- (a) Classification of particular financial assets and liabilities as measured at fair value through surplus or deficit or at amortized cost, or as a financial asset measured at fair value through net assets/equity in accordance with IPSAS 41 ~~IPSAS 29~~;
- (b) Designation of a derivative instrument as a hedging instrument in accordance with IPSAS 41 ~~IPSAS 29~~; and
- (c) Assessment of whether an embedded derivative should be separated from a host contract in accordance with IPSAS 41 ~~IPSAS 29~~ (which is a matter of ‘classification’ as this Standard uses that term).

...

Acquisition-Related Costs

111. Acquisition-related costs are costs the acquirer incurs to effect an acquisition. Those costs include finder's fees; advisory, legal, accounting, valuation and other professional or consulting fees; general administrative costs, including the costs of maintaining an internal acquisitions department; and costs of registering and issuing debt and equity securities. The acquirer shall account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception. The costs to issue debt or equity securities shall be recognized in accordance with IPSAS 28 and IPSAS 41 ~~IPSAS 29~~.

Subsequent Measurement and Accounting

...

Contingent Liabilities

115. After initial recognition and until the liability is settled, canceled or expires, the acquirer shall measure a contingent liability recognized in an acquisition at the higher of:
- (a) The amount that would be recognized in accordance with IPSAS 19; and
 - (b) The amount initially recognized less, if appropriate, cumulative amortization recognized in accordance with IPSAS 9, *Revenue from Exchange Transactions*.

This requirement does not apply to contracts accounted for in accordance with IPSAS 41, *Financial Instruments* ~~IPSAS 29~~.

...

Contingent Consideration

117. Some changes in the fair value of contingent consideration that the acquirer recognizes after the acquisition date may be the result of additional information that the acquirer obtained after that date about facts and circumstances that existed at the acquisition date. Such changes are measurement period adjustments in accordance with paragraphs 102–106. However, changes resulting from events after the acquisition date, such as meeting an earnings target, reaching a specified share price or reaching a milestone on a research and development project, are not measurement period adjustments. The acquirer shall account for changes in the fair value of contingent consideration that are not measurement period adjustments as follows:
- (a) Contingent consideration classified as a component of net assets/equity shall not be remeasured and its subsequent settlement shall be accounted for within net assets/equity.
 - (b) Other contingent consideration that:
 - (i) Is within the scope of IPSAS 41 ~~IPSAS 29~~ shall be measured at fair value at each reporting date and changes in fair value shall be recognized in surplus or deficit in accordance with IPSAS 41 ~~IPSAS 29~~.
 - (ii) Is not within the scope of IPSAS 41 ~~IPSAS 29~~ shall be measured at fair value at each reporting date and changes in fair value shall be recognized in surplus or deficit.

...

Effective Date

...

- 126A. Paragraphs 25, 45, 70, 111, 115, 117 and AG88 were amended by IPSAS 41, issued in August 2018. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2022. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2022 it shall disclose that fact and apply IPSAS 41 at the same time.

...

Application Guidance

This Appendix is an integral part of IPSAS 40.

...

Measuring the fair value of particular identifiable assets and a non-controlling interest in an acquired operation in an acquisition (see paragraphs 72–73)

Assets with Uncertain Cash Flows (Valuation Allowances)

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AG88. The acquirer shall not recognize a separate valuation allowance as of the acquisition date for assets acquired in an acquisition that are measured at their acquisition-date fair values because the effects of uncertainty about future cash flows are included in the fair value measure. For example, because this IPSAS requires the acquirer to measure acquired receivables, including loans, at their acquisition-date fair values in accounting for an acquisition, the acquirer does not recognize a separate valuation allowance for the cash flows of the binding arrangement that are deemed to be uncollectible at that date or a loss allowance for expected credit losses.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 41.

Introduction

- BC1. This Basis for Conclusions summarizes the IPSASB's considerations in reaching the conclusions in IPSAS 41, *Financial Instruments*. As this Standard is based on IFRS 9, *Financial Instruments* issued by the IASB, the Basis for Conclusions outlines only those areas where IPSAS 41 departs from the main requirements of IFRS 9.
- BC2. In July 2014, the IASB published the final version of IFRS 9, which brings together the classification and measurement, impairment and hedge accounting phases of the IASB's project to replace IAS 39, *Financial Instruments*. In 2016, the IPSASB commenced work on a project to update those IPSASs that dealt with accounting for financial instruments as part of the IPSASB's convergence program which aims to converge IPSASs with IFRSs. The text of IPSAS 41 is based on the requirements of IFRS 9, modified as appropriate for public sector entities and to reflect the requirements of other IPSASs. This new IPSAS replaces IPSAS 29, while providing entities a transition option to continue to apply the hedge accounting requirements of IPSAS 29.
- BC3. When developing IPSAS 41, the IPSASB acknowledged that there are other financial instruments and items with some financial instruments' characteristics as defined in IPSAS 41 to the public sector, and which are not addressed in IFRS 9. The IPSASB has undertaken separate projects on *Public Sector Specific Financial Instruments*, and *Revenue and Transfer Expenses*, to address:
- (a) Certain transactions undertaken by monetary authorities; and
 - (b) Receivables and payables that arise from arrangements that are, in substance, similar to, and have the same economic effect as, financial instruments, but are not contractual in nature.

Public Sector Specific Financial Instruments

- BC3A. The Public Sector Specific Financial Instruments (PSSFI) project arose because, in developing IPSAS 28, *Financial Instruments: Presentation*, IPSAS 29, *Financial Instruments: Recognition and Measurement*, and IPSAS 30, *Financial Instruments: Disclosures*, the IPSASB identified several items with characteristics that might make them public sector specific financial instruments (PSSFIs). These items were:
- Monetary gold;
 - International Monetary Fund (IMF) quota subscriptions;
 - IMF Special Drawing Rights (SDRs);
 - Currency in circulation;
 - Statutory receivables and payables;
 - Concessionary loans; and
 - Financial guarantee contracts.
- BC3B. Of the items listed in BC3A, two public sector specific items — concessionary loans and financial guarantee contracts issued through non-exchange transactions — meet the definition of a financial instrument and thus were addressed in the application guidance in IPSAS 41. Neither statutory receivables nor payables are contractual, and so do not meet the definition of a financial instrument. The IPSASB agreed to address these instruments in a separate project.
- BC3C. The IPSASB agreed to address the remaining public sector specific items in a PSSFI project. In July 2016, the IPSASB issued a Consultation Paper (CP), *Public Sector Specific Financial Instruments* which provided a detailed analysis of these items. This analysis included definitions, which were developed to reflect the substance of these items as well as conventions included in IPSAS and discussions by the IPSASB related to the transactions in an accounting context. The IPSASB intended for these definitions to have the same substance as guidance included in the various Government Finance Statistics manuals referenced.
- BC3D. Respondents to the CP agreed that:
- (a) Several of the items meet the definition of a financial instrument in IPSAS and therefore should be addressed in existing guidance; and

- (b) Items that meet the IPSAS definition of a financial instrument should be accounted for in accordance with existing IPSAS accounting principles.

In considering these responses to the CP, the IPSASB concluded, where possible, that PSSFIs should be addressed in the current financial instruments standards and the scope should be retained. This eliminated the need to incorporate the detailed analysis and definitions from the CP in non-authoritative amendments to IPSAS 41 as sufficient principles exist in IPSAS 41 to account for PSSFI items.

- BC3E. The IPSASB noted that additional non-authoritative guidance would help users identify these specific financial items that are (or share characteristics of) financial instruments, and developed additional implementation guidance for monetary gold, currency in circulation, and SDRs. However, the IPSASB noted IMF quota subscriptions share a number of features with those in Illustrative Example 32 in IPSAS 41 and decided that additional guidance for quota subscriptions was not required. The IPSASB concluded that the additional illustrative examples and augmented implementation guidance provide appropriate guidance for accounting for monetary gold, currency in circulation, and SDRs.
- BC3F. The IPSASB issued Exposure Draft (ED) 69 in August 2019 that proposed non-authoritative amendments to IPSAS 41 to illustrate the application of IPSAS 41 to PSSFIs. These amendments included the non-authoritative guidance noted in BC3E. Respondents to the ED supported the additional non-authoritative guidance provided by the IPSASB and the amendments proposed in the ED.
- BC4. In developing this Standard, the IPSASB agreed to retain the existing text of IFRS 9 wherever consistent with existing IPSASs, and provide examples and implementation guidance for certain public sector specific issues. In particular, the IPSASB noted the usefulness of the application guidance on concessionary loans and financial guarantees issued through a non-exchange transaction in IPSAS 29 and the continued need for such guidance in IPSAS 41. The IPSASB's view is that it is critical to provide non-authoritative material to support constituents in applying the principles in this Standard. Therefore the IPSASB followed a rigorous process to develop the following additional public sector examples to help with application of this Standard:
- (a) Examples related to concessionary loans, including when to assess the classification (see examples 20 and 21 and implementation guidance G.1) and the impact of contingent repayment features (see implementation guidance G.2);
 - (b) Examples related to measurement of unquoted equity instruments, including factors to be considered in determining the fair value (see examples 23–26 and implementation guidance E.2.4 and E.2.5) and accounting for those with a non-exchange component (see examples 27 and 28 and implementation guidance G.3);
 - (c) Example related to accounting for equity instruments with redemption features (see example 31);
 - (d) Examples related to the application of the effective interest rate in calculating the amortized cost of a financial asset (see examples 32 and implementation guidance H.1).
- BC5. The IPSASB also agreed to use revenue in place of income in IFRS 9, *Financial Instruments*, to be consistent with IPSAS 1, *Presentation of Financial Statements*, which uses revenue to correspond to income in the IASs/IFRSs. Therefore some items recognized as revenue or expense in IPSAS 1 are net amounts. As stated in the Basis for Conclusions in IPSAS 1, the IPSASs do not include a definition of income. The term income is broader than revenue, encompassing gains in addition to revenue.

Scope

- BC6. Assets and liabilities may arise out of contractual non-exchange revenue transactions. The initial recognition and measurement of assets and liabilities arising out of non-exchange revenue transactions is addressed in IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. IPSAS 23 does not provide requirements and guidance for the subsequent measurement or derecognition of these assets and liabilities. The IPSASB considered the interaction between this Standard and IPSAS 23 for assets and liabilities that arise out of non-exchange revenue transactions that meet the definition of financial assets and financial liabilities.
- BC7. The IPSASB agreed that where an asset acquired in a non-exchange transaction is a financial asset, an entity:
- Initially recognizes the asset using IPSAS 23; and
 - Initially measures the asset using IPSAS 23 and, considers the requirements in this Standard to determine the appropriate treatment for any transaction costs incurred to acquire the asset.

As IPSAS 23 does not prescribe subsequent measurement or derecognition requirements for assets acquired in a non-exchange transaction, this Standard is applied to those assets if they are financial assets.

- BC8. For liabilities, the IPSASB agreed that liabilities arising from conditions imposed on a transfer of resources in accordance with IPSAS 23 are initially recognized and initially measured using that IPSAS, as these liabilities usually do not meet the definition of a financial liability at initial recognition (see IPSAS 28). After initial recognition, if circumstances indicate that the liability is a financial liability, an entity assesses if the liability recognized in accordance with IPSAS 23 should be derecognized and a financial liability recognized in accordance with this Standard.
- BC9. The IPSASB agreed that other liabilities that arise from non-exchange revenue transactions, for example, the return of resources based on a restriction on the use of an asset, are recognized and measured in accordance with this Standard if they meet the definition of a financial liability.

Initial Measurement

- BC10. The IPSASB acknowledged that there is an interaction between IPSAS 23 and this Standard for assets acquired through a non-exchange transaction that also meet the definition of a financial asset. IPSAS 23 requires that assets acquired in a non-exchange revenue transaction are measured initially at fair value. This Standard requires financial assets to be measured initially at fair value, plus transaction costs, if the asset is not subsequently measured at fair value through surplus or deficit. The two measurement approaches are broadly consistent, except for the treatment of transaction costs.
- BC11. The IPSASB concluded that it would be inappropriate for financial assets arising from non-exchange transactions to be measured differently from those arising from exchange transactions. Consequently, the IPSASB agreed that assets acquired in a non-exchange transaction should be measured initially at fair value using the requirements in IPSAS 23, but that this Standard should also be considered where transaction costs are incurred to acquire the asset.

Equity Instruments Arising from Non-Exchange Transactions

- BC12. In the public sector, equity instruments are sometimes obtained with minimal cash flow expectations as a way to provide funding to another public sector entity for providing a service. The IPSASB considered the need for additional guidance similar to concessionary loans for such equity instruments acquired at non-market terms. While the IPSASB agreed that there are fundamental differences between the economic substance of such arrangements compared to concessionary loans. The IPSASB also agreed that the guidance in IPSAS 23 and the Standard sufficiently address the recognition and measurement of such transactions, additional guidance is included to provide clarity.

Sale of Future Flows Arising from a Sovereign Right

- BC13. In the public sector, securitization schemes may involve a sale of future flows arising from a sovereign right, such as a right to taxation. The IPSASB agreed that it would be helpful to acknowledge that such transactions may give rise to financial liabilities and agreed to include paragraph AG33. The IPSASB noted that revenue from such transactions should be accounted for in accordance with the relevant revenue standard. The IPSASB considered whether additional application guidance to address such scenarios was required. The IPSASB concluded that sufficient guidance exists in the Standard to address the accounting for any financial instruments arising from those transactions.

Impairment

- BC14. The IPSASB notes that for many public sector entities, receivables may be the only significant financial asset held. In addition, public sector entities may not have an ability to choose the counterparties they transact with because of the nature of services provided and laws or regulations requiring provision of services to all service recipients (for example, when a public utility provides water or hydro services). Under such scenarios, credit risk information at an individual counterparty level and forward looking information/forecasts may not be available without undue cost or effort. The IPSASB considered whether public sector modifications or additional guidance should be included in the Standard and concluded that the simplified approach for receivables along with practical expedients available in determining expected credit losses provide appropriate relief to the practical challenges under such scenarios. The IPSASB further acknowledges that the Standard allows for historical data and existing models be incorporated in estimating expected credit losses under such circumstances with consideration for any adjustments as needed to reflect current and forecasted conditions, as prescribed in the Standard.”

Effective Interest Method

- BC15. Constituents raised concerns with the IPSASB in regard to the cost/benefit of measuring financial liabilities (bonds) at amortized cost using the effective interest method. These constituents were concerned that, when transaction costs and any premium or discount on issuance are insignificant, measuring amortized cost using the effective interest rate produced similar or identical results to using the straight line method. However, the costs of applying the effective interest method were greater.

BC16. The IPSASB noted that paragraph 10 of IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, addressed this concern. Paragraph 10 of IPSAS 3 states that:

“IPSASs set out accounting policies that the IPSASB has concluded result in financial statements containing relevant and reliable information about the transactions, other events, and conditions to which they apply. Those policies need not be applied when the effect of applying them is immaterial. However, it is inappropriate to make, or leave uncorrected, immaterial departures from IPSASs to achieve a particular presentation of an entity’s financial position, financial performance, or cash flows.”

BC17. The IPSASB considered that, in instances when amortized cost calculated using the effective interest method is not materially different than an existing technique, the standards already allow for alternative approaches. The IPSASB also noted that IPSAS 1 includes similar provisions in relation to disclosures. Consequently, the IPSASB concluded that there was no cost/benefit justification for departing from the use of effective interest method in IPSAS 41.

Gold Bullion

BC18. Gold bullion does not meet the definition of a financial instrument as defined in IFRS 9. Given the proposals in its PSSFI project related to monetary gold, the IPSASB considered whether this was appropriate. The IPSASB noted that gold bullion has a wider meaning than monetary gold, and for entities that are not monetary authorities, the guidance may be appropriate. The IPSASB therefore agreed to include Implementation Guidance B.1.

Monetary Gold

BC18A. As part of the PSSFI project, the IPSASB considered accounting for gold held by monetary authorities as reserve assets that are available to them in carrying out their mandates, i.e., monetary gold. Some constituents indicated the scope of IPSAS 41 should be expanded to include monetary gold as it shares several characteristics with a financial asset. For example, monetary gold is:

- (a) Readily convertible into cash;
- (b) Quoted globally in US dollars;
- (c) Easily traded with willing counterparties (durable, divisible and portable);
- (d) Accepted as a form of payment by some central banks; and
- (e) A store of wealth.

Furthermore, monetary gold can be held for:

- (a) Its contribution to financial capacity because of its ability to be sold in the global liquid gold trading markets; and
- (b) An indeterminate period of time, because it provides confidence in the monetary authority’s financial strength and ability to carry out its activities.

BC18B. In considering the responses to the CP, the IPSASB confirmed its view that monetary gold is not a financial instrument. Although monetary gold is a highly liquid asset, there is no contractual right to receive cash or another financial asset inherent in monetary gold.

BC18C. The IPSASB also confirmed that the scope of IPSAS 41 should not be expanded. Nevertheless, the IPSASB considered whether applying the principles in IPSAS 41 to monetary gold might be appropriate under the hierarchy set out in paragraphs 9–15 of IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.

BC18D. The IPSASB concluded that, while monetary gold shares several characteristics with a financial asset, as noted in paragraph BC18A, the hierarchy set out in IPSAS 3 requires an entity to assess all facts specific to the circumstances related to the holding of monetary gold. Should an entity account for monetary gold using principles consistent with those applied to financial assets, the IPSASB expects all classification and measurement requirements set out in IPSAS 41 to be applied.

Transition

BC19. The IPSASB noted some public sector transactions may be reclassified under IPSAS 41. The IPSASB considered whether specific transitional provisions may be required for such reclassifications. The IPSASB noted that both general and specific transition relief was included in IFRS 9 and has been adopted in IPSAS 41. This includes a specific provision that provides relief from providing comparative information. The IPSASB therefore concluded that additional relief was not required.

Originated Credit-Impaired Short-Term Receivables

- BC20. As required by paragraphs 85–86, an entity includes expected credit losses over the life of a financial asset in the initial measurement of an instrument that is credit-impaired on purchase or origination. An entity is also required to include the initial expected credit losses in the estimated cash flows when calculating the credit-adjusted effective interest rate.
- BC21. The IPSASB noted that public sector entities are often required to transact with other parties to provide basic services, irrespective of whether those parties can afford to pay for the services received. This means that there is a high prevalence of transactions where collectability is in doubt at the initiation of the transaction. The potential implications of introducing the requirements for purchased or originated credit-impaired transactions could therefore have a pervasive effect on public sector entities.
- BC22. Given the potential implications, the Board considered the effect of including credit losses in the initial measurement of the receivable and on the recognition of revenue related to the sale of goods and services. In particular, the Board discussed whether this principle creates onerous financial reporting requirements for public sector entities that are required to enter into receivables that are originated credit-impaired.
- BC23. The IPSASB took the view that the costs to apply the originated credit-impaired requirements to short-term receivables would exceed the benefit for public sector entities. This is because regardless of whether the short-term receivable is originated credit-impaired or performing, the entity must calculate the expected credit losses. As short-term receivables are due in periods not exceeding 12 months, the lifetime and 12 month expected credit losses are equal. Consequently, benefits of the information provided by applying the originated credit-impaired requirements in IPSAS 41 are not justified by the cost of identifying short-term receivables that are originated credit-impaired in a portfolio of short-term receivables arising from routine, high volume transactions integral to the day to day operations of the entity.
- BC24. As a result, the Board agreed that the principles for purchased or originated credit-impaired instruments should not be applied to short-term receivables. The Board noted that while it supports a departure from IFRS 9, it is on cost/benefit grounds, rather than a disagreement with the conceptual merits of the principle.

Analyzing the Substance of Equity Instruments Arising from Non-Exchange Transactions

- BC25. Constituents noted that it can be difficult to identify when an equity instrument arises from a non-exchange transaction and sought additional guidance.
- BC26. The IPSASB considered that the existing requirements and guidance in IPSAS 28 and IPSAS 23 already appropriately addressed these matters. IPSAS 28 defines an equity instrument and explains how to determine whether a financial instrument is a financial liability or an equity instrument. IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*, paragraph 28, includes examples of contributions from owners. Nevertheless, the IPSASB agreed to develop implementation guidance (paragraph G.4) to support constituents in analyzing the substance of financial instruments arising from non-exchange transactions.

Designating Hedged Items in Consolidated Financial Statements

- BC27. The IPSASB acknowledged there is an interaction between IPSAS 35 and this Standard when determining which instruments can be designated as hedged items. Generally, this Standard allows assets, liabilities and firm commitments or highly probable transactions with a party external to the reporting entity to be designated as a hedged item for hedge accounting purposes. The restriction to only allow for instruments transacted with a party external to the reporting entity is necessary as transactions within the consolidated entity are eliminated in accordance with IPSAS 35.
- BC28. However, in accordance with IPSAS 35, paragraphs 56 and 58, an investment entity does not consolidate its controlled entities, and a controlling entity of an investment entity shall present consolidated financial statements measuring the investments of a controlled investment entity at fair value through surplus or deficit.
- BC29. The IPSASB concluded it would be inappropriate for transactions between a controlled investment entity and the investments of that controlled investment entity not to be eligible for designation as hedged items. Consequently, the IPSASB decided that hedge accounting can be applied to transactions between entities in the same economic entity in the consolidated statements of an investment entity or the consolidated statements of a controlling entity of an investment entity.

Illustrative Examples with Jurisdiction Specific Fact Patterns

- BC30. Some respondents suggested that illustrative examples would be more helpful if they included jurisdiction specific characteristics. These constituents indicated that generic illustrative examples would be more useful to constituents if characteristics common among some jurisdictions were illustrated.

- BC31. During the project the IPSASB developed illustrative examples based on fact patterns proposed by individual jurisdictions. This resulted in complex examples illustrating the application of multiple principles. When a constituent's fact pattern did not mirror the characteristics of the illustrative example, interpreting the application of any individual principle was challenging and was only helpful where an entity already had an understanding of how the accounting principles underlying financial instruments interact. The IPSASB concluded that such examples are unhelpful to the majority of entities.
- BC32. Consequently, the IPSASB decided that each illustrative example should illustrate the application of a single principle. This will provide useful guidance to a broader range of entities and assist in understanding basic concepts. When an entity has a more sophisticated fact pattern, individual illustrative examples can be aggregated as necessary in order to determine the appropriate application of the principles.

Consistency with IFRS 9

- BC33. In developing IPSAS 41, the IPSASB applied its *Process for Reviewing and Modifying IASB Documents*. Modifications to IFRS 9 were made in circumstances where public sector issues were identified that warranted a departure. As part of its development, the IPSASB debated a number of issues and whether departure was justified.

Short-Term Receivables and Payables

- BC34. Consistent with the fair value measurement guidance in IPSAS 29, IPSAS 41 proposed to permit short-term receivables and payables with no stated interest rate to be measured at the original invoice amount if the effect of discounting is immaterial. This option was located in the Application Guidance in IPSAS 41. Respondents to IPSAS 41 noted that IFRS 9 has an exception to fair value measurement for certain short-term trade receivables (as defined in IFRS 15) and were concerned about what they perceived as the absence of an equivalent exception in IPSAS 41. The IPSASB decided to highlight the existence of this option by moving it to the body of the standard and locating it in a similar place to the exception for short-term receivables in IFRS 9. The IPSASB also noted that paragraph 10 of IPSAS 3 already permits entities not to apply accounting policies set out in accordance with IPSASs when the effect of applying them is immaterial.
- BC35. To maintain consistent measurement requirements, the IPSASB agreed short-term receivables and payables are measured at the original invoice amount if the effect of discounting is immaterial (see paragraph 60).

Acceptable Valuation Methodologies

- BC36. IPSAS 41 requires entities to measure equity instruments at fair value. Given the public policy objectives of public sector entities, constituents expressed concerns that measuring fair value can be challenging as significant opportunity exists for investments in to be in the form of unquoted equity instruments.
- BC37. Some constituents expressed concerns about whether the fair value of such investments should be determined solely in a commercial manner by reference to expected cash flows with the objective of estimating how much the investment could be sold for in an arm's length transaction or whether fair value measurement should take into account other factors, such as the service potential of the unquoted equity investment.
- BC38. In considering this issue, the IPSASB developed illustrative examples 24–28 outlining various valuation techniques the public sector could apply in determining the fair value of the unquoted equity investment. These valuation techniques outlined in the examples are not an exhaustive list of valuation methodologies available.
- BC39. In order to highlight that public sector entities have a wide range of valuation techniques available when determining the fair value of an unquoted equity instrument, the IPSASB developed specific implementation guidance. IG E.2.4 does not prescribe the use of a specific valuation technique, but instead encourages the use of professional judgment and the consideration of all the facts and circumstances surrounding the selection of an appropriate measurement technique.

Valuation Assumptions

- BC40. Some respondents proposed adding guidance to address which inputs should be applied in fair value measurement and which assumptions should be applied in developing these inputs. Respondents highlighted challenges and complexities in determining inputs such as the prevailing market rates for a similar loan and the probability of default.
- BC41. The IPSASB acknowledges measuring some financial instruments can be a challenging process and that one aspect of this challenge relates to inputs.
- BC42. The IPSASB concluded that developing additional valuation guidance is beyond the scope of the Standard and consider the application of professional judgment an important aspect in measuring the fair value of financial instruments.

Fair Value at Initial Recognition does not Equal the Transaction Price

BC43. In developing this Standard, the IPSASB concluded that retaining paragraphs AG103–AG116 of IPSAS 29 was necessary in order to maintain a consistent approach to the valuation of financial instruments. This decision was reached because unlike in IFRS, where IFRS 9 directs users to IFRS 13, *Fair Value Measurement*, for guidance in measuring the fair value of a financial instrument, this option is not available as no equivalent IPSAS has been developed for IFRS 13.

Public Sector Specific Examples

BC44. Some respondents proposed that the IPSASB develop additional illustrative examples to support the application of the standard in practice. The IPSASB considered this request and agreed to develop additional illustrative examples and implementation guidance to the extent it related to an issue specific to the public sector. The IPSASB rejected respondents' proposals for additional illustrative examples for instruments that were also prevalent in the private sector. For these instruments, the IPSASB concluded that guidance drawn from IFRS 9 was sufficient to address the concerns of respondents and no departures were warranted.

Revision of IPSAS 41 as a result of *Long-term Interests in Associates and Joint Ventures (Amendments to IPSAS 36)* and *Prepayment Features with Negative Compensation (Amendments to IPSAS 41)*

BC45. The IPSASB reviewed the revisions to IFRS 9, *Financial Instruments*, included in *Prepayment Features with Negative Compensation* (Amendments to IFRS 9), issued by the IASB in October 2017, and the IASB's rationale for making these amendments as set out in its Basis for Conclusions, and concurred that there was no public sector specific reason for not adopting the amendments.

Revision of IPSAS 41 as a result of *COVID-19: Deferral of Effective Dates*

BC46. The IPSASB published IPSAS 41, *Financial Instruments* in August 2018. At the time this Standard was finalized, the Board decided that an entity shall apply it for annual financial statements covering periods beginning on or after January 1, 2022.

BC47. In June 2020, the IPSASB discussed the effect of the COVID-19 pandemic on financial reporting. The Board noted that the pandemic has created significant pressures on the resources public sector entities might otherwise allocate to the implementation of IPSAS 41.

BC48. The Board concluded that deferral during a time of significant disruption would provide much-needed operational relief to public sector entities. Therefore, the Board decided to propose a one-year deferral of the effective date of IPSAS 41.

BC49. The Board did not propose any changes to the Standard other than the deferral of the effective date. Earlier application of the amendments will continue to be permitted.

Revision of IPSAS 41 as a result of *Improvements to IPSAS, 2021*

BC50. The IPSASB reviewed the revisions to IFRS 9, *Financial Instruments*, included in *Interest Rate Benchmark Reform* (Amendments to IFRS 9, IAS 39 and IFRS 7) issued by the IASB in September 2019, and the IASB's rationale for making these amendments as set out in its Basis for Conclusions and concurred that there was no public sector specific reason for not adopting these amendments, henceforth labeled as *Interest Rate Benchmark Reform*.

BC51. The IPSASB reviewed the revisions to IFRS 9, *Financial Instruments*, included in *Interest Rate Benchmark Reform—Phase 2* (Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16) issued by the IASB in August 2020, and the IASB's rationale for making these amendments as set out in its Basis for Conclusions and concurred that there was no public sector specific reason for not adopting these amendments, henceforth labeled as *Interest Rate Benchmark Reform—Phase 2*.

BC52. The IPSASB reviewed the revisions to IFRS 9, *Financial Instruments*, included in *Annual Improvements to IFRS® Standards* (2018-2020) issued by the IASB in May 2020, and the IASB's rationale for making these amendments as set out in its Basis for Conclusions and concurred that there was no public sector specific reason for not adopting these amendments.

ILLUSTRATIVE EXAMPLES

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Illustrative Examples

These examples accompany, but are not part of, IPSAS 41.

Financial Liabilities at Fair Value through Surplus or Deficit

- IE1. The following example illustrates the calculation that an entity might perform in accordance with paragraph AG241 of IPSAS 41.
- IE2. On January 1, 20X1 an entity issues a 10-year bond with a par value of CU150,000⁸ and an annual fixed coupon rate of 8 per cent, which is consistent with market rates for bonds with similar characteristics.
- IE3. The entity uses LIBOR as its observable (benchmark) interest rate. At the date of inception of the bond, LIBOR is 5 per cent. At the end of the first year:
- LIBOR has decreased to 4.75 per cent.
 - The fair value for the bond is CU153,811, consistent with an interest rate of 7.6 per cent.⁹
- IE4. The entity assumes a flat yield curve, all changes in interest rates result from a parallel shift in the yield curve, and the changes in LIBOR are the only relevant changes in market conditions.
- IE5. The entity estimates the amount of change in the fair value of the bond that is not attributable to changes in market conditions that give rise to market risk as follows:

<p>[paragraph AG241(a)]</p> <p>First, the entity computes the liability's internal rate of return at the start of the period using the observed market price of the liability and the liability's contractual cash flows at the start of the period. It deducts from this rate of return the observed (benchmark) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.</p>	<p>At the start of the period of a 10-year bond with a coupon of 8 per cent, the bond's internal rate of return is 8 per cent.</p> <p>Because the observed (benchmark) interest rate (LIBOR) is 5 per cent, the instrument-specific component of the internal rate of return is 3 per cent.</p>
<p>[paragraph AG241(b)]</p> <p>Next, the entity calculates the present value of the cash flows associated with the liability using the liability's contractual cash flows at the end of the period and a discount rate equal to the sum of (i) the observed (benchmark) interest rate at the end of the period and (ii) the instrument-specific component of the internal rate of return as determined in accordance with paragraph AG241(a).</p>	<p>The contractual cash flows of the instrument at the end of the period are:</p> <ul style="list-style-type: none"> Interest: CU12,000^(a) per year for each of years 2–10. Principal: CU150,000 in year 10. <p>The discount rate to be used to calculate the present value of the bond is thus 7.75 per cent, which is the end of period LIBOR rate of 4.75 per cent, plus the 3 per cent instrument-specific component.</p> <p>This gives a present value of CU152,367.^(b)</p>
<p>[paragraph AG241(c)]</p> <p>The difference between the observed market price of the liability at the end of the period and the amount determined in accordance with paragraph AG241(b) is the change in fair value that is not attributable to changes in the observed (benchmark) interest rate. This is the amount to be presented in net assets/equity in accordance with paragraph 108(a).</p>	<p>The market price of the liability at the end of the period is CU153,811.^(c)</p> <p>Thus, the entity presents CU1,444 in net assets/equity, which is CU153,811 – CU152,367, as the increase in fair value of the bond that is not attributable to changes in market conditions that give rise to market risk.</p>
<p>(a) $CU150,000 \times 8 \text{ percent} = CU12,000.$</p> <p>(b) $PV = [CU12,000 \times (1 - (1 + 0.0775)^{-9})/0.0775] + CU150,000 \times (1 + 0.0775)^{-9}.$</p> <p>(c) $\text{market price} = [CU12,000 \times (1 - (1 + 0.076)^{-9})/0.076] + CU150,000 \times (1 + 0.076)^{-9}.$</p>	

⁸ In this guidance monetary amounts are denominated in 'currency units' (CU).

⁹ This reflects a shift in LIBOR from 5 per cent to 4.75 per cent and a movement of 0.15 per cent which, in the absence of other relevant changes in market conditions, is assumed to reflect changes in credit risk of the instrument.

Impairment (Paragraphs 73–93)

Assessing Significant Increases in Credit Risk Since Initial Recognition

IE6. IE6. The following examples illustrate possible ways to assess whether there have been significant increases in credit risk since initial recognition. For simplicity of illustration, the following examples only show one aspect of the credit risk analysis. However, the assessment of whether lifetime expected credit losses should be recognized is a multifactor and holistic analysis that considers reasonable and supportable information that is available without undue cost or effort and that is relevant for the particular financial instrument being assessed.

Example 1—Significant Increase in Credit Risk

IE7. Company Y has a funding structure that includes a senior secured loan facility with different tranches¹⁰. Company Y qualifies for assistance from the National Development Bank which provides a tranche of the loan facility to Company Y. At the time of origination of the loan by the National Development Bank, although Company Y's leverage was relatively high compared with other issuers with similar credit risk, it was expected that Company Y would be able to meet the covenants for the life of the instrument. In addition, the generation of revenue and cash flow was expected to be stable in Company Y's industry over the term of the senior facility. However, there was some business risk related to the ability to grow gross margins within its existing businesses.

IE8. At initial recognition, because of the considerations outlined in paragraph IE7, the National Development Bank considers that despite the level of credit risk at initial recognition, the loan is not an originated credit-impaired loan because it does not meet the definition of a credit-impaired financial asset in paragraph 9 of IPSAS 41.

IE9. Subsequent to initial recognition, macroeconomic changes have had a negative effect on total sales volume and Company Y has underperformed on its business plan for revenue generation and net cash flow generation. Although spending on inventory has increased, anticipated sales have not materialized. To increase liquidity, Company Y has drawn down more on a separate revolving credit facility, thereby increasing its leverage ratio. Consequently, Company Y is now close to breaching its covenants on the senior secured loan facility with the National Development Bank.

IE10. The National Development Bank makes an overall assessment of the credit risk on the loan to Company Y at the reporting date by taking into consideration all reasonable and supportable information that is available without undue cost or effort and that is relevant for assessing the extent of the increase in credit risk since initial recognition. This may include factors such as:

- (a) The National Development Bank's expectation that the deterioration in the macroeconomic environment may continue in the near future, which is expected to have a further negative impact on Company Y's ability to generate cash flows and to deleverage.
- (b) Company Y is closer to breaching its covenants, which may result in a need to restructure the loan or reset the covenants.
- (c) The National Development Bank's assessment that the trading prices for Company Y's bonds have decreased and that the credit margin on newly originated loans have increased reflecting the increase in credit risk, and that these changes are not explained by changes in the market environment (for example, benchmark interest rates have remained unchanged). A further comparison with the pricing of Company Y's peers shows that reductions in the price of Company Y's bonds and increases in credit margin on its loans have probably been caused by company-specific factors.
- (d) The National Development Bank has reassessed its internal risk grading of the loan on the basis of the information that it has available to reflect the increase in credit risk.

IE11. The National Development Bank determines that there has been a significant increase in credit risk since initial recognition of the loan in accordance with paragraph 75 of IPSAS 41. Consequently, the National Development Bank recognizes lifetime expected credit losses on its senior secured loan to Company Y. Even if the National Development Bank has not yet changed the internal risk grading of the loan it could still reach this conclusion—the absence or presence of a change in risk grading in itself is not determinative of whether credit risk has increased significantly since initial recognition.

¹⁰ The security on the loan affects the loss that would be realized if a default occurs, but does not affect the risk of a default occurring, so it is not considered when determining whether there has been a significant increase in credit risk since initial recognition as required by paragraph 75 of IPSAS 41.

Example 2—No Significant Increase in Credit Risk

- IE12. Company C, is the holding company of a group that operates in a cyclical production industry. State Government B provided a loan to Company C. At that time, the prospects for the industry were positive, because of expectations of further increases in global demand. However, input prices were volatile and given the point in the cycle, a potential decrease in sales was anticipated.
- IE13. In addition, in the past Company C has been focused on external growth, acquiring majority stakes in companies in related sectors. As a result, the group structure is complex and has been subject to change, making it difficult for investors to analyze the expected performance of the group and to forecast the cash that will be available at the holding company level. Even though leverage is at a level that is considered acceptable by Company C's creditors at the time that State Government B originates the loan, its creditors are concerned about Company C's ability to refinance its debt because of the short remaining life until the maturity of the current financing. There is also concern about Company C's ability to continue to service interest using the dividends it receives from its operating subsidiaries.
- IE14. At the time of the origination of the loan by State Government B, Company C's leverage was in line with that of other borrowers with similar credit risk and based on projections over the expected life of the loan, the available capacity (i.e., headroom) on its coverage ratios before triggering a default event, was high. State Government B applies its own internal rating methods to determine credit risk and allocates a specific internal rating score to its loans. State Government B's internal rating categories are based on historical, current and forward-looking information and reflect the credit risk for the tenor of the loans. On initial recognition, State Government B determines that the loan is subject to considerable credit risk, has speculative elements and that the uncertainties affecting Company C, including the group's uncertain prospects for cash generation, could lead to default. However, State Government B does not consider the loan to be originated credit-impaired because it does not meet the definition of a purchased or originated credit-impaired financial asset in paragraph 9 of IPSAS 41.
- IE15. Subsequent to initial recognition, Company C has announced that three of its five key subsidiaries had a significant reduction in sales volume because of deteriorated market conditions but sales volumes are expected to improve in line with the anticipated cycle for the industry in the following months. The sales of the other two subsidiaries were stable. Company C has also announced a corporate restructure to streamline its operating subsidiaries. This restructuring will increase the flexibility to refinance existing debt and the ability of the operating subsidiaries to pay dividends to Company C.
- IE16. Despite the expected continuing deterioration in market conditions, State Government B determines, in accordance with paragraph 75 of IPSAS 41, that there has not been a significant increase in the credit risk on the loan to Company C since initial recognition. This is demonstrated by factors that include:
- (a) Although current sale volumes have fallen, this was as anticipated by State Government B at initial recognition. Furthermore, sales volumes are expected to improve, in the following months.
 - (b) Given the increased flexibility to refinance the existing debt at the operating subsidiary level and the increased availability of dividends to Company C, State Government B views the corporate restructure as being credit enhancing. This is despite some continued concern about the ability to refinance the existing debt at the holding company level.
 - (c) State Government B's credit risk department, which monitors Company C, has determined that the latest developments are not significant enough to justify a change in its internal credit risk rating.
- IE17. As a consequence, State Government B does not recognize a loss allowance at an amount equal to lifetime expected credit losses on the loan. However, it updates its measurement of the 12-month expected credit losses for the increased risk of a default occurring in the next 12 months and for current expectations of the credit losses that would arise if a default were to occur.

Example 3—Highly Collateralized Financial Asset

- IE18. Company H owns land which is financed by a five-year loan from the State owned Agricultural Bank with a loan-to-value (LTV) ratio of 50 per cent. The loan is secured by a first-ranking security over the land. At initial recognition of the loan, the State owned Agricultural Bank does not consider the loan to be originated credit-impaired as defined in paragraph 9 of IPSAS 41.
- IE19. Subsequent to initial recognition, the revenues and operating profits of Company H have decreased because of an economic recession. Furthermore, expected increases in regulations have the potential to further negatively affect revenue and operating profit. These negative effects on Company H's operations could be significant and ongoing.

- IE20. As a result of these recent events and expected adverse economic conditions, Company H's free cash flow is expected to be reduced to the point that the coverage of scheduled loan payments could become tight. The State owned Agricultural Bank estimates that a further deterioration in cash flows may result in Company H missing a contractual payment on the loan and becoming past due.
- IE21. Recent third party appraisals have indicated a decrease in the value of the land, resulting in a current LTV ratio of 70 per cent.
- IE22. At the reporting date, the loan to Company H is not considered to have low credit risk in accordance with paragraph 82 of IPSAS 41. The State owned Agricultural Bank therefore needs to assess whether there has been a significant increase in credit risk since initial recognition in accordance with paragraph 75 of IPSAS 41, irrespective of the value of the collateral it holds. It notes that the loan is subject to considerable credit risk at the reporting date because even a slight deterioration in cash flows could result in Company H missing a contractual payment on the loan. As a result, the State owned Agricultural Bank determines that the credit risk (i.e., the risk of a default occurring) has increased significantly since initial recognition. Consequently, the State owned Agricultural Bank recognizes lifetime expected credit losses on the loan to Company H.
- IE23. Although lifetime expected credit losses should be recognized, the measurement of the expected credit losses will reflect the recovery expected from the collateral (adjusting for the costs of obtaining and selling the collateral) on the property as required by paragraph AG219 of IPSAS 41 and may result in the expected credit losses on the loan being very small.

Example 4—Public Investment-Grade Bond

- IE24. Company A is a large listed national logistics company. The only debt in the capital structure is a five-year public bond with a restriction on further borrowing as the only bond covenant. Company A reports quarterly to its shareholders. The National Public Investment Fund is one of many investors in the bond. The Investment Fund considers the bond to have low credit risk at initial recognition in accordance with paragraph 82 of IPSAS 41. This is because the bond has a low risk of default and Company A is considered to have a strong capacity to meet its obligations in the near term. The Investment Fund's expectations for the longer term are that adverse changes in economic and business conditions may, but will not necessarily, reduce Company A's ability to fulfil its obligations on the bond. In addition, at initial recognition the bond had an internal credit rating that is correlated to a global external credit rating of investment grade.
- IE25. At the reporting date, the Investment Fund's main credit risk concern is the continuing pressure on the total volume of sales that has caused Company A's operating cash flows to decrease.
- IE26. Because the Investment Fund relies only on quarterly public information and does not have access to private credit risk information (because it is a bond investor), its assessment of changes in credit risk is tied to public announcements and information, including updates on credit perspectives in press releases from rating agencies.
- IE27. The Investment Fund applies the low credit risk simplification in paragraph 82 of IPSAS 41. Accordingly, at the reporting date, the Investment Fund evaluates whether the bond is considered to have low credit risk using all reasonable and supportable information that is available without undue cost or effort. In making that evaluation, the Investment Fund reassesses the internal credit rating of the bond and concludes that the bond is no longer equivalent to an investment grade rating because:
- (a) The latest quarterly report of Company A revealed a quarter-on-quarter decline in revenues of 20 per cent and in operating profit by 12 per cent.
 - (b) Rating agencies have reacted negatively to a profit warning by Company A and put the credit rating under review for possible downgrade from investment grade to non-investment grade. However, at the reporting date the external credit risk rating was unchanged.
 - (c) The bond price has also declined significantly, which has resulted in a higher yield to maturity. The Investment Fund assesses that the bond prices have been declining as a result of increases in Company A's credit risk. This is because the market environment has not changed (for example, benchmark interest rates, liquidity etc. are unchanged) and comparison with the bond prices of peers shows that the reductions are probably company specific (instead of being, for example, changes in benchmark interest rates that are not indicative of company-specific credit risk).
- IE28. While Company A currently has the capacity to meet its commitments, the large uncertainties arising from its exposure to adverse business and economic conditions have increased the risk of a default occurring on the bond. As a result of the factors described in paragraph IE27, the Investment Fund determines that the bond does not have low credit risk at the reporting date. As a result, the Investment Fund needs to determine whether the increase in credit risk since initial recognition has been significant. On the basis of its assessment, the Investment Fund determines that the credit risk has

increased significantly since initial recognition and that a loss allowance at an amount equal to lifetime expected credit losses should be recognized in accordance with paragraph 75 of IPSAS 41.

Example 5—Responsiveness to Changes in Credit Risk

- IE29. Housing Corporation ABC provides mortgages to citizens of ABC to finance residential real estate in three different regions. The mortgage loans are originated across a wide range of LTV criteria and a wide range of income groups. As part of the mortgage application process, borrowers are required to provide information such as the industry within which the borrower is employed and the post code of the property that serves as collateral on the mortgage.
- IE30. Housing Corporation ABC sets its acceptance criteria based on credit scores. Loans with a credit score above the ‘acceptance level’ are approved because these borrowers are considered to be able to meet contractual payment obligations. When new mortgage loans are originated, Housing Corporation ABC uses the credit score to determine the risk of a default occurring as at initial recognition.
- IE31. At the reporting date Housing Corporation ABC determines that economic conditions are expected to deteriorate significantly in all regions. Unemployment levels are expected to increase while the value of residential property is expected to decrease, causing the LTV ratios to increase. As a result of the expected deterioration in economic conditions, Housing Corporation ABC expects default rates on the mortgage portfolio to increase.

Individual Assessment

- IE32. In Region One, Housing Corporation ABC assesses each of its mortgage loans on a monthly basis by means of an automated behavioral scoring process. Its scoring models are based on current and historical past due statuses, levels of borrower indebtedness, LTV measures, the loan size and the time since the origination of the loan. Housing Corporation ABC updates the LTV measures on a regular basis through an automated process that re-estimates property values using recent sales in each post code area and reasonable and supportable forward-looking information that is available without undue cost or effort.
- IE33. Housing Corporation ABC has historical data that indicates a strong correlation between the value of residential property and the default rates for mortgages. That is, when the value of residential property declines, a borrower has less economic incentive to make scheduled mortgage repayments, increasing the risk of a default occurring.
- IE34. Through the impact of the LTV measure in the behavioral scoring model, an increased risk of a default occurring due to an expected decline in residential property value adjusts the behavioral scores. The behavioral score can be adjusted as a result of expected declines in property value even when the mortgage loan is a bullet loan with the most significant payment obligations at maturity (and beyond the next 12 months). Mortgages with a high LTV ratio are more sensitive to changes in the value of the residential property and Housing Corporation ABC is able to identify significant increases in credit risk since initial recognition on individual borrowers before a mortgage becomes past due if there has been a deterioration in the behavioral score.
- IE35. When the increase in credit risk has been significant, a loss allowance at an amount equal to lifetime expected credit losses is recognized. Housing Corporation ABC measures the loss allowance by using the LTV measures to estimate the severity of the loss, i.e., the loss given default (LGD). The higher the LTV measure, the higher the expected credit losses all else being equal.
- IE36. If Housing Corporation ABC was unable to update behavioral scores to reflect the expected declines in property prices, it would use reasonable and supportable information that is available without undue cost or effort to undertake a collective assessment to determine the loans on which there has been a significant increase in credit risk since initial recognition and recognize lifetime expected credit losses for those loans.

Collective Assessment

- IE37. In Regions Two and Three, Housing Corporation ABC does not have an automated scoring capability. Instead, for credit risk management purposes, Housing Corporation ABC tracks the risk of a default occurring by means of past due statuses. It recognizes a loss allowance at an amount equal to lifetime expected credit losses for all loans that have a past due status of more than 30 days past due. Although Housing Corporation ABC uses past due status information as the only borrower-specific information, it also considers other reasonable and supportable forward-looking information that is available without undue cost or effort to assess whether lifetime expected credit losses should be recognized on loans that are not more than 30 days past due. This is necessary in order to meet the objective in paragraph 76 of IPSAS 41 of recognizing lifetime expected credit losses for all significant increases in credit risk.

Region Two

IE38. Region Two includes a mining community that is largely dependent on the export of coal and related products. Housing Corporation ABC becomes aware of a significant decline in coal exports and anticipates the closure of several coal mines. Because of the expected increase in the unemployment rate, the risk of a default occurring on mortgage loans to borrowers who are employed by the coal mines is determined to have increased significantly, even if those borrowers are not past due at the reporting date. Housing Corporation ABC therefore segments its mortgage portfolio by the industry within which borrowers are employed (using the information recorded as part of the mortgage application process) to identify borrowers that rely on coal mining as the dominant source of employment (i.e., a ‘bottom up’ approach in which loans are identified based on a common risk characteristic). For those mortgages, Housing Corporation ABC recognizes a loss allowance at an amount equal to lifetime expected credit losses while it continues to recognize a loss allowance at an amount equal to 12-month expected credit losses for all other mortgages in Region Two.¹¹ Newly originated mortgages to borrowers who are economically dependent on the coal mines in this community would, however, have a loss allowance at an amount equal to 12-month expected credit losses because they would not have experienced significant increases in credit risk since initial recognition. However, some of these mortgages may experience significant increases in credit risk soon after initial recognition because of the expected closure of the coal mines.

Region Three

IE39. In Region Three, Housing Corporation ABC anticipates the risk of a default occurring and thus an increase in credit risk, as a result of an expected increase in interest rates during the expected life of the mortgages. Historically, an increase in interest rates has been a lead indicator of future defaults on mortgages in Region Three—especially when borrowers do not have a fixed interest rate mortgage. Housing Corporation ABC determines that the variable interest-rate portfolio of mortgages in Region Three is homogenous and that unlike for Region Two, it is not possible to identify particular sub-portfolios on the basis of shared risk characteristics that represent borrowers who are expected to have increased significantly in credit risk. However, as a result of the homogenous nature of the mortgages in Region Three, Housing Corporation ABC determines that an assessment can be made of a proportion of the overall portfolio that has significantly increased in credit risk since initial recognition (i.e., a ‘top down’ approach can be used). Based on historical information, Housing Corporation ABC estimates that an increase in interest rates of 200 basis points will cause a significant increase in credit risk on 20 per cent of the variable interest-rate portfolio. Therefore, as a result of the anticipated increase in interest rates, Housing Corporation ABC determines that the credit risk on 20 per cent of mortgages in Region Three has increased significantly since initial recognition. Accordingly Housing Corporation ABC recognizes lifetime expected credit losses on 20 per cent of the variable rate mortgage portfolio and a loss allowance at an amount equal to 12-month expected credit losses for the remainder of the portfolio.¹²

Example 6—Comparison to Maximum Initial Credit Risk

IE40. The Economic Development Agency has two portfolios of small business loans with similar terms and conditions in Region W. The Economic Development Agency’s policy on financing decisions for each loan is based on an internal credit rating system that considers a borrower’s credit history, payment behavior and other factors, and assigns an internal credit risk rating from 1 (lowest credit risk) to 10 (highest credit risk) to each loan on origination. The risk of a default occurring increases exponentially as the credit risk rating deteriorates so, for example, the difference between credit risk rating grades 1 and 2 is smaller than the difference between credit risk rating grades 2 and 3. Loans in Portfolio 1 were only offered to repeat borrowers with a similar internal credit risk rating and at initial recognition all loans were rated 3 or 4 on the internal rating scale. The Economic Development Agency determines that the maximum initial credit risk rating at initial recognition it would accept for Portfolio 1 is an internal rating of 4. Loans in Portfolio 2 were offered to borrowers that responded to an advertisement for small business loans and the internal credit risk ratings of these borrowers range between 4 and 7 on the internal rating scale. The Economic Development Agency never originates a small business loan with an internal credit risk rating worse than 7 (i.e., with an internal rating of 8–10).

IE41. For the purposes of assessing whether there have been significant increases in credit risk, the Economic Development Agency determines that all loans in Portfolio 1 had a similar initial credit risk. It determines that given the risk of default reflected in its internal risk rating grades, a change in internal rating from 3 to 4 would not represent a significant increase in credit risk but that there has been a significant increase in credit risk on any loan in this portfolio that has an internal rating worse than 5. This means that the Department of Finance does not have to know the initial credit rating of each loan

¹¹ Except for those mortgages that are determined to have significantly increased in credit risk based on an individual assessment, such as those that are more than 30 days past due. Lifetime expected credit losses would also be recognized on those mortgages.

¹² Except for those mortgages that are determined to have significantly increased in credit risk based on an individual assessment, such as those that are more than 30 days past due. Lifetime expected credit losses would also be recognized on those mortgages.

in the portfolio to assess the change in credit risk since initial recognition. It only has to determine whether the credit risk is worse than 5 at the reporting date to determine whether lifetime expected credit losses should be recognized in accordance with paragraph 75 of IPSAS 41.

- IE42. However, determining the maximum initial credit risk accepted at initial recognition for Portfolio 2 at an internal credit risk rating of 7, would not meet the objective of the requirements as stated in paragraph 76 of IPSAS 41. This is because the Economic Development Agency determines that significant increases in credit risk arise not only when credit risk increases above the level at which an entity would originate new financial assets (i.e., when the internal rating is worse than 7). Although the Economic Development Agency never originates a small business loan with an internal credit rating worse than 7, the initial credit risk on loans in Portfolio 2 is not of sufficiently similar credit risk at initial recognition to apply the approach used for Portfolio 1. This means that the Economic Development Agency cannot simply compare the credit risk at the reporting date with the lowest credit quality at initial recognition (for example, by comparing the internal credit risk rating of loans in Portfolio 2 with an internal credit risk rating of 7) to determine whether credit risk has increased significantly because the initial credit quality of loans in the portfolio is too diverse. For example, if a loan initially had a credit risk rating of 4 the credit risk on the loan may have increased significantly if its internal credit risk rating changes to 6.

Example 7—Counterparty Assessment of Credit Risk

Scenario 1

- IE43. In 20X0 the Infrastructure Bank of Country A granted a loan of CU10,000 with a contractual term of 15 years to Company Q when the company had an internal credit risk rating of 4 on a scale of 1 (lowest credit risk) to 10 (highest credit risk). The risk of a default occurring increases exponentially as the credit risk rating deteriorates so, for example, the difference between credit risk rating grades 1 and 2 is smaller than the difference between credit risk rating grades 2 and 3. In 20X5, when Company Q had an internal credit risk rating of 6, the Infrastructure Bank issued another loan to Company Q for CU5,000 with a contractual term of 10 years. In 20X7 Company Q fails to retain its contract with a major customer and correspondingly experiences a large decline in its revenue. The Infrastructure Bank considers that as a result of losing the contract, Company Q will have a significantly reduced ability to meet its loan obligations and changes its internal credit risk rating to 8.
- IE44. The Infrastructure Bank assesses credit risk on a counterparty level for credit risk management purposes and determines that the increase in Company Q's credit risk is significant. Although the Infrastructure Bank did not perform an individual assessment of changes in the credit risk on each loan since its initial recognition, assessing the credit risk on a counterparty level and recognizing lifetime expected credit losses on all loans granted to Company Q, meets the objective of the impairment requirements as stated in paragraph 76 of IPSAS 41. This is because, even since the most recent loan was originated (in 20X7) when Company Q had the highest credit risk at loan origination, its credit risk has increased significantly. The counterparty assessment would therefore achieve the same result as assessing the change in credit risk for each loan individually.

Scenario 2

- IE45. The Infrastructure Bank of Country A granted a loan of CU150,000 with a contractual term of 20 years to Company X in 20X0 when the company had an internal credit risk rating of 4. During 20X5 economic conditions deteriorate and demand for Company X's products has declined significantly. As a result of the reduced cash flows from lower sales, Company X could not make full payment of its loan installment to the Infrastructure Bank. The Infrastructure Bank re-assesses Company X's internal credit risk rating, and determines it to be 7 at the reporting date. The Infrastructure Bank considered the change in credit risk on the loan, including considering the change in the internal credit risk rating, and determines that there has been a significant increase in credit risk and recognizes lifetime expected credit losses on the loan of CU150,000.
- IE46. Despite the recent downgrade of the internal credit risk rating, the Infrastructure Bank grants another loan of CU50,000 to Company X in 20X6 with a contractual term of 5 years, taking into consideration the higher credit risk at that date.
- IE47. The fact that Company X's credit risk (assessed on a counterparty basis) has previously been assessed to have increased significantly, does not result in lifetime expected credit losses being recognized on the new loan. This is because the credit risk on the new loan has not increased significantly since the loan was initially recognized. If the Infrastructure Bank only assessed credit risk on a counterparty level, without considering whether the conclusion about changes in credit risk applies to all individual financial instruments provided to the same borrower, the objective in paragraph 76 of IPSAS 41 would not be met.

Recognition and Measurement of Expected Credit Losses

IE48. The following examples illustrate the application of the recognition and measurement requirements in accordance with paragraphs 73–93 of IPSAS 41, as well as the interaction with the hedge accounting requirements.

Example 8—12-Month Expected Credit Loss Measurement Using an Explicit ‘Probability of Default’ Approach

Scenario 1

IE49. Government A originates a single 10 year amortizing loan for CU1 million. Taking into consideration the expectations for instruments with similar credit risk (using reasonable and supportable information that is available without undue cost or effort), the credit risk of the borrower, and the economic outlook for the next 12 months, Government A estimates that the loan at initial recognition has a probability of default (PD) of 0.5 per cent over the next 12 months. Government A also determines that changes in the 12-month PD are a reasonable approximation of the changes in the lifetime PD for determining whether there has been a significant increase in credit risk since initial recognition.

IE50. At the reporting date (which is before payment on the loan is due¹³), there has been no change in the 12-month PD and Government A determines that there was no significant increase in credit risk since initial recognition. Government A determines that 25 per cent of the gross carrying amount will be lost if the loan defaults (i.e., the LGD is 25 per cent).¹⁴ Government A measures the loss allowance at an amount equal to 12-month expected credit losses using the 12-month PD of 0.5 per cent. Implicit in that calculation is the 99.5 per cent probability that there is no default. At the reporting date the loss allowance for the 12 month expected credit losses is CU1,250 (0.5 percent × 25 percent × CU1,000,000).

Scenario 2

IE51. Government B acquires a portfolio of 1,000 five year bullet loans for CU1,000 each (i.e., CU1million in total) with an average 12-month PD of 0.5 per cent for the portfolio. Government B determines that because the loans only have significant payment obligations beyond the next 12 months, it would not be appropriate to consider changes in the 12-month PD when determining whether there have been significant increases in credit risk since initial recognition. At the reporting date Government B therefore uses changes in the lifetime PD to determine whether the credit risk of the portfolio has increased significantly since initial recognition.

IE52. Government B determines that there has not been a significant increase in credit risk since initial recognition and estimates that the portfolio has an average LGD of 25 per cent. Government B determines that it is appropriate to measure the loss allowance on a collective basis in accordance with IPSAS 41. The 12-month PD remains at 0.5 per cent at the reporting date. Government B therefore measures the loss allowance on a collective basis at an amount equal to 12-month expected credit losses based on the average 0.5 per cent 12-month PD. Implicit in the calculation is the 99.5 per cent probability that there is no default. At the reporting date the loss allowance for the 12-month expected credit losses is CU1,250 (0.5 percent × 25 percent × CU1,000,000).

Example 9—12-Month Expected Credit Loss Measurement Based on a Loss Rate Approach

IE53. Government A originates 2,000 bullet loans with a total gross carrying amount of CU500,000. Government A segments its portfolio into borrower groups (Groups X and Y) on the basis of shared credit risk characteristics at initial recognition. Group X comprises 1,000 loans with a gross carrying amount per borrower of CU200, for a total gross carrying amount of CU200,000. Group Y comprises 1,000 loans with a gross carrying amount per borrower of CU300, for a total gross carrying amount of CU300,000. There are no transaction costs and the loan contracts include no options (for example, prepayment or call options), premiums or discounts, points paid, or other fees.

IE54. Government A measures expected credit losses on the basis of a loss rate approach for Groups X and Y. In order to develop its loss rates, Government A considers samples of its own historical default and loss experience for those types of loans. In addition, Government A considers forward-looking information, and updates its historical information for current economic conditions as well as reasonable and supportable forecasts of future economic conditions. Historically, for a population of 1,000 loans in each group, Group X’s loss rates are 0.3 percent, based on four defaults, and historical loss rates for Group Y are 0.15 percent, based on two defaults.

¹³ Thus for simplicity of illustration it is assumed there is no amortization of the loan.

¹⁴ Because the LGD represents a percentage of the present value of the gross carrying amount, this example does not illustrate the time value of money.

	Number of clients in sample	Estimated per client gross carrying amount at default	Total estimated gross carrying amount at default	Historic per annum average defaults	Estimated total gross carrying amount at default	Present value of observed loss ^(a)	Loss rate
Group	A	B	C = A × B	D	E = B × D	F	G = F ÷ C
X	1,000	CU200	CU200,000	4	CU800	CU600	0.3 percent
Y	1,000	CU300	CU300,000	2	CU600	CU450	0.15 percent

(a) In accordance with paragraph 90(b) expected credit losses should be discounted using the effective interest rate. However, for purposes of this example, the present value of the observed loss is assumed.

IE55. At the reporting date, Government A expects an increase in defaults over the next 12 months compared to the historical rate. As a result, Government A estimates five defaults in the next 12 months for loans in Group X and three for loans in Group Y. It estimates that the present value of the observed credit loss per client will remain consistent with the historical loss per client.

IE56. On the basis of the expected life of the loans, Government A determines that the expected increase in defaults does not represent a significant increase in credit risk since initial recognition for the portfolios. On the basis of its forecasts, Government A measures the loss allowance at an amount equal to 12-month expected credit losses on the 1,000 loans in each group amounting to CU750 and CU675 respectively. This equates to a loss rate in the first year of 0.375 per cent for Group X and 0.225 per cent for Group Y.

	Number of clients in sample	Estimated per client gross carrying amount at default	Total estimated gross carrying amount at default	Expected defaults	Estimated total gross carrying amount at default	Present value of observed loss	Loss rate
Group	A	B	C = A × B	D	E = B × D	F	G = F ÷ C
X	1,000	CU200	CU200,000	5	CU1,000	CU750	0.375 percent
Y	1,000	CU300	CU300,000	3	CU900	CU675	0.225 percent

IE57. Government A uses the loss rates of 0.375 percent and 0.225 percent respectively to estimate 12-month expected credit losses on new loans in Group X and Group Y originated during the year and for which credit risk has not increased significantly since initial recognition.

Example 10—Revolving Credit Facilities

IE58. The Development Agency of Country A issues revolving loans to small construction companies that deliver public infrastructure. These revolving loans provide small construction companies with liquidity when cash inflows are limited. The revolving loans have a one-day notice period after which the Development Agency has the contractual right to cancel the loan (both the drawn and undrawn components). However, the Development Agency does not enforce its contractual right to cancel the revolving loans in the normal day-to-day management of the instruments and only cancels facilities when it becomes aware of an increase in credit risk and starts to monitor borrowers on an individual basis. The Development Agency therefore does not consider the contractual right to cancel the revolving loans to limit its exposure to credit losses to the contractual notice period.

IE59. For credit risk management purposes the Development Agency considers that there is only one set of contractual cash flows from borrowers to assess and does not distinguish between the drawn and undrawn balances at the reporting date. The portfolio is therefore managed and expected credit losses are measured on a facility level.

IE60. At the reporting date the outstanding balance on the revolving loan portfolio is CU60,000 and the available undrawn facility is CU40,000. The Development Agency determines the expected life of the portfolio by estimating the period over which it expects to be exposed to credit risk on the facilities at the reporting date, taking into account:

- The period over which it was exposed to credit risk on a similar portfolio of revolving construction loans;
- The length of time for related defaults to occur on similar financial instruments; and
- Past events that led to credit risk management actions because of an increase in credit risk on similar financial instruments, such as the reduction or removal of undrawn credit limits.

IE61. On the basis of the information listed in paragraph IE60, Development Agency determines that the expected life of the revolving loan portfolio is 30 months.

IE62. At the reporting date the Development Agency assesses the change in the credit risk on the portfolio since initial recognition and determines in accordance with paragraph 75 of IPSAS 41 that the credit risk on a portion of the loan facilities representing 25 per cent of the portfolio, has increased significantly since initial recognition. The outstanding

balance on these credit facilities for which lifetime expected credit losses should be recognized is CU20,000 and the available undrawn facility is CU10,000.

- IE63. When measuring the expected credit losses in accordance with paragraph 93 of IPSAS 41, Development Agency considers its expectations about future draw-downs over the expected life of the portfolio (i.e., 30 months) in accordance with paragraph AG195 and estimates what it expects the outstanding balance (i.e., exposure at default) on the portfolio would be if borrowers were to default. By using its credit risk models Development Agency determines that the exposure at default on the revolving loan facilities for which lifetime expected credit losses should be recognized, is CU25,000 (i.e., the drawn balance of CU20,000 plus further draw-downs of CU5,000 from the available undrawn commitment). The exposure at default of the loan facilities for which 12-month expected credit losses are recognized, is CU45,000 (i.e., the outstanding balance of CU40,000 and an additional draw-down of CU5,000 from the undrawn commitment over the next 12 months).
- IE64. The exposure at default and expected life determined by the Development Agency are used to measure the lifetime expected credit losses and 12-month expected credit losses on its loan portfolio.
- IE65. The Development Agency measures expected credit losses on a facility level and therefore cannot separately identify the expected credit losses on the undrawn commitment component from those on the loan component. It recognizes expected credit losses for the undrawn commitment together with the loss allowance for the loan component in the statement of financial position. To the extent that the combined expected credit losses exceed the gross carrying amount of the financial asset, the expected credit losses should be presented as a provision (in accordance with IPSAS 30 *Financial Instruments: Disclosures*).

Example 11—Modification of Contractual Cash Flows

- IE66. Government A originates a five-year loan that requires the repayment of the outstanding contractual amount in full at maturity. Its contractual par amount is CU1,000 with an interest rate of 5 per cent payable annually. The effective interest rate is 5 per cent. At the end of the first reporting period (Period 1), Government A recognizes a loss allowance at an amount equal to 12-month expected credit losses because there has not been a significant increase in credit risk since initial recognition. A loss allowance balance of CU20 is recognized.
- IE67. In the subsequent reporting period (Period 2), Government A determines that the credit risk on the loan has increased significantly since initial recognition. As a result of this increase, Government A recognizes lifetime expected credit losses on the loan. The loss allowance balance is CU30.
- IE68. At the end of the third reporting period (Period 3), following significant financial difficulty of the borrower, Government A modifies the contractual cash flows on the loan. It extends the contractual term of the loan by one year so that the remaining term at the date of the modification is three years. The modification does not result in the derecognition of the loan by Government A.
- IE69. As a result of that modification, Government A recalculates the gross carrying amount of the financial asset as the present value of the modified contractual cash flows discounted at the loan's original effective interest rate of 5 per cent. In accordance with paragraph 71 of IPSAS 41, the difference between this recalculated gross carrying amount and the gross carrying amount before the modification is recognized as a modification gain or loss. Government A recognizes the modification loss (calculated as CU300) against the gross carrying amount of the loan, reducing it to CU700, and a modification loss of CU300 in surplus or deficit.
- IE70. Government A also remeasures the loss allowance, taking into account the modified contractual cash flows and evaluates whether the loss allowance for the loan shall continue to be measured at an amount equal to lifetime expected credit losses. Government A compares the current credit risk (taking into consideration the modified cash flows) to the credit risk (on the original unmodified cash flows) at initial recognition. Government A determines that the loan is not credit-impaired at the reporting date but that credit risk has still significantly increased compared to the credit risk at initial recognition and continues to measure the loss allowance at an amount equal to lifetime expected credit losses. The loss allowance balance for lifetime expected credit losses is CU100 at the reporting date.

Period	Beginning gross carrying amount	Impairment (loss)/ gain	Modification (loss)/ gain	Interest revenue	Cash flows	Ending gross carrying amount	Loss allowance	Ending amortised cost amount
	A	B	C	D Gross: $A \times 5$ percent	E	$F = A + C + D - E$	G	$H = F - G$
1	CU1,000	(CU20)		CU50	CU50	CU1,000	CU20	CU980
2	CU1,000	(CU10)		CU50	CU50	CU1,000	CU30	CU970
3	CU1,000	(CU70)	(CU300)	CU50	CU50	CU700	CU100	CU600

- IE71. At each subsequent reporting date, Government A evaluates whether there is a significant increase in credit risk by comparing the loan's credit risk at initial recognition (based on the original, unmodified cash flows) with the credit risk at the reporting date (based on the modified cash flows), in accordance with paragraph 84 of IPSAS 41.
- IE72. Two reporting periods after the loan modification (Period 5), the borrower has outperformed its business plan significantly compared to the expectations at the modification date. In addition, the outlook for the business is more positive than previously envisaged. An assessment of all reasonable and supportable information that is available without undue cost or effort indicates that the overall credit risk on the loan has decreased and that the risk of a default occurring over the expected life of the loan has decreased, so Government A adjusts the borrower's internal credit rating at the end of the reporting period.
- IE73. Given the positive overall development, Government A re-assesses the situation and concludes that the credit risk of the loan has decreased and there is no longer a significant increase in credit risk since initial recognition. As a result, Government A once again measures the loss allowance at an amount equal to 12-month expected credit losses.

Example 12—Provision Matrix

- IE74. Municipality M provides water delivery services for households within its jurisdiction. Households are invoiced on a monthly basis based on the water consumed during the period. This represents a portfolio of trade receivables of CU30 million in 20X1 for Municipality M. The portfolio consists of a large number of households with small balances outstanding. The trade receivables are categorized by common risk characteristics that are representative of the households' abilities to pay all amounts due in accordance with the contractual terms. The trade receivables do not have a significant financing component. In accordance with paragraph 87 of IPSAS 41 the loss allowance for such trade receivables is always measured at an amount equal to lifetime time expected credit losses.
- IE75. To determine the expected credit losses for the portfolio, Municipality M uses a provision matrix. The provision matrix is based on its historical observed default rates over the expected life of the trade receivables and is adjusted for forward-looking estimates. At every reporting date the historical observed default rates are updated and changes in the forward-looking estimates are analyzed. In this case it is forecast that economic conditions will deteriorate over the next year.
- IE76. On that basis, Municipality M estimates the following provision matrix:

	Current	1–30 days past due	31–60 days past due	61–90 days past due	More than 90 days past due
Default rate	0.3 percent	1.6 percent	3.6 percent	6.6 percent	10.6 percent

- IE77. The trade receivables from the large number of households amount to CU30 million and are measured using the provision matrix.

	Gross carrying amount	Lifetime expected credit loss allowance (Gross carrying amount × lifetime expected credit loss rate)
Current	CU15,000,000	CU45,000
1–30 days past due	CU7,500,000	CU120,000
31–60 days past due	CU4,000,000	CU144,000
61–90 days past due	CU2,500,000	CU165,000
More than 90 days past due	CU1,000,000	CU106,000
	CU30,000,000	CU580,000

Example 13—Debt Instrument Measured at Fair Value through Net Assets/Equity

- IE78. Public Investment Fund A purchases a debt instrument with a fair value of CU1,000 on December 15, 20X0 and measures the debt instrument at fair value through net assets/equity. The instrument has an interest rate of 5 per cent over the contractual term of 10 years, and has a 5 per cent effective interest rate. At initial recognition the entity determines that the asset is not purchased or originated credit-impaired.

	Debit	Credit
Financial asset—Fair Value Through Net Assets/Equity	CU1,000	
Cash		CU1,000
<i>(To recognize the debt instrument measured at its fair value)</i>		

- IE79. On December 31, 20X0 (the reporting date), the fair value of the debt instrument has decreased to CU950 as a result of changes in market interest rates. The entity determines that there has not been a significant increase in credit risk since initial recognition and that expected credit losses should be measured at an amount equal to 12-month expected credit losses, which amounts to CU30. For simplicity, journal entries for the receipt of interest revenue are not provided.

	Debit	Credit
Impairment loss (surplus or deficit)	CU30	
Net Assets/Equity ^(a)	CU20	
Financial asset—Fair Value Through Net Assets/Equity		CU50
<i>(To recognize 12-month expected credit losses and other fair value changes on the debt instrument)</i>		
<small>(a) The cumulative loss in net assets/equity at the reporting date was CU20. That amount consists of the total fair value change of CU50 (i.e., CU1,000 – CU950) offset by the change in the accumulated impairment amount representing 12-month expected credit losses that was recognized (CU30).</small>		

- IE80. Disclosure would be provided about the accumulated impairment amount of CU30.
- IE81. On January 1, 20X1, the entity decides to sell the debt instrument for CU950, which is its fair value at that date.

	Debit	Credit
Cash	CU950	
Financial asset—Fair Value Through Net Assets/Equity		CU950
Loss (surplus or deficit)	CU20	
Net Assets/Equity		CU20
<i>(To derecognize the fair value through net assets/equity asset and recycle amounts accumulated in net assets/equity to surplus or deficit)</i>		

Example 14—Interaction Between the Fair Value Through Net Assets/Equity Measurement Category and Foreign Currency Denomination, Fair Value Hedge Accounting and Impairment

- IE82. This example illustrates the accounting relating to a debt instrument denominated in a foreign currency, measured at fair value through net assets/equity and designated in a fair value hedge accounting relationship. The example illustrates the interaction with accounting for impairment.
- IE83. An entity purchases a debt instrument (a bond) denominated in a foreign currency (FC) for its fair value of FC100,000 on January 1, 20X0 and classifies the bond as measured at fair value through net assets/equity. The bond has five years remaining to maturity and a fixed coupon of 5 per cent over its contractual life on the contractual par amount of FC100,000. On initial recognition the bond has a 5 per cent effective interest rate. The entity's functional currency is its local currency (LC). The exchange rate is FC1 to LC1 on January 1, 20X0. At initial recognition the entity determines that the bond is not purchased or originated credit-impaired. In addition, as at January 1, 20X0 the 12-month expected credit losses are determined to be FC1,200. Its amortized cost in FC as at January 1, 20X0 is equal to its gross carrying amount of FC100,000 less the 12-month expected credit losses (FC100,000—FC1,200).
- IE84. The entity has the following risk exposures:
- Fair value interest rate risk in FC: the exposure that arises as a result of purchasing a fixed interest rate instrument; and
 - Foreign exchange risk: the exposure to changes in foreign exchange rates measured in LC.
- IE85. The entity hedges its risk exposures using the following risk management strategy:
- For fixed interest rate risk (in FC) the entity decides to link its interest receipts in FC to current variable interest rates in FC. Consequently, the entity uses interest rate swaps denominated in FC under which it pays fixed interest and receives variable interest in FC; and
 - For foreign exchange risk the entity decides not to hedge against any variability in LC arising from changes in foreign exchange rates.
- IE86. The entity designates the following hedge relationship:¹⁵ a fair value hedge of the bond in FC as the hedged item with changes in benchmark interest rate risk in FC as the hedged risk. The entity enters into an on-market swap that pays fixed and receives variable interest on the same day and designates the swap as the hedging instrument. The tenor of the swap matches that of the hedged item (i.e., five years).

¹⁵ This example assumes that all qualifying criteria for hedge accounting are met (see paragraph 129 of IPSAS 41). The following description of the designation is solely for the purpose of understanding this example (i.e., it is not an example of the complete formal documentation required in accordance with paragraph 129 of IPSAS 41).

- IE87. For simplicity, in this example it is assumed that no hedge ineffectiveness arises in the hedge accounting relationship. This is because of the assumptions made in order to better focus on illustrating the accounting mechanics in a situation that entails measurement at fair value through net assets/equity of a foreign currency financial instrument that is designated in a fair value hedge relationship, and also to focus on the recognition of impairment gains or losses on such an instrument.
- IE88. The entity makes the following journal entries to recognize the bond and the swap on January 1, 20X0:

	Debit LC	Credit LC
Financial asset—Fair Value Through Net Assets/Equity	100,000	
Cash		100,000
<i>(To recognize the bond at its fair value)</i>		
Impairment loss (surplus or deficit)	1,200	
Net Assets/Equity		1,200
<i>(To recognize the 12-month expected credit losses)^(a)</i>		
Swap	–	
Cash		–
<i>(To recognize the swap at its fair value)</i>		
(a) In case of items measured in the functional currency of an entity the journal entry recognizing expected credit losses will usually be made at the reporting date.		

- IE89. As of December 31, 20X0 (the reporting date), the fair value of the bond decreased from FC100,000 to FC96,370 because of an increase in market interest rates. The fair value of the swap increased to FC1,837. In addition, as at December 31, 20X0 the entity determines that there has been no change to the credit risk on the bond since initial recognition and continues to carry a loss allowance for 12-month expected credit losses at FC1,200.¹⁶ As at December 31, 20X0, the exchange rate is FC1 to LC1.4. This is reflected in the following table:

	January 1, 20X0	December 31, 20X0
Bond		
Fair value (FC)	100,000	96,370
Fair value (LC)	100,000	134,918
Amortised cost (FC)	98,800	98,800
Amortised cost (LC)	98,800	138,320
Interest rate swap		
Interest rate swap (FC)	–	1,837
Interest rate swap (LC)	–	2,572
Impairment – loss allowance		
Loss allowance (FC)	1,200	1,200
Loss allowance (LC)	1,200	1,680
FX rate (FC:LC)	1:1	1:1.4

- IE90. The bond is a monetary asset. Consequently, the entity recognizes the changes arising from movements in foreign exchange rates in surplus or deficit in accordance with paragraphs 27(a) and 32 of IPSAS 4, *The Effects of Changes in Foreign Exchange Rates* and recognizes other changes in accordance with IPSAS 41. For the purposes of applying paragraph 32 of IPSAS 4 the asset is treated as an asset measured at amortized cost in the foreign currency.
- IE91. As shown in the table, on December 31, 20X0 the fair value of the bond is LC134,918 ($FC96,370 \times 1.4$) and its amortized cost is LC138,320 ($FC(100,000 - 1,200) \times 1.4$).
- IE92. The gain recognized in surplus or deficit that is due to the changes in foreign exchange rates is LC39,520 ($LC138,320 - LC98,800$), i.e., the change in the amortized cost of the bond during 20X0 in LC. The change in the fair value of the bond in LC, which amounts to LC34,918, is recognized as an adjustment to the carrying amount. The difference between the fair value of the bond and its amortized cost in LC is LC3,402 ($LC134,918 - LC138,320$). However, the change in the cumulative gain or loss recognized in net assets/equity during 20X0 as a reduction is LC 4,602 ($LC3,402 + LC1,200$).
- IE93. A gain of LC2,572 ($FC1,837 \times 1.4$) on the swap is recognized in surplus or deficit and, because it is assumed that there is no hedge ineffectiveness, an equivalent amount is recycled from net assets/equity in the same period. For simplicity, journal entries for the recognition of interest revenue are not provided. It is assumed that interest accrued is received in the period.
- IE94. The entity makes the following journal entries on December 31, 20X0:

¹⁶ For the purposes of simplicity the example ignores the impact of discounting when computing expected credit losses.

FINANCIAL INSTRUMENTS

	Debit LC	Credit LC
Financial asset—Fair Value Through Net Assets/Equity	34,918	
Net Assets/Equity	4,602	
Surplus or deficit		39,520
<i>(To recognize the foreign exchange gain on the bond, the adjustment to its carrying amount measured at fair value in LC and the movement in the accumulated impairment amount due to changes in foreign exchange rates)</i>		
Swap	2,572	
Surplus or deficit		2,572
<i>(To remeasure the swap at fair value)</i>		
Surplus or deficit	2,572	
Net Assets/Equity		2,572
<i>(To recognize in surplus or deficit the change in fair value of the bond due to a change in the hedged risk)</i>		

- IE95. In accordance with paragraph 20A of IPSAS 30, the loss allowance for financial assets measured at fair value through net assets/equity is not presented separately as a reduction of the carrying amount of the financial asset. However, disclosure would be provided about the accumulated impairment amount recognized in net assets/equity.
- IE96. As at December 31, 20X1 (the reporting date), the fair value of the bond decreased to FC87,114 because of an increase in market interest rates and an increase in the credit risk of the bond. The fair value of the swap increased by FC255 to FC2,092. In addition, as at December 31, 20X1 the entity determines that there has been a significant increase in credit risk on the bond since initial recognition, so a loss allowance at an amount equal to lifetime expected credit losses is recognized.¹⁷ The estimate of lifetime expected credit losses as at December 31, 20X1 is FC9,700. As at December 31, 20X1, the exchange rate is FC1 to LC1.25. This is reflected in the following table:

	December 31, 20X0	December 31, 20X1
Bond		
Fair value (FC)	96,370	87,114
Fair value (LC)	134,918	108,893
Amortised cost (FC)	98,800	90,300
Amortised cost (LC)	138,320	112,875
Interest rate swap		
Interest rate swap (FC)	1,837	2,092
Interest rate swap (LC)	2,572	2,615
Impairment – loss allowance		
Loss allowance (FC)	1,200	9,700
Loss allowance (LC)	1,680	12,125
FX rate (FC:LC)	1:1.4	1:1.25

- IE97. As shown in the table, as at December 31, 20X1 the fair value of the bond is LC108,893 ($FC87,114 \times 1.25$) and its amortized cost is LC112,875 ($FC(100,000 - 9,700) \times 1.25$).
- IE98. The lifetime expected credit losses on the bond are measured as FC9,700 as of December 31, 20X1. Thus the impairment loss recognized in surplus or deficit in LC is LC10,625 ($FC(9,700 - 1,200) \times 1.25$).
- IE99. The loss recognized in surplus or deficit because of the changes in foreign exchange rates is LC14,820 ($LC112,875 - LC138,320 + LC10,625$), which is the change in the gross carrying amount of the bond on the basis of amortized cost during 20X1 in LC, adjusted for the impairment loss. The difference between the fair value of the bond and its amortized cost in the functional currency of the entity on December 31, 20X1 is LC3,982 ($LC108,893 - LC112,875$). However, the change in the cumulative gain or loss recognized in net assets/equity during 20X1 as a reduction in net assets/equity is LC11,205 ($LC3,982 - LC3,402 + LC10,625$).
- IE100. A gain of LC43 ($LC2,615 - LC2,572$) on the swap is recognized in surplus or deficit and, because it is assumed that there is no hedge ineffectiveness, an equivalent amount is recycled from net assets/equity in the same period.

¹⁷ For simplicity this example assumes that credit risk does not dominate the fair value hedge relationship.

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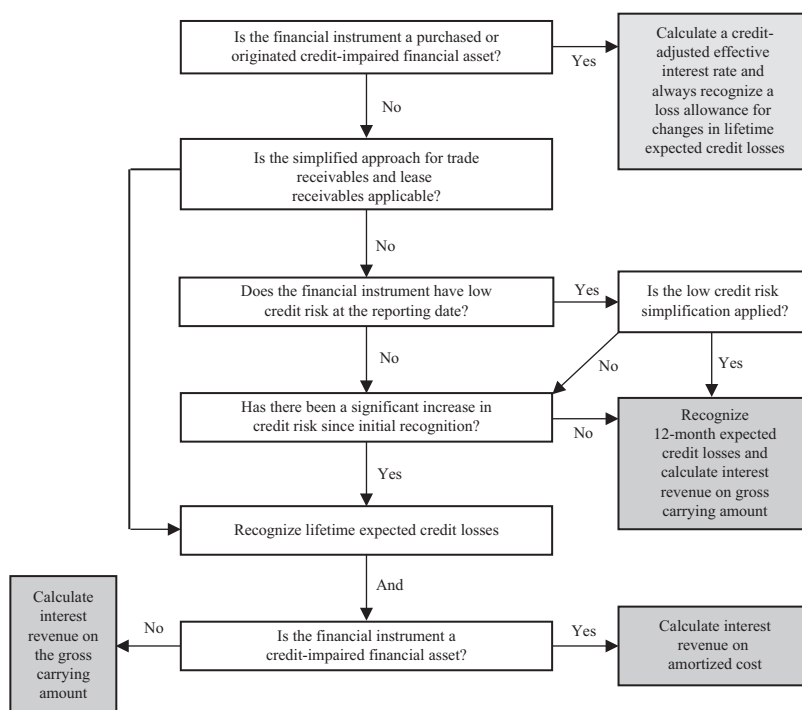
IE101. The entity makes the following journal entries on December 31, 20X1:

	Debit LC	Credit LC
Financial asset—Fair Value Through Net Assets/Equity		26,025
Net Assets/Equity	11,205	
Surplus or deficit	14,820	
<i>(To recognize the foreign exchange gain on the bond, the adjustment to its carrying amount measured at fair value in LC and the movement in the accumulated impairment amount due to changes in foreign exchange rates)</i>		
Swap	43	
Surplus or deficit		43
<i>(To remeasure the swap at fair value)</i>		
Surplus or deficit	43	
Net Assets/Equity		43
<i>(To recognize in surplus or deficit the change in fair value of the bond due to a change in the hedged risk)</i>		
Surplus or deficit (impairment loss)	10,625	
Net Assets/Equity (accumulated impairment amount)		10,625
<i>(To recognize lifetime expected credit losses)</i>		

IE102. On January 1, 20X2, the entity decides to sell the bond for FC 87,114, which is its fair value at that date and also closes out the swap at fair value. The foreign exchange rate is the same as at December 31, 20X1. The journal entries to derecognize the bond and reclassify the gains and losses that have accumulated in net assets/equity would be as follows:

	Debit LC	Credit LC
Cash	108,893	
Financial asset—Fair Value Through Net Assets/Equity		108,893
Loss on sale (surplus or deficit)	1,367 ^(a)	
Net Assets/Equity		1,367
<i>(To derecognize the bond)</i>		
Swap		2,615
Cash	2,615	
<i>(To close out the swap)</i>		
(a) This amount consists of the changes in fair value of the bond, the accumulated impairment amount and the changes in foreign exchange rates recognized in net assets/equity (LC2,572 + LC1,200 + LC43 + LC10,625 – LC4,602 – LC11,205 = -LC1,367, which is recycled as a loss in surplus or deficit).		

Application of the Impairment Requirements on a Reporting Date



Reclassification of Financial Assets (Paragraphs 94–100)

IE103. This example illustrates the accounting requirements for the reclassification of financial assets between measurement categories in accordance with paragraphs 94–100 of IPSAS 41. The example illustrates the interaction with the impairment requirements in paragraphs 73–93 of IPSAS 41.

Example 15—Reclassification of Financial Assets

IE104. An entity purchases a portfolio of bonds for its fair value (gross carrying amount) of CU500,000.

IE105. The entity changes the management model for managing the bonds in accordance with paragraph 54 of IPSAS 41. The fair value of the portfolio of bonds at the reclassification date is CU490,000.

IE106. If the portfolio was measured at amortized cost or at fair value through net assets/equity immediately prior to reclassification, the loss allowance recognized at the date of reclassification would be CU6,000 (reflecting a significant increase in credit risk since initial recognition and thus the measurement of lifetime expected credit losses).

IE107. The 12-month expected credit losses at the reclassification date are CU4,000.

IE108. For simplicity, journal entries for the recognition of interest revenue are not provided.

Scenario 1: Reclassification Out of the Amortized Cost Measurement Category and into the Fair Value through Surplus or Deficit Measurement Category

IE109. Department of Treasury A reclassifies the portfolio of bonds out of the amortized cost measurement category and into the fair value through surplus or deficit measurement category. At the reclassification date, the portfolio of bonds is measured at fair value. Any gain or loss arising from a difference between the previous amortized cost amount of the portfolio of bonds and the fair value of the portfolio of bonds is recognized in surplus or deficit on reclassification.

	Debit	Credit
Bonds (Fair Value Through Surplus or Deficit assets)	CU490,000	
Bonds (gross carrying amount of the amortized cost assets)		CU500,000
Loss allowance	CU6,000	
Reclassification loss (surplus or deficit)	CU4,000	
<i>(To recognize the reclassification of bonds from amortized cost to fair value through surplus or deficit and to derecognize the loss allowance.)</i>		

Scenario 2: Reclassification Out of the Fair Value through Surplus or Deficit Measurement Category and into the Amortized Cost Measurement Category

IE110. Department of Treasury A reclassifies the portfolio of bonds out of the fair value through surplus or deficit measurement category and into the amortized cost measurement category. At the reclassification date, the fair value of the portfolio of bonds becomes the new gross carrying amount and the effective interest rate is determined based on that gross carrying amount. The impairment requirements apply to the bond from the reclassification date. For the purposes of recognizing expected credit losses, the credit risk of the portfolio of bonds at the reclassification date becomes the credit risk against which future changes in credit risk shall be compared.

	Debit	Credit
Bonds (gross carrying amount of the amortized cost assets)	CU490,000	
Bonds (Fair Value Through Surplus or Deficit assets)		CU490,000
Impairment loss (surplus or deficit)	CU4,000	
Loss allowance		CU4,000
<i>(To recognize reclassification of bonds from fair value through surplus or deficit to amortized cost including commencing accounting for impairment.)</i>		

Scenario 3: Reclassification Out of the Amortized Cost Measurement Category and into the Fair Value through Net Assets/Equity Measurement Category

IE111. Department of Treasury A reclassifies the portfolio of bonds out of the amortized cost measurement category and into the fair value through net assets/equity measurement category. At the reclassification date, the portfolio of bonds is measured at fair value. Any gain or loss arising from a difference between the previous amortized cost amount of the portfolio of bonds and the fair value of the portfolio of bonds is recognized in net assets/equity. The effective interest rate and the measurement of expected credit losses are not adjusted as a result of the reclassification. The credit risk at initial recognition continues to be used to assess changes in credit risk. From the reclassification date the loss allowance ceases to be recognized as an adjustment to the gross carrying amount of the bond and is recognized as an accumulated impairment amount, which would be disclosed.

	Debit	Credit
Bonds (Fair Value Through Net Assets/Equity assets)	CU490,000	
Bonds (gross carrying amount of amortized cost assets)		CU500,000
Loss allowance	CU6,000	
Net Assets/Equity ^(a)	CU4,000	
<i>(To recognize the reclassification from amortized cost to fair value through net assets/equity. The measurement of expected credit losses is however unchanged.)</i>		
(a) For simplicity, the amount related to impairment is not shown separately. If it had been, this journal entry (i.e., DR CU4,000) would be split into the following two entries: DR Net Assets/Equity CU10,000 (fair value changes) and CR Net Assets/Equity CU6,000 (accumulated impairment amount).		

Scenario 4: Reclassification Out of the Fair Value through Net Assets/Equity Measurement Category and into the Amortized Cost Measurement Category

IE112. Department of Treasury A reclassifies the portfolio of bonds out of the fair value through net assets/equity measurement category and into the amortized cost measurement category. The portfolio of bonds is reclassified at fair value. However, at the reclassification date, the cumulative gain or loss previously recognized in net assets/equity is removed from net assets/equity and adjusted against the fair value of the portfolio of bonds. As a result, the portfolio of bonds is measured at the reclassification date as if it had always been measured at amortized cost. The effective interest rate and the measurement of expected credit losses are not adjusted as a result of the reclassification. The credit risk at initial recognition continues to be used to assess changes in the credit risk on the bonds. The loss allowance is recognized as an adjustment to the gross carrying amount of the bond (to reflect the amortized cost amount) from the reclassification date.

	Debit	Credit
Bonds (gross carrying value of the amortized cost assets)	CU490,000	
Bonds (Fair Value Through Net Assets/Equity assets)		CU490,000
Bonds (gross carrying value of the amortized cost assets)	CU10,000	
Loss allowance		CU6,000
Net Assets/Equity ^(a)		CU4,000
<i>(To recognize the reclassification from fair value through net assets/equity to amortized cost including the recognition of the loss allowance deducted to determine the amortized cost amount. The measurement of expected credit losses is however unchanged.)</i>		
(a) The cumulative loss in net assets/equity at the reclassification date was CU4,000. That amount consists of the total fair value change of CU10,000 (i.e., CU500,000 – 490,000) offset by the accumulated impairment amount recognized (CU6,000) while the assets were measured at fair value through net assets/equity.		

Scenario 5: Reclassification Out of the Fair Value through Surplus or Deficit Measurement Category and into the Fair Value Through Net Assets/Equity Measurement Category

IE113. Department of Treasury A reclassifies the portfolio of bonds out of the fair value through surplus or deficit measurement category and into the fair value through net assets/equity measurement category. The portfolio of bonds continues to be measured at fair value. However, for the purposes of applying the effective interest method, the fair value of the portfolio of bonds at the reclassification date becomes the new gross carrying amount and the effective interest rate is determined based on that new gross carrying amount. The impairment requirements apply from the reclassification date. For the purposes of recognizing expected credit losses, the credit risk of the portfolio of bonds at the reclassification date becomes the credit risk against which future changes in credit risk shall be compared.

	Debit	Credit
Bonds (Fair Value Through Net Assets/Equity assets)	CU490,000	
Bonds (Fair Value Through Surplus or Deficit assets)		CU490,000
Impairment loss (surplus or deficit)	CU4,000	
Net Assets/Equity		CU4,000
<i>(To recognize the reclassification of bonds from fair value through surplus or deficit to fair value through net assets/equity including commencing accounting for impairment. The net assets/equity amount reflects the loss allowance at the date of reclassification (an accumulated impairment amount relevant for disclosure purposes) of CU4,000.)</i>		

Scenario 6: Reclassification Out of the Fair Value through Net Assets/Equity Measurement Category and into the Fair Value Through Surplus or Deficit Measurement Category

IE114. Department of Treasury A reclassifies the portfolio of bonds out of the fair value through net assets/equity measurement category and into the fair value through surplus or deficit measurement category. The portfolio of bonds continues to be measured at fair value. However, the cumulative gain or loss previously recognized in net assets/equity is reclassified from net assets/equity to surplus or deficit as a reclassification adjustment (see IPSAS 1, *Presentation of Financial Statements*).

	Debit	Credit
Bonds (Fair Value Through Surplus or Deficit assets)	CU490,000	
Bonds (Fair Value Through Net Assets/Equity assets)		CU490,000
Reclassification loss (surplus or deficit)	CU4,000	
Net Assets/Equity ^(a)		CU4,000
<i>(To recognize the reclassification of bonds from fair value through net assets/equity to fair value through surplus or deficit.)</i>		
<small>(a) The cumulative loss in net assets/equity at the reclassification date was CU4,000. That amount consists of the total fair value change of CU10,000 (i.e., CU500,000 – 490,000) offset by the loss allowance that was recognized (CU6,000) while the assets were measured at fair value through net assets/equity.</small>		

Hedge Accounting for Aggregated Exposures

IE115. The following examples illustrate the mechanics of hedge accounting for aggregated exposures.

Example 16—Combined Commodity Price Risk and Foreign Currency Risk Hedge (Cash Flow Hedge/Cash Flow Hedge Combination)

Fact Pattern

IE116. Municipality A wants to hedge a highly probable forecast electricity purchase (which is expected to occur at the end of Period 5). Government A's functional currency is its Local Currency (LC). Electricity is traded in Foreign Currency (FC). Government A has the following risk exposures:

- (a) Commodity price risk: the variability in cash flows for the purchase price, which results from fluctuations of the spot price of electricity in FC; and
- (b) Foreign currency (FX) risk: the variability in cash flows that result from fluctuations of the spot exchange rate between LC and FC.

IE117. Municipality A hedges its risk exposures using the following risk management strategy:

- (a) Municipality A uses benchmark commodity forward contracts, which are denominated in FC, to hedge its electricity purchases four periods before delivery. The electricity price that Municipality A actually pays for its purchase is different from the benchmark price because of differences in the type of electricity, the location and delivery

arrangement.¹⁸ This gives rise to the risk of changes in the relationship between the two electricity prices (sometimes referred to as ‘basis risk’), which affects the effectiveness of the hedging relationship. Municipality A does not hedge this risk because it is not considered economical under cost/benefit considerations.

- (b) Municipality A also hedges its FX risk. However, the FX risk is hedged over a different horizon—only three periods before delivery. Municipality A considers the FX exposure from the variable payments for the electricity purchase in FC and the gain or loss on the commodity forward contract in FC as one aggregated FX exposure. Hence, Municipality A uses one single FX forward contract to hedge the FX cash flows from a forecast electricity purchase and the related commodity forward contract.

IE118. The following table sets out the parameters used for Example 16 (the ‘basis spread’ is the differential, expressed as a percentage, between the price of the electricity that Municipality A actually buys and the price for the benchmark electricity):

Example 16—Parameters					
Period	1	2	3	4	5
Interest rates for remaining maturity [FC]	0.26%	0.21%	0.16%	0.06%	0.00%
Interest rates for remaining maturity [LC]	1.12%	0.82%	0.46%	0.26%	0.00%
Forward price [FC/MWh]	1.25	1.01	1.43	1.22	2.15
Basis spread	-5.00%	-5.50%	-6.00%	-3.40%	-7.00%
FX rate (spot) [FC/LC]	1.3800	1.3300	1.4100	1.4600	1.4300

Accounting Mechanics

IE119. Municipality A designates as cash flow hedges the following two hedging relationships:¹⁹

- (a) A commodity price risk hedging relationship between the electricity price related variability in cash flows attributable to the forecast electricity purchase in FC as the hedged item and a commodity forward contract denominated in FC as the hedging instrument (the ‘first level relationship’). This hedging relationship is designated at the end of Period 1 with a term to the end of Period 5. Because of the basis spread between the price of the electricity that Municipality A actually buys and the price for the benchmark electricity, Municipality A designates a volume of 112,500 MWh of electricity as the hedging instrument and a volume of 118,421 MWh as the hedged item.²⁰
- (b) An FX risk hedging relationship between the aggregated exposure as the hedged item and an FX forward contract as the hedging instrument (the ‘second level relationship’). This hedging relationship is designated at the end of Period 2 with a term to the end of Period 5. The aggregated exposure that is designated as the hedged item represents the FX risk that is the effect of exchange rate changes, compared to the forward FX rate at the end of Period 2 (i.e., the time of designation of the FX risk hedging relationship), on the combined FX cash flows in FC of the two items designated in the commodity price risk hedging relationship, which are the forecast electricity purchase and the commodity forward contract. Municipality A’s long-term view of the basis spread between the price of the electricity that it actually buys and the price for the benchmark electricity has not changed from the end of Period 1. Consequently, the actual volume of hedging instrument that Municipality A enters into (the nominal amount of the FX forward contract of FC140,625) reflects the cash flow exposure associated with a basis spread that had remained at -5 per cent. However, Municipality A’s actual aggregated exposure is affected by changes in the basis spread. Because the basis spread has moved from -5 per cent to -5.5 per cent during Period 2, Municipality A’s actual aggregated exposure at the end of Period 2 is FC140,027.

IE120. The following table sets out the fair values of the derivatives, the changes in the value of the hedged items and the calculation of the cash flow hedge reserves and hedge ineffectiveness:²¹

¹⁸ For the purpose of this example it is assumed that the hedged risk is not designated based on a benchmark electricity price risk component. Consequently, the entire electricity price risk is hedged.

¹⁹ This example assumes that all qualifying criteria for hedge accounting are met (see paragraph 129 of IPSAS 41). The following description of the designation is solely for the purpose of understanding this example (i.e., it is not an example of the complete formal documentation required in accordance with paragraph 129(b) of IPSAS 41).

²⁰ In this example, the current basis spread at the time of designation is coincidentally the same as Municipality A’s long-term view of the basis spread (-5 per cent) that determines the volume of electricity purchases that it actually hedges. Also, this example assumes that Municipality A designates the hedging instrument in its entirety and designates as much of its highly probable forecast purchases as it regards as hedged. That results in a hedge ratio of 1/(100 percent -5 percent). Other entities might follow different approaches when determining what volume of their exposure they actually hedge, which can result in a different hedge ratio and also designating less than a hedging instrument in its entirety (see paragraph 129 of IPSAS 41).

²¹ In the following table for the calculations all amounts (including the calculations for accounting purposes of amounts for assets, liabilities, net assets/equity

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Example 16—Calculations		Period	1	2	3	4	5
Commodity Price Risk Hedging Relationship (First Level Relationship)							
<i>Forward Purchase Contract for Electricity</i>							
Volume (MWh)	112,500						
Forward price [FC/MWh]	1.25	Price (fwd) [FC/MWh]	1.25	1.01	1.43	1.22	2.15
		Fair value [FC]	0	(26,943)	20,219	(3,373)	101,250
		Fair value [LC]	0	(20,258)	14,339	(2,310)	70,804
		Change in fair value [LC]		(20,258)	34,598	(16,650)	73,114
<i>Hedged Forecast Electricity Purchase</i>							
Hedge ratio	105.26%	Basis spread	-5.00%	-5.50%	-6.00%	-3.40%	-7.00%
Hedged volume	118,421	Price (fwd) [FC/MWh]	1.19	0.95	1.34	1.18	2.00
Implied forward price	1.1875	Present value [FC]	0	27,540	(18,528)	1,063	(96,158)
		Present value [LC]	0	20,707	(13,140)	728	(67,243)
		Change in present value [LC]		20,707	(33,847)	13,868	(67,971)
<i>Accounting</i>			<i>LC</i>	<i>LC</i>	<i>LC</i>	<i>LC</i>	<i>LC</i>
Derivative			0	(20,258)	14,339	(2,310)	70,804
Cash flow hedge reserve			0	(20,258)	13,140	(728)	67,243
Change in cash flow hedge reserve				(20,258)	33,399	(13,868)	67,971
Surplus or deficit				0	1,199	(2,781)	5,143
Accumulated surplus or deficit			0	0	1,199	(1,582)	3,561
FX Risk Hedging Relationship (Second Level Relationship)							
FX rate [FC/LC]		Spot	1.3800	1.3300	1.4100	1.4600	1.4300
		Forward	1.3683	1.3220	1.4058	1.4571	1.4300
<i>FX forward contract (Buy FC/Sell LC)</i>							
Volume [FC]	140,625						
Forward rate (in P ₂)	1.3220	Fair value [LC]		0	(6,313)	(9,840)	(8,035)
		Change in fair value [LC]			(6,313)	(3,528)	1,805
<i>Hedged FX risk</i>							
Aggregated FX exposure		Hedged volume [FC]		140,027	138,932	142,937	135,533
		Present value [LC]		0	6,237	10,002	7,744
		Change in present value [LC]			6,237	3,765	(2,258)
<i>Accounting</i>			<i>LC</i>	<i>LC</i>	<i>LC</i>	<i>LC</i>	<i>LC</i>
Derivative				0	(6,313)	(9,840)	(8,035)
Cash flow hedge reserve				0	(6,237)	(9,840)	(7,744)
Change in cash flow hedge reserve					(6,237)	(3,604)	2,096
Surplus or deficit					(76)	76	(291)
Accumulated surplus or deficit				0	(76)	0	(291)

IE121. The commodity price risk hedging relationship is a cash flow hedge of a highly probable forecast transaction that starts at the end of Period 1 and remains in place when the FX risk hedging relationship starts at the end of Period 2, i.e., the first level relationship continues as a separate hedging relationship.

IE122. The volume of the aggregated FX exposure (in FC), which is the hedged volume of the FX risk hedging relationship, is the total of:²²

and surplus or deficit) are in the format of positive (plus) and negative (minus) numbers (e.g., a surplus or deficit amount that is a negative number is a loss).

²² For example, at the end of Period 3 the aggregated FX exposure is determined as: 118,421 MWh × 1.34 FC/MWh = FC159,182 for the expected price of the actual electricity purchase and 112,500 MWh × (1.25 [FC/MWh] – 1.43 [FC/MWh]) = FC(20,250) for the expected price differential under the commodity forward contract, which gives a total of FC138,932—the volume of the aggregated FX exposure at the end of Period 3.

- (a) The hedged electricity purchase volume multiplied by the current forward price (this represents the expected spot price of the actual electricity purchase); and
- (b) The volume of the hedging instrument (designated nominal amount) multiplied by the difference between the contractual forward rate and the current forward rate (this represents the expected price differential from benchmark electricity price movements in FC that Municipality A will receive or pay under the commodity forward contract).

IE123. The present value (in LC) of the hedged item of the FX risk hedging relationship (i.e., the aggregated exposure) is calculated as the hedged volume (in FC) multiplied by the difference between the forward FX rate at the measurement date and the forward FX rate at the designation date of the hedging relationship (i.e., the end of Period 2).²³

IE124. Using the present value of the hedged item and the fair value of the hedging instrument, the cash flow hedge reserve and the hedge ineffectiveness are then determined (see paragraph 140 of IPSAS 41).

IE125. The following table shows the effect on Municipality A's statement of financial performance and its statement of financial position (for the sake of transparency the line items²⁴ are disaggregated on the face of the statements by the two hedging relationships, i.e., for the commodity price risk hedging relationship and the FX risk hedging relationship):

Example 16—Overview of Effect on Statements of Financial Performance and Financial Position <i>[All amounts in LC]</i>					
Period	1	2	3	4	5
Statement of financial performance					
Hedge ineffectiveness					
Commodity hedge		0	(1,199)	2,781	(5,143)
FX hedge		0	76	(76)	291
Surplus or deficit	0	0	(1,123)	2,705	(4,852)
Statement of changes in net assets/equity					
Net assets/equity					
Commodity hedge		20,258	(33,399)	13,868	(67,971)
FX hedge		0	6,237	3,604	(2,096)
Total net assets/equity	0	20,258	(27,162)	17,472	(70,067)
Statement of financial position					
Commodity forward	0	(20,258)	14,339	(2,310)	70,804
FX forward		0	(6,313)	(9,840)	(8,035)
Total net assets	0	(20,258)	8,027	(12,150)	62,769
<i>Net assets/equity</i>					
Net assets/equity					
Commodity hedge	0	20,258	(13,140)	728	(67,243)
FX hedge		0	6,237	9,840	7,744
	0	20,258	(6,904)	10,568	(59,499)
Accumulated surplus or deficit					
Commodity hedge	0	0	(1,199)	1,582	(3,561)
FX hedge		0	76	0	291
	0	0	(1,123)	1,582	(3,270)
Total net assets/equity	0	20,258	(8,027)	12,150	(62,769)

²³ For example, at the end of Period 3 the present value of the hedged item is determined as the volume of the aggregated exposure at the end of Period 3 (FC138,932) multiplied by the difference between the forward FX rate at the end of Period 3 (1/1.4058) and the forward FX rate and the time of designation (i.e., the end of Period 2: 1/1.3220) and then discounted using the interest rate (in LC) at the end of Period 3 with a term of 2 periods (i.e., until the end of Period 5 – 0.46 percent). The calculation is: $FC138,932 \times (1/(1.4058[FC/LC]) - 1/(1.3220 [FC/LC])) / (1 + 0.46 \text{ percent}) = LC6,237$.

²⁴ The line items used in this example are a possible presentation. Different presentation formats using different line items (including line items that include the amounts shown here) are also possible (IPSAS 30 sets out disclosure requirements for hedge accounting that include disclosures about hedge ineffectiveness, the carrying amount of hedging instruments and the cash flow hedge reserve).

IE126. The total cost of inventory after hedging is as follows:²⁵

<i>Cost of inventory [all amounts in LC]</i>	
Cash price (at spot for commodity price risk and FX risk)	165,582
Gain/loss from CFHR for commodity price risk	(67,243)
Gain/loss from CFHR for FX risk	7,744
Cost of inventory	106,083

IE127. The total overall cash flow from all transactions (the actual electricity purchase at the spot price and the settlement of the two derivatives) is LC102,813. It differs from the hedge adjusted cost of inventory by LC3,270, which is the net amount of cumulative hedge ineffectiveness from the two hedging relationships. This hedge ineffectiveness has a cash flow effect but is excluded from the measurement of the inventory.

Example 17—Combined Interest Rate Risk and Foreign Currency Risk Hedge (Fair Value Hedge/Cash Flow Hedge Combination)

Fact Pattern

IE128. State Government B wants to hedge a fixed rate liability that is denominated in Foreign Currency (FC). The liability has a term of four periods from the start of Period 1 to the end of Period 4. State Government B's functional currency is its Local Currency (LC). State Government B has the following risk exposures:

- (a) Fair value interest rate risk and FX risk: the changes in fair value of the fixed rate liability attributable to interest rate changes, measured in LC.
- (b) Cash flow interest rate risk: the exposure that arises as a result of swapping the combined fair value interest rate risk and FX risk exposure associated with the fixed rate liability (see (a) above) into a variable rate exposure in LC in accordance with State Government B's risk management strategy for FC denominated fixed rate liabilities (see paragraph IE129(a) below).

IE129. State Government B hedges its risk exposures using the following risk management strategy:

- (a) State Government B uses cross-currency interest rate swaps to swap its FC denominated fixed rate liabilities into a variable rate exposure in LC. State Government B hedges its FC denominated liabilities (including the interest) for their entire life. Consequently, State Government B enters into a cross-currency interest rate swap at the same time as it issues an FC denominated liability. Under the cross-currency interest rate swap State Government B receives fixed interest in FC (used to pay the interest on the liability) and pays variable interest in LC.
- (b) State Government B considers the cash flows on a hedged liability and on the related cross-currency interest rate swap as one aggregated variable rate exposure in LC. From time to time, in accordance with its risk management strategy for variable rate interest rate risk (in LC), State Government B decides to lock in its interest payments and hence swaps its aggregated variable rate exposure in LC into a fixed rate exposure in LC. State Government B seeks to obtain as a fixed rate exposure a single blended fixed coupon rate (i.e., the uniform forward coupon rate for the hedged term that exists at the start of the hedging relationship).²⁶ Consequently, State Government B uses interest rate swaps (denominated entirely in LC) under which it receives variable interest (used to pay the interest on the pay leg of the cross-currency interest rate swap) and pays fixed interest.

IE130. The following table sets out the parameters used for Example 17:

Example 17—Parameters					
	t_0	Period 1	Period 2	Period 3	Period 4
FX spot rate [LC/FC]	1.2000	1.0500	1.4200	1.5100	1.3700
Interest curves (vertical presentation of rates for each quarter of a period on a p.a. basis)					

²⁵ 'CFHR' is the cash flow hedge reserve, i.e., the amount accumulated in net assets/equity for a cash flow hedge.

²⁶ An entity may have a different risk management strategy whereby it seeks to obtain a fixed rate exposure that is not a single blended rate but a series of forward rates that are each fixed for the respective individual interest period. For such a strategy the hedge effectiveness is measured based on the difference between the forward rates that existed at the start of the hedging relationship and the forward rates that exist at the effectiveness measurement date for the individual interest periods. For such a strategy a series of forward contracts corresponding with the individual interest periods would be more effective than an interest rate swap (that has a fixed payment leg with a single blended fixed rate).

Example 17—Parameters					
	t_0	Period 1	Period 2	Period 3	Period 4
LC	2.50%	5.02%	6.18%	0.34%	[N/A]
	2.75%	5.19%	6.26%	0.49%	
	2.91%	5.47%	6.37%	0.94%	
	3.02%	5.52%	6.56%	1.36%	
	2.98%	5.81%	6.74%		
	3.05%	5.85%	6.93%		
	3.11%	5.91%	7.19%		
	3.15%	6.06%	7.53%		
	3.11%	6.20%			
	3.14%	6.31%			
	3.27%	6.36%			
	3.21%	6.40%			
	3.21%				
	3.25%				
	3.29%				
3.34%					
FC	3.74%	4.49%	2.82%	0.70%	[N/A]
	4.04%	4.61%	2.24%	0.79%	
	4.23%	4.63%	2.00%	1.14%	
	4.28%	4.34%	2.18%	1.56%	
	4.20%	4.21%	2.34%		
	4.17%	4.13%	2.53%		
	4.27%	4.07%	2.82%		
	4.14%	4.09%	3.13%		
	4.10%	4.17%			
	4.11%	4.13%			
	4.11%	4.24%			
	4.13%	4.34%			
	4.14%				
	4.06%				
	4.12%				
4.19%					

Accounting Mechanics

IE131. State Government B designates the following hedging relationships:²⁷

- (a) As a fair value hedge, a hedging relationship for fair value interest rate risk and FX risk between the FC denominated fixed rate liability (fixed rate FX liability) as the hedged item and a cross-currency interest rate swap as the hedging instrument (the ‘first level relationship’). This hedging relationship is designated at the beginning of Period 1 (i.e., t_0) with a term to the end of Period 4.
- (b) As a cash flow hedge, a hedging relationship between the aggregated exposure as the hedged item and an interest rate swap as the hedging instrument (the ‘second level relationship’). This hedging relationship is designated at the end of Period 1, when State Government B decides to lock in its interest payments and hence swaps its aggregated variable rate exposure in LC into a fixed rate exposure in LC, with a term to the end of Period 4. The aggregated exposure that is designated as the hedged item represents, in LC, the variability in cash flows that is the effect of changes in the combined cash flows of the two items designated in the fair value hedge of the fair value interest rate risk and FX risk (see (a) above), compared to the interest rates at the end of Period 1 (i.e., the time of designation of the hedging relationship between the aggregated exposure and the interest rate swap).

²⁷ This example assumes that all qualifying criteria for hedge accounting are met (see paragraph 129 of IPSAS 41). The following description of the designation is solely for the purpose of understanding this example (i.e., it is not an example of the complete formal documentation required in accordance with paragraph 129(b) of IPSAS 41.

IE132. The following table²⁸ sets out the overview of the fair values of the derivatives, the changes in the value of the hedged items and the calculation of the cash flow hedge reserve and hedge ineffectiveness.²⁹ In this example, hedge ineffectiveness arises on both hedging relationships.³⁰

Example 17—Calculations					
	t_0	Period 1	Period 2	Period 3	Period 4
Fixed rate FX liability					
Fair value [FC]	(1,000,000)	(995,522)	(1,031,008)	(1,030,193)	(1,000,000)
Fair value [LC]	(1,200,000)	(1,045,298)	(1,464,031)	(1,555,591)	(1,370,000)
Change in fair value [LC]		154,702	(418,733)	(91,560)	185,591
CCIRS (receive fixed FC/pay variable LC)					
Fair value [LC]	0	(154,673)	264,116	355,553	170,000
Change in fair value [LC]		(154,673)	418,788	91,437	(185,553)
IRS (receive variable/pay fixed)					
Fair value [LC]		0	18,896	(58,767)	0
Change in fair value [LC]			18,896	(77,663)	(58,767)
CF variability of the aggregated exposure					
Present value [LC]		0	(18,824)	58,753	0
Change in present value [LC]			(18,824)	77,577	(58,753)
CFHR					
Balance (end of period) [LC]		0	18,824	(58,753)	0
Change [LC]			18,824	(77,577)	58,753

IE133. The hedging relationship between the fixed rate FX liability and the cross-currency interest rate swap starts at the beginning of Period 1 (i.e., t_0) and remains in place when the hedging relationship for the second level relationship starts at the end of Period 1, i.e., the first level relationship continues as a separate hedging relationship.

IE134. The cash flow variability of the aggregated exposure is calculated as follows:

- (a) At the point in time from which the cash flow variability of the aggregated exposure is hedged (i.e., the start of the second level relationship at the end of Period 1), all cash flows expected on the fixed rate FX liability and the cross-currency interest rate swap over the hedged term (i.e., until the end of Period 4) are mapped out and equated to a single blended fixed coupon rate so that the total present value (in LC) is nil. This calculation establishes the single blended fixed coupon rate (reference rate) that is used at subsequent dates as the reference point to measure the cash flow variability of the aggregated exposure since the start of the hedging relationship. This calculation is illustrated in the following table:

Example 17—Cash Flow Variability of the Aggregated Exposure (Calibration)								
	Variability in Cash Flows of the Aggregated Exposure							
	FX liability		CCIRS FC leg		CCIRS LC leg		Calibration	PV
	CF(s)	PV	CF(s)	PV	CF(s)	PV	1,200,000 Nominal percent Rate 4 Frequency	5.6963 Frequency
	[FC]	[FC]	[FC]	[FC]	[LC]	[LC]	[LC]	[LC]
Time								
t_0								

²⁸ Tables in this example use the following acronyms: 'CCIRS' for cross-currency interest rate swap, 'CF(s)' for cash flow(s), 'CFH' for cash flow hedge, 'CFHR' for cash flow hedge reserve, 'FVH' for fair value hedge, 'IRS' for interest rate swap and 'PV' for present value.

²⁹ In the following table for the calculations all amounts (including the calculations for accounting purposes of amounts for assets, liabilities and equity) are in the format of positive (plus) and negative (minus) numbers (e.g., an amount in the cash flow hedge reserve that is in brackets is a loss).

³⁰ For a situation such as in this example, hedge ineffectiveness can result from various factors, for example credit risk, differences in the day count method or, depending on whether it is included in the designation of the hedging instrument, the charge for exchanging different currencies that is included in cross-currency interest rate swaps (commonly referred to as the 'currency basis').

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Example 17—Cash Flow Variability of the Aggregated Exposure (Calibration)									
Variability in Cash Flows of the Aggregated Exposure									
FX liability		CCIRS FC leg				CCIRS LC leg		Calibration	PV
CF(s)	PV	CF(s)	PV	CF(s)	PV	CF(s)	PV	1,200,000 Nominal 5.6963 percent Rate 4 Frequency	1,200,000 Nominal 5.6963 percent Rate 4 Frequency
[FC]	[FC]	[FC]	[FC]	[LC]	[LC]	[LC]	[LC]	[LC]	[LC]
Period 1	t ₁								
	t ₂								
	t ₃								
	t ₄								
Period 2	t ₅	0	0	0	0	(14,771)	(14,591)	17,089	16,881
	t ₆	(20,426)	(19,977)	20,246	19,801	(15,271)	(14,896)	17,089	16,669
	t ₇	0	0	0	0	(16,076)	(15,473)	17,089	16,449
	t ₈	(20,426)	(19,543)	20,582	19,692	(16,241)	(15,424)	17,089	16,229
Period 3	t ₉	0	0	0	0	(17,060)	(15,974)	17,089	16,002
	t ₁₀	(20,426)	(19,148)	20,358	19,084	(17,182)	(15,862)	17,089	15,776
	t ₁₁	0	0	0	0	(17,359)	(15,797)	17,089	15,551
	t ₁₂	(20,426)	(18,769)	20,582	18,912	(17,778)	(15,942)	17,089	15,324
Period 4	t ₁₃	0	0	0	0	(18,188)	(16,066)	17,089	15,095
	t ₁₄	(20,426)	(18,391)	20,246	18,229	(18,502)	(16,095)	17,089	14,866
	t ₁₅	0	0	0	0	(18,646)	(15,972)	17,089	14,638
	t ₁₆	(1,020,426)	(899,695)	1,020,582	899,832	(1,218,767)	(1,027,908)	1,217,089	1,026,493
Totals		(995,522)		995,550		(1,200,000)		1,199,971	
Totals in LC		(1,045,298)		1,045,327		(1,200,000)		1,199,971	
PV of all CF(s) [LC]									

The nominal amount that is used for the calibration of the reference rate is the same as the nominal amount of aggregated exposure that creates the variable cash flows in LC (LC1,200,000), which coincides with the nominal amount of the cross-currency interest rate swap for the variable rate leg in LC. This results in a reference rate of 5.6963 per cent (determined by iteration so that the present value of all cash flows in total is nil).

- (b) At subsequent dates, the cash flow variability of the aggregated exposure is determined by comparison to the reference point established at the end of Period 1. For that purpose, all remaining cash flows expected on the fixed rate FX liability and the cross-currency interest rate swap over the remainder of the hedged term (i.e., from the effectiveness measurement date until the end of Period 4) are updated (as applicable) and then discounted. Also, the reference rate of 5.6963 per cent is applied to the nominal amount that was used for the calibration of that rate at the end of Period 1 (LC1,200,000) in order to generate a set of cash flows over the remainder of the hedged term that is then also discounted. The total of all those present values represents the cash flow variability of the aggregated exposure. This calculation is illustrated in the following table for the end of Period 2:

Example 17—Cash Flow Variability of the Aggregated Exposure (at the End of Period 2)									
Variability in Cash Flows of the Aggregated Exposure									
FX liability		CCIRS FC leg				CCIRS LC leg		Calibration	PV
CF(s)	PV	CF(s)	PV	CF(s)	PV	CF(s)	PV	1,200,000 Nominal 5.6963 percent Rate 4 Frequency	1,200,000 Nominal 5.6963 percent Rate 4 Frequency
[FC]	[FC]	[FC]	[FC]	[LC]	[LC]	[LC]	[LC]	[LC]	[LC]
Period 1	Time								
	t ₀								
	t ₁								
	t ₂								
	t ₃								
t ₄									

Example 17—Cash Flow Variability of the Aggregated Exposure (at the End of Period 2)									
Variability in Cash Flows of the Aggregated Exposure									
		FX liability		CCIRS FC leg		CCIRS LC leg		Calibration	PV
		CF(s)	PV	CF(s)	PV	CF(s)	PV	1,200,000 Nominal 5.6963 per- cent Rate 4 Frequency	5.6963 per- cent Rate 4 Frequency
		[FC]	[FC]	[FC]	[FC]	[LC]	[LC]	[LC]	[LC]
Period 2	t ₅	0	0	0	0	0	0	0	0
	t ₆	0	0	0	0	0	0	0	0
	t ₇	0	0	0	0	0	0	0	0
	t ₈	0	0	0	0	0	0	0	0
Period 3	t ₉	0	0	0	0	(18,120)	(17,850)	17,089	16,835
	t ₁₀	(20,426)	(20,173)	20,358	20,106	(18,360)	(17,814)	17,089	16,581
	t ₁₁	0	0	0	0	(18,683)	(17,850)	17,089	16,327
	t ₁₂	(20,426)	(19,965)	20,582	20,117	(19,203)	(18,058)	17,089	16,070
Period 4	t ₁₃	0	0	0	0	(19,718)	(18,243)	17,089	15,810
	t ₁₄	(20,426)	(19,726)	20,246	19,553	(20,279)	(18,449)	17,089	15,547
	t ₁₅	0	0	0	0	(21,014)	(18,789)	17,089	15,280
	t ₁₆	(1,020,426)	(971,144)	1,020,582	971,292	(1,221,991)	(1,072,947)	1,217,089	1,068,643
Totals			(1,031,008)		1,031,067		(1,200,000)		1,181,092
Totals in LC			(1,464,031)		1,464,116		(1,200,000)		1,181,092
PV of all CF(s) [LC]									
				┌──────────────────┐					
				└──────────────────┘					
				←──────────────────					
				Σ					
				(18,824)					

The changes in interest rates and the exchange rate result in a change of the cash flow variability of the aggregated exposure between the end of Period 1 and the end of Period 2 that has a present value of LC-18,824.³¹

IE135. Using the present value of the hedged item and the fair value of the hedging instrument, the cash flow hedge reserve and the hedge ineffectiveness are then determined (see paragraph 140 of IPSAS 41).

IE136. The following table shows the effect on State Government B's statement of financial performance and its statement of financial position (for the sake of transparency some line items³² are disaggregated on the face of the statements by the two hedging relationships, i.e., for the fair value hedge of the fixed rate FX liability and the cash flow hedge of the aggregated exposure):³³

Example 17—Overview of Effect on Statements of Financial Performance and Financial Position [All amounts in LC]					
	t ₀	Period 1	Period 2	Period 3	Period 4
Statement of financial performance					
Interest expense					
FX liability		45,958	50,452	59,848	58,827
FVH adjustment		(12,731)	11,941	14,385	(49,439)
		33,227	62,393	74,233	9,388
Reclassifications (CFH)			5,990	(5,863)	58,982
Total interest expense		33,227	68,383	68,370	68,370
Other gains/losses					

³¹ This is the amount that is included in the table with the overview of the calculations (see paragraph IE132) as the present value of the cash flow variability of the aggregated exposure at the end of Period 2.

³² The line items used in this example are a possible presentation. Different presentation formats using different line items (including line items that include the amounts shown here) are also possible (IPSAS 30 sets out disclosure requirements for hedge accounting that include disclosures about hedge ineffectiveness, the carrying amount of hedging instruments and the cash flow hedge reserve).

³³ For Period 4 the values in the table with the overview of the calculations (see paragraph IE132) differ from those in the following table. For Periods 1 to 3 the 'dirty' values (i.e., including interest accruals) equal the 'clean' values (i.e., excluding interest accruals) because the period end is a settlement date for all legs of the derivatives and the fixed rate FX liability. At the end of Period 4 the table with the overview of the calculations uses clean values in order to calculate the value changes consistently over time. For the following table the dirty values are presented, i.e., the maturity amounts including accrued interest immediately before the instruments are settled (this is for illustrative purposes as otherwise all carrying amounts other than cash and accumulated surplus or deficit would be nil).

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Example 17—Overview of Effect on Statements of Financial Performance and Financial Position <i>[All amounts in LC]</i>					
	<i>t₀</i>	Period 1	Period 2	Period 3	Period 4
Change in fair value of the CCIRS		154,673	(418,788)	(91,437)	185,553
FVH adjustment (FX liability)		(154,702)	418,733	91,560	(185,591)
Hedge ineffectiveness		0	(72)	(54)	(19)
Total other gains/losses		(29)	(127)	68	(57)
Surplus or deficit		33,198	68,255	68,438	68,313
Statement of changes in net assets/equity					
Net assets/equity					
Effective CFH gain/loss			(12,834)	71,713	229
Reclassifications			(5,990)	5,863	(58,982)
Total net assets/equity			(18,842)	77,577	(58,753)
Statement of financial position					
FX liability	(1,200,000)	(1,045,298)	(1,464,031)	(1,555,591)	(1,397,984)
CCIRS	0	(154,673)	264,116	355,553	194,141
IRS		0	18,896	(58,767)	(13,004)
Cash	1,200,000	1,166,773	1,098,390	1,030,160	978,641
Net assets	0	(33,198)	(82,630)	(228,645)	(238,205)
<i>Net Assets/equity</i>					
Net assets/equity		0	(18,824)	58,753	0
Accumulated surplus or deficit	0	33,198	101,454	169,892	238,205
Total net assets/equity	0	33,198	82,630	228,645	238,205

IE137. The total interest expense in surplus or deficit reflects State Government B's interest expense that results from its risk management strategy:

- (a) In Period 1 the risk management strategy results in interest expense reflecting variable interest rates in LC after taking into account the effect of the cross-currency interest rate swap, including a difference between the cash flows on the fixed rate FX liability and the fixed leg of the cross-currency interest rate swap that were settled during Period 1 (this means the interest expense does not exactly equal the variable interest expense that would arise in LC on a borrowing of LC1,200,000). There is also some hedge ineffectiveness that results from a difference in the changes in value for the fixed rate FX liability (as represented by the fair value hedge adjustment) and the cross-currency interest rate swap.
- (b) For Periods 2 to 4 the risk management strategy results in interest expense that reflects, after taking into account the effect of the interest rate swap entered into at the end of Period 1, fixed interest rates in LC (i.e., locking in a single blended fixed coupon rate for a three-period term based on the interest rate environment at the end of Period 1). However, State Government B's interest expense is affected by the hedge ineffectiveness that arises on its hedging relationships. In Period 2 the interest expense is slightly higher than the fixed rate payments locked in with the interest rate swap because the variable payments received under the interest rate swap are less than the total of the cash flows resulting from the aggregated exposure.³⁴ In Periods 3 and 4 the interest expense is equal to the locked in rate because the variable payments received under the swap are more than the total of the cash flows resulting from the aggregated exposure.³⁵

³⁴ In other words, the cash flow variability of the interest rate swap was lower than, and therefore did not fully offset, the cash flow variability of the aggregated exposure as a whole (sometimes called an 'underhedge' situation). In those situations the cash flow hedge does not contribute to the hedge ineffectiveness that is recognized in surplus or deficit because the hedge ineffectiveness is not recognized (see paragraph 140 of IPSAS 41). The hedge ineffectiveness arising on the fair value hedge affects surplus or deficit in all periods.

³⁵ In other words, the cash flow variability of the interest rate swap was higher than, and therefore more than fully offset, the cash flow variability of the aggregated exposure as a whole (sometimes called an 'overhedge' situation). In those situations the cash flow hedge contributes to the hedge ineffectiveness that is recognized in surplus or deficit (see paragraph 140 of IPSAS 41). The hedge ineffectiveness arising on the fair value hedge affects surplus or deficit in all periods.

Example 18—Combined Interest Rate Risk and Foreign Currency Risk Hedge (Cash Flow Hedge/Fair Value Hedge Combination)**Fact Pattern**

IE138. State Government C wants to hedge a variable rate liability that is denominated in Foreign Currency (FC). The liability has a term of four periods from the start of Period 1 to the end of Period 4. State Government C's functional currency is its Local Currency (LC). State Government C has the following risk exposures:

- (a) Cash flow interest rate risk and FX risk: the changes in cash flows of the variable rate liability attributable to interest rate changes, measured in LC.
- (b) Fair value interest rate risk: the exposure that arises as a result of swapping the combined cash flow interest rate risk and FX risk exposure associated with the variable rate liability (see (a) above) into a fixed rate exposure in LC in accordance with State Government C's risk management strategy for FC denominated variable rate liabilities (see paragraph IE139(a) below).

IE139. State Government C hedges its risk exposures using the following risk management strategy:

- (a) State Government C uses cross-currency interest rate swaps to swap its FC denominated variable rate liabilities into a fixed rate exposure in LC. State Government C hedges its FC denominated liabilities (including the interest) for their entire life. Consequently, State Government C enters into a cross-currency interest rate swap at the same time as it issues an FC denominated liability. Under the cross-currency interest rate swap State Government C receives variable interest in FC (used to pay the interest on the liability) and pays fixed interest in LC.
- (b) State Government C considers the cash flows on a hedged liability and on the related cross-currency interest rate swap as one aggregated fixed rate exposure in LC. From time to time, in accordance with its risk management strategy for fixed rate interest rate risk (in LC), State Government C decides to link its interest payments to current variable interest rate levels and hence swaps its aggregated fixed rate exposure in LC into a variable rate exposure in LC. Consequently, State Government C uses interest rate swaps (denominated entirely in LC) under which it receives fixed interest (used to pay the interest on the pay leg of the cross-currency interest rate swap) and pays variable interest.

IE140. The following table sets out the parameters used for Example 18:

Example 18—Parameter Overview					
	t_0	Period 1	Period 2	Period 3	Period 4
FX spot rate [LC/FC]	1.2	1.05	1.42	1.51	1.37
Interest curves (vertical presentation of rates for each quarter of a period on a p.a. basis)					
LC	2.50%	1.00%	3.88%	0.34%	[N/A]
	2.75%	1.21%	4.12%	0.49%	
	2.91%	1.39%	4.22%	0.94%	
	3.02%	1.58%	5.11%	1.36%	
	2.98%	1.77%	5.39%		
	3.05%	1.93%	5.43%		
	3.11%	2.09%	5.50%		
	3.15%	2.16%	5.64%		
	3.11%	2.22%			
	3.14%	2.28%			
	3.27%	2.30%			
	3.21%	2.31%			
	3.21%				
	3.25%				
	3.29%				
	3.34%				
FC	3.74%	4.49%	2.82%	0.70%	[N/A]
	4.04%	4.61%	2.24%	0.79%	

Example 18—Parameter Overview					
	t_0	Period 1	Period 2	Period 3	Period 4
	4.23%	4.63%	2.00%	1.14%	
	4.28%	4.34%	2.18%	1.56%	
	4.20%	4.21%	2.34%		
	4.17%	4.13%	2.53%		
	4.27%	4.07%	2.82%		
	4.14%	4.09%	3.13%		
	4.10%	4.17%			
	4.11%	4.13%			
	4.11%	4.24%			
	4.13%	4.34%			
	4.14%				
	4.06%				
	4.12%				
	4.19%				

Accounting Mechanics

IE141. State Government C designates the following hedging relationships:³⁶

- As a cash flow hedge, a hedging relationship for cash flow interest rate risk and FX risk between the FC denominated variable rate liability (variable rate FX liability) as the hedged item and a cross-currency interest rate swap as the hedging instrument (the ‘first level relationship’). This hedging relationship is designated at the beginning of Period 1 (i.e., t_0) with a term to the end of Period 4.
- As a fair value hedge, a hedging relationship between the aggregated exposure as the hedged item and an interest rate swap as the hedging instrument (the ‘second level relationship’). This hedging relationship is designated at the end of Period 1, when State Government C decides to link its interest payments to current variable interest rate levels and hence swaps its aggregated fixed rate exposure in LC into a variable rate exposure in LC, with a term to the end of Period 4. The aggregated exposure that is designated as the hedged item represents, in LC, the change in value that is the effect of changes in the value of the combined cash flows of the two items designated in the cash flow hedge of the cash flow interest rate risk and FX risk (see (a) above), compared to the interest rates at the end of Period 1 (i.e., the time of designation of the hedging relationship between the aggregated exposure and the interest rate swap).

IE142. The following table³⁷ sets out the overview of the fair values of the derivatives, the changes in the value of the hedged items and the calculation of the cash flow hedge reserve.³⁸ In this example no hedge ineffectiveness arises on either hedging relationship because of the assumptions made.³⁹

Example 18—Calculations					
	t_0	Period 1	Period 2	Period 3	Period 4
Variable rate FX liability					
Fair value [FC]	(1,000,000)	(1,000,000)	(1,000,000)	(1,000,000)	(1,000,000)
Fair value [LC]	(1,200,000)	(1,050,000)	(1,420,000)	(1,510,000)	(1,370,000)
Change in fair value [LC]		150,000	(370,000)	(90,000)	140,000

³⁶ This example assumes that all qualifying criteria for hedge accounting are met (see paragraph 129 of IPSAS 41). The following description of the designation is solely for the purpose of understanding this example (i.e., it is not an example of the complete formal documentation required in accordance with paragraph 129(b) of IPSAS 41).

³⁷ Tables in this example use the following acronyms: ‘CCIRS’ for cross-currency interest rate swap, ‘CF(s)’ for cash flow(s), ‘CFH’ for cash flow hedge, ‘CFHR’ for cash flow hedge reserve, ‘FVH’ for fair value hedge, ‘IRS’ for interest rate swap and ‘PV’ for present value.

³⁸ In the following table for the calculations all amounts (including the calculations for accounting purposes of amounts for assets, liabilities and net assets/equity) are in the format of positive (plus) and negative (minus) numbers (e.g., an amount in the cash flow hedge reserve that is a negative number is a loss).

³⁹ Those assumptions have been made for didactical reasons, in order to better focus on illustrating the accounting mechanics in a cash flow hedge/fair value hedge combination. The measurement and recognition of hedge ineffectiveness has already been demonstrated in Example 16 and Example 17. However, in reality such hedges are typically not perfectly effective because hedge ineffectiveness can result from various factors, for example credit risk, differences in the day count method or, depending on whether it is included in the designation of the hedging instrument, the charge for exchanging different currencies that is included in cross-currency interest rate swaps (commonly referred to as the ‘currency basis’).

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Example 18—Calculations					
	t_0	Period 1	Period 2	Period 3	Period 4
PV of change in variable CF(s) [LC]	0	192,310	(260,346)	(282,979)	(170,000)
Change in PV [LC]		192,310	(452,656)	(22,633)	112,979
CCIRS (receive variable FC/pay fixed LC)					
Fair value [LC]	0	(192,310)	260,346	282,979	170,000
Change in fair value [LC]		(192,310)	452,656	22,633	(112,979)
CFHR					
Opening balance	0	0	(42,310)	(28,207)	(14,103)
Reclassification FX risk		153,008	(378,220)	(91,030)	140,731
Reclassification (current period CF)		(8,656)	(18,410)	2,939	21,431
Effective CFH gain/loss		(186,662)	(479,286)	20,724	(135,141)
Reclassification for interest rate risk		0	(82,656)	67,367	(27,021)
Amortization of CFHR		0	14,103	14,103	14,103
Ending balance		(42,103)	(28,207)	(14,103)	0
IRS (receive fixed/pay variable)					
Fair value [LC]		0	(82,656)	(15,289)	(42,310)
Change in fair value			(82,656)	67,367	(27,021)
Change in present value of the aggregated exposure					
Present value [LC]		(1,242,310)	(1,159,654)	(1,227,021)	(1,200,000)
Change in present value [LC]			82,656	(67,367)	27,021

IE143. The hedging relationship between the variable rate FX liability and the cross-currency interest rate swap starts at the beginning of Period 1 (i.e., t_0) and remains in place when the hedging relationship for the second level relationship starts at the end of Period 1, i.e., the first level relationship continues as a separate hedging relationship. However, the hedge accounting for the first level relationship is affected by the start of hedge accounting for the second level relationship at the end of Period 1. The fair value hedge for the second level relationship affects the timing of the reclassification to surplus or deficit of amounts from the cash flow hedge reserve for the first level relationship:

- (a) The fair value interest rate risk that is hedged by the fair value hedge is included in the amount that is recognized in net assets/equity as a result of the cash flow hedge for the first level hedging relationship (i.e., the gain or loss on the cross-currency interest rate swap that is determined to be an effective hedge).⁴⁰ This means that from the end of Period 1 the part of the effective cash flow hedging gain or loss that represents the fair value interest rate risk (in LC), and is recognized in net assets/equity in a first step, is in a second step immediately (i.e., in the same period) transferred from the cash flow hedge reserve to surplus or deficit. That reclassification adjustment offsets the gain or loss on the interest rate swap that is recognized in surplus or deficit.⁴¹ In the context of accounting for the aggregated exposure as the hedged item, that reclassification adjustment is the equivalent of a fair value hedge adjustment because in contrast to a hedged item that is a fixed rate debt instrument (in LC) at amortized cost, the aggregated exposure is already remeasured for changes regarding the hedged risk but the resulting gain or loss is recognized in net assets/equity because of applying cash flow hedge accounting for the first level relationship. Consequently, applying fair value hedge accounting with the aggregated exposure as the hedged item does not result in changing the hedged item's measurement but instead affects where the hedging gains and losses are recognized (i.e., reclassification from the cash flow hedge reserve to surplus or deficit).
- (b) The amount in the cash flow hedge reserve at the end of Period 1 (LC42,310) is amortized over the remaining life of the cash flow hedge for the first level relationship (i.e., over Periods 2 to 4).⁴²

⁴⁰ As a consequence of hedging its exposure to cash flow interest rate risk by entering into the cross-currency interest rate swap that changed the cash flow interest rate risk of the variable rate FX liability into a fixed rate exposure (in LC), State Government C in effect assumed an exposure to fair value interest rate risk (see paragraph IE139).

⁴¹ In the table with the overview of the calculations (see paragraph IE142) this reclassification adjustment is the line item "Reclassification for interest rate risk" in the reconciliation of the cash flow hedge reserve (e.g., at the end of Period 2 a reclassification of a gain of LC82,656 from the cash flow hedge reserve to surplus or deficit—see paragraph IE144 for how that amount is calculated).

⁴² In the table with the overview of the calculations (see paragraph IE142) this amortization results in a periodic reclassification adjustment of LC14,103 that is included in the line item "Amortization of CFHR" in the reconciliation of the cash flow hedge reserve.

IE144. The change in value of the aggregated exposure is calculated as follows:

- (a) At the point in time from which the change in value of the aggregated exposure is hedged (i.e., the start of the second level relationship at the end of Period 1), all cash flows expected on the variable rate FX liability and the cross-currency interest rate swap over the hedged term (i.e., until the end of Period 4) are mapped out and their combined present value, in LC, is calculated. This calculation establishes the present value that is used at subsequent dates as the reference point to measure the change in present value of the aggregated exposure since the start of the hedging relationship. This calculation is illustrated in the following table:

Example 18—Present Value of the Aggregated Exposure (Starting Point)							
Present Value of the Aggregated Exposure							
FX liability		CCIRS FC leg		CCIRS LC leg			
CF(s)	PV	CF(s)	PV	CF(s)	PV		
[FC]	[FC]	[FC]	[FC]	[LC]	[LC]		
Time							
	t_0						
Period 1	t_1						
	t_2						
	t_3						
	t_4						
Period 2	t_5	(11,039)	(10,918)	11,039	10,918	(9,117)	(9,094)
	t_6	(11,331)	(11,082)	11,331	11,082	(9,117)	(9,067)
	t_7	(11,375)	(11,000)	11,375	11,000	(9,117)	(9,035)
	t_8	(10,689)	(10,227)	10,689	10,227	(9,117)	(9,000)
Period 3	t_9	(10,375)	(9,824)	10,375	9,824	(9,117)	(8,961)
	t_{10}	(10,164)	(9,528)	10,164	9,528	(9,117)	(8,918)
	t_{11}	(10,028)	(9,307)	10,028	9,307	(9,117)	(8,872)
	t_{12}	(10,072)	(9,255)	10,072	9,255	(9,117)	(8,825)
Period 4	t_{13}	(10,256)	(9,328)	10,256	9,328	(9,117)	(8,776)
	t_{14}	(10,159)	(9,147)	10,159	9,147	(9,117)	(8,727)
	t_{15}	(10,426)	(9,290)	10,426	9,290	(9,117)	(8,678)
	t_{16}	(1,010,670)	(891,093)	1,010,670	891,093	(1,209,117)	(1,144,358)
Totals			(1,000,000)		1,000,000		(1,242,310)
Totals in LC			(1,050,000)		1,050,000		(1,242,310)
PV of aggregated exposure [LC]							
<div style="text-align: center;"> </div>							

The present value of all cash flows expected on the variable rate FX liability and the cross-currency interest rate swap over the hedged term at the end of Period 1 is LC-1,242,310.⁴³

- (b) At subsequent dates, the present value of the aggregated exposure is determined in the same way as at the end of Period 1 but for the remainder of the hedged term. For that purpose, all remaining cash flows expected on the variable rate FX liability and the cross-currency interest rate swap over the remainder of the hedged term (i.e., from the effectiveness measurement date until the end of Period 4) are updated (as applicable) and then discounted. The total of those present values represents the present value of the aggregated exposure. This calculation is illustrated in the following table for the end of Period 2:

⁴³ In this example no hedge ineffectiveness arises on either hedging relationship because of the assumptions made (see paragraph IE142). Consequently, the absolute values of the variable rate FX liability and the FC denominated leg of the cross-currency interest rate are equal (but with opposite signs). In situations in which hedge ineffectiveness arises, those absolute values would not be equal so that the remaining net amount would affect the present value of the aggregated exposure.

Example 18—Present Value of the Aggregated Exposure (at the End of Period 2)						
Present Value of the Aggregated Exposure						
Time	FX liability		CCIRS FC leg		CCIRS LC leg	
	CF(s) [FC]	PV [FC]	CF(s) [FC]	PV [FC]	CF(s) [LC]	PV [LC]
Period 1						
t ₀						
t ₁						
t ₂						
t ₃						
t ₄						
Period 2						
t ₅	0	0	0	0	0	0
t ₆	0	0	0	0	0	0
t ₇	0	0	0	0	0	0
t ₈	0	0	0	0	0	0
Period 3						
t ₉	(6,969)	(6,921)	6,969	6,921	(9,117)	(9,030)
t ₁₀	(5,544)	(5,475)	5,544	5,475	(9,117)	(8,939)
t ₁₁	(4,971)	(4,885)	4,971	4,885	(9,117)	(8,847)
t ₁₂	(5,401)	(5,280)	5,401	5,280	(9,117)	(8,738)
Period 4						
t ₁₃	(5,796)	(5,632)	5,796	5,632	(9,117)	(8,624)
t ₁₄	(6,277)	(6,062)	6,277	6,062	(9,117)	(8,511)
t ₁₅	(6,975)	(6,689)	6,975	6,689	(9,117)	(8,397)
t ₁₆	(1,007,725)	(959,056)	1,007,725	956,056	(1,209,117)	(1,098,568)
Totals		(1,000,000)		1,000,000		(1,159,654)
Totals in LC		(1,420,000)		1,420,000		(1,159,654)
PV of aggregated exposure [LC]						
				Σ		
						(1,159,654) ←

The changes in interest rates and the exchange rate result in a present value of the aggregated exposure at the end of Period 2 of LC-1,159,654. Consequently, the change in the present value of the aggregated exposure between the end of Period 1 and the end of Period 2 is a gain of LC82,656.⁴⁴

IE145. Using the change in present value of the hedged item (i.e., the aggregated exposure) and the fair value of the hedging instrument (i.e., the interest rate swap), the related reclassifications from the cash flow hedge reserve to surplus or deficit (reclassification adjustments) are then determined.

IE146. The following table shows the effect on State Government C's statement of financial performance and its statement of financial position (for the sake of transparency some line items⁴⁵ are disaggregated on the face of the statements by the two hedging relationships, i.e., for the cash flow hedge of the variable rate FX liability and the fair value hedge of the aggregated exposure):⁴⁶

⁴⁴ This is the amount that is included in the table with the overview of the calculations (see paragraph IE142) as the change in present value of the aggregated exposure at the end of Period 2.

⁴⁵ The line items used in this example are a possible presentation. Different presentation formats using different line items (including line items that include the amounts shown here) are also possible (IPSAS 30 sets out disclosure requirements for hedge accounting that include disclosures about hedge ineffectiveness, the carrying amount of hedging instruments and the cash flow hedge reserve).

⁴⁶ For Period 4 the values in the table with the overview of the calculations (see paragraph IE142) differ from those in the following table. For Periods 1 to 3 the 'dirty' values (i.e., including interest accruals) equal the 'clean' values (i.e., excluding interest accruals) because the period end is a settlement date for all legs of the derivatives and the fixed rate FX liability. At the end of Period 4 the table with the overview of the calculations uses clean values in order to calculate the value changes consistently over time. For the following table the dirty values are presented, i.e., the maturity amounts including accrued interest immediately before the instruments are settled (this is for illustrative purposes as otherwise all carrying amounts other than cash and accumulated surplus or deficit would be nil).

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Example 18—Overview of Effect on Statements of Financial Performance and Financial Position <i>[All amounts in LC]</i>					
	t₀	Period 1	Period 2	Period 3	Period 4
Statement of financial performance					
Interest expense					
FX liability		45,122	54,876	33,527	15,035
FVH adjustment		0	(20,478)	16,517	(26,781)
		45,122	34,398	50,045	(11,746)
Reclassifications (CFH)		(8,656)	(18,410)	2,939	21,431
		36,466	15,989	52,983	9,685
Amortization of CFHR		0	14,103	14,103	14,103
Total interest expense		36,466	30,092	67,087	23,788
Other gains/losses					
IRS		0	82,656	(67,367)	27,021
FX gain/loss (liability)		(150,000)	370,000	90,000	(140,000)
FX gain/loss (interest)		(3,008)	8,220	1,030	(731)
Reclassification for FX risk		153,008	(378,220)	(91,030)	140,731
Reclassification for interest rate risk		0	(82,656)	67,367	(27,021)
Total other gains/losses		0	0	0	0
Surplus or deficit		36,466	30,092	67,087	23,788
Statement of changes in net assets/equity					
Net assets/equity					
Effective gain/loss		186,662	(479,286)	(20,724)	135,141
Reclassification (current period CF)		8,656	18,410	(2,939)	(21,431)
Reclassification for FX risk		(153,008)	378,220	91,030	(140,731)
Reclassification for interest rate risk		0	82,656	(67,367)	27,021
Amortization of CFHR		0	(14,103)	(14,103)	(14,103)
Total net assets/equity		42,310	(14,103)	(14,103)	(14,103)
Statement of financial position					
FX liability	(1,200,000)	(1,050,000)	(1,420,000)	(1,510,000)	(1,375,306)
CCIRS	0	(192,310)	260,346	282,979	166,190
IRS		0	(82,656)	(15,289)	(37,392)
Cash	1,200,000	1,163,534	1,147,545	1,094,562	1,089,076
Net assets	0	(78,776)	(94,765)	(147,748)	(157,433)
Net assets/equity	0	42,310	28,207	14,103	0
Accumulated surplus or deficit	0	36,466	66,558	133,645	157,433
Total net assets/equity	0	78,776	94,765	147,748	157,433

IE147. The total interest expense in surplus or deficit reflects State Government C's interest expense that results from its risk management strategy:

- (a) In Period 1 the risk management strategy results in interest expense reflecting fixed interest rates in LC after taking into account the effect of the cross-currency interest rate swap.
- (b) For Periods 2 to 4, after taking into account the effect of the interest rate swap entered into at the end of Period 1, the risk management strategy results in interest expense that changes with variable interest rates in LC (i.e., the variable interest rate prevailing in each period). However, the amount of the total interest expense is not equal to the amount of the variable rate interest because of the amortization of the amount that was in the cash flow hedge reserve for the first level relationship at the end of Period 1.⁴⁷

⁴⁷ See paragraph IE143(b). That amortization becomes an expense that has an effect like a spread on the variable interest rate.

Foreign Operations (Appendix B)

IE148. This example illustrates the application of paragraphs B12, B13, B14 and B15 of Appendix B in connection with the reclassification adjustment on the disposal of a foreign operation.

Example 19—Disposal of a Foreign Operation*Background*

IE149. This example assumes the economic entity structure set out in paragraph B16 and that Controlling Entity D used a USD borrowing in Controlled Entity A to hedge the EUR/USD risk of the net investment in Controlled Entity C in Controlling Entity D's consolidated financial statements. Controlling Entity D uses the step-by-step method of consolidation. Assume the hedge was fully effective and the full USD/EUR accumulated change in the value of the hedging instrument before disposal of Controlled Entity C is €24 million (gain). This is matched exactly by the fall in value of the net investment in Controlled Entity C, when measured against the functional currency of Controlling Entity D (euro).

IE150. If the direct method of consolidation is used, the fall in the value of Controlling Entity D's net investment in Controlled Entity C of €24 million would be reflected totally in the foreign currency translation reserve relating to Controlled Entity C in Controlling Entity D's consolidated financial statements. However, because Controlling Entity D uses the step-by-step method, this fall in the net investment value in Controlled Entity C of €24 million would be reflected both in Controlled Entity B's foreign currency translation reserve relating to Controlled Entity C and in Controlling Entity D's foreign currency translation reserve relating to Controlled Entity B.

IE151. The aggregate amount recognized in the foreign currency translation reserve in respect of Controlled Entities B and C is not affected by the consolidation method. Assume that using the direct method of consolidation, the foreign currency translation reserves for Controlled Entities B and C in Controlling Entity D's consolidated financial statements are €62 million gain and €24 million loss respectively; using the step-by-step method of consolidation those amounts are €49 million gain and €11 million loss respectively.

Reclassification

IE152. When the investment in Controlled Entity C is disposed of, IPSAS 41 requires the full €24 million gain on the hedging instrument to be reclassified in surplus or deficit. Using the step-by-step method, the amount to be reclassified to surplus or deficit in respect of the net investment in Controlled Entity C would be only €11 million loss. Controlling Entity D could adjust the foreign currency translation reserves of both Controlled Entities B and C by €13 million in order to match the amounts reclassified in respect of the hedging instrument and the net investment as would have been the case if the direct method of consolidation had been used, if that was its accounting policy. An entity that had not hedged its net investment could make the same reclassification.

Concessionary Loans (Paragraphs AG118–AG126)**Example 20—Receipt of a Concessionary Loan (Interest Concession)**

IE153. A local authority receives loan funding to the value of CU5 million from an international development agency to build primary healthcare clinics over a period of 5 years. The agreement stipulates that the loan is to be repaid over the 5 year period as follows:

Year 1: no principal repayments

Year 2: 10 percent of the principal

Year 3: 20 percent of the principal

Year 4: 30 percent of the principal

Year 5: 40 percent of the principal

Interest is paid annually in arrears, at a rate of 5 percent per annum on the outstanding balance of the loan. A market-related rate of interest for a similar transaction is 10 percent.

IE154. The local authority has received a concessionary loan of CU5 million, which will be repaid at 5 percent below the current market interest rate. The difference between the proceeds of the loan and the present value of the contractual payments in terms of the loan agreement, discounted using the market-related rate of interest, is recognized in accordance with IPSAS 23

IE155. The journal entries to account for the concessionary loan are as follows:

1. On initial recognition, the entity recognizes the following:

Dr	Bank	5,000,000	
	Cr	Loan (refer to Table 2 below)	4,215,450
	Cr	Liability or non-exchange revenue	784,550

Recognition of the receipt of the loan at fair value

IPSAS 23 is considered in recognizing either a liability or revenue for the off-market portion of the loan. Paragraph IG54 of that Standard provides journal entries for the recognition and measurement of the off-market portion of the loan deemed to be non-exchange revenue.

2. Year 1: The entity recognizes the following:

Dr	Interest (refer to Table 3 below)	421,545	
	Cr	Loan	421,545

Recognition of interest using the effective interest method (CU4,215,450 × 10 percent)

Dr	Loan (refer to Table 1 below)	250,000	
	Cr	Bank	250,000

Recognition of interest paid on outstanding balance (CU5m × 5 percent)

3. Year 2: The entity recognizes the following:

Dr	Interest	438,700	
	Cr	Loan	438,700

Recognition of interest using the effective interest method (CU4,386,995 × 10 percent)

Dr	Loan	750,000	
	Cr	Bank	750,000

Recognition of interest and principal paid on outstanding balance (CU5m × 5 percent + CU500,000)

4. Year 3: The entity recognizes the following:

Dr	Interest	407,569	
	Cr	Loan	407,569

Recognition of interest using the effective interest method (CU4,075,695 × 10 percent)

Dr	Loan	1,225,000	
	Cr	Bank	1,225,000

Recognition of interest and principal paid on outstanding balance (CU4.5m × 5 percent + CU1m)

5. Year 4: The entity recognizes the following:

Dr	Interest	325,827	
	Cr	Loan	325,827

Recognition of interest using the effective interest method (CU 3,258,264 × 10 percent)

Dr	Loan	1,675,000	
	Cr	Bank	1,675,000

Recognition of interest and principal paid on outstanding balance (CU3.5m × 5 percent + CU1.5m)

6. Year 5: The entity recognizes the following:

Dr	Interest	190,909	
	Cr	Loan	190,909

Recognition of interest using the effective interest method (CU1,909,091 × 10 percent)

Dr	Loan	2,100,000	
	Cr	Bank	2,100,000

Recognition of interest and principal paid on outstanding balance (CU2m × 5 percent + CU2m)

Calculations:

Table 1: Amortization Schedule (Using Contractual Repayments at 5 percent Interest)

	Year 0 CU	Year 1 CU	Year 2 CU	Year 3 CU	Year 4 CU	Year 5 CU
Principal	5,000,000	5,000,000	5,000,000	4,500,000	3,500,000	2,000,000
Interest	–	250,000	250,000	225,000	175,000	100,000
Payments	–	(250,000)	(750,000)	(1,225,000)	(1,675,000)	(2,100,000)
Balance	5,000,000	5,000,000	4,500,000	3,500,000	2,000,000	–

Table 2: Discounting Contractual Cash Flows (Based on a Market Rate of 10 percent)

	Year 1 CU	Year 2 CU	Year 3 CU	Year 4 CU	Year 5 CU
Principal balance	5,000,000	4,500,000	3,500,000	2,000,000	–
Interest payable	250,000	250,000	225,000	175,000	100,000
Total payments (principal and interest)	250,000	750,000	1,225,000	1,675,000	2,100,000
Present value of payments	227,272	619,835	920,360	1,144,048	1,303,935
Total present value of payments					4,215,450
Proceeds received					5,000,000
Less: Present value of outflows (fair value of loan on initial recognition)					4,215,450
Off-market portion of loan to be recognized as non-exchange revenue					784,550

Table 3: Calculation of Loan Balance and Interest Using the Effective Interest Method

	Year 1 CU	Year 2 CU	Year 3 CU	Year 4 CU	Year 5 CU
Principal	4,215,450	4,386,995	4,075,695	3,258,264	1,909,091
Interest accrual	421,545	438,700	407,569	325,827	190,909
Interest payments	(250,000)	(250,000)	(225,000)	(175,000)	(100,000)
Principal payments	–	(500,000)	(1,000,000)	(1,500,000)	(2,000,000)
Balance	4,386,995	4,075,695	3,258,264	1,909,091	–

Example 21—Payment of a Concessionary Loan (Principal Concession)⁴⁸

IE156. The department of education makes low interest loans available to qualifying students with delayed repayment terms as a means of promoting post-secondary education.

IE157. The department advanced CU250 million to various students at the beginning of the financial year, with the following terms and conditions:

Principal to be repaid as follows:

Year 1 to 3: no principal repayments

Year 4: 30 percent principal to be repaid

Year 5: 30 percent principal to be repaid

Year 6: 30 percent principal to be repaid

The remaining principal balance (10 percent of CU250 million) outstanding at the end of year 6 is to be forgiven.

⁴⁸ For simplicity, this example excludes any considerations in relation to calculating expected credit losses.

Interest is calculated at 11.5 percent interest on the outstanding loan balance, and is to be paid annually in arrears. Assume the market rate of interest for a similar loan is 11.5 percent.

Scenario 1: Amortized Cost

IE158. After assessing the substance of the concessionary loan, the department of education classifies the financial asset in accordance with paragraphs 39–44. Based on the facts in the example, the department of education classifies the financial assets as measured at amortized cost.

IE159. The aggregated journal entries to account for the concessionary loans when measured at amortized cost are as follows:

1.	On initial recognition, the entity recognizes the following:		
Dr	Loan	236,989,595	
Dr	Expense	13,010,405	
	Cr Bank		250,000,000

Recognition of the advance of the loans at fair value

Paragraph AG125(b) is considered in recognizing an expense for the off-market portion of the loan deemed to be a non-exchange expense.

2.	Year 1: The entity recognizes the following		
Dr	Loan	27,253,803	
	Cr Interest revenue		27,253,803

Interest accrual using the effective interest method (CU236,989,595 × 11.5 percent)

Dr	Bank	28,750,000	
	Cr Loan		28,750,000

Interest payment of CU250m × 11.5 percent

3.	Year 2: The entity recognizes the following:		
Dr	Loan	27,081,741	
	Cr Interest revenue		27,081,741

Interest accrual using the effective interest method (CU235,493,398 × 11.5 percent)

Dr	Bank	28,750,000	
	Cr Loan		28,750,000

Interest payment of CU250m × 11.5 percent

4.	Year 3: The entity recognizes the following:		
Dr	Loan	26,889,891	
	Cr Interest revenue		26,889,891

Interest accrual using the effective interest method (CU233,825,139 × 11.5 percent)

Dr	Bank	28,750,000	
	Cr Loan		28,750,000

Interest payment of (CU250m × 11.5 percent)

5.	Year 4: The entity recognizes the following:		
Dr	Loan	26,675,979	
	Cr Interest revenue		26,675,979

Interest accrual using the effective interest method (CU231,965,030 × 11.5 percent)

Dr	Bank	103,750,000	
	Cr Loan		103,750,000

Recognition of interest and principal received on outstanding balance (CU250m × 11.5 percent + CU75m)

6.	Year 5: The entity recognizes the following:		
Dr	Loan	17,812,466	
	Cr Interest revenue		17,812,466

Interest accrual using the effective interest method (CU154,891,009 × 11.5 percent)

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Dr		Bank	95,125,000	
	Cr	Loan		95,125,000

Recognition of interest and principal received on outstanding balance (CU175m × 11.5 percent + CU75m)

7. Year 6: The entity recognizes the following:

Dr		Loan	8,921,525	
	Cr	Interest revenue		8,921,525

Interest accrual using the effective interest method (CU77,578,475 × 11.5 percent)

Dr		Bank	86,500,000	
	Cr	Loan		86,500,000

Recognition of interest and principal received on outstanding balance (CU100m × 11.5 percent + CU75m)

Scenario 2: Fair Value through Surplus/Deficit

IE160. In addition to the terms outlined in paragraph IE157, the loans provide the department of education the ability to call the instrument at any time for an amount that does not substantially reflect payment of outstanding principal and interest. After assessing the substance of the concessionary loans, the department of education determines the classification of the financial asset in accordance with paragraphs 39–44. Because the call feature in this example precludes the cash flows of this instrument from being solely payments of principal and interest, the department of education concludes the financial assets are classified at fair value through surplus/deficit.

IE161. The aggregated journal entries to account for the concessionary loans when classified at fair value through surplus/deficit are as follows:

1. On initial recognition, the entity recognizes the following:

Dr		Loan	236,989,595	
Dr		Expense	13,010,405	
	Cr	Bank		250,000,000

Recognition of the advance of the loans at fair value

Paragraph AG125(b) is considered in recognizing an expense for the off-market portion of the loan deemed to be a non-exchange expense.

2. Year 1: The entity recognizes the following

Dr		Loan	27,253,803	
	Cr	Interest revenue		27,253,803

Interest accrual of CU236,989,595 × 11.5 percent

Dr		Bank	28,750,000	
	Cr	Loan		28,750,000

Interest payment of CU250m × 11.5 percent

3. Year 2: The entity recognizes the following:

Dr		Loan	27,081,741	
	Cr	Interest revenue		27,081,741

Interest accrual of CU235,493,398 × 11.5 percent

Dr		Bank	28,750,000	
	Cr	Loan		28,750,000

Interest payment of CU250m × 11.5 percent

Dr		Fair value adjustment	2,766,221	
	Cr	Loan		2,766,221

Fair value adjustment (CU231,058,918⁴⁸ – (CU235,493,398 + CU27,081,741 – CU28,750,000))

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4. Year 3: The entity recognizes the following:			
Dr	Loan	26,571,776	
	Cr Interest revenue		26,571,776
<i>Interest accrual of CU231,058,918 × 11.5 percent</i>			
Dr	Bank	28,750,000	
	Cr Loan		28,750,000
<i>Interest payment of CU250m × 11.5 percent</i>			
Dr	Fair value adjustment	2,620,867	
	Cr Loan		2,620,867
<i>Fair value adjustment (CU226,259,827⁴⁷ – (CU231,058,918 + CU26,571,776 – CU28,750,000))</i>			
5. Year 4: The entity recognizes the following:			
Dr	Loan	26,019,880	
	Cr Interest revenue		26,019,880
<i>Interest accrual of CU226,259,827 × 11.5 percent</i>			
Dr	Bank	103,750,000	
	Cr Loan		103,750,000
<i>Interest payment of CU250m × 11.5 percent + CU75m principal repaid</i>			
Dr	Loan	1,472,217	
	Cr Fair value adjustment		1,472,217
<i>Fair value adjustment (CU150,001,924⁴⁷ – (CU226,259,827 + CU26,019,880 – CU103,750,000))</i>			
6. Year 5: The entity recognizes the following:			
Dr	Loan	17,250,221	
	Cr Interest revenue		17,250,221
<i>Interest accrual of CU150,001,924 × 11.5 percent</i>			
Dr	Bank	95,125,000	
	Cr Loan		95,125,000
<i>Interest payment of CU175m × 11.5 percent + CU75m principal repaid</i>			
Dr	Loan	3,750,048	
	Cr Fair value adjustment		3,750,048
<i>Fair value adjustment (CU75,877,193⁴⁷ – (CU150,001,924 + CU17,250,221 – CU95,125,000))</i>			
7. Year 6: The entity recognizes the following:			
Dr	Loan	8,725,877	
	Cr Interest revenue		8,725,877
<i>Interest accrual of CU75,877,193 × 11.5 percent</i>			
Dr	Bank	86,500,000	
	Cr Loan		86,500,000
<i>Interest payment of CU100m × 11.5 percent + CU75m principal repaid</i>			
Dr	Loan	1,896,930	
	Cr Fair value adjustment		1,896,930
<i>Fair value adjustment (CU0⁴⁷ – (CU75,877,193 + CU8,725,877 – CU86,500,000))</i>			

⁴⁹ See table 4 in this example for reference to fair values.

Calculations

Table 1: Amortization Schedule (Using Contractual Repayments at 11.5 percent Interest)

	Year 0 CU*000	Year 1 CU*000	Year 2 CU*000	Year 3 CU*000	Year 4 CU*000	Year 5 CU*000	Year 6 CU*000
Principal	250,000	250,000	250,000	250,000	250,000	175,000	100,000
Interest	–	28,750	28,750	28,750	28,750	20,125	11,500
Payments	–	(28,750)	(28,750)	(28,750)	(103,750)	(95,125)	(86,500)
Balance	250,000	250,000	250,000	250,000	175,000	100,000	25,000

Table 2: Discounting Contractual Cash Flows (Based on a Market Rate of 11.5 Percent)

	Year 1 CU	Year 2 CU	Year 3 CU	Year 4 CU	Year 5 CU	Year 6 CU
Principal balance	250,000,000	250,000,000	250,000,000	175,000,000	100,000,000	25,000,000
Interest receivable	28,750,000	28,750,000	28,750,000	28,750,000	20,125,000	11,500,000
Total receipts (principal and interest)	28,750,000	28,750,000	28,750,000	103,750,000	95,125,000	86,500,000
Present value of cash flows	25,784,753	23,125,339	20,740,215	67,125,670	55,197,618	45,016,000
Total present value of cash flows						236,989,595
Proceeds paid						250,000,000
Less: Present value of inflows (fair value of loan on initial recognition)						236,989,595
Off-market portion of loan to be recognized as expense						13,010,405

Table 3: Calculation of Loan Balance and Interest Using the Effective Interest Method

	Year 1 CU	Year 2 CU	Year 3 CU	Year 4 CU	Year 5 CU	Year 6 CU
Principal	236,989,595	235,493,398	233,825,139	231,965,030	154,891,009	77,578,475
Interest accrual	27,253,803	27,081,741	26,889,891	26,675,979	17,812,466	8,921,525
Interest	(28,750,000)	(28,750,000)	(28,750,000)	(28,750,000)	(20,125,000)	(11,500,000)
Principal receipts	-	-	-	(75,000,000)	(75,000,000)	(75,000,000)
Balance	235,493,398	233,825,139	231,965,030	154,891,009	77,578,475	–

Table 4: Fair Value of Loan

	Year 1 CU	Year 2 CU	Year 3 CU	Year 4 CU	Year 5 CU	Year 6 CU
Fair value	236,989,595	235,493,398	231,058,918	226,259,827	150,001,924	75,877,193
Market interest rate (beginning of year)	11.5 percent	11.5 percent	12 percent	13 percent	14 percent	14 percent
Market interest rate (end of year)	11.5 percent	12 percent	13 percent	14 percent	14 percent	14 percent
Interest accrual (11.5 percent)	27,253,803	27,081,741	26,571,776	26,019,880	17,250,221	8,725,877
Interest	(28,750,000)	(28,750,000)	(28,750,000)	(28,750,000)	(20,125,000)	(11,500,000)
Principal receipts	-	-	-	(75,000,000)	(75,000,000)	(75,000,000)
Fair value adjustment	-	(2,766,221)	(2,620,867)	1,472,217	3,750,048	1,896,930
Balance	235,493,398	231,058,918	226,259,827	150,001,924	75,877,193	–

Example 22—Payment of a Concessionary Loan (Loan Commitment)

IE162. Prior to the beginning of every wheat agricultural season, the department of agriculture makes low-interest loans available to qualifying farmers as a means of promoting the cultivation of wheat within the jurisdiction. These loans are available on demand by individual farmers at any time during the planting season and must be repaid prior to the subsequent planting season.

IE163. The department makes available CU100 million to various farmers at the beginning of the harvest season in 20x1. By the end of the harvest season the department has distributed all CU100 million with the following terms and conditions:

- Principal is to be repaid prior to the next harvest season.
- No interest is charged on the outstanding loan balance. Assume the market rate of interest for similar loans is 1.5 percent.

At the origination of the loan commitments, there is no indication that the instruments are credit-impaired.

Scenario 1: No Expected Credit Losses Identified During the Loan Commitment Period

IE164. As the department of agriculture has committed to issue below-market-rate loans, the commitments are accounted for in accordance with paragraphs 45(d) and 57. The aggregated journal entries to initially account for the loan commitments are as follows:

1. On initial recognition, the entity recognizes the following:

Dr	Expense	1,477,833	
	Cr	Loan commitment liability	1,477,833

Recognition of commitments to issue loans at below-market rates

The loan commitments are initially measured at fair value in accordance with paragraph 57.

IE165. No further entries are required during the commitment period. This is a result of the department of agriculture electing not to charge a commitment fee, resulting in no revenue to recognize associated with the loan commitments, and the department identifying no credit losses during the commitment period.

IE166. When the concessionary loans are granted, and the loan commitments are satisfied, the substance of the concessionary loans is assessed. The department of agriculture classifies the financial assets in accordance with paragraphs 39–44. Based on the facts in the example, the department of agriculture classifies the financial assets as measured at amortized cost.

IE167. The aggregated journal entries to account for the concessionary loans are as follows:

2. On initial recognition, the entity recognizes the following:

Dr	Loan	98,522,167	
Dr	Loan commitment liability	1,477,833	
	Cr	Cash	100,000,000

Recognition of the advance of the loans at fair value

Paragraph AG125(b) is considered in recognizing an expense for the off-market portion of the loan deemed to be a non-exchange expense. However, as an expense was previously recognized as part of the loan commitment, no further expense is required.

3. Interest is recognized as follows:

Dr	Loan	1,477,833	
	Cr	Interest revenue	1,477,833

Interest accrual using the effective interest method (CU98,522,167 × 1.5 percent)

4. Loan repayments are recognized as follows:

Dr	Cash	100,000,000	
	Cr	Loan	100,000,000

Department of agriculture collects principal repayments of CU100 million

Scenario 2: Evidence of Credit Impairment Identified During the Loan Commitment Period

IE168. As the department of agriculture has committed to issue below-market-rate loans, the commitments are accounted for in accordance with paragraphs 45(d) and 57. The aggregated journal entries to initially account for the loan commitments are as follows:

1. On initial recognition, the entity recognizes the following:

Dr	Expense	1,477,833	
	Cr	Loan commitment liability	1,477,833

Recognition of commitments to issue loans at below-market rates

The loan commitments are initially measured at fair value in accordance with paragraph 57.

IE169. During the loan commitment period, the department of agriculture noted the yield from the current season's wheat harvest was expected to be lower than initially projected. Using the most recent information available, the department of agriculture makes the following estimates:

- The portfolio of loans has a lifetime probability of default of 5 percent; and
- The loss given default is 35 percent, and would occur when the principal is repaid.

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2. The impairment is recognized as follows:

Dr	Impairment expense	1,724,137	
Dr	Loan commitment liability	1,477,833	
	Cr	Loss allowance	3,201,970

Recognition of impairment expense of CU 1.724 million

The impairment expense is CU1.724 million, which is calculated by multiplying the amount of cash flows receivable (CU 100 million) by the probability of default (5 percent) and by the loss given default (35 percent), and discounting at the effective interest rate for one year (1.5 percent).

IE170. As the concessionary loans are provided, and the loan commitments are satisfied, the substance of the concessionary loans is assessed. The department of agriculture classifies the financial assets in accordance with paragraphs 39–44. Based on the facts in the example, the department of agriculture classifies the financial assets as measured at amortized cost.

IE171. The aggregated journal entries to account for the concessionary loans are as follows:

3. On initial recognition, the entity recognizes the following:

Dr	Loan	96,798,030	
Dr	Loss allowance	3,201,970	
	Cr	Cash	100,000,000

Recognition of the advance of the loans at fair value

Paragraph AG125(b) is considered in recognizing an expense for the off-market portion of the concessionary originated credit-impaired loan. However, as an expense was previously recognized as part of the loan commitment, no further expense is required.

4. Interest is recognized as follows:

Dr	Loan	1,451,970	
	Cr	Interest revenue	1,451,970

Interest accrual using the effective interest method (CU96,798,030 × 1.5 percent)

IE172. Prior to the loan maturing, the harvest was stronger than projected during the commitment period. Credit losses on the principal balance are expected to be CU 500,000.

5. The impairment gain is recognized as follows:

Dr	Loan	1,250,000	
	Cr	Impairment gain	1,250,000

Recognition of the impairment gain of CU1.25 million

Reduction of CU1.25 million is required in order to recognize total expected credit losses of CU500,000 (CU99,500,000 – CU96,798,030 – CU1,451,970).

6. Loan repayments are recognized as follows:

Dr	Cash	99,500,000	
	Cr	Loan	99,500,000

Department of agriculture collects principal repayments of CU99.5 million

Calculations

Table 1: Amortization Schedule (Using Contractual Repayments at 1.5 Percent Interest)

	Year 0	Year 1
Principal	100,000,000	100,000,000
Interest	–	–
Payments	–	100,000,000
Balance	100,000,000	–

Table 2: Discounting Contractual Cash Flows (Based on a Market Rate of 1.5 Percent)

	Year 1 CU
Principal balance	100,000,000
Interest payable	–
Total payments (principal and interest)	100,000,000
Present value of payments	98,522,167
Total present value of payments	98,522,167
Proceeds paid	100,000,000
Less: Present value of outflows (fair value of loan on initial recognition)	98,522,167
Off-market portion of loan to be recognized as expense	1,477,833

Table 3: Calculation of Loan Balance and Interest Using the Effective Interest Method

	Year 1 CU
Principal	98,522,167
Interest accrual	1,477,833
Interest	–
Principal payments	100,000,000
Balance	–

Financial Guarantee (Paragraphs AG131–AG136)

Example 23—Financial Guarantee Contract Provided at Nominal Consideration

IE173. Entity C is a major motor vehicle manufacturer in Jurisdiction A. On January 1, 20X1 Government A (the issuer) enters into a financial guarantee contract with Entity B (the holder) to reimburse Entity B against the financial effects of default by Entity C (the debtor) for a 5 year loan of 50 million Currency Units (CUs) repayable in two equal installments of CU25 million in 20X3 and 20X5. Entity C provides nominal consideration of CU5,000 to Government A. At initial recognition, Government A measures the financial guarantee contract at fair value. Applying a valuation technique, Government A determines the fair value of the financial guarantee contract to be CU5,000,000.

IE174. On December 31, 20X1, having reviewed the financial position and performance of Entity C and having evaluated forward looking information including expected automotive industry trends, Government A determines there has been no significant increase in credit risk since initial recognition. In applying the measurement requirements of paragraph 45(c), Government A measures the financial guarantee contract at the higher of:

- (i) The amount of the loss allowance calculated in accordance with this standard; and
- (ii) The amount initially recognized, less the cumulative amount of revenue recognized.

Government A measures the loss allowance at an amount equal to the 12 month expected credit losses. Government A calculates the amount of loss allowance to be less than the amount initially recognized. Government A therefore does not recognize an additional liability in its statement of financial position. Government A makes the disclosures relating to fair value and credit risk in IPSAS 30, *Financial Instruments: Disclosures* in respect of the financial guarantee contract. In its statement of financial performance Government A recognizes revenue of CU1,000,000 in respect of the initial fair value of the instrument (total consideration of CU5,000,000 / 5 years).

IE175. In 20X2 there has been a downturn in the motor manufacturing sector affecting Entity C. Although it has met its obligations for interest payments, Entity C is seeking bankruptcy protection and is expected to default on its first repayment of principal. Negotiations are advanced with a potential acquirer (Entity D), which will restructure Entity C. Entity D has indicated that it will assume responsibility for the final installment of the loan with Entity B, but not the initial installment. Government A determines there has been a significant increase in credit risk since initial recognition of the financial guarantee contract and measures the loss allowance associated with the financial guarantee contract at an amount equal to the lifetime expected credit losses. Government A calculates the lifetime expected credit losses to be CU25.5 million and recognizes an expense for, and increases its liability by, CU22.5 million (after the sale to Entity D, the Government has an expected loss of 25 million CUs on the first installment and CU500,000 on the final installment, for a total liability of CU25.5 million. The current balance of the financial guarantee of CU3 million is required to be increased by CU22.5 million).

IE176. The journal entries at initial acquisition and at the reporting dates are as follows:

1. On initial recognition, the entity recognizes the following:

Dr	Bank	5,000	
Dr	Expense	4,995,000	
	Cr	Financial guarantee contract	5,000,000

2. Year 1: The entity recognizes the following

Dr	Financial guarantee contract	1,000,000	
	Cr	Revenue	1,000,000

Revenue of CU5,000,000 is recognized over a 5 year period

3. Year 2: The entity recognizes the following:

Dr	Financial guarantee contract	1,000,000	
	Cr	Revenue	1,000,000

Revenue of CU5,000,000 is recognized over a 5 year period

Dr	Expense	22,500,000	
	Cr	Financial guarantee contract	22,500,000

Lifetime expected credit losses of CU25.5 million less CU3,000,000 recognized as a liability

Fair Value Measurement Considerations (Paragraphs 66–68)

IE177. Illustrative examples 23–26 demonstrate different valuation techniques for valuing unquoted equity instruments. When selecting an appropriate valuation technique, professional judgment is exercised in considering the requirements in AG149–AG154.

Example 24—Valuation of Unquoted Equity Instruments (Transaction Price Paid for an Identical or Similar Instrument)

IE178. In 20X0, a Sovereign Wealth Fund bought ten equity shares of Entity D, a private company, representing ten per cent of the outstanding voting shares of Entity D, for CU1,000. The Sovereign Wealth Fund prepares annual financial statements and is required to measure the fair value of its non-controlling equity interest in Entity D as at December 31, 20X2 (i.e., the measurement date).

IE179. During December of 20X2, Entity D raised funds by issuing new equity capital (ten shares for CU1,200) to other investors. The Sovereign Wealth Fund concludes that the transaction price of the new equity capital issue for CU1,200 represents fair value at the date those shares were issued.

IE180. Both the Sovereign Wealth Fund and the other investors in Entity D have shares with the same rights and conditions. Between the new equity capital issue to other investors and the measurement date, there have been no significant external or internal changes in the environment in which Entity D operates. As a result, the Sovereign Wealth Fund concludes that CU1,200 is the amount that is most representative of the fair value of its non-controlling equity interest in Entity D at the measurement date.

Analysis

IE181. When an investor has recently made an investment in an instrument that is identical to the unquoted equity instrument being valued, the transaction price can be a reasonable starting point for measuring the fair value of the unquoted equity instrument at the measurement date, if that transaction price represented the fair value of the instrument at initial recognition. An

investor must, however, use all information about the performance and operations of an investee that becomes reasonably available to the investor after the date of initial recognition up to the measurement date, because such information might have an effect on the fair value of the unquoted equity instrument of the investee at the measurement date.

Example 25—Valuation of Unquoted Equity Instruments (Discounted Cash Flow)

- IE182. As part of an initiative to encourage the use of renewable energy, Government A has a five per cent non-controlling equity interest in Entity R, a private company developing highly efficient solar panels in Government A's jurisdiction. Government A derives Entity R's indicated fair value of equity by deducting the fair value of debt (in this case assumed to be CU240 million) from the enterprise value of CU1,121.8 million as shown in the table below. Government A has concluded that there are no relevant non-operating items that need to be adjusted from Entity R's expected free cash (FCF).
- IE183. Entity R's value was computed by discounting the expected free cash flows (i.e., post-tax cash flows before interest expense and debt movements, using an unlevered tax rate) by an assumed weighted average cost of capital (WACC) of 8.9 per cent. The WACC computation included the following variables: cost of equity capital of 10.9 per cent, cost of debt capital of 5.7 percent, effective income tax rate of 30 per cent, debt to total capital ratio of 28.6 per cent and equity to total capital ratio of 71.4 per cent.

	Year 0 CU'000	Year 1 CU'000	Year 2 CU'000	Year 3 CU'000	Year 4 CU'000	Year 5 CU'000
FCF ⁴⁹	-	100	100	100	100	100
Terminal value ⁵⁰						1,121.8
DCF Method using enterprise value less fair value of debt						
Discount factors ⁵¹		0.9182	0.8430	0.7740	0.7107	0.6525
Present value of FCF and terminal value ⁵²		91.8	84.3	77.4	71.1	797.2
Enterprise value	1,121.8					
Less fair value of debt	(240.0)					
Indicated fair value of equity	881.8					

- IE184. This example assumes that all unquoted equity instruments of Entity R have the same features and give the holders the same rights. However, Government A considers that the indicated fair value of equity obtained above (CU881.8 million) must be further adjusted to consider:
- A non-controlling interest discount because Government A's interest in Entity R is a non-controlling equity interest and Government A has concluded that there is a benefit associated with control. For the purposes of this example, it has been assumed that the non-controlling interest discount is CU8.00 million;⁵⁴ and
 - A discount for the lack of liquidity, because Government A's interest in Entity R is unquoted. For the purposes of this example, it has been assumed that the discount for the lack of liquidity amounts to CU4.09 million.⁵¹
- IE185. As a result, Government A concludes that CU32 million is the price that is most representative of the fair value of its five per cent non-controlling equity interest in Entity R at the measurement date, as shown below:

	CU'000
Indicated fair value of equity × 5 percent (i.e., CU881.8 × 5 percent)	44.09
Non-controlling interest discount	(8.00)
Discount for lack of liquidity	(4.09)
Fair value of 5 percent non-controlling equity interest	32.00

⁵⁰ FCF represent cash flows before interest expense and debt movements. The tax charge has been computed considering no deduction for interest expense.

⁵¹ The terminal value has been computed assuming the yearly cash flows amounting to CU100 million would grow in perpetuity at a rate of zero (i.e., assuming that the impact of inflation on future cash flows is expected to be offset by market shrinkage).

⁵² The discount factors have been computed using the formula: $1/(1 + WACC)^{\text{year}}$. This formula, however, implies that the cash flows are expected to be received at the end of each period. Sometimes it might be more appropriate to assume that cash flows are received more or less evenly throughout the year (mid-year discounting convention). Using the mid-year discounting convention, the discount factor for year 'n' would have been computed as follows: $1/(1 + WACC)^{(n - 0.5)}$.

⁵³ The present value amounts have been computed by multiplying the FCF and terminal value by the corresponding discount factors.

⁵⁴ The process shown above is not the only possible method that a public sector entity could apply to measure the fair value of its non-controlling equity interest. As a result, the adjustments above should not be considered to be a comprehensive list of all applicable adjustments. The necessary adjustments will depend on the specific facts and circumstances. In addition, the amounts of the adjustments above are not supported by detailed calculations. They have been included for illustrative purposes only.

Example 26—Valuation of Unquoted Equity Instruments (Constant Growth with Limited Information)

- IE186. Entity S is a private company. Public Investment Fund T has a ten per cent non-controlling equity interest in Entity S. Entity S's management has prepared a two-year budget. However, Entity S's management shared with the manager of Public Pension Plan T materials from its annual Board meetings, at which management discussed the assumptions to back up the expected growth plan for the next five years.
- IE187. On the basis of the information obtained from the Board meeting, Public Investment Fund T has extrapolated the two-year budget by reference to the basic growth assumptions discussed in the Board meeting and has performed a discounted cash flow calculation.
- IE188. On the basis of Entity S's management's two-year detailed budget, sales and EBIT would reach CU200 and CU50, respectively, in 20X3. Public Investment Fund T understands that Entity S's management expects sales to achieve further growth of five per cent per annum until 20X8 with the same EBIT margin (as a percentage of sales) as in 20X3. Consequently, Public Investment Fund T projects the EBIT of Entity S as follows:⁵⁵

	Year 1 CU'000	Year 2 CU'000	Year 3 CU'000	Year 4 CU'000	Year 5 CU'000	Year 6 CU'000	Year 7 CU'000
Sales	150	200	210	221	232	243	255
EBIT margin	23%	25%	25%	25%	25%	25%	25%
EBIT	35	50	53	55	58	61	64

- IE189. Public Investment Fund T is also aware that the management of Entity S expects the entity to reach a stable growth stage by 20X8. To calculate the terminal value, using the constant growth discount model, Public Investment Fund T assumes a long-term terminal growth rate of two per cent on the basis of the long-term outlook of Entity S, its industry and the economy in the country where Entity S operates. If Entity S has not reached the stable growth stage by the end of the projection period, Public Investment Fund T would need to extend the projection period until the stable growth stage is reached and calculate the terminal value at that point.⁵⁶
- IE190. Finally, Public Investment Fund T cross-checks this valuation by comparing Entity S's implied multiples to those of its comparable company peers.⁵⁷

Example 27—Valuation of Unquoted Equity Instruments (Adjusted Net Assets)

- IE191. State Government A has a ten per cent non-controlling equity interest in Entity V, a private company. There is no controlling shareholder for Entity V, which is a payroll services provider for its investors, including State Government A. Entity V's transactions, and therefore service fees, depend on the total number of employees of its investors (which are all the State Governments of Jurisdiction Z) and, as a result, Entity V does not have its own growth strategy. Entity V has a very low profit margin and it does not have comparable public company peers.
- IE192. State Government A needs to measure the fair value of its non-controlling equity interest in Entity V as of December 31, 20X1 (i.e., the measurement date). State Government A has Entity V's latest statement of financial position, which is dated September 30, 20X1.
- IE193. The following are the adjustments performed by State Government A to the latest statement of financial position of Entity V:
- Entity V's major asset is an office building that was acquired when Entity V was founded 25 years ago. The fair value of the building was measured by a valuation specialist at CU2,500 at the measurement date. This value compares to a book value of CU1,000.
 - During the three-month period from September 30, 20X1 to the measurement date, the fair value of Entity V's investments in public companies changed from CU500 to CU600.
 - State Government A observes that Entity V measures its current assets and current liabilities at fair value. The volume of operations of Entity V is so flat that the investor estimates that the amounts of the current assets and current liabilities shown in Entity V's statement of financial position as of September 30, 20X1 are most representative

⁵⁵ To derive Entity S's FCF for use in the discounted cash flow method, Public Investment Fund T used Entity S's two-year budget and its understanding of the investee's asset and capital structures, reinvestment requirements and working capital needs.

⁵⁶ This example illustrates a two-stage model in which the first stage is delineated by a finite number of periods (20X2–20X8) and after this first stage the example assumes a period of constant growth for which Public Investment Fund T calculates a terminal value for Entity S. In other cases an investor might conclude that a multiple-stage model rather than a two-stage model would be more appropriate. A multiple-stage model would generally have a period after the discrete projection period in which growth might be phased down over a number of years before the constant growth period for which a terminal value can be estimated.

⁵⁷ This example assumes that the fair value conclusion would have included any necessary adjustments (for example, non-controlling interest discount, discount for the lack of liquidity etc.) that market participants would incorporate when pricing the equity instruments at the measurement date.

of their fair value at the measurement date, with the exception of an amount of CU50 included in Entity V's trade receivables that became unrecoverable after September 30, 20X1.

- On the basis of Entity V's management model and profitability, State Government A estimates that unrecognized intangible assets would not be material.
- State Government A does not expect that Entity V's cash flows for the quarter ended December 31, 20X1 are material.
- State Government A does not expect any major sales of assets from Entity V. As a result, it concludes that there are no material tax adjustments that need to be considered when valuing Entity V.

Entity V – Statement of financial position (CU)

	Sept 30, 20X1	Adjustments	Estimated Dec 31, 20x1
ASSETS			
Non-current assets			
Property, plant and equipment	2,000	1,500	3,500
Investments in equity instruments	500	100	600
	2,500	1,600	4,100
Current assets			
Trade receivables	500	(50)	450
Cash and cash equivalents	500	-	500
	1,000	(50)	950
Total Assets	3,500	1,550	5,050
NET ASSETS/EQUITY AND LIABILITIES			
Total net assets/equity	2,500	1,550	4,050
Current liabilities	1,000	0	1,000
Total net assets/equity and liabilities	3,500	1,550	5,050

- IE194. Before considering any adjustments (for example, discount for the lack of liquidity, non-controlling interest discount), the indicated fair value of State Government A's ten per cent non-controlling equity interest in Entity V is CU405 (10 percent × CU4,050 = CU405). For the purpose of this example, it has been assumed that the discount for the lack of liquidity amounts to CU40 and that the non-controlling interest discount amounts to CU80.
- IE195. On the basis of the facts and circumstances described above, State Government A concludes that the price that is most representative of fair value for its ten per cent non-controlling equity interest in Entity V is CU285 at the measurement date (CU405 – (CU40 – CU85 = CU285).⁵⁸

Example 28—Valuation of Unquoted Equity Instruments with Non-Exchange Component

- IE196. National Government A purchased 1,000 shares of International Investment Bank B on 1 July 20X6 for CU5,000, or CU5 per share. Because National Government A is a non-controlling shareholder, it does not receive the Bank's budgets or cash flow forecasts. National Government A prepares annual financial statements and is measuring the fair value of its non-controlling equity interest in the International Investment Bank on December 31, 20X6 (i.e., the measurement date).
- IE197. The amount paid for the unquoted equity instruments (CU5,000) in July 20X6 is a reasonable starting point for measuring the fair value of the investor's non-controlling equity interest in International Investment Bank B at the measurement date. However, National Government A is required to assess whether the amount paid needs to be adjusted if there is evidence that other factors exist or if other evidence indicates that the transaction price is not representative of fair value at the measurement date. For example, in some circumstances a public sector entity may transfer consideration in excess of the fair value of the shares acquired, to provide a subsidy to the recipient. In these circumstances, National Government A adjusts the transaction price accordingly and recognizes an expense for the concessionary portion of the consideration because the transaction includes a payment for the equity instrument and subsidy.

⁵⁸ The process shown above is not the only possible method that a public sector entity could apply to measure the fair value of its non-controlling equity interest. As a result, the adjustments above should not be considered to be a comprehensive list of all applicable adjustments. The necessary adjustments will depend on the specific facts and circumstances. In addition, the amounts of the adjustments above are not supported by detailed calculations. They have been included for illustrative purposes only.

Example 29—Valuation of Unquoted Equity Instruments Arising from a Non-Exchange Transaction

- IE198. On January 1, 20X1, National Government A transfers CU1000 to International Development Bank B. In exchange, Bank B issues 100 common shares with a par value of CU8. In transferring the CU1000, National Government A granted a concession of CU200, as evidenced in the transaction documentation.
- IE199. When accounting for the transaction, National Government A identifies two components embedded in the transfer of CU1000. The first component is a non-exchange expense of CU200. National Government A applies the guidance in paragraphs AG128–AG130 when accounting for this component.
- IE200. The second component is the 100 common shares in Bank B. IPSAS 41 requires, at initial recognition, financial instruments be measured at fair value plus or minus, in the case of a financial asset or financial liability not at fair value through surplus or deficit, directly attributable transaction costs.
- IE201. As the best evidence of fair value at initial recognition is normally the transaction price, National Government A determines the transaction price of CU800, as evidenced in the transaction document (100 common shares x par value of CU8/share), is the appropriate value at initial recognition.
- IE202. In addition to the transaction documentation, National Government concludes CU8 per share is the fair value of each share based on other similar transactions Bank B had with other national governments. In each transaction, Bank B issued common shares for CU8.

Example 30—Valuation of Debt Obligations: Quoted Price

- IE203. On January 1, 20X1, State Government B issues at par a CU2 million BBB-rated exchange-traded five-year fixed rate debt instrument with an annual 10 per cent coupon. State Government B designated this financial liability as at fair value through surplus or deficit.
- IE204. On December 31, 20X1, the instrument is trading as an asset in an active market at CU929 per CU1,000 of par value after payment of accrued interest. State Government B uses the quoted price of the asset in an active market as its initial input into the fair value measurement of its liability (CU929 × [CU2 million ÷ CU1,000] = CU1,858,000).
- IE205. In determining whether the quoted price of the asset in an active market represents the fair value of the liability, State Government B evaluates whether the quoted price of the asset includes the effect of factors not applicable to the fair value measurement of a liability. State Government B determines that no adjustments are required to the quoted price of the asset. Accordingly, State Government B concludes that the fair value of its debt instrument at December 31, 20X1, is CU1,858,000. State Government B categorizes and discloses the fair value measurement of its debt instrument within Level 1 of the fair value hierarchy in accordance with IPSAS 30, *Financial Instruments: Disclosures*.

Example 31—Valuation of Debt Obligations: Present Value Technique

- IE206. On January 1, 20X1, National Government C issues at par in a private placement a CU2 million BBB-rated five-year fixed rate debt instrument with an annual 10 per cent coupon. National Government C designated this financial liability as at fair value through surplus or deficit.
- IE207. At December 31, 20X1, National Government C still carries a BBB credit rating. Market conditions, including available interest rates, credit spreads for a BBB-quality credit rating and liquidity, remain unchanged from the date the debt instrument was issued. However, National Government C's credit spread has deteriorated by 50 basis points because of a change in its risk of non-performance. After taking into account all market conditions, National Government C concludes that if it was to issue the instrument at the measurement date, the instrument would bear a rate of interest of 10.5 per cent or National Government C would receive less than par in proceeds from the issue of the instrument.
- IE208. For the purpose of this example, the fair value of National Government C's liability is calculated using a present value technique. National Government C concludes that a market participant would use all the following inputs when estimating the price the market participant would expect to receive to assume National Government C's obligation:
- (a) the terms of the debt instrument, including all the following:
 - (i) coupon of 10 percent;
 - (ii) principal amount of CU2 million; and
 - (iii) term of four years.
 - (b) the market rate of interest of 10.5 per cent (which includes a change of 50 basis points in the risk of non-performance from the date of issue).

- IE209. On the basis of its present value technique, National Government C concludes that the fair value of its liability at December 31, 20X1 is CU1,968,641.
- IE210. Entity C does not include any additional input into its present value technique for risk or profit that a market participant might require for compensation for assuming the liability. Because National Government C's obligation is a financial liability, National Government C concludes that the interest rate already captures the risk or profit that a market participant would require as compensation for assuming the liability. Furthermore, National Government C does not adjust its present value technique for the existence of a restriction preventing it from transferring the liability.

Classification of Financial Assets (Paragraphs 39–44)

Example 32—Capital Subscriptions Held with Redemption Features

- IE211. In order to participate in and support the activities of International Development Bank A, or similar international organization, Federal Government B invested and acquired a fixed number of subscription rights in International Development Bank A, based on Federal Government B's proportional share of global Gross Domestic Product. Each subscription right costs CU1,000, which provides Federal Government B with the right to put the subscription rights back to International Development Bank A in exchange for the initial amount invested (i.e., CU1,000 per subscription right). International Development Bank A has no obligation to deliver dividends on the subscription rights.
- IE212. Government B is evaluating the appropriate classification of the financial asset based on the terms of the subscription rights.
- IE213. In determining the classification of the financial asset, Government B concludes the subscription rights do not meet the definition of an equity instrument as defined in IPSAS 28, *Financial Instruments: Presentation*.⁵⁹ As a result, Government B concludes the election available in paragraph 43 to measure an equity instrument at fair value through net assets/equity is not available.
- IE214. Furthermore, as the contractual terms of the subscription rights fail to give rise on specified dates to cash flows solely for payments of principal and interest, the subscription rights cannot be classified as a debt instrument measured at amortized cost or fair value through net assets/equity. Government B concludes puttable subscription rights are required to be classified at fair value through surplus or deficit.

Effective Interest Method (Paragraphs 69–70)

Example 33—Measuring the Effective Interest Rate of a Bond Issued at a Discount with Transaction Costs

- IE215. State Government A issues a 5-year bond with a face value of CU500,000. The instrument carries a fixed yield of 4 percent, with interest payments paid annually. The bond was issued at a discount of 2 percent and State Government A was required to pay the bond underwriters a fee equal to CU12,000 on the transaction date.
- IE216. In determining the amortized cost of the instrument, State Government A must calculate the effective interest rate. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the instrument to the gross carrying amount of the instrument.
- IE217. Assuming there are no expectations of prepayment, extension or other call options, the estimated future cash flows are CU20,000 per annum in interest payments ($CU20,000 = CU500,000 \times 4$ percent), with an additional CU500,000 principal payment made at maturity.
- IE218. The gross carrying amount of the bond on the transaction date is calculated based on the net proceeds received by State Government A. Since the bond was issued at a discount, before transaction costs, State Government A received CU490,000 ($CU500,000 \times (100 \text{ percent} - 2 \text{ percent})$). Taking transaction costs into account, the net proceeds on issue were CU478,000 ($CU490,000 - CU12,000$).

⁵⁹ Based on guidance in paragraphs 15, 16, 17 and 18 of IPSAS 28 it is possible the puttable subscription rights meet the requirements to be classified as an equity instrument from the Bank's perspective. However, instruments meeting the provisions of paragraphs 15, 16, 17 and 18 of IPSAS 28 do not meet the definition of an equity instrument in IPSAS 28.

FINANCIAL INSTRUMENTS

Year	(a) Cash inflows	(b) Cash outflows (transaction costs and interest)	(c) Cash outflows (principal)	(d = a – b – c) Net cash flows
Year 1 (beginning)	500,000	12,000	10,000	478,000
Year 1 (end)	-	20,000	-	(20,000)
Year 2	-	20,000	-	(20,000)
Year 3	-	20,000	-	(20,000)
Year 4	-	20,000	-	(20,000)
Year 5	-	20,000	500,000	(520,000)

IE219. The effective interest rate of the bond is calculated by determining the rate that exactly discounts the estimated cash flows of CU20,000 per annum, plus the principal repayment at maturity, to the gross amount of CU478,000. Essentially, the effective interest rate determines the rate of interest incurred based on the net proceeds received by State Government A.

IE220. In this example, the effective interest rate is 5.02 percent. This is appropriate as the bond yield was stated to be 4 percent on a principal amount of CU500,000. However, in substance, State Government A only receives CU478,000 and continues to make annual interest payments of CU20,000. As such, as the transaction costs and discount increase, the more the effective interest rate will diverge from the contractual rate.

Effective interest rate = 5.02

Year	(a) Opening balance	(b) Interest expense	(c) Interest/principal payment	(d = a + b – c) Ending balance
Year 1	478,000	23,980	20,000	481,980
Year 2	481,980	24,180	20,000	486,160
Year 3	486,160	24,389	20,000	490,549
Year 4	490,549	24,610	20,000	495,159
Year 5	495,159	24,841	520,000	-

IMPLEMENTATION GUIDANCE

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Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 41.

Section A: Scope

A.1 Practice of Settling Net: Forward Contract to Purchase a Commodity

Entity XYZ enters into a fixed price forward contract to purchase one million barrels of oil in accordance with its expected usage requirements. The contract permits XYZ to take physical delivery of the oil at the end of twelve months or to pay or receive a net settlement in cash, based on the change in fair value of oil. Is the contract accounted for as a derivative?

While such a contract meets the definition of a derivative, it is not necessarily accounted for as a derivative. The contract is a derivative instrument because there is no initial net investment, the contract is based on the price of oil and it is to be settled at a future date. However, if XYZ intends to settle the contract by taking delivery and has no history for similar contracts of settling net in cash or of taking delivery of the oil and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin, the contract is not accounted for as a derivative under IPSAS 41. Instead, it is accounted for as an executory contract (unless the entity irrevocably designates it as measured at fair value through surplus or deficit in accordance with paragraph 6 of IPSAS 41).

A.2 Option to Put a Non-Financial Asset

Entity XYZ owns an office building. XYZ enters into a put option with an investor that permits XYZ to put the building to the investor for CU150 million. The current value of the building is CU175 million.⁶⁰ The option expires in five years. The option, if exercised, may be settled through physical delivery or net cash, at XYZ's option. How do both XYZ and the investor account for the option?

XYZ's accounting depends on XYZ's intention and past practice for settlement. Although the contract meets the definition of a derivative, XYZ does not account for it as a derivative if XYZ intends to settle the contract by delivering the building if XYZ exercises its option and there is no past practice of settling net (paragraph 5 of IPSAS 41; but see also paragraph 6 of IPSAS 41).

The investor, however, cannot conclude that the option was entered into to meet the investor's expected purchase, sale or usage requirements because the investor does not have the ability to require delivery (IPSAS 41, paragraph 8). In addition, the option may be settled net in cash. Therefore, the investor has to account for the contract as a derivative. Regardless of past practices, the investor's intention does not affect whether settlement is by delivery or in cash. The investor has written an option, and a written option in which the holder has a choice of physical settlement or net cash settlement can never satisfy the normal delivery requirement for the exemption from IPSAS 41 because the option writer does not have the ability to require delivery.

However, if the contract were a forward contract instead of an option, and if the contract required physical delivery and the reporting entity had no past practice of settling net in cash or of taking delivery of the building and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin, the contract would not be accounted for as a derivative. (But see also paragraph 6 of IPSAS 41).

Section B Definitions

Section B provides non-authoritative guidance on whether certain items meet the definitions in IPSAS 41.

B.1 Definition of a Financial Instrument: Gold Bullion

Is gold bullion a financial instrument (like cash) or is it a commodity?

It is a commodity. Although bullion is highly liquid, there is no contractual right to receive cash or another financial asset inherent in bullion.

B.1.1 Definition of a Financial Instrument: Monetary Gold

Is monetary gold a financial instrument (like cash)?

No. Similar to gold bullion, monetary gold is not a financial instrument as there is no contractual right to receive cash or another financial asset inherent in the item. However, given that monetary gold shares several characteristics with a financial asset, applying the principles set out in IPSAS 41 is generally appropriate under the hierarchy set out in paragraphs 9–15 of IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*. It may however be appropriate for an entity to consider other IPSAS depending on the facts and circumstances related to its holding of monetary gold.

⁶⁰ In this guidance, monetary amounts are denominated in 'currency units' (CU).

B.1.2 Public Sector Specific Financial Instruments

B.1.2.1 Definition of a Financial Instrument: Currency Issued as Legal Tender

Does issuing currency as legal tender create a financial liability for the issuer?

It depends. Currency derives its value, in part, through the statutory arrangement established between the issuer and the holder of the currency whereby currency is accepted as a medium of exchange and is recognized legally as a valid form of payment. In some jurisdictions, this statutory arrangement further obligates the issuer to exchange currency when it is presented by holders and may explicitly indicate that currency is a charge on government assets.

For the purposes of this Standard, an entity considers the substance rather than the legal form of an arrangement in determining whether there is a contractual obligation to deliver cash. Contracts are evidenced by the following:

- *Willing parties entering into an arrangement;*
- *The terms of the contract create rights and obligations for the parties to the contract; and*
- *The remedy for non-performance is enforceable by law.*

When laws and regulations or similar requirements enforceable by law, such as a Banking Act, set out the requirements and responsibilities of an entity to exchange outstanding currency, a “contract” exists for the purposes of this Standard. A financial liability is created when an entity issues currency to the counterparty as, at this point, two willing parties have agreed to the terms of the arrangement. Where no financial liability exists, an entity should consider whether an obligation is created in accordance with paragraphs 22–43 of IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*. Prior to currency being issued, there is no transaction between willing parties. Unissued currency does not meet the definition of a financial instrument. An entity applies paragraph 13 of IPSAS 12, *Inventories*, in accounting for any unissued currency.

B.1.2.2 Definition of a Financial Instrument: Special Drawing Rights (SDR) Holdings

Do Special Drawing Rights (SDR) Holdings meet the definition of a financial asset?

Yes. SDR holdings represent a claim on the currencies of members of the International Monetary Fund (IMF). SDR’s can be used in transactions with the IMF or can be exchanged between participants of the IMF’s SDR Department. Liquidity is guaranteed by a mechanism requiring participants to deliver cash in exchange for SDRs. Accordingly, SDR holdings are regarded as a financial asset.

B.1.2.3 Definition of a Financial Instrument: Special Drawing Rights (SDR) Allocations

Do Special Drawing Rights (SDR) Allocations meet the definition of a financial liability?

Yes. SDR allocations represent the obligation assumed when SDR holdings are distributed to members. IMF members must stand ready to provide currency holdings up to the amount of their SDR allocation. This represents a contractual obligation to deliver cash. Accordingly, SDR allocations are regarded as a financial liability.

B.2 Definition of a Derivative: Examples of Derivatives and Underlyings

What are examples of common derivative contracts and the identified underlying?

IPSAS 41 defines a derivative as follows:

A derivative is a financial instrument or other contract within the scope of this Standard with all three of the following characteristics.

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

Type of contract	Main pricing-settlement variable (underlying variable)
Interest rate swap	Interest rates
Currency swap (foreign exchange swap)	Currency rates
Commodity swap	Commodity prices
Equity swap	Equity prices (equity instrument of another entity)
Credit swap	Credit rating, credit index or credit price
Total return swap	Total fair value of the reference asset and interest rates
Purchased or written treasury bond option (call or put)	Interest rates
Purchased or written currency option (call or put)	Currency rates
Purchased or written commodity option (call or put)	Commodity prices
Purchased or written stock option (call or put)	Equity prices (equity instrument of another entity)
Interest rate futures linked to government debt (treasury futures)	Interest rates
Currency futures	Currency rates
Commodity futures	Commodity prices
Interest rate forward linked to government debt (treasury forward)	Interest rates
Currency forward	Currency rates
Commodity forward	Commodity prices
Equity forward	Equity prices (equity instrument of another entity)

The above list provides examples of contracts that normally qualify as derivatives under IPSAS 41. The list is not exhaustive. Any contract that has an underlying may be a derivative. Moreover, even if an instrument meets the definition of a derivative contract, special provisions may apply, for example, if it is a weather derivative (see paragraph AG1 of IPSAS 41), a contract to buy or sell a non-financial item such as commodity (see paragraphs 6–8 and AG8 of IPSAS 41) or a contract settled in an entity's own shares (see paragraphs 25–29 of IPSAS 28). Therefore, an entity must evaluate the contract to determine whether the other characteristics of a derivative are present and whether special provisions apply.

B.3 Definition of a Derivative: Settlement at a Future Date, Interest Rate Swap with Net or Gross Settlement

For the purpose of determining whether an interest rate swap is a derivative financial instrument under IPSAS 41, does it make a difference whether the parties pay the interest payments to each other (gross settlement) or settle on a net basis?

No. The definition of a derivative does not depend on gross or net settlement.

To illustrate: Entity ABC enters into an interest rate swap with a counterparty (XYZ) that requires ABC to pay a fixed rate of 8 percent and receive a variable amount based on three-month LIBOR, reset on a quarterly basis. The fixed and variable amounts are determined based on a CU100 million notional amount. ABC and XYZ do not exchange the notional amount. ABC pays or receives a net cash amount each quarter based on the difference between 8 percent and three-month LIBOR. Alternatively, settlement may be on a gross basis.

The contract meets the definition of a derivative regardless of whether there is net or gross settlement because its value changes in response to changes in an underlying variable (LIBOR), there is no initial net investment, and settlements occur at future dates.

B.4 Definition of a Derivative: Prepaid Interest Rate Swap (Fixed Rate Payment Obligation Prepaid at Inception or Subsequently)

If a party prepays its obligation under a pay-fixed, receive-variable interest rate swap at inception, is the swap a derivative financial instrument?

Yes. To illustrate: Entity S enters into a CU100 million notional amount five-year pay-fixed, receive-variable interest rate swap with Counterparty C. The interest rate of the variable part of the swap is reset on a quarterly basis to three-month LIBOR. The interest rate of the fixed part of the swap is 10 percent per year. Entity S prepays its fixed obligation under the swap of CU50 million (CU100 million × 10 percent × 5 years) at inception, discounted using market interest rates, while retaining the right to receive interest payments on the CU100 million reset quarterly based on three-month LIBOR over the life of the swap.

The initial net investment in the interest rate swap is significantly less than the notional amount on which the variable payments under the variable leg will be calculated. The contract requires an initial net investment that is smaller than would be required for

other types of contracts that would be expected to have a similar response to changes in market factors, such as a variable rate bond. Therefore, the contract fulfills the “no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors” provision of IPSAS 41. Even though Entity S has no future performance obligation, the ultimate settlement of the contract is at a future date and the value of the contract changes in response to changes in the LIBOR index. Accordingly, the contract is regarded as a derivative contract.

Would the answer change if the fixed rate payment obligation is prepaid subsequent to initial recognition?

If the fixed leg is prepaid during the term, that would be regarded as a termination of the old swap and an origination of a new instrument that is evaluated under IPSAS 41.

B.5 Definition of a Derivative: Prepaid Pay-Variable, Receive-Fixed Interest Rate Swap

If a party prepays its obligation under a pay-variable, receive-fixed interest rate swap at inception of the contract or subsequently, is the swap a derivative financial instrument?

No. A prepaid pay-variable, receive-fixed interest rate swap is not a derivative if it is prepaid at inception and it is no longer a derivative if it is prepaid after inception because it provides a return on the prepaid (invested) amount comparable to the return on a debt instrument with fixed cash flows. The prepaid amount fails the “no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors” criterion of a derivative.

To illustrate: Entity S enters into a CU100 million notional amount five-year pay-variable, receive-fixed interest rate swap with Counterparty C. The variable leg of the swap is reset on a quarterly basis to three-month LIBOR. The fixed interest payments under the swap are calculated as 10 percent times the swap’s notional amount, i.e., CU10 million per year. Entity S prepays its obligation under the variable leg of the swap at inception at current market rates, while retaining the right to receive fixed interest payments of 10 percent on CU100 million per year.

The cash inflows under the contract are equivalent to those of a financial instrument with a fixed annuity stream since Entity S knows it will receive CU10 million per year over the life of the swap. Therefore, all else being equal, the initial investment in the contract should equal that of other financial instruments that consist of fixed annuities. Thus, the initial net investment in the pay-variable, receive-fixed interest rate swap is equal to the investment required in a non-derivative contract that has a similar response to changes in market conditions. For this reason, the instrument fails the “no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors” criterion of IPSAS 41. Therefore, the contract is not accounted for as a derivative under IPSAS 41. By discharging the obligation to pay variable interest rate payments, Entity S in effect provides a loan to Counterparty C.

B.6 Definition of a Derivative: Offsetting Loans

Entity A makes a five-year fixed rate loan to Entity B, while B at the same time makes a five-year variable rate loan for the same amount to A. There are no transfers of contractual par amount at inception of the two loans, since A and B have a netting agreement. Is this a derivative under IPSAS 41?

Yes. This meets the definition of a derivative (that is to say, there is an underlying variable, no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, and future settlement). The contractual effect of the loans is the equivalent of an interest rate swap arrangement with no initial net investment. Non-derivative transactions are aggregated and treated as a derivative when the transactions result, in substance, in a derivative. Indicators of this would include:

- They are entered into at the same time and in contemplation of one another;
- They have the same counterparty;
- They relate to the same risk; and
- There is no apparent economic need or substantive business purpose for structuring the transactions separately that could not also have been accomplished in a single transaction.

The same answer would apply if Entity A and Entity B did not have a netting agreement, because the definition of a derivative instrument in IPSAS 41 does not require net settlement.

B.7 Definition of a Derivative: Option Not Expected to be Exercised

The definition of a derivative in IPSAS 41 requires that the instrument “is settled at a future date”. Is this criterion met even if an option is expected not to be exercised, for example, because it is out of the money?

Yes. An option is settled upon exercise or at its maturity. Expiry at maturity is a form of settlement even though there is no additional exchange of consideration.

B.8 Definition of a Derivative: Foreign Currency Contract Based on Sales Volume

A South African entity, Entity XYZ, whose functional currency is the South African rand, sells electricity to Mozambique denominated in US dollars. XYZ enters into a contract with an investment bank to convert US dollars to rand at a fixed exchange rate. The contract requires XYZ to remit US dollars based on its sales volume in Mozambique in exchange for rand at a fixed exchange rate of 6.00. Is that contract a derivative?

Yes. The contract has two underlying variables (the foreign exchange rate and the volume of sales), no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, and a payment provision. IPSAS 41 does not exclude from its scope derivatives that are based on sales volume.

B.9 Definition of a Derivative: Prepaid Forward

An entity enters into a forward contract to purchase shares of stock in one year at the forward price. It prepays at inception based on the current price of the shares. Is the forward contract a derivative?

No. The forward contract fails the “no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors” test for a derivative.

To illustrate: Entity XYZ enters into a forward contract to purchase one million T ordinary shares in one year. The current market price of T is CU50 per share; the one-year forward price of T is CU55 per share. XYZ is required to prepay the forward contract at inception with a CU50 million payment. The initial investment in the forward contract of CU50 million is less than the notional amount applied to the underlying, one million shares at the forward price of CU55 per share, i.e., CU55 million. However, the initial net investment approximates the investment that would be required for other types of contracts that would be expected to have a similar response to changes in market factors because T’s shares could be purchased at inception for the same price of CU50. Accordingly, the prepaid forward contract does not meet the initial net investment criterion of a derivative instrument.

While this instrument does not meet the definition of a derivative in its entirety, it meets the classification criteria of a financial asset to be measured at fair value through surplus or deficit. As the contractual terms of the forward contract do not include a requirement for Entity XYZ to receive cash flows that are solely payments of principal and interest, the instrument fails the conditions to be measured at amortized cost.

B.10 Definition of a Derivative: Initial Net Investment

Many derivative instruments, such as futures contracts and exchange traded written options, require margin accounts. Is the margin account part of the initial net investment?

No. The margin account is not part of the initial net investment in a derivative instrument. Margin accounts are a form of collateral for the counterparty or clearing house and may take the form of cash, securities or other specified assets, typically liquid assets. Margin accounts are separate assets that are accounted for separately.

B.11 Definition of Held for Trading: Portfolio with a Recent Actual Pattern of Short-Term Profit-Taking

The definition of a financial asset or financial liability held for trading states that “a financial asset or financial liability is classified as held for trading if it is ... part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking”. What is a “portfolio” for the purposes of applying this definition?

Although the term “portfolio” is not explicitly defined in IPSAS 41, the context in which it is used suggests that a portfolio is a group of financial assets or financial liabilities that are managed as part of that group (paragraph 9 of IPSAS 41). If there is evidence of a recent actual pattern of short-term profit-taking on financial instruments included in such a portfolio, those financial instruments qualify as held for trading even though an individual financial instrument may in fact be held for a longer period of time.

B.12 Definition of Gross Carrying Amount: Perpetual Debt Instruments with Fixed or Market-Based Variable Rate

Sometimes entities purchase or issue debt instruments that are required to be measured at amortized cost and in respect of which the issuer has no obligation to repay the gross carrying amount. The interest rate may be fixed or variable. Would the difference between the initial amount paid or received and zero (“the maturity amount”) be amortized immediately on initial recognition for the purpose of determining amortized cost if the rate of interest is fixed or specified as a market-based variable rate?

No. Since there are no repayment of the gross carrying amount, there is no amortization of the difference between the initial amount and the maturity amount if the rate of interest is fixed or specified as a market-based variable rate. Because interest payments are fixed or market-based and will be paid in perpetuity, the amortized cost (the present value of the stream of future cash payments discounted at the effective interest rate) equals the gross carrying amount in each period.

B.13 Definition of Gross Carrying Amount: Perpetual Debt Instruments with Decreasing Interest Rate

If the stated rate of interest on a perpetual debt instrument decreases over time, would the gross carrying amount equal the contractual par amount in each period?

No. From an economic perspective, some or all of the contractual interest payments are repayments of the gross carrying amount. For example, the interest rate may be stated as 16 percent for the first ten years and as zero percent in subsequent periods. In that case, the initial amount is amortized to zero over the first ten years using the effective interest method, since a portion of the contractual interest payments represents repayments of the gross carrying amount. The gross carrying amount is zero after year ten because the present value of the stream of future cash payments in subsequent periods is zero (there are no further contractual cash payments in subsequent periods).

B.14 Example of Calculating the Gross Carrying Amount: Financial Asset

How is the gross carrying amount calculated for financial assets measured at amortized cost in accordance with IPSAS 41?

The gross carrying amount is calculated using the effective interest method. The effective interest rate inherent in a financial instrument is the rate that exactly discounts the estimated cash flows associated with the financial instrument through the expected life of the instrument or, where appropriate, a shorter period to the gross carrying amount at initial recognition. The computation includes all fees and points paid or received that are an integral part of the effective interest rate, directly attributable transaction costs and all other premiums or discounts.

The following example illustrates how the gross carrying amount is calculated using the effective interest method. Entity A purchases a debt instrument with five years remaining to maturity for its fair value of CU1,000 (including transaction costs). The instrument has a contractual par amount of CU1,250 and carries fixed interest of 4.7 percent that is paid annually ($CU1,250 \times 4.7$ percent = CU59 per year). The contract also specifies that the borrower has an option to prepay the instrument at par and that no penalty will be charged for prepayment. At inception, the entity expects the borrower not to prepay (and, therefore, the entity determines that the fair value of the prepayment feature is insignificant when the financial asset is initially recognized).

It can be shown that in order to allocate interest receipts and the initial discount over the term of the debt instrument at a constant rate on the carrying amount, they must be accrued at the rate of ten percent annually. The table below provides information about the gross carrying amount, interest revenue and cash flows of the debt instrument in each reporting period.

Year	(a) Gross carrying amount at the beginning of the year	(b = a × 10 percent) Interest revenue	(c) Cash flows	(d = a + b – c) Gross carrying amount at the end of the year
20X0	1,000	100	59	1,041
20X1	1,041	104	59	1,086
20X2	1,086	109	59	1,136
20X3	1,136	113	59	1,190
20X4	1,190	119	1,250 + 59	–

On the first day of 20X2 the entity revises its estimate of cash flows. It now expects that 50 percent of the contractual par amount will be prepaid at the end of 20X2 and the remaining 50 percent at the end of 20X4. In accordance with paragraph AG161 of IPSAS 41, the gross carrying amount of the debt instrument in 20X2 is adjusted. The gross carrying amount is recalculated by discounting the amount the entity expects to receive in 20X2 and subsequent years using the original effective interest rate (10 percent). This results in the new gross carrying amount in 20X2 of CU1,138. The adjustment of CU52 ($CU1,138 - CU1,086$) is recorded in surplus or deficit in 20X2. The table below provides information about the gross carrying amount, interest revenue and cash flows as they would be adjusted taking into account the change in estimate.

Year	(a) Gross carrying amount at the beginning of the year	(b = a × 10 percent) Interest revenue	(c) Cash flows	(d = a + b – c) Gross carrying amount at the end of the year
20X0	1,000	100	59	1,041
20X1	1,041	104	59	1,086
20X2	1,086 + 52	114	625 + 59	568
20X3	568	57	30	595
20X4	595	60	625 + 30	–

B.15 Example of Calculating the Gross Carrying Amount: Debt Instruments with Stepped Interest Payments

Sometimes entities purchase or issue debt instruments with a predetermined rate of interest that increases or decreases progressively (“stepped interest”) over the term of the debt instrument. If a debt instrument with stepped interest is issued at CU1,250 and has a maturity amount of CU1,250, would the gross carrying amount equal CU1,250 in each reporting period over the term of the debt instrument?

No. Although there is no difference between the initial amount and maturity amount, an entity uses the effective interest method to allocate interest payments over the term of the debt instrument to achieve a constant rate on the carrying amount.

The following example illustrates how the gross carrying amount is calculated using the effective interest method for an instrument with a predetermined rate of interest that increases or decreases over the term of the debt instrument (“stepped interest”).

On January 1, 20X0, Entity A issues a debt instrument for a price of CU1,250. The contractual par amount is CU1,250 and the debt instrument is repayable on December 31, 20X4. The rate of interest is specified in the debt agreement as a percentage of the contractual par amount as follows: 6.0 percent in 20X0 (CU75), 8.0 percent in 20X1 (CU100), 10.0 percent in 20X2 (CU125), 12.0 percent in 20X3 (CU150), and 16.4 percent in 20X4 (CU205). In this case, the interest rate that exactly discounts the stream of future cash payments through maturity is ten percent. Therefore, cash interest payments are reallocated over the term of the debt instrument for the purposes of determining the gross carrying amount in each period. In each period, the gross carrying amount at the beginning of the period is multiplied by the effective interest rate of ten percent and added to the gross carrying amount. Any cash payments in the period are deducted from the resulting number. Accordingly, the gross carrying amount in each period is as follows:

Year	(a) Gross carrying amount at the beginning of the year	(b = a × 10 percent) Interest revenue	(c) Cash flows	(d = a + b – c) Gross carrying amount at the end of the year
20X0	1,250	125	75	1,300
20X1	1,300	130	100	1,330
20X2	1,330	133	125	1,338
20X3	1,338	134	150	1,322
20X4	1,322	133	1,250 + 205	–

B.16 Regular Way Contracts: No Established Market

Can a contract to purchase a financial asset be a regular way contract if there is no established market for trading such a contract?

Yes. IPSAS 41 refers to terms that require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned. Marketplace is not limited to a formal stock exchange or organized over-the-counter market. Instead, it means the environment in which the financial asset is customarily exchanged. An acceptable time frame would be the period reasonably and customarily required for the parties to complete the transaction and prepare and execute closing documents.

For example, a market for private issue financial instruments can be a marketplace.

B.17 Regular Way Contracts: Forward Contract

Entity ABC enters into a forward contract to purchase one million of M’s ordinary shares in two months for CU10 per share. The contract is not an exchange-traded contract. The contract requires ABC to take physical delivery of the shares and pay

the counterparty CU10 million in cash. M's shares trade in an active public market at an average of 100,000 shares a day. Regular way delivery is three days. Is the forward contract regarded as a regular way contract?

No. The contract must be accounted for as a derivative because it is not settled in the way established by regulation or convention in the marketplace concerned.

B.18 Regular Way Contracts: Which Customary Settlement Provisions Apply?

If an entity's financial instruments trade in more than one active market, and the settlement provisions differ in the various active markets, which provisions apply in assessing whether a contract to purchase those financial instruments is a regular way contract?

The provisions that apply are those in the market in which the purchase actually takes place.

To illustrate: Entity XYZ purchases one million shares of Entity ABC on a US stock exchange, for example, through a broker. The settlement date of the contract is six business days later. Trades for equity shares on US exchanges customarily settle in three business days. Because the trade settles in six business days, it does not meet the exemption as a regular way trade.

However, if XYZ did the same transaction on a foreign exchange that has a customary settlement period of six business days, the contract would meet the exemption for a regular way trade.

B.19 Regular Way Contracts: Share Purchase by Call Option

Entity A purchases a call option in a public market permitting it to purchase 100 shares of Entity XYZ at any time over the next three months at a price of CU100 per share. If Entity A exercises its option, it has 14 days to settle the transaction according to regulation or convention in the options market. XYZ shares are traded in an active public market that requires three-day settlement. Is the purchase of shares by exercising the option a regular way purchase of shares?

Yes. The settlement of an option is governed by regulation or convention in the marketplace for options and, therefore, upon exercise of the option it is no longer accounted for as a derivative because settlement by delivery of the shares within 14 days is a regular way transaction.

B.20 Recognition and Derecognition of Financial Liabilities Using Trade Date or Settlement Date Accounting

IPSAS 41 has special rules about recognition and derecognition of financial assets using trade date or settlement date accounting. Do these rules apply to transactions in financial instruments that are classified as financial liabilities, such as transactions in deposit liabilities and trading liabilities?

No. IPSAS 41 does not contain any specific requirements about trade date accounting and settlement date accounting in the case of transactions in financial instruments that are classified as financial liabilities. Therefore, the general recognition and derecognition requirements in paragraphs 10 and 35 of IPSAS 41 apply. Paragraph 10 of IPSAS 41 states that financial liabilities are recognized on the date the entity 'becomes a party to the contractual provisions of the instrument'. Such contracts generally are not recognized unless one of the parties has performed or the contract is a derivative contract not exempted from the scope of IPSAS 41. Paragraph 35 of IPSAS 41 specifies that financial liabilities are derecognized only when they are extinguished, i.e., when the obligation specified in the contract is discharged or canceled or expires.

Section C Embedded derivatives

C.1 Embedded Derivatives: Separation of Host Debt Instrument

If an embedded non-option derivative is required to be separated from a host debt instrument, how are the terms of the host debt instrument and the embedded derivative identified? For example, would the host debt instrument be a fixed rate instrument, a variable rate instrument or a zero coupon instrument?

The terms of the host debt instrument reflect the stated or implied substantive terms of the hybrid contract. In the absence of implied or stated terms, the entity makes its own judgment of the terms. However, an entity may not identify a component that is not specified or may not establish terms of the host debt instrument in a manner that would result in the separation of an embedded derivative that is not already clearly present in the hybrid contract, that is to say, it cannot create a cash flow that does not exist. For example, if a five-year debt instrument has fixed interest payments of CU40,000 annually and a contractual payment at maturity of CU1,000,000 multiplied by the change in an equity price index, it would be inappropriate to identify a floating rate host contract and an embedded equity swap that has an offsetting floating rate leg in lieu of identifying a fixed rate host. In that example, the host contract is a fixed rate debt instrument that pays CU40,000 annually because there are no floating interest rate cash flows in the hybrid contract.

In addition, the terms of an embedded non-option derivative, such as a forward or swap, must be determined so as to result in the embedded derivative having a fair value of zero at the inception of the hybrid contract. If it were permitted to separate embedded non-option derivatives on other terms, a single hybrid contract could be decomposed into an infinite variety of combinations of host debt instruments and embedded derivatives, for example, by separating embedded derivatives with terms that create leverage, asymmetry or some other risk exposure not already present in the hybrid contract. Therefore, it is inappropriate to separate an embedded non-option derivative on terms that result in a fair value other than zero at the inception of the hybrid contract. The determination of the terms of the embedded derivative is based on the conditions existing when the financial instrument was issued.

C.2 Embedded Derivatives: Separation of Embedded Option

The response to Question C.1 states that the terms of an embedded non-option derivative should be determined so as to result in the embedded derivative having a fair value of zero at the initial recognition of the hybrid contract. When an embedded option-based derivative is separated, must the terms of the embedded option be determined so as to result in the embedded derivative having either a fair value of zero or an intrinsic value of zero (that is to say, be at the money) at the inception of the hybrid contract?

No. The economic behavior of a hybrid contract with an option-based embedded derivative depends critically on the strike price (or strike rate) specified for the option feature in the hybrid contract, as discussed below. Therefore, the separation of an option-based embedded derivative (including any embedded put, call, cap, floor, caplet, floorlet or swaption feature in a hybrid contract) should be based on the stated terms of the option feature documented in the hybrid contract. As a result, the embedded derivative would not necessarily have a fair value or intrinsic value equal to zero at the initial recognition of the hybrid contract.

If an entity were required to identify the terms of an embedded option-based derivative so as to achieve a fair value of the embedded derivative of zero, the strike price (or strike rate) generally would have to be determined so as to result in the option being infinitely out of the money. This would imply a zero probability of the option feature being exercised. However, since the probability of the option feature in a hybrid contract being exercised generally is not zero, it would be inconsistent with the likely economic behavior of the hybrid contract to assume an initial fair value of zero. Similarly, if an entity were required to identify the terms of an embedded option-based derivative so as to achieve an intrinsic value of zero for the embedded derivative, the strike price (or strike rate) would have to be assumed to equal the price (or rate) of the underlying variable at the initial recognition of the hybrid contract. In this case, the fair value of the option would consist only of time value. However, such an assumption would not be consistent with the likely economic behavior of the hybrid contract, including the probability of the option feature being exercised, unless the agreed strike price was indeed equal to the price (or rate) of the underlying variable at the initial recognition of the hybrid contract.

The economic nature of an option-based embedded derivative is fundamentally different from a forward-based embedded derivative (including forwards and swaps), because the terms of a forward are such that a payment based on the difference between the price of the underlying and the forward price will occur at a specified date, while the terms of an option are such that a payment based on the difference between the price of the underlying and the strike price of the option may or may not occur depending on the relationship between the agreed strike price and the price of the underlying at a specified date or dates in the future. Adjusting the strike price of an option-based embedded derivative, therefore, alters the nature of the hybrid contract. On the other hand, if the terms of a non-option embedded derivative in a host debt instrument were determined so as to result in a fair value of any amount other than zero at the inception of the hybrid contract, that amount would essentially represent a borrowing or lending. Accordingly, as discussed in the answer to Question C.1, it is not appropriate to separate a non-option embedded derivative in a host debt instrument on terms that result in a fair value other than zero at the initial recognition of the hybrid contract.

C.3 Embedded Derivatives: Equity Kicker

In some instances, investment entities providing subordinated loans agree that if and when the borrower lists its shares on a stock exchange, the venture capital entity is entitled to receive shares of the borrowing entity free of charge or at a very low price (an “equity kicker”) in addition to the contractual payments. As a result of the equity kicker feature, the interest on the subordinated loan is lower than it would otherwise be. Assuming that the subordinated loan is not measured at fair value with changes in fair value recognized in surplus or deficit (paragraph 49(c) of IPSAS 41), does the equity kicker feature meet the definition of an embedded derivative even though it is contingent upon the future listing of the borrower?

Yes. The economic characteristics and risks of an equity return are not closely related to the economic characteristics and risks of a host debt instrument (paragraph 49(a) of IPSAS 41). The equity kicker meets the definition of a derivative because it has a value that changes in response to the change in the price of the shares of the borrower, it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, and it is settled at a future date (paragraph 49(b) and paragraph 9 of IPSAS 41). The equity kicker feature meets the definition of a derivative even though the right to receive shares is contingent upon the future listing of the borrower.

Paragraph AG7 of IPSAS 41 states that a derivative could require a payment as a result of some future event that is unrelated to a notional amount. An equity kicker feature is similar to such a derivative except that it does not give a right to a fixed payment, but an option right, if the future event occurs.

C.4 Embedded Derivatives: Synthetic Instruments

Entity A issues a five-year floating rate debt instrument. At the same time, it enters into a five-year pay-fixed, receive-variable interest rate swap with Entity B. Entity A regards the combination of the debt instrument and swap as a synthetic fixed rate instrument. Entity A contends that separate accounting for the swap is inappropriate since paragraph AG106(a) of IPSAS 41 requires an embedded derivative to be classified together with its host instrument if the derivative is linked to an interest rate that can change the amount of contractual interest that would otherwise be paid or received on the host debt contract. Is the entity's analysis correct?

No. Embedded derivative instruments are terms and conditions that are included in non-derivative host contracts. It is generally inappropriate to treat two or more separate financial instruments as a single combined instrument ("synthetic instrument" accounting) for the purpose of applying IPSAS 41. Each of the financial instruments has its own terms and conditions and each may be transferred or settled separately. Therefore, the debt instrument and the swap are classified separately. The transactions described here differ from the transactions discussed in Question B.6, which had no substance apart from the resulting interest rate swap.

C.5 Embedded Derivatives: Purchases and Sales Contracts in Foreign Currency Instruments

A supply contract provides for payment in a currency other than (a) the functional currency of either party to the contract, (b) the currency in which the product is routinely denominated in commercial transactions around the world and (c) the currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place. Is there an embedded derivative that should be separated under IPSAS 41?

Yes. To illustrate: a Norwegian entity agrees to sell oil to an entity in France. The oil contract is denominated in Swiss francs, although oil contracts are routinely denominated in US dollars in commercial transactions around the world, and Norwegian krone are commonly used in contracts to purchase or sell non-financial items in Norway. Neither entity carries out any significant activities in Swiss francs. In this case, the Norwegian entity regards the supply contract as a host contract with an embedded foreign currency forward to purchase Swiss francs. The French entity regards the supply contract as a host contract with an embedded foreign currency forward to sell Swiss francs. Each entity includes fair value changes on the currency forward in surplus or deficit unless the reporting entity designates it as a cash flow hedging instrument, if appropriate.

C.6 Embedded Foreign Currency Derivatives: Unrelated Foreign Currency Provision

Entity A, which measures items in its financial statements on the basis of the euro (its functional currency), enters into a contract with Entity B, which has the Norwegian krone as its functional currency, to purchase oil in six months for 1,000 US dollars. The host oil contract is not within the scope of IPSAS 41 because it was entered into and continues to be for the purpose of delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements (paragraphs 5 and AG8 of IPSAS 41) and the entity has not irrevocably designated it as measured at fair value through surplus or deficit in accordance with paragraph 6 of IPSAS 41. The oil contract includes a leveraged foreign exchange provision that states that the parties, in addition to the provision of, and payment for, oil will exchange an amount equal to the fluctuation in the exchange rate of the US dollar and Norwegian krone applied to a notional amount of 100,000 US dollars. Under paragraph 49 of IPSAS 41, is that embedded derivative (the leveraged foreign exchange provision) regarded as closely related to the host oil contract?

No, that leveraged foreign exchange provision is separated from the host oil contract because it is not closely related to the host oil contract (paragraph AG106(d) of IPSAS 41).

The payment provision under the host oil contract of 1,000 US dollars can be viewed as a foreign currency derivative because the US dollar is neither Entity A's nor Entity B's functional currency. This foreign currency derivative would not be separated because it follows from paragraph AG106(d) of IPSAS 41 that a crude oil contract that requires payment in US dollars is not regarded as a host contract with a foreign currency derivative.

The leveraged foreign exchange provision that states that the parties will exchange an amount equal to the fluctuation in the exchange rate of the US dollar and Norwegian krone applied to a notional amount of 100,000 US dollars is in addition to the required payment for the oil transaction. It is unrelated to the host oil contract and therefore separated from the host oil contract and accounted for as an embedded derivative under paragraph 49 of IPSAS 41.

C.7 Embedded Foreign Currency Derivatives: Currency of International Commerce

Paragraph AG106(d) of IPSAS 41 refers to the currency in which the price of the related goods or services is routinely denominated in commercial transactions around the world. Could it be a currency that is used for a certain product or service in commercial transactions within the local area of one of the substantial parties to the contract?

No. The currency in which the price of the related goods or services is routinely denominated in commercial transactions around the world is only a currency that is used for similar transactions all around the world, not just in one local area. For example, if cross-border transactions in natural gas in North America are routinely denominated in US dollars and such transactions are routinely denominated in euro in Europe, neither the US dollar nor the euro is a currency in which the goods or services are routinely denominated in commercial transactions around the world.

C.8 Embedded Derivatives: Holder Permitted, but not Required, to Settle Without Recovering Substantially All of its Recognized Investment

If the terms of a combined contract permit, but do not require, the holder to settle the combined contract in a manner that causes it not to recover substantially all of its recognized investment and the issuer does not have such a right (for example, a puttable debt instrument), does the contract satisfy the condition in paragraph AG106(a) of IPSAS 41 that the holder would not recover substantially all of its recognized investment?

No. The condition that “the holder would not recover substantially all of its recognized investment” is not satisfied if the terms of the combined contract permit, but do not require, the investor to settle the combined contract in a manner that causes it not to recover substantially all of its recognized investment and the issuer has no such right. Accordingly, an interest-bearing host contract with an embedded interest rate derivative with such terms is regarded as closely related to the host contract. The condition that “the holder would not recover substantially all of its recognized investment” applies to situations in which the holder can be forced to accept settlement at an amount that causes the holder not to recover substantially all of its recognized investment.

Section D Recognition and Derecognition*D.1 Initial Recognition*

D.1.1 Recognition: Cash Collateral

Entity B transfers cash to Entity A as collateral for another transaction with Entity A (for example, a securities borrowing transaction). The cash is not legally segregated from Entity A’s assets. Should Entity A recognize the cash collateral it has received as an asset?

Yes. The ultimate realization of a financial asset is its conversion into cash and, therefore, no further transformation is required before the economic benefits of the cash transferred by Entity B can be realized by Entity A. Therefore, Entity A recognizes the cash as an asset and a payable to Entity B while Entity B derecognizes the cash and recognizes a receivable from Entity A.

D.2 Regular Way Purchase or Sale of a Financial Asset

D.2.1 Trade Date vs Settlement Date: Amounts to be Recorded for a Purchase

How are the trade date and settlement date accounting principles in IPSAS 41 applied to a purchase of a financial asset?

The following example illustrates the application of the trade date and settlement date accounting principles in IPSAS 41 for a purchase of a financial asset. On December 29, 20X1, an entity commits itself to purchase a financial asset for CU1,000, which is its fair value on commitment (trade) date. Transaction costs are immaterial. On December 31, 20X1 (financial year-end) and on January 4, 20X2 (settlement date) the fair value of the asset is CU1,002 and CU1,003, respectively. The amounts to be recorded for the asset will depend on how it is classified and whether trade date or settlement date accounting is used, as shown in the two tables below.

FINANCIAL INSTRUMENTS

Settlement date accounting			
Balances	Financial assets measured at amortized cost	Financial assets measured at fair value through net assets/ equity	Financial assets measured at fair value through surplus/deficit
December 29, 20X1			
Financial asset	–	–	–
Financial liability	–	–	–
December 31, 20X1			
Receivable	–	2	2
Financial asset	–	–	–
Financial liability	–	–	–
Net assets/equity (fair value adjustment)	–	(2)	–
Accumulated surplus or deficit (through surplus or deficit)	–	–	(2)
January 4, 20X2			
Receivable	–	–	–
Financial asset	1,000	1,003	1,003
Financial liability	–	–	–
Net assets/equity (fair value adjustment)	–	(3)	–
Accumulated surplus or deficit (through surplus or deficit)	–	–	(3)
Trade date accounting			
Balances	Financial assets measured at amortized cost	Financial assets measured at fair value through net assets/equity	Financial assets measured at fair value through surplus or deficit
December 29, 20X1			
Financial asset	1,000	1,000	1,000
Financial liability	(1,000)	(1,000)	(1,000)
December 31, 20X1			
Receivable	–	–	–
Financial asset	1,000	1,002	1,002
Financial liability	(1,000)	(1,000)	(1,000)
Net assets/equity (fair value adjustment)	–	(2)	–
Accumulated surplus or deficit (through surplus or deficit)	–	–	(2)
January 4, 20X2			
Receivable	–	–	–
Financial asset	1,000	1,003	1,003
Financial liability	–	–	–
Net assets/equity (fair value adjustment)	–	(3)	–
Accumulated surplus or deficit (through surplus or deficit)	–	–	(3)

D.2.2 Trade Date vs Settlement Date: Amounts to be Recorded for a Sale

How are the trade date and settlement date accounting principles in IPSAS 41 applied to a sale of a financial asset?

The following example illustrates the application of the trade date and settlement date accounting principles in IPSAS 41 for a sale of a financial asset. On December 29, 20X2 (trade date) an entity enters into a contract to sell a financial asset for its current fair value of CU1,010. The asset was acquired one year earlier for CU1,000 and its gross carrying amount is CU1,000. On December 31, 20X2 (financial year-end), the fair value of the asset is CU1,012. On January 4, 20X3 (settlement date), the fair value is CU1,013. The amounts to be recorded will depend on how the asset is classified and whether trade date or settlement date accounting is used as shown in the two tables below (any loss allowance or interest revenue on the financial asset is disregarded for the purpose of this example).

A change in the fair value of a financial asset that is sold on a regular way basis is not recorded in the financial statements between trade date and settlement date even if the entity applies settlement date accounting because the seller's right to changes in the fair value ceases on the trade date.

Settlement date accounting			
Balances	Financial assets measured at amortized cost	Financial assets measured at fair value through net assets/ equity	Financial assets measured at fair value through surplus or deficit
December 29, 20X2			
Receivable	–	–	–
Financial asset	1,000	1,010	1,010
Net assets/equity (fair value adjustment)	–	10	–
Accumulated surplus or deficit (through surplus or deficit)	–	–	10
December 31, 20X2			
Receivable	–	–	–
Financial asset	1,000	1,010	1,010
Net assets/equity (fair value adjustment)	–	10	–
Accumulated surplus or deficit (through surplus or deficit)	–	–	10
January 4, 20X3			
Net assets/equity (fair value adjustment)	–	–	–
Accumulated surplus or deficit (through surplus or deficit)	10	10	10

Trade date accounting			
Balances	Financial assets measured at amortized cost	Financial assets measured at fair value through net assets/equity	Financial assets measured at fair value through surplus or deficit
December 29, 20X2			
Receivable	1,010	1,010	1,010
Financial asset	–	–	–
Net assets/equity (fair value adjustment)	–	–	–
Accumulated surplus or deficit (through surplus or deficit)	10	10	10
December 31, 20X2			
Receivable	1,010	1,010	1,010
Financial asset	–	–	–

Trade date accounting			
Net assets/equity (fair value adjustment)	–	–	–
Accumulated surplus or deficit (through surplus or deficit)	10	10	10
January 4, 20X3			
Net assets/equity (fair value adjustment)	–	–	–
Accumulated surplus or deficit (through surplus or deficit)	10	10	10

D.2.3 Settlement Date Accounting: Exchange of Non-Cash Financial Assets

If an entity recognizes sales of financial assets using settlement date accounting, would a change in the fair value of a financial asset to be received in exchange for the non-cash financial asset that is sold be recognized in accordance with paragraph 105 of IPSAS 41?

It depends. Any change in the fair value of the financial asset to be received would be accounted for under paragraph 105 of IPSAS 41 if the entity applies settlement date accounting for that category of financial assets. However, if the entity classifies the financial asset to be received in a category for which it applies trade date accounting, the asset to be received is recognized on the trade date as described in paragraph AG19 of IPSAS 41. In that case, the entity recognizes a liability of an amount equal to the carrying amount of the financial asset to be delivered on settlement date.

To illustrate: on December 29, 20X2 (trade date) Entity A enters into a contract to sell Note Receivable A, which is measured at amortized cost, in exchange for Bond B, which meets the definition of held for trading and is measured at fair value. Both assets have a fair value of CU1,010 on December 29, while the amortized cost of Note Receivable A is CU1,000. Entity A uses settlement date accounting for financial assets measured at amortized cost and trade date accounting for assets that meet the definition of held for trading. On December 31, 20X2 (financial year-end), the fair value of Note Receivable A is CU1,012 and the fair value of Bond B is CU1,009. On January 4, 20X3, the fair value of Note Receivable A is CU1,013 and the fair value of Bond B is CU1,007. The following entries are made:

December 29, 20X2

Dr	Bond B	CU1,010	
	Cr Payable		CU1,010

December 31, 20X2

Dr	Trading loss	CU1	
	Cr Bond B		CU1

January 4, 20X3

Dr	Payable	CU1,010	
Dr	Trading loss	CU2	
	Cr Note Receivable A		CU1,000
	Cr Bond B		CU2
	Cr Realization gain		CU10

Section E Measurement*E.1 Initial Measurement of Financial Assets and Financial Liabilities*

E.1.1 Initial Measurement: Transaction Costs

Transaction costs should be included in the initial measurement of financial assets and financial liabilities other than those at fair value through surplus or deficit. How should this requirement be applied in practice?

For financial assets not measured at fair value through surplus or deficit, transaction costs are added to the fair value at initial recognition. For financial liabilities, transaction costs are deducted from the fair value at initial recognition.

For financial instruments that are measured at amortized cost, transaction costs are subsequently included in the calculation of amortized cost using the effective interest method and, in effect, amortized through surplus or deficit over the life of the instrument.

For financial instruments that are measured at fair value through net assets/equity in accordance with either paragraphs 41 and 111 or paragraphs 43 and 106 of IPSAS 41, transaction costs are recognized in net assets/equity as part of a change in fair value at the next remeasurement. If the financial asset is measured in accordance with paragraphs 41 and 111 of IPSAS 41, those transaction costs are amortized to surplus or deficit using the effective interest method and, in effect, amortized through surplus or deficit over the life of the instrument.

Transaction costs expected to be incurred on transfer or disposal of a financial instrument are not included in the measurement of the financial instrument.

E.2 Gains and Losses

E.2.1 IPSAS 41 and IPSAS 4—Financial Assets Measured at Fair Value through Net Assets/Equity: Separation of Currency Component

A financial asset measured at fair value through net assets/equity in accordance with paragraph 41 of IPSAS 41 is treated as a monetary item. Therefore, the entity recognizes changes in the carrying amount relating to changes in foreign exchange rates in surplus or deficit in accordance with paragraphs 27(a) and 32 of IPSAS 4 and other changes in the carrying amount in net assets/equity in accordance with IPSAS 41. How is the cumulative gain or loss that is recognized in net assets/equity determined?

It is the difference between the amortized cost of the financial asset⁶¹ and the fair value of the financial asset in the functional currency of the reporting entity. For the purpose of applying paragraph 32 of IPSAS 4 the asset is treated as an asset measured at amortized cost in the foreign currency.

To illustrate: on December 31, 20X1 Entity A acquires a bond denominated in a foreign currency (FC) for its fair value of FC1,000. The bond has five years remaining to maturity and a contractual par amount of FC1,250, carries fixed interest of 4.7 percent that is paid annually ($FC1,250 \times 4.7$ percent = FC59 per year), and has an effective interest rate of 10 percent. Entity A classifies the bond as subsequently measured at fair value through net assets/equity in accordance with paragraph 41 of IPSAS 41, and thus recognizes gains and losses in net assets/equity. The entity's functional currency is its local currency (LC). The exchange rate is FC1 to LC1.5 and the carrying amount of the bond is LC1,500 ($= FC1,000 \times 1.5$).

Dr	Bond	LC1,500	
	Cr	Cash	LC1,500

On December 31, 20X2, the foreign currency has appreciated and the exchange rate is FC1 to LC2. The fair value of the bond is FC1,060 and thus the carrying amount is LC2,120 ($= FC1,060 \times 2$). The amortized cost is FC1,041 ($= LC2,082$). In this case, the cumulative gain or loss to be recognized in net assets/equity and accumulated in net assets/equity is the difference between the fair value and the amortized cost on December 31, 20X2, i.e., LC38 ($= LC2,120 - LC2,082$).

Interest received on the bond on December 31, 20X2 is FC59 ($= LC118$). Interest revenue determined in accordance with the effective interest method is FC100 ($= FC1,000 \times 10$ percent). The average exchange rate during the year is FC1 to LC1.75. For the purpose of this question, it is assumed that the use of the average exchange rate provides a reliable approximation of the spot rates applicable to the accrual of interest revenue during the year (see paragraph 25 of IPSAS 41). Thus, reported interest revenue is LC175 ($= FC100 \times 1.75$) including accretion of the initial discount of LC72 ($= [FC100 - FC59] \times 1.75$). Accordingly, the exchange difference on the bond that is recognized in surplus or deficit is LC510 ($= LC2,082 - LC1,500 - LC72$). Also, there is an exchange gain on the interest receivable for the year of LC15 ($= FC59 \times [2.00 - 1.75]$).

Dr	Bond	LC620	
Dr	Cash	LC118	
	Cr	Interest revenue	LC175
	Cr	Exchange gain	LC525
	Cr	Fair value change in net assets/equity	LC38

⁶¹ The objective of this example is to illustrate the separation of the currency component for a financial asset that is measured at fair value through net assets/equity in accordance with paragraph 41 of IPSAS 41. Consequently, for simplicity, this example does not reflect the effect of the impairment requirements in paragraphs 73-93 of IPSAS 41.

On December 31, 20X3, the foreign currency has appreciated further and the exchange rate is FC1 to LC2.50. The fair value of the bond is FC1,070 and thus the carrying amount is LC2,675 (= FC1,070 × 2.50). The amortized cost is FC1,086 (= LC2,715). The cumulative gain or loss to be accumulated in net assets/equity is the difference between the fair value and the amortized cost on December 31, 20X3, i.e., negative LC40 (= LC2,675 – LC2,715). Thus, the amount recognized in net assets/equity equals the change in the difference during 20X3 of LC78 (= LC40 + LC38).

Interest received on the bond on December 31, 20X3 is FC59 (= LC148). Interest revenue determined in accordance with the effective interest method is FC104 (= FC1,041 × 10 percent). The average exchange rate during the year is FC1 to LC2.25. For the purpose of this question, it is assumed that the use of the average exchange rate provides a reliable approximation of the spot rates applicable to the accrual of interest revenue during the year (see paragraph 25 of IPSAS 4). Thus, recognized interest revenue is LC234 (= FC104 × 2.25) including accretion of the initial discount of LC101 (= [FC104 – FC59] × 2.25). Accordingly, the exchange difference on the bond that is recognized in surplus or deficit is LC532 (= LC2,715 – LC2,082 – LC101). Also, there is an exchange gain on the interest receivable for the year of LC15 (= FC59 × [2.50 – 2.25]).

Dr	Bond	LC555	
Dr	Cash	LC148	
Dr	Fair value change in net assets/equity	LC78	
	Cr	Interest revenue	LC234
	Cr	Exchange gain	LC547

E.2.2 IPSAS 41 and IPSAS 4—Exchange Differences Arising on Translation of Foreign Entities: Net Assets/Equity or Surplus or Deficit?

Paragraphs 37 and 57 of IPSAS 4 state that all exchange differences resulting from translating the financial statements of a foreign operation should be recognized in net assets/equity until disposal of the net investment. This would include exchange differences arising from financial instruments carried at fair value, which would include both financial assets measured at fair value through surplus or deficit and financial assets that are measured at fair value through net assets/equity in accordance with IPSAS 41.

IPSAS 41 requires that changes in fair value of financial assets measured at fair value through surplus or deficit should be recognized in surplus or deficit and changes in fair value of financial assets measured at fair value through net assets/equity should be recognized in net assets/equity.

If the foreign operation is a controlled entity whose financial statements are consolidated with those of its controlling entity, in the consolidated financial statements how are IPSAS 41 and paragraph 44 of IPSAS 4 applied?

IPSAS 41 applies in the accounting for financial instruments in the financial statements of a foreign operation and IPSAS 4 applies in translating the financial statements of a foreign operation for incorporation in the financial statements of the reporting entity.

To illustrate: Entity A is domiciled in Country X and its functional currency and presentation currency are the local currency of Country X (LCX). A has a foreign controlled entity (Entity B) in Country Y whose functional currency is the local currency of Country Y (LCY). B is the owner of a debt instrument, which meets the definition of held for trading and is therefore measured at fair value through surplus or deficit in accordance with IPSAS 41.

In B's financial statements for year 20X0, the fair value and carrying amount of the debt instrument is LCY100 in the local currency of Country Y. In A's consolidated financial statements, the asset is translated into the local currency of Country X at the spot exchange rate applicable at the end of the reporting period (2.00). Thus, the carrying amount is LCX200 (= LCY100 × 2.00) in the consolidated financial statements.

At the end of year 20X1, the fair value of the debt instrument has increased to LCY110 in the local currency of Country Y. B recognizes the trading asset at LCY110 in its statement of financial position and recognizes a fair value gain of LCY10 in its surplus or deficit. During the year, the spot exchange rate has increased from 2.00 to 3.00 resulting in an increase in the fair value of the instrument from LCX200 to LCX330 (= LCY110 × 3.00) in the currency of Country X. Therefore, Entity A recognizes the trading asset at LCX330 in its consolidated financial statements.

Entity A translates the statement of changes in net assets/equity of B "at the exchange rates at the dates of the transactions" (paragraph 44(b) of IPSAS 4). Since the fair value gain has accrued through the year, A uses the average rate as a practical approximation ($[3.00 + 2.00] / 2 = 2.50$, in accordance with paragraph 25 of IPSAS 4). Therefore, while the fair value of the trading asset has increased by LCX130 (= LCX330 – LCX200), Entity A recognizes only LCX25 (= LCY10 × 2.5) of this increase in consolidated surplus or deficit to comply with paragraph 44(b) of IPSAS 4. The resulting exchange difference, i.e., the remaining

increase in the fair value of the debt instrument ($LCX130 - LCX25 = LCX105$), is accumulated in net assets/equity until the disposal of the net investment in the foreign operation in accordance with paragraph 57 of IPSAS 4.

E.2.3 IPSAS 41 and IPSAS 4—Interaction Between IPSAS 41 and IPSAS 4

IPSAS 41 includes requirements about the measurement of financial assets and financial liabilities and the recognition of gains and losses on remeasurement in surplus or deficit. IPSAS 4 includes rules about the reporting of foreign currency items and the recognition of exchange differences in surplus or deficit. In what order are IPSAS 4 and IPSAS 41 applied?

Statement of Financial Position

Generally, the measurement of a financial asset or financial liability at fair value or amortized cost is first determined in the foreign currency in which the item is denominated in accordance with IPSAS 41. Then, the foreign currency amount is translated into the functional currency using the closing rate or a historical rate in accordance with IAS 21 (paragraph AG224 of IPSAS 41). For example, if a monetary financial asset (such as a debt instrument) is measured at amortized cost in accordance with IPSAS 41, amortized cost is calculated in the currency of denomination of that financial asset. Then, the foreign currency amount is recognized using the closing rate in the entity's financial statements (paragraph 27 of IPSAS 4). That applies regardless of whether a monetary item is measured at amortized cost or fair value in the foreign currency (paragraph 28 of IPSAS 4). A non-monetary financial asset (such as an investment in an equity instrument) that is measured at fair value in the foreign currency is translated using the closing rate (paragraph 27 (c) of IPSAS 4).

As an exception, if the financial asset or financial liability is designated as a hedged item in a fair value hedge of the exposure to changes in foreign currency rates under IPSAS 41 (or IPSAS 29 if an entity chooses as its accounting policy to continue to apply the hedge accounting requirements in IPSAS 29), the hedged item is remeasured for changes in foreign currency rates even if it would otherwise have been recognized using a historical rate under IPSAS 4 (paragraph 137 of IPSAS 41 or paragraph 99 of IPSAS 29), i.e., the foreign currency amount is recognized using the closing rate. This exception applies to non-monetary items that are carried in terms of historical cost in the foreign currency and are hedged against exposure to foreign currency rates (paragraph 27(b) of IPSAS 4).

Surplus or Deficit

The recognition of a change in the carrying amount of a financial asset or financial liability in surplus or deficit depends on a number of factors, including whether it is an exchange difference or other change in carrying amount, whether it arises on a monetary item (for example, most debt instruments) or non-monetary item (such as most equity investments), whether the associated asset or liability is designated as a cash flow hedge of an exposure to changes in foreign currency rates, and whether it results from translating the financial statements of a foreign operation. The issue of recognizing changes in the carrying amount of a financial asset or financial liability held by a foreign operation is addressed in a separate question (see Question E.2.2).

Any exchange difference arising on recognizing a *monetary item* at a rate different from that at which it was initially recognized during the period, or recognized in previous financial statements, is recognized in surplus or deficit in accordance with IPSAS 4 (paragraph AG224 of IPSAS 41, paragraphs 32 and 37 of IPSAS 4), unless the monetary item is designated as a cash flow hedge of a highly probable forecast transaction in foreign currency, in which case the requirements for recognition of gains and losses on cash flow hedges (paragraph 140 of IPSAS 41 or paragraph 106 of IPSAS 29). Differences arising from recognizing a monetary item at a foreign currency amount different from that at which it was previously recognized are accounted for in a similar manner, since all changes in the carrying amount relating to foreign currency movements should be treated consistently. All other changes in the statement of financial position measurement of a monetary item are recognized in surplus or deficit in accordance with IPSAS 41. For example, although an entity recognizes gains and losses on financial assets measured at fair value through net assets/equity (paragraphs 111 and AG225 of IPSAS 41), the entity nevertheless recognizes the changes in the carrying amount relating to changes in foreign exchange rates in surplus or deficit (paragraph 27(a) of IPSAS 4).

Any changes in the carrying amount of a *non-monetary item* are recognized in surplus or deficit or in net assets/equity in accordance with IPSAS 41. For example, for an investment in an equity instrument that is presented in accordance with paragraph 106 of IPSAS 41, the entire change in the carrying amount, including the effect of changes in foreign currency rates, is presented in net assets/equity (paragraph AG226 of IPSAS 41). If the non-monetary item is designated as a cash flow hedge of an unrecognized firm commitment or a highly probable forecast transaction in foreign currency, the requirements for recognition of gains and losses on cash flow hedges (paragraph 140 of IPSAS 41 or paragraph 106 of IPSAS 29).

When some portion of the change in carrying amount is recognized in net assets/equity and some portion is recognized in surplus or deficit, for example, if the amortized cost of a foreign currency bond measured at fair value through net assets/equity has increased in foreign currency (resulting in a gain in surplus or deficit) but its fair value has decreased in foreign currency (resulting in a loss recognized in net assets/equity), an entity cannot offset those two components for the purposes of determining gains or losses that should be recognized in surplus or deficit or in net assets/equity.

E.2.4—Valuation of Unquoted Equity Instruments

What valuation technique is most appropriate to apply when determining the fair value of these unquoted equity instruments?

Public sector entities have a wide range of valuation techniques available when determining the fair value of an unquoted equity instrument. IPSAS 41 does not prescribe the use of a specific valuation technique, but instead encourages the use of professional judgment and the consideration of all the facts and circumstances surrounding the selection of an appropriate measurement technique. Figure 1 illustrates various valuation techniques that may be applicable based on the transactions facts and circumstances. This is not an exhaustive list.

Valuation approach	Valuation techniques
Market approach	<ul style="list-style-type: none"> • Transaction price paid for an identical or similar instrument of an investee (see illustrative example 23) • Comparable company valuation multiples
Other approaches	<ul style="list-style-type: none"> • Discounted cash flow method (see illustrative example 24) • Dividend discount model • Constant growth model (see illustrative example 25) • Capitalization model • Adjusted net asset method (see illustrative example 26)

The economic characteristics of unquoted equity instruments and the information that is reasonably available to a public sector entity are two of the factors that should be considered when selecting the most appropriate valuation technique. For example, an entity is likely to place more emphasis on the comparable company valuation multiples technique when there are sufficiently comparable company peers or when the background or details of the observed transactions are known. Similarly, a public sector entity is likely to place more emphasis on the discounted cash flow method when, for example:

- (a) The cash flows of a public sector entity present unique characteristics such as periods of unequal rates of growth (for example, a period of high growth that stabilizes later to more steady levels of growth).
- (b) Alternatively, when measuring the fair value of unquoted equity instruments, a public sector entity might conclude that, on the basis of the specific facts and circumstances (for example, the nature of the investment, the history and stage of the development of the investment, the nature of the investment's assets and liabilities, its capital structure etc.).
- (c) It is appropriate to apply the adjusted net asset method. Consequently, given specific facts and circumstances, one valuation technique might be more appropriate than another.

Some of the factors that a public sector entity will need to consider when selecting the most appropriate valuation technique(s) include (this list is not exhaustive):

1. The information that is reasonably available to a public sector entity;
2. The market conditions;
3. The investment horizon and investment type (for example, the market sentiment when measuring the fair value of a short-term financial investment might be better captured by some valuation techniques than by others);
4. The life cycle of the investment (i.e., what may trigger value in different stages of an entity's life cycle might be better captured by some valuation techniques than by others);
5. The nature of an investment's business (for example, the volatile or cyclical nature of an investee's business might be better captured by some valuation techniques than others); and
6. The industry in which an entity operates.

The fair value measurement technique must reflect current market conditions. An entity might ensure that the valuation techniques reflect current market conditions by calibrating them at the measurement date. At initial recognition, if the transaction price represented fair value and an investor will use a valuation technique to measure fair value in subsequent periods that uses unobservable inputs, the entity must calibrate the valuation technique so that it equals the transaction price (if the transaction contains a non-exchange

component, recalibrate to the fair value of the equity instrument). The use of calibration when measuring the fair value of the unquoted equity instruments at the measurement date is a good exercise for an entity to ensure that the valuation technique reflects current market conditions and to determine whether an adjustment to the valuation technique is necessary (for example, there might be a characteristic of the instrument that is not captured by the valuation technique or a new fact that has arisen at the measurement date that was not present at initial recognition).

In some circumstances, an entity may have to apply more than one valuation technique when determining fair value.

Examples of various types of techniques for measurement of the fair value of unquoted equity instruments, are provided in Illustrative Examples 23–26.

E.2.5—Cost as a Proxy for Fair Value of Equity Instruments

Can the cost of the equity instrument be used by default for subsequent measurement?

No. Investments in equity instruments must be measured at fair value. However, as noted in paragraph AG140 cost may be an appropriate estimate of fair value because there is insufficient recent information available to measure fair value or because there is a wide range of possible fair value measurements and cost represents the best estimate of fair value within that range.

Section F Other

F.1 IPSAS 41 and IPSAS 2—Hedge Accounting: Cash Flow Statement

How should cash flows arising from hedging instruments be classified in the cash flow statement?

Cash flows arising from hedging instruments are classified as operating, investing or financing activities, on the basis of the classification of the cash flows arising from the hedged item. While the terminology in IPSAS 2 has not been updated to reflect IPSAS 41, the classification of cash flows arising from hedging instruments in the cash flow statement should be consistent with the classification of these instruments as hedging instruments under IPSAS 41.

Section G Concessionary Loans and Non-Exchange Equity Transactions

G.1 Sequencing of “Solely Payments of Principal and Interest” Evaluation for a Concessionary Loan

If an entity issues a concessionary loan (financial asset) when does it assess classification for subsequent measurement purposes?

An entity firstly assesses whether the substance of the concessionary loan is in fact a loan, a grant, a contribution from owners or a combination thereof, by applying the principles in IPSAS 28 and paragraphs 42–58 of IPSAS 23. If an entity has determined that the transaction, or part of the transaction, is a loan, it assesses whether the transaction price represents the fair value of the loan on initial recognition. An entity determines the fair value of the loan by using the principles in paragraphs AG144–AG155.

After initial recognition at fair value, an entity subsequently assesses the classification of concessionary loans in accordance with paragraphs 39–44 and measures concessionary loans in accordance with paragraphs 61–65.

G.2 Concessionary Loans and “Solely Payments of Principal and Interest” Evaluation

Can a concessionary loan satisfy the SPPI condition?

Yes. When the payments of the loan, based on its fair value determined at initial recognition, reflect solely payments of principal and interest.

However, if a financial asset contains a contractual term that could change the timing or amount of contractual cash flows (for example, a contingent repayment feature specific to the borrower), the entity must determine whether the contractual cash flows that could arise over the life of the instrument due to that contractual term are solely payments of principal and interest on the principal amount outstanding. If the terms of the financial asset give rise to any other cash flows or limit the cash flows in a manner inconsistent with payments representing principal and interest, the financial asset does not meet the condition in paragraphs 40(b) and 41(b). To make this determination, the entity must assess the contractual cash flows that could arise both before, and after, the change in contractual cash flows. The entity may also need to assess the nature of any contingent event (i.e., the trigger) that would change the timing or amount of the contractual cash flows (see paragraphs AG72–AG75).

A common feature of a concessionary loan is an interest concession. A concessionary loan with a contractual interest rate of nil does not preclude the instrument from satisfying the SPPI condition.

*G.3 Valuation of Non-Exchange Component***Can the non-exchange component of an equity transaction equal the transaction cost?**

No. To the extent an entity receives an equity instrument, such as common shares, in exchange for consideration, the equity instrument will have some value on initial recognition and must be measured at fair value.

At initial recognition, the entity must evaluate the substance of the arrangement and assess whether a portion of the consideration provided is a non-exchange component such as a grant or subsidy.

*G.4 Equity Instruments Arising from Non-Exchange Transactions***How might an equity instrument included in a non-exchange transaction be evidenced?**

In assessing whether an equity instrument is included as part of a transaction that also includes a non-exchange component, an entity applies the definition of an equity instrument and the requirements in IPSAS 28.

Indicators that may evidence the existence of an equity instrument may include:

- (a) A formal designation of the transfer (or a class of such transfers) of equity instruments forming part of the investment's contributed net assets/equity, either before the investment occurs or at the time of the investment;
- (b) A formal agreement, in relation to the equity instrument, establishing or increasing an existing financial interest in the net assets/equity of the investment that can be sold, transferred, or redeemed; or
- (c) The receipt of equity instruments that can be sold, transferred, or redeemed.

*G.5 Factors to Consider in Evaluating Concessionary and Originated Credit-Impaired Loans***What factors should be considered when evaluating whether a loan is a concessionary loan or an originated credit-impaired loan?**

Both concessionary loans and originated credit-impaired loans have lower estimated future cash flows than similar loans that do not have a concessionary or credit-impaired component.

The issuer of a debt instrument evaluates the substance of the financial instrument to determine whether the instrument is classified as a concessionary loan or an originated credit-impaired loan.

Features that indicate that the financial instrument is a concessionary loan include:

- The lender has an objective to incorporate a non-exchange component in the loan transaction. As such, the lender intends to give up a portion of the cash flows that would otherwise be available had the transaction been negotiated at market terms;
- The financial instrument is extended below-market terms, by way of an interest and/or a principal concession; and
- The characteristics of the loan agreement, i.e., the contractual terms that are negotiated off market, result in a decrease in the estimated future cash flows of the instrument when compared to a similar loan that does not have a concessionary or credit-impaired component.

Originated credit-impaired financial assets (see paragraphs 85–86) are generally extended at market terms at origination but have lower estimated cash flows in comparison to similar instruments, because the borrowing entity is not expected to be able to satisfy the contractual terms of the arrangement. The lender expects a portion of the contractual cash flows to be uncollectible, as opposed to intending to give up a portion of the cash flows which would otherwise be available at market terms. As such, originated credit-impaired loans present an opportunity for the lender to collect cash flows in excess of the estimated future cash flows, while with concessionary loans, the estimated future cash flows approximate the contractual cash flows, meaning no additional cash flows are available.

*G.6 Concessionary Loans that are Originated Credit-Impaired***Can a concessionary loan be originated credit-impaired?**

Yes. In some circumstances a concessionary loan may be granted that is also originated credit-impaired. A concessionary loan may be credit-impaired at origination because one or more events have had a detrimental impact on the estimated future cash flows of the financial asset.

For example, in order to support the operation of the national airline's domestic routes, the department of finance advances loans to the airline on an annual basis. The annual interest payments are based on a contract rate of 6 percent. Assuming the market rate at the time the loan is advanced is 10 percent, this represents a concession.

Historically, even with the concessionary terms, the department of finance has collected only 85 percent of the loan's contractual cash flows. The department of finance expects this trend to continue with the current loan issue.

This example represents a concessionary originated credit-impaired loan as the loan has concessionary terms, but even with those terms, significant credit losses are expected to occur.

In evaluating whether the expected credit losses on the concessionary loan support the loan being originated credit-impaired or just represent normal credit losses, the entity considers whether one or more events has occurred that have had a detrimental impact on the estimated future cash flows of the loan.

Section H Effective Interest Method

H.1 Requirement to Use the Effective Interest Method

When transaction costs and any premium or discount on issuance are insignificant, measuring the amortized cost of an instrument using the effective interest rate produces similar results as using the straight-line method.

In circumstances where measuring the gross amount of an instrument using the effective interest method yields immaterial differences as compared to applying the straight-line method, is the effective interest method required to be used?

Measuring the amortized cost of an instrument requires the use of the effective interest method. However, in practice there may be scenarios where applying the straight-line method yields materially the same result.

Paragraph 10 of IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, indicates “IPSASs set out accounting policies that the IPSASB has concluded result in financial statements containing relevant and faithfully representative information about the transactions, other events, and conditions to which they apply. Those policies need not be applied when the effect of applying them is immaterial...”

When an alternative technique – in this case the straight-line method – yields materially the same result as measuring amortized cost using the effective interest method, management need not apply the effective interest method as required by IPSAS 41, *Financial Instruments*.

The following example illustrates why differences arise when measuring the gross amount of a debt instrument using the effective interest method compared to the straight-line method. National Government A issues a bond with a face value of CU100,000. The bond yield of 10 percent is paid annually until maturity in 5 years. The bond was issued at a discount of 3 percent and National Government A had to pay CU2,000 in transaction costs.

Under both measurement methodologies, National Government A received CU95,000 on issuance of the instrument (CU95,000 = CU100,000 – CU2,000 – CU100,000 x 3 percent).

Straight Line Method

Measuring the gross amount of the instrument using the straight line method requires amortizing the discount and transaction costs evenly until maturity.

Year	(a)	(b = 100,000 × 10 percent)	(c)	(d)	(e = a + b + c – d)
	Gross carrying amount at the beginning of the year	Interest expense	Amortization of transaction costs and discount	Cash flows	Gross carrying amount at the end of the year
1	95,000	10,000	1,000	10,000	96,000
2	96,000	10,000	1,000	10,000	97,000
3	97,000	10,000	1,000	10,000	98,000
4	98,000	10,000	1,000	10,000	99,000
5	99,000	10,000	1,000	110,000	–

Effective Interest Method

Measuring the gross amount of the instrument using the effective interest method requires calculating the rate that exactly discounts the estimate future cash payments through the expected life of the instrument to the gross carrying amount of the instrument. Discounting the estimated cash flows of the bond yields an effective interest rate of 11.37 percent.

Year	(a) Gross carrying amount at the beginning of the year	(b = a × 11.37 percent) Interest expense	(c) Cash flows	(d = a + b – c) Gross carrying amount at the end of the year
1	95,000	10,797	10,000	95,797
2	95,797	10,888	10,000	96,685
3	96,685	10,989	10,000	97,673
4	97,673	11,101	10,000	98,774
5	98,774	11,226	110,000	–

When evaluating whether measuring the gross amount of the bond using the straight line method yields an immaterial difference compared to applying the effective interest method, the gross amount is compared at each measurement date as detailed in the table below.

Year	Straight Line Method Gross carrying amount at the beginning of the year	Effective Interest Method Gross carrying amount at the beginning of the year	Difference
1	95,000	95,000	-
2	96,000	95,797	203
3	97,000	96,685	315
4	98,000	97,673	327
5	99,000	98,774	226

The measurement difference between the two methods is a result of the transaction costs and the discount on issuance of the bond. As the costs approach zero, the difference between measuring the bond using the straight line method or the effective interest method will become smaller. As the costs increase, the difference will grow in size.

Furthermore, contemplating the effect on annual interest expense may yield further considerations when assessing whether applying the straight line method or effective interest method is material.

Section I Sovereign Debt Restructurings

I.1 Sovereign Debt Restructurings

Are sovereign debt restructurings covered by IPSAS 41?

Yes. Sovereign debt restructurings involve the modification, and/or derecognition, of financial liabilities, which are addressed in IPSAS 41. The requirements and guidance relevant to sovereign debt restructurings include:

- (a) Paragraphs 57 and 64 establish the requirements for the initial, and subsequent, measurement of financial liabilities;
- (b) Paragraphs 35–38 establish the derecognition requirements for financial liabilities;
- (c) Paragraph AG46 provides application guidance for assessing the extent of modifications to financial liabilities; and
- (d) Paragraphs AG118–AG127 provide application guidance for loans granted at concessionary terms.

Comparison with IFRS 9

IPSAS 41, *Financial Instruments* is drawn primarily from IFRS 9, *Financial Instruments* (including amendments up to December 31, 2015). The main differences between IPSAS 41 and IFRS 9 are as follows:

- IPSAS 41 contains additional application guidance to deal with concessionary loans, financial guarantee contracts entered into at nil or nominal consideration, equity instruments arising from non-exchange transactions and fair value measurement.
- In certain instances, IPSAS 41 uses different terminology from IFRS 9. The most significant examples are the use of the terms “statement of financial performance” and “net assets/equity.” The equivalent terms in IFRS 9 are “statement of comprehensive income or separate income statement (if presented)” and “equity.”
- IPSAS 41 does not distinguish between “revenue” and “income.” IFRS 9 distinguishes between “revenue” and “income,” with “income” having a broader meaning than the term “revenue.”
- Principles from IFRIC 16, *Hedges of a Net Investment in a Foreign Operation* and IFRIC 19, *Extinguishing Financial Liabilities with Equity Instruments* have been included as authoritative appendices to IPSAS 41. The IASB issues IFRICs as separate documents.
- IPSAS 41 includes additional fair value measurement guidance retained from IPSAS 29, *Financial Instruments: Recognition and Measurement*.

IPSAS 42—SOCIAL BENEFITS

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2022.

IPSAS 42, *Social Benefits* was issued in January 2019.

Since then, IPSAS 42 has been amended by the following IPSASs:

- *COVID-19: Deferral of Effective Dates* (issued November 2020)
- *Collective and Individual Services (Amendments to IPSAS 19)* (issued January 2020)

Table of Amended Paragraphs in IPSAS 42

Paragraph Affected	How Affected	Affected By
4A	New	Collective and Individual Services January 2020
35	Amended	COVID-19: Deferral of Effective Dates November 2020
35A	Amended	COVID-19: Deferral of Effective Dates November 2020

IPSAS 42, SOCIAL BENEFITS

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Objective

1. The objective of this Standard is to improve the relevance, faithful representativeness and comparability of the information that a reporting entity provides in its financial statements about social benefits as defined in this Standard. The information provided should help users of the financial statements and general purpose financial reports assess:
 - (a) The nature of such social benefits provided by the entity;
 - (b) The key features of the operation of those social benefit schemes; and
 - (c) The impact of such social benefits provided on the entity's financial performance, financial position and cash flows.
2. To accomplish that, this IPSAS establishes principles and requirements for:
 - (a) Recognizing expenses and liabilities for social benefits;
 - (b) Measuring expenses and liabilities for social benefits;
 - (c) Presenting information about social benefits in the financial statements; and
 - (d) Determining what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the social benefits provided by the reporting entity.

Scope

3. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for social benefits.**
4. **This Standard applies to a transaction that meets the definition of a social benefit. This Standard does not apply to cash transfers that are accounted for in accordance with other Standards:**
 - (a) **Financial instruments that are within the scope of IPSAS 41, *Financial Instruments* (or IPSAS 29, *Financial Instruments: Recognition and Measurement* prior to an entity adopting IPSAS 41);**
 - (b) **Employee benefits that are within the scope of IPSAS 39, *Employee Benefits*; and**
 - (c) **Insurance contracts that are within the scope of the relevant international or national accounting standard dealing with insurance contracts.**

Paragraphs AG1–AG3 provide additional guidance on the scope of this Standard.

- 4A. Collective services and individual services (as defined in IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*) are not social benefits. Guidance on determining whether a provision arises for these transactions is provided in IPSAS 19.

Definitions

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

Social benefits are cash transfers provided to:

- (a) **Specific individuals and/or households who meet eligibility criteria;**
- (b) **Mitigate the effect of social risks; and**
- (c) **Address the needs of society as a whole.**

Paragraphs AG4–AG8 provide additional guidance on this definition.

Social risks are events or circumstances that:

- (a) **Relate to the characteristics of individuals and/or households – for example, age, health, poverty and employment status; and**
- (b) **May adversely affect the welfare of individuals and/or households, either by imposing additional demands on their resources or by reducing their income.**

Paragraphs AG9–AG10 provide additional guidance on what is encompassed by social risks.

General Approach

Recognition of a Liability for a Social Benefit Scheme

6. **An entity shall recognize a liability for a social benefit scheme when:**
- (a) **The entity has a present obligation for an outflow of resources that results from a past event; and**
 - (b) **The present obligation can be measured in a way that achieves the qualitative characteristics and takes account of constraints on information in general purpose financial reports as set out in the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*.**

Outflow of Resources

7. A liability must involve an outflow of resources from the entity for it to be settled. An obligation that can be settled without an outflow of resources from the entity is not a liability.
8. There may be uncertainty associated with the measurement of the liability. The use of estimates is an essential part of the accrual basis of accounting. Uncertainty regarding the outflow of resources does not prevent the recognition of a liability unless the level of uncertainty is so large that the qualitative characteristics of relevance and faithful representativeness cannot be met. Where the level of uncertainty does not prevent the recognition of a liability, it is taken into account when measuring the liability.

Past Event

9. The past event that gives rise to a liability for a social benefit scheme is the satisfaction by each beneficiary of all eligibility criteria to receive a social benefit payment. The satisfaction of eligibility criteria for each social benefit payment is a separate past event.

Paragraphs AG11–AG14 provide additional guidance on the recognition of a liability.

Recognition of an Expense for a Social Benefit Scheme

10. **An entity shall recognize an expense for a social benefit scheme at the same point that it recognizes a liability.**
11. An entity shall not recognize an expense for a social benefit scheme where a social benefit payment is made prior to all eligibility criteria for the next payment being satisfied. Rather, an entity shall recognize a payment in advance as an asset in the statement of financial position, unless the amount becomes irrecoverable, in which case it shall recognize an expense.

Measurement of a Liability for a Social Benefit Scheme

Initial Measurement of the Liability

12. **An entity shall measure the liability for a social benefit scheme at the best estimate of the costs (i.e., the social benefit payments) that the entity will incur in fulfilling the present obligations represented by the liability.**
13. An entity's best estimate of the costs (i.e., the social benefit payments) that the entity will make takes into account the possible effect of subsequent events on those social benefit payments.
14. When the liability in respect of a social benefit scheme is not expected to be settled before twelve months after the end of the reporting period in which the liability is recognized (i.e., the next social benefit payment will not be made for more than twelve months), the liability shall be discounted using the discount rate specified in paragraph 19.
15. Paragraphs AG15–AG18 provide additional guidance on measuring the liability.

Subsequent Measurement

16. **The liability for a social benefit scheme shall be reduced as social benefit payments are made. Any difference between the cost of making the social benefit payments and the carrying amount of the liability in respect of the social benefit scheme is recognized in surplus or deficit in the period in which the liability is settled.**
17. **Where a liability is discounted in accordance with paragraph 14, the liability is increased and interest expense recognized in each reporting period until the liability is settled, to reflect the unwinding of the discount.**
18. **Where a liability has yet to be settled, the liability shall be reviewed at each reporting date, and adjusted to reflect the current best estimate of the costs (i.e., the social benefit payments) that the entity will incur in fulfilling the present obligations represented by the liability.**

Discount Rate

19. **The rate used to discount a liability in respect of a social benefit scheme 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 social benefit liability.**
20. Paragraph AG18 provides additional guidance on the discount rate to be used.

Measurement of an Expense for a Social Benefit Scheme

21. **An entity shall initially measure the expense for a social benefit scheme at an amount equivalent to the amount of the liability measured in accordance with paragraph 12. Where the entity makes a social benefit payment prior to all eligibility criteria for the next payment being satisfied, it shall measure the payment in advance or expense recognized in accordance with paragraph 11 at the amount of the cash transferred.**

Disclosure

22. **The objective of the disclosures under the general approach, together with the information provided in the statement of financial position, statement of financial performance, statement of changes in net assets/equity and statement of cash flows, is for entities to give users of the financial statements a basis to assess the effect that social benefits may have on the financial position, financial performance and cash flows of the entity. Paragraphs 23–25 specify requirements on how to meet this objective.**
23. **An entity shall disclose information that:**
- (a) **Explains the characteristics of its social benefit schemes; and**
 - (b) **Explains the demographic, economic and other external factors that may affect its social benefit schemes.**
24. To meet the requirements of paragraph 23, an entity shall disclose:
- (a) Information about the characteristics of its social benefit schemes, including:
 - (i) The nature of the social benefits provided by the schemes (for example, retirement benefits, unemployment benefits, child benefits).
 - (ii) Key features of the social benefit schemes, such as a description of the legislative framework governing the schemes, a summary of the main eligibility criteria that must be satisfied to receive the social benefits, and a statement about how additional information about the scheme can be obtained.
 - (iii) A description of how the schemes are funded, including whether the funding for the schemes is provided by means of a budget appropriation, a transfer from another public sector entity, or by other means. If a scheme is funded (whether in full or in part) by social contributions, the entity shall provide:
 - a. A cross reference to the location of information about those social contributions and any dedicated assets (where this information is included in the entity's financial statements); or
 - b. A statement regarding the availability of information on those social contributions and any dedicated assets in another entity's financial statements and how that information can be obtained.
 - (iv) A description of the key demographic, economic and other external factors that influence the level of expenditure under the social benefit schemes. This description may be presented in aggregate where the same demographic, economic and other external factors impact a number of social benefit schemes in a similar manner.
 - (b) The total expenditure on social benefits recognized in the statement of financial performance, analyzed by social benefit scheme.
 - (c) A description of any significant amendments to the social benefit schemes made during the reporting period, along with a description of the expected effect of the amendments. Amendments to a social benefit scheme include, but are not limited to:
 - (i) Changes to the level of social benefits provided; and
 - (ii) Changes to the eligibility criteria, including the individuals and/or households covered by the social benefit scheme.

In making the disclosures required by this paragraph, an entity shall have regard to the requirements of paragraphs 45–47 of IPSAS 1, *Presentation of Financial Statements*, which provide guidance on materiality and aggregation.

25. If a social benefit scheme satisfies the criteria in paragraph 28 to permit the use of the insurance approach, a statement to that effect.

Insurance Approach

Recognition and Measurement

26. **Where a social benefit scheme satisfies the criteria in paragraph 28, an entity is permitted, but not required, to recognize and measure the assets, liabilities, revenue and expenses associated with that social benefit scheme by applying, by analogy, the requirements of the relevant international or national accounting standard dealing with insurance contracts¹.**

Paragraph AG19 provides additional guidance on the accounting standards dealing with insurance contracts that may be applied, by analogy, in accounting for social benefits.

27. Where an entity elects not to apply by analogy the requirements of the relevant international or national accounting standard dealing with insurance contracts, the entity shall recognize and measure the liabilities and expenses associated with that social benefit scheme, and include disclosures in the financial statements, in accordance with paragraphs 6–25 of this Standard.
28. An entity may recognize and measure the assets, liabilities, revenue and expenses associated with a social benefit scheme by applying, by analogy, the requirements of the relevant international or national accounting standard dealing with insurance contracts where:
- (a) The social benefit scheme is intended to be fully funded from contributions; and
 - (b) There is evidence that the entity manages the scheme in the same way as an issuer of insurance contracts, including assessing the financial performance and financial position of the scheme on a regular basis.

Paragraphs AG20–AG25 provide additional guidance on determining whether these criteria have been satisfied.

Disclosure

29. **The objective of the disclosures under the insurance approach, together with the information provided in the statement of financial position, statement of financial performance, statement of changes in net assets/equity and statement of cash flows, is for entities to give users of the financial statements a basis to assess the effect that social benefits may have on the financial position, financial performance and cash flows of the entity. Paragraphs 30 and 31 specify requirements on how to meet this objective.**
30. **Where an entity recognizes and measures the assets, liabilities, revenue and expenses associated with a social benefit scheme by applying, by analogy, the requirements of the relevant international or national accounting standard dealing with insurance contracts, the entity shall disclose:**
- (a) **The basis for determining that the insurance approach is appropriate;**
 - (b) **The information required by the relevant international or national accounting standard dealing with insurance contracts; and**
 - (c) **Any additional information required by paragraph 31 of this Standard.**
31. To meet the requirements of paragraph 30(c) of this Standard, an entity shall disclose:
- (a) Information about the characteristics of its social benefit schemes, including:
 - (i) The nature of the social benefits provided by the schemes (for example, retirement benefits, unemployment benefits, child benefits); and
 - (ii) Key features of the social benefit schemes, such as a description of the legislative framework governing the scheme, a summary of the main eligibility criteria that must be satisfied to receive the social benefit, and a statement about how additional information about the scheme can be obtained; and

¹ In the insurance approach section of this Standard, the term “the relevant international or national accounting standard dealing with insurance contracts” refers to IFRS 17, *Insurance Contracts* and national standards that have adopted substantially the same principles as IFRS 17.

- (b) A description of any significant amendments to the social benefit schemes made during the reporting period, along with a description of the expected effect of the amendments. Amendments to a social benefit scheme include, but are not limited to:
- (i) Changes to the level of social benefits provided; and
 - (ii) Changes to the eligibility criteria, including the individuals and/or households covered by the social benefit scheme.

In making the disclosures required by this paragraph, an entity shall have regard to the requirements of paragraphs 45–47 of IPSAS 1, which provide guidance on materiality and aggregation.

Reporting on the Long-Term Sustainability of an Entity's Finances

32. Entities with social benefits are encouraged, but not required, to prepare general purpose financial reports that provide information on the long-term sustainability of the entity's finances. Recommended Practice Guideline (RPG) 1, *Reporting on the Long-Term Sustainability of an Entity's Finances*, provides guidance on the preparation of such reports.

Transitional Provisions

General Approach

33. **In accounting for a social benefit scheme that is recognized and measured, and about which disclosures are made, in accordance with the general approach (see paragraphs 6–25), an entity shall apply this Standard retrospectively, in accordance with IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.**

Insurance Approach

34. **An entity shall apply the transitional provisions in the relevant international or national accounting standard dealing with insurance contracts in accounting for a social benefit scheme that is recognized and measured, and about which disclosures are made, in accordance with the insurance approach (see paragraphs 26–31).**

Effective Date

35. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2023, it shall disclose that fact.**
- 35A. **Paragraph 4A was added by *Collective and Individual Services (Amendments to IPSAS 19)*. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged.**
36. When an entity adopts the accrual basis IPSASs of accounting as defined in IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of IPSAS.

Application Guidance

This Appendix is an integral part of IPSAS 42

Scope (see paragraphs 3–4)

- AG1. This Standard is applied in accounting for transactions and obligations that meet the definition of a social benefit in paragraph 5 of this Standard. This Standard does not address transactions that are addressed in other IPSAS, such as employee pensions (which are accounted for in accordance with IPSAS 39, *Employee Benefits*) and concessionary loans such as student loans (which are accounted for in accordance with IPSAS 41, *Financial Instruments* (or IPSAS 29, *Financial Instruments: Recognition and Measurement* prior to an entity adopting IPSAS 41)).
- AG2. Similarly, this Standard does not apply to insurance contracts, even if the risk covered by the insurance contract is a social risk as defined in paragraph 5 of this Standard. Insurance contracts are accounted for in accordance with the relevant international or national accounting standard dealing with insurance contracts.
- AG3. This Standard does not apply to collective and individual services. The definition of social benefits only includes cash transfers, not the provision of services. This Standard does not apply to cash transfers to individuals and households that do not address social risks, for example emergency relief.

Definitions (see paragraph 5)

Guidance on the Definition of Social Benefits

- AG4. Social benefits are cash transfers (including transfers in the form of cash equivalents, for example pre-paid debit cards) provided to individuals and/or households. Services provided by a public sector entity are not social benefits. In some jurisdictions, a public sector entity may provide vouchers that allow individuals and/or households to access services, or may reimburse individuals and/or households for costs incurred in accessing services. The economic substance of these transactions is that the public sector entity is paying for the provision of the services; such transactions do not, therefore, meet the definition of a social benefit. Where a public sector entity provides vouchers or reimbursements, the individual and/or household has no discretion over the use of the benefit. By contrast, social benefits provide cash transfers that may be used indistinguishably from income coming from other sources.
- AG5. Some jurisdictions may provide cash transfers in the form of cash equivalents that have limited restrictions on the use of the cash transfer. For example, a government may provide a pre-paid debit card that can be used to purchase any item except alcohol and tobacco products. Such limited restrictions do not contravene the principle that social benefits provide cash transfers that may be used indistinguishably from income coming from other sources. Pre-paid debit cards with limited restrictions are cash transfers, not the provision of services by a government.
- AG6. Social benefits are only provided when eligibility criteria to receive a social benefit payment when it is next paid are met. For example, a government may provide unemployment benefits to ensure that the needs of those whose income during periods of unemployment would otherwise be insufficient are met. Although the unemployment benefit scheme potentially covers the population as a whole, unemployment benefits are only paid to those who are unemployed, i.e. those who meet the eligibility criteria. In some cases, eligibility criteria may relate to citizenship or residence, for example where a public sector entity pays a universal basic income to all adult residents.
- AG7. The assessment of whether a benefit is provided to mitigate the effect of social risks is made by reference to society as a whole; the benefit does not need to mitigate the effect of social risks for each recipient. An example is where a government pays a retirement pension to all those over a certain age, regardless of income or wealth, to ensure that the needs of those whose income after retirement would otherwise be insufficient are met. Such benefits satisfy the definition criteria that they are provided to mitigate the effect of social risks.
- AG8. Social benefits are organized to ensure that the needs of society as a whole are addressed. This distinguishes them from benefits provided through insurance contracts, which are organized for the benefit of individuals, or groups of individuals. Addressing the needs of society as a whole does not require that each social benefit covers all members of society; in some jurisdictions, social benefits are provided through a range of similar benefits that cover different segments of society. A social benefit that covers a segment of society as part of a wider system of social benefits meets the requirement that it addresses the needs of society as a whole.

Guidance on the Definition of Social Risks

- AG9. Social risks relate to the characteristics of individuals and/or households—for example, age, health, poverty and employment status. The nature of a social risk is that it relates directly to the characteristics of an individual and/or household. The condition, event, or circumstance that leads to or contributes to an unplanned or undesired event arises from the characteristics of the individuals and/or households. This distinguishes social risks from other risks, where the condition, event, or circumstance that leads to or contributes to an unplanned or undesired event arises from something other than the characteristics of an individual or household.
- AG10. For example, unemployment benefits are social benefits because the condition, event, or circumstance covered by the unemployment benefit arises from characteristics of the individuals and/or households – in this case a change in an individual’s employment status. By contrast, aid provided immediately following an earthquake is not a social benefit. The condition, event, or circumstance that leads to or contributes to an unplanned or undesired event is an active fault line, and the risk is that a possible earthquake causes damage. Because the risk relates to geography rather than individuals and/or households, this risk is not a social risk.

General Approach (see paragraphs 6–21)*Recognition of a Liability for a Social Benefit Scheme*

- AG11. In accordance with paragraph 9 of this Standard, the past event that gives rise to a liability for a social benefit scheme is the satisfaction by each beneficiary of all eligibility criteria to receive a social benefit payment. Being alive at the point at which the eligibility criteria are required to be satisfied may be an eligibility criterion, whether explicitly stated or implicit. Other ongoing eligibility criteria may be relevant for some social benefit schemes. For example, many unemployment benefits are only payable while the individual remains resident in the jurisdiction; residence is an ongoing eligibility criterion. For a liability to be recognized, a beneficiary must satisfy the eligibility criteria (to receive a social benefit payment) at, or prior to, the reporting date, even if formal validation of the eligibility criteria occurs less frequently.
- AG12. Where a beneficiary has not previously satisfied the eligibility criteria for the next payment, or there has been a break in satisfying the eligibility criteria, a liability is recognized at the point that the eligibility criteria for the next payment are first satisfied or when all the eligibility criteria are satisfied again. Examples may include:
- (a) Reaching retirement age (in the case of a retirement pension);
 - (b) The death of a partner (in the case of a survivor benefit);
 - (c) Becoming unemployed (in the case of an unemployment benefit without a waiting period); and
 - (d) Being unemployed for a specified period (in the case of an unemployment benefit with a waiting period).

An entity will recognize a liability where beneficiaries satisfy the eligibility criteria (to receive a social benefit payment) at, or prior to, the reporting date. Where a beneficiary satisfies the eligibility criteria for a social benefit payment prior to the point at which the next social benefit payment will be made, but after the reporting date, no liability is recognized, as there is no present obligation as at the reporting date.

- AG13. Where a beneficiary has previously satisfied the eligibility criteria, and there has been no break in satisfying those criteria, a liability for social benefits is recognized each time the criteria are satisfied.
- AG14. Whether being alive is a separate eligibility criterion will depend on the characteristics of each individual social benefit scheme. For some schemes, separate consideration of being alive is not required as it is indirectly addressed by another eligibility criterion. For example:
- (a) An unemployment benefit may only be payable to those who have become unemployed and are available for work (which implicitly includes being alive).
 - (b) Being alive may not be an eligibility criterion for the recipient of the social benefit. A child benefit may be paid to the parents or guardian of the child; the payment of the benefit may be dependent on the child being alive, and not on the status of the parent or guardian.
 - (c) Benefits may be transferred to a survivor following the death of the beneficiary.

An entity needs to consider how being alive affects the recognition of each particular social benefit scheme, taking all relevant factors into consideration.

Measurement of a Liability for a Social Benefit Scheme

- AG15. In accordance with paragraph 12 of this Standard, an entity shall measure the liability for a social benefit scheme at the best estimate of the costs (i.e., the social benefit payments) that the entity expects to make in fulfilling the present obligation represented by the liability. Satisfaction of the eligibility criteria for each social benefit payment is a separate past event, and the liability for each payment is measured separately. The maximum amount to be recognized as a liability is the costs the entity expects to incur in making the next social benefit payment. This is because social benefit payments beyond this point are future events for which there is no present obligation.
- AG16. In measuring the liability, an entity takes into account the possibility that beneficiaries may cease to be eligible for the social benefit prior to the next point at which eligibility criteria for the next payment are required (implicitly or explicitly) to be satisfied. Examples include:
- (a) The death of the beneficiary (where no survivor benefits are payable);
 - (b) Commencing employment (in the case of an unemployment benefit); and
 - (c) Exceeding the maximum period for which a social benefit is provided (where an unemployment benefit is provided for a limited period).

The extent to which such events affect the measurement of the liability will depend on the terms of the scheme. For example, an unemployment benefit is payable on the 15th of each month, and the reporting date is December 31. If the payment to be made on January 15 relates to unemployment up to December 15, then at the time the eligibility criteria for the next social benefit payment are met, the amount due will be known and is recognized at the reporting date. No adjustment for beneficiaries subsequently ceasing to be eligible is required.

However, if the payment on January 15 relates to unemployment between December 16 and January 15, measurement of the liability to be recognized at the reporting date is based on an estimate of the extent to which eligibility criteria for a payment have been satisfied.

- AG17. Because a liability cannot extend beyond the point at which eligibility criteria for the next payment will be next satisfied, liabilities in respect of social benefits will usually be short-term liabilities. Consequently, prior to the financial statements being authorized for issue, an entity may receive information regarding the eligibility of beneficiaries to receive the social benefit. IPSAS 14, *Events After the Reporting Date*, provides guidance on using this information.
- AG18. Because a liability for a social benefit scheme will usually be a short-term liability, the time value of money may not be material. Nevertheless, this Standard requires an entity to discount the liability in those cases where the liability is not expected to be settled within twelve months of the reporting date and the impact of discounting is material. IPSAS 39 provides additional guidance on the discount rate to be used.

Insurance Approach (see paragraphs 26–28)

- AG19. In the insurance approach section of this Standard, the term “the relevant international or national accounting standard dealing with insurance contracts” refers to IFRS 17, *Insurance Contracts*, and national standards that have adopted substantially the same principles as IFRS 17. IFRS 17 has adopted principles for accounting for insurance contracts that, when applied by analogy to social benefit schemes that satisfy the criteria to use the insurance approach, will provide information that meets users’ needs and satisfies the qualitative characteristics. This may not be the case for other accounting standards dealing with insurance contracts. For example, the IASB has described IFRS 4, *Insurance Contracts*, as an “interim Standard that permits a wide range of practices and includes a “temporary exemption”, which explicitly states that an entity does not need to ensure that its accounting policies are relevant to the economic decision-making needs of users of financial statements, or that those accounting policies are reliable.”² IFRS 4, and national standards that are consistent with the principles of IFRS 4, may not provide information that meets users’ needs and satisfies the qualitative characteristics. Consequently, an entity may not recognize and measure the assets, liabilities, revenue and expenses associated with a social benefit scheme by applying, by analogy, the requirements of standards that have not adopted substantially the same principles as IFRS 17.

Guidance on Determining Whether a Social Benefit Scheme is Intended to be Fully Funded from Contributions

- AG20. A social benefit scheme is intended to be fully funded from contributions when:
- (a) The legislation or other arrangement governing the social benefit scheme provides for the scheme to be funded by contributions or levies paid by or on behalf of either the potential beneficiaries or those whose activities create or

² Exposure Draft ED/2013/7 *Insurance Contracts*

exacerbate the social risks which are mitigated by the social benefit scheme, together with investment returns arising from the contributions or levies; and

- (b) One or both of the following indicators (individually or in combination) is satisfied:
- (i) Contribution rates or levy rates are reviewed (and, where appropriate, adjusted in line with the scheme's funding policy), either on a regular basis or when specified criteria are met, with the aim of ensuring that the revenue from contributions or levies will be sufficient to fully fund the social benefit scheme; and/or
 - (ii) Social benefit levels are reviewed (and, where appropriate, adjusted in line with the scheme's funding policy), either on a regular basis or when specified criteria are met, with the aim of ensuring that the levels of social benefits provided will not exceed the level of funding available from contributions or levies.

In subparagraphs (i) and (ii) above, reviews are undertaken on a regular basis when they are performed at a frequency appropriate for the specific scheme. While annual reviews are common, less frequent—or more frequent—reviews will be appropriate for some schemes.

- AG21. In some circumstances, a public sector entity may be required to make contributions to a social benefit scheme on behalf of those individuals and/or households who could not afford to do so. Such contributions may be made by the entity administering the scheme or some other entity. For example, a public sector entity may be required to make contributions to a retirement pension scheme for those individuals who are unemployed. Where the contributions relate to specified individuals and/or households (which in some cases will require the contributions to be credited against the individuals' contribution accounts), the contributions made by the public sector entity are to be considered as contributions for the purposes of determining whether a social benefit scheme is intended to be fully funded from contributions in accordance with paragraph 28(a). Where a public sector entity makes contributions to fund the deficit on a social benefit scheme, the contributions are not related to specified individuals and/or households, and are not considered as contributions for the purposes of determining whether a social benefit scheme is intended to be fully funded from contributions in accordance with paragraph 28(a).
- AG22. In assessing whether a social benefit scheme is intended to be fully funded from contributions, an entity considers substance over form. For example, where a social benefit scheme is in deficit for a period but the scheme has an ability to adjust the future contribution rates and/or benefits payable such that the deficit is addressed, the scheme may still satisfy the criteria to be accounted for under the insurance approach.
- AG23. The reference in paragraph AG20(a) to “those whose activities create or exacerbate the social risks which are mitigated by the social benefit scheme” is intended to cover those social benefit schemes such as an accident insurance scheme that:
- (a) Are funded by levies on, for example, motorists or employers in particular industries; and
 - (b) Provide coverage against social risks to the wider population.

Guidance on Determining Whether an Entity is Managing a Scheme in the Same Way as an Insurer

- AG24. An entity is managing a social benefit scheme in the same way as an insurer would manage an insurance portfolio when the social benefit scheme has, with the exception of its legislative rather than contractual origins, the characteristics of an insurance contract. The social benefit scheme should confer the rights and obligations on parties similar to that of an insurance contract.
- AG25. In determining whether it is managing a social benefit scheme in the same way as an insurer would manage an insurance portfolio, an entity considers the following indicators:
- (a) Does the entity consider itself bound by the scheme in a similar manner to an insurer being bound by an insurance contract? For example, there may be evidence that the entity considers that it can amend the terms of the scheme for existing participants in a manner that an insurer could not (such as where the entity can make retrospective changes to the scheme). In such cases, the entity will not be bound in a similar manner to an insurer, and the social benefit scheme will not have the characteristics of an insurance contract. An entity will be bound by the scheme in a similar manner to an insurer where its ability to amend the scheme for existing participants is limited to:
 - (i) Circumstances prescribed by the legislation that establishes the scheme (equivalent to a contractual term permitting changes in specific circumstances); or
 - (ii) When a government is setting new contribution or levy rates (where a trade-off between the contributions and prospective benefits is part of the process of determining an appropriate rate).

- (b) Are assets relating to the social benefit scheme held in a separate fund, or otherwise earmarked, and restricted to being used to provide social benefits to participants? If an entity does not separately identify amounts relating to social benefits, this will provide evidence that the entity considers the contributions as a form of taxation. The social benefit scheme will not have the characteristics of an insurance contract. There will also be practical difficulties with applying the measurement requirements of the relevant international or national accounting standard dealing with insurance contracts if the assets associated with a social benefit scheme are not separately identified.
- (c) Does the legislation that establishes the social benefit give enforceable rights to participants in the event that the social risk occurs? Insurance contracts give such rights to policyholders. If the social benefit scheme does not also include such rights, then any social benefits provided by the entity will have a discretionary nature, meaning that the social benefit scheme will not have the characteristics of an insurance contract. For rights to be enforceable, a participant would need to have the right to challenge—in a court of law, via an arbitration or dispute resolution process or similar mechanism—decisions by the entity. The decisions that may be challenged include, but are not limited to, those regarding whether an event is covered by a scheme, the level of social benefits payable by a scheme, and the duration of any social benefits payable by a scheme.
- (d) An entity assesses the financial performance and financial position of a social benefit scheme on a regular basis where it is required to report internally on the financial performance of the scheme, and, where necessary, to take action to address any under-performance by the scheme. The assessment is expected to involve the use of actuarial reviews, mathematical modelling, or similar techniques to provide information for internal decision-making on the different possible outcomes that might occur.
- (e) Is there a separate entity established by the government, which is expected to act like an insurer in relation to a social benefit scheme? The existence of such an entity provides evidence that the entity is managing a scheme in the same way as an insurer would manage an insurance portfolio. However, it is not a requirement for applying the insurance approach that a separate entity has been established. Relevant international and national accounting standards dealing with insurance contracts apply to insurance contracts, not just to insurance companies.

Amendments to Other IPSAS

Amendments to IPSAS 1, *Presentation of Financial Statements*

Paragraphs 88, 94, and 112–115 are amended and paragraph 153M is added. New text is underlined and deleted text is struck through.

...

Structure and Content

...

Statement of Financial Position

...

Information to be Presented on the Face of the Statement of Financial Position

88. **As a minimum, the face of the statement of financial position shall include line items that present the following amounts:**

- (a) **Property, plant, and equipment;**
- ...
- (j) **Taxes and transfers payable;**
- (ja) **Social benefits liabilities;**
- (k) **Payables under exchange transactions;**
- ...

...

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

...

94. The detail provided in subclassifications depends on the requirements of IPSASs and on the size, nature and function of the amounts involved. The factors set out in paragraph 91 also are used to decide the basis of subclassification. The disclosures vary for each item, for example:

- (a) Items of property, plant and equipment are disaggregated into classes in accordance with IPSAS 17;
- ...
- (d) Taxes and transfers payable are disaggregated into tax refunds payable, transfers payable, and amounts payable to other members of the economic entity;
- (da) Social benefits liabilities are disaggregated into separate social benefit schemes where these are material;
- (e) Provisions are disaggregated into provisions for employee benefits and other items; and
- (f) Components of net assets/equity are disaggregated into contributed capital, accumulated surpluses and deficits, and any reserves.

...

Statement of Financial Performance

...

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

...

SOCIAL BENEFITS

112. The first form of analysis is the nature of expense method. Expenses are aggregated in the statement of financial performance according to their nature (for example, depreciation, purchases of materials, transport costs, employee benefits, and advertising costs), and are not reallocated among various functions within the entity. This method may be simple to apply because no allocations of expenses to functional classifications are necessary. An example of a classification using the nature of expense method is as follows:

Revenue		X
Employee benefits costs	X	
<u>Social benefits expenses</u>	<u>X</u>	
Depreciation and amortization expense	X	
Other expenses	X	
Total expenses		(X)
Surplus		<u>X</u>

113. The second form of analysis is the function of expense method and classifies expenses according to the program or purpose for which they were made. This method can provide more relevant information to users than the classification of expenses by nature, but allocating costs to functions may require arbitrary allocations and involves considerable judgment. An example of a classification using the function of expense method is as follows:

Revenue		X
Expenses:		
<u>Social benefits expenses</u>		(X)
Health expenses		(X)
Education expenses		(X)
Other expenses		(X)
Surplus		<u>X</u>

114. The expenses associated with the main functions undertaken by the entity are shown separately. In this example, the entity has functions relating to the provision of social benefits, health and education services. The entity would present expense line items for each of these functions.

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

...

Effective Date

...

153M. Paragraphs 88, 94 and 112–115 were amended by IPSAS 42, *Social Benefits*, issued in January 2019. An entity shall apply these amendments at the same time as it applies IPSAS 42.

...

Implementation Guidance

...

Public Sector Entity—Statement of Financial Position

SOCIAL BENEFITS

As at December 31, 20X2

(in thousands of currency units)

	20X2	20X1
ASSETS		
...		
LIABILITIES		
Current liabilities		
Payables	X	X
Short-term borrowings	X	X
Current portion of long-term borrowings	X	X
Short-term provisions	X	X
<u>Social benefits</u>	<u>X</u>	<u>X</u>
Employee benefits	X	X
Superannuation	X	X
	<hr/> X <hr/>	<hr/> X <hr/>
Non-current liabilities		
Payables	X	X
Long-term borrowings	X	X
Long-term provisions	X	X
<u>Social benefits</u>	<u>X</u>	<u>X</u>
Employee benefits	X	X
Superannuation	X	X
	<hr/> X <hr/>	<hr/> X <hr/>
Total liabilities	<hr/> X <hr/>	<hr/> X <hr/>
Net assets	<hr/> X <hr/>	<hr/> X <hr/>
Net assets/equity		
...		
Non-controlling interest	X	X
Total net assets/equity	<hr/> X <hr/>	<hr/> X <hr/>

Public Sector Entity—Statement of Financial Performance for the Year Ended December 31, 20X2

(Illustrating the Classification of Expenses by Function)

(in thousands of currency units)

	20X2	20X1
Revenue		
...		
Expenses		
General public services	(X)	(X)
Defense	(X)	(X)
Public order and safety	(X)	(X)
Education	(X)	(X)
Health	(X)	(X)
<u>Social benefits</u>	<u>(X)</u>	<u>(X)</u>
Other social protection	(X)	(X)
Housing and community amenities	(X)	(X)
Recreational, cultural and religion	(X)	(X)
Economic affairs	(X)	(X)

SOCIAL BENEFITS

	20X2	20X1
Environmental protection	(X)	(X)
Other expenses	(X)	(X)
Finance costs	(X)	(X)
Total Expenses	<u>(X)</u>	<u>(X)</u>

Public Sector Entity—Statement of Financial Performance for the Year Ended December 31, 20X2

(Illustrating the Classification of Expenses by Nature)

(in thousands of currency units)

	20X2	20X1
Revenue		
...		
Expenses		
Wages, salaries, and employee benefits	(X)	(X)
<u>Social benefits</u>	<u>(X)</u>	<u>(X)</u>
Grants and other transfer payments	(X)	(X)
Supplies and consumables used	(X)	(X)
Depreciation and amortization expense	(X)	(X)
Impairment of property, plant, and equipment*	(X)	(X)
Other expenses	(X)	(X)
Finance costs	(X)	(X)
Total Expenses	<u>(X)</u>	<u>(X)</u>

Amendments to IPSAS 2, Cash Flow Statements

Paragraph 22 is amended and paragraph 63G is added. New text is underlined and deleted text is struck through.

Presentation of a Cash Flow Statement

Operating Activities

22. Cash flows from operating activities are primarily derived from the principal cash-generating activities of the entity. Examples of cash flows from operating activities are:

- (a) Cash receipts from taxes, levies, and fines;
- ...
- (d) Cash receipts from royalties, fees, commissions, and other revenue;
- (da) Cash payments to beneficiaries of social benefit schemes;
- (e) Cash payments to other public sector entities to finance their operations (not including loans);

Some transactions, such as the sale of an item of plant, may give rise to a gain or loss that is included in surplus or deficit. The cash flows relating to such transactions are cash flows from investing activities. However, cash payments to construct or acquire assets held for rental to others and subsequently held for sale as described in paragraph 83A of IPSAS 17, *Property, Plant, and Equipment* are cash flows from operating activities. The cash receipts from rents and subsequent sales of such assets are also cash flows from operating activities.

* In a statement of financial performance in which expenses are classified by nature, an impairment of property, plant, and equipment is shown as a separate line item. By contrast, if expenses are classified by function, the impairment is included in the function(s) to which it relates.

Effective Date

63G. Paragraph 22 was amended by IPSAS 42, *Social Benefits*, issued in January 2019. An entity shall apply this amendment at the same time as it applies IPSAS 42.

...

Illustrative Examples

These examples accompany, but are not part of, IPSAS 2.

Cash Flow Statement (For an Entity Other Than a Financial Institution)**Direct Method Cash Flow Statement (paragraph 27(a))****Public Sector Entity—Consolidated Cash Flow Statement for Year Ended December 31, 20X2**

	(in thousands of currency units)	20X2	20X1
CASH FLOWS FROM OPERATING ACTIVITIES			
Receipts			
...			
Payments			
Employee costs		(X)	(X)
Superannuation		(X)	(X)
Suppliers		(X)	(X)
<u>Social benefits</u>		<u>(X)</u>	<u>(X)</u>
Interest paid		(X)	(X)
Other payments		(X)	(X)
Net cash flows from operating activities		<u>X</u>	<u>X</u>

...

Notes to the Cash Flow Statement

...

(C) Reconciliation of Net Cash Flows from Operating Activities to Surplus/(Deficit)

	(in thousands of currency units)	20X2	20X1
Surplus/(deficit)		X	X
Non-cash movements			
Depreciation		X	X
...			
Increase in borrowings		X	X
<u>Increase in social benefits liabilities</u>		<u>X</u>	<u>X</u>
Increase in provisions relating to employee costs		X	X
...			
Increase in receivables		(X)	(X)
Net cash flows from operating activities		<u>X</u>	<u>X</u>

Indirect Method Cash Flow Statement (paragraph 27(b))**Public Sector Entity—Consolidated Cash Flow Statement for Year Ended December 31, 20X2**

	(in thousands of currency units)	20X2	20X1
CASH FLOWS FROM OPERATING ACTIVITIES			
Surplus/(deficit)		X	X
Non-cash movements			
Depreciation		X	X
Amortization		X	X

SOCIAL BENEFITS

	(in thousands of currency units)	20X2	20X1
CASH FLOWS FROM OPERATING ACTIVITIES			
Increase in provision for doubtful debts		X	X
Increase in payables		X	X
Increase in borrowings		X	X
<u>Increase in social benefits liabilities</u>		<u>X</u>	<u>X</u>
Increase in provisions relating to employee costs		X	X
(Gains)/losses on sale of property, plant and equipment		(X)	(X)
(Gains)/losses on sale of investments		(X)	(X)
Increase in other current assets		(X)	(X)
Increase in investments due to revaluation		(X)	(X)
Increase in receivables		(X)	(X)
Net cash flows from operating activities		<u>X</u>	<u>X</u>

Amendments to IPSAS 19, Provisions, Contingent Liabilities and Contingent Assets

Paragraphs 1, 12, 19, and 77 are amended, paragraph 111I is added and paragraphs 7–11, 99 and 104 are deleted. New text is underlined and deleted text is struck through.

Scope

1. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for provisions, contingent liabilities, and contingent assets, except:**

- (a) ~~Those provisions and contingent liabilities arising from social benefits provided by an entity for which it does not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of those benefits~~Social benefits within the scope of IPSAS 42;

...

Social Benefits

7. For the purposes of this Standard, “social benefits” refer to goods, services, and other benefits provided in the pursuit of the social policy objectives of a government. These benefits may include:

- (a) The delivery of health, education, housing, transport, and other social services to the community. In many cases, there is no requirement for the beneficiaries of these services to pay an amount equivalent to the value of these services; and
- (b) Payment of benefits to families, the aged, the disabled, the unemployed, veterans, and others. That is, governments at all levels may provide financial assistance to individuals and groups in the community to access services to meet their particular needs, or to supplement their income.

8. In many cases, obligations to provide social benefits arise as a consequence of a government’s commitment to undertake particular activities on an ongoing basis over the long term in order to provide particular goods and services to the community. The need for, and nature and supply of, goods and services to meet social policy obligations will often depend on a range of demographic and social conditions, and are difficult to predict. These benefits generally fall within the social protection, education, and health classifications under the International Monetary Fund’s Government Finance Statistics framework, and often require an actuarial assessment to determine the amount of any liability arising in respect of them.

9. For a provision or contingency arising from a social benefit to be excluded from the scope of this Standard, the public sector entity providing the benefit will not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of the benefit. This exclusion would encompass those circumstances where a charge is levied in respect of the benefit, but there is no direct relationship between the charge and the benefit received. The exclusion of these provisions and contingent liabilities from the scope of this Standard reflects the Committee’s view that both (a) the determination of what constitutes the obligating event, and (b) the measurement of the liability require further consideration before proposed Standards are exposed. For example, the Committee is aware that there are differing views about whether the obligating event occurs when the individual meets the eligibility criteria for the benefit or at some earlier stage. Similarly, there are differing views about whether the amount of any obligation reflects an estimate of the current period’s entitlement, or the present value of all expected future benefits determined on an actuarial basis.

10. ~~Where an entity elects to recognize a provision for such obligations, the entity discloses the basis on which the provisions have been recognized and the measurement basis adopted. The entity also makes other disclosures required by this Standard in respect of those provisions. IPSAS 1 provides guidance on dealing with matters not specifically dealt with by another IPSAS. IPSAS 1 also includes requirements relating to the selection and disclosure of accounting policies.~~

11. ~~In some cases, social benefits may give rise to a liability for which there is:~~

- ~~(a) Little or no uncertainty as to amount; and~~
- ~~(b) The timing of the obligation is not uncertain.~~

~~Accordingly, these are not likely to meet the definition of a provision in this Standard. Where such liabilities for social benefits exist, they are recognized where they satisfy the criteria for recognition as liabilities (refer also to paragraph 19). An example would be a period-end accrual for an amount owing to the existing beneficiaries in respect of aged or disability pensions that have been approved for payment consistent with the provisions of a contract or legislation.~~

Other Exclusions from the Scope of the Standard

12. ~~This Standard does not apply to executory contracts unless they are onerous. Contracts to provide social benefits entered into with the expectation that the entity will not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of those benefits, are excluded from the scope of this Standard.~~

...

Definitions

...

Provisions and Other Liabilities

19. ~~Provisions can be distinguished from other liabilities such as payables and accruals because there is uncertainty about the timing or amount of the future expenditure required in settlement. By contrast:~~

- ~~(a) Payables are liabilities to pay for goods or services that have been received or supplied, and have been invoiced or formally agreed with the supplier (and include payments in respect of social benefits where formal agreements for specified amounts exist); and~~

...

Application of the Recognition and Measurement Rules

...

Onerous Contracts

77. ~~Paragraph 76 of this Standard applies only to contracts that are onerous. Contracts to provide social benefits entered into with the expectation that the entity does not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of those benefits, are excluded from the scope of this Standard.~~

...

Disclosure

...

99. ~~**Where an entity elects to recognize in its financial statements provisions for social benefits for which it does not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of those benefits, it shall make the disclosures required in paragraphs 97 and 98 in respect of those provisions:**~~

...

104. ~~The disclosure requirements in paragraph 100 do not apply to contingent liabilities that arise from social benefits provided by an entity for which it does not receive consideration that is approximately equal to the value of goods or services provided, directly in return from the recipients of those benefits (see paragraphs 1(a) and 7–11 for a discussion of the exclusion of social benefits from this Standard).~~

...

Effective Date

...

111I. Paragraphs 1, 12, 19, and 77 were amended and paragraphs 7–11, 99 and 104 were deleted by IPSAS 42, *Social Benefits*, issued in January 2019. An entity shall apply these amendments at the same time as it applies IPSAS 42.

...

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 19.

...

Revision of IPSAS 19 as a result of IPSAS 42, *Social Benefits*

BC3. When issued, this Standard excluded provisions and contingent liabilities “arising from social benefits provided by an entity for which it does not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of those benefits” from the scope of the Standard. This reflected the view at that time that both (a) the determination of what constitutes the obligating event, and (b) the measurement of the liability required further consideration.

BC4. This Standard did not, however, prohibit the recognition of provisions relating to social benefits, and required disclosures where an entity elected to recognize a provision for such obligations.

BC5. Following the publication of IPSAS 42, all social benefits (as defined in that Standard) will be accounted for in accordance with that Standard. This Standard has therefore been revised to exclude all social benefits within the scope of IPSAS 42.

Comparison with IAS 37

IPSAS 19 is drawn primarily from IAS 37 (1998). The main differences between IPSAS 19 and IAS 37 are as follows:

- IPSAS 19 includes commentary additional to that in IAS 37 to clarify the applicability of the standards to accounting by public sector entities. IPSAS 19 clarifies that it does not apply to social benefits within the scope of IPSAS 42, *Social Benefits*. In particular, the scope of IPSAS 19 clarifies that it does not apply to provisions and contingent liabilities arising from social benefits provided by an entity for which it does not receive consideration that is approximately equal to the value of the goods and services provided directly in return from recipients of those benefits. However, if the entity elects to recognize provisions for social benefits, IPSAS 19 requires certain disclosures in this respect.

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

Paragraph 2 is amended and paragraph 124G is added. New text is underlined and deleted text is struck through.

...

Scope

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for revenue from non-exchange transactions. This Standard does not apply to:**
 - (a) ~~A~~ a public sector combination that is a non-exchange transaction; and
 - (b) Contributions to social benefit schemes that are accounted for in accordance with paragraphs 26–31 of IPSAS 42, *Social Benefits* (the insurance approach).

...

Effective Date

...

124G. Paragraph 2 was amended by IPSAS 42, *Social Benefits*, issued in January 2019. An entity shall apply this amendment at the same time as it applies IPSAS 42.

...

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 23.

...

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. At the time that IPSAS 23 was developed, the IPSASB considered that ~~W~~ 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.

BC26A. The IPSASB reconsidered this issue in developing IPSAS 42, *Social Benefits*. The IPSASB concluded that such contributions are non-exchange transactions, and should be accounted for in accordance with this Standard. The one exception to this is where an entity elects to account for a social benefit scheme using the insurance approach. The insurance approach takes into account both cash inflows and cash outflows, and hence contributions to a social benefit scheme accounted for under the insurance approach are not accounted for as revenue under this Standard.

Amendments to IPSAS 24, *Presentation of Budget Information in Financial Statements*

Paragraph 48 is amended and paragraph 54E is added. New text is underlined.

...

Reconciliation of Actual Amounts on a Comparable Basis and Actual Amounts in 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. For example, social benefits as defined in IPSAS 42, *Social Benefits*, are limited to cash transfers. The GFS classification of social benefits is wider, and includes some individual services provided by governments.

...

Effective Date

...

54E. Paragraph 48 was amended by IPSAS 42 issued in January 2019. An entity shall apply this amendment at the same time as it applies IPSAS 42.

...

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 24.

...

Revision of IPSAS 24 as a result of IPSAS 42, *Social Benefits*

BC25. In developing IPSAS 42, *Social Benefits*, the IPSASB noted that its definition of social benefits did not include all the transactions classified as social benefits under GFS. As some public sector entities may prepare budgets using the GFS basis, the IPSASB considered that it would be helpful to preparers to include social benefits as an example of where there may be differences in the classification schemes adopted for presentation of financial statements and the budget.

Illustrative Examples

These examples accompany, but are not part of, IPSAS 24.

Statement of Comparison of Budget and Actual Amounts

For Government XX for the Year Ended December 31, 20XX

BUDGET ON CASH BASIS**(Classification of Payments by Functions)**

Note: The budget and the accounting basis is different. This Statement of Comparison of Budget and Actual Amounts is prepared on the budget basis.

(in currency units)	Budgeted Amounts		Actual Amounts on Comparable Basis	<i>*Difference: Final Budget and Actual</i>
	Original	Final		
RECEIPTS				
...				
PAYMENTS				
Health	(X)	(X)	(X)	(X)
Education	(X)	(X)	(X)	(X)
Public order/safety	(X)	(X)	(X)	(X)
<u>Social Benefits</u>	<u>(X)</u>	<u>(X)</u>	<u>(X)</u>	<u>(X)</u>
Other 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)
...				

* 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

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 1 st Year	Revised Budget in 1 st Year	1 st Year Actual on Comparable Basis	Balance Available for 2 nd Year	Target Budget for 2 nd Year	Revised Budget in 2 nd Year	2 nd Year Actual on Comparable Basis	<i>*Difference: Budget and Actual over Budget Period</i>
RECEIPTS									
...									
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)
<u>Social Benefits</u>	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
SOther 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 payments	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
NET RECEIPTS/ (PAYMENTS)	X	X	X	X	X	X	X	X	X

Amendments to IPSAS 28, *Financial Instruments: Presentation*

Paragraph 60G is added and paragraph AG23 is amended. New text is underlined and deleted text is struck through.

...

Effective date

60G. Paragraph AG23 was amended by IPSAS 42, *Social Benefits*, issued in January 2019. An entity shall apply this amendment at the same time as it applies IPSAS 42.

Application Guidance

...

Definitions (paragraphs 9–12)*Financial Assets and Financial Liabilities*

...

AG23. Statutory obligations can be accounted for in a number of ways:

- Obligations to pay income taxes are accounted for in accordance with the relevant international or national accounting standard dealing with income taxes.
- Obligations to provide social benefits are accounted for in accordance with ~~IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*~~ and IPSAS 42, *Social Benefits*.
- Other statutory obligations are accounted for in accordance with IPSAS 19.

Amendments to IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)*

Paragraph 36 is amended and paragraphs 134A, 134B and 154G are added. New text is underlined and deleted text is struck through.

...

Exemptions that Affect Fair Presentation and Compliance with Accrual Basis IPSASs during the Period of Transition

...

Three Year Transitional Relief Period for the Recognition and/or Measurement of Assets and/or Liabilities

Recognition and/or Measurement of Assets and/or Liabilities

36. Where a first-time adopter has not recognized assets and/or liabilities under its previous basis of accounting, it is not required to recognize and/or measure the following assets and/or liabilities for reporting periods beginning on a date within three years following the date of adoption of IPSASs:
- (a) Inventories (see IPSAS 12, *Inventories*);
 - (b) Investment property (see IPSAS 16, *Investment Property*);
 - (c) Property, plant and equipment (see IPSAS 17, *Property, Plant and Equipment*);
 - (d) Defined benefit plans and other long-term employee benefits (see IPSAS 39, *Employee Benefits*);
 - (e) Biological assets and agricultural produce (see IPSAS 27, *Agriculture*);
 - (f) Intangible assets (see IPSAS 31, *Intangible Assets*);
 - (g) Service concession assets and the related liabilities, either under the financial liability model or the grant of a right to the operator model (see IPSAS 32, *Service Concession Arrangements: Grantor*); ~~and~~
 - (h) Financial instruments (see IPSAS 41, *Financial Instruments*); and
 - (i) Social benefits (see IPSAS 42, *Social Benefits*).

...

Exemptions that Do Not Affect Fair Presentation and Compliance with Accrual Basis IPSASs During the Period of Adoption

...

IPSAS 42, *Social Benefits*

- 134A. On the date of adoption of IPSASs, or where a first-time adopter takes advantage of the three year transitional exemption, the date on which the exemption expires, or when the relevant liabilities are recognized and/or measured in the financial statements (whichever is earlier), a first-time adopter shall determine its initial liability for a social benefit scheme at that date in accordance with IPSAS 42.
- 134B. If the initial liability in accordance with paragraph 134A is more or less than the liability that was recognized and/or measured at the end of the comparative period under the first-time adopter's previous basis of accounting, the first-time adopter shall recognize that increase/decrease in opening accumulated surplus or deficit in the period in which the items are recognized and/or measured.

...

Effective Date

...

- 154G. Paragraph 36 was amended and paragraphs 134A and 134B were added by IPSAS 42, *Social Benefits*, issued in January 2019. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2019. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2019 it shall disclose that fact and apply IPSAS 42 at the same time.

...

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 33.

...

Exemptions that Affect Fair Presentation and Compliance with Accrual Basis IPSAS

...

IPSAS 42, Social Benefits

BC60A. The IPSASB issued IPSAS 42, Social Benefits, in January 2019. The IPSASB acknowledged that the recognition and/or measurement of liabilities related to social benefits may be challenging for some public sector entities. The IPSASB therefore agreed that a first-time adopter should be given a three year relief period for the recognition and/or measurement of liabilities related to social benefits.

...

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 33.

...

Presentation and Disclosure

...

Summary of Transitional Exemptions and Provisions Included in IPSAS 33 First-time Adoption of Accrual Basis IPSASs

IG91. The diagram below summarizes the transitional exemptions and provisions included in other accrual basis IPSASs

...

	Transitional exemption provided							
	NO	YES						
		Deemed cost	3 year transitional relief for recognition	3 year transitional relief for measurement	3 year transitional relief for recognition and/or measurement	3 year transitional relief for disclosure	Elimination of transactions, balances, revenue and expenses	Other
<u>IPSAS 42, Social Benefits</u>			√ <u>liabilities for social benefits not recognized under previous basis of accounting</u>	√ <u>liabilities for social benefits recognized under previous basis of accounting</u>				

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 42

Objective (paragraphs 1–2)

BC1. In the absence of an International Public Sector Accounting Standard (IPSAS) dealing with social benefits, public sector entities were required to develop their own accounting policies for recognizing, measuring and presenting social benefits. As a result, there may not have been consistent or appropriate reporting of transactions and obligations related to social benefits in general purpose financial statements (financial statements). Consequently, users may not have been able to obtain the information needed to identify the social benefits provided by an entity and evaluate their financial effect. The IPSASB believes that IPSAS 42 will promote consistency and comparability in how social benefits are reported by public sector entities.

Scope and Definitions (paragraphs 3–5)

History

BC2. In developing IPSAS 42, the IPSASB noted that existing IPSASs did not define social benefits. Instead, a broad description was given in IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*.

BC3. IPSAS 19 described social benefits as “goods, services, and other benefits provided in the pursuit of the social policy objectives of a government. These benefits may include:

- (a) The delivery of health, education, housing, transport, and other social services to the community. In many cases, there is no requirement for the beneficiaries of these services to pay an amount equivalent to the value of these services; and
- (b) Payment of benefits to families, the aged, the disabled, the unemployed, veterans, and others. That is, governments at all levels may provide financial assistance to individuals and groups in the community to access services to meet their particular needs, or to supplement their income.”

BC4. The IPSASB also had regard to its previous work in this area. The 2004 Invitation to Comment (ITC), *Accounting for Social Policies of Government*, sought views on how to account for a wide range of social benefits. The ITC noted that “Social benefits could also be provided under other categories of government activity (for example, Defense, Public Order and Safety and Community Amenities).” These are often referred to as “collective services” or “collective goods and services.”

BC5. Responses to the ITC supported the development of an IPSAS on social benefits. However, the IPSASB failed to reach a consensus on when a present obligation arises especially for contributory cash transfer schemes. Consequently, in 2008 the IPSASB issued Exposure Draft (ED) 34, *Social Benefits: Disclosure of Cash Transfers to Individuals or Households*, and a Consultation Paper (CP), *Social Benefits: Issues in Recognition and Measurement*. At this time the IPSASB also issued a Project Brief, *Long-Term Fiscal Sustainability*.

BC6. Respondents did not consider that the proposed disclosures in the financial statements could convey sufficient information about social benefits. Consequently, the IPSASB agreed not to proceed with ED 34.

BC7. The CP, *Social Benefits: Issues in Recognition and Measurement*, proposed a narrower definition of social benefits than had been included in the 2004 ITC. The CP included the following definition of social benefits:

“The IPSASB defines social benefits as;

- (a) Cash transfers; and
- (b) Collective and individual goods and services

that are provided by an entity to individuals or households in non-exchange transactions to protect the entire population, or a particular segment of the population, against certain social risks.”

BC8. This definition introduced the idea of social benefits being related to social risks for the first time in the IPSASB’s literature. According to this definition, not all cash transfers or collective and individual goods and services are social benefits. Only those cash transfers or collective and individual goods and services that are provided to protect the entire population, or a particular segment of the population, against certain social risks meet the definition of social benefits. The CP did not, however, define social risks.

- BC9. Despite the narrower scope and the link with social risks, the IPSASB did not reach a consensus on when a present obligation arises for social benefits within the scope of the CP. The IPSASB recognized the linkages between its work in developing *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the *Conceptual Framework*) and accounting for social benefits. The elements and recognition phase of the *Conceptual Framework* would define a liability. This definition and supporting analysis would influence the accounting for social benefits. The IPSASB therefore decided to defer further work on this topic until after the completion of the *Conceptual Framework*.
- BC10. In the interim, the IPSASB initiated a project on the long-term sustainability of public finances in 2008, based on the project brief. Recommended Practice Guideline (RPG) 1, *Reporting on the Long-Term Sustainability of an Entity's Finances* was published in 2013.
- BC11. RPG 1 provides guidance on preparing general purpose financial reports that can meet users' needs for information about the long-term fiscal sustainability of an entity, including the social benefit schemes the entity provides.
- BC12. In the context of social benefits, general purpose financial reports prepared in accordance with RPG 1 will provide information about expected obligations to be settled in the future, including obligations to individuals who have not met the eligibility criteria for a scheme, or who are not currently contributing to a scheme that would entitle them to future social benefits. RPG 1 does not address the question of whether such obligations meet the definition of a present obligation, and so should be recognized in the financial statements.
- BC13. General purpose financial reports prepared in accordance with RPG 1 will also include information about the expected resources to be realized in the future that will be used to finance social benefits. In many jurisdictions this will include future taxation income. Because an entity does not currently control these resources, they are not recognized in the financial statements.
- BC14. The IPSASB restarted its work on social benefits in 2014. The IPSASB noted that the broad scope of social benefits included in previous projects had been a factor in the IPSASB failing to reach consensus. Consequently, the IPSASB decided to adopt a narrower definition of social benefits. At this time, the IPSASB had agreed to commence work on a non-exchange expenses project; the IPSASB considered that adopting a narrower definition of social benefits would best meet the project management needs of both projects.

Role of Government Finance Statistics (GFS)

- BC15. The IPSASB considers it important to reduce differences with the statistical basis of reporting where appropriate. The IPSASB therefore considered the approach to social benefits taken in GFS.
- BC16. In developing the CP, *Recognition and Measurement of Social Benefits* (issued in 2015) the IPSASB considered that social benefits, other transfers in kind and collective services would be expected to raise similar issues regarding the recognition and measurement of liabilities and expenses. However, the IPSASB considered that different factors would arise in the recognition and measurement of transactions that address specific social risks (i.e., social benefits) and those transactions that do not. For example, the recognition and measurement of an obligation in respect of social benefits may be related to individuals satisfying eligibility criteria.
- BC17. Having reviewed the approach to social benefits taken in GFS, the IPSASB noted that the economic consequences described in GFS were likely to be similar to those in a future IPSAS. The IPSASB decided to align, as far as possible, its definition of social benefit with those in GFS. This was the approach taken in the CP, *Recognition and Measurement of Social Benefits*.
- BC18. The alignment with GFS was intended to provide clearer definitions that demarcate transactions and events which are, in substance dissimilar. It also maximized consistency between the two frameworks, in line with the IPSASB policy paper, *Process for Considering GFS Reporting Guidelines during Development of IPSASs*.

Responses to Consultation Paper, Recognition and Measurement of Social Benefits

- BC19. A majority of respondents supported the scope of the project as set out in the 2015 CP, and the IPSASB's intention to align the scope of the project, and the definitions of social benefits and social risks, with GFS. These respondents considered that alignment with GFS would assist with interpreting an IPSAS and help ensure consistency in its application.
- BC20. However, a significant minority raised concerns. The main concerns were:
- (a) Definition of social risk. A number of respondents considered that the definition of social risk was difficult to apply in practice, and that it was therefore difficult to differentiate between social benefits and certain other non-exchange expenses of government.

- (b) The boundary between social benefits and non-exchange expenses. Some respondents considered that social benefits in kind and other transfers in kind give rise to the same issues. These respondents considered that the scope of the 2015 CP creates an artificial boundary between social benefits and other non-exchange expenses.

BC21. The IPSASB considered these concerns in developing ED 63, *Social Benefits*, as follows:

- (a) The definition of social risks was reframed to fit an accounting framework as opposed to an economic/statistical framework. Although the wording of the definition was amended in ED 63, the IPSASB's intention in so doing was to clarify the meaning of the definitions for preparers, rather than to modify the risks that are considered to be social risks. The definition of social benefits was also amended to improve the clarity of the definition.
- (b) ED 63 distinguished between social risks and other risks, for example, risks related to the characteristics of geography or climate, such as the risk of an earthquake or flooding occurring. The hazards or events that give rise to these risks are not related to the characteristics of individuals and/or households, which is a distinguishing feature of social risks. The IPSASB also noted that governments' responses to social risks are often different to their response to other risks. Governments usually plan for the occurrence of social risks, with schemes, backed by legislation, in place to address these risks. By contrast, governments' responses to other risks such as geographical risks are often reactive, and may be put in place following the occurrence of an event such as flooding or an earthquake. The IPSASB considered that the reactive nature of responses to other risks was more suited to its non-exchange expenses project than this Standard. The IPSASB also noted that this approach would be consistent with the approach taken in GFS.
- (c) ED 63 distinguished between those benefits that are provided to specific individuals and/or households and those that are universally accessible. This distinction was intended to provide a more principles based, less artificial boundary between social benefits and other non-exchange expenses. Liabilities and expenses associated with social risks can be measured by reference to an individual's eligibility to receive the social benefit, which does not apply to other non-exchange expenses. In developing this boundary, the IPSASB acknowledged that social benefits and other non-exchange expenses form a continuum, and that any boundary will, to some extent, be artificial. However, the IPSASB's earlier experiences convinced the Board that a boundary would be required for a social benefits project to be manageable.

BC22. The effect of these decisions was to align the scope of ED 63, and its definitions of social benefits and social risks, with those in GFS, with the exception of universally accessible services. Universally accessible services such as a universal healthcare service are considered to be social benefits under GFS, but were outside the scope of ED 63. The IPSASB considered that outcome would satisfy the majority of respondents who supported alignment with GFS, whilst addressing the concerns of the significant minority of respondents who had concerns with the boundary between social benefits and other non-exchange expenses.

Responses to ED 63, Social Benefits

- BC23. ED 63 specifically excluded collective services and universally accessible services from the scope of social benefits, as proposed in the 2015 CP. Most respondents to ED 63 supported the proposed scope. In doing so, respondents who supported the proposed scope commented that it was important that the boundary between social benefits and universally accessible services was clearly defined. They also commented that accounting treatments for social benefits and universally accessible services should have the same conceptual basis, with any differences in treatment being related to the different nature of the transactions.
- BC24. The minority of respondents who did not support the proposed scope and definitions in ED 63 had similar concerns. These respondents considered that the scope and definitions needed to be further refined to avoid confusion and possible boundary issues or divergent accounting treatments. In particular, they considered that excluding universally accessible services from the scope of the proposed Standard could be difficult to apply, as the boundary between social benefits and universally accessible services was unclear.
- BC25. As a result of these concerns, the IPSASB decided to clarify the scope and definitions. The IPSASB noted that respondents had different understandings of the scope and definitions in ED 63. Some respondents appeared to consider that social benefits were limited to cash transfers, whereas other respondents considered that social benefits included the provision of some services.
- BC26. The IPSASB concluded that ED 63 was insufficiently clear about the definition of social benefits (and whether social benefits were limited to cash transfers), and therefore about the scope of the proposed Standard. The IPSASB also noted that in the Illustrative Examples provided in ED 63, all the transactions that satisfied the definition of a social benefit were cash transfers, whereas a number of the transactions that did not satisfy the definition of a social benefit involved the provision of services.

- BC27. The IPSASB noted that defining social benefits as cash transfers would remove much of the confusion regarding the boundary between social benefits and universally accessible services.
- BC28. The IPSASB also concluded that, when considering these transactions, there were conceptual differences between cash transfers and the provision of services. The provision of services would involve exchange transactions (for example, the expenses incurred in employing staff to provide these services or the expenses incurred in procuring goods and services from other entities). Cash transfers do not involve any additional transactions.
- BC29. For these reasons, the IPSASB concluded that the economic substance of cash transfers made to individuals and households was different to the economic substance of services provided to individuals and households. The IPSASB therefore agreed that the scope of this social benefits Standard should be limited to cash transfers.
- BC30. Following this decision, the IPSASB considered the nature of cash transfers. The IPSASB agreed that the form of the cash transfer was not important, and could include cash equivalents such as pre-paid debit cards. In this context, the IPSASB also agreed that cash transfers in the form of cash equivalents should impose no or limited restrictions on the use of the cash. The IPSASB noted that some jurisdictions using pre-paid debit cards imposed limited restrictions on the card, for example preventing its use to purchase alcohol or tobacco products. The IPSASB agreed that this type of limited restriction was not equivalent to a government directing how the cash should be used. Consequently, the IPSASB agreed that the provision of a pre-paid debit card with limited restrictions on its use was a cash transfer for the purposes of the social benefits definition.
- BC31. Some respondents to ED 63 did not see the rationale for distinguishing between social risks and other risks. These respondents proposed removing the reference to social risks in the definition of social benefits, and extending the scope of this Standard to include other benefits such as emergency relief.
- BC32. The IPSASB noted that respondents to both the CP, *Recognition and Measurement of Social Benefits* and ED 63 had generally supported the reference to social risks, which maintained consistency with GFS. The IPSASB also remained of the view that governments' responses to social risks are often different to their response to other risks (see paragraph BC21(b) above).
- BC33. For these reasons, the IPSASB decided to retain the reference to social risks in the definition of social benefits.

Approaches to Accounting for Social Benefits

- BC34. The IPSASB consulted on three approaches to accounting for social benefits in the CP, *Recognition and Measurement of Social Benefits*. These were the obligating event approach (now referred to as the general approach), the social contract approach and the insurance approach.
- BC35. The social contract approach viewed obligations to provide social benefits by governments as quasi-contractual in nature, and adopted executory contract accounting.
- BC36. In developing the CP, the IPSASB came to a preliminary view that the social contract approach was not consistent with the *Conceptual Framework*. Respondents to the CP supported this preliminary view. Respondents considered that the social contract approach would result in items that met the definition of a liability not being recognized. Consequently, respondents considered that the social contract approach would not provide information that is useful for accountability and decision-making purposes.
- BC37. The IPSASB noted the support for its preliminary view, and agreed not to proceed with the social contract approach.
- BC38. In developing the CP, the IPSASB came to a preliminary view that a combination of the general approach and (for some or all contributory schemes) the insurance approach might be required to reflect the different economic circumstances arising in respect of social benefits.
- BC39. Respondents to the CP supported this preliminary view. The IPSASB therefore agreed to develop both the general approach and the insurance approach in IPSAS 42.

Non-Exchange Expenses Project

- BC40. As noted in paragraph BC14, the IPSASB has adopted a narrower definition of social benefits, considering that this would best meet the project management needs of both the social benefits project and the non-exchange expenses project.
- BC41. The IPSASB issued a CP, *Accounting for Revenue and Non-Exchange Expenses*, in August 2017. In this CP, the IPSASB expressed a preliminary view that a performance obligation approach would be appropriate for recognizing and measuring

some types of non-exchange expense transactions. Consequently, the IPSASB considered whether such an approach could be applied to social benefits.

- BC42. The IPSASB noted that social benefits are provided where a social risk has occurred, for example an individual has become unemployed or an individual has reached retirement age. The IPSASB concluded that social risks do not involve performance of an obligation by the individual and, consequently, the performance obligation approach would not be appropriate for recognizing and measuring social benefits. For similar reasons, the IPSASB is not proposing to adopt the performance obligation approach to non-exchange expenses for universally accessible services and collective services.

General Approach (paragraphs 6–25)

Recognition

- BC43. In developing the CP, *Recognition and Measurement of Social Benefits*, the IPSASB identified five distinct points at which a case could be made for recognizing a social benefit obligation in the financial statements. These were:
- (a) Key participatory events have occurred;
 - (b) Threshold eligibility criteria have been satisfied;
 - (c) The eligibility criteria to receive the next benefit have been satisfied;
 - (d) A claim has been approved; and
 - (e) A claim is enforceable.
- BC44. The CP sought respondents' views on these possible obligating events. The CP also asked respondents whether a future IPSAS should consider that an obligating event could arise at different points, depending on the nature of the social benefit or the legal framework under which the social benefit arose.
- BC45. In reviewing the responses to the CP, the IPSASB noted that there was substantial support for the view that an obligating event could arise at different points, depending on the nature of the social benefit or the legal framework under which the social benefit arose. The IPSASB agreed to take this view into account in determining which obligating events should be included in ED 63.
- BC46. The IPSASB also noted, however, that there was no consensus as to the range of different points at which an obligating event could arise. The IPSASB therefore focused on analyzing the various obligating events by reference to the *Conceptual Framework*, noting respondents' comments where these provided evidence about a particular obligating event or raised other matters that required consideration.
- BC47. In developing the CP, the IPSASB had initially agreed that aligning the recognition and measurement of social benefits with GFS could only be considered once responses had been reviewed. Subsequently, the IPSASB noted that a range of recognition points might be appropriate under the general approach.
- BC48. If this were the case, this would implicitly reject alignment of the recognition and measurement of social benefits with GFS under the general approach. This is because, under GFS, an expense is recorded only when the payment of the social benefits is due (i.e., in line with the claim is enforceable obligating event only).
- BC49. The IPSASB also concluded that consistency with the *Conceptual Framework* should take priority over alignment with the GFS treatment. Any alignment that emerged from the IPSASB's deliberations would, therefore, be coincidental.

Requirement to Satisfy Ongoing Eligibility Criteria (Including Revalidation) Affects Recognition

- BC50. The IPSASB accepted that, at least for some social benefits, the requirement to satisfy ongoing eligibility criteria (including revalidation) affects recognition as well as measurement. This could be the case where a social benefit was intended to be provided on a "one-off" or short-term basis. The IPSASB therefore considered when it would be appropriate to recognize a liability that took account of the requirement to satisfy ongoing eligibility criteria.
- BC51. The first possible obligating event identified in the 2015 CP that took account of the requirement to satisfy ongoing eligibility criteria was that the eligibility criteria to receive the next benefit have been satisfied. Respondents to the CP gave significant support to the inclusion of this obligating event. Respondents noted that for some social benefits, the satisfaction of the eligibility criteria by a potential beneficiary would be sufficient to give rise to a legal obligation for an entity. Where this was not the case, respondents considered that this possible obligating event would give rise to a non-legally binding obligation. The IPSASB agreed with these comments.

- BC52. A small number of respondents did not support this possible obligating event, arguing that an entity still had discretion to avoid payment until a claim has been approved. These respondents commented that no government can bind its successor, and any social benefit obligation can be changed at the whim of the government in power.
- BC53. The IPSASB did not support this view. The IPSASB noted that paragraph 5.22 of the *Conceptual Framework* addressed the issue of sovereign power:
- “Sovereign power is not a rationale for concluding that an obligation does not meet the definition of a liability in this Framework. The legal position should be assessed at each reporting date to consider if an obligation is no longer binding and does not meet the definition of a liability.”
- BC54. The IPSASB concluded that a beneficiary satisfying the eligibility criteria to receive the next social benefit would give rise to a present obligation that meets the definition of a liability. Consequently, the IPSASB agreed that the ‘eligibility criteria to receive the next social benefit have been satisfied’ obligating event should be included as an obligating event in ED 63.
- BC55. The IPSASB next considered the claim has been approved and claim is enforceable obligating events. The IPSASB noted that respondents generally did not support the use of these obligating events. In particular, a significant majority of respondents opposed the use of the claim is enforceable obligating event, arguing that it would limit the recognition of a liability to those cases where a legal obligation existed. Respondents argued that this was inconsistent with the *Conceptual Framework*, which recognizes that liabilities can arise from non-legally binding obligations.
- BC56. Respondents also argued that, once eligibility criteria have been satisfied, a present obligation that the entity would have little or no realistic alternative to avoid would usually arise. Consequently, a liability would arise prior to a claim being approved or becoming enforceable.
- BC57. The IPSASB concurred with respondents’ views, and decided that, for social benefits where there was a requirement to satisfy ongoing eligibility criteria only the ‘eligibility criteria to receive the next social benefit have been satisfied’ obligating event should be included in ED 63.
- BC58. In coming to this conclusion, the IPSASB noted that there may be social benefits where the eligibility criteria are not met until a claim has been approved or is enforceable. The IPSASB considered these obligating events to be effectively subsets of the ‘eligibility criteria to receive the next social benefit have been satisfied’ obligating event. Consequently, these obligating events did not need to be separately addressed.

Requirement to Satisfy Ongoing Eligibility Criteria (Including Revalidation) Affects Measurement Only

- BC59. As noted in paragraph BC50, the IPSASB accepted that, at least for some social benefits, the requirement to satisfy ongoing eligibility criteria (including revalidation) affects recognition as well as measurement.
- BC60. In developing ED 63, the IPSASB considered whether, for some other social benefits, the requirement to satisfy ongoing eligibility criteria (including revalidation) should only affect measurement, not recognition.
- BC61. The IPSASB noted that for a liability to exist, there has to be a past event that gives rise to the liability. The IPSASB considered the nature of the past event for a social benefit and concluded that the past event is the satisfaction of all eligibility criteria, which may include being alive. Consequently, any liability that arises is only for the next social benefit. Additional liabilities only arise when all eligibility criteria are met for further social benefits.
- BC62. In coming to this conclusion, the IPSASB also had regard to a number of supporting points:
- (a) Accepting that the requirement to satisfy ongoing eligibility criteria (including revalidation) should only affect measurement, not recognition, could result in entities reporting present obligations for long-term social benefits for certain social benefit schemes (primarily old-age pensions). For other social benefit schemes, entities would recognize relatively short-term social benefits, even though for certain schemes, they may ultimately be paid to beneficiaries over a long-term horizon (e.g., income-based welfare benefits).
 - (b) Being alive is an explicit eligibility criterion for some social benefit programs, established through law or policy, and in these cases there is frequently active compliance monitoring and enforcement. Many public sector entities take active steps to periodically validate that a beneficiary is alive and actively monitor and enforce compliance with this eligibility criterion. For example, annual certifications that the beneficiary is alive may be required. Also, there may be requirements for hospitals, funeral homes, or others to report deaths. Further, many public sector entities retract social benefits improperly paid to beneficiaries who are not alive or prosecute fraudulent non-reporting of a beneficiary’s death. For other social benefit programs, being alive is an implicit eligibility criterion. Similar recovery action is taken where social benefits were improperly paid to beneficiaries who are not alive.

- (c) Meeting all eligibility requirements creates an obligation to provide a social benefit related to eligibility requirement(s) that are met, consistent with social benefit schemes where there are ongoing eligibility requirements. Typically, for an individual social benefit scheme, eligibility requirements and related social benefits are clearly established. For example, a social benefit may be paid monthly based on meeting eligibility criteria as of the end of the prior month. This would be true both for schemes that have ongoing eligibility criteria (other than being alive) and those where being alive is the only ongoing eligibility criteria.
- (d) The requirement to satisfy ongoing eligibility criteria (including revalidation) is consistent with the approach the IPSASB proposed for universally accessible services and collective services in its CP, *Accounting for Revenue and Non-Exchange Expenses*.

BC63. The IPSASB also considered paragraph 5.21 of the *Conceptual Framework*, which states (emphasis added):

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

BC64. The IPSASB considered whether, although social benefits are not exchange transactions, a liability should be recognized for social benefit schemes such as retirement benefits when threshold eligibility criteria are met. This would be as a result of legal obligations arising with the passage of time without the beneficiary having to take any further action or meet further conditions.

BC65. The IPSASB concluded this was not appropriate. Paragraph 5.21 of the *Conceptual Framework* relates solely to legal obligations in the context of exchange transactions, as indicated. Specifically, this paragraph would apply where the external party in the exchange transaction has met all of the conditions of the exchange transaction and it is unconditionally enforceable, but the public sector entity will not meet its conditions until after the reporting date.

BC66. Consequently, the IPSASB considered that the only appropriate obligating event is that all eligibility criteria for the next social benefit have been met. The IPSASB concluded that this approach, combined with the insurance approach, would recognize the nature of the social benefit and the legal framework under which the social benefit arises.

BC67. The IPSASB also considered that there would be practical difficulties with recognizing a liability prior to all eligibility criteria for the next payment (including being alive) being satisfied. The IPSASB noted that approaches such as ‘threshold eligibility criteria have been met’ are said to give rise to a non-legally binding obligation where there is a valid expectation that results in an entity having little or no realistic alternative to settling the obligation. The basis for including threshold eligibility is that a valid expectation will arise when there are no further eligibility criteria (excluding being alive) to be satisfied. The IPSASB was not convinced that this would be the case in all instances, and considered that there may be situations where:

- (a) A valid expectation that results in an entity having little or no realistic alternative to settling the obligation did not arise, even though there were no further eligibility criteria to be satisfied; or
- (b) A valid expectation that results in an entity having little or no realistic alternative to settling the obligation arose, even though there were further eligibility criteria to be satisfied.

BC68. The IPSASB considered that similar difficulties would arise with other obligating events that occur prior to all eligibility criteria being satisfied, such as ‘key participatory events have occurred’.

BC69. The IPSASB considered that, under these alternative obligating events, determining whether a valid expectation that results in an entity having little or no realistic alternative to settling the obligation has arisen could only be determined on a case by case basis. The IPSASB considered that this would result in inconsistent application of any IPSAS based on ED 63, and considered that this was a further reason for not including the ‘threshold eligibility criteria obligating event’ in ED 63.

BC70. The IPSASB concluded that only the ‘eligibility criteria for the next social benefit have been met’ recognition point should be included in ED 63, and that the accounting treatment should reflect that being alive may be an eligibility criterion (whether explicitly stated or implicit) that affects recognition.

Approach to Developing Exposure Draft 63

BC71. In coming to the conclusion that only the ‘eligibility criteria for the next social benefit have been met’ recognition point should be included in ED 63, the IPSASB did not reach consensus, with some members holding the view that other recognition points should also be included in ED 63.

- BC72. These members were of the opinion that prescribing a single recognition point applicable to all social benefits is inappropriate, as this approach:
- (a) Does not reflect the economic substance of different social benefits;
 - (b) Is not in accordance with the *Conceptual Framework*; and
 - (c) Treats “being alive” as a recognition criterion instead of a measurement criterion.
- BC73. These members therefore proposed, in an Alternative View, that the obligating event should be dependent on the economic substance of each social benefit scheme. The conceptual basis for these members’ Alternative View is set out in paragraphs BC74–BC93 below.

Conceptual Basis for Alternative View

BC74. In the view of those members, for some social benefits, recognizing a liability when the eligibility criteria for the next benefit are satisfied would be appropriate. For other social benefits, a liability should be recognized at an earlier point. For example, a liability for all remaining benefits might be recognized when an individual reaches retirement age, or a liability might be accrued over time as an individual makes contributions. Preparers would determine which obligating event is most appropriate for their individual social benefit schemes, based on their economic substance.

The Approach Set Forth in ED 63 did not Reflect the Economic Substance of Different Social Benefits and thus did not Result in Information that Meets the Needs of Financial Statement Users

- BC75. The members who proposed the Alternative View noted that the IPSASB’s constituents who responded to the Consultation Paper, *Recognition and Measurement of Social Benefits*, expressed substantial support for the view that an obligating event could arise at different points, depending on the nature of the social benefit or the legal framework under which the social benefit arose. Therefore, these members did not dispute that in some cases a liability in respect of social benefits should be recognized only when the eligibility criteria for receipt of the next benefit (but not with the inclusion of being alive) have been satisfied, but they disputed this for other cases.
- BC76. They considered that since social benefit schemes vary, they can give rise to differing expectations throughout the population as a whole. For example, a social benefit scheme designed to be funded by future beneficiaries (i.e., operating on a pay-as-you-go basis) will give rise to expectations at the reporting date of entitlement amongst current recipients and potential future recipients, for example, based on the fact that individuals have contributed in the past. A differently designed social benefit scheme may not give rise to equal expectations.
- BC77. These members accepted that the relative validity of these expectations may differ, for example expectations may be based on a legal right to receive a benefit notified to the scheme’s recipients and participants, on a long running precedent, or on other, less compelling grounds. Thus they contended that the nature of the expectations in any given case must be taken into account in the determination of whether an entity has a realistic alternative to avoid an outflow of resources when recognizing a liability in relation to social benefits.
- BC78. These members therefore considered that treating all social benefits in the same manner, regardless of different economic substance, would not provide users with the information they needed to assess social benefits.
- BC79. These members believed that financial statement users need relevant, faithfully representative information as to the economic substance of social benefits for their different decision making purposes, including, where relevant, assessing the intergenerational impacts of social benefits.
- BC80. For example, in respect of a state pension scheme designed to be funded on an inter-generational basis, the amount of the entity’s present obligation at the reporting date (excluding being alive as an entitlement criterion) to both current beneficiaries and participants provides useful information as to the magnitude as at the reporting date of pension payments that will need to be funded by future contributions from current and future participants.
- BC81. Not recognizing a liability at the reporting date beyond the next payment would not facilitate, for example, the reflection of changes in policy for state pensions (for example, raising retirement age) in the amount of the liability at a subsequent reporting date. It will also give a false message to current beneficiaries and participants as well as to future contributions as to the entity’s acknowledgement of their respective entitlements.
- BC82. Furthermore, not recognizing an obligation at the reporting date beyond the next payment does not reflect the economic substance of contributory schemes. Contributions will be shown as revenue when paid by the participant, whereas the part of the benefit that is earned with this payment will not be shown at this point in time as an obligation, but only (probably years later) when the payment is made to the then beneficiary, respectively the former participant.

The Approach Set Forth in ED 63 was not in Accordance with the IPSASB's *Conceptual Framework*

- BC83. In the view of the members who proposed an Alternative View, the approach in ED 63 would not achieve the qualitative characteristics: relevance, faithful representation, understandability or comparability.
- BC84. These members also considered that reflecting the economic substance of a social benefit is necessary to meet the qualitative characteristic of comparability, which the *Conceptual Framework* defines as “the quality of information that enables users to identify similarities in, and differences between, two sets of phenomena.” Therefore, these members disagreed with the argument of inconsistent application, as explained in paragraph BC69. In contrast these members contended that if the economic substance of the social benefits differs amongst schemes and jurisdictions, those differences should be reflected in the financial statements’ accounting for social benefits. This would be a consistent application of accounting principles to different economic phenomena resulting in different accounting outcomes.
- BC85. Consequently, these members considered that, for some social benefits, it would be appropriate to recognize a liability that exceeds the amount of benefit until the next point at which eligibility criteria are required to be satisfied. They noted that paragraph 8.15 of the IPSASB’s *Conceptual Framework* explains that disclosure (in the notes accompanying the financial statements) is not a substitute for display (on the face of a financial statement).
- BC86. They pointed out that the IPSASB’s *Conceptual Framework* states the following (emphasis added):

- 5.14. A liability is: A present obligation of the entity for an outflow of resources that results from a past event.
- 5.15. Public sector entities can have a number of obligations. A present obligation is a **legally binding obligation** (legal obligation) or **non-legally binding obligation**, which an entity has little or no realistic alternative to avoid. Obligations are not present obligations unless they are binding and there is little or no realistic alternative to avoid an outflow of resources.
- 5.20. ...For some types of non-exchange transactions, judgement will be necessary to determine whether an obligation is enforceable in law. Where it is determined that an obligation is enforceable in law, there can be no doubt that an entity has no realistic alternative to avoid the obligation and a liability exists.
- 5.25. The point at which an obligation gives rise to a liability depends on the nature of the obligation. Factors that are likely to impact on judgements whether other parties can validly conclude that the obligation is such that the entity has little or no realistic alternative to avoid an outflow of resources include:
- The nature of the past event or events that give rise to the obligation...
 - The ability of the entity to modify or change the obligation before it crystallizes...
 - There may be a correlation between the availability of funding to settle a particular obligation and the creation of a present obligation....
- 5.26. “Economic coercion”, “political necessity” or other circumstances may give rise to situations where, although the public sector entity is not legally obliged to incur an outflow of resources, the economic or political consequences of refusing to do so are such that the entity may have little or no realistic alternative to avoid an outflow of resources. Economic coercion, political necessity or other circumstances may lead to a liability arising from a non-legally binding obligation.”

- BC87. They contended that in accordance with the IPSASB’s *Conceptual Framework*, in some cases a liability may arise from a key participatory event that occurs prior to the eligibility criteria for the next benefit having been satisfied. This may be the case, for example, in respect of certain contributory social benefit schemes, or where there is a legally binding present obligation.

The Criterion “Being Alive” is not a Recognition Criterion, but a Measurement Criterion

- BC88. These members did not consider that being alive at the point at which the eligibility criteria are satisfied ahead of each payment cycle is an implicit eligibility criterion impacting the recognition of an entity’s present obligation in respect of all social benefits.
- BC89. They noted that whilst it cannot be certain that a specific individual who meets the eligibility criteria at the reporting date will be alive at the point in time the next provision of social benefit is due, it is reasonable to assume that a measurable

* This column is not required. However, a comparison between actual and the original or the final budget, clearly identified as appropriate, may be included.

number of individual beneficiaries will be alive into the future and therefore the entity can have a binding present obligation at the reporting date in respect of provision of the social benefit beyond the next due installment of the social benefit.

- BC90. They did not believe that there is a social benefit-specific imperative to treat “being alive” differently in comparison to its treatment in regard to other economic phenomena such as a pension payable as a post-employment benefit to public sector employees pursuant to IPSAS 39. Where applicable, reference to, e.g., mortality statistics etc. could equally be made in measuring liabilities for social benefits.
- BC91. These members considered that the inclusion of being alive as a recognition criterion, resulting in a present obligation for only the next due benefit for all social benefits, would distort the recognition of entity’s present obligation in relation to social benefits, for example pension schemes, since in many cases it would result in recognition of a liability for only the provision of the next social benefit. Such an approach fails to recognize the valid expectation of longevity in a given recipient population and cannot provide relevant information about social benefit schemes.
- BC92. In their view, being alive was therefore a criterion to be taken into account in the measurement of social benefit liabilities. In this context, they also noted that the material in ED 63 in regard to measurement might need further consideration in order to include being alive as a measurement criterion.
- BC93. The definition of a liability in the *Conceptual Framework* requires that an item can be measured in a way that achieves the qualitative characteristics and takes account of the constraints on information included in general purpose financial reports. The members who proposed the Alternative View recognized that accounting estimates are subject to inherent estimation uncertainty; this requirement can usually be met when recognizing liabilities existing at the reporting date for future payments for appropriate social benefits. Uncertainties as to the actual amount likely to be settled at a future date or the ability of the entity to settle would be reflected in the measurement of the liability. Uncertainties such as how many recipients will reach which age before dying are dealt with by reference to mortality statistics etc.

Arguments for Stakeholders’ Consideration in ED 63

- BC94. As a consequence of the lack of consensus, the IPSASB agreed to develop ED 63 in a manner that would allow stakeholders to consider the different arguments. The ‘eligibility criteria for the next social benefit have been met’ recognition point was included in ED 63 as all members agreed that this would be appropriate for at least some social benefits. Other recognition points were not included in ED 63 as some members considered that these recognition points would never be an appropriate recognition point for a social benefit. In agreeing to develop ED 63 in this manner, the IPSASB noted that members who supported the inclusion of other recognition points had set out their reasoning in an Alternative View. The IPSASB considered it important from a public interest perspective that this reasoning was exposed to stakeholders.
- BC95. In agreeing to develop ED 63 in this manner, the IPSASB confirmed its previously expressed view that the financial statements cannot satisfy all of a user’s information needs on social benefits. Further information about the long-term fiscal sustainability of those social benefit schemes is required. The IPSASB considered that adoption of the guidance in RPG 1 would provide users with the information they need. Consequently, the IPSASB agreed to encourage entities to prepare general purpose financial reports that provide information on the long-term sustainability of the entity’s finances. In so doing, the IPSASB also noted that such information would be equally helpful where an entity had adopted the insurance approach.

Responses to ED 63, *Social Benefits*

- BC96. The responses to ED 63 reflected the wide range of views that had surfaced during the IPSASB’s deliberations in developing ED 63. While a number of respondents supported the proposals in ED 63, a similar number supported the approach outlined in the Alternative View (see paragraphs BC71–BC93 above).
- BC97. The reasons given by respondents for supporting either the proposals in ED 63, the Alternative View, or some variation on either of these approaches generally reflected the issues the IPSASB had debated in arriving at its proposed approach.
- BC98. Where new issues were raised by respondents, these generally reflected concerns that the information that would be presented under the Alternative View could be misunderstood. One respondent was concerned that the Alternative View, by recognizing liabilities at an earlier point, might provide perverse incentives to reduce the time span of social benefits and thus avoid recognition of bigger liabilities and bigger related expenses. Similarly, one respondent was concerned that the larger liabilities that would be recognized under the Alternative View could be misleading; in their view, a forward looking approach, taking account of future benefits and contributions, is required to assess the sustainability of social benefits such as state pensions.

- BC99. The IPSASB concluded that these issues reflected the Board’s earlier debates about the users’ information needs and the qualitative characteristics.
- BC100. The IPSASB noted that there was no consensus about whether recognizing a large liability for social benefits without also recognizing an asset for the future taxation or contribution revenue that would fund the settlement of that liability would provide useful information. There were different views as to whether the recognition or non-recognition of this liability would best satisfy the qualitative characteristics of relevance, faithful representation, understandability and comparability.
- BC101. However, because the consultation process had not generated any significant new conceptual issues, the IPSASB did not consider that undertaking further work in developing the conceptual approach to social benefits would be fruitful. The long history of the IPSASB’s work on social benefits suggested that the strong views held by individuals on both sides of the argument were unlikely to be changed by any such further work at this stage.
- BC102. Consequently, the IPSASB agreed to proceed with an IPSAS based on the proposals in ED 63.
- BC103. In coming to this conclusion, the IPSASB noted that preparers’ experiences of applying an IPSAS on social benefits along with users’ experiences of using the information provided may suggest ways of better reconciling the different views that exist. The IPSASB therefore considered it likely that a post-implementation review of IPSAS 42 would be appropriate at some point in the future.
- BC104. In developing an IPSAS based on the proposals in ED 63, the IPSASB noted that many respondents, whether they supported the proposals in ED 63 or the Alternative View, were concerned that ‘being alive’ had been over-emphasized in the Exposure Draft. They considered that there were circumstances where reliance on being alive would be inappropriate. Some respondents also expressed concerns over the different treatment of ‘being alive’ in ED 63 and in IPSAS 39. However, a small minority of respondents considered that the reliance on being alive was necessary.
- BC105. The IPSASB considered these comments, and agreed to modify the requirements to reduce the emphasis on being alive. The IPSASB considered that in many cases, being alive would be an eligibility criterion, and that being alive would therefore affect recognition of a liability. The IPSASB acknowledged, however, that this might not always be the case, and that the IPSAS should reflect this.
- BC106. In making these changes, the IPSASB included additional guidance that the satisfaction of the eligibility criteria for each social benefit payment is a separate past event. Satisfaction of the eligibility criteria for a benefit beyond the next payment is a future event that does not give rise to a present obligation.
- BC107. In acknowledging that there had been significant support for the Alternative View, the IPSASB considered whether it would be appropriate to accommodate both accounting treatments in IPSAS 42. This would permit preparers to use the Alternative View for social benefit schemes where they determine that a different past event to that proposed in ED 63 is appropriate. The IPSASB concluded that this would not satisfy the qualitative characteristic of consistency, and decided not to incorporate the accounting treatment set out in the Alternative View into IPSAS 42.

Use of Term “Resources”

- BC108. In developing ED 63, the IPSASB included recognition requirements that referred to an entity having “a present obligation for an outflow of resources that results from a past event.” Following the decision to clarify that the definition of social benefits only includes cash transfers, the IPSASB debated whether the use of the term “resources” in the recognition requirements should be replaced with the term “cash transfers.” The IPSASB noted that the definition of a liability in the *Conceptual Framework* referred to “resources”, and as a consequence the Board agreed to retain that term in the recognition requirements.

Measurement

- BC109. In developing the 2015 CP, the IPSASB came to a preliminary view that, “under the obligating event approach [general approach], liabilities in respect of social benefits should be measured using the cost of fulfillment. The cost of fulfillment should reflect the estimated value of the required benefits.” The *Conceptual Framework* defines the cost of fulfillment as “the costs that the entity will incur in fulfilling the obligations represented by the liability, assuming that it does so in the least costly manner.”
- BC110. The IPSASB came to this view because:
- (a) Many social benefits liabilities will arise from non-exchange transactions. There may be no consideration on which a historical cost value could be based. Historical cost can also be difficult to apply to liabilities that may vary in amount, which may be the case with some social benefits.

- (b) It is extremely unlikely that there will be a market value for social benefits.
- (c) In the context of social benefits, the cost of release is the amount that “a third party would charge to accept the transfer of the liability.” For social benefits, a transfer of the liability will rarely be practically possible.
- (d) Assumption price “is the amount which the entity would rationally be willing to accept in exchange for assuming an existing liability.” This is not relevant to the measurement of social benefits under the general approach. Under this approach, the liability is viewed as arising as a result of the public sector entity’s own actions.

BC111. Respondents to the CP supported this view, as did respondents to ED 63. Consequently, the IPSASB agreed that liabilities in respect of social benefits should be measured using the cost of fulfillment (i.e., the social benefit payments to be made, discounted where the payment will not be made in the next year). In coming to this decision, the IPSASB agreed that the cost should refer to the cash transfer being made, and should not include other elements such as administrative costs and bank charges.

Revenue

BC112. At the time of developing IPSAS 42, the IPSASB had an ongoing project to review the requirements in all of its revenue standards. The IPSASB decided that social contributions (revenue in respect of a social benefit scheme) and similar compulsory contributions and levies would be best addressed in that project, to ensure that all revenue is accounted for on a consistent basis. However, as the IPSASB had concluded that social contributions are non-exchange transactions, the IPSASB agreed to amend IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)* to clarify that social contributions are accounted for in accordance with that Standard. The one exception to this is where an entity elects to account for a social benefit scheme using the insurance approach. The insurance approach takes into account both cash inflows and cash outflows, and hence contributions to a social benefit schemes accounted for under the insurance approach are not accounted for as revenue under IPSAS 23.

Disclosure

BC113. In developing ED 63, the IPSASB agreed that entities should disclose information that explains the characteristics of - its social benefit schemes; identifies and explains the amounts in its financial statements arising from its social benefit schemes; and quantifies and explains the future cash flows that may arise from its social benefit schemes.

BC114. The IPSASB considered whether to provide guidance on aggregating the disclosures for social benefit schemes that are not individually material. The IPSASB noted that IPSAS 1, *Presentation of Financial Statements*, contains guidance on materiality and aggregation, and concluded that no further guidance was required.

BC115. As part of the explanation of the characteristics of a social benefit scheme, the IPSASB agreed that an entity should explain how a social benefit scheme is funded. Where a scheme is funded, (whether in full or in part) by social contributions, an entity is required to provide a cross reference to the location of information on those social contributions. Although IPSAS 42 does not address social contributions (as explained in paragraph BC112 above), the IPSASB considers that users will need information about social contributions in order to make assessments of social benefit schemes. However, the IPSASB acknowledges that in some jurisdictions, social contributions for various social benefits may be collected by one entity, and the social benefits provided by another entity. In these circumstances, the entity that provides the social benefits would include a cross reference to the financial statements of the entity that collects the social contributions.

BC116. The IPSASB considered whether to require an entity to describe how its social benefit schemes may give rise to future obligations. The IPSASB decided not to require such disclosures. However, in developing ED 63 the IPSASB agreed that providing the entity’s best estimate of the projected cash outflows for the next five reporting periods would provide useful information for users of the financial statements. The IPSASB considered that such information would assist users in assessing the liquidity and solvency of the entity.

Responses to ED 63, Social Benefits

BC117. Respondents to ED 63 generally supported the proposed disclosures about the characteristics of an entity’s social benefit schemes, and the IPSASB agreed to retain these disclosures in IPSAS 42.

BC118. Most respondents also supported the proposed disclosures of the amounts in the financial statements. However, some respondents questioned the level of detail required when presenting the amounts in the financial statements. Given the likely short-term nature of the liabilities that would be recognized in respect of social benefits, these respondents did not consider that the proposed reconciliation (of the opening and closing balances of the liability) would provide any information that would not be available elsewhere in the financial statements. They considered that the requirement to present the reconciliation could be removed without any loss of information. The IPSASB concurred with the view of these

respondents that the reconciliation of the liability was not necessary. The IPSASB did consider, however, that users would need information about the expenditure on each material social benefit scheme, and agreed to require the disclosure of this information rather than the reconciliation.

- BC119. With regards to the proposed disclosure of future cash outflows, there was no consensus among respondents. Respondents, regardless of whether they supported the proposed disclosure or not, raised a number of issues:
- (a) Future cash flows are not required for other transactions (such as tax revenue).
 - (b) Financial statements report on the current position of an entity, whereas future cash outflows are part of an entity's budget forecast information, not information about the current position.
 - (c) Projections of outflows are best considered together with projections of inflows and are most useful when they are comprehensive, rather than focusing on a single social benefit scheme. In many cases, it would not be possible to project cash inflows for a single social benefit scheme as a number of social benefit schemes will be funded from the general tax take.
 - (d) Disclosing future cash outflows could imply that the future cash outflows represent a liability or obligation, which is inconsistent with the general approach.
- BC120. The IPSASB accepted the concerns raised by respondents, in particular the concern that the disclosure would go beyond reporting on the current position of an entity. Consequently, the IPSASB agreed to remove the requirement to disclose future cash outflows.
- BC121. The IPSASB considered, however, that users would need some information to help them assess how circumstances may impact social benefit schemes. The IPSASB therefore agreed to require preparers to provide a narrative disclosure explaining the demographic, economic and other external factors that affect its social benefit schemes.
- BC122. A further suggestion from respondents was that an entity should disclose where a social benefit scheme met the criteria to be accounted for using the insurance approach. The IPSASB agreed that this is important information about the characteristics of a social benefit scheme, and that an entity should disclose where the criteria for using the insurance approach had been satisfied.

Insurance Approach (paragraphs 26–31)

Application of the Insurance Approach

- BC123. In the CP, *Recognition and Measurement of Social Benefits*, the IPSASB proposed an approach based on insurance accounting for some or all contributory schemes. The IPSASB proposed that this approach should be based on the IASB's proposed IFRS Standard on insurance contracts, contained in Exposure Draft ED/2013/7, *Insurance Contracts* (June 2013). This ED has subsequently been further developed and issued as IFRS 17, *Insurance Contracts*.
- BC124. Respondents to the CP generally supported the IPSASB's proposals regarding the insurance approach, although a number of concerns were raised. Respondents considered that the insurance approach should only be applied in limited circumstances. These were that the social benefit scheme operated in a similar manner to an insurance contract, and that the scheme was funded from dedicated sources of revenue, not general taxation. Respondents considered that applying the insurance approach to other social benefit schemes would not faithfully represent the economic substance of those schemes.
- BC125. The IPSASB concurred with this view. Consequently, the IPSASB agreed that the insurance approach should only be applied where:
- (a) The social benefit scheme is intended to be fully funded from contributions; and
 - (b) There is evidence that the entity manages the scheme in the same way as an issuer of insurance contracts, including assessing the financial performance and financial position of the scheme on a regular basis.
- BC126. In developing ED 63, the IPSASB then considered whether the insurance approach should be mandatory for social benefit schemes that meet the criteria, or optional.
- BC127. The IPSASB considered that, for a social benefit scheme that meets the criteria to apply the insurance approach, that approach is expected to provide the information that best meets users' needs. In order to assess whether the entity is managing the financial performance of the social benefit scheme appropriately, users will need information as to whether the contributions are sufficient to meet the expected liabilities. Where a loss is recorded under the insurance approach, this will provide users with the information they need to question whether a scheme is sustainable without changes to contribution rates or benefits. Similarly, if a social benefit scheme has ongoing large surpluses, this will allow a debate as

to whether that scheme is being used to subsidize other expenditure, and if so, whether this is appropriate. The IPSASB initially considered that the fact that users' needs are best met by the insurance approach was the main reason for making the insurance approach mandatory.

- BC128. The insurance approach is, however, expected to be more costly and complex to implement than the general approach. Actuarial estimates may not be required under the general approach. The insurance approach will require estimates of cash inflows and cash outflows over the duration of the scheme. In addition, the IASB had only recently issued IFRS 17 and that Standard has significantly different requirements from many existing national standards dealing with insurance. Consequently, it may take some time for any practical issues to be fully identified and addressed. Applying these new requirements to social benefits would introduce a further level of complexity. The IPSASB considered that there may be cost/benefit reasons for not using the insurance approach, and that this was the main reason for making the insurance approach an optional approach.
- BC129. The IPSASB did note that, if an entity is managing a social benefit scheme as if it were a portfolio of insurance contracts, the entity may already have the information required to implement the insurance approach. It may also need that information in order to be able to effectively manage the social benefit scheme. This suggested that, where a social benefit scheme meets the criteria to be accounted for under the insurance approach, the costs associated with so doing may not be as high as it would initially appear.
- BC130. The IPSASB considered that a further advantage of making the insurance approach optional would arise where an entity is having difficulty determining whether the criteria for applying the insurance approach have been met. The entity could avoid expending additional resources to make that determination by electing to apply the general approach.
- BC131. However, the IPSASB accepted that making the insurance approach optional would carry the risk that very few entities adopt the approach, and that users would not be provided with the most appropriate information about some social benefit schemes. Social benefit schemes that could be accounted for under the insurance approach are likely to have a different economic substance to other social benefit schemes, which the general approach may not fully capture.
- BC132. On balance, the IPSASB considered that the insurance approach should be optional, based on the cost/benefit reasons given above. The IPSASB noted that this could be revisited at a future date, once entities have experience with applying the new IFRS Standard, and the insurance approach proposed in ED 63.

Responses to ED 63, *Social Benefits*

- BC133. As discussed above, ED 63 proposed that the insurance approach should be optional. Respondents to ED 63 had mixed views on the proposal, with some respondents agreeing that the insurance approach should be optional, and others proposing that the insurance approach should be mandatory where schemes satisfied the criteria.
- BC134. The IPSASB noted that the reasons given by respondents reflected the Board's earlier discussions, with the key issue being whether the benefits of the better information that the insurance approach would provide would outweigh the cost of producing that information. Some respondents were also concerned that the existence of options within IPSAS may reduce the ability of users to make comparisons between entities.
- BC135. On balance, the IPSASB considered that no new information had arisen from the responses to ED 63 that was sufficiently persuasive to lead to a modification of the proposals in ED 63. The IPSASB therefore agreed to retain the insurance approach as an optional approach in this Standard.
- BC136. However, the IPSASB also considered that it would be appropriate to keep this issue under review, given the lack of consensus amongst respondents and the likelihood of practice developing as entities gained practical experience of implementing both this Standard and IFRS 17. This practical experience may cause the IPSASB to reconsider its view on the cost-benefit balance.
- BC137. Most respondents to ED 63 agreed that the criteria for determining whether an entity was permitted to apply the insurance approach were appropriate. However, some respondents had doubts regarding the requirement that the social benefit scheme is intended to be fully funded from contributions.
- BC138. These respondents considered that there would be cases where the requirements in IFRS 17 would be appropriate where a scheme was substantially funded from contributions rather than fully funded from contributions. A particular concern was that a scheme could be classed as fully funded by an individual entity, where another entity made contributions on behalf of those who could not afford to do so, but that the scheme would not be classed as fully funded in the consolidated financial statements. These respondents considered that the management of the scheme was more significant than the funding approach.

- BC139. The IPSASB noted these concerns. The IPSASB remained of the view that a scheme that was designed to be funded in part through general taxation was not being managed in the same way as an insurance portfolio.
- BC140. However, the IPSASB agreed that where an entity made contributions on behalf of those who could not afford to do so, these should be treated as contributions and the scheme classified as being fully funded from contributions. The IPSASB agreed to include Application Guidance to clarify this point.
- BC141. Some respondents also commented that the decision as to whether the criteria for applying the insurance approach have been satisfied should focus on substance over form. The IPSASB noted that substance over form is embedded in the *Conceptual Framework* notion of faithful representation. However, the IPSASB agreed that additional Application Guidance emphasizing the need to consider substance over form in assessing the criteria for applying the insurance approach would be helpful for preparers.

Accounting Requirements

- BC142. In the CP, *Recognition and Measurement of Social Benefits*, the IPSASB proposed that the insurance approach should be based on the IASB's Exposure Draft.
- BC143. The IPSASB identified three options for introducing the insurance approach in ED 63:
- (a) Develop the insurance approach in ED 63. The IPSASB noted that this option would be consistent with the proposals in the CP, and would be tailored to social benefits. However, this option would significantly increase the duration of the project, and would not have wider application.
 - (b) Develop a separate IPSAS on insurance. The IPSASB noted that this would fill a gap in the IPSASB's literature and could address social benefits as well as having wider application. However, the IPSASB noted that such an IPSAS was not included in the IPSASB's work plan, and that developing an additional Standard would delay the social benefits project.
 - (c) Direct preparers to apply IFRS 17 (or the relevant national accounting standard dealing with insurance) by analogy to a social benefit scheme that meets the criteria for applying the insurance approach. The IPSASB noted that this would require less resources and would ensure consistency with IFRS. However, guidance on social benefit specific issues might be required.
- BC144. The IPSASB noted that the number of preparers to whom the insurance approach will be relevant is likely to be small. The IPSASB also noted that the criteria for applying the insurance approach meant that only those social benefit schemes that were very similar to insurance contracts would be affected.
- BC145. The IPSASB concluded, therefore, that the additional time and resources required to develop the insurance approach, either in ED 63 or as a separate IPSAS on insurance, could not be justified. The IPSASB agreed to direct preparers to apply IFRS 17 (or the relevant national accounting standard dealing with insurance) by analogy to a social benefit scheme:
- (a) That meets the criteria for applying the insurance approach; and
 - (b) Which the entity elects to account for under the insurance approach.
- BC146. The IPSASB then considered whether any guidance on social benefit specific issues was required when applying IFRS 17 (or the relevant national accounting standard dealing with insurance) by analogy to a social benefit scheme. In particular, the IPSASB considered whether the arrangements in IFRS 17 in respect of the discount rate and the risk adjustment were appropriate for a social benefit scheme. In considering these questions, the IPSASB agreed to limit the application of the insurance approach to those cases where an entity would be referring to IFRS 17 or a national standard that has adopted substantially the same principles as IFRS 17. This is because other standards, for example IFRS 4, *Insurance Contracts* (and national standards based on IFRS 4) may not provide information that meets users' needs and satisfy the qualitative characteristics.
- BC147. The requirements in IFRS 17 specify that the selected discount rate should adjust the future cash flows to reflect the time value of money. Such rates should be consistent with observable market prices for instruments with cash flows that are consistent with the timing, currency and liquidity of the insurance contract. The IPSASB noted that these requirements differ from those in IPSAS 39, *Employee Benefits*, where no liquidity adjustment is included in the discount rate.
- BC148. The IPSASB noted that statistical reporting uses consistent discount rates for accounting for employee benefits and social benefits. Consistency with statistical reporting would suggest adopting the approach to discount rates specified in IPSAS 39.
- BC149. The IPSASB considered the nature of a liquidity adjustment. Where financial markets are illiquid, a seller of a financial instrument may have to accept a lower price for the instrument. This may lead them to demand a higher market yield.

Longer duration insurance contracts may be seen as illiquid. In developing the CP, the IPSASB questioned whether the notion of a policy holder demanding a higher market yield is relevant where the terms of a social benefit are prescribed by government.

BC150. For these reasons, the IPSASB came to the view, in developing the CP, that the discount rate used under the insurance approach should not include a liquidity adjustment. The IPSASB took the view at that time that the discount rate approach in IPSAS 39 was appropriate. Respondents to the CP generally concurred with this view.

BC151. The IPSASB noted that IFRS 17 requires the use of a risk adjustment. In developing the CP, the IPSASB had noted that there were differing views on the appropriateness of a risk adjustment in the context of social benefits:

- 6.42 For some social security schemes, uncertainty regarding future cash flows will be relatively small. An example would be where past experience shows that the level of both contributions received and benefits provided is relatively stable. In these circumstances, information about the best estimate of the entity's liability related to the scheme may be most useful to users of the financial statements.
- 6.43 For other social security schemes, there may be significant uncertainty regarding future cash flows. In these circumstances, some consider that the use of the assumption price measurement basis may be more appropriate. They argue that information regarding the risk adjustment applied by the entity may enable users of the financial statements to better evaluate the risks borne by the entity in operating the scheme. Others consider that the use of the assumption price measurement basis is not appropriate for the public sector where there is no third party that might assume the liability. They argue that applying a risk adjustment results in an estimate other than the best estimate of the claims on the entity's resources in regard to the scheme; such an estimate may not be neutral and may therefore not satisfy the qualitative characteristic of faithful representation.

BC152. The IPSASB sought the views of respondents to the CP regarding a risk adjustment. Respondents generally considered that the cost of fulfillment measurement basis, which does not include a risk adjustment, was the most appropriate measurement basis for social benefits.

BC153. In the light of these comments, the publication of IFRS 17 by the IASB, and the decision to direct preparers to apply IFRS 17 (or the relevant national accounting standard) by analogy, the IPSASB revisited its conclusions in the CP.

BC154. The IPSASB acknowledged that the views discussed in the CP were still valid. The IPSASB also accepted that adopting the discount rate included in IPSAS 39, and not including a risk adjustment, would produce greater consistency with social benefit schemes recognized and measured using the general approach. Conversely, retaining the discount rate included in IFRS 17, and retaining the risk adjustment, might result in significantly different amounts being included in the financial statements.

BC155. In addition, the IPSASB considered that amending the requirements of IFRS 17 could only be achieved by undertaking significant due process on that standard, in order to ensure there were no unintended consequences. This would require a significant use of resources, which would defeat the IPSASB's intentions in directing preparers to apply IFRS 17 (or the relevant national accounting standard) by analogy (see paragraph BC145 above).

BC156. The IPSASB also noted that inconsistencies in the application of discount rates was a wider issue, and that a number of standard setters, including the IASB, were undertaking work on this area.

BC157. Finally, the IPSASB noted that the insurance approach was optional, not a requirement (although, as noted in paragraph BC132 above, this might be subject to review at a later date). An entity that considered the use of different discount rates problematic could elect to account for all its social benefit schemes using the general approach.

BC158. For these reasons, the IPSASB agreed not to amend the requirements in IFRS 17 when applying that standard by analogy to social benefit schemes in ED 63.

Responses to ED 63, *Social Benefits*

BC159. Respondents generally agreed with the IPSASB's proposal to direct preparers to IFRS 17 or national standards that have adopted substantially the same principles as IFRS 17:

BC160. However, a minority of respondents considered that additional guidance on applying the insurance approach to social benefits would be helpful. In particular, these respondents considered that the IPSASB should provide guidance on discount rates and risk adjustments for social benefits, as these might be different than for commercial insurance contracts.

- BC161. The IPSASB accepted that providing guidance on discount rates and risk adjustments for social benefits might assist preparers to apply the insurance approach. However, for the reasons given in paragraphs BC154–BC158 above, the IPSASB agreed not to amend the requirements in IFRS 17 when applying that standard by analogy to social benefit schemes.
- BC162. The IPSASB noted that entities would need to consider the requirements relating to discount rates and risk adjustments carefully. In particular, the risk adjustment is an entity specific adjustment, and entities will need to consider their unique circumstances in determining the risk adjustment.
- BC163. The IPSASB also noted that some national standard setters are considering how the requirements in IFRS 17 (or national standards on insurance) in respect of discount rates and risk adjustments can be applied to social benefits and similar public sector specific transactions. The IPSASB considered that it would be appropriate for entities to consider such guidance once it becomes available.

Revision of IPSAS 42 as a result of COVID-19: Deferral of Effective Dates

- BC164. The IPSASB published IPSAS 42, *Social Benefits* in January 2019. At the time this Standard was finalized, the Board decided that an entity shall apply it for annual financial statements covering periods beginning on or after January 1, 2022.
- BC165. In June 2020, the IPSASB discussed the effect of the COVID-19 pandemic on financial reporting. The Board noted that the pandemic has created significant pressures on the resources public sector entities might otherwise allocate to the implementation of IPSAS 42.
- BC166. The Board concluded that deferral during a time of significant disruption would provide much-needed operational relief to public sector entities. Therefore, the Board decided to propose a one-year deferral of the effective date of IPSAS 42.
- BC167. The Board did not propose any changes to the Standard other than the deferral of the effective date. Earlier application of the amendments will continue to be permitted.

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 42

IG1. The purpose of this Implementation Guidance is to illustrate certain aspects of the requirements of IPSAS 42.

Scope of IPSAS 42

IG2. The following diagram illustrates the scope of IPSAS 42 and the boundaries between social benefits and other transactions.

Category	Non-Exchange Expenses Project				Social Benefits		Other IPSAS/IFRS	
	Grants, Contributions and Other Transfers	Emergency Relief	Collective Services	Individual Services	Social Benefits	Employee Benefits	Contracts for Insurance	Contracts for Goods and Services
Examples	Grants to other public sector entities Grants to charities	Emergency relief Planning and preparation activities	Defense Street lighting	Education Healthcare	State pensions Unemployment benefits Income support	Employee pensions Healthcare Salaries	Vehicle insurance Private medical insurance	Purchase of goods Payment for services
Exchange or Non-Exchange Transaction?	Both	Non-Exchange	Non-Exchange	Non-Exchange	Non-Exchange	Exchange	Exchange	Exchange
Provided as cash transfers to specific individuals/households	Sometimes	Sometimes	No	No	Yes	Sometimes	No	No
Provided to specific individuals/households who meet eligibility criteria?	Sometimes	Sometimes	No	Sometimes	Yes	Yes	No	No
Mitigates effect of social risks?	No	No	No	Sometimes	Yes	Yes	No	No
Addresses needs of society as a whole?	Sometimes	No	Yes	Yes	Yes	No	No	No

Scope of Social Benefits in GFS

Recognition and Measurement of Liabilities and Expenses in IPSAS 42

IG3. **Where a retirement pension is paid monthly in arrears, will the liability at the reporting date be the same as the amount paid in the following month?**

IG4. The liability at the reporting date is unlikely to be exactly the same as the amount paid the following month. The extent of the difference will depend on the circumstances of the retirement benefit. Factors that will affect the extent of the difference include the following:

- (a) **Timing differences.** The payment in the month following the reporting date may include payments that do not form part of the liability at that reporting date. For example, an entity prepares its financial statements as at December 31. If retirement benefits are paid on the 15th of each month, the payment made on January 15 may include payments made to individuals who reached retirement age between January 1 and January 15. The payments to these individuals will not form part of the liability as at December 31, because, at that date, those individuals had not met the eligibility criteria for the retirement pension.
- (b) **Incomplete information.** The information which is used to calculate payments may be incomplete, and consequently the payment in the following month may not exactly match the liability at the reporting date. For example, payments are usually calculated a number of days prior to the payment being made. Changes in circumstances notified after that date are not reflected in the payment, but are adjusted in subsequent periods.

- IG5. In considering the liability to be recognized as at the reporting date, entities may find it helpful to refer to the discussion of materiality in IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.
- IG6. **How do breaks in meeting the eligibility criteria for a social benefit scheme affect the recognition and measurement of the liability?**
- IG7. For a social benefit scheme that has ongoing eligibility criteria (other than being alive, where this is an eligibility criterion) an individual may alternate between periods when they meet the eligibility criteria for the next social benefit payment, and periods when they do not meet those eligibility criteria. In these circumstances, each instance of an individual satisfying the eligibility criteria is recognized and measured separately.
- IG8. For example, an entity prepares its financial statements as at December 31. As at that date, an individual was unemployed, and eligible to receive unemployment benefits. Consequently, the entity has a present obligation to the individual at the reporting date. The individual finds temporary employment on January 10 and ceases to be eligible for the unemployment benefits. This employment ends on January 24, when the individual once more becomes eligible for unemployment benefits. Only the first period of unemployment might be included in the liability at the reporting date, as the eligibility criteria for the subsequent period were not satisfied until after that reporting date.

Illustrative Examples

These examples accompany, but are not part of, IPSAS 42

Scope and Definitions

Illustrating the Consequences of Applying Paragraphs 3–5 and AG1–AG10 of IPSAS 42

IE1. The following scenarios illustrate the process for determining whether a transaction is within the scope of IPSAS 42, *Social Benefits*. These scenarios portray hypothetical situations. Although some aspects of the scenarios may be present in actual fact patterns, all facts and circumstances of a particular fact pattern would need to be evaluated when applying IPSAS 42.

Example 1—Provision of Retirement Benefits to Government Employees

IE2. Employees of Province A are entitled, under the terms of their employment contracts, to retirement benefits once they reach the age of 65. The employees are required to contribute a percentage of their salary while they are employed. The retirement benefits provided are based on the final salary of the employees, and their length of service.

IE3. The retirement benefits are cash transfers provided to specific individuals who meet eligibility criteria. The retirement benefits are intended to mitigate social risks, in that they are intended to ensure that the employees have sufficient income once they reach retirement age.

IE4. However, the retirement benefits do not address the needs of society as a whole, as they are only available to former employees of Province A. The retirement benefits are paid as compensation for employment services rendered. It follows that the retirement benefits do not meet all the elements of the definition of a social benefit. Consequently, the retirement benefits are outside the scope of IPSAS 42. The retirement benefits are employee benefits, and are accounted for in accordance with IPSAS 39, *Employee Benefits*.

Example 2—Provision of State Retirement Pension

IE5. Government B pays a minimum state retirement pension to all citizens and residents who have reached the retirement age of 65. The state retirement pension is governed by legislation. Individuals are required to make contributions during their working life, based on their salary. However, the state retirement pension pays the same amount to each retiree regardless of the contributions made.

IE6. The retirement benefits are provided as cash transfers to specific individuals who meet eligibility criteria. The retirement benefits are intended to mitigate social risks, in that they are intended to ensure that individuals and households have sufficient income once they reach retirement age.

IE7. The retirement benefits address the needs of society as a whole. Paragraph AG7 of IPSAS 42 notes that the “assessment of whether a benefit is provided to mitigate the effect of social risks is made by reference to society as a whole; the benefit does not need to mitigate the effect of social risks for each recipient. An example is where a government pays a retirement pension to all those over a certain age, regardless of income or wealth, to ensure that the needs of those whose income after retirement would otherwise be insufficient are met.”

IE8. Consequently, the state retirement pension is within the scope of IPSAS 42.

Example 3—Provision of Universal Healthcare Services

IE9. Government C provides basic healthcare services to all its citizens, and to other individuals who meet residency requirements. The healthcare services are provided free at the point of delivery.

IE10. The healthcare services are provided to specific individuals who meet eligibility criteria. The healthcare services are intended to mitigate social risks, in that they are intended to ensure that the welfare of individuals and households is not adversely affected by ill health. In doing so, they address the needs of society as a whole.

IE11. However, Government C is providing services rather than cash transfers. Consequently, the healthcare services are outside the scope of IPSAS 42.

Example 4—Provision of Disability Pensions

IE12. State Government D pays disability pensions to individuals who have a permanent disability that prevents them from working, regardless of their age. A disability pension is only payable after a medical examiner certifies that the disability is permanent, and that the disability will prevent the individual affected from undertaking paid employment. The level of

disability pension is dependent on the individual, and is intended to cover basic needs and to allow the individual to pay for an appropriate level of care.

IE13. The disability pensions are provided as cash transfers to specific individuals who meet eligibility criteria. The disability pensions are intended to mitigate the social risk of ill health, in that they are intended to ensure that the welfare of individuals and households is not adversely affected by disability. In doing so, they address the needs of society as a whole.

IE14. Consequently, the disability pensions are within the scope of IPSAS 42.

Example 5–Provision of Unemployment Benefits

IE15. Province E pays unemployment benefits to individuals who are resident in the province and who become unemployed. The unemployment benefits are payable for a maximum of one year, and there is a two week ‘waiting period’ before the unemployment benefits are payable.

IE16. The unemployment benefits are provided as cash transfers to specific individuals who meet eligibility criteria. The unemployment benefits are intended to mitigate social risks, in that they are intended to ensure that individuals and households have sufficient income during periods of unemployment. In doing so, they address the needs of society as a whole.

IE17. Consequently, the unemployment benefits are within the scope of IPSAS 42.

Example 6–Provision of Emergency Relief

IE18. Following an earthquake that has caused significant damage in a region, Government F provides emergency relief to assist with reconstruction and with providing services such as temporary housing to those affected by the earthquake.

IE19. Some costs will relate to providing benefits as cash transfers to specific individuals who meet eligibility criteria. Other costs will relate to the provision of assets and services, for example the reconstruction of roads damaged by the earthquake.

IE20. The provision of assets, such as the reconstruction of roads, or services to specific individuals is not a cash transfer and consequently is outside the scope of IPSAS 42.

IE21. The emergency relief provided as cash transfers does not mitigate the effects of social risks, but instead mitigates the effects of a geographical risk – the risk of earthquake. Paragraph AG10 of IPSAS 42 explains that risks that do not relate to the characteristics of individuals and/or households – for example, risks related to the characteristics of geography or climate, such as the risk of an earthquake or flooding occurring – are not social risks. Consequently, the emergency relief is outside the scope of IPSAS 42.

IE22. Following a natural disaster, individuals and/or households may subsequently become eligible for other benefits, for example unemployment benefits. These benefits may be social benefits if they satisfy the definition of a social benefit (including the requirements that they are cash transfers and they mitigate social risks).

Example 7–Provision of Defense Services

IE23. Government G maintains an army, navy and air force to provide defense for the country.

IE24. These defense services are not cash transfers provided to specific individuals who meet eligibility criteria, but instead are collective services, in that:

- (a) They are delivered simultaneously to each member of the community or section of the community; and
- (b) Individuals cannot be excluded from the benefits of collective goods and services.

IE25. Consequently, the provision of defense services is outside the scope of IPSAS 42.

General Approach: Recognition and Measurement

Illustrating the Consequences of Applying Paragraphs 6–21 and AG11–AG18 of IPSAS 42

Example 8

IE26. The following example illustrates the process for recognizing and measuring the liability and expense for a retirement pension. This example is not based on actual transactions.

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- IE27. Government H provides a retirement pension to its citizens and permanent residents. The pension scheme pays a fixed amount of CU250 per month to each individual who has reached the retirement age of 65. Amounts are paid in full to those individuals who satisfied the eligibility criteria in full at the end of the previous month.
- IE28. Government H prepares its financial statements as at December 31. Retirement pensions are paid at the end of each month.
- IE29. As at December 31, 20X1, Government H recognized a liability for retirement pensions of CU1,950,500. During 20X2, Government H paid retirement pensions as follows:

Month(s)	Pensions Paid (CU)
January 20X2	1,950,500
February–December 20X2	22,258,000
Total	24,208,500

- IE30. During January 20X3, Government H pays retirement pensions totaling CU2,095,750.
- IE31. As at December 31, 20X2, Government H recognizes a liability for retirement pensions payable to those who satisfied the eligibility criteria at that date. Consequently, Government H recognizes a liability of CU2,095,750, the full amount of the retirement pensions paid in January.
- IE32. During 20X2, the total amount recognized as an expense is CU24,353,750. The breakdown of this amount is as follows:

	CU
Pensions paid in February 20X2 (recognized in January 20X2) to December 20X2 (recognized in November 20X2)	22,258,000
Pensions paid in January 20X3 (recognized in December 20X2)	2,095,750
Total	24,353,750

Example 9

- IE33. The following example illustrates the process for recognizing and measuring the liability and expense for a retirement pension. This example is not based on actual transactions.
- IE34. Government I provides a retirement pension to its citizens and permanent residents. The pension scheme pays a fixed amount of CU100 per month (in arrears) to each individual who has reached the retirement age of 70. Amounts are pro-rated in the months in which an individual reaches the retirement age, and in the months in which an individual dies.
- IE35. Government I prepares its financial statements as at December 31. Retirement pensions are paid at the end of each month.
- IE36. As at December 31, 20X7, Government I recognized a liability for retirement pensions of CU2,990,656. During 20X8, Government I paid retirement pensions as follows:

Month(s)	Pensions Paid (CU)
January 20X8	3,024,997
February–December 20X8	33,435,183
Total	36,460,180

- IE37. In this example, it is assumed that Government I has complete information at the date it pays retirement pensions. Consequently, the difference between the amount paid in January 20X8 (CU3,024,997) and the liability recognized as at December 31, 20X7 (CU2,990,656) represents the pro-rated retirement pensions paid to those who reached retirement age during January 20X8 (CU34,341).
- IE38. On January 31, 20X9, Government I pays retirement pensions totaling CU3,053,576. There are three elements to this payment:

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	CU
Full pensions paid to those pensioners eligible at December 31, 20X8 and remaining eligible at January 31, 20X9	2,979,600
Pro-rated pensions paid to those pensioners eligible at December 31, 20X8 who died during January 20X9	36,420
Pro-rated pensions paid to those who reached retirement age during January 20X9	37,556
Total	3,053,576

IE39. As at December 31, 20X8, Government I recognizes a liability for retirement pensions payable to those who satisfied the eligibility criteria at that date. Because its 20X8 financial statements are issued after the January 20X9 retirement pensions have been paid, Government I uses the information available at that time to prepare its financial statements.

IE40. Consequently, Government I recognizes a liability of CU3,016,020. This includes the full pensions paid to those pensioners eligible at December 31, 20X8 and remaining eligible at January 31, 20X9 (CU2,979,600) and the pro-rated pensions paid to those pensioners eligible at December 31 who died during January 20X9 (CU36,420). The liability does not include the pro-rated pensions paid to those who reached retirement age during January 20X9 because they had not satisfied the eligibility criteria as at December 31, 20X8.

IE41. During 20X8, the total amount recognized as an expense is CU36,485,544. The breakdown of this amount is as follows:

	CU
Pro-rated pensions paid to those who reached retirement age during January 20X8 (recognized in January 20X8)	34,341
Pensions paid between February 20X8 and December 20X8 and recognized in the financial year January 1, 20X8 to December 31, 20X8	33,435,183
Full pensions paid to those pensioners eligible at December 31, 20X8 and remaining eligible at January 31, 20X9 (recognized in December 20X8)	2,979,600
Pro-rated pensions paid to those pensioners eligible at December 31, 20X8 who died during January 20X9 (recognized in December 20X8)	36,420
Total	36,485,544

Example 10

IE42. The following example illustrates the process for recognizing and measuring the liability and expense for an unemployment benefit. This example is not based on actual transactions.

IE43. State Government J provides unemployment benefits to its citizens and permanent residents. The unemployment benefit scheme pays monthly amounts of 50% of an individual's previous salary, to a maximum of CU500 per month (in arrears). Unemployment benefits are payable for a maximum of eighteen months. To be eligible to receive benefits, an individual must have been in paid employment in the State for at least 100 days in the past twelve months. Eligibility commences fourteen days after the individual last worked. Amounts are pro-rated in the months in which an individual first meets the eligibility criteria, and in the months in which an individual's eligibility comes to an end (finding paid employment, becoming self-employed, expiry of the eighteen month maximum period, moving out of the State or dying).

IE44. State Government J prepares its financial statements as at June 30. Unemployment benefits are paid on the 15th day of each month.

IE45. As at June 30, 20X1, State Government J recognized a liability for unemployment benefits of CU125,067. During the financial year July 1, 20X1–June 30, 20X2, State Government J paid unemployment benefits as follows:

Month	Unemployment Benefits Paid (CU)
July 20X1	129,745
August 20X1–June 20X2	1,582,131
Total	1,711,876

IE46. In this example, it is assumed that State Government J has complete information at the date it pays unemployment benefits. Consequently, the difference between the amount paid on July 15, 20X1 (CU129,745) and the liability recognized as

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at June 30 20X1 (CU125,067) represents the pro-rated unemployment benefit paid to those who became eligible for unemployment benefits between July 1, 20X1 and July 15, 20X1 (CU4,678).

IE47. On July 15, 20X2, State Government J pays unemployment benefits totaling CU132,952. There are four elements to this payment:

	CU
Unemployment benefits paid to unemployed persons eligible at June 15, 20X2 and remaining eligible at July 15, 20X2	113,120
Pro-rated unemployment benefits paid to those unemployed persons eligible at June 15, 20X2 whose eligibility had come to an end by July 15, 20X2	9,975
Pro-rated unemployment benefits paid to those unemployed persons who became eligible between June 15, 20X2 and June 30, 20X2	5,045
Pro-rated unemployment benefits paid to those unemployed persons who became eligible between July 1, 20X2 and July 15, 20X2	4,812
Total	132,952

IE48. As at June 30, 20X2, State Government J recognizes a liability for unemployment benefits payable to those who satisfied the eligibility criteria at that date. Because its July 20X1–June 20X2 financial statements are issued after the July 20X2 unemployment benefits have been paid, State Government J uses the information available at that time to prepare its financial statements.

IE49. Consequently, State Government J recognizes a liability of CU128,140. This includes:

- (a) The unemployment benefits paid to those unemployed persons eligible at June 15, 20X2 and remaining eligible at July 15, 20X2 (CU113,120);
- (b) The pro-rated unemployment benefits paid to those unemployed persons eligible at June 15, 20X2 whose eligibility had come to an end by July 15, 20X2 (CU9,975); and
- (c) The pro-rated unemployment benefits paid to those unemployed persons who became eligible between June 15, 20X2 and June 30, 20X2 (CU5,045).

IE50. The liability does not include the pro-rated unemployment benefits paid to those who became eligible between July 1, 20X2 and July 15, 20X2 because they had not satisfied the eligibility criteria as at June 30, 20X2.

IE51. During the financial year July 1, 20X1–June 30, 20X2, the total amount recognized as an expense is CU1,714,949. The breakdown of this amount is as follows:

	CU
Pro-rated unemployment benefits paid in July 20X1 to those who became eligible between July 1, 20X1 and July 15, 20X1 (recognized in July 20X1)	4,678
Unemployment benefits paid in between August 20X1 and June 20X2 and recognized in the financial year July 1, 20X1–June 30, 20X2	1,582,131
Unemployment benefits paid in July 20X2 to unemployed persons eligible at June 15, 20X2, both those remaining eligible and those whose eligibility had come to an end by July 15, 20X2; and those unemployed persons who became eligible between June 15, 20X2 and June 30, 20X2 (recognized in June 20X2)	128,140
	1,714,949

Comparison with GFS

In developing IPSAS 42, *Social Benefits*, the IPSASB considered Government Finance Statistics (GFS) reporting guidelines.

Key similarities and differences with GFS are as follows:

- IPSAS 42 uses similar concepts as GFS. For example, the concept of “social risk” in GFS is a defined term in IPSAS 42 that underpins the definition of social benefits.
- IPSAS 42 adopts a narrower definition of social benefits than GFS. IPSAS 42 limits its definition of social benefits to cash transfers (including cash equivalents). Under GFS, social benefits can be provided in cash or in kind (for example, health services).
- Under IPSAS 42, an entity recognizes a liability for the cash transfers that the entity will make until the next point at which eligibility criteria are required to be satisfied. Generally, no such liability is recognized in GFS for social benefits although liabilities are recorded for funded social insurance schemes.
- IPSAS 42 permits relevant social benefits to be recognized and measured using the insurance approach. GFS does not include this option.
- IPSAS 42 includes disclosure requirements that are not present in GFS.

IPSAS 43—LEASES

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Financial Reporting Standard (IFRS) 16, *Leases*. Extracts from IFRS 16 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards Foundation.

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IPSAS 43—LEASES

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2022.

IPSAS 43, *Leases* was issued in January 2022.

IPSAS 43, LEASES

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Objective

1. **This Standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. The objective is to ensure that lessees and lessors provide relevant information in a manner that faithfully represents those transactions. This information gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of an entity.**
2. An entity shall consider the terms and conditions of contracts and all relevant facts and circumstances when applying this Standard. An entity shall apply this Standard consistently to contracts with similar characteristics and in similar circumstances.

Scope

3. An entity shall apply this Standard to all leases, including leases of right-of-use assets in a sublease, except for:
 - (a) Leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources;
 - (b) Leases of biological assets within the scope of IPSAS 27, *Agriculture* held by a lessee;
 - (c) Service concession arrangements within the scope of IPSAS 32, *Service Concession Arrangements: Grantor*; and
 - (d) Rights held by a lessee under licensing agreements within the scope of IPSAS 31, *Intangible Assets* for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights.
4. A lessee may, but is not required to, apply this Standard to leases of intangible assets other than those described in paragraph 3(d).

Definitions

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

The commencement date of the lease (commencement date) is the date on which a lessor makes an underlying asset available for use by a lessee.

A contract, for the purpose of this Standard, is an agreement between two or more parties that creates enforceable rights and obligations.

Economic life is either:

- (a) The period over which an asset is expected to be economically usable by one or more users; or
- (b) The number of production or similar units expected to be obtained from an asset by one or more users.

The effective date of the modification is the date when both parties agree to a lease modification.

Fair value, for the purpose of applying the lessor accounting requirements in this Standard, is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of an underlying asset.

Fixed payments are payments made by a lessee to a lessor for the right to use an underlying asset during the lease term, excluding variable lease payments.

Gross investment in the lease is the sum of:

- (a) The lease payments receivable by a lessor under a finance lease; and
- (b) Any unguaranteed residual value accruing to the lessor.

The inception date of the lease (inception date) is the earlier of the date of a lease agreement and the date of commitment by the parties to the principal terms and conditions of the lease.

Initial direct costs are incremental costs of obtaining a lease that would not have been incurred if the lease had not been obtained.

The interest rate implicit in the lease is the rate of interest that causes the present value of (a) the lease payments and (b) the unguaranteed residual value to equal the sum of (i) the fair value of the underlying asset and (ii) any initial direct costs of the lessor.

A **lease** is a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration.

Lease incentives are payments made by a lessor to a lessee associated with a lease, or the reimbursement or assumption by a lessor of costs of a lessee.

Lease modification is a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease (for example, adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term).

Lease payments are payments made by a lessee to a lessor relating to the right to use an underlying asset during the lease term, comprising the following:

- (a) Fixed payments (including in-substance fixed payments), less any lease incentives;
- (b) Variable lease payments that depend on an index or a rate;
- (c) The exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and
- (d) Payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

For the lessee, lease payments also include amounts expected to be payable by the lessee under residual value guarantees. Lease payments do not include payments allocated to non-lease components of a contract, unless the lessee elects to combine non-lease components with a lease component and to account for them as a single lease component.

For the lessor, lease payments also include any residual value guarantees provided to the lessor by the lessee, a party related to the lessee or a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee. Lease payments do not include payments allocated to non-lease components.

The **lease term** is the non-cancellable period for which a lessee has the right to use an underlying asset, together with both:

- (a) Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and
- (b) Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.

A **lessee** is an entity that obtains the right to use an underlying asset for a period of time in exchange for consideration.

The **lessee's incremental borrowing rate** is the rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment.

A **lessor** is an entity that provides the right to use an underlying asset for a period of time in exchange for consideration.

Net investment in the lease is the gross investment in the lease discounted at the interest rate implicit in the lease.

Operating lease is a lease that does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset.

Optional lease payments are payments to be made by a lessee to a lessor for the right to use an underlying asset during periods covered by an option to extend or terminate a lease that are not included in the lease term.

Period of use is the total period of time that an asset is used to fulfill a contract with a customer (including any non-consecutive periods of time).

The **residual value guarantee** is a guarantee made to a lessor by a party unrelated to the lessor that the value (or part of the value) of an underlying asset at the end of a lease will be at least a specified amount.

A **right-of-use asset** is an asset that represents a lessee's right to use an underlying asset for the lease term.

A **short-term lease** is a lease that, at the commencement date, has a lease term of 12 months or less. A lease that contains a purchase option is not a short-term lease.

A **sublease** is a transaction for which an underlying asset is re-leased by a lessee ('intermediate lessor') to a third party, and the lease ('head lease') between the head lessor and lessee remains in effect.

Underlying asset is an asset that is the subject of a lease, for which the right to use that asset has been provided by a lessor to a lessee.

Unearned finance revenue is the difference between:

- (a) The gross investment in the lease; and
- (b) The net investment in the lease.

Unguaranteed residual value is that portion of the residual value of the underlying asset, the realization of which by a lessor is not assured or is guaranteed solely by a party related to the lessor.

Variable lease payments are the portion of payments made by a lessee to a lessor for the right to use an underlying asset during the lease term that varies because of changes in facts or circumstances occurring after the commencement date, other than the passage of time.

Terms defined in other IPSASs are used in this Standard with the same meaning as in those Standards and are reproduced in the *Glossary of Defined Terms* published separately. The defined term useful life is used in this Standard with the same meaning as in IPSAS 17, *Property, Plant, and Equipment*.

Recognition Exemptions (see paragraphs AG4–AG9)

6. A lessee may elect not to apply the requirements in paragraphs 23–52 to:
 - (a) Short-term leases; and
 - (b) Leases for which the underlying asset is of low value (as described in paragraphs AG4–AG9).
7. If a lessee elects not to apply the requirements in paragraphs 23–52 to either short-term leases or leases for which the underlying asset is of low value, the lessee shall recognize the lease payments associated with those leases as an expense on either a straight-line basis over the lease term or another systematic basis. The lessee shall apply another systematic basis if that basis is more representative of the pattern of the lessee's benefit.
8. If a lessee accounts for short-term leases applying paragraph 7, the lessee shall consider the lease to be a new lease for the purposes of this Standard if:
 - (a) There is a lease modification; or
 - (b) There is any change in the lease term (for example, the lessee exercises an option not previously included in its determination of the lease term).
9. The election for short-term leases shall be made by class of underlying asset to which the right of use relates. A class of underlying asset is a grouping of underlying assets of a similar nature and use in an entity's operations. The election for leases for which the underlying asset is of low value can be made on a lease-by-lease basis.

Identifying a Lease (see paragraphs AG10–AG34)

10. **At inception of a contract, an entity shall assess whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. Paragraphs AG10–AG32 set out guidance on the assessment of whether a contract is, or contains, a lease.**
11. A period of time may be described in terms of the amount of use of an identified asset (for example, the number of production units that an item of equipment will be used to produce).
12. An entity shall reassess whether a contract is, or contains, a lease only if the terms and conditions of the contract are changed.

Separating Components of a Contract

13. For a contract that is, or contains, a lease, an entity shall account for each lease component within the contract as a lease separately from non-lease components of the contract, unless the entity applies the practical expedient in paragraph 16. Paragraphs AG33–AG34 set out guidance on separating components of a contract.

Lessee

14. For a contract that contains a lease component and one or more additional lease or non-lease components, a lessee shall allocate the consideration in the contract to each lease component on the basis of the relative stand-alone price of the lease component and the aggregate stand-alone price of the non-lease components.
15. The relative stand-alone price of lease and non-lease components shall be determined on the basis of the price the lessor, or a similar supplier, would charge an entity for that component, or a similar component, separately. If an observable stand-alone price is not readily available, the lessee shall estimate the stand-alone price, maximizing the use of observable information.
16. As a practical expedient, a lessee may elect, by class of underlying asset, not to separate non-lease components from lease components, and instead account for each lease component and any associated non-lease components as a single lease component. A lessee shall not apply this practical expedient to embedded derivatives that meet the criteria in paragraph 49 of IPSAS 41, *Financial Instruments*.
17. Unless the practical expedient in paragraph 16 is applied, a lessee shall account for non-lease components applying other applicable Standards.

Lessor

18. For a contract that contains a lease component and one or more additional lease or non-lease components, a lessor shall allocate the consideration in the contract applying IFRS 15 *Revenue from Contracts with Customers*.

Lease Term (see paragraphs AG35–AG42)

19. An entity shall determine the lease term as the non-cancellable period of a lease, together with both:
 - (a) Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and
 - (b) Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.
20. In assessing whether a lessee is reasonably certain to exercise an option to extend a lease, or not to exercise an option to terminate a lease, an entity shall consider all relevant facts and circumstances that create an economic incentive for the lessee to exercise the option to extend the lease, or not to exercise the option to terminate the lease, as described in paragraphs AG38–AG41.
21. A lessee shall reassess whether it is reasonably certain to exercise an extension option, or not to exercise a termination option, upon the occurrence of either a significant event or a significant change in circumstances that:
 - (a) Is within the control of the lessee; and
 - (b) Affects whether the lessee is reasonably certain to exercise an option not previously included in its determination of the lease term, or not to exercise an option previously included in its determination of the lease term (as described in paragraph AG42).
22. An entity shall revise the lease term if there is a change in the non-cancellable period of a lease. For example, the non-cancellable period of a lease will change if:
 - (a) The lessee exercises an option not previously included in the entity's determination of the lease term;
 - (b) The lessee does not exercise an option previously included in the entity's determination of the lease term;
 - (c) An event occurs that contractually obliges the lessee to exercise an option not previously included in the entity's determination of the lease term; or
 - (d) An event occurs that contractually prohibits the lessee from exercising an option previously included in the entity's determination of the lease term.

Lessee**Recognition**

23. **At the commencement date, a lessee shall recognize a right-of-use asset and a lease liability.**

Measurement

Initial Measurement

Initial Measurement of the Right-of-Use Asset

24. **At the commencement date, a lessee shall measure the right-of-use asset at cost.**
25. The cost of the right-of-use asset shall comprise:
- The amount of the initial measurement of the lease liability, as described in paragraph 27;
 - Any lease payments made at or before the commencement date, less any lease incentives received;
 - Any initial direct costs incurred by the lessee; and
 - An estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories. The lessee incurs the obligation for those costs either at the commencement date or as a consequence of having used the underlying asset during a particular period.
26. A lessee shall recognize the costs described in paragraph 25(d) as part of the cost of the right-of-use asset when it incurs an obligation for those costs. A lessee applies IPSAS 12, *Inventories* to costs that are incurred during a particular period as a consequence of having used the right-of-use asset to produce inventories during that period. The obligations for such costs accounted for applying this Standard or IPSAS 12 are recognized and measured applying IPSAS 19, *Provisions, Contingent Liabilities, and Contingent Assets*.

Initial Measurement of the Lease Liability

27. **At the commencement date, a lessee shall measure the lease liability at the present value of the lease payments that are not paid at that date. The lease payments shall be discounted using the interest rate implicit in the lease, if that rate can be readily determined. If that rate cannot be readily determined, the lessee shall use the lessee's incremental borrowing rate.**
28. At the commencement date, the lease payments included in the measurement of the lease liability comprise the following payments for the right to use the underlying asset during the lease term that are not paid at the commencement date:
- Fixed payments (including in-substance fixed payments as described in paragraph AG43), less any lease incentives receivable;
 - Variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date (as described in paragraph 29);
 - Amounts expected to be payable by the lessee under residual value guarantees;
 - The exercise price of a purchase option if the lessee is reasonably certain to exercise that option (assessed considering the factors described in paragraphs AG38–AG41); and
 - Payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.
29. Variable lease payments that depend on an index or a rate described in paragraph 28(b) include, for example, payments linked to a consumer price index, payments linked to a benchmark interest rate (such as LIBOR) or payments that vary to reflect changes in market rental rates.

Subsequent Measurement

Subsequent Measurement of the Right-of-Use Asset

30. **After the commencement date, a lessee shall measure the right-of-use asset applying a cost model, unless it applies either of the measurement models described in paragraphs 35 and 36.**

Cost Model

31. To apply a cost model, a lessee shall measure the right-of-use asset at cost:
- Less any accumulated depreciation and any accumulated impairment losses; and
 - Adjusted for any remeasurement of the lease liability specified in paragraph 37(c).

32. A lessee shall apply the depreciation requirements in IPSAS 17 in depreciating the right-of-use asset, subject to the requirements in paragraph 33.
33. If the lease transfers ownership of the underlying asset to the lessee by the end of the lease term or if the cost of the right-of-use asset reflects that the lessee will exercise a purchase option, the lessee shall depreciate the right-of-use asset from the commencement date to the end of the useful life of the underlying asset. Otherwise, the lessee shall depreciate the right-of-use asset from the commencement date to the earlier of the end of the useful life of the right-of-use asset or the end of the lease term.
34. A lessee shall apply IPSAS 21, *Impairment of Non-Cash-Generating Assets* or IPSAS 26, *Impairment of Cash-Generating Assets*, as appropriate, to determine whether the right-of-use asset is impaired and to account for any impairment loss identified.

Other Measurement Models

35. If a lessee applies the fair value model in IPSAS 16, *Investment Property* to its investment property, the lessee shall also apply that fair value model to right-of-use assets that meet the definition of investment property in IPSAS 16.
36. If right-of-use assets relate to a class of property, plant and equipment to which the lessee applies the revaluation model in IPSAS 17, a lessee may elect to apply that revaluation model to all of the right-of-use assets that relate to that class of property, plant and equipment.

Subsequent Measurement of the Lease Liability

37. **After the commencement date, a lessee shall measure the lease liability by:**
- (a) **Increasing the carrying amount to reflect interest on the lease liability;**
 - (b) **Reducing the carrying amount to reflect the lease payments made; and**
 - (c) **Remeasuring the carrying amount to reflect any reassessment or lease modifications specified in paragraphs 40–47, or to reflect revised in-substance fixed lease payments (see paragraph AG43).**
38. Interest on the lease liability in each period during the lease term shall be the amount that produces a constant periodic rate of interest on the remaining balance of the lease liability. The periodic rate of interest is the discount rate described in paragraph 27, or if applicable the revised discount rate described in paragraph 42, paragraph 44 or paragraph 46(c).
39. After the commencement date, a lessee shall recognize in surplus or deficit, unless the costs are included in the carrying amount of another asset applying other applicable Standards, both:
- (a) Interest on the lease liability; and
 - (b) Variable lease payments not included in the measurement of the lease liability in the period in which the event or condition that triggers those payments occurs.

Reassessment of the Lease Liability

40. After the commencement date, a lessee shall apply paragraphs 41–44 to remeasure the lease liability to reflect changes to the lease payments. A lessee shall recognize the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset. However, if the carrying amount of the right-of-use asset is reduced to zero and there is a further reduction in the measurement of the lease liability, a lessee shall recognize any remaining amount of the remeasurement in surplus or deficit.
41. A lessee shall remeasure the lease liability by discounting the revised lease payments using a revised discount rate, if either:
- (a) There is a change in the lease term, as described in paragraphs 21–22. A lessee shall determine the revised lease payments on the basis of the revised lease term; or
 - (b) There is a change in the assessment of an option to purchase the underlying asset, assessed considering the events and circumstances described in paragraphs 21–22 in the context of a purchase option. A lessee shall determine the revised lease payments to reflect the change in amounts payable under the purchase option.
42. In applying paragraph 41, a lessee shall determine the revised discount rate as the interest rate implicit in the lease for the remainder of the lease term, if that rate can be readily determined, or the lessee's incremental borrowing rate at the date of reassessment, if the interest rate implicit in the lease cannot be readily determined.

43. A lessee shall remeasure the lease liability by discounting the revised lease payments, if either:
- (a) There is a change in the amounts expected to be payable under a residual value guarantee. A lessee shall determine the revised lease payments to reflect the change in amounts expected to be payable under the residual value guarantee.
 - (b) There is a change in future lease payments resulting from a change in an index or a rate used to determine those payments, including for example a change to reflect changes in market rental rates following a market rent review. The lessee shall remeasure the lease liability to reflect those revised lease payments only when there is a change in the cash flows (i.e., when the adjustment to the lease payments takes effect). A lessee shall determine the revised lease payments for the remainder of the lease term based on the revised contractual payments.
44. In applying paragraph 43, a lessee shall use an unchanged discount rate, unless the change in lease payments results from a change in floating interest rates. In that case, the lessee shall use a revised discount rate that reflects changes in the interest rate.

Lease Modifications

45. A lessee shall account for a lease modification as a separate lease if both:
- (a) The modification increases the scope of the lease by adding the right to use one or more underlying assets; and
 - (b) The consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope and any appropriate adjustments to that stand-alone price to reflect the circumstances of the particular contract.
46. For a lease modification that is not accounted for as a separate lease, at the effective date of the lease modification a lessee shall:
- (a) Allocate the consideration in the modified contract applying paragraphs 14–17;
 - (b) Determine the lease term of the modified lease applying paragraphs 19–20; and
 - (c) Remeasure the lease liability by discounting the revised lease payments using a revised discount rate. The revised discount rate is determined as the interest rate implicit in the lease for the remainder of the lease term, if that rate can be readily determined, or the lessee’s incremental borrowing rate at the effective date of the modification, if the interest rate implicit in the lease cannot be readily determined.
47. For a lease modification that is not accounted for as a separate lease, the lessee shall account for the remeasurement of the lease liability by:
- (a) Decreasing the carrying amount of the right-of-use asset to reflect the partial or full termination of the lease for lease modifications that decrease the scope of the lease. The lessee shall recognize in surplus or deficit any gain or loss relating to the partial or full termination of the lease.
 - (b) Making a corresponding adjustment to the right-of-use asset for all other lease modifications.
48. As a practical expedient, a lessee may elect not to assess whether a rent concession that meets the conditions in paragraph 49 is a lease modification. A lessee that makes this election shall account for any change in lease payments resulting from the rent concession the same way it would account for the change applying this Standard if the change were not a lease modification.
49. The practical expedient in paragraph 48 applies only to rent concessions occurring as a direct consequence of the COVID-19 pandemic and only if all of the following conditions are met:
- (a) The change in lease payments results in revised consideration for the lease that is substantially the same as, or less than, the consideration for the lease immediately preceding the change;
 - (b) Any reduction in lease payments affects only payments originally due on or before June 30, 2022 (for example, a rent concession would meet this condition if it results in reduced lease payments on or before June 30, 2022 and increased lease payments that extend beyond June 30, 2022); and
 - (c) There is no substantive change to other terms and conditions of the lease.

Presentation

50. A lessee shall either present in the statement of financial position, or disclose in the notes:
- (a) Right-of-use assets separately from other assets. If a lessee does not present right-of-use assets separately in the statement of financial position, the lessee shall:

- (i) Include right-of-use assets within the same line item as that within which the corresponding underlying assets would be presented if they were owned; and
 - (ii) Disclose which line items in the statement of financial position include those right-of-use assets.
- (b) Lease liabilities separately from other liabilities. If the lessee does not present lease liabilities separately in the statement of financial position, the lessee shall disclose which line items in the statement of financial position include those liabilities.
51. The requirement in paragraph 50(a) does not apply to right-of-use assets that meet the definition of investment property, which shall be presented in the statement of financial position as investment property.
52. In the statement of financial performance, a lessee shall present interest expense on the lease liability separately from the depreciation charge for the right-of-use asset. Interest expense on the lease liability is a component of finance costs, which paragraph 102(b) of IPSAS 1, *Presentation of Financial Statements* requires to be presented separately in the statement of financial performance.
53. In the cash flow statement, a lessee shall classify:
- (a) Cash payments for the principal portion of the lease liability within financing activities;
 - (b) Cash payments for the interest portion of the lease liability applying the requirements in IPSAS 2, *Cash Flow Statement* for interest paid; and
 - (c) Short-term lease payments, payments for leases of low-value assets and variable lease payments not included in the measurement of the lease liability within operating activities.

Disclosure

54. **The objective of the disclosures is for lessees to disclose information in the notes that, together with the information provided in the statement of financial position, statement of financial performance and cash flow statement, gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of the lessee. Paragraphs 55–64 specify requirements on how to meet this objective.**
55. A lessee shall disclose information about its leases for which it is a lessee in a single note or separate section in its financial statements. However, a lessee need not duplicate information that is already presented elsewhere in the financial statements, provided that the information is incorporated by cross-reference in the single note or separate section about leases.
56. A lessee shall disclose the following amounts for the reporting period:
- (a) Depreciation charge for right-of-use assets by class of underlying asset;
 - (b) Interest expense on lease liabilities;
 - (c) The expense relating to short-term leases accounted for applying paragraph 7. This expense need not include the expense relating to leases with a lease term of one month or less;
 - (d) The expense relating to leases of low-value assets accounted for applying paragraph 7. This expense shall not include the expense relating to short-term leases of low-value assets included in paragraph 56(c);
 - (e) The expense relating to variable lease payments not included in the measurement of lease liabilities;
 - (f) Revenue from subleasing right-of-use assets;
 - (g) Total cash outflow for leases;
 - (h) Additions to right-of-use assets;
 - (i) Gains or losses arising from sale and leaseback transactions; and
 - (j) The carrying amount of right-of-use assets at the end of the reporting period by class of underlying asset.
57. A lessee shall provide the disclosures specified in paragraph 56 in a tabular format, unless another format is more appropriate. The amounts disclosed shall include costs that a lessee has included in the carrying amount of another asset during the reporting period.
58. A lessee shall disclose the amount of its lease commitments for short-term leases accounted for applying paragraph 7 if the portfolio of short-term leases to which it is committed at the end of the reporting period is dissimilar to the portfolio of short-term leases to which the short-term lease expense disclosed applying paragraph 56(c) relates.

59. If right-of-use assets meet the definition of investment property, a lessee shall apply the disclosure requirements in IPSAS 16. In that case, a lessee is not required to provide the disclosures in paragraph 56(a), 56(f), 56(h) or 56(j) for those right-of-use assets.
60. If a lessee measures right-of-use assets at revalued amounts applying IPSAS 17, the lessee shall disclose the information required by paragraph 92 of IPSAS 17 for those right-of-use assets.
61. A lessee shall disclose a maturity analysis of lease liabilities applying paragraphs 46 and AG12 of IPSAS 30, *Financial Instruments: Disclosures* separately from the maturity analyses of other financial liabilities.
62. In addition to the disclosures required in paragraphs 56–61, a lessee shall disclose additional qualitative and quantitative information about its leasing activities necessary to meet the disclosure objective in paragraph 54 (as described in paragraph AG49). This additional information may include, but is not limited to, information that helps users of financial statements to assess:
- (a) The nature of the lessee’s leasing activities;
 - (b) Future cash outflows to which the lessee is potentially exposed that are not reflected in the measurement of lease liabilities. This includes exposure arising from:
 - (i) Variable lease payments (as described in paragraph AG50);
 - (ii) Extension options and termination options (as described in paragraph AG51);
 - (iii) Residual value guarantees (as described in paragraph AG52); and
 - (iv) Leases not yet commenced to which the lessee is committed.
 - (c) Restrictions or covenants imposed by leases; and
 - (d) Sale and leaseback transactions (as described in paragraph AG53).
63. A lessee that accounts for short-term leases or leases of low-value assets applying paragraph 7 shall disclose that fact.
64. If a lessee applies the practical expedient in paragraph 48, the lessee shall disclose:
- (a) That it has applied the practical expedient to all rent concessions that meet the conditions in paragraph 49 or, if not applied to all such rent concessions, information about the nature of the contracts to which it has applied the practical expedient (see paragraph 2); and
 - (b) The amount recognized in surplus or deficit for the reporting period to reflect changes in lease payments that arise from rent concessions to which the lessee has applied the practical expedient in paragraph 48.

Lessor

Classification of Leases (see paragraphs AG54–AG59)

65. **A lessor shall classify each of its leases as either an operating lease or a finance lease.**
66. **A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset.**
67. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:
- (a) The lease transfers ownership of the underlying asset to the lessee by the end of the lease term;
 - (b) The lessee has the option to purchase the underlying 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 date, that the option will be exercised;
 - (c) The lease term is for the major part of the economic life of the underlying asset even if title is not transferred;
 - (d) At the inception date, the present value of the lease payments amounts to at least substantially all of the fair value of the underlying asset; and
 - (e) The underlying asset is of such a specialized nature that only the lessee can use it without major modifications.

68. Indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease are:
- (a) If the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;
 - (b) Gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (for example, in the form of a rent rebate equaling most of the sales proceeds at the end of the lease); and
 - (c) The lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.
69. The examples and indicators in paragraphs 67–68 are not always conclusive. If it is clear from other features that the lease does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset, the lease is classified as an operating lease. For example, this may be the case if ownership of the underlying asset transfers at the end of the lease for a variable payment equal to its then fair value, or if there are variable lease payments, as a result of which the lessor does not transfer substantially all such risks and rewards.
70. Lease classification is made at the inception date and is reassessed only if there is a lease modification. Changes in estimates (for example, changes in estimates of the economic life or of the residual value of the underlying asset), or changes in circumstances (for example, default by the lessee), do not give rise to a new classification of a lease for accounting purposes.

Finance Leases

Recognition and Measurement

71. **At the commencement date, a lessor shall recognize assets held under a finance lease in its statement of financial position and present them as a receivable at an amount equal to the net investment in the lease.**

Initial Measurement

72. The lessor shall use the interest rate implicit in the lease to measure the net investment in the lease. In the case of a sublease, if the interest rate implicit in the sublease cannot be readily determined, an intermediate lessor may use the discount rate used for the head lease (adjusted for any initial direct costs associated with the sublease) to measure the net investment in the sublease.
73. Initial direct costs are included in the initial measurement of the net investment in the lease and reduce the amount of revenue recognized over the lease term. The interest rate implicit in the lease is defined in such a way that the initial direct costs are included automatically in the net investment in the lease; there is no need to add them separately.

Initial Measurement of the Lease Payments Included in the Net Investment in the Lease

74. At the commencement date, the lease payments included in the measurement of the net investment in the lease comprise the following payments for the right to use the underlying asset during the lease term that are not received at the commencement date:
- (a) Fixed payments (including in-substance fixed payments as described in paragraph AG43), less any lease incentives payable;
 - (b) Variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date;
 - (c) Any residual value guarantees provided to the lessor by the lessee, a party related to the lessee or a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee;
 - (d) The exercise price of a purchase option if the lessee is reasonably certain to exercise that option (assessed considering the factors described in paragraph AG38); and
 - (e) Payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

Subsequent Measurement

75. **A lessor shall recognize finance revenue over the lease term, based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the lease.**

76. A lessor aims to allocate finance revenue over the lease term on a systematic and rational basis. A lessor shall apply the lease payments relating to the period against the gross investment in the lease to reduce both the principal and the unearned finance revenue.
77. A lessor shall apply the derecognition and impairment requirements in IPSAS 41 to the net investment in the lease. A lessor shall regularly review estimated unguaranteed residual values used in computing the gross investment in the lease. If there has been a reduction in the estimated unguaranteed residual value, the lessor shall revise the revenue allocation over the lease term and recognize immediately any reduction in respect of amounts accrued.
78. A lessor that classifies an asset under a finance lease as held for sale (or includes it in a disposal group that is classified as held for sale) applying the relevant national or international accounting standard dealing with non-current assets held for sale and discontinued operations shall account for the asset in accordance with that Standard.

Lease Modifications

79. A lessor shall account for a modification to a finance lease as a separate lease if both:
- (a) The modification increases the scope of the lease by adding the right to use one or more underlying assets; and
 - (b) The consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope and any appropriate adjustments to that stand-alone price to reflect the circumstances of the particular contract.
80. For a modification to a finance lease that is not accounted for as a separate lease, a lessor shall account for the modification as follows:
- (a) If the lease would have been classified as an operating lease had the modification been in effect at the inception date, the lessor shall:
 - (i) Account for the lease modification as a new lease from the effective date of the modification; and
 - (ii) Measure the carrying amount of the underlying asset as the net investment in the lease immediately before the effective date of the lease modification.
 - (b) Otherwise, the lessor shall apply the requirements of IPSAS 41.

Operating Leases

Recognition and Measurement

81. **A lessor shall recognize lease payments from operating leases as revenue on either a straight-line basis or another systematic basis. The lessor shall apply another systematic basis if that basis is more representative of the pattern in which benefit from the use of the underlying asset is diminished.**
82. A lessor shall recognize costs, including depreciation, incurred in earning the lease revenue as an expense.
83. A lessor shall add initial direct costs incurred in obtaining an operating lease to the carrying amount of the underlying asset and recognize those costs as an expense over the lease term on the same basis as the lease revenue.
84. The depreciation policy for depreciable underlying assets subject to operating leases shall be consistent with the lessor's normal depreciation policy for similar assets. A lessor shall calculate depreciation in accordance with IPSAS 17 and IPSAS 31.
85. A lessor shall apply IPSAS 21 or IPSAS 26, as appropriate, to determine whether an underlying asset subject to an operating lease is impaired and to account for any impairment loss identified.

Lease Modifications

86. A lessor shall account for a modification to an operating lease as a new lease from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease.

Presentation

87. A lessor shall present underlying assets subject to operating leases in its statement of financial position according to the nature of the underlying asset.

Disclosure

88. **The objective of the disclosures is for lessors to disclose information in the notes that, together with the information provided in the statement of financial position, statement of financial performance and cash flow statement, gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of the lessor. Paragraphs 89–96 specify requirements on how to meet this objective.**
89. A lessor shall disclose the following amounts for the reporting period:
- (a) For finance leases:
 - (i) Selling surplus or deficit;
 - (ii) Finance revenue on the net investment in the lease; and
 - (iii) Revenue relating to variable lease payments not included in the measurement of the net investment in the lease.
 - (b) For operating leases, lease revenue, separately disclosing revenue relating to variable lease payments that do not depend on an index or a rate.
90. A lessor shall provide the disclosures specified in paragraph 89 in a tabular format, unless another format is more appropriate.
91. A lessor shall disclose additional qualitative and quantitative information about its leasing activities necessary to meet the disclosure objective in paragraph 88. This additional information includes, but is not limited to, information that helps users of financial statements to assess:
- (a) The nature of the lessor's leasing activities; and
 - (b) How the lessor manages the risk associated with any rights it retains in underlying assets. In particular, a lessor shall disclose its risk management strategy for the rights it retains in underlying assets, including any means by which the lessor reduces that risk. Such means may include, for example, buy-back agreements, residual value guarantees or variable lease payments for use in excess of specified limits.

Finance Leases

92. A lessor shall provide a qualitative and quantitative explanation of the significant changes in the carrying amount of the net investment in finance leases.
93. A lessor shall disclose a maturity analysis of the lease payments receivable, showing the undiscounted lease payments to be received on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years. A lessor shall reconcile the undiscounted lease payments to the net investment in the lease. The reconciliation shall identify the unearned finance revenue relating to the lease payments receivable and any discounted unguaranteed residual value.

Operating Leases

94. For items of property, plant and equipment subject to an operating lease, a lessor shall apply the disclosure requirements of IPSAS 17. In applying the disclosure requirements in IPSAS 17, a lessor shall disaggregate each class of property, plant and equipment into assets subject to operating leases and assets not subject to operating leases. Accordingly, a lessor shall provide the disclosures required by IPSAS 17 for assets subject to an operating lease (by class of underlying asset) separately from owned assets held and used by the lessor.
95. A lessor shall apply the disclosure requirements in IPSAS 16, IPSAS 21 or IPSAS 26, as appropriate, IPSAS 27 and IPSAS 31 for assets subject to operating leases.
96. A lessor shall disclose a maturity analysis of lease payments, showing the undiscounted lease payments to be received on an annual basis for a minimum of each of the first five years and a total of the amounts for the remaining years.

Sale and Leaseback Transactions

97. If an entity (the seller-lessee) transfers an asset to another entity (the buyer-lessor) and leases that asset back from the buyer-lessor, both the seller-lessee and the buyer-lessor shall account for the transfer contract and the lease applying paragraphs 98–102.

Assessing Whether the Transfer of the Asset is a Sale

98. An entity shall apply the requirements for determining when a performance obligation is satisfied in IFRS 15 to determine whether the transfer of an asset is accounted for as a sale of that asset.

Transfer of the Asset is a Sale

99. If the transfer of an asset by the seller-lessee satisfies the requirements of IFRS 15 to be accounted for as a sale of the asset:
- (a) The seller-lessee shall measure the right-of-use asset arising from the leaseback at the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee. Accordingly, the seller-lessee shall recognize only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor.
 - (b) The buyer-lessor shall account for the purchase of the asset applying applicable Standards, and for the lease applying the lessor accounting requirements in this Standard.
100. If the fair value of the consideration for the sale of an asset does not equal the fair value of the asset, or if the payments for the lease are not at market rates, an entity shall make the following adjustments to measure the sale proceeds at fair value:
- (a) Any below-market terms shall be accounted for as a prepayment of lease payments; and
 - (b) Any above-market terms shall be accounted for as additional financing provided by the buyer-lessor to the seller-lessee.
101. The entity shall measure any potential adjustment required by paragraph 100 on the basis of the more readily determinable of:
- (a) The difference between the fair value of the consideration for the sale and the fair value of the asset; and
 - (b) The difference between the present value of the contractual payments for the lease and the present value of payments for the lease at market rates.

Transfer of the Asset is not a Sale

102. If the transfer of an asset by the seller-lessee does not satisfy the requirements of IFRS 15 to be accounted for as a sale of the asset:
- (a) The seller-lessee shall continue to recognize the transferred asset and shall recognize a financial liability equal to the transfer proceeds. It shall account for the financial liability applying IPSAS 41.
 - (b) The buyer-lessor shall not recognize the transferred asset and shall recognize a financial asset equal to the transfer proceeds. It shall account for the financial asset applying IPSAS 41.

Effective Date and Transition

Effective Date

103. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted for entities that apply IPSAS 41, at or before the date of initial application of this Standard. If an entity applies this Standard earlier, it shall disclose that fact.**
104. When an entity adopts the accrual basis IPSASs of accounting as defined in IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of IPSASs.
105. If a lessee elects to apply this Standard early, a lessee shall apply paragraphs 48, 49, 64, 124, 125 and 126 for annual financial statements covering periods beginning on or after February 1, 2022. Earlier application is permitted, including in financial statements not authorized for issue at January 31, 2022.

Transition

106. For the purposes of the requirements in paragraphs 103–123, the date of initial application is the beginning of the annual reporting period in which an entity first applies this Standard.

Definition of a Lease

107. As a practical expedient, an entity is not required to reassess whether a contract is, or contains, a lease at the date of initial application. Instead, the entity is permitted:
- (a) To apply this Standard to contracts that were previously identified as leases applying IPSAS 13, *Leases*. The entity shall apply the transition requirements in paragraphs 109–122 to those leases.
 - (b) To not apply this Standard to contracts that were not previously identified as containing a lease applying IPSAS 13.
108. If an entity chooses the practical expedient in paragraph 107, it shall disclose that fact and apply the practical expedient to all of its contracts. As a result, the entity shall apply the requirements in paragraphs 10–12 only to contracts entered into (or changed) on or after the date of initial application.

Lessees

109. A lessee shall apply this Standard to its leases either:
- (a) Retrospectively to each prior reporting period presented applying IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*; or
 - (b) Retrospectively with the cumulative effect of initially applying the Standard recognized at the date of initial application in accordance with paragraphs 111–117.
110. A lessee shall apply the election described in paragraph 109 consistently to all of its leases in which it is a lessee.
111. If a lessee elects to apply this Standard in accordance with paragraph 109(b), the lessee shall not restate comparative information. Instead, the lessee shall recognize the cumulative effect of initially applying this Standard as an adjustment to the opening balance of accumulated surpluses/(deficits) (or other component of net assets/equity, as appropriate) at the date of initial application.

Leases Previously Classified as Operating Leases

112. If a lessee elects to apply this Standard in accordance with paragraph 109(b), the lessee shall:
- (a) Recognize a lease liability at the date of initial application for leases previously classified as an operating lease applying IPSAS 13. The lessee shall measure that lease liability at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate at the date of initial application.
 - (b) Recognize a right-of-use asset at the date of initial application for leases previously classified as an operating lease applying IPSAS 13. The lessee shall choose, on a lease-by-lease basis, to measure that right-of-use asset at either:
 - (i) Its carrying amount as if the Standard had been applied since the commencement date, but discounted using the lessee's incremental borrowing rate at the date of initial application; or
 - (ii) An amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognized in the statement of financial position immediately before the date of initial application.
 - (c) Apply IPSAS 21 or IPSAS 26, as appropriate, to right-of-use assets at the date of initial application, unless the lessee applies the practical expedient in paragraph 114(b).
113. Notwithstanding the requirements in paragraph 112, for leases previously classified as operating leases applying IPSAS 13, a lessee:
- (a) Is not required to make any adjustments on transition for leases for which the underlying asset is of low value (as described in paragraphs AG4–AG9) that will be accounted for applying paragraph 7. The lessee shall account for those leases applying this Standard from the date of initial application.
 - (b) Is not required to make any adjustments on transition for leases previously accounted for as investment property using the fair value model in IPSAS 16. The lessee shall account for the right-of-use asset and the lease liability arising from those leases applying IPSAS 16 and this Standard from the date of initial application.
 - (c) Shall measure the right-of-use asset at fair value at the date of initial application for leases previously accounted for as operating leases applying IPSAS 13 and that will be accounted for as investment property using the fair value model in IPSAS 16 from the date of initial application. The lessee shall account for the right-of-use asset and the lease liability arising from those leases applying IPSAS 16 and this Standard from the date of initial application.

114. A lessee may use one or more of the following practical expedients when applying this Standard retrospectively in accordance with paragraph 109(b) to leases previously classified as operating leases applying IPSAS 13. A lessee is permitted to apply these practical expedients on a lease-by-lease basis:
- (a) A lessee may apply a single discount rate to a portfolio of leases with reasonably similar characteristics (such as leases with a similar remaining lease term for a similar class of underlying asset in a similar economic environment).
 - (b) A lessee may rely on its assessment of whether leases are onerous applying IPSAS 19 immediately before the date of initial application as an alternative to performing an impairment review. If a lessee chooses this practical expedient, the lessee shall adjust the right-of-use asset at the date of initial application by the amount of any provision for onerous leases recognized in the statement of financial position immediately before the date of initial application.
 - (c) A lessee may elect not to apply the requirements in paragraph 112 to leases for which the lease term ends within 12 months of the date of initial application. In this case, a lessee shall:
 - (i) Account for those leases in the same way as short-term leases as described in paragraph 7; and
 - (ii) Include the cost associated with those leases within the disclosure of short-term lease expense in the annual reporting period that includes the date of initial application.
 - (d) A lessee may exclude initial direct costs from the measurement of the right-of-use asset at the date of initial application.
 - (e) A lessee may use hindsight, such as in determining the lease term if the contract contains options to extend or terminate the lease.

Leases Previously Classified as Finance Leases

115. If a lessee elects to apply this Standard in accordance with paragraph 109(b), for leases that were classified as finance leases applying IPSAS 13, the carrying amount of the right-of-use asset and the lease liability at the date of initial application shall be the carrying amount of the lease asset and lease liability immediately before that date measured applying IPSAS 13. For those leases, a lessee shall account for the right-of-use asset and the lease liability applying this Standard from the date of initial application.

Disclosure

116. If a lessee elects to apply this Standard in accordance with paragraph 109(b), the lessee shall disclose information about initial application required by paragraph 33 of IPSAS 3, except for the information specified in paragraph 33(f) of IPSAS 3. Instead of the information specified in paragraph 33(f) of IPSAS 3, the lessee shall disclose:
- (a) The weighted average lessee's incremental borrowing rate applied to lease liabilities recognized in the statement of financial position at the date of initial application; and
 - (b) An explanation of any difference between:
 - (i) Operating lease commitments disclosed applying IPSAS 13 at the end of the annual reporting period immediately preceding the date of initial application, discounted using the incremental borrowing rate at the date of initial application as described in paragraph 112(a); and
 - (ii) Lease liabilities recognized in the statement of financial position at the date of initial application.
117. If a lessee uses one or more of the specified practical expedients in paragraph 114, it shall disclose that fact.

Lessors

118. Except as described in paragraph 119, a lessor is not required to make any adjustments on transition for leases in which it is a lessor and shall account for those leases applying this Standard from the date of initial application.
119. An intermediate lessor shall:
- (a) Reassess subleases that were classified as operating leases applying IPSAS 13 and are ongoing at the date of initial application, to determine whether each sublease should be classified as an operating lease or a finance lease applying this Standard. The intermediate lessor shall perform this assessment at the date of initial application on the basis of the remaining contractual terms and conditions of the head lease and sublease at that date.
 - (b) For subleases that were classified as operating leases applying IPSAS 13 but finance leases applying this Standard, account for the sublease as a new finance lease entered into at the date of initial application.

Sale and Leaseback Transactions Before the Date of Initial Application

120. An entity shall not reassess sale and leaseback transactions entered into before the date of initial application to determine whether the transfer of the underlying asset satisfies the requirements in IFRS 15 to be accounted for as a sale.
121. If a sale and leaseback transaction was accounted for as a sale and a finance lease applying IPSAS 13, the seller-lessee shall:
- (a) Account for the leaseback in the same way as it accounts for any other finance lease that exists at the date of initial application; and
 - (b) Continue to amortize any gain on sale over the lease term.
122. If a sale and leaseback transaction was accounted for as a sale and operating lease applying IPSAS 13, the seller-lessee shall:
- (a) Account for the leaseback in the same way as it accounts for any other operating lease that exists at the date of initial application; and
 - (b) Adjust the leaseback right-of-use asset for any deferred gains or losses that relate to off-market terms recognized in the statement of financial position immediately before the date of initial application.

Amounts Previously Recognized in Respect of Public Sector Combinations

123. If a lessee previously recognized an asset or a liability applying IPSAS 40, *Public Sector Combinations* relating to favorable or unfavorable terms of an operating lease acquired as part of a public sector combination, the lessee shall derecognize that asset or liability and adjust the carrying amount of the right-of-use asset by a corresponding amount at the date of initial application.

COVID-19-Related Rent Concessions for Lessees

124. A lessee shall apply paragraphs 48, 49, and 64 retrospectively, recognizing the cumulative effect of initially applying that amendment as an adjustment to the opening balance of accumulated surpluses/(deficits) (or other component of net assets/equity, as appropriate) at the beginning of the annual reporting period in which the lessee first applies the amendment.
125. In the reporting period in which a lessee first applies paragraph 48, 49, and 64, a lessee is not required to disclose the information required by paragraph 33(f) of IPSAS 3.
126. Applying paragraph 2 of this Standard, a lessee shall apply the practical expedient in paragraph 48 consistently to eligible contracts with similar characteristics and in similar circumstances, irrespective of whether the contract became eligible for the practical expedient as a result of the lessee applying the COVID-19-Related Rent Concessions requirements.

Withdrawal and Replacement of IPSAS 13 (December 2006)

127. This Standard supersedes IPSAS 13 issued in 2006. IPSAS 13 remains applicable until this Standard is applied or becomes effective, whichever is earlier.

Application Guidance

This Appendix is an integral part of IPSAS 43.

Portfolio Application

AG1. This Standard specifies the accounting for an individual lease. However, as a practical expedient, an entity may apply this Standard to a portfolio of leases with similar characteristics if the entity reasonably expects that the effects on the financial statements of applying this Standard to the portfolio would not differ materially from applying this Standard to the individual leases within that portfolio. If accounting for a portfolio, an entity shall use estimates and assumptions that reflect the size and composition of the portfolio.

Combination of Contracts

AG2. In applying this Standard, an entity shall combine two or more contracts entered into at or near the same time with the same counterparty (or related parties of the counterparty), and account for the contracts as a single contract if one or more of the following criteria are met:

- (a) The contracts are negotiated as a package with an overall commercial objective that cannot be understood without considering the contracts together;
- (b) The amount of consideration to be paid in one contract depends on the price or performance of the other contract; or
- (c) The rights to use underlying assets conveyed in the contracts (or some rights to use underlying assets conveyed in each of the contracts) form a single lease component as described in paragraph AG33.

Definitions (see paragraph 5)

AG3. An entity considers the substance rather than the legal form of an arrangement in determining whether it is a “contract” for the purposes of this Standard. Contracts, for the purposes of this Standard, are generally evidenced by the following (although this may differ from jurisdiction to jurisdiction):

- Contracts involve willing parties entering into an arrangement;
- The terms of the contract create rights and obligations for the parties to the contract, and those rights and obligations need not result in equal performance by each party; and
- The remedy for non-performance is enforceable by law.

Recognition Exemption: Leases for Which the Underlying Asset is of Low Value (paragraphs 6–9)

AG4. Except as specified in paragraph AG8, this Standard permits a lessee to apply paragraph 7 to account for leases for which the underlying asset is of low value. A lessee shall assess the value of an underlying asset based on the value of the asset when it is new, regardless of the age of the asset being leased.

AG5. The assessment of whether an underlying asset is of low value is performed on an absolute basis. Leases of low-value assets qualify for the accounting treatment in paragraph 7 regardless of whether those leases are material to the lessee. The assessment is not affected by the size, nature or circumstances of the lessee. Accordingly, different lessees are expected to reach similar conclusions about whether a particular underlying asset is of low value.

AG6. An underlying asset can be of low value only if:

- (a) The lessee can benefit from use of the underlying asset on its own or together with other resources that are readily available to the lessee; and
- (b) The underlying asset is not highly dependent on, or highly interrelated with, other assets.

AG7. A lease of an underlying asset does not qualify as a lease of a low-value asset if the nature of the asset is such that, when new, the asset is typically not of low value. For example, leases of cars would not qualify as leases of low-value assets because a new car would typically not be of low value.

AG8. If a lessee subleases an asset, or expects to sublease an asset, the head lease does not qualify as a lease of a low-value asset.

AG9. Examples of low-value underlying assets can include tablet and personal computers, small items of office furniture and telephones.

Identifying a Lease (paragraphs 10–12)

AG10. To assess whether a contract conveys the right to control the use of an identified asset (see paragraphs AG14–AG21) for a period of time, an entity shall assess whether, throughout the period of use, the customer has both of the following:

- (a) The right to obtain substantially all of the economic benefits or service potential from use of the identified asset (as described in paragraphs AG22–AG24); and
- (b) The right to direct the use of the identified asset (as described in paragraphs AG25–AG31).

AG11. If the customer has the right to control the use of an identified asset for only a portion of the term of the contract, the contract contains a lease for that portion of the term.

AG12. A contract to receive goods or services may be entered into by a joint arrangement, or on behalf of a joint arrangement, as defined in IPSAS 37, *Joint Arrangements*. In this case, the joint arrangement is considered to be the customer in the contract. Accordingly, in assessing whether such a contract contains a lease, an entity shall assess whether the joint arrangement has the right to control the use of an identified asset throughout the period of use.

AG13. An entity shall assess whether a contract contains a lease for each potential separate lease component. Refer to paragraph AG33 for guidance on separate lease components.

Identified Asset

AG14. An asset is typically identified by being explicitly specified in a contract. However, an asset can also be identified by being implicitly specified at the time that the asset is made available for use by the customer.

Substantive Substitution Rights

AG15. Even if an asset is specified, a customer does not have the right to use an identified asset if the supplier has the substantive right to substitute the asset throughout the period of use. A supplier's right to substitute an asset is substantive only if both of the following conditions exist:

- (a) The supplier has the practical ability to substitute alternative assets throughout the period of use (for example, the customer cannot prevent the supplier from substituting the asset and alternative assets are readily available to the supplier or could be sourced by the supplier within a reasonable period of time); and
- (b) The supplier would benefit economically from the exercise of its right to substitute the asset (i.e., the economic benefits associated with substituting the asset are expected to exceed the costs associated with substituting the asset).

AG16. If the supplier has a right or an obligation to substitute the asset only on or after either a particular date or the occurrence of a specified event, the supplier's substitution right is not substantive because the supplier does not have the practical ability to substitute alternative assets throughout the period of use.

AG17. An entity's evaluation of whether a supplier's substitution right is substantive is based on facts and circumstances at inception of the contract and shall exclude consideration of future events that, at inception of the contract, are not considered likely to occur. Examples of future events that, at inception of the contract, would not be considered likely to occur and, thus, should be excluded from the evaluation include:

- (a) An agreement by a future customer to pay an above market rate for use of the asset;
- (b) The introduction of new technology that is not substantially developed at inception of the contract;
- (c) A substantial difference between the customer's use of the asset, or the performance of the asset, and the use or performance considered likely at inception of the contract; and
- (d) A substantial difference between the market price of the asset during the period of use, and the market price considered likely at inception of the contract.

AG18. If the asset is located at the customer's premises or elsewhere, the costs associated with substitution are generally higher than when located at the supplier's premises and, therefore, are more likely to exceed the benefits associated with substituting the asset.

- AG19. The supplier's right or obligation to substitute the asset for repairs and maintenance, if the asset is not operating properly or if a technical upgrade becomes available does not preclude the customer from having the right to use an identified asset.
- AG20. If the customer cannot readily determine whether the supplier has a substantive substitution right, the customer shall presume that any substitution right is not substantive.

Portions of Assets

- AG21. A capacity portion of an asset is an identified asset if it is physically distinct (for example, a floor of a building). A capacity or other portion of an asset that is not physically distinct (for example, a capacity portion of a fiber optic cable) is not an identified asset, unless it represents substantially all of the capacity of the asset and thereby provides the customer with the right to obtain substantially all of the economic benefits or service potential from use of the asset.

Right to Obtain Economic Benefits or Service Potential from Use

- AG22. To control the use of an identified asset, a customer is required to have the right to obtain substantially all of the economic benefits or service potential from use of the asset throughout the period of use (for example, by having exclusive use of the asset throughout that period). A customer can obtain economic benefits or service potential from use of an asset directly or indirectly in many ways, such as by using, holding or sub-leasing the asset. The economic benefits or service potential from use of an asset include its primary output and by-products (including potential cash flows derived from these items), and other economic benefits or service potential from using the asset that could be realized from a commercial transaction with a third party.
- AG23. When assessing the right to obtain substantially all of the economic benefits or service potential from use of an asset, an entity shall consider the economic benefits or service potential that result from use of the asset within the defined scope of a customer's right to use the asset (see paragraph AG31). For example:
- (a) If a contract limits the use of a motor vehicle to only one particular territory during the period of use, an entity shall consider only the economic benefits or service potential from use of the motor vehicle within that territory, and not beyond.
 - (b) If a contract specifies that a customer can drive a motor vehicle only up to a particular number of miles during the period of use, an entity shall consider only the economic benefits or service potential from use of the motor vehicle for the permitted mileage, and not beyond.
- AG24. If a contract requires a customer to pay the supplier or another party a portion of the cash flows derived from use of an asset as consideration, those cash flows paid as consideration shall be considered to be part of the economic benefits that the customer obtains from use of the asset. For example, if the customer is required to pay the supplier a percentage of sales from use of space as consideration for that use, that requirement does not prevent the customer from having the right to obtain substantially all of the economic benefits from use of the space. This is because the cash flows arising from those sales are considered to be economic benefits that the customer obtains from use of the space, a portion of which it then pays to the supplier as consideration for the right to use that space.

Right to Direct the Use

- AG25. A customer has the right to direct the use of an identified asset throughout the period of use only if either:
- (a) The customer has the right to direct how and for what purpose the asset is used throughout the period of use (as described in paragraphs AG26–AG31); or
 - (b) The relevant decisions about how and for what purpose the asset is used are predetermined and:
 - (i) The customer has the right to operate the asset (or to direct others to operate the asset in a manner that it determines) throughout the period of use, without the supplier having the right to change those operating instructions; or
 - (ii) The customer designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used throughout the period of use.

How and For What Purpose the Asset is Used

- AG26. A customer has the right to direct how and for what purpose the asset is used if, within the scope of its right of use defined in the contract, it can change how and for what purpose the asset is used throughout the period of use. In making this assessment, an entity considers the decision-making rights that are most relevant to changing how and for what purpose the asset is used throughout the period of use. Decision-making rights are relevant when they affect the economic benefits or service potential to be derived from use. The decision-making rights that are most relevant are likely to be different for different contracts, depending on the nature of the asset and the terms and conditions of the contract.
- AG27. Examples of decision-making rights that, depending on the circumstances, grant the right to change how and for what purpose the asset is used, within the defined scope of the customer's right of use, include:
- (a) Rights to change the type of output that is produced by the asset (for example, to decide whether to use a shipping container to transport goods or for storage, or to decide upon the mix of products sold from a tourism outlet);
 - (b) Rights to change when the output is produced (for example, to decide when an item of machinery or a power plant will be used);
 - (c) Rights to change where the output is produced (for example, to decide upon the destination of a truck or a ship, or to decide where an item of equipment is used); and
 - (d) Rights to change whether the output is produced, and the quantity of that output (for example, to decide whether to produce energy from a power plant and how much energy to produce from that power plant).
- AG28. Examples of decision-making rights that do not grant the right to change how and for what purpose the asset is used include rights that are limited to operating or maintaining the asset. Such rights can be held by the customer or the supplier. Although rights such as those to operate or maintain an asset are often essential to the efficient use of an asset, they are not rights to direct how and for what purpose the asset is used and are often dependent on the decisions about how and for what purpose the asset is used. However, rights to operate an asset may grant the customer the right to direct the use of the asset if the relevant decisions about how and for what purpose the asset is used are predetermined (see paragraph AG25(b)(i)).

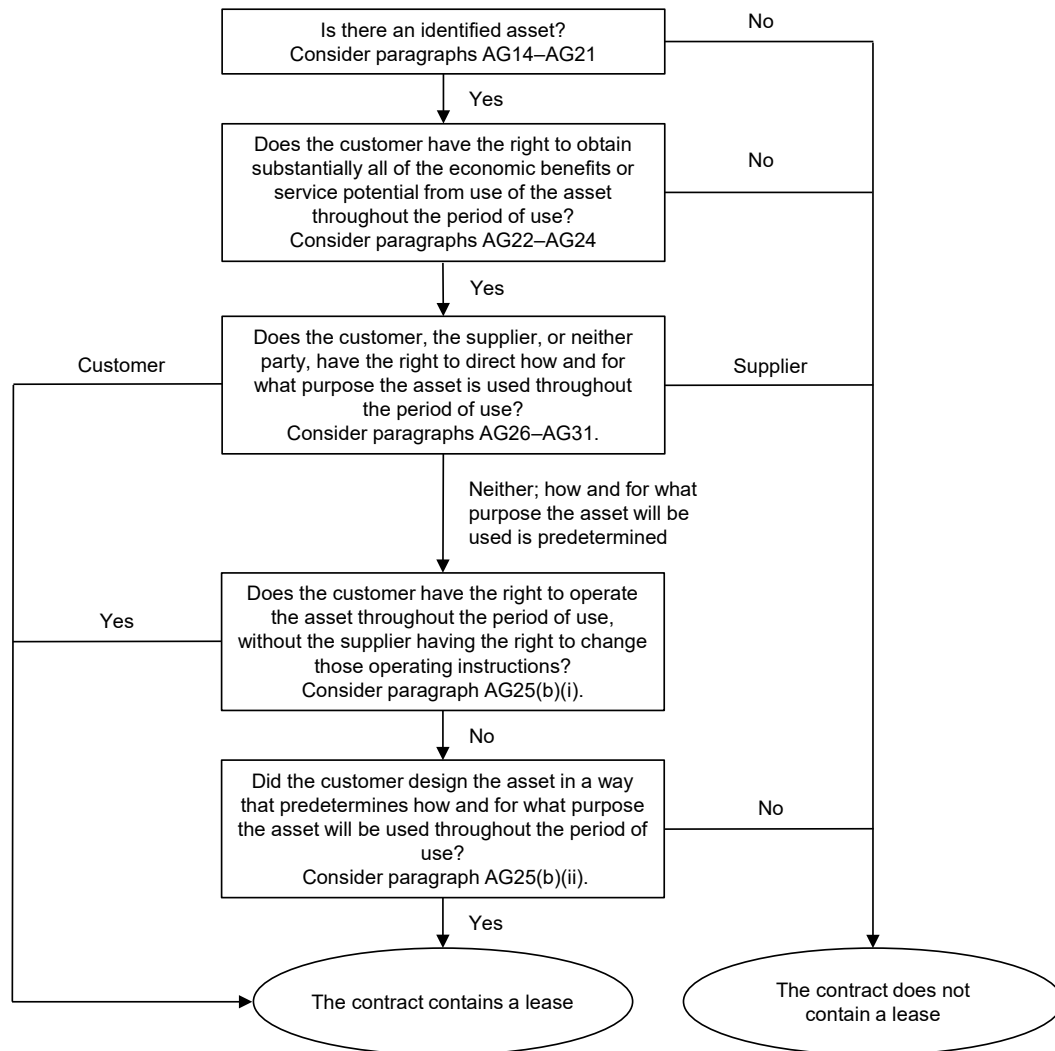
Decisions Determined During and Before the Period of Use

- AG29. The relevant decisions about how and for what purpose the asset is used can be predetermined in a number of ways. For example, the relevant decisions can be predetermined by the design of the asset or by contractual restrictions on the use of the asset.
- AG30. In assessing whether a customer has the right to direct the use of an asset, an entity shall consider only rights to make decisions about the use of the asset during the period of use, unless the customer designed the asset (or specific aspects of the asset) as described in paragraph AG25(b)(ii). Consequently, unless the conditions in paragraph AG25(b)(ii) exist, an entity shall not consider decisions that are predetermined before the period of use. For example, if a customer is able only to specify the output of an asset before the period of use, the customer does not have the right to direct the use of that asset. The ability to specify the output in a contract before the period of use, without any other decision-making rights relating to the use of the asset, gives a customer the same rights as any customer that purchases goods or services.

Protective Rights

- AG31. A contract may include terms and conditions designed to protect the supplier's interest in the asset or other assets, to protect its personnel, or to ensure the supplier's compliance with laws or regulations. These are examples of protective rights. For example, a contract may (i) specify the maximum amount of use of an asset or limit where or when the customer can use the asset, (ii) require a customer to follow particular operating practices, or (iii) require a customer to inform the supplier of changes in how an asset will be used. Protective rights typically define the scope of the customer's right of use but do not, in isolation, prevent the customer from having the right to direct the use of an asset.
- AG32. The following flowchart may assist entities in making the assessment of whether a contract is, or contains, a lease.

LEASES



Separating Components of a Contract (paragraphs 13–18)

AG33. The right to use an underlying asset is a separate lease component if both:

- (a) The lessee can benefit from use of the underlying asset either on its own or together with other resources that are readily available to the lessee. Readily available resources are goods or services that are sold or leased separately (by the lessor or other suppliers) or resources that the lessee has already obtained (from the lessor or from other transactions or events); and
- (b) The underlying asset is neither highly dependent on, nor highly interrelated with, the other underlying assets in the contract. For example, the fact that a lessee could decide not to lease the underlying asset without significantly affecting its rights to use other underlying assets in the contract might indicate that the underlying asset is not highly dependent on, or highly interrelated with, those other underlying assets.

AG34. A contract may include an amount payable by the lessee for activities and costs that do not transfer a good or service to the lessee. For example, a lessor may include in the total amount payable a charge for administrative tasks, or other costs it incurs associated with the lease, that do not transfer a good or service to the lessee. Such amounts payable do not give rise to a separate component of the contract, but are considered to be part of the total consideration that is allocated to the separately identified components of the contract.

Lease Term (paragraphs 19–22)

- AG35. In determining the lease term and assessing the length of the non-cancellable period of a lease, an entity shall apply the definition of a contract and determine the period for which the contract is enforceable. A lease is no longer enforceable when the lessee and the lessor each has the right to terminate the lease without permission from the other party with no more than an insignificant penalty.
- AG36. If only a lessee has the right to terminate a lease, that right is considered to be an option to terminate the lease available to the lessee that an entity considers when determining the lease term. If only a lessor has the right to terminate a lease, the non-cancellable period of the lease includes the period covered by the option to terminate the lease.
- AG37. The lease term begins at the commencement date and includes any rent-free periods provided to the lessee by the lessor.
- AG38. At the commencement date, an entity assesses whether the lessee is reasonably certain to exercise an option to extend the lease or to purchase the underlying asset, or not to exercise an option to terminate the lease. The entity considers all relevant facts and circumstances that create an economic incentive for the lessee to exercise, or not to exercise, the option, including any expected changes in facts and circumstances from the commencement date until the exercise date of the option. Examples of factors to consider include, but are not limited to:
- (a) Contractual terms and conditions for the optional periods compared with market rates, such as:
 - (i) The amount of payments for the lease in any optional period;
 - (ii) The amount of any variable payments for the lease or other contingent payments, such as payments resulting from termination penalties and residual value guarantees; and
 - (iii) The terms and conditions of any options that are exercisable after initial optional periods (for example, a purchase option that is exercisable at the end of an extension period at a rate that is currently below market rates).
 - (b) Significant leasehold improvements undertaken (or expected to be undertaken) over the term of the contract that are expected to have significant economic benefit for the lessee when the option to extend or terminate the lease, or to purchase the underlying asset, becomes exercisable;
 - (c) Costs relating to the termination of the lease, such as negotiation costs, relocation costs, costs of identifying another underlying asset suitable for the lessee's needs, costs of integrating a new asset into the lessee's operations, or termination penalties and similar costs, including costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location;
 - (d) The importance of that underlying asset to the lessee's operations, considering, for example, whether the underlying asset is a specialized asset, the location of the underlying asset and the availability of suitable alternatives; and
 - (e) Conditionality associated with exercising the option (i.e., when the option can be exercised only if one or more conditions are met), and the likelihood that those conditions will exist.
- AG39. An option to extend or terminate a lease may be combined with one or more other contractual features (for example, a residual value guarantee) such that the lessee guarantees the lessor a minimum or fixed cash return that is substantially the same regardless of whether the option is exercised. In such cases, and notwithstanding the guidance on in-substance fixed payments in paragraph AG43, an entity shall assume that the lessee is reasonably certain to exercise the option to extend the lease, or not to exercise the option to terminate the lease.
- AG40. The shorter the non-cancellable period of a lease, the more likely a lessee is to exercise an option to extend the lease or not to exercise an option to terminate the lease. This is because the costs associated with obtaining a replacement asset are likely to be proportionately higher the shorter the non-cancellable period.
- AG41. A lessee's past practice regarding the period over which it has typically used particular types of assets (whether leased or owned), and its economic reasons for doing so, may provide information that is helpful in assessing whether the lessee is reasonably certain to exercise, or not to exercise, an option. For example, if a lessee has typically used particular types of assets for a particular period of time or if the lessee has a practice of frequently exercising options on leases of particular types of underlying assets, the lessee shall consider the economic reasons for that past practice in assessing whether it is reasonably certain to exercise an option on leases of those assets.
- AG42. Paragraph 21 specifies that, after the commencement date, a lessee reassesses the lease term upon the occurrence of a significant event or a significant change in circumstances that is within the control of the lessee and affects whether the lessee is reasonably certain to exercise an option not previously included in its determination of the lease term, or not to

exercise an option previously included in its determination of the lease term. Examples of significant events or changes in circumstances include:

- (a) Significant leasehold improvements not anticipated at the commencement date that are expected to have significant economic benefit for the lessee when the option to extend or terminate the lease, or to purchase the underlying asset, becomes exercisable;
- (b) A significant modification to, or customization of, the underlying asset that was not anticipated at the commencement date;
- (c) The inception of a sublease of the underlying asset for a period beyond the end of the previously determined lease term; and
- (d) A decision of the lessee that is directly relevant to exercising, or not exercising, an option (for example, a decision to extend the lease of a complementary asset, to dispose of an alternative asset or to dispose of an operation within which the right-of-use asset is employed).

In-Substance Fixed Lease Payments (paragraphs 28(a), 37(c) and 74(a))

AG43. Lease payments include any in-substance fixed lease payments. In-substance fixed lease payments are payments that may, in form, contain variability but that, in substance, are unavoidable. In-substance fixed lease payments exist, for example, if:

- (a) Payments are structured as variable lease payments, but there is no genuine variability in those payments. Those payments contain variable clauses that do not have real economic substance. Examples of those types of payments include:
 - (i) Payments that must be made only if an asset is proven to be capable of operating during the lease, or only if an event occurs that has no genuine possibility of not occurring; or
 - (ii) Payments that are initially structured as variable lease payments linked to the use of the underlying asset but for which the variability will be resolved at some point after the commencement date so that the payments become fixed for the remainder of the lease term. Those payments become in-substance fixed payments when the variability is resolved.
- (b) There is more than one set of payments that a lessee could make, but only one of those sets of payments is realistic. In this case, an entity shall consider the realistic set of payments to be lease payments.
- (c) There is more than one realistic set of payments that a lessee could make, but it must make at least one of those sets of payments. In this case, an entity shall consider the set of payments that aggregates to the lowest amount (on a discounted basis) to be lease payments.

Lessee Involvement with the Underlying Asset before the Commencement Date

Costs of the Lessee relating to the Construction or Design of the Underlying Asset

AG44. An entity may negotiate a lease before the underlying asset is available for use by the lessee. For some leases, the underlying asset may need to be constructed or redesigned for use by the lessee. Depending on the terms and conditions of the contract, a lessee may be required to make payments relating to the construction or design of the asset.

AG45. If a lessee incurs costs relating to the construction or design of an underlying asset, the lessee shall account for those costs applying other applicable Standards, such as IPSAS 17. Costs relating to the construction or design of an underlying asset do not include payments made by the lessee for the right to use the underlying asset. Payments for the right to use an underlying asset are payments for a lease, regardless of the timing of those payments.

Legal Title to the Underlying Asset

AG46. A lessee may obtain legal title to an underlying asset before that legal title is transferred to the lessor and the asset is leased to the lessee. Obtaining legal title does not in itself determine how to account for the transaction.

AG47. If the lessee controls (or obtains control of) the underlying asset before that asset is transferred to the lessor, the transaction is a sale and leaseback transaction that is accounted for applying paragraphs 97–102.

AG48. However, if the lessee does not obtain control of the underlying asset before the asset is transferred to the lessor, the transaction is not a sale and leaseback transaction. For example, this may be the case if a producer, a lessor and a lessee negotiate a transaction for the purchase of an asset from the producer by the lessor, which is in turn leased to the lessee. The lessee may obtain legal title to the underlying asset before legal title transfers to the lessor. In this case, if the lessee obtains legal

title to the underlying asset but does not obtain control of the asset before it is transferred to the lessor, the transaction is not accounted for as a sale and leaseback transaction, but as a lease.

Lessee Disclosures (paragraph 62)

AG49. In determining whether additional information about leasing activities is necessary to meet the disclosure objective in paragraph 54, a lessee shall consider:

- (a) Whether that information is relevant to users of financial statements. A lessee shall provide additional information specified in paragraph 62 only if that information is expected to be relevant to users of financial statements. In this context, this is likely to be the case if it helps those users to understand:
 - (i) The flexibility provided by leases. Leases may provide flexibility if, for example, a lessee can reduce its exposure by exercising termination options or renewing leases with favorable terms and conditions.
 - (ii) Restrictions imposed by leases. Leases may impose restrictions, for example, by requiring the lessee to maintain particular financial ratios.
 - (iii) Sensitivity of reported information to key variables. Reported information may be sensitive to, for example, future variable lease payments.
 - (iv) Exposure to other risks arising from leases.
 - (v) Deviations from industry practice. Such deviations may include, for example, unusual or unique lease terms and conditions that affect a lessee's lease portfolio.
- (b) Whether that information is apparent from information either presented in the primary financial statements or disclosed in the notes. A lessee need not duplicate information that is already presented elsewhere in the financial statements.

AG50. Additional information relating to variable lease payments that, depending on the circumstances, may be needed to satisfy the disclosure objective in paragraph 54 could include information that helps users of financial statements to assess, for example:

- (a) The lessee's reasons for using variable lease payments and the prevalence of those payments;
- (b) The relative magnitude of variable lease payments to fixed payments;
- (c) Key variables upon which variable lease payments depend and how payments are expected to vary in response to changes in those key variables; and
- (d) Other operational and financial effects of variable lease payments.

AG51. Additional information relating to extension options or termination options that, depending on the circumstances, may be needed to satisfy the disclosure objective in paragraph 54 could include information that helps users of financial statements to assess, for example:

- (a) The lessee's reasons for using extension options or termination options and the prevalence of those options;
- (b) The relative magnitude of optional lease payments to lease payments;
- (c) The prevalence of the exercise of options that were not included in the measurement of lease liabilities; and
- (d) Other operational and financial effects of those options.

AG52. Additional information relating to residual value guarantees that, depending on the circumstances, may be needed to satisfy the disclosure objective in paragraph 54 could include information that helps users of financial statements to assess, for example:

- (a) The lessee's reasons for providing residual value guarantees and the prevalence of those guarantees;
- (b) The magnitude of a lessee's exposure to residual value risk;
- (c) The nature of underlying assets for which those guarantees are provided; and
- (d) Other operational and financial effects of those guarantees.

AG53. Additional information relating to sale and leaseback transactions that, depending on the circumstances, may be needed to satisfy the disclosure objective in paragraph 54 could include information that helps users of financial statements to assess, for example:

- (a) The lessee's reasons for sale and leaseback transactions and the prevalence of those transactions;
- (b) Key terms and conditions of individual sale and leaseback transactions;
- (c) Payments not included in the measurement of lease liabilities; and
- (d) The cash flow effect of sale and leaseback transactions in the reporting period.

Lessor Lease Classification (paragraphs 65–70)

- AG54. The classification of leases for lessors in this Standard is based on the extent to which the lease transfers the risks and rewards incidental to ownership of an underlying asset. Risks include the possibilities of losses from idle capacity or technological obsolescence and of variations in return because of changing economic conditions. Rewards may be represented by the expectation of service potential or profitable operation over the underlying asset's economic life and of gain from appreciation in value or realization of a residual value.
- AG55. A lease contract may include terms and conditions to adjust the lease payments for particular changes that occur between the inception date and the commencement date (such as a change in the lessor's cost of the underlying asset or a change in the lessor's cost of financing the lease). In that case, for the purposes of classifying the lease, the effect of any such changes shall be deemed to have taken place at the inception date.
- AG56. When a lease includes both land and buildings elements, a lessor shall assess the classification of each element as a finance lease or an operating lease separately applying paragraphs 66–70 and AG54–AG55. In determining whether the land element is an operating lease or a finance lease, an important consideration is that land normally has an indefinite economic life.
- AG57. Whenever necessary in order to classify and account for a lease of land and buildings, a lessor shall allocate lease payments (including any lump-sum upfront payments) between the land and the buildings elements in proportion to the relative fair values of the leasehold interests in the land element and buildings element of the lease at the inception date. If the lease payments cannot be allocated reliably¹ between these two elements, the entire lease is classified as a finance lease, unless it is clear that both elements are operating leases, in which case the entire lease is classified as an operating lease.
- AG58. For a lease of land and buildings in which the amount for the land element is immaterial to the lease, a lessor may treat the land and buildings as a single unit for the purpose of lease classification and classify it as a finance lease or an operating lease applying paragraphs 66–70 and AG54–AG55. In such a case, a lessor shall regard the economic life of the buildings as the economic life of the entire underlying asset.

Sublease Classification

- AG59. In classifying a sublease, an intermediate lessor shall classify the sublease as a finance lease or an operating lease as follows:
- (a) If the head lease is a short-term lease that the entity, as a lessee, has accounted for applying paragraph 6, the sublease shall be classified as an operating lease.
 - (b) Otherwise, the sublease shall be classified by reference to the right-of-use asset arising from the head lease, rather than by reference to the underlying asset (for example, the item of property, plant or equipment that is the subject of the lease).

¹ Information that is reliable is free from material error and bias, and can be depended on by users to faithfully represent that which it purports to represent or could reasonably be expected to represent. Paragraph BC16 of IPSAS 1 discusses the transitional approach to the explanation of reliability.

Amendments to Other IPSAS

Amendments to IPSAS 2, *Cash Flow Statements*

Paragraphs 26 and 55 are amended. Paragraph 63H is added. New text is underlined and deleted text is struck through.

Presentation of a Cash Flow Statement

...

Financing Activities

26. The separate disclosure of cash flows arising from financing activities is important, because it is useful in predicting claims on future cash flows by providers of capital to the entity. Examples of cash flows arising from financing activities are:

- (a) Cash proceeds from issuing debentures, loans, notes, bonds, mortgages, and other short or long-term borrowings;
- (b) Cash repayments of amounts borrowed; and
- (c) Cash payments by a lessee for the reduction of the outstanding liability relating to a ~~finance~~ lease.

...

Noncash Transactions

...

55. Many investing and financing activities do not have a direct impact on current cash flows, although they do affect the capital and asset structure of an entity. The exclusion of noncash transactions from the cash flow statement is consistent with the objective of a cash flow statement, as these items do not involve cash flows in the current period. Examples of noncash transactions are:

- (a) The acquisition of assets through the exchange of assets, the assumption of directly related liabilities, or by means of a ~~finance~~ lease; and
- (b) The conversion of debt to equity;

...

Effective Date

63H. Paragraphs 26 and 55 were amended by IPSAS 43, *Leases* issued in January 2022. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted. If an entity applies the amendment for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 43 at the same time.

Amendments to IPSAS 4, *The Effects of Changes in Foreign Exchange Rates*

Paragraph 17 is amended. Paragraph 71F is added. New text is underlined and deleted text is struck through.

Definitions

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Monetary Items

17. The essential feature of a monetary item is a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Examples include: social policy obligations and other employee benefits to be paid in cash; provisions that are to be settled in cash; lease liabilities; and cash dividends or similar distributions that are recognized as a liability. Conversely, the essential feature of a non-monetary item is the absence of a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Examples include: amounts prepaid for goods and services (~~e.g., prepaid rent~~); goodwill; intangible assets; inventories; property, plant, and equipment; right-of-use assets; and provisions that are to be settled by the delivery of a non-monetary asset.

...

Effective Date

...

71F. Paragraph 17 was amended by IPSAS 43, *Leases* issued in January 2022. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted. If an entity applies the amendments for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 43 at the same time.

Amendments to IPSAS 5, *Borrowing Costs*

Paragraph 6 is amended. Paragraph 42F is added. New text is underlined and deleted text is struck through.

Definitions**Borrowing Costs**

...

6. Borrowing costs may include:
- (a) Interest on bank overdrafts and short-term and long-term borrowings;
 - (b) Amortization of discounts or premiums relating to borrowings;
 - (c) Amortization of ancillary costs incurred in connection with the arrangement of borrowings;
 - (d) ~~Finance charges~~ Interest in respect of ~~finance~~ leases liabilities and service concession arrangements; and
 - (e) Exchange differences arising from foreign currency borrowings, to the extent that they are regarded as an adjustment to interest costs.

...

Effective Date

...

42F. Paragraph 6 was amended by IPSAS 43, *Leases* issued in January 2022. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted. If an entity applies the amendments for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 43 at the same time.

Amendments to IPSAS 12, *Inventories*

Paragraph 20 is amended. Paragraph 51F is added. New text is underlined and deleted text is struck through.

Measurement of Inventories

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Cost of Inventories

...

Costs of Conversion

20. The costs of converting work-in-progress inventories into finished goods inventories are incurred primarily in a manufacturing environment. The costs of conversion of inventories include costs directly related to the units of production, such as direct labor. They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Fixed production overheads are those indirect costs of production that remain relatively constant regardless of (a) the volume of production, such as depreciation and maintenance of factory buildings, ~~and equipment~~ and right-of-use assets used in the production process, and (b) the cost of factory management and admin-

istration. Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labor.

Effective date

51F. Paragraph 20 was amended by IPSAS 43, *Leases* issued in January 2022. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted. If an entity applies the amendment for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 43 at the same time.

Amendments to IPSAS 16, *Investment Property*

Paragraphs 7, 10, 12, 13, 20, 26, 27, 39, 49, 50, 59, 62, 62A, 63, 65, 71, 72, 73, 78, 80, 85, 86, 88, and 89 were amended. Paragraphs 25A, 38A, 41A, 41B, 41C, 49A, 100A and its related heading and paragraph 101H were added. Paragraphs 5, 8, 34, 35 and 43 were deleted.

Scope

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5. ~~[Deleted] This Standard applies to accounting for investment property, including (a) the measurement in a lessee's financial statements of investment property interests held under a lease accounted for as a finance lease, and to (b) the measurement in a lessor's financial statements of investment property provided to a lessee under an operating lease. This Standard does not deal with matters covered in IPSAS 13, *Leases*, including:~~

- ~~(a) Classification of leases as finance leases or operating leases;~~
- ~~(b) Recognition of lease revenue from investment property (see also IPSAS 9, Revenue from Exchange Transactions);~~
- ~~(c) Measurement in a lessee's financial statements of property interests held under a lease accounted for as an operating lease;~~
- ~~(d) Measurement in a lessor's financial statements of its net investment in a finance lease;~~
- ~~(e) Accounting for sale and leaseback transactions; and~~
- ~~(f) Disclosure about finance leases and operating leases.~~

...

Definitions

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

...

Investment property is property (land or a building – or part of a building – or both) held **(by the owner or by the lessee as a right-of-use asset)** to earn rentals or for capital appreciation, or both, rather than for:

- (a) Use in the production or supply of goods or services, or for administrative purposes; or
- (b) Sale in the ordinary course of operations.

Owner-occupied property is property held **(by the owner or by the lessee under a finance lease as a right-of-use asset)** for use in the production or supply of goods or services, or for administrative purposes.

...

Property Interest Held by a Lessee under an Operating Lease

8. ~~[Deleted] A property interest that is held by a lessee under an operating lease may be classified and accounted for as investment property if, and only if, (a) the property would otherwise meet the definition of an investment property, and (b) the lessee uses the fair value model set out in paragraphs 42–64 for the asset recognized. This classification alternative is available on a property-by-property basis. However, once this classification alternative is selected for one such property interest held under an operating lease, all property classified as investment property shall be accounted for using the fair value model. When this classification alternative is selected, any interest so classified is included in the disclosures required by paragraphs 85–89.~~

Investment Property

...

10. Investment property is held to earn rentals or for capital appreciation, or both. Therefore, investment property generates cash flows largely independently of the other assets held by an entity. This distinguishes investment property from other land or buildings controlled by public sector entities, including owner-occupied property. The production or supply of goods or services (or the use of property for administrative purposes) can also generate cash flows. For example, public sector entities may use a building to provide goods and services to recipients in return for full or partial cost recovery. However, the building is held to facilitate the production of goods and services, and the cash flows are attributable not only to the building, but also to other assets used in the production or supply process. *IPSAS 17, Property, Plant, and Equipment*, applies to owned owner-occupied property and *IPSAS 43, Leases* applies to owner-occupied property held by a lessee as a right-of-use asset.

...

12. The following are examples of investment property:
- (a) Land held for long-term capital appreciation rather than for short-term sale in the ordinary course of operations. For example, land held by a hospital for capital appreciation that may be sold at a beneficial time in the future.
 - (b) Land held for a currently undetermined future use. (If an entity has not determined that it will use the land as owner-occupied property, including occupation to provide services such as those provided by national parks to current and future generations, or for short-term sale in the ordinary course of operations, the land is regarded as held for capital appreciation).
 - (c) A building owned by the entity (or a right-of-use asset relating to a building held by the entity ~~under a finance lease~~) and leased out under one or more operating leases on a commercial basis. For example, a university may own a building that it leases on a commercial basis to external parties.
 - (d) A building that is vacant but is held to be leased out under one or more operating leases on a commercial basis to external parties.
 - (e) Property that is being constructed or developed for future use as investment property.
13. The following are examples of items that are not investment property and are therefore outside the scope of this Standard:
- (a) Property held for sale in the ordinary course of operations or in the process of construction or development for such sale (see *IPSAS 12, Inventories*). For example, a municipal government may routinely supplement rate income by buying and selling property, in which case property held exclusively with a view to subsequent disposal in the near future or for development for resale is classified as inventory. A housing department may routinely sell part of its housing stock in the ordinary course of its operations as a result of changing demographics, in which case any housing stock held for sale is classified as inventory.
 - (b) Property being constructed or developed on behalf of third parties. For example, a property and service department may enter into construction contracts with entities external to its government (see *IPSAS 11, Construction Contracts*).
 - (c) Owner-occupied property (see *IPSAS 17* and *IPSAS 43*), including (among other things) property held for future use as owner-occupied property, property held for future development and subsequent use as owner-occupied property, property occupied by employees such as housing for military personnel (whether or not the employees pay rent at market rates) and owner-occupied property awaiting disposal.
 - (d) [Deleted]
 - (e) Property that is leased to another entity under a finance lease.
 - (f) Property held to provide a social service and which also generates cash inflows. For example, a housing department may hold a large housing stock used to provide housing to low income families at below market rental. In this situation, the property is held to provide housing services rather than for rentals or capital appreciation and rental revenue generated is incidental to the purposes for which the property is held. Such property is not considered an “investment property” and would be accounted for in accordance with *IPSAS 17*.
 - (g) Property held for strategic purposes which would be accounted for in accordance with *IPSAS 17*.

...

Recognition

20. An owned ~~investment investment~~ property shall be recognized as an asset when, and only when:

- (a) **It is probable that the future economic benefits or service potential that are associated with the investment property will flow to the entity; and**
- (b) **The cost or fair value of the investment property can be measured reliably.**

...

25A. An investment property held by a lessee as a right-of-use asset shall be recognized in accordance with IPSAS 43.

Measurement at Recognition

26. An owned ~~investment investment~~ property shall be measured initially at its cost (transaction costs shall be included in this initial measurement).

27. Where an ~~owned~~ investment property is acquired through a non-exchange transaction, its cost shall be measured at its fair value as at the date of acquisition.

...

34. ~~[Deleted] The initial cost of a property interest held under a lease and classified as an investment property shall be as prescribed for a finance lease by paragraph 28 of IPSAS 13, i.e., the asset shall be recognized at the lower of the fair value of the property and the present value of the minimum lease payments. An equivalent amount shall be recognized as a liability in accordance with that same paragraph.~~

35. ~~[Deleted] Any premium paid for a lease is treated as part of the minimum lease payments for this purpose, and is therefore included in the cost of the asset, but is excluded from the liability. If a property interest held under a lease is classified as investment property, the item accounted for at fair value is that interest and not the underlying property. Guidance on determining the fair value of a property interest is set out for the fair value model in paragraphs 42–61. That guidance is also relevant to the determination of fair value when that value is used as cost for initial recognition purposes.~~

...

38A. An investment property held by a lessee as a right-of-use asset shall be measured initially in accordance with IPSAS 43.

Measurement after Recognition

Accounting Policy

39. With the exception noted in paragraph 43 ~~41A~~, an entity shall choose as its accounting policy either the fair value model in paragraphs 42–64 or the cost model in paragraph 65, and shall apply that policy to all of its investment property.

...

41A. An entity may:

- (a) Choose either the fair value model or the cost model for all investment property backing liabilities that pay a return linked directly to the fair value of, or returns from, specified assets including that investment property; and
- (b) Choose either the fair value model or the cost model for all other investment property, regardless of the choice made in (a).

41B. Some insurers and other entities operate an internal property fund that issues notional units, with some units held by investors in linked contracts and others held by the entity. Paragraph 41A does not permit an entity to measure the property held by the fund partly at cost and partly at fair value.

41C. If an entity chooses different models for the two categories described in paragraph 41A, sales of investment property between pools of assets measured using different models shall be recognized at fair value and the cumulative change in fair value shall be recognized in surplus or deficit. Accordingly, if an investment property is sold from a pool in which the fair value model is used into a pool in which the cost model is used, the property's fair value at the date of the sale becomes its deemed cost.

Fair Value Model

...

43. ~~[Deleted] When a property interest held by a lessee under an operating lease is classified as an investment property under paragraph 8, paragraph 39 is not elective; the fair value model shall be applied.~~

...

49. The fair value of investment property reflects, among other things, rental revenue from current leases and reasonable and supportable assumptions that represent what knowledgeable, willing parties would assume about rental revenue from future leases in the light of current conditions. It also reflects, on a similar basis, any cash outflows (including rental payments and other outflows) that could be expected in respect of the property. ~~Some of those outflows are reflected in the liability whereas others relate to outflows that are not recognized in the financial statements until a later date (e.g. periodic payments such as contingent rents).~~

49A. ~~When a lessee uses the fair value model to measure an investment property that is held as a right-of-use asset, it shall measure the right-of-use asset, and not the underlying asset, at fair value.~~

50. ~~Paragraph 34 IPSAS 43 specifies the basis for initial recognition of the cost of an interest in a leased property an investment property held by a lessee as a right-of-use asset. Paragraph 42 requires the interest in the leased property investment property held by a lessee as a right-of-use asset to be remeasured, if necessary, to fair value if the entity chooses the fair value model. In a lease negotiated When lease payments are at market rates, the fair value of an interest in a leased property an investment property held by a lessee as a right-of-use asset at acquisition, net of all expected lease payments (including those relating to recognized lease liabilities), should be zero. This fair value does not change regardless of whether, for accounting purposes, a leased asset and liability are recognized at fair value or at the present value of minimum lease payments, in accordance with paragraph 28 of IPSAS 13. Thus, remeasuring a leased right-of-use asset from cost in accordance with paragraph 34 IPSAS 43 to fair value in accordance with paragraph 42 (taking into account the requirements in paragraph 59) should not give rise to any initial gain or loss, unless fair value is measured at different times. This could occur when an election to apply the fair value model is made after initial recognition.~~

...

59. In determining the carrying amount of investment property under the fair value model, an entity does not double-count assets or liabilities that are recognized as separate assets or liabilities. For example:

- (a) Equipment such as elevators or air-conditioning is often an integral part of a building and is generally included in the fair value of the investment property, rather than recognized separately as property, plant, and equipment.
- (b) If an office is leased on a furnished basis, the fair value of the office generally includes the fair value of the furniture, because the rental revenue relates to the furnished office. When furniture is included in the fair value of investment property, an entity does not recognize that furniture as a separate asset.
- (c) The fair value of investment property excludes prepaid or accrued ~~operating~~ lease revenue, because the entity recognizes it as a separate liability or asset.
- (d) The fair value of investment property held by a lessee as a right-of-use asset ~~under a lease~~ reflects expected cash flows (including ~~contingent rent that is variable~~ lease payments that are expected to become payable). Accordingly, if a valuation obtained for a property is net of all payments expected to be made, it will be necessary to add back any recognized lease liability, to arrive at the carrying amount of the investment property using the fair value model.

...

Inability to Determine Fair Value Reliably

62. **There is a rebuttable presumption that an entity can reliably determine the fair value of an investment property on a continuing basis. However, in exceptional cases, there is clear evidence when an entity first acquires an investment property (or when an existing property first becomes investment property after a change in use) that the fair value of the investment property is not reliably determinable on a continuing basis. This arises when, and only when, comparable market transactions are infrequent and alternative reliable estimates of fair value (for example, based on discounted cash flow projections) are not available. If an entity determines that the fair value of an investment property under construction is not reliably determinable but expects the fair value of the property to be reliably determinable when construction is complete, it shall measure that investment property under construction at cost until either its fair value becomes reliably determinable or construction is completed (whichever is earlier). If an**

entity determines that the fair value of an investment property (other than an investment property under construction) is not reliably determinable on a continuing basis, the entity shall measure that investment property using the cost model in IPSAS 17 for owned investment property or in accordance with IPSAS 43 for investment property held by a lessee as a right-of-use asset. The residual value of the investment property shall be assumed to be zero. The entity shall continue to apply IPSAS 17 or IPSAS 43 until disposal of the investment property.

- 62A. Once an entity becomes able to measure reliably the fair value of an investment property under construction that has previously been measured at cost, it shall measure that property at its fair value. Once construction of that property is complete, it is presumed that fair value can be measured reliably. If this is not the case, in accordance with paragraph 62, the property shall be accounted for using the cost model in accordance with IPSAS 17 for owned assets or IPSAS 43 for investment property held by a lessee as a right-of-use asset.

...

63. In the exceptional cases when an entity is compelled, for the reason given in paragraph 62, to measure an investment property using the cost model in accordance with IPSAS 17 or IPSAS 43, it measures at fair value all its other investment property, including investment property under construction. In these cases, although an entity may use the cost model for one investment property, the entity shall continue to account for each of the remaining properties using the fair value model.

Cost Model

65. ~~After initial recognition, an entity that chooses the cost model shall measure all of its investment property in accordance with IPSAS 17's requirements for that model, i.e., at cost less any accumulated depreciation and any accumulated impairment losses.~~

After initial recognition, an entity that chooses the cost model shall measure investment property:

- (a) In accordance with IPSAS 43 if it is held by a lessee as a right-of-use asset; and
 (b) In accordance with the requirements in IPSAS 17 for the cost model if it is held by an owner as an owned investment property.

Transfers

...

71. For a transfer from investment property carried at fair value to owner-occupied property or inventories, the property's cost for subsequent accounting in accordance with IPSAS 17, IPSAS 43 or IPSAS 12, shall be its fair value at the date of change in use.
72. If an owner-occupied property becomes an investment property that will be carried at fair value, an entity shall apply IPSAS 17 for owned property and IPSAS 43 for property held by a lessee as a right-of-use asset up to the date of change in use. The entity shall treat any difference at that date between the carrying amount of the property in accordance with IPSAS 17 or IPSAS 43, and its fair value in the same way as a revaluation in accordance with IPSAS 17.
73. Up to the date when an owner-occupied property becomes an investment property carried at fair value, an entity depreciates the property (or right-of-use asset) and recognizes any impairment losses that have occurred. The entity treats any difference at that date between the carrying amount of the property in accordance with IPSAS 17 or IPSAS 43, and its fair value in the same way as a revaluation in accordance with IPSAS 17. In other words:
- (a) Any resulting decrease in the carrying amount of the property is recognized in surplus or deficit. However, to the extent that an amount is included in revaluation surplus for that property, the decrease is charged against that revaluation surplus.
- (b) Any resulting increase in the carrying amount is treated as follows:
- (i) To the extent that the increase reverses a previous impairment loss for that property, the increase is recognized in surplus or deficit. The amount recognized in surplus or deficit does not exceed the amount needed to restore the carrying amount to the carrying amount that would have been determined (net of depreciation) if no impairment loss had been recognized.
- (ii) Any remaining part of the increase is credited directly to net assets/equity in revaluation surplus. On subsequent disposal of the investment property, the revaluation surplus included in net assets/equity may

be transferred to accumulated surpluses or deficits. The transfer from revaluation surplus to accumulated surpluses or deficits is not made through surplus or deficit.

...

Disposals

...

78. The disposal of an investment property may be achieved by sale or by entering into a finance lease. In determining the date of disposal for investment property that is sold, an entity applies the criteria in IPSAS 9 for recognizing revenue from the sale of goods and considers the related guidance in the Implementation Guidance to IPSAS 9. ~~IPSAS 13~~ IPSAS 43 applies to a disposal effected by entering into a finance lease and to a sale and leaseback.

...

80. **Gains or losses arising from the retirement or disposal of investment property shall be determined as the difference between the net disposal proceeds and the carrying amount of the asset, and shall be recognized in surplus or deficit (unless ~~IPSAS 13~~ IPSAS 43 requires otherwise on a sale and leaseback) in the period of the retirement or disposal.**

...

Disclosure

Fair Value Model and Cost Model

85. The disclosures below apply in addition to those in ~~IPSAS 13~~ IPSAS 43. In accordance with ~~IPSAS 13~~ IPSAS 43, the owner of an investment property provides lessors' disclosures about leases into which it has entered. ~~An entity A lessee that holds an investment property under a finance lease or operating lease as a right-of-use asset provides lessees' disclosures for finance leases as required by IPSAS 43 and lessors' disclosures as required by IPSAS 43 for any operating leases into which it has entered.~~

86. **An entity shall disclose:**

- (a) **Whether it applies the fair value or the cost model;**
- (b) ~~[Deleted] If it applies the fair value model, whether, and in what circumstances, property interests held under operating leases are classified and accounted for as investment property;~~
- (c) **When classification is difficult (see paragraph 18), the criteria it uses to distinguish investment property from owner-occupied property and from property held for sale in the ordinary course of operations;**
- (d) **The methods and significant assumptions applied in determining the fair value of investment property, including a statement whether the determination of fair value was supported by market evidence, or was more heavily based on other factors (which the entity shall disclose) because of the nature of the property and lack of comparable market data;**
- (e) **The extent to which the fair value of investment property (as measured or disclosed in the financial statements) is based on a valuation by an independent valuer who holds a recognized and relevant professional qualification and has recent experience in the location and category of the investment property being valued. If there has been no such valuation, that fact shall be disclosed;**
- (f) **The amounts recognized in surplus or deficit for:**
 - (i) **Rental revenue from investment property;**
 - (ii) **Direct operating expenses (including repairs and maintenance) arising from investment property that generated rental revenue during the period; and**
 - (iii) **Direct operating expenses (including repairs and maintenance) arising from investment property that did not generate rental revenue during the period.**
- (g) **The existence and amounts of restrictions on the realizability of investment property or the remittance of revenue and proceeds of disposal; and**
- (h) **Contractual obligations to purchase, construct, or develop investment property or for repairs, maintenance, or enhancements.**

Fair Value Model

...

88. When a valuation obtained for investment property is adjusted significantly for the purpose of the financial statements, for example to avoid double-counting of assets or liabilities that are recognized as separate assets and liabilities as described in paragraph 59, the entity shall disclose a reconciliation between the valuation obtained and the adjusted valuation included in the financial statements, showing separately the aggregate amount of any recognized lease ~~obligations~~ liabilities that have been added back, and any other significant adjustments.
89. In the exceptional cases referred to in paragraph 62, when an entity measures investment property using the cost model in IPSAS 17 or in accordance with IPSAS 43, the reconciliation required by paragraph 87 shall disclose amounts relating to that investment property separately from amounts relating to other investment property. In addition, an entity shall disclose:
- (a) A description of the investment property;
 - (b) An explanation of why fair value cannot be determined reliably;
 - (c) If possible, the range of estimates within which fair value is highly likely to lie; and
 - (d) On disposal of investment property not carried at fair value:
 - (i) The fact that the entity has disposed of investment property not carried at fair value;
 - (ii) The carrying amount of that investment property at the time of sale; and
 - (iii) The amount of gain or loss recognized.

Transitional Provisions

...

Fair Value Model

...

IPSAS 43

100A. An entity applying IPSAS 43, and its related amendments to this Standard, for the first time shall apply the transition requirements in IPSAS 43 to its investment property held as a right-of-use asset.

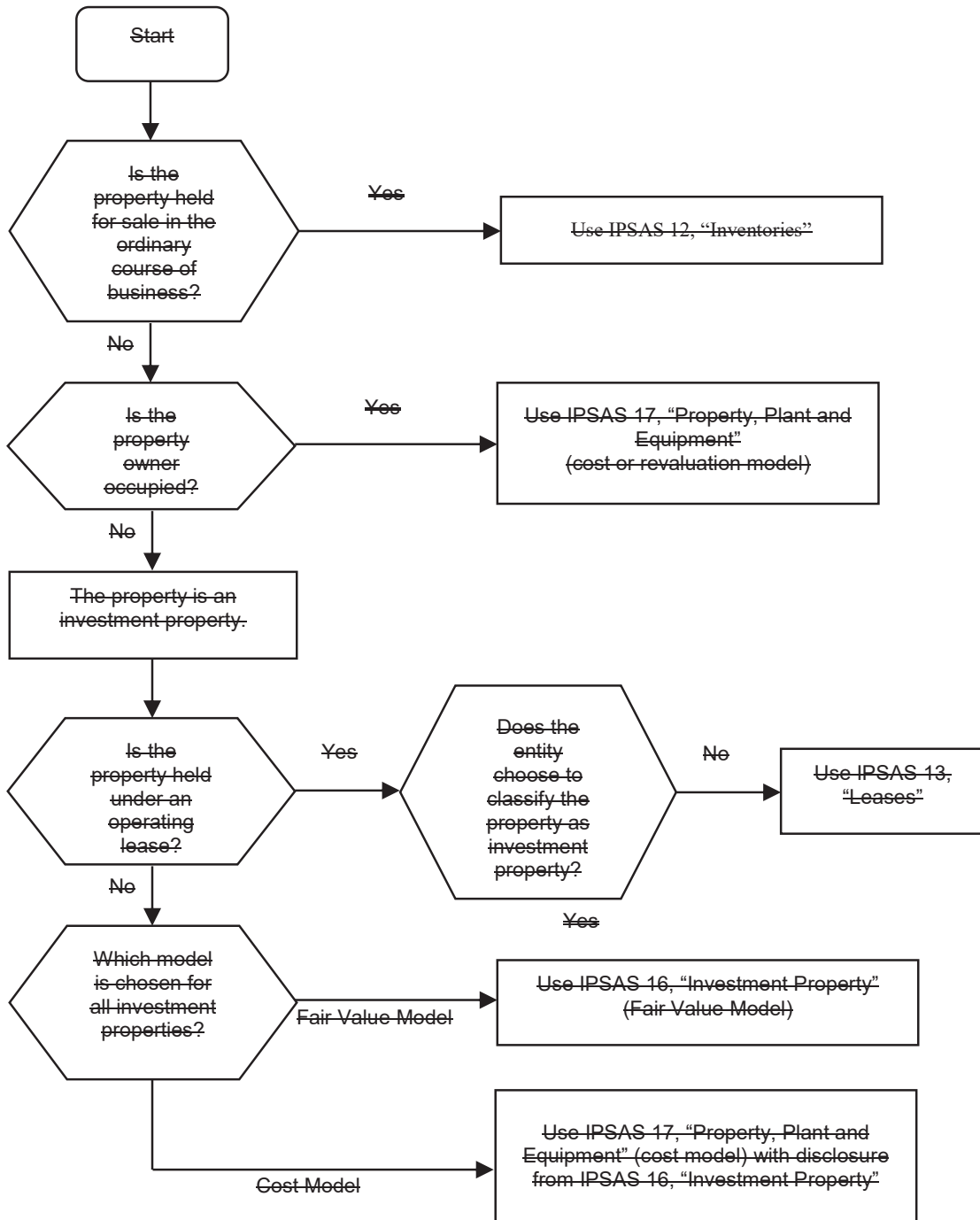
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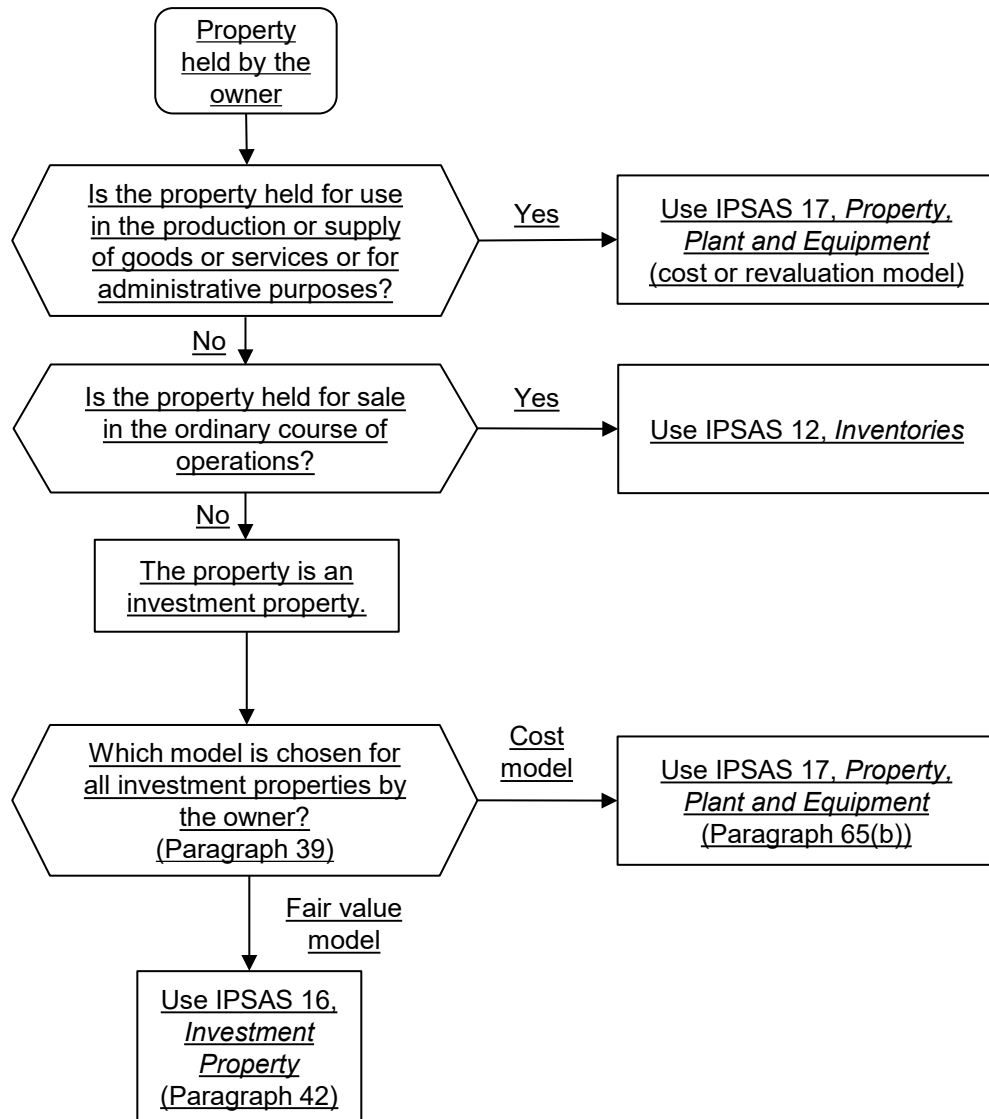
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101H. IPSAS 43 issued in January 2022, amended the scope of IPSAS 16 by defining investment property to include both owned investment property and property held by a lessee as a right-of-use asset. Paragraphs 7, 10, 12, 13, 14, 20, 26, 27, 39, 49, 50, 59, 62, 62A, 63, 65, 71, 72, 73, 78, 80, 85, 86, 88, and 89 were amended, paragraphs 25A, 38A, 41A, 41B, 41C, 49A and 100A and its related heading were added, and paragraphs 5, 8, 34, 35 and 43 were deleted by IPSAS 43. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted. If an entity applies the amendments for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 43 at the same time.

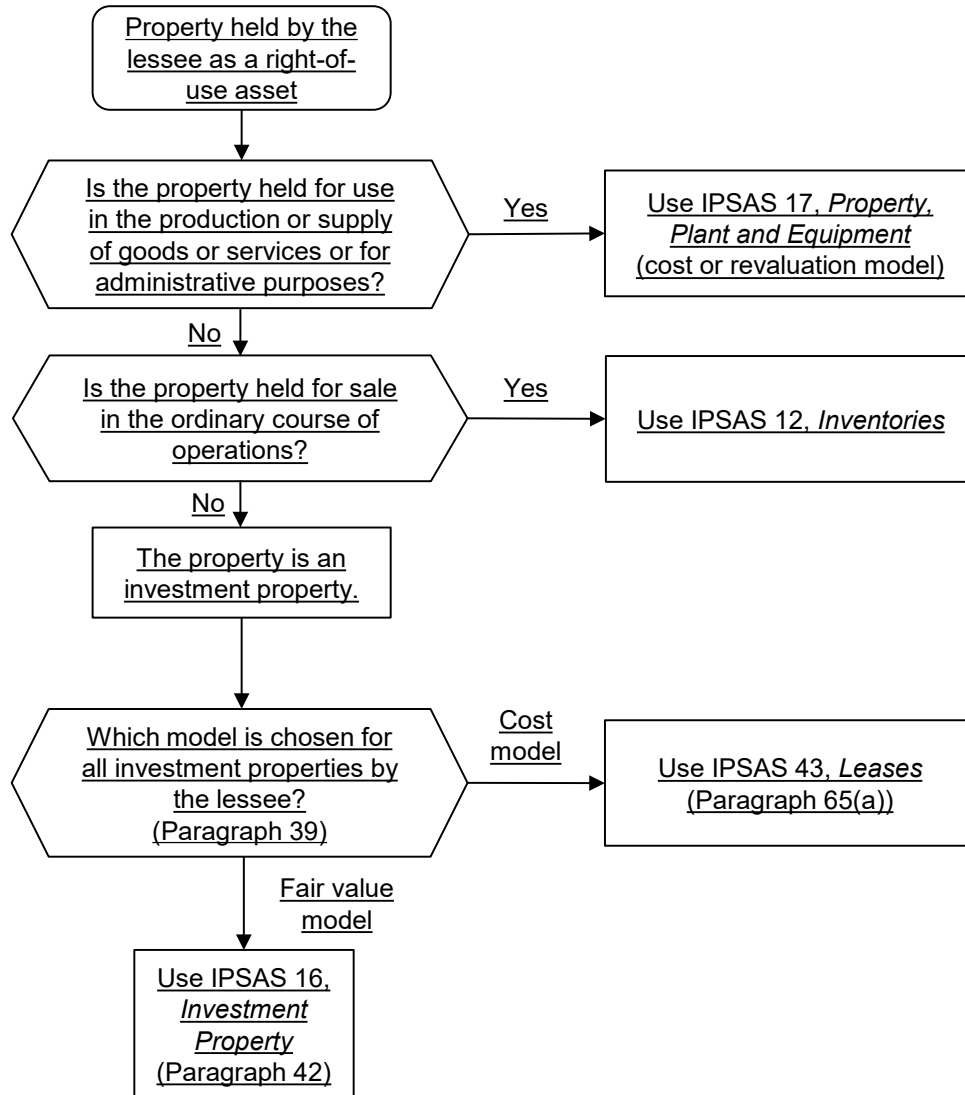
Illustrative Decision Trees

This These decision trees accompanys accompany, but is are not part of, IPSAS 16.





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Amendments to IPSAS 17, *Property, Plant, and Equipment*

Paragraphs 8, 19, 60, 83, 84 are amended. Paragraph 107R is added. Paragraphs 7 and 41 are deleted. New text is underlined and deleted text is struck through.

Scope

...

7. ~~[Deleted] Other IPSASs may require recognition of an item of property, plant, and equipment based on an approach different from that in this Standard. For example, IPSAS 13, *Leases*, requires an entity to evaluate its recognition of an item of leased property, plant, and equipment on the basis of the transfer of risks and rewards. IPSAS 32 requires an entity to evaluate the recognition of an item of property, plant, and equipment used in a service concession arrangement on the basis of control of the asset. However, in such cases other aspects of the accounting treatment for these assets, including depreciation, are prescribed by this Standard.~~
8. An entity using the cost model for investment property in accordance with IPSAS 16, *Investment Property* shall use the cost model in this Standard for owned investment property.

Recognition

...

19. An entity evaluates under this recognition principle all its property, plant, and equipment costs at the time they are incurred. These costs include costs incurred initially to acquire or construct an item of property, plant, and equipment and costs incurred subsequently to add to, replace part of, or service it. The cost of an item of property, plant, and equipment may include costs incurred relating to leases of assets that are used to construct, add to, replace part of or service an item of property, plant and equipment, such as depreciation of right-of-use assets.

Measurement at Recognition

...

Measurement of Cost

...

41. ~~[Deleted] The cost of an item of property, plant, and equipment held by a lessee under a finance lease is determined in accordance with IPSAS 13.~~

Measurement after Recognition

...

Depreciation

...

60. An entity allocates the amount initially recognized in respect of an item of property, plant, and equipment to its significant parts and depreciates separately each such part. For example, in most cases, it would be required to depreciate separately the pavements, formation, curbs and channels, footpaths, bridges, and lighting within a road system. Similarly, it may be appropriate to depreciate separately the airframe and engines of an aircraft, ~~whether owned or subject to a finance lease~~. Similarly, if an entity acquires property, plant and equipment subject to an operating lease in which it is the lessor, it may be appropriate to depreciate separately amounts reflected in the cost of that item that are attributable to favorable or unfavorable lease terms relative to market terms.

...

Derecognition

...

83. **The gain or loss arising from the derecognition of an item of property, plant, and equipment shall be included in surplus or deficit when the item is derecognized (unless ~~IPSAS 13~~ IPSAS 43, *Leases* requires otherwise on a sale and leaseback).**

...

84. The disposal of an item of property, plant and equipment may occur in a variety of ways (e.g., by sale, by entering into a finance lease or by donation). In determining the date of disposal of an item, an entity applies the criteria in IPSAS 9 for recognizing revenue from the sale of goods. ~~IPSAS 13~~ IPSAS 43 applies to disposal by a sale and leaseback.

...

Effective Date

...

- 107R. Paragraphs 8, 19, 60, 83, 84 were amended and paragraphs 7 and 41 were deleted by IPSAS 43 issued in January 2022. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted. If an entity applies the amendments for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 43 at the same time.

Amendments to IPSAS 18, *Segment Reporting*

Paragraphs 33 and 35 are amended. Paragraph 76F is added. New text is underlined and deleted text is struck through.

Definitions of Segment Revenue, Expense, Assets, Liabilities, and Accounting Policies

...

Segment Assets, Liabilities, Revenue, Expense, and Accounting Policies

33. Examples of segment assets include current assets that are used in the operating activities of the segment: property, plant, and equipment; right-of-use assets ~~that are the subject of finance leases~~; and intangible assets. If a particular item of depreciation or amortization is included in segment expense, the related asset is also included in segment assets. Segment assets do not include assets used for general entity or head office purposes. For example:
- The office of the central administration and policy development unit of a department of education is not included in segments reflecting the delivery of primary, secondary and tertiary educational services; or
 - The parliamentary or other general assembly building is not included in segments reflecting major functional activities such as education, health, and defense when reporting at the whole-of-government level.

Segment assets include operating assets shared by two or more segments if a reasonable basis for allocation exists.

...

35. Examples of segment liabilities include trade and other payables, accrued liabilities, advances from members of the community for the provision of partially subsidized goods and services in the future, product warranty provisions arising from any commercial activities of the entity, and other claims relating to the provision of goods and services. Segment liabilities do not include borrowings, liabilities related to right-of-use assets ~~that are the subject of finance leases~~, and other liabilities that are incurred for financing rather than operating purposes. If interest expense is included in segment expense, the related interest-bearing liability is included in segment liabilities.

Effective Date

...

- 76F. Paragraphs 33 and 35 were amended by IPSAS 43, *Leases* issued in January 2022. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted. If an entity applies the amendments for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 43 at the same time.

Amendments to IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*

Paragraph 13 is amended. Paragraph 111L is added. New text is underlined and deleted text is struck through.

Scope

13. Where another IPSAS deals with a specific type of provision, contingent liability, or contingent asset, an entity applies that standard instead of this Standard. For example, certain types of provisions are also addressed in Standards on:
- Construction contracts (see IPSAS 11, *Construction Contracts*); and

- (b) Leases (see ~~IPSAS 13~~ IPSAS 43, Leases). However, as ~~IPSAS 13~~ contains no specific requirements to deal with operating leases that have become onerous, this Standard applies to such cases this Standard applies to any lease that becomes onerous before the commencement date of the lease as defined in IPSAS 43. This Standard also applies to short-term leases and leases for which the underlying asset is of low value accounted for in accordance with paragraph 7 of IPSAS 43 and that have become onerous.

Effective Date

...

111L. Paragraph 13 was amended by IPSAS 43 issued in January 2022. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted. If an entity applies the amendments for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 43 at the same time.

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 19.

...

An Onerous Contract

IG13. ~~[Deleted] A hospital laundry operates from a building that the hospital (the reporting entity) has leased under an operating lease. During December 2004, the laundry relocates to a new building. The lease on the old building continues for the next four years; it cannot be canceled. The hospital has no alternative use for the building and the building cannot be re-let to another user.~~

Analysis

Present obligation as a result of a past obligating event—The obligating event is the signing of the lease contract, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits or service potential in settlement—When the lease becomes onerous, an outflow of resources embodying economic benefits is probable. (Until the lease becomes onerous, the hospital accounts for the lease under IPSAS 13, Leases).

Conclusion

A provision is recognized for the best estimate of the unavoidable lease payments (see paragraphs 13(b), 22 and 76).

Amendments to IPSAS 27, Agriculture

Paragraph 3 is amended. Paragraph 56G is added. New text is underlined and deleted text is struck through.

Scope

3. This Standard does not apply to:
- (a) Land related to agricultural activity (see IPSAS 16, *Investment Property* and IPSAS 17, *Property, Plant, and Equipment*);
 - (b) Intangible assets related to agricultural activity (see IPSAS 31, *Intangible Assets*); and
 - (c) Biological assets held for the provision or supply of services.
 - (d) Right-of-use assets arising from a lease of land related to agricultural activity (see IPSAS 43, *Leases*).

Effective Date

...

56G. Paragraph 3 was amended by IPSAS 43 issued in January 2022. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted. If an entity applies the amendments for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 43 at the same time.

Amendments to IPSAS 28, *Financial Instruments: Presentation*

Paragraphs AG16 and AG17 are amended. Paragraph 60H is added. New text is underlined and deleted text is struck through.

Effective Date

...

60H. Paragraphs AG16 and AG17 were amended by IPSAS 43, *Leases* issued in January 2022. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted. If an entity applies the amendments for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 43 at the same time.

Definitions (paragraphs 9 and 10)

Designation as at Fair Value through Surplus or Deficit

...

AG16. Under IPSAS 13, ~~*Leases*~~, a finance lease is regarded as primarily A lease typically creates an entitlement of the lessor to receive, and an obligation of the lessee to pay, a stream of payments that are substantially the same as blended payments of principal and interest under a loan agreement. The lessor accounts for its investment in the amount receivable under the a ~~finance lease~~ rather than the ~~leased~~ underlying asset itself that is subject to the finance lease. Accordingly, a lessor regards a finance lease as a financial instrument. ~~Under IPSAS 43, *Leases* a lessor does not recognize its entitlement to receive lease payments under an operating lease. An operating lease, on the other hand, is regarded as primarily an uncompleted contract committing the lessor to provide the use of an asset in future periods in exchange for consideration similar to a fee for a service. The lessor continues to account for the leased~~ underlying asset itself rather than any amount receivable in the future under the contract. Accordingly, a lessor ~~finance lease is regarded as a financial instrument and does not regard an operating lease is not regarded as a financial instrument, (except as regards individual payments currently due and payable by the lessee).~~

AG17. Physical assets (such as inventories, property, plant and equipment), ~~leased~~ right-of-use assets and intangible assets (such as patents and trademarks) are not financial assets. Control of such physical ~~assets, right-of-use assets~~ and intangible assets creates an opportunity to generate an inflow of cash or another financial asset, but it does not give rise to a present right to receive cash or another financial asset.

Amendments to IPSAS 29, *Financial Instruments: Recognition and Measurement*

Paragraph 125A is amended. New text is underlined and deleted text is struck through.

Effective Date

...

125A. Paragraph 2 was amended by IPSAS 32, *Service Concession Arrangements: Grantor* issued in October 2011. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2014. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2014, it shall disclose that fact and at the same time apply IPSAS 32, the amendments to paragraphs 6 and 42A of IPSAS 5, ~~the amendments to paragraphs 25–27 and 85B of IPSAS 13~~, the amendments to paragraphs 5, 7 and 107C of IPSAS 17 and the amendments to paragraphs 6 and 132A of IPSAS 31.

Amendments to IPSAS 30, *Financial Instruments: Disclosures*

Paragraphs 35 and AG16 are amended. Paragraph 52L is added. New text is underlined and deleted text is struck through.

Significance of Financial Instruments for Financial Position and Financial Performance

...

Other Disclosures

...

Fair Value

...

35. Disclosures of fair value are not required:
- (a) When the carrying amount is a reasonable approximation of fair value, for example, for financial instruments such as short-term trade receivables and payables;
 - (b) [Deleted]
 - (c) For a contract containing a discretionary participation feature if the fair value of that feature cannot be measured reliably; or
 - (d) For lease liabilities.

...

Effective Date and Transition

...

52L. Paragraphs 35 and AG16 were amended by IPSAS 43, *Leases* issued in January 2022. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted. If an entity applies the amendments for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 43 at the same time.

Appendix A

Application Guidance

...

Nature and Extent of Risks Arising from Financial Instruments (paragraphs 38–49)

...

Quantitative Liquidity Risk Disclosures (paragraphs 41(a), and 46(a) and (b))

...

- AG16. The contractual amounts disclosed in the maturity analyses as required by paragraph 46(a) and (b) are the contractual undiscounted cash flows, for example:
- (a) Gross ~~finance lease obligations~~ liabilities (before deducting finance charges);
 - (b) Prices specified in forward agreements to purchase financial assets for cash;
 - (c) Net amounts for pay-floating/receive-fixed interest rate swaps for which net cash flows are exchanged;
 - (d) Contractual amounts to be exchanged in a derivative financial instrument (e.g., a currency swap) for which gross cash flows are exchanged; and
 - (e) Gross loan commitments.

Such undiscounted cash flows differ from the amount included in the statement of financial position because the amount in that statement is based on discounted cash flows. When the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing at the end of the reporting period. For example, when the amount payable varies with changes in an index, the amount disclosed may be based on the level of the index at the end of the period.

Amendments to IPSAS 31, *Intangible Assets*

Paragraphs 6, 9, 112, 113 and AG6 are amended. Paragraph 132K is added. New text is underlined and deleted text is struck through.

Scope

...

6. If another IPSAS prescribes the accounting for a specific type of intangible asset, an entity applies that IPSAS instead of this Standard. For example, this Standard does not apply to:

- (a) Intangible assets held by an entity for sale in the ordinary course of operations (see IPSAS 11, *Construction Contracts*, and IPSAS 12, *Inventories*);
- (b) ~~Leases that are within the scope of IPSAS 13 of intangible assets accounted for in accordance with IPSAS 43, *Leases*;~~
- (c) Assets arising from employee benefits (see IPSAS 39, *Employee Benefits*);
- (d) Financial assets as defined in IPSAS 28. The recognition and measurement of some financial assets are covered by IPSAS 34, *Separate Financial Statements*, IPSAS 35, *Consolidated Financial Statements* and IPSAS 36, *Investments in Associates and Joint Ventures*; and
- (e) Recognition and initial measurement of service concession assets that are within the scope of IPSAS 32, *Service Concession Assets: Grantor*. However, this Standard applies to the subsequent measurement and disclosure of such assets.

9. ~~In the case of a finance lease, the underlying asset may be either tangible or intangible. After initial recognition, a lessee accounts for an intangible asset held under a finance lease in accordance with this Standard. Rights held by a lessee under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents, and copyrights are excluded from the scope of IPSAS 13 and are within the scope of this Standard and are excluded from the scope of IPSAS 43.~~

...

Retirements and Disposals

...

- 112. **The gain or loss arising from the derecognition of an intangible asset shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the asset. It shall be recognized in surplus or deficit when the asset is derecognized (unless ~~IPSAS 13~~ IPSAS 43 requires otherwise on a sale and leaseback).**
- 113. The disposal of an intangible asset may occur in a variety of ways (e.g., by sale, by entering into a finance lease, or through a non-exchange transaction). In determining the date of disposal of such an asset, an entity applies the criteria in IPSAS 9, *Revenue from Exchange Transactions* for recognizing revenue from the sale of goods. ~~IPSAS 13~~ IPSAS 43 applies to disposal by a sale and leaseback.

Effective Date

...

132K. **Paragraphs 6, 9, 112, 113 and AG6 were amended by IPSAS 43 issued in January 2022. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted. If an entity applies the amendments for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 43 at the same time.**

Appendix A

Application Guidance

Website costs

...

AG6. ~~IPSAS 31 does not apply to intangible assets held by an entity for sale in the ordinary course of operations (see IPSAS 11 and IPSAS 12) or leases that fall within the scope of IPSAS 13 of intangible assets accounted for in accordance with IPSAS 43. Accordingly, this Application Guidance does not apply to expenditure on the development or operation of a website (or website software) for sale to another entity or that is accounted for in accordance with IPSAS 43. When a website is leased under an operating lease, the lessor applies this Application Guidance. When a website is leased under a finance lease, the lessee applies this Application Guidance after initial recognition of the leased asset.~~

Amendments to IPSAS 32, *Service Concession Arrangements: Grantor*

Paragraphs AG13 and AG17 are amended. Paragraph 36E is added. New text is underlined and deleted text is struck through.

Effective Date

...

36E. Paragraphs AG13 and AG17 were amended by IPSAS 43, *Leases* issued in January 2022. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted. If an entity applies the amendments for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 43 at the same time.

Appendix A**Application Guidance**

This Appendix is an integral part of IPSAS 32

...

AG13. The operator may have a right to use the separable asset described in paragraph AG12(a), or the facilities used to provide ancillary unregulated services described in paragraph AG12(b). In either case, there may in substance be a lease from the grantor to the operator; if so, it is accounted for in accordance with ~~IPSAS 13~~ IPSAS 43.

...

AG17. If the asset no longer meets the conditions for recognition in paragraph 9 (or paragraph 10 for a whole-of-life asset), the grantor follows the derecognition principles in IPSAS 17 or IPSAS 31, as appropriate. For example, if the asset is transferred to the operator on a permanent basis, it is derecognized. If the asset is transferred on a temporary basis, the grantor considers the substance of this term of the service concession arrangement in determining whether the asset should be derecognized. In such cases, the grantor also considers whether the arrangement is a lease transaction or a sale and lease-back transaction that should be accounted for in accordance with ~~IPSAS 13~~ IPSAS 43.

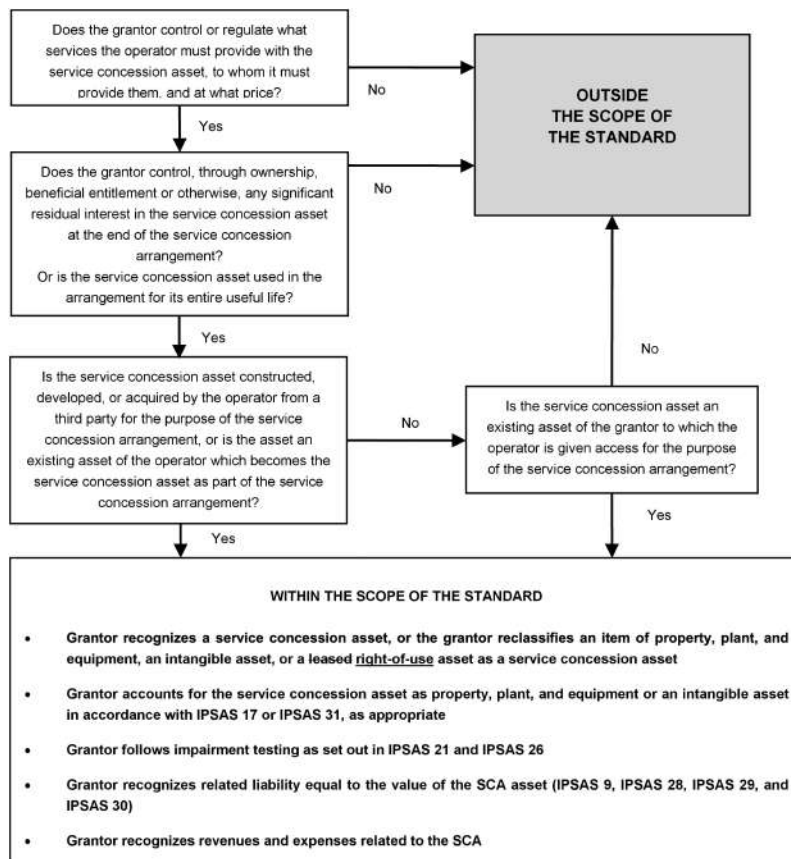
Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 32.

(...)

Accounting Framework for Service Concession Arrangements

IG2. The diagram below summarizes the accounting for service concession arrangements established by IPSAS 32.



References to IPSASs that Apply to Typical Types of Arrangements Involving an Asset Combined with Provision of a Service

(...)

IG4. Shaded text shows arrangements within the scope of IPSAS 32.

Category	Lessee	Service provider			Owner	
Typical arrangement types	Lease (e.g., operator leases asset from grantor)	Service and/or maintenance contract (specific tasks e.g., debt collection, facility management)	Rehabilitate-operate-transfer	Build-operate-transfer	Build-own-operate	100% Divestment/ Privatization/ Corporation
Asset ownership		Grantor			Operator	
Capital investment		Grantor		Operator		
Demand risk	Shared	Grantor	Grantor and/or Operator		Operator	
Typical duration	8–20 years	1–5 years	25–30 years		Indefinite (or may be limited by binding arrangement or license)	
Residual interest		Grantor			Operator	
Relevant IPSASs	IPSAS 13 IPSAS 43	IPSAS 1	This IPSAS/IPSAS 17/ IPSAS 31		IPSAS 17/IPSAS 31 (derecognition) IPSAS 9 (revenue recognition)	

Amendments to IPSAS 33, *First-Time Adoption of Accrual Basis IPSASs*

Paragraphs 36, 46, 47, 64, 95, and 148 and the headings above paragraphs 46, 95, 148 are amended. Paragraphs 96A, 96B, 96C, 96D, and 154J are added. Paragraph 96 is deleted. New text is underlined and deleted text is struck through.

Exemptions that Affect Fair Presentation and Compliance with Accrual Basis IPSASs during the Period of Transition

...

Three Year Transitional Relief Period for the Recognition and/or Measurement of Assets and/or Liabilities*Recognition and/or Measurement of Assets and/or Liabilities*

36. **Where a first-time adopter has not recognized assets and/or liabilities under its previous basis of accounting, it is not required to recognize and/or measure the following assets and/or liabilities for reporting periods beginning on a date within three years following the date of adoption of IPSASs:**
- (a) **Inventories (see IPSAS 12, *Inventories*);**
 - (b) **Investment property (see IPSAS 16, *Investment Property*);**
 - (c) **Property, plant and equipment (see IPSAS 17, *Property, Plant and Equipment*);**
 - (d) **Defined benefit plans and other long-term employee benefits (see IPSAS 39, *Employee Benefits*);**
 - (e) **Biological assets and agricultural produce (see IPSAS 27, *Agriculture*);**
 - (f) **Intangible assets (see IPSAS 31, *Intangible Assets*);**
 - (fa) Right-of-use assets and the related lease liabilities (see IPSAS 43, *Leases*);**
 - (g) **Service concession assets and the related liabilities, either under the financial liability model or the grant of a right to the operator model (see IPSAS 32, *Service Concession Arrangements: Grantor*); and**
 - (h) **Financial instruments (see IPSAS 29, *Financial Instruments; Recognition and Measurement*).**

Other Exemptions

...

~~IPSAS 13~~ IPSAS 43, *Leases*

46. Where a first-time adopter takes advantage of the exemption in paragraph 36 which allows a three year transitional relief period to not recognize assets, it is not required to apply the requirements related to ~~finance~~ leases until the exemption that provided the relief has expired, and/or when the relevant assets are recognized in accordance with the applicable IPSASs (whichever is earlier).
47. This IPSAS allows a first-time adopter a period of up to three years from the date of adoption of IPSASs to not recognize assets in accordance with IPSASs 16, 17, 27, 31 and 32. During this period, a first-time adopter may need to consider the recognition requirements of those IPSASs at the same time as considering the recognition of ~~finance~~ leases in this IPSAS. Where a first-time adopter takes advantage of the exemption in accordance with IPSASs 16, 17, 27, 31 and 32 it is not required to recognize ~~finance~~ lease assets and/or liabilities until the exemptions that provided the relief have expired, and/or when the relevant assets are recognized in accordance with the applicable IPSASs (whichever is earlier).

Exemptions that Do Not Affect Fair Presentation and Compliance with Accrual Basis IPSASs During the Period of Adoption

...

Using Deemed Cost to Measure Assets and/or Liabilities

64. **A first-time adopter may elect to measure the following assets and/or liabilities at their fair value when reliable cost information about the assets and liabilities is not available, and use that fair value as the deemed cost for:**

- (a) Inventory (see IPSAS 12);
- (b) Investment property, if the first-time adopter elects to use the cost model in IPSAS 16;
- (ba) Right-of-use assets (see IPSAS 43);**
- (c) Property, plant and equipment (see IPSAS 17);
- (d) Intangible assets, other than internally generated intangible assets (see IPSAS 31) that meets:
 - (i) The recognition criteria in IPSAS 31 (excluding the reliable measurement criterion); and
 - (ii) The criteria in IPSAS 31 for revaluation (including the existence of an active market);
- (e) Financial Instruments (see IPSAS 29); or
- (f) Service concession assets (see IPSAS 32).

...

IPSAS-13 IPSAS 43, Leases

95. A first-time adopter that is a lessor shall on the date of adoption of IPSAS, classify all existing leases as operating or finance leases on the basis of circumstances existing at the inception of the lease, to the extent that these are known on the date of adoption of IPSASs. A first-time adopter may assess whether a contract existing at the date of adoption of IPSASs contains a lease by applying paragraphs 10–12 of IPSAS 43 to those contracts on the basis of facts and circumstances existing at that date.
96. ~~[Deleted] If, however, the lessee and the lessor have agreed to change the provisions of the lease between the date of inception of the lease and the date of adoption of accrual basis IPSASs in a manner that would have resulted in a different classification of the lease identification of a lease at the date of adoption, the revised agreement contract shall be regarded as a new agreement contract. A first-time adopter shall consider the provisions of the new agreement contract at the date of adoption of accrual basis IPSASs in classifying the lease as an operating or finance lease identifying a lease.~~
- 96A. When a first-time adopter that is a lessee recognizes lease liabilities and right-of-use assets, it may apply the following approach to all of its leases (subject to the practical expedients described in paragraph 96C):
- (a) Measure a lease liability at the date of adoption of IPSASs. A lessee following this approach shall measure that lease liability at the present value of the remaining lease payments (see paragraph 96D), discounted using the lessee's incremental borrowing rate (see paragraph 96D) at the date of adoption of IPSASs.
 - (b) Measure a right-of-use asset at the date of adoption of IPSASs. The lessee shall choose, on a lease-by-lease basis, to measure that right-of-use asset at either:
 - (i) Its carrying amount as if IPSAS 43 had been applied since the commencement date of the lease (see paragraph 96D), but discounted using the lessee's incremental borrowing rate at the date of adoption of IPSASs; or
 - (ii) An amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognized in the statement of financial position immediately before the date of adoption of IPSASs;
 - (c) Apply IPSAS 21 or IPSAS 26 to right-of-use assets at the date of adoption of IPSASs.
- 96B. Notwithstanding the requirements in paragraph 96A, a first-time adopter that is a lessee shall measure the right-of-use asset at fair value at the date of adoption of IPSASs for leases that meet the definition of investment property in IPSAS 16 and are measured using the fair value model in IPSAS 16 from the date of adoption of IPSASs.
- 96C. A first-time adopter that is a lessee may do one or more of the following at the date of adoption of IPSASs, applied on a lease-by-lease basis:
- (a) Apply a single discount rate to a portfolio of leases with reasonably similar characteristics (for example, a similar remaining lease term for a similar class of underlying asset in a similar economic environment).

- (b) Elect not to apply the requirements in paragraph 96A to leases for which the lease term (see paragraph 96D) ends within 12 months of the date of adoption of IPSASs. Instead, the entity shall account for (including disclosure of information about) these leases as if they were short-term leases accounted for in accordance with paragraph 7 of IPSAS 43.
- (c) Elect not to apply the requirements in paragraph 96A to leases for which the underlying asset is of low value (as described in paragraphs AG4–AG9 of IPSAS 43). Instead, the entity shall account for (including disclosure of information about) these leases in accordance with paragraph 7 of IPSAS 43.
- (d) Exclude initial direct costs (see paragraph 96D) from the measurement of the right-of-use asset at the date of adoption of IPSASs.
- (e) Use hindsight, such as in determining the lease term if the contract contains options to extend or terminate the lease.
- 96D. Lease payments, lessor, lessee, lessee’s incremental borrowing rate, commencement date of the lease, initial direct costs and lease term are defined terms in IPSAS 43 and are used in this Standard with the same meaning.

Disclosures

...

Disclosures where Deemed Cost is Used for Inventory, Investment Property, Property, Plant and Equipment, Intangible Assets, Right-of-Use Assets, Financial Instruments or Service Concession Assets

148. If a first-time adopter uses fair value, or the alternative in paragraphs 64, 67 or 70, as deemed cost for inventory, investment property, property, plant and equipment, intangible assets, right-of-use assets, financial instruments, or service concession assets, its financial statements shall disclose:
- The aggregate of those fair values or other measurement alternatives that were considered in determining deemed cost;
 - The aggregate adjustment to the carrying amounts recognized under the previous basis of accounting; and
 - Whether the deemed cost was determined on the date of adoption of IPSASs or during the period of transition.

Effective Date

...

154J. Paragraphs 36, 46, 47, 64, 95, and 148, and the headings above paragraphs 46, 95, and 148 were amended, paragraph 96 was deleted, and paragraphs 96A, 96B, 96C, and 96D were added by IPSAS 43 issued in January 2022. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted. If an entity applies the amendments for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 43 at the same time.

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 33.

...

Transitional Exemptions that Provide Three Year Relief for the Recognition and/or Measurement of Assets and/or Liabilities

...

Accounting for Finance Leases Assets and Finance Lease Liabilities

- IG20. Where a first-time adopter that is a lessee takes advantage of the exemption that provides a three year transitional relief period to not recognize its finance lease right-of-use assets, it will also not be able to comply with the recognition requirements relating to the finance lease liabilities, until the transitional exemptions related to the finance leased right-of-use assets have expired, or the finance leased assets have been recognized in accordance with IPSAS 13.
- IG21. For example, assume that a first-time adopter that is a lessee has a motor vehicle right-of-use asset that is subject to a finance as a result of a lease agreement contract on the date of adoption of accrual basis IPSASs on January 1, 20X1. The

first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize the ~~motor vehicle right-of-use asset~~. The ~~motor vehicle right-of-use asset~~ is recognized on December 31, 20X3 when the exemption expires. IPSAS 33 requires the first-time adopter to only recognize the corresponding ~~finance lease liability for the motor vehicle right-of-use asset~~ on December 31, 20X3, i.e., on the date that the ~~finance lease asset (the motor vehicle) right-of-use asset~~ is recognized.

...

IG51. Paragraphs 23–26 of the IPSAS 33 do not override requirements in other IPSASs that base classifications or measurements on circumstances existing at a particular date. Examples include:

- (a) ~~The distinction between finance leases and operating leases~~ identification of a lease (see ~~IPSAS 13, Leases~~ IPSAS 43, Leases); and
- (b) The distinction between financial liabilities and equity instruments (see IPSAS 28, *Financial Instruments: Presentation*).

~~IPSAS 13, IPSAS 43, Leases~~

IG52. In accordance with paragraph 95 of IPSAS 33 and paragraph ~~18 of IPSAS 13~~ 70 of IPSAS 43, a lessee or lessor classifies leases as operating leases or finance leases on the basis of circumstances existing at the inception of the lease, on the date of adoption of accrual basis IPSASs. In some cases, the lessee and the lessor may agree to change the provisions of the lease, other than by renewing the lease, in a manner that would have resulted in a different classification for the lessor in accordance with ~~IPSAS 13~~ IPSAS 43 had the changed terms been in effect at the inception of the lease. If so, the revised agreement is considered as a new agreement contract over its term from the date of adoption of accrual basis IPSASs. ~~However, changes in estimates (for example, changes in estimates of the economic life or of the residual value of the leased property) or changes in circumstances (for example, default by the lessee) do not give rise to a new classification of a lease.~~

Summary of Transitional Exemptions and Provisions Included in IPSAS 33, *First-time Adoption of Accrual Basis IPSASs*

IG91.

IPSAS	Transitional exemption provided							
	NO	YES						
		Deemed cost	3 year transitional relief for recognition	3 year transitional relief for measurement	3 year transitional relief for recognition and/or measurement	3 year transitional relief for disclosure	Elimination of transactions, balances, revenue and expenses	Other
IPSAS 13 <i>Leases</i>			√ Leased assets and/or liabilities not recognized under previous basis of accounting	√ Leased assets and/or liabilities recognized under previous basis of accounting				

Appendix

Differentiation between transitional exemptions and provisions that a first-time adopter is required to apply and/or can elect to apply on adoption of accrual basis IPSASs

This Appendix summarises how the transitional exemptions and provisions that a first-time adopter is required to apply in terms of this IPSAS, and those that a first-time adopter may elect to apply on adoption of accrual basis IPSASs.

As the transitional exemptions and provisions that may be elected can also affect the fair presentation and the first-time adopter’s ability to assert compliance with accrual basis IPSASs as explained in paragraphs 27 to 32 of IPSAS 33, the Appendix makes a distinction between those transitional exemptions and provisions that affect fair presentation and the ability to assert compliance with accrual basis IPSASs, and those that do not.

Transitional exemption or provision	Transitional exemptions or provisions that have to be applied	Transitional exemptions or provisions that may be applied or elected	
	Do not affect fair presentation and compliance with accrual basis IPSAS	Do not affect fair presentation and compliance with accrual basis IPSAS	Affect fair presentation and compliance with accrual basis IPSAS
<p>IPSAS 13 <u>IPSAS 43</u></p> <ul style="list-style-type: none"> Where a first-time adopter is a lessee; No recognition and/or measurement of finance lease liability and finance lease right-of-use asset if relief period for recognition and/or measurement of assets is adopted Classification <u>Identification</u> of a lease based on circumstances at adoption of accrual basis IPSAS 	√		√

Amendments to IPSAS 40, *Public Sector Combinations*

Paragraphs 68, 71, 120, AG76, and AG89 are amended. Paragraphs AG72–AG74 and their related heading are deleted. Paragraphs 82A, 82B, and 126E are added. The heading before paragraph 82A is added. New text is underlined and deleted text is struck through.

The Acquisition Method of Accounting

...

Recognizing and Measuring the Identifiable Assets Acquired, the Liabilities Assumed and any Non-Controlling Interest in the Acquired Operation

Recognition Principle

...

Recognition Conditions

...

68. Paragraphs ~~AG72–AG84~~ AG75–AG84 provide guidance on recognizing ~~operating leases and~~ intangible assets. Paragraphs 76–82B specify the types of identifiable assets and liabilities that include items for which this Standard provides limited exceptions to the recognition principle and conditions.

...

Classifying or Designating Identifiable Assets Acquired and Liabilities Assumed in an Acquisition

...

71. This Standard provides two exceptions to the principle in paragraph 69:
- (a) Classification of a lease ~~arrangement contract in which the acquiree is the lessor~~ as either an operating lease or a finance lease in accordance with ~~IPSAS 13, *Leases*~~ IPSAS 43, *Leases*; and
 - (b) Classification of a contract as an insurance contract in accordance with the relevant international or national accounting standard dealing with insurance contracts.

Exceptions to the Recognition or Measurement Principles

...

Exceptions to both the Recognition and Measurement Principles

...

Leases in Which the Acquiree is the Lessee

82A. The acquirer shall recognize right-of-use assets and lease liabilities for leases identified in accordance with IPSAS 43 in which the acquiree is the lessee. The acquirer is not required to recognize right-of-use assets and lease liabilities for:

- (a) Leases for which the lease term (as defined in IPSAS 43) ends within 12 months of the acquisition date; or
- (b) Leases for which the underlying asset is of low value (as described in paragraphs AG4–AG9 of IPSAS 43).

82B. The acquirer shall measure the lease liability at the present value of the remaining lease payments (as defined in IPSAS 43) as if the acquired lease were a new lease at the acquisition date. The acquirer shall measure the right-of-use asset at the same amount as the lease liability, adjusted to reflect favorable or unfavorable terms of the lease when compared with market terms.

Disclosures

...

120. To meet the objective in paragraph 119, the acquirer shall disclose the following information for each acquisition that occurs during the reporting period:

- (a) The name and a description of the acquired operation.
- (b) The acquisition date.
- (c) The percentage of voting equity interests or equivalent acquired.
- (d) The primary reasons for the acquisition and a description of how the acquirer obtained control of the acquired operation including, where applicable, the legal basis for the acquisition.
- (e) A qualitative description of the factors that make up the goodwill recognized, such as expected synergies from combining the operations of the acquired operation and the acquirer, intangible assets that do not qualify for separate recognition or other factors.
- (f) The acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration, such as:
 - (i) Cash;
 - (ii) Other tangible or intangible assets, including an operation or controlled entity of the acquirer;
 - (iii) Liabilities incurred, for example, a liability for contingent consideration; and
 - (iv) Equity interests of the acquirer, including the number of instruments or interests issued or issuable and the method of measuring the fair value of those instruments or interests.
- (g) For contingent consideration arrangements and indemnification assets:
 - (i) The amount recognized as of the acquisition date;
 - (ii) A description of the arrangement and the basis for determining the amount of the payment; and
 - (iii) An estimate of the range of outcomes (undiscounted) or, if a range cannot be estimated, that fact and the reasons why a range cannot be estimated. If the maximum amount of the payment is unlimited, the acquirer shall disclose that fact.
- (h) For acquired receivables:
 - (i) The fair value of the receivables;
 - (ii) The gross amounts receivable in accordance with a binding arrangement; and
 - (iii) The best estimate at the acquisition date of the cash flows in accordance with a binding arrangement not expected to be collected.

The disclosures shall be provided by major class of receivable, such as loans, ~~direct finance~~ leases and any other class of receivables.

- (i) (...)

Effective Date and Transition

Effective Date

...

126E. Paragraphs 68, 71, 120, AG76 and AG89 were amended, paragraphs AG72–AG74 and their related heading were deleted, and paragraphs 82A and 82B and the related heading were added by IPSAS 43 issued in January 2022. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted. If an entity applies the amendments for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 43 at the same time.

Application Guidance

This Appendix is an integral part of IPSAS 40.

Recognizing Particular Assets Acquired and Liabilities Assumed in an Acquisition (see paragraphs 64–68)

Operating leases

- AG72. ~~[Deleted] The acquirer shall recognize no assets or liabilities related to an operating lease in which the acquired operation is the lessee except as required by paragraphs AG73–AG74.~~
- AG73. ~~[Deleted] The acquirer shall determine whether the terms of each operating lease in which the acquired operation is the lessee are favorable or unfavorable. The acquirer shall recognize an intangible asset if the terms of an operating lease are favorable relative to market terms and a liability if the terms are unfavorable relative to market terms. Paragraph AG89 provides guidance on measuring the acquisition-date fair value of assets subject to operating leases in which the acquired operation is the lessor.~~
- AG74. ~~[Deleted] An identifiable intangible asset may be associated with an operating lease, which may be evidenced by market participants' willingness to pay a price for the lease even if it is at market terms. For example, a lease of gates at an airport or of retail space in a prime shopping area might provide entry into a market or other future economic benefits or service potential that qualify as identifiable intangible assets, for example, as a relationship with users of a service. In that situation, the acquirer shall recognize the associated identifiable intangible asset(s) in accordance with paragraph AG75.~~

...

Intangible Assets

...

- AG76. An intangible asset that meets the binding arrangement criterion is identifiable even if the asset is not transferable or separable from the acquired operation or from other rights and obligations. For example:
- (a) ~~[Deleted] An acquired operation leases a facility under an operating lease that has terms that are favorable relative to market terms. The lease terms explicitly prohibit transfer of the lease (through either sale or sublease). The amount by which the lease terms are favorable compared with the terms of current market transactions for the same or similar items is an intangible asset that meets the binding arrangement criterion for recognition separately from goodwill, even though the acquirer cannot sell or otherwise transfer the lease arrangement.~~
 - (b) An acquired operation owns and operates a nuclear power plant. The license to operate that power plant is an intangible asset that meets the binding arrangement criterion for recognition separately from goodwill, even if the acquirer cannot sell or transfer it separately from the acquired power plant. An acquirer may recognize the fair value of the operating license and the fair value of the power plant as a single asset for financial reporting purposes if the useful lives of those assets are similar.
 - (c) An acquired operation owns a technology patent. It has licensed that patent to others for their exclusive use outside the domestic market, receiving a specified percentage of future foreign revenue in exchange. Both the technology

patent and the related license agreement meet the binding arrangement criterion for recognition separately from goodwill even if selling or exchanging the patent and the related license agreement separately from one another would not be practical.

...

Assets Subject to Operating Leases in Which the Acquired Operation is the Lessor

AG89. In measuring the acquisition-date fair value of an asset such as a building that is subject to an operating lease in which the acquired operation is the lessor, the acquirer shall take into account the terms of the lease. ~~In other words, ¶~~The acquirer does not recognize a separate asset or liability if the terms of an operating lease are either favorable or unfavorable when compared with market terms as ~~paragraph AG73 requires for leases in which the acquired operation is the lessee.~~

Illustrative Examples

These examples accompany, but are not part of, IPSAS 40

...

Identifiable Intangible Assets in an Acquisition

...

Binding Arrangement-Based Intangible Assets

IE224. Binding arrangement-based intangible assets represent the value of rights that arise from binding arrangements. Binding arrangements with customers are one type of binding arrangement-based intangible asset. If the terms of a binding arrangement give rise to a liability (for example, if the terms of ~~an operating lease or a~~ binding arrangement with a customer are unfavorable relative to market terms), the acquirer recognizes it as a liability assumed in the acquisition. Examples of binding arrangement-based intangible assets are:

Class	Basis
Licensing, royalty and standstill agreements	Binding arrangement
Advertising, construction, management, service or supply binding arrangements	Binding arrangement
Lease agreements (whether the acquired operation is the lessee or the lessor)	Binding arrangement
Construction permits	Binding arrangement
Franchise agreements	Binding arrangement
Operating and broadcast rights	Binding arrangement
Servicing binding arrangements, such as mortgage servicing binding arrangements	Binding arrangement
Binding arrangements for employment	Binding arrangement
Use rights, such as drilling, water, air, timber cutting and route authorities	Binding arrangement

Amendments to IPSAS 41, *Financial Instruments*

Paragraphs 2, 87, AG198, and AG210 are amended. Paragraph 156E is added. New text is underlined and deleted text is struck through.

Scope

2. **This Standard shall be applied by all entities to all types of financial instruments except:**

(a) ...

(b) **Rights and obligations under leases to which ~~IPSAS 13, *Leases*~~ IPSAS 43, *Leases* applies. However:**

(i) **Finance lease receivables (i.e., net investments in finance leases) and operating lease receivables recognized by a lessor are subject to the derecognition and impairment requirements of this Standard;**

- (ii) Lease liabilities recognized by a lessee are subject to the derecognition requirements in paragraph 35 of this Standard; and
 - (iii) Derivatives that are embedded in leases are subject to the embedded derivatives requirements of this Standard.
- (c) ...

Simplified Approach for Receivables

87. Despite paragraphs 75 and 77, an entity shall always measure the loss allowance at an amount equal to lifetime expected credit losses for:
- (a) Receivables that result from exchange transactions that are within the scope of IPSAS 9 and non-exchange transactions within the scope of IPSAS 23.
 - (b) Lease receivables that result from transactions that are within the scope of ~~IPSAS 13~~ IPSAS 43, if the entity chooses as its accounting policy to measure the loss allowance at an amount equal to lifetime expected credit losses. That accounting policy shall be applied to all lease receivables but may be applied separately to finance and operating lease receivables.

Effective Date and Transition

Effective Date

...

156E. Paragraphs 2, 87, AG198 and AG210 were amended by IPSAS 43 issued in January 2022. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2025. Earlier application is permitted. If an entity applies the amendments for a period beginning before January 1, 2025, it shall disclose that fact and apply IPSAS 43 at the same time.

Application Guidance

...

Measurement of Expected Credit Losses

Expected Credit Losses

...

AG198. When measuring a loss allowance for a lease receivable, the cash flows used for determining the expected credit losses should be consistent with the cash flows used in measuring the lease receivable in accordance with ~~IPSAS 13, Leases~~ IPSAS 43, Leases.

...

Time Value of Money

...

AG210. Expected credit losses on lease receivables shall be discounted using the same discount rate used in the measurement of the lease receivable in accordance with ~~IPSAS 13~~ IPSAS 43, Leases.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 43.

Introduction

- BC1. IPSAS 13, *Leases*, was drawn primarily from International Accounting Standard (IAS) 17, *Leases*, (revised 2003) issued by the International Accounting Standards Board (IASB). In January 2016, the IASB issued International Financial Reporting Standard (IFRS) 16, *Leases*. IFRS 16 replaced IAS 17 and a number of related interpretations¹.
- BC2. In June 2016, the IPSASB approved a project brief to develop revised requirements for accounting for leases. This brief acknowledged, and reconfirmed, the IPSASB's conclusion in IPSAS 13 that the economics of a lease transaction are the same in both the public and private sectors, resulting in the decision that this should be an IFRS 16 alignment project.
- BC3. The IPSASB's policy document, *Process for Reviewing and Modifying IASB Documents*, sets out the process the IPSASB follows when developing an aligned Standard. The first step of the process is to consider whether there are any public sector issues that warrant a departure from an IASB document.
- BC4. In determining whether public sector issues warrant a departure from an IASB document, the IPSASB considers the following:
- (a) Whether applying the requirements of the IASB document would mean that the objectives of public sector financial reporting would not be adequately met;
 - (b) Whether applying the requirements of the IASB document would mean that the qualitative characteristics of public sector financial reporting would not be adequately met; and
 - (c) Whether applying the requirements of the IASB document would require undue cost or effort.
- BC5. The *Process for Reviewing and Modifying IASB Documents* requires the IPSASB to make its decisions in the context of the following:
- (a) Consistency with the IPSASB's *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the *Conceptual Framework*);
 - (b) Internal consistency with existing IPSAS; and
 - (c) Consistency with the statistical bases.

Background

Development of ED 64, Leases

Lessee Accounting

- BC6. IFRS 16 introduced a new lease accounting model for lessees—the right-of-use model. The right-of-use model is based on the foundational principle that leases are financings of the right to use an underlying asset, and results in lessee accounting as follows²:
- (a) Recognizes a 'right-of-use asset'; and
 - (b) Recognizes a lease liability related to the future lease payments.
- BC7. When developing ED 64, *Leases*, the IPSASB had considered whether there were any public sector issues that warranted a departure from the right-of-use model for lessee accounting in IFRS 16. In so doing, the IPSASB came to the following conclusions:
- (a) The right-of-use asset satisfies the definition of, and recognition criteria for, an asset in the IPSASB's *Conceptual Framework*.
 - (b) The right-of-use asset is recognized when the lessee controls the asset, which is consistent with the IPSASB's *Conceptual Framework*.

¹ International Financial Reporting Interpretations Committee Interpretation IFRIC-4, *Determining whether an Arrangement contains a Lease* and Standing Interpretations Committee Interpretations SIC-15, *Operating Leases—Incentives* and SIC-27, *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*.

² Except for short-term leases and leases for which the underlying asset is of low value, as described in IFRS 16.5–8.

- (c) The information reported under the single right-of-use lessee accounting model specified in IFRS 16 would provide the most useful information to the broadest range of users of financial statements.
- (d) The right-of-use model prevents accounting arbitrage and information asymmetry. It improves comparability between public sector entities that lease assets and public sector entities that purchase assets.
- (e) The IPSASB acknowledged that there would be costs for lessees associated with implementing the right-of-use model in the public sector. However, the IPSASB considered that the benefits outweigh the costs, particularly if the IPSASB also adopted the exemptions in IFRS 16.

BC8. Consequently, the IPSASB had agreed that there were no public sector issues that warranted a departure from the right-of-use model for lessee accounting in IFRS 16. The IPSASB therefore had decided to develop ED 64 with lessee accounting requirements that were aligned with the requirements in IFRS 16.

Lessor Accounting

BC9. IFRS 16 retained the ‘risks and rewards incidental to ownership’ model applied in IAS 17 (and IPSAS 13). The IPSASB had considered whether there were any public sector issues that warranted a departure from the lessor accounting requirements in IFRS 16. In developing ED 64, the IPSASB had come to the view that the ‘risks and rewards incidental to ownership’ model:

- (a) Is not based on control and would not be consistent with the IPSASB’s *Conceptual Framework*.
- (b) Does not distinguish between the right-of-use asset and the underlying asset. The IPSASB considered these to be different economic phenomena which should both be accounted for.
- (c) If applied for lessor accounting, while a control-based model was applied for lessee accounting, would:
 - (i) Be inconsistent with IPSAS 17, *Property, Plant, and Equipment* and IPSAS 32, *Service Concession Arrangements: Grantor*, which are based on control; and
 - (ii) Raise consolidation issues and impair understandability and the decision usefulness of information where the lessor and the lessee are part of the same economic entity. For example, if the lessor classifies the lease as a finance lease, the underlying asset is not recognized by either party, and separate records will need to be maintained to report the underlying asset in the consolidated financial statements. In this context, the IPSASB had formed the view that a lessor would not be expected to derecognize a leased asset because the lessor has only transferred the right to use an underlying asset, not the underlying asset itself.

BC10. As a consequence, the IPSASB had decided to develop a right-of-use model for lessor accounting specifically designed for public sector financial reporting.

IPSASB Consultative Advisory Group

BC11. The IPSASB Consultative Advisory Group (CAG) had been consulted during the development of ED 64, in particular on the IPSASB’s decision to depart from IFRS 16 in lessor accounting.

BC12. At its December 2016 meeting, the CAG advised the IPSASB of its views that:

- (a) Symmetry may not be needed in lease accounting;
- (b) The treatment of the underlying asset is an important issue in the public sector, and it needs to be recognized in the financial statements; and
- (c) An approach drawn from IFRS 16 would result in the underlying asset not appearing in the statement of financial position of either the lessor or lessee in some cases and expressed a view that this would give rise to a public interest concern.

BC13. The CAG also advised the IPSASB that if it wants to pursue proposals other than IFRS 16 lessor accounting it may take a long time to develop an appropriate lessor accounting model given the experiences and challenges the IASB faced in attempting to do so.

ED 64, Leases

BC14. In January 2018, the IPSASB published ED 64, *Leases* proposing a single right-of-use model for lease accounting for lessees and lessors under which:

- (a) The lessee would recognize a ‘right-of-use asset’ and a lease liability related to the future lease payments at the commencement of a lease; and
- (b) The lessor would recognize a lease receivable and a lease liability (unearned revenue) at the commencement of a lease, while continuing to recognize and measure the underlying asset according to the applicable Standards.

BC15. ED 64 also proposed specific public sector accounting requirements on leases at below-market terms, also known as concessionary leases. The proposal was that such leases be measured at fair value leading to recognition of the implicit subsidy (the difference between the market value and the lease contract value) in both lessees’ and lessors’ financial statements.

Feedback from Constituents on ED 64, Leases

BC16. The IPSASB received 39 comment letters in response to ED 64. This feedback indicated that:

- (a) The vast majority of respondents agreed with the right-of-use model for lessee accounting. Many respondents who agreed with the proposals noted that their thinking was generally consistent with IPSASB’s reasoning set out in the Basis for Conclusions to ED 64.
- (b) Respondents that disagreed or partially agreed with the right-of-use model for lessees were of the view that:
 - (i) The proposed model was too complicated, costly and focused on the statement of financial position;
 - (ii) The right-of-use model for lessee accounting by itself was inadequate for public sector reporting because the IPSASB did not consider sufficiently the allocations of rights, which pertain to physical and intangible assets, which are prevalent in the public sector;
 - (iii) An exemption should be provided for leases between public sector entities; and
 - (iv) Guidance should be provided on the recognition and measurement of the transferred asset at the end of the lease term.³
- (c) Respondents were almost equally divided over whether a departure from IFRS 16 lessor accounting was justified, with a small majority supporting departure. Generally, those in support of IFRS 16 lessor accounting, were of the view that the IPSASB had not made a strong enough case to depart from IFRS 16. On the other hand, those supporting departure from IFRS 16 lessor accounting on conceptual grounds agreed with the IPSASB’s reasoning set out in the Basis for Conclusions, but did not agree consistently with the proposals for lessor accounting set out in ED 64.
- (d) Respondents that did not agree with ED 64 proposals for lessor accounting did not have a unified view on the approach that should be adopted for lessor accounting and proposed a number of alternatives. The lack of consensus among respondents on the economics of, and accounting for, leases by lessors highlighted significant differences across jurisdictions.
- (e) Respondents were of the view that the IPSASB needed to address public sector specific issues related to leases (for example, concessionary leases, access rights, and other types of arrangements in the public sector, etc.). However, respondents provided diverse views on how to address these public sector specific issues.

IPSASB’s Response to Constituents’ Feedback on ED 64, Leases

IPSASB Consultative Advisory Group

BC17. After considering constituents’ feedback on ED 64, at the December 2018 CAG meeting the IPSASB sought CAG’s views on actions to move the Leases project forward in light of the responses to ED 64.

BC18. The CAG advised the IPSASB that at this stage of the Leases project it would be in the public interest to:

- (a) Slow down the Leases project by extending its timeline to better understand the issues raised by respondents to ED 64;
- (b) Further consider alignment with IFRS 16 regarding lessor accounting; and
- (c) Focus on public sector differences related to lease transactions.

³ See paragraph BC27.

Other IPSASB initiatives

BC19. The IPSASB decided to:

- (a) Create a Task Force in December 2018, with members from several jurisdictions, including preparers, users, auditors and standard-setters, to undertake an in-depth review of all constituent comments; and
- (b) Invite guest speakers to the June and September 2019 IPSASB meetings to provide their views on lease accounting and the implementation challenges of applying IFRS 16 in both the private and public sectors. Speakers included national standard-setters, auditors, preparers and the statistical accounting community.

BC20. The guest speakers highlighted that the new lessee accounting model in IFRS 16 was raising significant implementation issues in both the private and public sectors. The IPSASB considered that leases are a very common transaction in the public sector, and that any changes on how to account for leases would have similar or greater implementation cost and challenges for the public sector. IFRS 16 also presents significant conceptual and practical challenges for the statistical community.

New Approach to the Leases Project

BC21. In the light of these presentations and the responses to ED 64, in March 2020 the IPSASB decided to revisit its overall approach to the Leases project, and to adopt a phased approach as follows:

- (a) Phase One, dealing with lease accounting model(s) for both lessees and lessors based on the same definition of a lease as in IFRS 16; and
- (b) Phase Two, dealing with public sector specific issues, such as concessionary leases, access rights, and other types of arrangements in the public sector. The IPSASB also decided to issue a 'Request for Information' to better inform this Phase Two work.

BC22. In determining how to approach the first phase of the project, the IPSASB discussed whether it should consider a variant to IFRS 16 lessor accounting that would require all lessors to account for leases as operating leases only. The aim of this variant would be to deal with the concern raised by respondents regarding the non-recognition of the underlying asset by both the lessor and the lessee if the lessor classifies the lease as a finance lease.

BC23. The IPSASB decided not to proceed with this IFRS 16 variant for lessors because:

- (a) Requiring operating lease accounting for all lessor transactions would remove the judgement by preparers that is inherent to the risks and rewards model and would transform it into a rules-based model without sufficient economic rationale;
- (b) It would create consolidation issues where both lessor and lessee are part of the same economic entity applying IPSAS; and
- (c) It would create mixed group⁴ issues where some commercial public sector entities apply IFRS Standards but are controlled by public sector entities that apply IPSAS. Different requirements are costly to those applying IPSAS when there is no public sector specific reason to develop different accounting treatments.

Three Strategic Options for the Leases Project

BC24. After making this decision, the IPSASB discussed three strategic options:

- (a) Option 1 – Retain IPSAS 13, which would pause the project;
- (b) Option 2 – Proceed with the right-of-use model for lessees and risks and rewards model for lessors in developing a Standard aligned with IFRS 16; or
- (c) Option 3 – Proceed with the right-of-use model for both lessees and lessors and develop a Standard based on ED 64.

BC25. In order to make this strategic decision on the overall future direction of the project, the IPSASB considered the following six factors alongside the public interest:

- (a) Public Financial Management (PFM)⁵ benefits;

⁴ Mixed groups are groups that encompass public sector entities that apply IPSAS and commercial public sector entities that apply IFRS Standards.

⁵ Defined in *The CIPFA FM Model, Statements of Good Practice* as "Public Financial Management is the system by which financial resources are planned, directed and controlled to enable and influence the efficient and effective achievement of public service outcomes." (see <https://www.cipfa.org/media/files/training%20and%20qualifications/keystone%20guides/cipfa%20fm%20model.pdf>).

- (b) Implementation costs and challenges—training, information technology changes, change of processes, accounting changes (first-time implementation of new Standard), and on-going accounting (maintenance);
- (c) Government Finance Statistics (GFS) alignment—at the conceptual level, when comparing IPSAS and GFS accounting frameworks, and at the practical level, when compiling GFS accounts using information from accrual-based IPSAS accounts;
- (d) IPSASB’s *Conceptual Framework*—public sector financial reporting objectives of accountability and decision-making, and whether transactions and events meet the definition of elements⁶;
- (e) IFRS Alignment—alignment with IFRS 16; and
- (f) Feasibility of the Leases project—timeliness, and impact on project management, IPSASB’s resource allocation, and IPSASB’s Work Program.

BC26. The IPSASB first considered whether to pause with the leases project by retaining IPSAS 13 (Option 1). The IPSASB was of the view that retaining IPSAS 13 would be the least favorable option in terms of PFM benefits, consistency with the IPSASB’s *Conceptual Framework* and IFRS Alignment because it would:

- (a) Continue to allow off-balance sheet financing of operating leases for lessees;
- (b) Create mixed group issues where some controlled entities are required to apply IFRS Standards;
- (c) Result in some cases the underlying asset not being recognized by either the lessee or the lessor, or being recognized by both;
- (d) Be inconsistent with the control-based approach to asset recognition and derecognition in the IPSASB’s *Conceptual Framework*; and
- (e) Retain an accounting model that differs from that in IFRS 16 for both lessees and, to a lesser extent, lessors⁷.

BC27. During its discussion of Option 1, the IPSASB also considered the comments made by respondents that disagreed or partially agreed with the right-of-use model for lessees (see paragraphs BC16(b)(i)–BC16(b)(ii)). The IPSASB concluded that the respondents’ concerns were not public sector specific and, therefore, did not warrant a departure from IFRS 16. The IPSASB also concluded that the benefits of the right-of-use model for lessees would outweigh the costs of the accounting changes as there would be a number of simplifications, such as:

- (a) Providing a single accounting model for lessees which would remove the different lease classifications in IPSAS 13;
- (b) Permitting a lessee not to recognize assets and liabilities, for short-term leases and leases of low-value assets;
- (c) Permitting application of the Standard by entities on a portfolio basis for leases with similar characteristics;
- (d) Simplifying the measurement requirements for lease liabilities, in particular the requirements for variable lease payments, payments during optional periods and the reassessment of lease liabilities;
- (e) Establishing requirements for separating lease and non-lease components included in the same contract;
- (f) Establishing lessee disclosure requirements focused on the most significant features of their lease portfolios; and
- (g) Simplifying lessee transition requirements.

BC28. Consequently, the IPSASB decided that it would be in the public interest not to proceed with Option 1, and so to replace IPSAS 13 with a new Standard.

BC29. The IPSASB then considered whether to proceed with Option 2 (an IFRS 16-aligned Standard) or to proceed with Option 3 (ED 64) by applying the six factors outlined in paragraph BC25. Since the main difference between these two options was the lessor accounting model, this was the focus for the Board’s discussions, and therefore the paragraphs below focus on lessor accounting, except where otherwise stated.

BC30. Regarding PFM benefits, it was not clear from the responses to ED 64 which option provides the greater overall benefits. For example, some respondents argued that the recognition of a liability would lead to increased financial leverage reflected

This definition is aligned with the principles in the *IFAC/CIPFA International Framework: Good Governance in the Public Sector* (see <https://www.ifac.org/knowledge-gateway/contributing-global-economy/publications/international-framework-good-governance-public-sector>)

⁶ The main difference between the three options is related to recognition of elements and how this impacts accountability and decision-making.

⁷ For lessees, IPSAS 13 includes the risks and rewards incidental to ownership model and IFRS 16 includes the right-of-use model. For lessors, IFRS 16 changed the risks and rewards incidental to ownership model compared to IAS 17 (the Standard from which IPSAS 13 was drawn primarily) because it made changes to the requirements for subleases, lease modifications, initial direct costs, variable lease payments, and disclosures.

in the lessor's statement of financial position. Therefore, this factor did not provide a clear indication of which option was preferable.

- BC31. Option 3 would entail greater implementation costs and challenges than Option 2 because IFRS 16 substantially carried forward the lessor accounting model in IAS 17 (with which IPSAS 13 is aligned), making only relatively minor changes.
- BC32. With respect to alignment with GFS, wherein the lessees and lessors both follow the concept of risks and rewards, the Option 2 accounting model would be aligned for lessors, but not for lessees. From a GFS perspective Option 2 would still require the use of surveys to obtain data on the underlying asset in a lease (when the lessor has a finance lease). However, Option 2 is currently being applied in the private sector and any additional statistical information or data processes required by GFS can be replicated in the public sector if the IPSASB chose this option. Under Option 3, the accounting model would not be aligned with GFS for both lessees and lessors.
- BC33. Option 3, under which both the lessees and lessors would follow the concept of control, would be more consistent with the IPSASB's *Conceptual Framework*, while Option 2 would be less consistent with the IPSASB's *Conceptual Framework*⁸.
- BC34. On the other hand, Option 2 would be aligned with IFRS Standards, while Option 3 would not be so aligned.
- BC35. From a project management perspective, Option 2 would have the advantage of being more straightforward and therefore more feasible than Option 3. Additionally, Option 3 would be more challenging from a project delivery perspective because of the probable continued variations in views in further developing the ED 64 lessor accounting proposals, which could therefore extend the project timeline.
- BC36. After careful consideration of the respective arguments for and against the Options for each of the six factors, the IPSASB decided that, on balance, the public interest would be better served by proceeding with Option 2 (an IFRS 16-aligned Standard) because it would:
- (a) Be less costly and challenging to implement by changing only lessee accounting, and the public sector could benefit from the private sector experience in implementing IFRS 16;
 - (b) Align with the IPSASB's Strategy & Work Plan strategic theme of Maintaining IFRS Alignment, which was an original objective of the Leases project;
 - (c) Address more quickly the important off-balance sheet financing of operating leases by lessees that IPSAS 13 permits, without waiting for a new accounting model for lessors; and
 - (d) Facilitate Phase One delivery, thus permitting the IPSASB to focus on Phase Two of the project, and so to address the important public sector specific issues described in paragraph BC21(b) in a more timely manner.

Exposure Draft (ED) 75, *Leases* and Request for Information

- BC37. In January 2020, the IPSASB published:
- (a) ED 75, *Leases* as part of Phase One of the Leases project; and
 - (b) Request for Information, *Concessionary Leases and Other Arrangements Similar to Leases* as part of the Phase Two of the Leases project.
- BC38. The IPSASB received 48 and 37 comment letters in response to ED 75 and Request for Information, respectively.
- BC39. The feedback received on the proposals in ED 75⁹ indicated that:
- (a) The majority of respondents agree or partially agreed with the ED 75 proposals for alignment with IFRS 16 and consequently with the right-of-use model for lessees¹⁰ and risks and rewards model for lessors; and
 - (b) Some respondents who agreed with ED 75 noted that their thinking was generally consistent with IPSASB's reasoning set out in the Basis for Conclusions (BC) to ED 75. Other respondents agreed with ED 75 without providing additional reasons.
- BC40. The IPSASB noted that the ED 75 proposals for lessor accounting have much stronger support from respondents when comparing with the ED 64 proposals, which received mixed support.
- BC41. Some respondents, while agreeing with the ED 75 proposals for lessee and lessor accounting, provided minor points for further consideration by the IPSASB.

⁸ Where a Standard is developed that departs from the *Conceptual Framework*, the IPSASB explains the reasons.

⁹ The analysis of the responses to the Request for Information will be made in Phase Two of the Leases project.

¹⁰ This feedback was consistent with ED 64 lessee accounting model aligned with IFRS 16, which was also supported.

- BC42. The few respondents that partially agreed or disagreed with ED 75 provided the following reasons:
- (a) Exemption should be added for public sector entities to provide relief from applying the proposed accounting requirements for leases between entities of the public sector because of cost-benefit reasons;
 - (b) Accounting asymmetry between lessee and lessor;
 - (c) The underlying asset is recognized neither in the lessor's nor in the lessee's financial statements in the case of a finance lease from the lessor's perspective;
 - (d) Divergence with Government Finance Statistics (GFS) in lessee accounting;
 - (e) Scope of public debt for lessees;
 - (f) The Leases project should have a single phase;
 - (g) Continue adopting IPSAS 13; and
 - (h) Proposed model for lessees is too complicated, costly and concentrated on the statement of financial position
- BC43. The IPSASB considered the overall feedback received and concluded that the issues raised by respondents that partially agreed or disagreed with ED 75 were:
- (a) Not public sector specific that warrant departure from IFRS 16; or
 - (b) Considered by the IPSASB during the development of ED 75 as set out in its Basis for Conclusions (see BC21–BC36).
- BC44. Therefore, the IPSASB decided to proceed with the ED 75 proposals for lessee and lessor accounting, subject to addressing the minor points raised by respondents that in the view of the IPSASB would enhance ED 75.

IPSAS 43, *Leases*

- BC45. This Standard is based on IFRS 16, *Leases* issued by the IASB. In accordance with existing practice, this Basis for Conclusions outlines only those areas where IPSAS 43 departs from the main requirements of IFRS 16, or where the IPSASB considered such departures taking into consideration the feedback received to ED 75.

Scope (see paragraph 3)

- BC46. In developing ED 75, the IPSASB had considered whether to provide an explicit scope exclusion for concessionary leases. The IPSASB had decided not to provide that explicit scope exclusion because:
- (a) IPSAS 13 does not have a scope exclusion for concessionary leases;
 - (b) ED 75 is an IFRS aligned Standard, and IFRS 16 does not exclude concessionary leases from its scope; and
 - (c) Any issues in applying ED 75 to concessionary leases, including the concession component, will be considered further in Phase Two of the Leases project (see paragraph BC21(b)).
- BC47. In reaching this decision, the IPSASB had noted that ED 75 already addressed lease incentives paid by the lessor to the lessee to entice the lessee to enter into the lease. However, in this situation the lease incentives do not modify the nature of the lease as being a lease at market terms. The leases to be considered in Phase Two of the Leases project are concessionary leases where the lessor has the intention of providing a concession that modifies the nature of the lease into a lease at below-market terms.

*Responses to ED 75, *Leases**

- BC48. The majority of respondents to ED 75 supported the proposed scope based on the same reasons as set out in paragraph BC39.
- BC49. The minority respondents who did not support the proposed scope in ED 75 commented that they would prefer to explicitly scope out concessionary lease because:
- (a) The separation of the lease component requirement cannot be applied to leases with no consideration or the exchange is insignificant;
 - (b) It would help clarify whether ED 75 (measured at cost) or IPSAS 23 (measured at fair value) applies to concessionary leases;
 - (c) It would help clarify whether ED 75 or the future pronouncement based on the RFI apply to concessionary leases;

- (d) Preparers may have to change their accounting treatment of concessionary leases in order to comply with ED 75 following Phase One, and later on have to again change their accounting treatment of concessionary leases in order to comply with the pronouncement issued following Phase Two of IPSASB's Leases project.

BC50. The IPSASB considered the issues raised by the respondents and decided to proceed with the ED 75 proposals as the basis for IPSAS 43 due to:

- (a) The reasons identified in paragraph BC46; and
- (b) The issues raised by respondents to ED 75 were not persuasive enough to justify a different approach.

Definitions

Definition of a Lease

BC51. In developing ED 75, the IPSASB decided to adopt the IFRS 16 definition of a lease because it had not identified a public sector specific reason that warranted departure from IFRS 16.

Responses to ED 75, *Leases*

BC52. While the majority of respondents agreed with the ED 75 proposal, a few respondents suggested that the IPSASB should:

- (a) Clarify the term consideration to refer to financial or nonfinancial consideration as public sector entities may also enter into lease contracts in exchange for consideration that is nonfinancial;
- (b) Clarify the difference between concessionary leases and nominal leases and quantifying the value and the basis of a nominal lease from the definition of a lease perspective; and
- (c) Amend the definition of a lease by adding the term “control the” before “use of an identified asset” [footnote omitted] to be consistent with the application guidance of ED 75.10 because inconsistent references to the right to use make it difficult to decide whether the analysis should focus on the right to use, the right to control the use or the right to direct the use.

BC53. The IPSASB noted that ED 75 deals with consideration in the form of cash flows because:

- (a) The definition of a lease is linked to the definition of lease payments, and
- (b) This approach is consistent with both IPSAS 13, *Leases* and IFRS 16, *Leases*.

BC54. The IPSASB also noted that Phase Two of the Leases project will address concessionary leases, which the Request for Information, *Concessionary Leases and Other Arrangements Similar to Leases* is part of.

BC55. The IPSASB considered the consistency between the definition of a lease and its application guidance. The IPSASB concluded that the application guidance in ED 75 clarifies the principle set out in the definition of a lease about conveying the right to use an identified asset by explicitly referring to the right to control the use of an identified asset, without the need to include it in the definition of a lease. The IPSASB noted that this approach is consistent with the approach in IFRS 16.

BC56. In conclusion, the IPSASB decided to retain the ED 75 proposals in IPSAS 43, *Leases* because it did not identify a public sector specific reason that would warrant a departure from IFRS 16.

Contractual Arrangements

BC57. In developing ED 75, the IPSASB had noted that, in certain jurisdictions, public sector entities are precluded from entering into formal contracts but do enter into arrangements that have the substance of contracts. These arrangements may be known by another term, e.g., a “government order.” To assist entities in identifying contracts, which either have the substance or legal form of a contract, the IPSASB had considered it appropriate to issue additional Application Guidance explaining the factors an entity should consider in assessing whether an arrangement is contractual or non-contractual.

BC58. Consideration was given to whether the term “binding arrangement” should be used to describe the arrangements highlighted in paragraph AG3. The term “binding arrangement” is defined in IPSAS 32, *Service Concession Arrangements: Grantor* as contracts and other arrangements that confer similar rights and obligations on the parties to it as if they were in the form of a contract. For example, an arrangement between two government departments that do not have the power to contract may be a binding arrangement. The IPSASB had concluded that the term “binding arrangements,” as used in IPSASs, embraces a wider set of arrangements than those identified in paragraph AG3 and therefore concluded that it should not be used in this Standard. Entities in a binding arrangement would enforce their rights and obligations through legal (enforceable

through judicial system) or equivalent means (enforceable through cabinet and ministerial directives, executive authority, or other means that are similar). However, entities in a contract would enforce their rights and obligations only through legal means (i.e., by law, through judicial system).

Responses to ED 75, *Leases*

- BC59. ED 75 specifically referred to contracts in the definition of a lease. Although the majority of respondents agreed with the ED 75 proposals, some respondents disagreed with limiting the definition of a lease to contracts because it would scope out from the final IPSAS on Leases types of arrangements that are not contracts, but are prevalent in the public sector because:
- (a) There might not be willing parties to the arrangement; or
 - (b) Many public sector entities do not have the power to enter into contracts but enter into binding arrangements that confer similar rights and obligations on the parties as if they were a form of contract.
- BC60. As a result of these concerns, the IPSASB decided to clarify that IPSAS 43 is designed only for transactions that have the three elements identified in paragraph AG3.
- BC61. As noted in BC58, the IPSASB differentiated contracts as enforced by legal means whereas binding arrangements are enforced by legal or equivalent means. A transaction that does not have willing parties is neither a contract nor a binding arrangement.
- BC62. As a result, the IPSASB decided to retain the term “contract” in the definition of a lease in IPSAS 43.

Initial Direct Costs

- BC63. The IPSASB decided not to include the IFRS 16 requirements for a manufacturer or dealer lessor (see paragraph BC93) in IPSAS 43. Therefore, the IFRS 16 definition of ‘initial direct costs’ has also been amended to remove the reference to a manufacturer or dealer lessor.

Fair Value

- BC64. In developing ED 75, the IPSASB had considered whether to retain the fair value definition consistent with IFRS 16 and IPSAS 13 or to include the fair value definition consistent with ED 77, *Measurement*.
- BC65. The IPSASB had noted that including the fair value definition consistent with ED 77 might significantly change the lease classification and the timing of recognizing gains or losses for sale and leaseback transactions.
- BC66. Therefore, the IPSASB had decided to retain the fair value definition consistent with IFRS 16 because:
- (a) It is consistent with the IPSASB’s March 2020 decision to retain the IPSAS 13 lessor requirements and align with IFRS 16 for cost-benefit reasons (see paragraph BC36); and
 - (b) It is consistent with the IASB’s decision to retain in IFRS 16 the fair value definition that existed in IAS 17, as the previous lessor accounting model in IAS 17 was not fundamentally flawed and should not be changed.

Responses to ED 75, *Leases*

- BC67. While the majority of respondents agreed with the ED 75 proposals, some respondents disagreed with the retention of the fair value definition from IFRS 16, *Leases* and IPSAS 13, *Leases* in ED 75 because:
- (a) Of the possible confusion for users and preparers of having two different fair value definitions in IPSASB’s literature;
 - (b) Sale and leaseback transactions (where the definition of fair value is used) occur infrequently in the public sector;
 - (c) Of the benefits of the consistent use of terminology in IPSASB literature; and
 - (d) Most countries are still in the process of implementing IPSAS and, therefore, the change to the ED 77 fair value definition would not cause significant change for their accounting system.
- BC68. The IPSASB decided to retain the ED 75 fair value definition in IPSAS 43 because there was no compelling public sector reason to depart from IFRS 16.

Identifying a Lease

- BC69. In developing ED 75, the IPSASB had considered whether to refer to both “economic benefits” and “service potential” in the application guidance section in ED 75 on identifying a lease, rather than “economic benefits” alone.

- BC70. If the guidance referred only to “economic benefits”, the IPSASB had noted that an entity that intends to use the identified asset to provide services to the community might reach the conclusion that the transaction is not a lease because it does not derive economic benefits from the use of that asset, despite the fact that the transaction meets the definition of a lease in ED 75.5. Therefore, the IPSASB had decided to add the term “service potential” in the application guidance section on identifying a lease, where appropriate.
- BC71. In reaching this conclusion, the IPSASB had also noted that this approach is consistent with *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (2014) in referring to assets in terms of both economic benefits and service potential.

Responses to ED 75, *Leases*

- BC72. All respondents to ED 75 supported referring to both “economic benefits” and “service potential” in the application guidance section on identifying a lease, rather than “economic benefits” alone.
- BC73. Based on a respondent’s suggestion, the IPSASB decided to extend this approach, where appropriate, to the Illustrative Examples. In doing so, the IPSASB’s rationale was to refer to “service potential” in all illustrative examples that have generic references to the benefits of the lease.

Lessee Accounting

Recognition Exemptions

- BC74. The IPSASB considered the recognition exemptions in IFRS 16. The IPSASB did not identify a public sector specific reason that would warrant different recognition exemptions in this Standard.
- BC75. The IPSASB also considered whether the permissible recognition exemptions in IFRS 16 should be a requirement or an option in this IPSAS. The IPSASB noted that, according to the IASB’s research, leases of low-value assets represent less than 1% of total non-current assets. In this context, the IPSASB considered that, on the one hand, making the recognition exemptions a requirement rather than an option would enhance the comparability between public sector entities and provide increased cost relief to them, with a low probability of a negative impact on the reliability and accuracy of financial statements. However, on the other hand, the IPSASB noted that requiring recognition exemptions for short-term leases may create a new arbitrage point, where entities could design their lease contracts to achieve desired accounting outcomes.
- BC76. On balance, the IPSASB concluded that there was no public sector specific reason to require rather than permit recognition exemptions. The IPSASB also considered that, by not requiring the application of the exemptions, public sector entities would be able to adopt an approach that appropriately provides a faithful representation of leasing transactions in terms of their own statements of financial position.
- BC77. The IPSASB noted that IFRS 16 does not set a specific monetary amount for a lease of a low-value asset. Instead, the IASB included in paragraph BC100 of the Basis for Conclusions: “the IASB had in mind leases of underlying assets with a value, when new, in the order of the magnitude of US\$5,000 or less”. The IPSASB considered whether it was appropriate for public sector financial reporting to use the same or a different dollar amount, or not make any reference to a threshold in the Basis for Conclusions of this Standard.
- BC78. The IPSASB acknowledged that, for many public sector entities that are services-based, a figure of US\$5,000 might represent the value of most of their individual assets. The IPSASB concluded that public sector entities, if they decide to apply the exemption, should use a threshold for determining leases of low-value assets, considering the materiality of leasing transactions in relation to their financial statements. The IPSASB concluded that it would not provide guidance on a specific monetary amount. In assessing materiality, preparers consider whether the omission of information could influence financial statement users’ assessments of accountability or their decision-making.

Responses to ED 75, *Leases*

- BC79. In determining a dollar amount for leases of low-value assets, the IPSASB considered the following feedback received on ED 75:
- (a) There is an apparent inconsistency between the application guidance on leases of low value assets that refers to an assessment on an absolute basis and the Basis for Conclusions where it refers to an assessment in terms of materiality; and
 - (b) There is no public sector specific reason for public sector entities not to benefit from the same monetary amount to guide entities in applying the exemption.

- BC80. Based on the feedback received, the IPSASB concluded that public sector entities, if they decide to apply the exemption, should use a threshold for determining leases of low-value assets, considering the guidance in IPSAS 43.AG4–AG9. The IPSASB noted that the exemption is to apply to leases for which the underlying asset, when new, is of low value. A lease will not qualify for the exemption if the nature of the underlying asset is such that, when new, its value is typically not low.
- BC81. The IPSASB concluded that it would not provide a specific monetary amount in the Basis for Conclusions because the application guidance already provides guidance for applying the requirements consistent with IFRS 16. The IPSASB decided that the outcome of the assessment of whether an underlying asset is of low value should not be affected by the size, nature, or circumstances of the lessee—i.e., the exemption is based on the value, when new, of the asset being leased; it is not based on the size or nature of the entity that leases the asset.

Discount Rate

- BC82. In developing ED 75, the IPSASB had considered whether to provide additional guidance where:
- (a) The lessee’s incremental borrowing rate is different from the likely interest rate implicit in the lease; or
 - (b) The lessee is unable to determine the interest rate implicit in the lease or has difficulties in determining the incremental borrowing rate.
- BC83. The IPSASB had decided that this issue is not public sector specific because private sector entities encounter similar difficulties in determining the implicit rate in the lease and the incremental borrowing rate.
- BC84. The IPSASB had noted that the incremental borrowing rate can be determined by:
- (a) Taking into account the terms and conditions of the lease;
 - (b) Referring to a rate that is readily observable as a starting point (for example, the rate that a lessee has paid, or would pay, to borrow money to purchase the type of asset being leased, or the property yield when determining the discount rate to apply to property leases); and
 - (c) Adjusting such observable rates as is needed to determine the lessee’s incremental borrowing rate as defined in ED 75.

Responses to ED 75, *Leases*

- BC85. While the majority of respondents agreed with the ED 75 proposals, a few respondents suggested including some guidance on determining the discount rate because of:
- (a) Difficulties in determining the implicit rate in the lease, where public sector entities have challenges in accessing borrowings to determine the incremental borrowing rate;
 - (b) Differences between real and nominal interest rates in non-developed countries with high inflation; and
 - (c) The lack of guidance on the meaning of “similar value” in the definition of lessee’s incremental borrowing rate.
- BC86. The IPSASB decided to proceed with the proposals in ED 75 and not provide additional guidance on the discount rate because:
- (a) Lack of incremental borrowing rate is also prevalent in the private sector;
 - (b) The IPSASB has already clarified in BC84 how to identify an appropriate incremental borrowing rate based on similar transactions; and
 - (c) Differences between real and nominal interest rates are not a public sector specific issue.

COVID-19 Requirements

- BC87. In developing ED 75, the IPSASB had included the 2020 amendments to IFRS 16 for COVID-19-related rent concessions. The IPSASB was of the view that the inclusion of these requirements might be useful to preparers and users of general purpose financial reports (GPFs) because of the uncertain duration and future impacts of the pandemic.

Responses to ED 75, *Leases*

- BC88. While the majority of respondents agreed with the ED 75 proposals, a few respondents suggested that these requirements should be applicable to pandemics in general due to the:

- (a) Applicability of these requirements may be overtaken by events and therefore will be of no value to the preparers and users of GPFs; and
- (b) Delayed effective dates of other IPSAS.

BC89. The IPSASB noted that the IASB also considered the risk of the practical expedient being applied too broadly, which could result in unintended consequences. Therefore, the IASB decided to limit the scope of the practical expedient so that it applies only to rent concessions that occur as a direct consequence of the COVID-19 pandemic if other conditions are met.

BC90. Additionally, some respondents suggested changing the date until which the practical expedient can be applied because it will date the Standard and will limit the duration affected by COVID-19. In the end, having the same affected period for all might not work because it might not be the case for everyone.

BC91. The IPSASB noted that, in March 2021, the IASB published Covid-19-Related Rent Concessions beyond 30 June 2021 (Amendments to IFRS 16). In this publication, the IASB only extended the date of the practical expedient to end on June 30, 2022—it did not introduce either a new practical expedient or a new option to apply (or not apply) the practical expedient. The IASB only wanted these requirements to be applicable to the COVID-19 pandemic by providing a single criterion to be applicable in all jurisdictions.

BC92. The IPSASB decided to retain the ED 75 proposals in IPSAS 43 because it did not identify a public sector specific reason that would warrant a departure from IFRS 16.

Lessor Accounting

Manufacturer or Dealer Lessors

BC93. The IPSASB decided not to include in this Standard the manufacturer or dealer lessor requirements included in IFRS 16 because:

- (a) They are not expected to be applied to public sector entities for which IPSAS are designed; and
- (b) The IPSASB's constituents did not request its inclusion during consultation on ED 64, which also excluded those requirements.

Responses to ED 75, *Leases*

BC94. While respondents strongly agreed with the ED 75 proposal, one respondent was of the view that the rationale for excluding manufacturer or dealer lessor requirements was not persuasive because although it might not be expected, the public sector is not prohibited from manufacturing or dealing activities.

BC95. The IPSASB recognizes that the relative importance of manufacturer or dealer lessors requirements might vary across jurisdictions. However, the IPSASB decided to proceed with the ED 75 proposal to exclude the manufacturer or dealer lessors requirements in IPSAS 43 because of the:

- (a) Reasons identified in paragraph BC93;
- (b) Overwhelming support for the ED 75 proposal.

BC96. In reaching this conclusion, the IPSASB noted that if a public sector entity does have manufacturer or dealer lessor arrangements, they could follow IFRS 16 under the hierarchy in IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.

Intermediate Lessors

Responses to ED 75, *Leases*

BC97. While respondents strongly agreed with the ED 75 proposal, one respondent suggested that the IPSASB consider adding guidance related to the scenario where there is a head lease with fixed payments and a sublease with variable lease payments linked to sales, when both have the same lease period. This respondent was of the view that judgements may differ on whether the lease should be classified as an operating lease or a finance lease by the intermediate lessor. A further consideration was related to the recognition of profit and loss related to the right-of-use asset at the commencement date of the sublease.

BC98. The IPSASB decided to proceed with the ED 75 proposals in IPSAS 43 because the IPSASB did not identify a public sector specific reason to depart from the IFRS 16 requirements for intermediate lessors.

Cross-Reference to IFRS 15 Revenue from Contracts with Customers

BC99. The IPSASB decided to refer to IFRS 15 instead of the relevant national or international accounting standard dealing with revenue from contracts with customers, where appropriate, because it is consistent with the:

- (a) Control-based approach to lessee accounting in IPSAS 43; and
- (b) IFRS 16 reference to IFRS 15 in the corresponding requirements.

BC100. In reaching this decision, the IPSASB noted that these references will be updated when a new IPSAS on Revenue is issued.

Effective Date

BC101. The IPSASB decided that IPSAS 43 should have an effective date of annual financial statements covering periods beginning on or after January 1, 2025, with earlier application permitted.

BC102. In deciding the effective date, the IPSASB considered that:

- (a) IFRS 16 also had a three-year period for its application;
- (b) IPSAS 41, *Financial Instruments* will be effective in January 1, 2023, which will add to the workload for preparers before having to apply IPSAS 43;
- (c) It provides sufficient time for the IPSASB to finalize a new IPSAS on Revenue and other IPSAS under development in the IPSASB's Work Program, which may have consequential amendments to IPSAS 43;
- (d) It allows the IPSASB time to finish Phase Two of the Leases project; and
- (e) It allows public sector entities time to identify the impacts of and to prepare for the implementation of the new Leases Standard.

BC103. The IPSASB decided to permit the earlier application of IPSAS 43, instead of encouraging it, because, ideally, the Standard should be applied together with the new IPSAS on Revenue aligned with IFRS 15. However, the principles in IFRS 15 are currently under consideration by the IPSASB.

BC104. For those public sector entities that elect to apply IPSAS 43 early, there might be greater complexity in analyzing revenue transactions under different principles: some lease transactions would be accounted for according to the principles in IFRS 15, while the revenue from other non-lease transactions will still be accounted for according to the principles in IPSAS 9, *Revenue from Exchange Transactions*, until the IPSASB publishes a new IPSAS on Revenue. However, cross-referencing to IFRS 15, where appropriate for revenue recognition, provides a temporary solution that allows public sector entities to prepare for the future changes that might be required when the IPSASB completes its Revenue project.

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Illustrative Examples

These examples accompany, but are not part of, IPSAS 43

IE1. These examples portray hypothetical situations illustrating how an entity might apply some of the requirements in IPSAS 43 to particular aspects of a lease (or other contracts) on the basis of the limited facts presented. The analysis in each example is not intended to represent the only manner in which the requirements could be applied, nor are the examples intended to apply only to the specific industry illustrated. Although some aspects of the examples may be present in actual fact patterns, all relevant facts and circumstances of a particular fact pattern would need to be evaluated when applying IPSAS 43.

Identifying a Lease (see paragraphs 10–12 and AG10–AG31)

IE2. The following examples illustrate how an entity determines whether a contract is, or contains, a lease.

Example 1–Rail Cars

Example 1A: a contract between Customer and a freight carrier (Supplier) provides Customer with the use of 10 rail cars of a particular type for five years. The contract specifies the rail cars; the cars are owned by Supplier. Customer determines when, where and which goods are to be transported using the cars. When the cars are not in use, they are kept at Customer's premises. Customer can use the cars for another purpose (for example, storage) if it so chooses. However, the contract specifies that Customer cannot transport particular types of cargo (for example, explosives). If a particular car needs to be serviced or repaired, Supplier is required to substitute a car of the same type. Otherwise, and other than on default by Customer, Supplier cannot retrieve the cars during the five-year period.

The contract also requires Supplier to provide an engine and a driver when requested by Customer. Supplier keeps the engines at its premises and provides instructions to the driver detailing Customer's requests to transport goods. Supplier can choose to use any one of a number of engines to fulfil each of Customer's requests, and one engine could be used to transport not only Customer's goods, but also the goods of other customers (i.e., if other customers require the transportation of goods to destinations close to the destination requested by Customer and within a similar timeframe, Supplier can choose to attach up to 100 rail cars to the engine).

The contract contains leases of rail cars. Customer has the right to use 10 rail cars for five years.

There are 10 identified cars. The cars are explicitly specified in the contract. Once delivered to Customer, the cars can be substituted only when they need to be serviced or repaired (see paragraph AG19). The engine used to transport the rail cars is not an identified asset because it is neither explicitly specified nor implicitly specified in the contract.

Customer has the right to control the use of the 10 rail cars throughout the five-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits or service potential from use of the cars over the five-year period of use. Customer has exclusive use of the cars throughout the period of use, including when they are not being used to transport Customer's goods.
- (b) Customer has the right to direct the use of the cars because the conditions in paragraph AG25(a) exist. The contractual restrictions on the cargo that can be transported by the cars are protective rights of Supplier and define the scope of Customer's right to use the cars. Within the scope of its right of use defined in the contract, Customer makes the relevant decisions about how and for what purpose the cars are used by being able to decide when and where the rail cars will be used and which goods are transported using the cars. Customer also determines whether and how the cars will be used when not being used to transport its goods (for example, whether and when they will be used for storage). Customer has the right to change these decisions during the five-year period of use.

Although having an engine and driver (controlled by Supplier) to transport the rail cars is essential to the efficient use of the cars, Supplier's decisions in this regard do not give it the right to direct how and for what purpose the rail cars are used. Consequently, Supplier does not control the use of the cars during the period of use.

Example 1B: the contract between Customer and Supplier requires Supplier to transport a specified quantity of goods by using a specified type of rail car in accordance with a stated timetable for a period of five years. The timetable and quantity of goods specified are equivalent to Customer having the use of 10 rail cars for five years. Supplier provides the rail cars, driver and engine as part of the contract. The contract states the nature and quantity of the goods to be transported (and the type of rail car to be used to transport the goods). Supplier has a large pool of similar cars that can be used to fulfil the requirements of the contract. Similarly, Supplier can choose to use any one of a number of engines to fulfil each

of Customer's requests, and one engine could be used to transport not only Customer's goods, but also the goods of other customers. The cars and engines are stored at Supplier's premises when not being used to transport goods.

The contract does not contain a lease of rail cars or of an engine.

The rail cars and the engines used to transport Customer's goods are not identified assets. Supplier has the substantive right to substitute the rail cars and engine because:

- (a) Supplier has the practical ability to substitute each car and the engine throughout the period of use (see paragraph AG15(a)). Alternative cars and engines are readily available to Supplier and Supplier can substitute each car and the engine without Customer's approval.
- (b) Supplier would benefit economically from substituting each car and the engine (see paragraph AG15(b)). There would be minimal, if any, cost associated with substituting each car or the engine because the cars and engines are stored at Supplier's premises and Supplier has a large pool of similar cars and engines. Supplier benefits from substituting each car or the engine in contracts of this nature because substitution allows Supplier to, for example, (i) use cars or an engine to fulfil a task for which the cars or engine are already positioned to perform (for example, a task at a rail yard close to the point of origin) or (ii) use cars or an engine that would otherwise be sitting idle because they are not being used by a customer.

Accordingly, Customer does not direct the use, nor have the right to obtain substantially all of the economic benefits or service potential from use, of an identified car or an engine. Supplier directs the use of the rail cars and engine by selecting which cars and engine are used for each particular delivery and obtains substantially all of the economic benefits from use of the rail cars and engine. Supplier is only providing freight capacity.

Example 2—Allocated Space

A coffee company (Customer) enters into a contract with an airport operator (Supplier) to use a space in the airport to sell its goods for a three-year period. The contract states the amount of space and that the space may be located at any one of several boarding areas within the airport. Supplier has the right to change the location of the space allocated to Customer at any time during the period of use. There are minimal costs to Supplier associated with changing the space for the Customer: Customer uses a kiosk (that it owns) that can be moved easily to sell its goods. There are many areas in the airport that are available and that would meet the specifications for the space in the contract.

The contract does not contain a lease.

Although the amount of space Customer uses is specified in the contract, there is no identified asset. Customer controls its owned kiosk. However, the contract is for space in the airport, and this space can change at the discretion of Supplier. Supplier has the substantive right to substitute the space Customer uses because:

- (a) Supplier has the practical ability to change the space used by Customer throughout the period of use (see paragraph AG15(a)). There are many areas in the airport that meet the specifications for the space in the contract, and Supplier has the right to change the location of the space to other space that meets the specifications at any time without Customer's approval.
- (b) Supplier would benefit economically from substituting the space (see paragraph AG15(b)). There would be minimal cost associated with changing the space used by Customer because the kiosk can be moved easily. Supplier benefits from substituting the space in the airport because substitution allows Supplier to make the most effective use of the space at boarding areas in the airport to meet changing circumstances.

Example 3—Fiber-Optic Cable

Example 3A: Customer enters into a 15-year contract with a utilities company (Supplier) for the right to use three specified, physically distinct dark fibers within a larger cable connecting Hong Kong to Tokyo. Customer makes the decisions about the use of the fibers by connecting each end of the fibers to its electronic equipment (i.e., Customer 'lights' the fibers and decides what data, and how much data, those fibers will transport). If the fibers are damaged, Supplier is responsible for the repairs and maintenance. Supplier owns extra fibers, but can substitute those for Customer's fibers only for reasons of repairs, maintenance or malfunction (and is obliged to substitute the fibers in these cases).

The contract contains a lease of dark fibers. Customer has the right to use the three dark fibers for 15 years.

There are three identified fibers. The fibers are explicitly specified in the contract and are physically distinct from other fibers within the cable. Supplier cannot substitute the fibers other than for reasons of repairs, maintenance or malfunction (see paragraph AG19).

Customer has the right to control the use of the fibers throughout the 15-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits or service potential from use of the fibers over the 15-year period of use. Customer has exclusive use of the fibers throughout the period of use.
- (b) Customer has the right to direct the use of the fibers because the conditions in paragraph AG25(a) exist. Customer makes the relevant decisions about how and for what purpose the fibers are used by deciding (i) when and whether to light the fibers and (ii) when and how much output the fibers will produce (i.e., what data, and how much data, those fibers will transport). Customer has the right to change these decisions during the 15-year period of use.

Although Supplier's decisions about repairing and maintaining the fibers are essential to their efficient use, those decisions do not give Supplier the right to direct how and for what purpose the fibers are used. Consequently, Supplier does not control the use of the fibers during the period of use.

Example 3B: Customer enters into a 15-year contract with Supplier for the right to use a specified amount of capacity within a cable connecting Hong Kong to Tokyo. The specified amount is equivalent to Customer having the use of the full capacity of three fiber strands within the cable (the cable contains 15 fibers with similar capacities). Supplier makes decisions about the transmission of data (i.e., Supplier lights the fibers, makes decisions about which fibers are used to transmit Customer's traffic and makes decisions about the electronic equipment that Supplier owns and connects to the fibers).

The contract does not contain a lease.

Supplier makes all decisions about the transmission of its customers' data, which requires the use of only a portion of the capacity of the cable for each customer. The capacity portion that will be provided to Customer is not physically distinct from the remaining capacity of the cable and does not represent substantially all of the capacity of the cable (see paragraph AG21). Consequently, Customer does not have the right to use an identified asset.

Example 4—Office Unit

Customer enters into a contract with a property owner (Supplier) to use Office Unit A for a five-year period. Office Unit A is part of a larger office space with many office units.

Customer is granted the right to use Office Unit A. Supplier can require Customer to relocate to another office unit. In that case, Supplier is required to provide Customer with an office unit of similar quality and specifications to Office Unit A and to pay for Customer's relocation costs. Supplier would benefit economically from relocating Customer only if a major new tenant were to decide to occupy a large amount of office space at a rate sufficiently favorable to cover the costs of relocating Customer and other tenants in the office space. However, although it is possible that those circumstances will arise, at inception of the contract, it is not likely that those circumstances will arise.

The contract requires Customer to use Office Unit A to operate its well-known tourist office to sell or provide its services during the hours that the larger office space is open. Customer makes all of the decisions about the use of the office unit during the period of use. For example, Customer decides on the mix of services sold or provided from the unit, the pricing of the services sold or provided and the number of employees working. Customer also controls physical access to the unit throughout the five-year period of use.

The contract requires Customer to make fixed payments to Supplier, as well as variable payments that are a percentage of services sold or provided from Office Unit A.

Supplier provides cleaning and security services as part of the contract.

The contract contains a lease of office space. Customer has the right to use Office Unit A for five years.

Office Unit A is an identified asset. It is explicitly specified in the contract. Supplier has the practical ability to substitute the office unit, but could benefit economically from substitution only in specific circumstances. Supplier's substitution right is not substantive because, at inception of the contract, those circumstances are not considered likely to arise (see paragraph AG17).

Customer has the right to control the use of Office Unit A throughout the five-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits or service potential from use of Office Unit A over the five-year period of use. Customer has exclusive use of Office Unit A throughout the period of use. Although a portion of the cash flows derived from services sold or provided from Office Unit A will flow from Customer to Supplier, this represents consideration that Customer pays Supplier for the right to use the office unit. It does not prevent Customer from having the right to obtain substantially all of the economic benefits or service potential from use of Office Unit A.
- (b) Customer has the right to direct the use of Office Unit A because the conditions in paragraph AG25(a) exist. The contractual restrictions on the services that can be provided or sold from Office Unit A, and when Office Unit A is open, define the scope of Customer's right to use Office Unit A. Within the scope of its right of use defined in the contract, Customer makes the relevant decisions about how and for what purpose Office Unit A is used by being able to decide, for example, the mix of services that will be provided from or sold in the office unit and the sale price for those services. Customer has the right to change these decisions during the five-year period of use.

Although cleaning, security, and advertising services are essential to the efficient use of Office Unit A, Supplier's decisions in this regard do not give it the right to direct how and for what purpose Office Unit A is used. Consequently, Supplier does not control the use of Office Unit A during the period of use and Supplier's decisions do not affect Customer's control of the use of Office Unit A.

Example 5—Truck Rental

Customer enters into a contract with Supplier for the use of a truck for one week to transport cargo from New York to San Francisco. Supplier does not have substitution rights. Only cargo specified in the contract is permitted to be transported on this truck for the period of the contract. The contract specifies a maximum distance that the truck can be driven. Customer is able to choose the details of the journey (speed, route, rest stops, etc.) within the parameters of the contract. Customer does not have the right to continue using the truck after the specified trip is complete.

The cargo to be transported, and the timing and location of pick-up in New York and delivery in San Francisco, are specified in the contract.

Customer is responsible for driving the truck from New York to San Francisco.

The contract contains a lease of a truck. Customer has the right to use the truck for the duration of the specified trip.

There is an identified asset. The truck is explicitly specified in the contract, and Supplier does not have the right to substitute the truck.

Customer has the right to control the use of the truck throughout the period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits or service potential from use of the truck over the period of use. Customer has exclusive use of the truck throughout the period of use.
- (b) Customer has the right to direct the use of the truck because the conditions in AG25(b)(i) exist. How and for what purpose the truck will be used (i.e., the transportation of specified cargo from New York to San Francisco within a specified timeframe) is predetermined in the contract. Customer directs the use of the truck because it has the right to operate the truck (for example, speed, route, rest stops) throughout the period of use. Customer makes all of the decisions about the use of the truck that can be made during the period of use through its control of the operations of the truck.

Because the duration of the contract is one week, this lease meets the definition of a short-term lease.

Example 6—Ship

Example 6A: Customer enters into a contract with a ship owner (Supplier) for the transportation of cargo from Rotterdam to Sydney on a specified ship. The ship is explicitly specified in the contract and Supplier does not have substitution rights. The cargo will occupy substantially all of the capacity of the ship. The contract specifies the cargo to be transported on the ship and the dates of pickup and delivery.

Supplier operates and maintains the ship and is responsible for the safe passage of the cargo on board the ship. Customer is prohibited from hiring another operator for the ship or operating the ship itself during the term of the contract.

The contract does not contain a lease.

There is an identified asset. The ship is explicitly specified in the contract and Supplier does not have the right to substitute that specified ship.

Customer has the right to obtain substantially all of the economic benefits or service potential from use of the ship over the period of use. Its cargo will occupy substantially all of the capacity of the ship, thereby preventing other parties from obtaining economic benefits or service potential from use of the ship.

However, Customer does not have the right to control the use of the ship because it does not have the right to direct its use. Customer does not have the right to direct how and for what purpose the ship is used. How and for what purpose the ship will be used (i.e., the transportation of specified cargo from Rotterdam to Sydney within a specified timeframe) is predetermined in the contract. Customer has no right to change how and for what purpose the ship is used during the period of use. Customer has no other decision-making rights about the use of the ship during the period of use (for example, it does not have the right to operate the ship) and did not design the ship. Customer has the same rights regarding the use of the ship as if it were one of many customers transporting cargo on the ship.

Example 6B: Customer enters into a contract with Supplier for the use of a specified ship for a five-year period. The ship is explicitly specified in the contract and Supplier does not have substitution rights.

Customer decides what cargo will be transported, and whether, when and to which ports the ship will sail, throughout the five-year period of use, subject to restrictions specified in the contract. Those restrictions prevent Customer from sailing the ship into waters at a high risk of piracy or carrying hazardous materials as cargo.

Supplier operates and maintains the ship and is responsible for the safe passage of the cargo on board the ship. Customer is prohibited from hiring another operator for the ship of the contract or operating the ship itself during the term of the contract.

The contract contains a lease. Customer has the right to use the ship for five years.

There is an identified asset. The ship is explicitly specified in the contract, and Supplier does not have the right to substitute that specified ship.

Customer has the right to control the use of the ship throughout the five-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits or service potential from use of the ship over the five-year period of use. Customer has exclusive use of the ship throughout the period of use.
- (b) Customer has the right to direct the use of the ship because the conditions in paragraph AG25(a) exist. The contractual restrictions about where the ship can sail and the cargo to be transported by the ship define the scope of Customer's right to use the ship. They are protective rights that protect Supplier's investment in the ship and Supplier's personnel. Within the scope of its right of use, Customer makes the relevant decisions about how and for what purpose the ship is used throughout the five-year period of use because it decides whether, where and when the ship sails, as well as the cargo it will transport. Customer has the right to change these decisions throughout the five-year period of use.

Although the operation and maintenance of the ship are essential to its efficient use, Supplier's decisions in this regard do not give it the right to direct how and for what purpose the ship is used. Instead, Supplier's decisions are dependent upon Customer's decisions about how and for what purpose the ship is used.

Example 7—Aircraft

Customer enters into a contract with an aircraft owner (Supplier) for the use of an explicitly specified aircraft for a two-year period. The contract details the interior and exterior specifications for the aircraft.

There are contractual and legal restrictions in the contract on where the aircraft can fly. Subject to those restrictions, Customer determines where and when the aircraft will fly, and which passengers and cargo will be transported on the aircraft. Supplier is responsible for operating the aircraft, using its own crew. Customer is prohibited from hiring another operator for the aircraft or operating the aircraft itself during the term of the contract.

Supplier is permitted to substitute the aircraft at any time during the two-year period and must substitute the aircraft if it is not working. Any substitute aircraft must meet the interior and exterior specifications in the contract. There are significant costs involved in outfitting an aircraft in Supplier's fleet to meet Customer's specifications.

The contract contains a lease. Customer has the right to use the aircraft for two years.

There is an identified asset. The aircraft is explicitly specified in the contract and, although Supplier can substitute the aircraft, its substitution right is not substantive because the conditions in paragraph AG15(b) do not exist. Supplier's substitution right is not substantive because of the significant costs involved in outfitting another aircraft to meet the specifications required by the contract such that Supplier is not expected to benefit economically from substituting the aircraft.

Customer has the right to control the use of the aircraft throughout the two-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits or service potential from use of the aircraft over the two-year period of use. Customer has exclusive use of the aircraft throughout the period of use.
- (b) Customer has the right to direct the use of the aircraft because the conditions in paragraph AG25(a) exist. The restrictions on where the aircraft can fly define the scope of Customer's right to use the aircraft. Within the scope of its right of use, Customer makes the relevant decisions about how and for what purpose the aircraft is used throughout the two-year period of use because it decides whether, where and when the aircraft travels as well as the passengers and cargo it will transport. Customer has the right to change these decisions throughout the two-year period of use.

Although the operation of the aircraft is essential to its efficient use, Supplier's decisions in this regard do not give it the right to direct how and for what purpose the aircraft is used. Consequently, Supplier does not control the use of the aircraft during the period of use and Supplier's decisions do not affect Customer's control of the use of the aircraft.

Example 8—Contract for Shirts

Customer enters into a contract with a producer (Supplier) to purchase a particular type, quality and quantity of shirts for a three-year period. The type, quality and quantity of shirts are specified in the contract.

Supplier has only one factory that can meet the needs of Customer. Supplier is unable to supply the shirts from another factory or source the shirts from a third party supplier. The capacity of the factory exceeds the output for which Customer has contracted (i.e., Customer has not contracted for substantially all of the capacity of the factory).

Supplier makes all decisions about the operations of the factory, including the production level at which to run the factory and which customer contracts to fulfil with the output of the factory that is not used to fulfil Customer's contract.

The contract does not contain a lease.

The factory is an identified asset. The factory is implicitly specified because Supplier can fulfil the contract only through the use of this asset.

Customer does not control the use of the factory because it does not have the right to obtain substantially all of the economic benefits or service potential from use of the factory. This is because Supplier could decide to use the factory to fulfil other customer contracts during the period of use.

Customer also does not control the use of the factory because it does not have the right to direct the use of the factory. Customer does not have the right to direct how and for what purpose the factory is used during the three-year period of use. Customer's rights are limited to specifying output from the factory in the contract with Supplier. Customer has the same rights regarding the use of the factory as other customers purchasing shirts from the factory. Supplier has the right to direct the use of the factory because Supplier can decide how and for what purpose the factory is used (i.e., Supplier has the right to decide the production level at which to run the factory and which customer contracts to fulfil with the output produced).

Either the fact that Customer does not have the right to obtain substantially all of the economic benefits or service potential from use of the factory, or that Customer does not have the right to direct the use of the factory, would be sufficient in isolation to conclude that Customer does not control the use of the factory.

Example 9—Contract for Energy/Power

Example 9A: a public sector entity (Customer) enters into a contract with a power company (Supplier) to purchase all of the electricity produced by a new solar farm for 20 years. The solar farm is explicitly specified in the contract and Supplier has no substitution rights. The solar farm is owned by Supplier and the energy cannot be provided to Customer from another asset. Customer designed the solar farm before it was constructed—Customer hired experts in solar energy to assist in determining the location of the farm and the engineering of the equipment to be used. Supplier is responsible for building the solar farm to Customer's specifications, and then operating and maintaining it. There are no decisions to be made

about whether, when or how much electricity will be produced because the design of the asset has predetermined those decisions. Supplier will receive tax credits relating to the construction and ownership of the solar farm, while Customer receives renewable energy credits that accrue from use of the solar farm.

The contract contains a lease. Customer has the right to use the solar farm for 20 years.

There is an identified asset because the solar farm is explicitly specified in the contract, and Supplier does not have the right to substitute the specified solar farm.

Customer has the right to control the use of the solar farm throughout the 20-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits or service potential from use of the solar farm over the 20-year period of use. Customer has exclusive use of the solar farm; it takes all of the electricity produced by the farm over the 20-year period of use as well as the renewable energy credits that are a by-product from use of the solar farm. Although Supplier will receive economic benefits from the solar farm in the form of tax credits, those economic benefits relate to the ownership of the solar farm rather than the use of the solar farm and, thus, are not considered in this assessment.
- (b) Customer has the right to direct the use of the solar farm because the conditions in paragraph AG25(b)(ii) exist. Neither Customer, nor Supplier, decides how and for what purpose the solar farm is used during the period of use because those decisions are predetermined by the design of the asset (i.e., the design of the solar farm has, in effect, programmed into the asset any relevant decision-making rights about how and for what purpose the solar farm is used throughout the period of use). Customer does not operate the solar farm; Supplier makes the decisions about the operation of the solar farm. However, Customer's design of the solar farm has given it the right to direct the use of the farm. Because the design of the solar farm has predetermined how and for what purpose the asset will be used throughout the period of use, Customer's control over that design is substantively no different from Customer controlling those decisions.

Example 9B: Customer enters into a contract with Supplier to purchase all of the power produced by an explicitly specified power plant for three years. The power plant is owned and operated by Supplier.

Supplier is unable to provide power to Customer from another plant. The contract sets out the quantity and timing of power that the power plant will produce throughout the period of use, which cannot be changed in the absence of extraordinary circumstances (for example, emergency situations). Supplier operates and maintains the plant on a daily basis in accordance with industry-approved operating practices. Supplier designed the power plant when it was constructed some years before entering into the contract with Customer—Customer had no involvement in that design.

The contract does not contain a lease.

There is an identified asset because the power plant is explicitly specified in the contract, and Supplier does not have the right to substitute the specified plant.

Customer has the right to obtain substantially all of the economic benefits or service potential from use of the identified power plant over the three-year period of use. Customer will take all of the power produced by the power plant over the three-year period of use.

However, Customer does not have the right to control the use of the power plant because it does not have the right to direct its use. Customer does not have the right to direct how and for what purpose the plant is used. How and for what purpose the plant is used (i.e., whether, when and how much power the plant will produce) is predetermined in the contract. Customer has no right to change how and for what purpose the plant is used during the period of use. Customer has no other decision-making rights about the use of the power plant during the period of use (for example, it does not operate the power plant) and did not design the plant. Supplier is the only party that can make decisions about the plant during the period of use by making the decisions about how the plant is operated and maintained. Customer has the same rights regarding the use of the plant as if it were one of many customers obtaining power from the plant.

Example 9C: Customer enters into a contract with Supplier to purchase all of the power produced by an explicitly specified power plant for 10 years. The contract states that Customer has rights to all of the power produced by the plant (i.e., Supplier cannot use the plant to fulfil other contracts).

Customer issues instructions to Supplier about the quantity and timing of the delivery of power. If the plant is not producing power for Customer, it does not operate.

Supplier operates and maintains the plant on a daily basis in accordance with industry-approved operating practices.

The contract contains a lease. Customer has the right to use the power plant for 10 years.

There is an identified asset. The power plant is explicitly specified in the contract and Supplier does not have the right to substitute the specified plant.

Customer has the right to control the use of the power plant throughout the 10-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits or service potential from use of the power plant over the 10-year period of use. Customer has exclusive use of the power plant; it has rights to all of the power produced by the power plant throughout the 10-year period of use.
- (b) Customer has the right to direct the use of the power plant because the conditions in paragraph AG25(a) exist. Customer makes the relevant decisions about how and for what purpose the power plant is used because it has the right to determine whether, when and how much power the plant will produce (i.e., the timing and quantity, if any, of power produced) throughout the period of use. Because Supplier is prevented from using the power plant for another purpose, Customer's decision-making about the timing and quantity of power produced, in effect, determines when, and whether, the plant produces output.

Although the operation and maintenance of the power plant are essential to its efficient use, Supplier's decisions in this regard do not give it the right to direct how and for what purpose the power plant is used. Consequently, Supplier does not control the use of the power plant during the period of use. Instead, Supplier's decisions are dependent upon Customer's decisions about how and for what purpose the power plant is used.

Example 10—Contract for Network Services

Example 10A: Customer enters into a contract with a telecommunications company (Supplier) for network services for two years. The contract requires Supplier to supply network services that meet a specified quality level. In order to provide the services, Supplier installs and configures servers at Customer's premises—Supplier determines the speed and quality of data transportation in the network using the servers. Supplier can reconfigure or replace the servers when needed to continuously provide the quality of network services defined in the contract. Customer does not operate the servers or make any significant decisions about their use.

The contract does not contain a lease. Instead, the contract is a service contract in which Supplier uses the equipment to meet the level of network services determined by Customer.

There is no need to assess whether the servers installed at Customer's premises are identified assets. This assessment would not change the analysis of whether the contract contains a lease because Customer does not have the right to control the use of the servers.

Customer does not control the use of the servers because Customer's only decision-making rights relate to deciding upon the level of network services (the output of the servers) before the period of use—the level of network services cannot be changed during the period of use without modifying the contract. For example, even though Customer produces the data to be transported, that activity does not directly affect the configuration of the network services and, thus, it does not affect how and for what purpose the servers are used.

Supplier is the only party that can make relevant decisions about the use of the servers during the period of use. Supplier has the right to decide how data is transported using the servers, whether to reconfigure the servers and whether to use the servers for another purpose. Accordingly, Supplier controls the use of the servers in providing network services to Customer.

Example 10B: Customer enters into a contract with an information technology company (Supplier) for the use of an identified server for three years. Supplier delivers and installs the server at Customer's premises in accordance with Customer's instructions, and provides repair and maintenance services for the server, as needed, throughout the period of use. Supplier substitutes the server only in the case of malfunction. Customer decides which data to store on the server and how to integrate the server within its operations. Customer can change its decisions in this regard throughout the period of use.

The contract contains a lease. Customer has the right to use the server for three years.

There is an identified asset. The server is explicitly specified in the contract. Supplier can substitute the server only if it is malfunctioning (see paragraph AG19).

Customer has the right to control the use of the server throughout the three-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits or service potential from use of the server over the three-year period of use. Customer has exclusive use of the server throughout the period of use.
- (b) Customer has the right to direct the use of the server (because the conditions in paragraph AG25(a) exist). Customer makes the relevant decisions about how and for what purpose the server is used because it has the right to decide which aspect of its operations the server is used to support and which data it stores on the server. Customer is the only party that can make decisions about the use of the server during the period of use.

Leases of Low-Value Assets and Portfolio Application (see paragraphs 6–7, AG1 and AG4–AG9)

IE3. The following example illustrates how a lessee might (a) apply paragraphs AG4–AG9 of IPSAS 43 to leases of low-value assets; and (b) determine portfolios of leases to which it would apply the requirements in IPSAS 43.

Example 11— Leases of Low-Value Assets and Portfolio Application

A public sector entity (Lessee) with offices in each province/state of the country has the following leases:

- (a) *Leases of real estate (both office buildings and warehouses).*
- (b) *Leases of hospital equipment.*
- (c) *Leases of cars, both for services personnel and senior management and of varying quality, specification and value.*
- (d) *Leases of trucks and vans used for service delivery purposes, of varying size and value.*
- (e) *Leases of IT equipment for use by individual employees (such as laptop computers, desktop computers, hand held computer devices, desktop printers and mobile phones).*
- (f) *Leases of servers, including many individual modules that increase the storage capacity of those servers. The modules have been added to the mainframe servers over time as Lessee has needed to increase the storage capacity of the servers.*
- (g) *Leases of office equipment:*
 - (i) *Office furniture (such as chairs, desks and office partitions);*
 - (ii) *Water dispensers; and*
 - (iii) *High-capacity multifunction photocopier devices.*

Leases of low-value assets

Lessee determines that the following leases qualify as leases of low-value assets on the basis that the underlying assets, when new, are individually of low value:

- (a) Leases of IT equipment for use by individual employees; and
- (b) Leases of office furniture and water dispensers.

Lessee elects to apply the requirements in paragraph 7 of IPSAS 43 in accounting for all of those leases.

Although each module within the servers, if considered individually, might be an asset of low value, the leases of modules within the servers do not qualify as leases of low-value assets. This is because each module is highly interrelated with other parts of the servers. Lessee would not lease the modules without also leasing the servers.

Portfolio application

As a result, Lessee applies the recognition and measurement requirements in IPSAS 43 to its leases of real estate, hospital equipment, cars, trucks and vans, servers and high-capacity multifunction photocopier devices. In doing so, Lessee groups its cars, trucks and vans into portfolios.

Lessee's cars are leased under a series of master lease agreements. Lessee uses eight different types of car, which vary by price and are assigned to staff on the basis of seniority and territory. Lessee has a master lease agreement for each different type of car. The individual leases within each master lease agreement are all similar (including similar start and end dates), but the terms and conditions generally vary from one master lease agreement to another. Because the individual leases within each master lease agreement are similar to each other, Lessee reasonably expects that applying the requirements of IPSAS 43 to each master lease agreement would not result in a materially different effect than applying the requirements of IPSAS 43 to each individual lease within the master lease agreement. Consequently, Lessee concludes that it can apply the requirements of IPSAS 43 to each master lease agreement as a portfolio. In addition, Lessee concludes that two of the eight master lease agreements are similar and cover substantially similar types of cars in similar territories. Lessee reasonably expects that the effect of applying IPSAS 43 to the combined portfolio of leases within the two master lease agreements would not differ materially from applying IPSAS 43 to each lease within that combined portfolio. Lessee, therefore, concludes that it can further combine those two master lease agreements into a single lease portfolio.

Lessee's trucks and vans are leased under individual lease agreements. There are 6,500 leases in total. All of the truck leases have similar terms, as do all of the van leases. The truck leases are generally for four years and involve similar models of truck. The van leases are generally for five years and involve similar models of van. Lessee reasonably expects that applying the requirements of IPSAS 43 to portfolios of truck leases and van leases, grouped by type of underlying asset, territory and the quarter of the year within which the lease was entered into, would not result in a materially different effect from applying those requirements to each individual truck or van lease. Consequently, Lessee applies the requirements of IPSAS 43 to different portfolios of truck and van leases, rather than to 6,500 individual leases.

Allocating Consideration to Components of a Contract (see paragraphs 13–17 and AG33–AG34)

IE4. The following example illustrates the allocation of consideration in a contract to lease and non-lease components by a lessee.

Example 12—Lessee allocation of consideration to lease and non-lease components of a contract

Lessor leases a server, a medical ventilator and a computed tomography machine to Lessee to be used in Lessee's hospital operations for four years. Lessor also agrees to maintain each item of equipment throughout the lease term. The total consideration in the contract is CU600,000^(a), payable in annual instalments of CU150,000, and a variable amount that depends on the hours of work performed in maintaining the computed tomography machine. The variable payment is capped at 2 per cent of the replacement cost of the computed tomography machine. The consideration includes the cost of maintenance services for each item of equipment.

Lessee accounts for the non-lease components (maintenance services) separately from each lease of equipment applying paragraph 13 of IPSAS 43. Lessee does not elect the practical expedient in paragraph 16 of IPSAS 43. Lessee considers the requirements in paragraph AG33 of IPSAS 43 and concludes that the lease of the server, the lease of the *medical ventilator* and the lease of the *computed tomography machine* are each separate lease components. This is because:

- (a) Lessee can benefit from use of each of the three items of equipment on its own or together with other readily available resources (for example, Lessee could readily lease or purchase an alternative medical ventilator or computed tomography machine to use in its operations); and
- (b) Although Lessee is leasing all three items of equipment for one purpose (i.e., to engage in hospital operations), the machines are neither highly dependent on, nor highly interrelated with, each other. Lessee's ability to derive benefit from the lease of each item of equipment is not significantly affected by its decision to lease, or not lease, the other equipment from Lessor.

Consequently, Lessee concludes that there are three lease components and three non-lease components (maintenance services) in the contract. Lessee applies the guidance in paragraphs 14–15 of IPSAS 43 to allocate the consideration in the contract to the three lease components and the non-lease components.

Several suppliers provide maintenance services for a similar server and a similar medical ventilator. Accordingly, there are observable standalone prices for the maintenance services for those two items of leased equipment. Lessee is able to establish observable stand-alone prices for the maintenance of the server and the medical ventilator of CU32,000 and CU16,000, respectively, assuming similar payment terms to those in the contract with Lessor. The computed tomography machine is highly specialized and, accordingly, other suppliers do not lease or provide maintenance services for similar computed tomography machines. Nonetheless, Lessor provides four-year maintenance service contracts to customers that

purchase similar computed tomography machine from Lessor. The observable consideration for those four-year maintenance service contracts is a fixed amount of CU56,000, payable over four years, and a variable amount that depends on the hours of work performed in maintaining the computed tomography machine. That variable payment is capped at 2 per cent of the replacement cost of the computed tomography machine. Consequently, Lessee estimates the stand-alone price of the maintenance services for the computed tomography machine to be CU56,000 plus any variable amounts. Lessee is able to establish observable stand-alone prices for the leases of the server, the desktop computer and the computed tomography machine of CU170,000, CU102,000 and CU224,000, respectively.

Lessee allocates the fixed consideration in the contract (CU600,000) to the lease and non-lease components as follows:

CU	Server	Medical ventilator	Computed tomography machine	Total
Lease	170.000	102.000	224.000	496.000
Non-lease				104.000
Total fixed consideration				600.000

Lessee allocates all of the variable consideration to the maintenance of the *computed tomography machine*, and, thus, to the non-lease components of the contract. Lessee then accounts for each lease component applying the guidance in IPSAS 43, treating the allocated consideration as the lease payments for each lease component.

- (a) In these Illustrative Examples, currency amounts are denominated in 'currency units' (CU).

Lessee Measurement (see paragraphs 19–42 and AG35–AG42)

- IE5. The following example illustrates how a lessee measures right-of-use assets and lease liabilities. It also illustrates how a lessee accounts for a change in the lease term.

Example 13—Measurement by a Lessee and Accounting for a Change in the Lease Term

Part 1—Initial Measurement of the Right-of-Use Asset and the Lease Liability

Lessee enters into a 10-year lease of a floor of a building, with an option to extend for five years. Lease payments are CU50,000 per year during the initial term and CU55,000 per year during the optional period, all payable at the beginning of each year. To obtain the lease, Lessee incurs initial direct costs of CU20,000, of which CU15,000 relates to a payment to a former tenant occupying that floor of the building and CU5,000 relates to a commission paid to the real estate agent that arranged the lease. As an incentive to Lessee for entering into the lease, Lessor agrees to reimburse to Lessee the real estate commission of CU5,000.

At the commencement date, Lessee concludes that it is not reasonably certain to exercise the option to extend the lease and, therefore, determines that the lease term is 10 years.

The interest rate implicit in the lease is not readily determinable. Lessee's incremental borrowing rate is 5 per cent per annum, which reflects the fixed rate at which Lessee could borrow an amount similar to the value of the right-of-use asset, in the same currency, for a 10-year term, and with similar collateral.

At the commencement date, Lessee makes the lease payment for the first year, incurs initial direct costs, receives the lease incentive from Lessor and measures the lease liability at the present value of the remaining nine payments of CU50,000, discounted at the interest rate of 5 per cent per annum, which is CU355,391.

Lessee initially recognizes assets and liabilities in relation to the lease as follows.

Right-of-use asset	CU405,391	
Lease liability		CU355,391
Cash (lease payment for the first year)		CU50,000
Right-of-use asset	CU20,000	
Cash (initial direct costs)		CU20,000
Cash (lease incentive)	CU5,000	
Right-of-use asset		CU5,000

Part 2—Subsequent Measurement and Accounting for a Change in the Lease Term

In the sixth year of the lease, Lessee acquires Entity A. Entity A has been leasing a floor in another building. The lease entered into by Entity A contains a termination option that is exercisable by Entity A. Following the acquisition of Entity A, Lessee needs two floors in a building suitable for the increased workforce. To minimize costs, Lessee (a) enters into a separate eight-year lease of another floor in the building leased that will be available for use at the end of Year 7 and (b) terminates early the lease entered into by Entity A with effect from the beginning of Year 8.

Moving Entity A's staff to the same building occupied by Lessee creates an economic incentive for Lessee to extend its original lease at the end of the non-cancellable period of 10 years. The acquisition of Entity A and the relocation of Entity A's staff is a significant event that is within the control of Lessee and affects whether Lessee is reasonably certain to exercise the extension option not previously included in its determination of the lease term. This is because the original floor has greater utility (and thus provides greater benefits) to Lessee than alternative assets that could be leased for a similar amount to the lease payments for the optional period—Lessee would incur additional costs if it were to lease a similar floor in a different building because the workforce would be located in different buildings. Consequently, at the end of Year 6, Lessee concludes that it is now reasonably certain to exercise the option to extend its original lease as a result of its acquisition and planned relocation of Entity A.

Lessee's incremental borrowing rate at the end of Year 6 is 6 per cent per annum, which reflects the fixed rate at which Lessee could borrow an amount similar to the value of the right-of-use asset, in the same currency, for a nine-year term, and with similar collateral. Lessee expects to consume the right-of-use asset's future economic benefits or service potential evenly over the lease term and, thus, depreciates the right-of-use asset on a straight-line basis.

The right-of-use asset and the lease liability from Year 1 to Year 6 are as follows.

Year	Lease liability				Right-of-use asset		
	Beginning balance	Lease payment	5% interest expense	Ending balance	Beginning balance	Depreciation charge	Ending balance
	CU	CU	CU	CU	CU	CU	CU
1	355,391	-	17,770	373,161	420,391	(42,039)	378,352
2	373,161	(50,000)	16,158	339,319	378,352	(42,039)	336,313
3	339,319	(50,000)	14,466	303,785	336,313	(42,039)	294,274
4	303,785	(50,000)	12,689	266,474	294,274	(42,039)	252,235
5	266,474	(50,000)	10,823	227,297	252,235	(42,039)	210,196
6	227,297	(50,000)	8,865	186,162	210,196	(42,039)	168,157

At the end of the sixth year, before accounting for the change in the lease term, the lease liability is CU186,162 (the present value of four remaining payments of CU50,000, discounted at the original interest rate of 5 per cent per annum). Interest expense of CU8,865 is recognized in Year 6. Lessee's right-of-use asset is CU168,157.

Lessee remeasures the lease liability at the present value of four payments of CU50,000 followed by five payments of CU55,000, all discounted at the revised discount rate of 6 per cent per annum, which is CU378,174. Lessee increases the lease liability by CU192,012, which represents the difference between the remeasured liability of CU378,174 and its previous carrying amount of CU186,162. The corresponding adjustment is made to the right-of-use asset to reflect the cost of the additional right of use, recognized as follows.

Right-of-use asset	CU192,012
Lease liability	CU192,012

Following the remeasurement, the carrying amount of Lessee's right-of-use asset is CU360,169 (i.e., CU168,157 + CU192,012). From the beginning of Year 7 Lessee calculates the interest expense on the lease liability at the revised discount rate of 6 per cent per annum.

The right-of-use asset and the lease liability from Year 7 to Year 15 are as follows.

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Year	Lease liability				Right-of-use asset		
	Beginning balance	Lease payment	6% interest expense	Ending balance	Beginning balance	Depreciation charge	Ending balance
	CU	CU	CU	CU	CU	CU	CU
7	378,174	(50,000)	19,690	347,864	360,169	(40,019)	320,150
8	347,864	(50,000)	17,872	315,736	320,150	(40,019)	280,131
9	315,736	(50,000)	15,944	281,680	280,131	(40,019)	240,112
10	281,680	(50,000)	13,901	245,581	240,112	(40,019)	200,093
11	245,581	(55,000)	11,435	202,016	200,093	(40,019)	160,074
12	202,016	(55,000)	8,821	155,837	160,074	(40,019)	120,055
13	155,837	(55,000)	6,050	106,887	120,055	(40,019)	80,036
14	106,887	(55,000)	3,113	55,000	80,036	(40,018)	40,018
15	55,000	(55,000)	-	-	40,018	(40,018)	-

Variable Lease Payments (see paragraphs 28, 40, 43(b) and 44)

IE6. The following example illustrates how a lessee accounts for variable lease payments that depend on an index and variable lease payments not included in the measurement of the lease liability.

Example 14—Variable Lease Payments Dependent on an Index and Variable Lease Payments Linked to Sales

Example 14A—Lessee enters into a 10-year lease of property with annual lease payments of CU50,000, payable at the beginning of each year. The contract specifies that lease payments will increase every two years on the basis of the increase in the Consumer Price Index for the preceding 24 months. The Consumer Price Index at the commencement date is 125. This example ignores any initial direct costs. The rate implicit in the lease is not readily determinable. Lessee's incremental borrowing rate is 5 per cent per annum, which reflects the fixed rate at which Lessee could borrow an amount similar to the value of the right-of-use asset, in the same currency, for a 10-year term, and with similar collateral.

At the commencement date, Lessee makes the lease payment for the first year and measures the lease liability at the present value of the remaining nine payments of CU50,000, discounted at the interest rate of 5 per cent per annum, which is CU355,391.

Lessee initially recognizes assets and liabilities in relation to the lease as follows.

Right-of-use asset	CU405,391
Lease liability	CU355,391
Cash (lease payment for the first year)	CU50,000

Lessee expects to consume the right-of-use asset's future economic benefits evenly over the lease term and, thus, depreciates the right-of-use asset on a straight-line basis.

During the first two years of the lease, Lessee recognizes in aggregate the following related to the lease.

Interest expense	CU33,928
Lease liability	CU33,928
Depreciation charge	CU81,078 (CU405,391 ÷ 10 × 2 years)
Right-of-use asset	CU81,078

At the beginning of the second year, Lessee makes the lease payment for the second year and recognizes the following.

Lease liability	CU50,000
Cash	CU50,000

At the beginning of the third year, before accounting for the change in future lease payments resulting from a change in the Consumer Price Index and making the lease payment for the third year, the lease liability is CU339,319 (the present value of eight payments of CU50,000 discounted at the interest rate of 5 per cent per annum = CU355,391 + CU33,928 – CU50,000).

At the beginning of the third year of the lease the Consumer Price Index is 135.

The payment for the third year, adjusted for the Consumer Price Index, is CU54,000 ($CU50,000 \times 135 \div 125$). Because there is a change in the future lease payments resulting from a change in the Consumer Price Index used to determine those payments, Lessee remeasures the lease liability to reflect those revised lease payments, i.e., the lease liability now reflects eight annual lease payments of CU54,000.

At the beginning of the third year, Lessee remeasures the lease liability at the present value of eight payments of CU54,000 discounted at an unchanged discount rate of 5 per cent per annum, which is CU366,464. Lessee increases the lease liability by CU27,145, which represents the difference between the remeasured liability of CU366,464 and its previous carrying amount of CU339,319. The corresponding adjustment is made to the right-of-use asset, recognized as follows.

Right-of-use asset	CU27,145	
Lease liability		CU27,145

At the beginning of the third year, Lessee makes the lease payment for the third year and recognizes the following.

Lease liability	CU54,000	
Cash		CU54,000

Example 14B—Assume the same facts as Example 14A except that Lessee is also required to make variable lease payments for each year of the lease, which are determined as 1 per cent of Lessee's sales generated from the leased property.

At the commencement date, Lessee measures the right-of-use asset and the lease liability recognized at the same amounts as in Example 14A. This is because the additional variable lease payments are linked to future sales and, thus, do not meet the definition of lease payments. Consequently, those payments are not included in the measurement of the asset and liability.

Right-of-use asset	CU405,391	
Lease liability		CU355,391
Cash (lease payment for the first year)		CU50,000

Lessee prepares financial statements on an annual basis. During the first year of the lease, Lessee generates sales of CU800,000 from the leased property.

Lessee incurs an additional expense related to the lease of CU8,000 ($CU800,000 \times 1$ per cent), which Lessee recognizes in surplus or deficit in the first year of the lease.

Lease Modifications (see paragraphs 45–47)

IE7. Examples 15–19 illustrate the requirements of IPSAS 43 regarding lease modifications for a lessee.

Example 15—Modification that is a Separate Lease

Lessee enters into a 10-year lease for 2,000 square meters of office space. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease for the remaining five years to include an additional 3,000 square meters of office space in the same building. The additional space is made available for use by Lessee at the end of the second quarter of Year 6. The increase in total consideration for the lease is commensurate with the current market rate for the new 3,000 square meters of office space, adjusted for the discount that Lessee receives reflecting that Lessor does not incur costs that it would otherwise have incurred if leasing the same space to a new tenant (for example, marketing costs).

Lessee accounts for the modification as a separate lease, separate from the original 10-year lease. This is because the modification grants Lessee an additional right to use an underlying asset, and the increase in consideration for the lease is commensurate with the stand-alone price of the additional right-of-use adjusted to reflect the circumstances of the contract. In this example, the additional underlying asset is the new 3,000 square meters of office space. Accordingly, at

the commencement date of the new lease (at the end of the second quarter of Year 6), Lessee recognizes a right-of-use asset and a lease liability relating to the lease of the additional 3,000 square meters of office space. Lessee does not make any adjustments to the accounting for the original lease of 2,000 square meters of office space as a result of this modification.

Example 16—Modification that Increases the Scope of the Lease by Extending the Contractual Lease Term

Lessee enters into a 10-year lease for 5,000 square meters of office space. The annual lease payments are CU100,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6 per cent per annum. At the beginning of Year 7, Lessee and Lessor agree to amend the original lease by extending the contractual lease term by four years. The annual lease payments are unchanged (i.e., CU100,000 payable at the end of each year from Year 7 to Year 14). Lessee's incremental borrowing rate at the beginning of Year 7 is 7 per cent per annum.

At the effective date of the modification (at the beginning of Year 7), Lessee remeasures the lease liability based on: (a) an eight-year remaining lease term, (b) annual payments of CU100,000 and (c) Lessee's incremental borrowing rate of 7 per cent per annum. The modified lease liability equals CU597,130. The lease liability immediately before the modification (including the recognition of the interest expense until the end of Year 6) is CU346,511. Lessee recognizes the difference between the carrying amount of the modified lease liability and the carrying amount of the lease liability immediately before the modification (CU250,619) as an adjustment to the right-of-use asset.

Example 17—Modification that Decreases the Scope of the Lease

Lessee enters into a 10-year lease for 5,000 square meters of office space. The annual lease payments are CU50,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6 per cent per annum. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease to reduce the space to only 2,500 square meters of the original space starting from the end of the first quarter of Year 6. The annual fixed lease payments (from Year 6 to Year 10) are CU30,000. Lessee's incremental borrowing rate at the beginning of Year 6 is 5 per cent per annum.

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability based on: (a) a five-year remaining lease term, (b) annual payments of CU30,000 and (c) Lessee's incremental borrowing rate of 5 per cent per annum. This equals CU129,884.

Lessee determines the proportionate decrease in the carrying amount of the right-of-use asset on the basis of the remaining right-of-use asset (i.e., 2,500 square meters corresponding to 50 per cent of the original right-of-use asset).

50 per cent of the pre-modification right-of-use asset (CU184,002) is CU92,001. Fifty per cent of the pre-modification lease liability (CU210,618) is CU105,309. Consequently, Lessee reduces the carrying amount of the right-of-use asset by CU92,001 and the carrying amount of the lease liability by CU105,309. Lessee recognizes the difference between the decrease in the lease liability and the decrease in the right-of-use asset (CU105,309 – CU92,001 = CU13,308) as a gain in surplus or deficit at the effective date of the modification (at the beginning of Year 6).

Lessee recognizes the difference between the remaining lease liability of CU105,309 and the modified lease liability of CU129,884 (which equals CU24,575) as an adjustment to the right-of-use asset reflecting the change in the consideration paid for the lease and the revised discount rate.

Example 18—Modification that Both Increases and Decreases the Scope of the Lease

Lessee enters into a 10-year lease for 2,000 square meters of office space. The annual lease payments are CU100,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6 per cent per annum. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease to (a) include an additional 1,500 square meters of space in the same building starting from the beginning of Year 6 and (b) reduce the lease term from 10 years to eight years. The annual fixed payment for the 3,500 square meters is CU150,000 payable at the end of each year (from Year 6 to Year 8). Lessee's incremental borrowing rate at the beginning of Year 6 is 7 per cent per annum.

The consideration for the increase in scope of 1,500 square meters of space is not commensurate with the stand-alone price for that increase adjusted to reflect the circumstances of the contract. Consequently, Lessee does not account for the increase in scope that adds the right to use an additional 1,500 square meters of space as a separate lease.

The pre-modification right-of-use asset and the pre-modification lease liability in relation to the lease are as follows.

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Year	Lease liability				Right-of-use asset		
	Beginning balance	6% interest expense	Lease payment	Ending balance	Beginning balance	Depreciation charge	Ending balance
	CU	CU	CU	CU	CU	CU	CU
1	736,009	44,160	(100,000)	680,169	736,009	(73,601)	662,408
2	680,169	40,810	(100,000)	620,979	662,408	(73,601)	588,807
3	620,979	37,259	(100,000)	558,238	588,807	(73,601)	515,206
4	558,238	33,494	(100,000)	491,732	515,206	(73,601)	441,605
5	491,732	29,504	(100,000)	421,236	441,605	(73,601)	368,004
6	421,236				368,004		

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability on the basis of: (a) a three-year remaining lease term, (b) annual payments of CU150,000 and (c) Lessee's incremental borrowing rate of 7 per cent per annum. The modified liability equals CU393,647, of which (a) CU131,216 relates to the increase of CU50,000 in the annual lease payments from Year 6 to Year 8 and (b) CU262,431 relates to the remaining three annual lease payments of CU100,000 from Year 6 to Year 8.

Decrease in the lease term

At the effective date of the modification (at the beginning of Year 6), the pre-modification right-of-use asset is CU368,004. Lessee determines the proportionate decrease in the carrying amount of the right-of-use asset based on the remaining right-of-use asset for the original 2,000 square meters of office space (i.e., a remaining three-year lease term rather than the original five-year lease term). The remaining right-of-use asset for the original 2,000 square meters of office space is CU220,802 (i.e., $CU368,004 \div 5 \times 3$ years).

At the effective date of the modification (at the beginning of Year 6), the pre-modification lease liability is CU421,236. The remaining lease liability for the original 2,000 square meters of office space is CU267,301 (i.e., present value of three annual lease payments of CU100,000, discounted at the original discount rate of 6 per cent per annum).

Consequently, Lessee reduces the carrying amount of the right-of-use asset by CU147,202 ($CU368,004 - CU220,802$), and the carrying amount of the lease liability by CU153,935 ($CU421,236 - CU267,301$). Lessee recognizes the difference between the decrease in the lease liability and the decrease in the right-of-use asset ($CU153,935 - CU147,202 = CU6,733$) as a gain in surplus or deficit at the effective date of the modification (at the beginning of Year 6).

Lease liability	CU153,935
Right-of-use asset	CU147,202
Gain	CU6,733

At the effective date of the modification (at the beginning of Year 6), Lessee recognizes the effect of the remeasurement of the remaining lease liability reflecting the revised discount rate of 7 per cent per annum, which is CU4,870 ($CU267,301 - CU262,431$), as an adjustment to the right-of-use asset.

Lease liability	CU4,870
Right-of-use asset	CU4,870

Increase in the leased space

At the commencement date of the lease for the additional 1,500 square meters of space (at the beginning of Year 6), Lessee recognizes the increase in the lease liability related to the increase in scope of CU131,216 (i.e., present value of three annual lease payments of CU50,000, discounted at the revised interest rate of 7 per cent per annum) as an adjustment to the right-of-use asset.

Right-of-use asset	CU131,216
Lease liability	CU131,216

The modified right-of-use asset and the modified lease liability in relation to the modified lease are as follows.

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Year	Lease liability				Right-of-use asset		
	Beginning balance	7% interest expense	Lease payment	Ending balance	Beginning balance	Depreciation charge	Ending balance
	CU	CU	CU	CU	CU	CU	CU
6	393,647	27,556	(150,000)	271,203	347,148	(115,716)	231,432
7	271,203	18,984	(150,000)	140,187	231,432	(115,716)	115,716
8	140,187	9,813	(150,000)	-	115,716	(115,716)	-

Example 19—Modification that is a Change in Consideration Only

Lessee enters into a 10-year lease for 5,000 square meters of office space. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease for the remaining five years to reduce the lease payments from CU100,000 per year to CU95,000 per year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6 per cent per annum. Lessee's incremental borrowing rate at the beginning of Year 6 is 7 per cent per annum. The annual lease payments are payable at the end of each year.

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability based on: (a) a five-year remaining lease term, (b) annual payments of CU95,000 and (c) Lessee's incremental borrowing rate of 7 per cent per annum. Lessee recognizes the difference between the carrying amount of the modified liability (CU389,519) and the lease liability immediately before the modification (CU421,236) of CU31,717 as an adjustment to the right-of-use asset.

Subleases (see paragraph AG59)

IE8. Examples 20–21 illustrate the application of the requirements in IPSAS 43 for an intermediate lessor that enters into a head lease and a sublease of the same underlying asset.

Example 20—Sublease Classified as a Finance Lease

Head lease—An intermediate lessor enters into a five-year lease for 5,000 square meters of office space (the head lease) with Entity A (the head lessor).

Sublease—At the beginning of Year 3, the intermediate lessor subleases the 5,000 square meters of office space for the remaining three years of the head lease to a sublessee.

The intermediate lessor classifies the sublease by reference to the right-of-use asset arising from the head lease. The intermediate lessor classifies the sublease as a finance lease, having considered the requirements in paragraphs 65–70 of IPSAS 43.

When the intermediate lessor enters into the sublease, the intermediate lessor:

- Derecognizes the right-of-use asset relating to the head lease that it transfers to the sublessee and recognizes the net investment in the sublease;
- Recognizes any difference between the right-of-use asset and the net investment in the sublease in surplus or deficit; and
- Retains the lease liability relating to the head lease in its statement of financial position, which represents the lease payments owed to the head lessor.

During the term of the sublease, the intermediate lessor recognizes both finance revenue on the sublease and interest expense on the head lease (Entity A).

Example 21—Sublease Classified as Operating Lease

Head lease—An intermediate lessor enters into a five-year lease for 5,000 square meters of office space (the head lease) with Entity A (the head lessor).

Sublease—At commencement of the head lease, the intermediate lessor subleases the 5,000 square meters of office space for two years to a sublessee.

The intermediate lessor classifies the sublease by reference to the right-of-use asset arising from the head lease. The intermediate lessor classifies the sublease as an operating lease, having considered the requirements in paragraphs 65–70 of IPSAS 43.

When the intermediate lessor enters into the sublease, the intermediate lessor retains the lease liability and the right-of-use asset relating to the head lease in its statement of financial position.

During the term of the sublease, the intermediate lessor:

- (a) Recognizes a depreciation charge for the right-of-use asset and interest on the lease liability; and
- (b) Recognizes lease revenue from the sublease.

Lessee Disclosure (see paragraphs 62 and AG50–AG51)

IE9. Example 22 illustrates how a lessee with different types of lease portfolios might comply with the disclosure requirements described in paragraphs 62 and AG50 of IPSAS 43 about variable lease payments. This example shows only current period information. IPSAS 1, *Presentation of Financial Statements* requires an entity to present comparative information.

Example 22—Variable Payment Terms

Lessee with a High Volume of Leases with Some Consistent Payment Terms

Example 22A: City XYZ (Lessee) operates four tourism outlets selling touristic merchandise about the city—A, B, C and D. Lessee has a high volume of property leases. Lessee’s policy is to negotiate variable payment terms for newly established tourism outlets. Lessee concludes that information about variable lease payments is relevant to users of its financial statements and is not available elsewhere in its financial statements. In particular, Lessee concludes that information about the proportion of total lease payments that arise from variable payments, and the sensitivity of those variable lease payments to changes in sales, is the information that is relevant to users of its financial statements. This information is similar to that reported to Lessee’s senior management about variable lease payments.

Some of the property leases within the city contain variable payment terms that are linked to sales generated from the tourism outlet. Variable payment terms are used, when possible, in newly established tourism outlets in order to link rental payments to tourism outlet cash flows and minimize fixed costs. Fixed and variable rental payments by tourism outlet for the period ended 31 December 20X0 are summarized below.

	Tourism outlet	Fixed payments	Variable payments	Total payments	Estimated annual impact on total tourism outlet rent of a 1% increase in sales
	No.	CU	CU	CU	%
A	4,522	3,854	120	3,974	0.03%
B	965	865	105	970	0.11%
C	124	26	163	189	0.86%
D	652	152	444	596	0.74%
	6,263	4,897	832	5,729	0.15%

Refer to the management commentary for tourism outlet information presented on a like-for-like basis and to Note X for segmental information applying IPSAS 18, *Segment Reporting* relating to Tourism Outlets A–D.

Example 22B: City XYZ (Lessee) has a high volume of property leases of tourism outlets selling touristic merchandise about the city. Many of these leases contain variable payment terms linked to sales from the store. Lessee’s group policy sets out the circumstances in which variable payment terms are used and all lease negotiations must be approved centrally. Lease payments are monitored centrally. Lessee concludes that information about variable lease payments is relevant to users of its financial statements and is not available elsewhere in its financial statements. In particular, Lessee concludes that information about the different types of contractual terms it uses with respect to variable lease payments, the effect of those terms on its financial performance and the sensitivity of variable lease payments to changes in sales is the information that is relevant to users of its financial statements. This is similar to the information that is reported to Lessee’s senior management about variable lease payments.

Many of the property leases within *City XYZ* contain variable payment terms that are linked to the volume of sales made from leased tourism outlets. These terms are used, when possible, in order to match lease payments with tourism outlets generating higher cash flows. For individual tourism outlets, up to 100 per cent of lease payments are on the basis of vari-

able payment terms and there is a wide range of sales percentages applied. In some cases, variable payment terms also contain minimum annual payments and caps.

Lease payments and terms for the period ended 31 December 20X0 are summarized below.

	Tourism outlets	Fixed payments	Variable payments	Total payments
	No.	CU	CU	CU
Fixed rent only	1,490	1,153	-	1,153
Variable rent with no minimum	986	-	562	562
Variable rent with minimum	3,089	1,091	1,435	2,526
	5,565	2,244	1,997	4,241

A 1 per cent increase in sales across all tourism outlets in the public sector entity would be expected to increase total lease payments by approximately 0.6–0.7 per cent. A 5 per cent increase in sales across all tourism outlets in the public sector entity would be expected to increase total lease payments by approximately 2.6–2.8 per cent.

Lessee with a High Volume of Leases with a Wide Range of Different Payment Terms

Example 22C: City XYZ (Lessee) has a high volume of property leases of tourism outlets selling touristic merchandise about the city. These leases contain a wide range of different variable payment terms. Lease terms are negotiated and monitored by local management. Lessee concludes that information about variable lease payments is relevant to users of its financial statements and is not available elsewhere in its financial statements. Lessee concludes that information about how its property lease portfolio is managed is the information that is relevant to users of its financial statements. Lessee also concludes that information about the expected level of variable lease payments in the coming year (similar to that reported internally to senior management) is also relevant to users of its financial statements.

Many of the property leases within the city contain variable payment terms. Local management are responsible for store margins. Accordingly, lease terms are negotiated by local management and contain a wide range of payment terms. Variable payment terms are used for a variety of reasons, including minimising the fixed cost base for newly established tourism outlets or for reasons of margin control and operational flexibility. Variable lease payment terms vary widely across the city:

- (a) The majority of variable payment terms are based on a range of percentages of tourism outlet sales;
- (b) Lease payments based on variable terms range from 0–20 per cent of total lease payments on an individual property; and
- (c) Some variable payment terms include minimum or cap clauses.

The overall financial effect of using variable payment terms is that higher rental costs are incurred by tourism outlet with higher sales. This facilitates the management of margins across the city's tourism outlets.

Variable rent expenses are expected to continue to represent a similar proportion of store sales in future years.

- IE10. Example 23 illustrates how a lessee with different types of lease portfolios might comply with the disclosure requirements described in paragraphs 62 and AG51 of IPSAS 43 about extension options and termination options. This example shows only current period information. IPSAS 1 requires an entity to present comparative information.

Example 23—Extension Options and Termination Options

Lessee with a High Volume of Leases, that Have a Wide Range of Different Terms and Conditions, which are not Managed Centrally

Example 23A: Lessee has a high volume of equipment leases with a wide range of different terms and conditions. Lease terms are negotiated and monitored by local management. Lessee concludes that information about how it manages the use of termination and extension options is the information that is relevant to users of its financial statements and is not

available elsewhere in its financial statements. Lessee also concludes that information about (a) the financial effect of reassessing options and (b) the proportion of its short-term lease portfolio resulting from leases with annual break clauses is also relevant to users of its financial statements.

Extension and termination options are included in a number of equipment leases across the economic entity. Local teams are responsible for managing their leases and, accordingly, lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. Extension and termination options are included, when possible, to provide local management with greater flexibility to align its need for access to equipment with the fulfilment of customer contracts. The individual terms and conditions used vary across the economic entity.

The majority of extension and termination options held are exercisable only by Lessee and not by the respective lessors. In cases in which Lessee is not reasonably certain to use an optional extended lease term, payments associated with the optional period are not included within lease liabilities.

During 20X0, the financial effect of revising lease terms to reflect the effect of exercising extension and termination options was an increase in recognized lease liabilities of CU489.

In addition, Lessee has a number of lease arrangements containing annual break clauses at no penalty. These leases are classified as short-term leases and are not included within lease liabilities. The short-term lease expense of CU30 recognized during 20X0 included CU27 relating to leases with an annual break clause.

Lessee with a High Volume of Leases with Some Consistent Terms and Options

Example 23B: City XYZ (Lessee) has a high volume of property leases containing penalty free termination options that are exercisable at the option of Lessee. Lessee's policy is to have termination options in leases of more than five years, whenever possible. Lessee has a central property team that negotiates leases. Lessee concludes that information about termination options is relevant to users of its financial statements and is not available elsewhere in its financial statements. In particular, Lessee concludes that information about (a) the potential exposure to future lease payments that are not included in the measurement of lease liabilities and (b) the proportion of termination options that have been exercised historically is the information that is relevant to users of its financial statements. Lessee also notes that presenting this information on the basis of the same operation for which segment information is disclosed applying IPSAS 18 is relevant to users of its financial statements. This is similar to the information that is reported to Lessee's senior management about termination options.

Many of the property leases across the city contain termination options. These options are used to limit the period to which the city is committed to individual lease contracts and to maximize operational flexibility in terms of opening and closing individual offices. For most leases of offices, recognized lease liabilities do not include potential future rental payments after the exercise date of termination options because Lessee is not reasonably certain to extend the lease beyond that date. This is the case for most leases for which a longer lease period can be enforced only by Lessee and not by the landlord, and for which there is no penalty associated with the option.

Potential future rental payments relating to periods following the exercise date of termination options are summarized below.

Segment	Lease liabilities recognized	Potential future lease payments not included in lease liabilities (undiscounted)		
	(discounted)	Payable during 20X1–20X5	Payable during 20X6–20Y0	Total
	CU	CU	CU	CU
Operation A	569	71	94	165
Operation B	2,455	968	594	1,562
Operation C	269	99	55	154
Operation D	1,002	230	180	410
Operation E	914	181	321	502
	5,209	1,549	1,244	2,793

The table below summarizes the rate of exercise of termination options during 20X0.

Segment	Termination option exercisable	Termination option not	Termination option
	during 20X0	exercised	exercised
	No. of leases	No. of leases	No. of leases

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Operation A	33	30	3
Operation B	86	69	17
Operation C	19	18	1
Operation D	30	5	25
Operation E	66	40	26
	234	162	72

Example 23C: Lessee has a high volume of large equipment leases containing extension options that are exercisable by Lessee during the lease. Lessee's policy is to use extension options to align, when possible, committed lease terms for large equipment with the initial contractual term of associated customer contracts, whilst retaining flexibility to manage its large equipment and reallocate assets across contracts. Lessee concludes that information about extension options is relevant to users of its financial statements and is not available elsewhere in its financial statements. In particular, Lessee concludes that (a) information about the potential exposure to future lease payments that are not included in the measurement of lease liabilities and (b) information about the historical rate of exercise of extension options is the information that is relevant to users of its financial statements. This is similar to the information that is reported to Lessee's senior management about extension options.

Many of the large equipment leases across the city contain extension options. These terms are used to maximize operational flexibility in terms of managing contracts. These terms are not reflected in measuring lease liabilities in many cases because the options are not reasonably certain to be exercised. This is generally the case when the underlying large equipment has not been allocated for use on a particular customer contract after the exercise date of an extension option. The table below summarizes potential future rental payments relating to periods following the exercise dates of extension options.

Segment	Lease liabilities recognized (discounted) CU	Potential future lease payments not included in lease liabilities (discounted) CU	Historical rate of exercise of extension options %
Operation A	569	799	52%
Operation B	2,455	269	69%
Operation C	269	99	75%
Operation D	1,002	111	41%
Operation E	914	312	76%
	5,209	1,590	67%

Sale and Leaseback Transactions (see paragraphs 97–102)

IE11. Example 24 illustrates the application of the requirements in paragraphs 97–102 of IPSAS 43 for a seller-lessee and a buyer-lessor.

Example 24–Sale and Leaseback Transaction

An entity (Seller-lessee) sells a building to another entity (Buyer-lessor) for cash of CU2,000,000. Immediately before the transaction, the building is carried at a cost of CU1,000,000. At the same time, Seller-lessee enters into a contract with Buyer-lessor for the right to use the building for 18 years, with annual payments of CU120,000 payable at the end of each year. The terms and conditions of the transaction are such that the transfer of the building by Seller-lessee satisfies the requirements for determining when a performance obligation is satisfied in IFRS 15 Revenue from Contracts with Custom-

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ers. Accordingly, Seller-lessee and Buyer-lessor account for the transaction as a sale and leaseback. This example ignores any initial direct costs.

The fair value of the building at the date of sale is CU1,800,000. Because the consideration for the sale of the building is not at fair value, Seller-lessee and Buyer-lessor make adjustments to measure the sale proceeds at fair value. The amount of the excess sale price of CU200,000 (CU2,000,000 – CU1,800,000) is recognized as additional financing provided by Buyer-lessor to Seller-lessee.

The interest rate implicit in the lease is 4.5 per cent per annum, which is readily determinable by Seller-lessee. The present value of the annual payments (18 payments of CU120,000, discounted at 4.5 per cent per annum) amounts to CU1,459,200, of which CU200,000 relates to the additional financing and CU1,259,200 relates to the lease—corresponding to 18 annual payments of CU16,447 and CU103,553, respectively.

Seller-lessee

At the commencement date, Seller-lessee measures the right-of-use asset arising from the leaseback of the building at the proportion of the previous carrying amount of the building that relates to the right of use retained by Seller-lessee, which is CU699,555. This is calculated as: CU1,000,000 (the carrying amount of the building) ÷ CU1,800,000 (the fair value of the building) × CU1,259,200 (the discounted lease payments for the 18-year right-of-use asset).

Seller-lessee recognizes only the amount of the gain that relates to the rights transferred to Buyer-lessor of CU240,355 calculated as follows. The gain on sale of building amounts to CU800,000 (CU1,800,000 – CU1,000,000), of which:

- (a) CU559,645 (CU800,000 ÷ CU1,800,000 × CU1,259,200) relates to the right to use the building retained by Seller-lessee; and
- (b) CU240,355 (CU800,000 ÷ CU1,800,000 × (CU1,800,000 – CU1,259,200)) relates to the rights transferred to Buyer-lessor.

At the commencement date, Seller-lessee accounts for the transaction as follows.

Cash	CU2,000,000	
Right-of-use asset	CU699,555	
Building		CU1,000,000
Financial liability		CU1,459,200
Gain on rights transferred		CU240,355

Buyer-lessor

At the commencement date, Buyer-lessor accounts for the transaction as follows.

Building	CU1,800,000	
Financial asset	CU200,000 (18 payments of CU16,447, discounted at	
	4.5 per cent per annum)	
Cash		CU2,000,000

After the commencement date, Buyer-lessor accounts for the lease by treating CU103,553 of the annual payments of CU120,000 as lease payments. The remaining CU16,447 of annual payments received from Seller-lessee are accounted for as (a) payments received to settle the financial asset of CU200,000 and (b) interest revenue.

Comparison with IFRS 16

IPSAS 43, *Leases* is drawn primarily from IFRS 16 (2016) *Leases*, including amendments up to March 2021.

The main differences between IPSAS 43 and IFRS 16 are as follows:

- IPSAS 43 uses different terminology from IFRS 16. For example, IPSAS 43 uses the terms “revenue”, “operation”, “accumulated surpluses/(deficits)” and “segment”, while IFRS 16 uses the terms “income”, “business unit”, “retained earnings” and “business segment”, respectively.
- IPSAS 43 refers to both “economic benefits” and “service potential”, where appropriate, in the section on identifying a lease, while IFRS 16 refers only to “economic benefits”.
- IPSAS 43 does not include specific requirements for manufacturer or dealer lessors, whereas IFRS 16 does.

Comparison with GFS

In developing IPSAS 43, *Leases*, the IPSASB considered Government Finance Statistics (GFS) reporting guidelines.

Key similarities and differences with GFS are as follows:

- IPSAS 43 applies a right-of-use model for lessees and a risks and rewards model for lessors, while GFS applies a risks and rewards model for both lessees and lessors.
- Under IPSAS 43, lessors classify leases as finance lease or operating lease and lessees do not classify leases as finance lease or operating lease. Under GFS, leases are classified as financial lease, operating lease, or resource lease.
- Under IPSAS 43, lessees recognize a right-of use asset and a lease liability. Under GFS, an underlying asset and a loan are recognized in a financial lease and lease payments from operating leases are recognized as use of goods and services.
- IPSAS 43 provides an optional recognition exemption for lessees on short-term leases and leases for which the underlying asset is of low value. GFS does not provide such recognition exemption.

INTRODUCTION TO THE INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD UNDER THE CASH BASIS OF ACCOUNTING—ISSUED IN 2017

The International Public Sector Accounting Standards Board (the IPSASB) develops accounting standards for public sector entities referred to as International Public Sector Accounting Standards (IPSAS). The IPSASB recognizes the significant benefits of achieving consistent and comparable financial information across jurisdictions and it believes that the IPSAS will play a key role in enabling these benefits to be realized. The IPSASB strongly encourages governments and national standard-setters to engage in the development of its Standards by commenting on the proposals set out in its Exposure Drafts and Consultation Papers.

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

The adoption of IPSAS by governments will improve both the quality and comparability of financial information reported by public sector entities around the world. The IPSASB recognizes the right of governments and national standard-setters to establish accounting standards and guidelines for financial reporting in their jurisdictions. The IPSASB considers that this Standard is an important step forward in improving the consistency and comparability of financial reporting under the cash basis of accounting and encourages the adoption of this Standard. Financial statements should be described as complying with this IPSAS only if they comply with all the requirements of Part 1 of this IPSAS.

The IPSASB encourages governments to progress to the accrual basis of accounting and to harmonize national requirements with the IPSAS 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—ISSUED IN 2017

Structure of the Standard

This Standard comprises two parts:

- Part 1 is mandatory. It sets out the requirements which are applicable to all public sector 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 public sector entities which claim to be reporting in accordance with the International Public Sector Accounting Standard *Financial Reporting under the Cash Basis of Accounting*.
- Part 2 is not mandatory. It identifies additional accounting policies and disclosures that a public sector entity is encouraged to adopt to enhance the usefulness of its financial statements for accountability and decision-making purposes and to support its transition to the accrual basis of financial reporting and adoption of accrual IPSAS.
- The Cash Basis IPSAS was issued in January 2003. The IPSAS was updated with additional requirements and encouragements dealing with the presentation of budget information in 2006 and external assistance in 2007.
- In 2017 a revised Cash Basis IPSAS was issued. The objectives of the revisions were to:
 - (a) Remove obstacles to the adoption of the Cash Basis IPSAS represented by the existing requirements dealing with consolidation, external assistance and third party payments: in particular, to recast the requirements in Part 1 of the IPSAS to prepare consolidated financial statements and disclose information about external assistance and third party payments as encouragements in Part 2 of the IPSAS;
 - (b) Ensure that requirements and encouragements in the Standard are not contrary to those of the equivalent accrual IPSAS, except where such differences are appropriate to reflect adoption of the cash basis; and
 - (c) Clarify that the role the Cash Basis IPSAS is intended to play in the IPSASB's overall standards setting strategy is primarily as a step on the path to adoption of the accrual basis IPSAS, rather than as an end in itself.

FINANCIAL REPORTING UNDER THE CASH BASIS OF ACCOUNTING

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PART 1: REQUIREMENTS

Part 1 of this Standard sets out the requirements for reporting under the cash basis of accounting.

Authoritative requirements are set out in bold italic type. They use the term “shall” to signal that they are authoritative requirements. They are to 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 are to be presented under the cash basis of accounting.

The objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users of general purpose financial statements and other general purpose financial reports (GPFRs) for accountability and decision-making purposes. 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 general purpose financial statements of previous periods and with the financial statements of other entities which adopt the cash basis of accounting.

Role of the Cash Basis IPSAS

The IPSASB is of the view that the objectives of financial reporting can best be achieved by adoption of the accrual IPSAS. Consequently the IPSASB encourages governments and other public sector entities to present financial statements that comply with the requirements of the accrual IPSAS. However, the IPSASB appreciates that in some jurisdictions a transitional process may be necessary to achieve that end. The Cash Basis IPSAS has been developed as an intermediate step to assist in the transition to the accrual basis of financial reporting and adoption of accrual IPSAS. It is not intended as an end in itself. The role of the encouraged disclosures in Part 2 of the Standard is to support an entity’s transition to the accrual basis of financial reporting and adoption of the accrual IPSAS.

The path chosen to transition to the accrual basis of financial reporting and adoption of the accrual IPSAS will reflect jurisdiction circumstances and, consequently, may differ from jurisdiction to jurisdiction. The IPSASB does not specify that a particular transitional path should be adopted nor that entities must necessarily adopt the Cash Basis IPSAS as the first step in the transition process.

1.1 Scope of the Requirements

1.1.1 The IPSAS are designed to apply to public sector entities¹ that meet all the following criteria:

- (a) Are responsible for the delivery of services² to benefit the public and/or to redistribute income and wealth;
- (b) Mainly finance their activities, directly or indirectly, by means of taxes and/or transfers from other levels of government, social contributions, debt or fees; and
- (c) Do not have a primary objective to make profits.

1.1.2 ***A public sector entity which prepares and presents general purpose financial statements (financial statements) under the cash basis of accounting, as defined in this Standard, shall apply the requirements of Part 1 of this Standard in the presentation of its annual financial statements.***

1.1.3 General purpose financial statements are developed primarily to respond to the information needs of service recipients and resource providers who are not in a position to demand reports tailored to meet their specific information needs,

¹ Paragraph 1.8 of *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* identifies a wide range of public sector entities for which IPSASs are designed.

² Services encompasses goods, services and policy advice, including to other public sector entities.

and representatives of these users. Service recipients and their representatives and resource providers and their representatives include citizens, residents, taxpayers and ratepayers, members of the legislature (or similar body) and members of parliament (or a similar representative body), donor agencies, lenders and others that provide resources to, or benefit from, services of governments. General purpose financial statements prepared to respond to the information needs of service recipients and resource providers for accountability and decision-making purposes may also provide information useful to other parties. General purpose financial statements include those financial statements that are presented separately or within another public document such as an annual report. For purposes of this Standard, the terms “general purpose financial statements” and “financial statements” are used interchangeably, unless specified otherwise.

- 1.1.4 A reporting entity is an individual entity that presents financial statements or, where a controlling entity elects to present group financial statements, a reporting entity may comprise a controlling entity and one or more controlled entities that present financial statements as if they are a single entity. A public sector reporting entity (hereafter referred to as a reporting entity or entity, unless specified otherwise) is a government or other public sector organization, program or identifiable area of activity for which financial statements are prepared. Paragraph 1.4.7 of this Standard requires the disclosure of certain information about the entities and activities in respect of which financial statements have been prepared.
- 1.1.5 This Standard applies equally to the financial statements of an individual entity and to the financial statements of a reporting entity that comprises a controlling entity and one or more controlled entities. 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.
- 1.1.6 *An entity whose financial statements comply with the requirements of Part 1 of this Standard shall disclose that fact. Financial statements shall not be described as complying with this Standard unless they comply with all the requirements in Part 1 of this Standard.*

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.

Control of an entity: An entity controls another entity when the entity is exposed, or has rights, to variable benefits from its involvement with the other entity and has the ability to affect the nature or amount of those benefits through its power over the other entity.

Controlled entity is an entity that is under the control of another entity (known as the controlling 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 2.1.6 to 2.1.13 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 "treasury single account". Under these arrangements, individual departments and entities do not establish their own separate bank accounts. Rather, the centralized treasury function acts as a bank on behalf of the individual departments and other entities. The cash inflows, cash outflows and cash balances of the entity which flow through, or are held in, the treasury single account will be reported in the statement of cash receipts and payments in accordance with the requirements of paragraph 1.3.4. From the perspective of the centralized treasury function, payments on behalf of individual departments and other entities are treated as changes within their accounts — reflecting the approach adopted by a bank in accounting for payments made on behalf of its customers.
- 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.

Control of an entity

- 1.2.10 Governments and other public sector entities may control a large number of entities including government departments, agencies and commercial public sector entities. Financial statements may be prepared in respect of a reporting entity that comprises an individual entity or a controlling entity and all or some of its controlled entities. This Standard encourages (at paragraph 2.1.37) but does not require, controlling entities to prepare and present consolidated financial statements that encompass the controlling entity and all its controlled entities, with exceptions in certain defined circumstances. The

factors to be considered in assessing whether one entity controls another entity for financial reporting purposes are set out in IPSAS 35, *Consolidated Financial Statements*.

1.3 Presentation and Disclosure Requirements

Definitions

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

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

Materiality: information is material if its omission or misstatement could influence the discharge of accountability by the entity, or the decisions that users make on the basis of the entity's financial statements prepared for that reporting period. Materiality depends on both the nature and amount of the item judged in the particular circumstances of each entity.

Reporting date means the date of the last day of the reporting period to which financial statements relate.

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 shall prepare and present financial statements which include the following components:*

- (a) *A statement of cash receipts and payments which recognizes all cash receipts, cash payments and cash balances controlled by the entity;*
- (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 1.7.8 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 paragraph 1.3.4(c), such information shall be disclosed in the notes to the financial statements.*

1.3.6 The 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) 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 financial statements may include a comparison of budget and actual amounts as an additional financial statement.

1.3.7 Paragraph 1.7.17 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 shall 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, shall 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 shall 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 objectives and qualitative characteristics of financial reporting under the cash basis of accounting. Appendix 4 of this Standard summarizes the qualitative characteristics of information included in general purpose financial reports. 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.
- 1.3.18 Part 2 of this Standard encourages the disclosure of certain information about external assistance and other assistance received during the reporting period, and the balance of undrawn external assistance and other assistance available to the entity at reporting date. For many public sector reporting entities in developing economies, the classification of cash receipts and payments to identify the amount of external assistance and other assistance received as cash and the use of that assistance is likely to be relevant for accountability and decision-making purposes.

Line Items, Headings and Sub-Totals

- 1.3.19 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; 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. Part 2 of this Standard sets 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

- 1.3.20 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 1.3.21 and 1.3.24 below further elaborate on those circumstances in which reporting on a net basis may be justified.
- 1.3.21 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).
- 1.3.22 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.
- 1.3.23 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.

1.3.24 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.

Accounting Policies and Explanatory Notes

Structure of the Notes

1.3.25 *The notes to the financial statements of an entity shall:*

- (a) *Present information about the basis of preparation of the financial statements and the specific accounting policies selected and applied for significant transactions and other 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.*

1.3.26 *Notes to the financial statements shall be presented in a systematic manner. Each item on the face of the statement of cash receipts and payments and other financial statements shall be cross referenced to any related information in the notes.*

Selection and Disclosure of Accounting Policies

1.3.27 *Financial statements shall present information that is:*

- (a) *Understandable;*
- (b) *Relevant to the decision-making and accountability needs of users;*
- (c) *A faithful representation of the cash receipts, cash payments and cash balances of the entity and the other information disclosed in the financial statements in that it is:*
 - (i) *Complete;*
 - (ii) *Neutral; and*
 - (iii) *Free from material error;*
- (d) *Comparable;*
- (e) *Timely; and*
- (f) *Verifiable.*

Constraints on information included in financial statements are that it is material, satisfies a cost-benefit assessment, and achieves an appropriate balance between the qualitative characteristics identified in (a) to (f) above.

1.3.28 The quality of information provided in financial statements determines the usefulness of those statements to users. Paragraph 1.3.27 identifies the qualitative characteristics of, and pervasive constraints on, information included in financial statements. It requires the development of accounting policies to ensure that the financial statements provide information that meets the qualitative characteristics identified in paragraphs 1.3.27(a) to 1.3.27(f), and satisfies the constraints on information included in financial statements. Appendix 4 of this Standard summarizes the qualitative characteristics of, and constraints on, information included in general purpose financial reports. The maintenance of complete and accurate accounting records during the reporting period is essential for timely production of the financial statement.

1.3.29 *The accounting policies section of the notes to the financial statements shall 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.*

1.3.30 *Inappropriate accounting treatments are not rectified either by disclosure of the accounting policies used, or by notes or explanatory material.*

- 1.3.31 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 1.3.29 above also apply to notes to the financial statements.
- 1.3.32 *Where an entity elects to include in its financial statements any disclosures encouraged in Part 2 of this Standard, those disclosures shall comply with the requirements of paragraph 1.3.27 above.*
- 1.3.33 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 shall 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 shall 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 shall disclose the date when the financial statements were authorized for issue and who gave that authorization. If another body has the power to amend the financial statements after issuance, the entity shall disclose that fact.*
- 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 shall disclose the following in the notes to the financial statements if not disclosed elsewhere in information published with the financial statements:*
- (a) *The domicile and legal form of the entity, and the jurisdiction(s) 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 significant entities or sectors of government that are presented in the financial statements, and changes in the significant entities or sectors that comprise the reporting entity and were presented in the previous periods financial statements.*

1.4.8 Financial statements may be prepared for a single organization or administrative unit such as a government department, agency or program; for the government as a whole; or for a group of entities or identifiable activities such as those that reflect the budget sector, general government sector or other sector of government. 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. It will also enable users to identify the significant entities or sectors that make up the reporting entity and changes therein since the last reporting date. 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 shall 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 shall be retained from one period to the next unless:*

- (a) *It is apparent, following a significant change in the nature of the operations of the entity or a review of its financial statements that another presentation or classification would be more appropriate having regard to the criteria for the selection and application of accounting policies in paragraph 1.3.27; 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 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 entities with the remaining entities conducting 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 an alternative presentation provides information that is a faithful representation and is more relevant to users of the financial statement, 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 shall 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 shall 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 shall 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 shall be disclosed. When it is impracticable to reclassify comparative amounts, an entity shall 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 shall 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 shall be clearly identified. In addition, the following information shall 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 an individual entity or a group of entities;***
 - (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 presentation 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 presentation 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 shall be reported by adjusting the cash at the beginning of the period. Comparative information shall be restated, unless it is impracticable to do so.*
- 1.5.2 *An entity shall disclose in the notes to the financial statements the following:*
- (a) *The nature of the error that relates to a prior period;*
 - (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 Potential current period errors discovered in the current period are corrected before the financial statements are authorized for issue. 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 prior period 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 Foreign Currency

Definitions

- 1.6.1 *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 translating a given number of units of one currency into another currency at different exchange rates.*
- Exchange rate is the ratio of exchange for two currencies.*
- Foreign currency is a currency other than the presentation currency of the entity.*
- Presentation currency is the currency in which the financial statements are presented.*
- Spot exchange rate is the exchange rate for immediate delivery.*

Treatment of Foreign Currency Cash Receipts, Payments and Balances

- 1.6.2 *Cash receipts and payments arising from transactions in a foreign currency shall be incorporated in the Statement of Receipts and Payments in an entity's presentation currency by applying to the foreign currency amount the spot exchange rate between the reporting currency and the foreign currency at the date of the receipts and payments.*
- 1.6.3 *Cash balances held in a foreign currency shall be translated using the closing rate.*
- 1.6.4 *The cash receipts and cash payments of a foreign controlled entity shall be translated at the exchange rates between the presentation currency and the foreign currency at the dates of the receipts and payments.*
- 1.6.5 *An entity shall disclose the amount of exchange differences included as reconciling items between opening and closing cash balances for the period.*
- 1.6.6 *When the presentation currency is different from the currency of the country in which the entity is domiciled, the reason for using a different currency shall be disclosed. The reason for any change in the presentation currency shall also be disclosed.*

- 1.6.7 Governments and government entities may have transactions in foreign currencies such as borrowing an amount of foreign currency, receiving external and other assistance in the form 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 the currency in which the reporting entity presents its financial statements.
- 1.6.8 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.

1.7 Presentation of Budget Information in Financial Statements

Definitions

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

***Accounting basis** means the accrual or cash basis of accounting as defined in the accrual basis International Public Sector Accounting Standards and the Cash Basis International Public Sector Accounting Standard.*

***Annual budget** means an approved budget for one year. It does not include published forward estimates or projections for periods beyond the budget period.*

***Appropriation** is an authorization granted by a legislative body to allocate funds for purposes specified by the legislature or similar authority.*

***Approved budget** means the expenditure authority derived from laws, appropriation bills, government ordinances and other decisions related to the anticipated revenue or receipts for the budgetary period.*

***Budgetary basis** means the accrual, cash or other basis of accounting adopted in the budget that has been approved by the legislative body.*

***Comparable basis** means the actual amounts presented on the same accounting basis, same classification basis, for the same entities and for the same period as the approved budget.*

***Final budget** is the original budget adjusted for all reserves, carry over amounts, transfers, allocations, supplemental appropriations, and other authorized legislative or similar authority changes applicable to the budget period.*

***Multiyear budget** is an approved budget for more than one year. It does not include published forward estimates or projections for periods beyond the budget period.*

***Original budget** is the initial approved budget for the budget period.*

Approved Budgets

- 1.7.2 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.
- 1.7.3 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.
- 1.7.4 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

- 1.7.5 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.
- 1.7.6 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

- 1.7.7 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

- 1.7.8 *Subject to the requirements of paragraph 1.7.17, 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

- 1.7.9 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.
- 1.7.10 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

- 1.7.11 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.
- 1.7.12 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.
- 1.7.13 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 1.7.8(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.

- 1.7.14 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 1.7.23 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 1.7.8 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.
- 1.7.15 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 1.7.8(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.
- 1.7.16 Where approved budgets are only made publicly available for some of the entities or activities included in the financial statements, the requirements of paragraph 1.7.8 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 1.7.8 will be made only in respect of the general government sector of the government.

Presentation

- 1.7.17 *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.*
- 1.7.18 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.
- 1.7.19 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

- 1.7.20 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).
- 1.7.21 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 statements as identified in paragraph 1.3.27 of this Standard.
- 1.7.22 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

- 1.7.23 *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.*
- 1.7.24 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

- 1.7.25 *All comparisons of budget and actual amounts shall be presented on a comparable basis to the budget.*
- 1.7.26 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.
- 1.7.27 As noted in paragraph 1.7.10, separate budgets may be approved and made publicly available for individual entities or particular activities that make up the reporting entity. Where this occurs, the separate budgets may be recompiled for presentation in the financial statements in accordance with the requirements and encouragements 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.
- 1.7.28 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.
- 1.7.29 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.
- 1.7.30 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, the consolidated financial statements of the national government will not consolidate state/provincial or local governments that it does not control. However, separate financial statements may be 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

- 1.7.31 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.
- 1.7.32 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

- 1.7.33 *An entity shall explain in notes to the financial statements the budgetary basis and classification basis adopted in the approved budget.*
- 1.7.34 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.
- 1.7.35 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).
- 1.7.36 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.
- 1.7.37 *An entity shall disclose in notes to the financial statements the period of the approved budget.*
- 1.7.38 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.
- 1.7.39 *An entity shall identify in notes to the financial statements the entities included in the approved budget.*
- 1.7.40 Paragraph 2.1.37 of Part 2 of this Standard encourages controlling entities to prepare and present consolidated financial statements which encompass budget-dependent entities and commercial public sector entities controlled by the government. However, as noted in paragraph 1.7.29, 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 1.7.25, 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

- 1.7.41 *The actual amounts presented on a comparable basis to the budget in accordance with paragraph 1.7.25 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.*
- 1.7.42 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.

- 1.7.43 The reconciliation required by paragraph 1.7.41 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.
- 1.7.44 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.
- 1.7.45 *The disclosure of comparative information in respect of the previous period in accordance with the requirements of this Standard is not required.*
- 1.7.46 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.

1.8 Effective Date of Part 1 and Transitional Provisions

Transitional Provisions

- 1.8.1 *Entities which are adopting the Cash Basis IPSAS, Financial Reporting under the Cash Basis of Accounting for the first time shall apply all its provisions from the date of its first adoption.*
- 1.8.2 *Entities that currently present financial statements in accordance with the superseded Cash Basis IPSAS, Financial Reporting under the Cash Basis of Accounting are not required to comply with the requirements in this Standard until 1 January 2019.*

- 1.8.3 *Where entities apply the transitional provision in paragraph 1.8.2, they shall disclose the accounting policies that have not yet been adopted.*
- 1.8.4 When an entity adopts the Cash Basis IPSAS for the first time, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption. The transitional provisions provide entities that currently adopt the Cash Basis IPSAS with a period of up to two years from the effective date of this Standard to adopt all of its accounting policies. Entities that take advantage of the transitional provisions shall identify the policies that they are not yet fully compliant with. All changes to accounting policies resulting from the application of this Standard shall be accounted for in accordance with the requirements of paragraphs 1.8.11 to 1.8.13 below.

Effective Date

- 1.8.5 *An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2019. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2019 it shall disclose that fact.*
- 1.8.6 This Standard applies to an entity which adopts the Cash Basis IPSAS for the first time and to an entity which already adopts the Cash Basis IPSAS.

Withdrawal of the Cash Basis IPSAS (2007)

- 1.8.7 *This Standard supersedes the Cash Basis IPSAS, Financial Reporting under the Cash Basis of Accounting issued in 2007.*
- 1.8.8 The Cash Basis IPSAS was first issued in January 2003. It was applicable to annual financial statements covering periods beginning on or after 1 January 2004. It was subsequently updated with additional requirements and encouragements dealing with budget reporting and external assistance in 2006 and 2007. The effective date of the additional requirements in Section 9, *Presentation of Budget Information in Financial Statements* and Section 10, *Recipients of External Assistance* of Part 1 of the Standard was for annual financial statements covering periods beginning on or after 1 January 2009.
- 1.8.9 This Standard was issued in 2017. It supersedes the 2007 Standard previously on issue. It has been revised to provide relief from the requirement for preparation of consolidated financial statements and disclosure of information about third party payments and external assistance included in Part 1 of the 2007 Standard. Certain of those requirements are now included as encouragements in Part 2 of this Standard. This Standard has also been amended to better align with *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the Conceptual Framework) and the accrual IPSAS currently on issue where appropriate.
- 1.8.10 The combination of requirements and encouragements in Part 1 and Part 2 of this Standard will mean that in many, though not necessarily all, respects information presented in financial statements prepared in accordance with the superseded standard will also be presented by financial statements prepared in accordance with this Standard. However, entities that presented financial statements that complied with the superseded standard will need to review the requirements and encouragements in this Standard to ensure they remain compliant.

Changes in Accounting Policies of Entities that Adopt the Superseded Cash Basis IPSAS

- 1.8.11 *When the adoption of this Standard requires a change in an accounting policy of an entity that currently applies the superseded Cash Basis IPSAS, the entity shall apply the change retrospectively by adjusting the opening cash balance of the current period presented and the other comparative amounts disclosed for the immediate prior period presented as if the new accounting policy had always been applied.*
- 1.8.12 *When it is impracticable for an entity that currently applies the superseded Cash Basis IPSAS to determine the cumulative effect, at the beginning of the current period, of applying a new accounting policy to the immediate prior period presented, the entity shall:*
- (a) *Apply the new accounting policy to transactions, other events and conditions occurring after the date at which the policy is changed; and*
 - (b) *Recognize the effects of the new policy on the cash receipts, payments and balances of the current period and future periods affected by the change.*

- 1.8.13 *When initial application of this Standard by an entity that currently applies the superseded Cash Basis IPSAS, (a) has an effect on the current period or the immediate prior period, or (b) would have such an effect, except that it is impracticable to determine the amount of the adjustment, the entity shall disclose:*
- (a) *The nature of the change in accounting policy;*
 - (b) *For the current period and the immediate prior period presented, to the extent practicable, the amount of the adjustment for each financial statement line item affected; and*
 - (c) *If retrospective application required by paragraph 1.8.11 is impracticable, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.*

Basis for Conclusions – Cash Basis IPSAS Part 1

This Basis for Conclusions accompanies, but is not part of the IPSAS, Financial Reporting under the Cash Basis of Accounting.

The Basis for Conclusions which follows Part 2 of this Standard deals with amendments to the encouragements in Part 2.

Introduction

BC1 The IPSAS, *Financial Reporting under the Cash Basis of Accounting* (the Cash Basis IPSAS) was issued in January 2003 and updated with additional requirements and encouragements about the presentation of budget information in 2006 and external assistance in 2007. It comprises two parts: Part 1 identifies the requirements that must be adopted by a reporting entity whose general purpose financial statements comply with this Standard. Part 2 identifies encouraged additional disclosures which provide additional information useful for accountability and decision-making purposes and support those entities transitioning to the accrual basis of financial reporting and adoption of accrual IPSAS.

Reasons for, and Scope of, this Review

BC2 While there are different views about just how many governments and other public sector entities have adopted the Cash Basis IPSAS, there is general agreement that it is not widely adopted. The requirements for consolidation, external assistance and third party payments have been identified by the IPSASB Task Force established to review operation of the IPSAS (IPSASB Task Force Report 2010) and many constituents, including those implementing the IPSAS, as major obstacles to adoption of the Cash Basis IPSAS.

BC3 Despite its limited adoption, the IPSASB’s strategy consultation in 2014 found that there is strong support for retention of the Cash Basis IPSAS, whether as a Standard in its own right or as first step on the transition to the accrual basis of financial reporting and adoption of accrual IPSAS and, in some cases, for revisions to its requirements to remove obstacles to its adoption. Entities transitioning to the accrual basis of financial reporting are also encouraged to refer to IPSASB Study 14 *Transition to the Accrual Basis of Accounting: Guidance for Public Sector Entities* (Third Edition January 2011) which provides guidance on the approaches that may be adopted in transitioning to the accrual basis.

BC4 The amendments made through this revised Cash Basis IPSAS (2017) reflect a limited scope review of the IPSAS as a response to input the IPSASB has received from constituents on the operation of the Cash Basis IPSAS. The amendments are intended to:

- (a) Overcome the substantial obstacles to its adoption represented by the requirements relating to consolidation, external assistance and third party payments; and
- (b) Clarify that the role the Cash Basis IPSAS is intended to play in the IPSASB’s standards setting strategy is primarily as a step on the path to adoption of the accrual basis IPSAS, rather than an end in itself.

BC5 This revised Cash Basis IPSAS (2017) also includes minor “housekeeping” amendments intended to ensure that, while the requirements and encouragements in this Standard may differ from the requirements in equivalent accrual IPSAS, they are not contrary to those requirements unless intended to be so to reflect the cash basis focus in this Standard. Since issue of the Cash Basis IPSAS in 2003, the accrual IPSAS have been updated, and in some cases withdrawn and/or replaced. The “housekeeping” amendments reflect, as far as is appropriate, developments in the accrual IPSAS.

Consolidation

BC6 Many public sector entities wishing to prepare financial statements that comply with the requirements of this Standard and reflect best practice for financial reporting under the cash basis of accounting faced significant obstacles in the preparation and presentation of fully consolidated financial statements. This may be for a number of reasons including: (a) compatibility with existing legislation or regulation which requires the preparation of financial reports for the budget or general government sector or other grouping of activities; (b) difficulties in identifying all controlled entities at reporting date; (c) differences in the reporting basis adopted by commercial public sector entities, and (d) the capacity (including access to necessary technical expertise) to collect and process the necessary data on a timely basis and meet reporting deadlines.

BC7 Many constituents expressed concern that the previous consolidation requirements undermined the capacity of the Cash Basis IPSAS (2007) to perform its role of enhancing the quality of financial statements prepared under the cash basis of accounting and supporting the transition to the accrual basis of financial reporting and adoption of accrual IPSAS — because governments and other public sector entities could not comply with the Standard. This revised Cash Basis IPSAS (2017) makes amendments to the Cash Basis IPSAS (2007) to respond to these concerns, as outlined below.

- BC8 This revision removes from Part 1 of the Standard and recasts as an encouragement in Part 2 of the Standard the requirement that controlling entities are to prepare consolidated financial statements that consolidate all controlled entities be This is intended to overcome a major obstacle to adoption of the IPSAS.
- BC9 Part 2 of this Standard also encourages controlling entities that do not consolidate all controlled entities to prepare financial statements that reflect a budget sector, general government sector or other representation of core government activities as they transition to the accrual basis of financial reporting and adoption of the accrual IPSAS. This supports an orderly and achievable transition to full consolidation as required by the accrual IPSAS, and responds to concerns of some constituents that full consolidation would result in the loss of information about core governmental activities and, in some cases, is contrary to legislative requirements.
- BC10 To support those entities transitioning to the accrual basis, the key definitions, including that of control, are revised where necessary to ensure that they do not conflict with IPSAS 34, *Separate Financial Statements* and IPSAS 35, *Consolidated Financial Statements*.
- BC11 The IPSASB considered a number of approaches to removing the obstacles to adoption represented by the current requirements for consolidation. While many of these approaches had merit, the IPSASB decided that, on balance, the approach taken in this revised Cash Basis IPSAS (2017) best responded to the concerns of those faced with implementing the Cash Basis IPSAS, and those dependent on financial statements prepared in accordance with the IPSAS for information useful for accountability and decision-making purposes. The other approaches considered, and IPSASB's reasons for not proposing their adoption, include:
- (a) The inclusion of a transitional period of 3 to 5 years, or longer, from first adoption for entities to comply with the requirement that controlling entities shall consolidate all controlled entities. However, it is some 12 years since issue of the Cash Basis IPSAS and consolidation remains a major obstacle to its adoption. The IPSASB was not convinced that a 3 to 5 year transitional period was sufficient to overcome the wide, and differing, range of obstacles identified in many jurisdictions;
 - (b) Recasting all the consolidation requirements as encouragements, except for those requirements relating to the accounting procedures that are to be adopted in the preparation of consolidated financial statements and disclosure of the composition of the economic entity. Such an approach was appealing. It meant that the procedures adopted for the preparation of any consolidated financial statements would be identified as requirements to be applied consistently from period to period for the same economic entity and across all entities that complied with the IPSAS. However, the retention of these matters as requirements may continue to present obstacles to the adoption of the IPSAS. In addition, the IPSASB was of the view that designation of some processes and disclosures central to the preparation and presentation of consolidated financial statements as requirements and the designation of other such processes and disclosures as only encouragements is difficult to justify and results in an unnecessarily complex Standard;
 - (c) Retaining the existing consolidation requirements but providing relief for specific practical obstacles such as the need to consolidate commercial public sector entities or other problematic class of public sector entities. Such an approach would respond to some of the obstacles identified by constituents and was appealing on that basis. However, it did not respond to all of the obstacles identified by constituents. In addition, for consistency of application, it would have also required an agreed definition of what constitutes a commercial public sector entity or other specified class of public sector entities. It was not clear that such a definition would be readily applicable across all jurisdictions; and
 - (d) Requiring presentation of financial statements for an economic entity that reflects the budget sector or the general government sector or similar interim group of controlled entities, rather than for all controlled entities. Such an approach responded to obstacles identified by constituents in many jurisdictions and was appealing on that basis. However, any attempt to define or specify such an interim group may trigger some jurisdictional specific obstacles, particularly if legislative requirements did not directly align with a specified interim group. It may also give rise to obstacles in jurisdictions that are transitioning to the accrual basis and have moved past the interim group reporting entity that might be specified. This revised Cash Basis IPSAS (2017) allows and acknowledges that group financial statements reflecting the budget sector or general government sector may be prepared and presented on the path to the full accrual basis.

External Assistance

- BC12 The requirements and encouragements for the disclosure of information about external assistance were added to the Cash Basis IPSAS in 2007 in response to requests from, and with the support of, many recipients, donors and others from the financial reporting community who saw a need for internationally agreed authoritative requirements for financial reporting of external assistance under the cash basis of accounting.

- BC13 However, the IPSASB was aware that the information recipients of external assistance needed to satisfy the requirements of that Standard was not made as readily available or accessible as was anticipated by the IPSASB and its constituents when the requirements were developed and, after being subject to the IPSASB's due process, included in the Cash Basis IPSAS (2007). The Cash Basis IPSAS (2007) provided some relief from the disclosure requirements when the information is not readily available or verifiable. However, the IPSASB was concerned that the extent to which that relief was necessary, and the resultant inability to verify the completeness and accuracy of information disclosed, may well have undermined the usefulness for accountability or decision-making purposes of any resultant information that was disclosed. This revised Cash Basis IPSAS (2017) responded to these concerns as outlined below.
- BC14 All requirements to disclose information about external assistance received during the reporting period and available to the entity at reporting date have been removed from Part 1 and recast as encouragements in Part 2 of the IPSAS and revised to focus on the disclosure of information about external assistance received as cash or in the form of third party payments. The Cash Basis IPSAS (2017) also encourages disclosure of similar information about *other assistance* (assistance from non-government organizations and other sources) received by the entity during the period.
- BC15 The recasting of these requirements as encouragements will overcome a major obstacle to adoption of the IPSAS. It also responds to concerns of constituents that the requirements for disclosure of information about external assistance included in the Cash Basis IPSAS (2007) were:
- (a) More detailed and onerous than those specified in the accrual basis IPSAS, and that was not consistent with the role in supporting the transition to the accrual basis of financial reporting and adoption of accrual IPSAS; and
 - (b) In the nature of information that sits more comfortably in special purpose financial reports than in general purpose financial statements.
- BC16 External assistance received in cash will continue to be recognized in the Statement of Cash Receipts and Payments. Paragraph 1.3.18 is added to Part 1 of the Cash Basis IPSAS (2017) to explain that for many public sector reporting entities in developing economies, the amount of external assistance received as cash is likely to warrant separate disclosure in the statement of cash receipts and payments.

Third Party payments

- BC17 In principle, the rationale for the disclosure of third party payments as a separate column on the statement of cash receipts and payments appears sound — to ensure that the form of arrangements to provide cash resources to support an entity's operations during any period, whether provided to the recipient entity for the acquisition of goods or services or provided directly to the supplier of those goods or services as designated by the recipient, does not determine whether it is reported in the statement of cash receipts and payments. However, payments made by third parties are likely to mostly comprise payments for goods and services that satisfy the definition of external assistance and other assistance.
- BC18 Concerns about limited access to information necessary to satisfy the requirements for disclosure of information about external assistance in the form of third party payments noted above, and the potential misinterpretation of the inevitable incomplete information that results, also apply to other categories of third party payments.
- BC19 The Cash Basis IPSAS (2017) removes from Part 1 and recasts as encouraged disclosures in Part 2 the requirements for disclosure of information about payments made by third parties. This responds to the concerns of many constituents and overcome a major obstacle to adoption of the IPSAS.
- BC20 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 "treasury single account". The Cash Basis IPSAS (2007) reflected that under "treasury single account" arrangements, amounts paid by a central agency on behalf of a government department or other government entity that is a reporting entity are also to be classified as third party payments. The IPSASB was of the view that, while the individual departments and entities do not establish separate bank accounts in which amounts authorized for their use are deposited, they can use and will benefit from those amounts. Therefore they do control such cash inflows, outflows and available balances. The Cash Basis IPSAS (2017) includes additional explanation of treasury single account arrangements to reflect the IPSASB's view that such arrangements do not give rise to third party payments.

"Housekeeping" — Correction of Errors, Foreign Currency, Government Business Enterprises and Qualitative Characteristics

- BC21 Some minor amendments have been made to terminology and explanation of defined terms in sections dealing with *Correction of Errors* and *Foreign Currency* to ensure that the requirements of this Standard are not directly in conflict with those in the equivalent accrual IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors* (issued

in December 2006 and last updated in October 2011), and IPSAS 4, *The Effects of Changes in Foreign Exchange Rates* (issued in April 2008 and last updated in October 2011).

- BC22 The differences between the current IPSAS 3 and IPSAS 4 and the equivalent IPSAS that were on issue when the Cash Basis IPSAS (2007) was approved are substantial. In some cases, they involved different accounting methods and in other cases additional disclosures. Readers should be aware that the revisions to these sections in the Cash Basis IPSAS (2017) do not fully reflect all the requirements of the updated IPSAS 3 and IPSAS 4. This is because the IPSASB has not received input that the requirements of the Cash Basis IPSAS (2007) present obstacles to its adoption. The IPSASB was concerned that amending the Cash Basis IPSAS to incorporate all changes to IPSAS 3 and IPSAS 4 may have some unintended effects that could introduce additional obstacles to adoption of the IPSAS. While more substantial amendments to these sections are beyond the limited scope of this review, they may be considered in any future review of the Standard.
- BC23 As part of the housekeeping process, this revised Cash Basis IPSAS (2017):
- (a) Deletes the definition and explanation of a *Government Business Enterprise* (GBE). The characteristics of the public sector entities to which IPSAS are designed to apply are identified. This is consistent with amendments made in the IPSAS, *Applicability of IPSASs* (issued April 2016);
 - (b) Updates the objectives of financial reporting and the identification and explanation of the qualitative characteristics of information included in general purpose financial statements and pervasive constraints on such information, and the users of general purpose financial statements, to better reflect their explanation in the Conceptual Framework. Similar amendments are being developed for inclusion in accrual IPSAS; and
 - (c) Brings together and amends the requirements for the effective date of application of the Standard and transitional arrangements to better reflect the equivalent requirements of in IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors* currently on issue.

Illustration of the Requirements of Part 1 of the Standard

This Appendix is illustrative only and does not form part of the Standard. Its purpose is to assist in clarifying the meaning of the requirements of Part 1 of this Standard by illustrating their application in the preparation and presentation of general purpose financial statements under the cash basis of accounting for:

A The Financial Statements of National Government A;

***B The financial Statements of Government Entity B,** which controls its own bank account; and*

***C The financial Statements of Government Department C,** whose cash receipts and payments are managed through a centralized treasury function often referred to as a “treasury single account”.*

APPENDIX 1A – GOVERNMENT A**FINANCIAL STATEMENTS FOR NATIONAL GOVERNMENT A****STATEMENT OF CASH RECEIPTS AND PAYMENTS FOR YEAR ENDED 31 DECEMBER 200X****(RECEIPTS ONLY)**

(in thousands of currency units)	Note	200X Receipts/(Payments)	200X-1 Receipts/(Payments)
RECEIPTS			
<i>Taxation</i>			
Income tax		X	X
Value-added tax		X	X
Property tax		X	X
Other taxes		<u>X</u>	<u>X</u>
		X	X
<i>Donations, Grants and Other Aid</i>	10	X	X
<i>Borrowings</i>	3		
Proceeds from:			
Commercial Institutions		X	
Development Banks and similar organizations		X	
<i>Capital Receipts</i>			
Proceeds from disposal of plant and equipment		X	X
Proceeds from disposal of financial instruments		<u>X</u>	<u>X</u>
		<u>X</u>	<u>X</u>
<i>Trading Activities</i>			
Receipts from trading activities		X	X
<i>Other receipts</i>	4	X	X
Total receipts		<u>X</u>	<u>X</u>

FINANCIAL REPORTING UNDER THE CASH BASIS OF ACCOUNTING

(in thousands of currency units)	Note	200X Receipts/(Payments)	200X-1 Receipts/(Payments)
PAYMENTS			
<i>Operations</i>			
Wages, salaries and employee benefits		(X)	(X)
Supplies and consumables		<u>(X)</u>	<u>(X)</u>
		(X)	(X)
<i>Transfers</i>			
Grants		(X)	(X)
Other transfer payments		<u>(X)</u>	<u>(X)</u>
		(X)	(X)
<i>Capital Payments</i>			
Purchase/construction of plant and equipment		(X)	(X)
Purchase of financial instruments		<u>(X)</u>	<u>(X)</u>
		(X)	(X)
<i>Loan and Interest Repayments</i>			
Repayment of borrowings		(X)	(X)
Interest payments		<u>(X)</u>	<u>(X)</u>
		(X)	(X)
<i>Other payments</i>	5	<u>(X)</u>	<u>(X)</u>
Total payments		<u>(X)</u>	<u>(X)</u>
Increase/(Decrease)Cash		X	X
Cash beginning of year	2	X	X
Increase/(Decrease)Cash		<u>X</u>	<u>X</u>
Cash at end of year	2	<u><u>X</u></u>	<u><u>X</u></u>

STATEMENT OF COMPARISON OF BUDGET AND ACTUAL AMOUNT

For Government A for the Year Ended 31 December 200X

Budget Approved on the Cash Basis

(Classification of Payments by Functions)

(in thousands of currency units)	Actual Amounts	Final Budget	Original Budget	<i>*Difference: Final Budget and Actual</i>
CASH INFLOWS				
Taxation	X	X	X	X
Grants and Aid agreements	X	X	X	X
Proceeds: borrowing	X	X	X	X
Proceeds: disposal of plant and equipment	X	X	X	X
Proceeds: disposal of financial instruments	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)
Environmental Protection	(X)	(X)	(X)	(X)
General Public Services	(X)	(X)	(X)	(X)
Total payments	(X)	(X)	(X)	(X)
NET CASH FLOWS	X	X	X	X

* The "Difference..." column is not required. However, a comparison between actual and the original or the final budget, clearly identified as appropriate, may be included.

ADDITIONAL FINANCIAL STATEMENTS (OPTIONAL)

Additional financial statements may be prepared to provide details of amounts included in the 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	200X-1
	Receipts	Receipts
RECEIPTS		
Consolidated Funds	X	X
Special Funds	X	X
Trading Funds	X	X
Loans	X	X
Total receipts	<u>X</u>	<u>X</u>

PROCEEDS OF BORROWINGS

(in thousands of currency units)	Note	200X	200X-1
		Cash Receipts	Cash Receipts
BORROWINGS			
Domestic Commercial Institution		X	X
Offshore Commercial Institution		X	X
Development Banks and Similar Lending Agencies		X	X
Total borrowings	3	<u>X</u>	<u>X</u>

STATEMENT OF PAYMENTS BY PROGRAMS/ACTIVITIES/FUNCTION OF GOVERNMENT

(in thousands of currency units)	200X	200X-1
	Payments	Payments
PAYMENTS – Operating Account		
Education	X	X
Health	X	X
Social Protection	X	X
Defense	X	X
Public Order and Safety	X	X
Recreation, Culture and Religion	X	X
Economic Affairs	X	X
Environment Protection	X	X
General Public Services	X	X
Total payments	<u><u>X</u></u>	<u><u>X</u></u>
PAYMENTS – Capital Account		
Education	X	X
Health	X	X
Social Protection and Welfare	X	X
Defense	X	X
Public Order and Safety	X	X
Recreation, Culture and Religion	X	X
Environment Protection	X	X
General Public Services	X	X
Total payments	<u><u>X</u></u>	<u><u>X</u></u>
Total Operating and Capital Accounts	<u><u>X</u></u>	<u><u>X</u></u>

PUBLIC SECTOR ENTITY – WHOLE-OF-GOVERNMENT A**Notes to the Financial Statements****1. Accounting Policies****Basis of preparation**

The financial statements have been prepared in accordance with Cash Basis IPSAS, *Financial Reporting under the Cash Basis of Accounting*.

The accounting policies have been applied consistently throughout the period.

Reporting entity

The financial statements are for the national government of Country A. The financial statements encompass the reporting entity as specified in the relevant legislation (Public Finance Act 20XX).

Government activities include the provision of health, education, defense, social protection, housing, recreational and cultural and general public services and economic management to, and on behalf of, constituents. [Identify level of government, jurisdiction and nature of services provided.]

A list of significant entities encompassed in the financial statements and the sectors in which they operate is shown in Note 7 to the financial statements.

Presentation currency

The presentation currency is (currency of Country A).

2. Cash

Cash comprises cash on hand, demand deposits and cash equivalents. Demand deposits and cash equivalents consist of balances with banks and investments in short-term money market instruments.

Cash included in the statement of cash receipts and payments comprise the following amounts:

(in thousands of currency units)	200X	200X-1
Cash on hand and balances with banks	X	X
Short-term investments	X	X
	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 commercial banks and similar commercial institutions and development banks and similar aid agencies.

4. Other Receipts

Included in other receipts are fees, fines, penalties and miscellaneous receipts.

5. Other Payments

Included in other payments are dividends, distributions paid, legal settlements of lawsuits and miscellaneous payments.

6. Undrawn Borrowing Facilities

(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
Development Banks and similar organizations	X	X
Total undrawn borrowing facilities	X	X

7. Significant Entities

<u>Entity 200X</u>	<u>Entity 200X-1</u>
Entity A	Entity A
Entity B	Entity B
Entity C	Entity C
Entity D	Entity D

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 1 January 200X to 31 December 200X and includes all entities within the general government sector. The general government sector includes all government departments – significant departments are included in the list of entities 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 government are prepared on the cash basis using a classification based on the nature of expenses. The financial statements include all controlled entities, including commercial public sector entities for the fiscal period from 1 January 20XX to 31 December 20XX. The budget is approved on the modified cash basis

by functional classification and deals only with the general government sector which excludes commercial public sector entities 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 (commercial public sector entities 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 31 December 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 include all entities controlled by the government. There is also a basis difference: the budget is prepared on a modified cash basis and the financial statements on the 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. Donations, Grants and Other Aid

Cash receipts during the period included donations, grants and other aid provided by individual multilateral and bilateral donor agencies and non-governmental organizations; co-operative financing facilities established by such organizations and donations from charities, corporations and private individuals.

The amount of donations, grants and other aid (XXX) does not include aid received during the reporting period in the form of the proceeds of loans. The proceeds of any aid received during the period in the form of loans are included in the amount of borrowings presented as a separate line item in the Statement of Receipts and Payments.

APPENDIX 1B – GOVERNMENT ENTITY B**(THIS ENTITY CONTROLS ITS OWN BANK ACCOUNT.)****STATEMENT OF CASH RECEIPTS AND PAYMENTS FOR ENTITY B****FOR YEAR ENDED 31 DECEMBER 200X**

(in thousands of currency units)	Note	200X Receipts/(Payments)	200X-1 Receipts/(Payments)
RECEIPTS			
Authorized allocations		X	X
Other receipts		X	X
Total receipts		X	X
PAYMENTS			
Wages, salaries and employee benefits		(X)	(X)
Rent		(X)	(X)
Capital Payments		(X)	(X)
Transfers	3	(X)	(X)
Total payments		(X)	(X)
Increase/(Decrease) in Cash		X	X
Cash at beginning of year	2	X	X
Increase/(Decrease) in Cash		X	X
Cash at end of year	2	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. An example of a statement by function is included below.

STATEMENT OF PAYMENTS BY FUNCTION

(in thousands of currency units)	Note	200X Payments	200X-1 Payments
PAYMENTS			
Program I		(X)	(X)
Program II		(X)	(X)
Program III		(X)	(X)
Program IV		(X)	(X)
Other payments		(X)	(X)
Total payments		<u>(X)</u>	<u>(X)</u>

NOTES TO THE FINANCIAL STATEMENTS

1. Accounting Policies**Basis of preparation**

The financial statements have been prepared in accordance with the 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 B). The financial statements encompass the reporting entity as specified in the relevant legislation (Public Finance Act 20XX).

Government Entity B's principal activity is to provide [identify type of] services to constituents. The Entity controls its own bank account.

Presentation currency

The presentation 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.

Appropriations and other cash receipts are deposited in the Entity's bank account. All borrowings are undertaken by a central finance entity.

Receipts from exchange transactions are deposited in trading fund accounts controlled by the Entity. They are *transferred* to consolidated revenue at year end.

Cash included in the *statement* of cash receipts and payments comprise the following amounts:

(in thousands of currency units)	200X	200X-1
Cash on hand and balances with banks	X	X
Short-term investments	X	X
	<u>X</u>	<u>X</u>

3. Transfers

Amounts are transferred to eligible recipients in accordance with the operating mandate and authority of the entity.

4. Significant Entities

Entity 200X	Entity 200X-1	
Entity X		X
Entity Y		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 C**(THE GOVERNMENT OPERATES A CENTRALIZED SINGLE ACCOUNT SYSTEM)****STATEMENT OF CASH RECEIPTS AND PAYMENTS FOR DEPARTMENT C FOR YEAR ENDED 31 DECEMBER 200X**

(in thousands of currency units)	Note	200X Receipts/(Payments)	200X-1 Receipts/(Payments)
RECEIPTS			
Allocations/	2	X	X
Appropriations			
Other receipts		X	X
Total receipts		X	X
PAYMENTS			
Wages, salaries and employee benefits		(X)	(X)
Rent		(X)	(X)
Capital Payments		(X)	(X)
Transfers	3	(X)	(X)
Total payments		(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

(in thousands of currency units)	Note	200X Receipts/(Payments)	200X-1 Receipts/(Payments)
PAYMENTS			
Program I		X	X
Program II		X	X
Program III		X	X
Program IV		X	X
Other payments		X	X
Total payments		X	X

NOTES TO THE FINANCIAL STATEMENTS**1. Accounting Policies****Basis of preparation**

The financial statements have been prepared in accordance with the 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 C. The financial statements encompass the reporting entity as specified in the relevant legislation (Public Finance Act 20XX).

Government Department C's principal activity is to provide (specify type of) services to constituents.

Government Department C does not operate its own bank account. The Government operates a centralized treasury function which manages the cash receipts and payments (expenditures) of the department during the financial year.

Presentation currency

The presentation currency is (currency of Country A).

2. Amounts authorized for use by Department C

Amounts authorized for use by Government Department C are managed through a central account administered by the Office of the Treasury on the Department's behalf. Amounts are deployed on behalf of Department C on request when supported by presentation of appropriate documentation and authorization. All borrowings are undertaken by a central finance entity.

Amounts authorized for use of the Department which are unexpended amounts at year end are transferred to consolidated revenue.

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 C.

PART 2: FINANCIAL REPORTING UNDER THE CASH BASIS OF ACCOUNTING—ENCOURAGED ADDITIONAL DISCLOSURES

This part of the Standard is not mandatory. It is has been prepared to support those entities transitioning from the cash basis of accounting to the accrual basis of financial reporting and adoption of the accrual IPSAS. It sets out encouraged additional disclosures for reporting under the cash basis of accounting. 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 type, should be read in the context of the commentary paragraphs in this part of the Standard, which are in plain type.

Reporting entities should plot their path to adoption of the accrual IPSAS, and commence the process of building the information necessary to comply with those IPSAS consistent with the transition path that has been adopted.

FINANCIAL REPORTING UNDER THE CASH BASIS OF ACCOUNTING PART 2: ENCOURAGED ADDITIONAL DISCLOSURES

The encouraged disclosures are set out in italicized type. They are to be read in the context of the commentary paragraphs in Part 2 of this Standard, which are in plain type,

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.

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.

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.

Administered Transactions

- 2.1.6 *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.*
- 2.1.7 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.
- 2.1.8 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 2.1.9 to 2.1.13 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

- 2.1.9 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.
- 2.1.10 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.
- 2.1.11 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

2.1.12 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) 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

2.1.13 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

2.1.14 *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 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.*

2.1.15 The sub-classifications encouraged in paragraph 2.1.14(a) may be presented on the face of the statement of cash receipts and payments in accordance with the requirements of paragraph 1.3.12 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 2.1.14(a) above is encouraged either as a separate statement or by way of note.

2.1.16 Cash payment items 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.

2.1.17 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
Wages and salaries	(X)
Transport costs	(X)
Capital acquisitions	(X)
Borrowing costs	(X)
Other	(X)
Total payments	(X)

- 2.1.18 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
Health services	(X)
Education services	(X)
Other	(X)
Total payments	(X)

- 2.1.19 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.
- 2.1.20 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.
- 2.1.21 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 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 total amount of receipts from external and other assistance (possibly classified by the amount of grants, loans and other assistance provided, the significant classes of 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, donations, and other forms of assistance.

Related Party Disclosures

- 2.1.22 *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."*
- 2.1.23 IPSAS 20, in the accrual based series of IPSAS, 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, Revenues, Expenses and Comparison with Budgets

- 2.1.24 *An entity is encouraged to disclose in the notes to the financial statements:*
- (a) *Information about the assets, liabilities, revenues and expenses of the entity; and*
 - (b) *If the entity does not make publicly available its approved budget, a comparison with budgets*
- 2.1.25 Governments and government entities control significant resources in addition to cash and deploy those resources in the achievement of service delivery objectives. They 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. They also incur costs and generate revenues during the reporting period which will result in cash flows of a future reporting period. Non-cash assets, liabilities, revenues and expenses 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, their non-cash assets and the costs of their

activities during the reporting period and the sources and amount of related revenues. The disclosure of information about assets, liabilities and the costs and revenues of particular programs and activities will enhance accountability and provide information useful for decision-making purposes and, therefore, is encouraged by this Standard.

2.1.26 Entities that make such disclosures are encouraged to identify revenues and expenses by nature or their function as appropriate to the entity's operations and 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 as they transition to full adoption of the accrual IPSAS. In order to comply with the requirements of paragraphs 1.3.5 and 1.3.32 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.

2.1.27 Accrual basis IPSAS can provide useful guidance to entities disclosing additional information about assets, liabilities revenues and expense. Recommended Practice Guidelines will also provide guidance on disclosures that will assist users to better understand such matters as the financial position, financial performance and cash flows of the entity; its service performance objectives and achievements; and the sustainability of its finances.

Comparison with Budgets

2.1.28 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 1.7.1 to 1.7.46 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.

2.1.29 *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.*

2.1.30 *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.*

2.1.31 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.

2.1.32 As noted in paragraph 1.7.32 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

Definitions

2.1.33 *The following terms are used in this Part of the Standard with the meanings specified:*

Consolidated financial statements are the financial statements of an economic entity in which the cash receipts, cash payments and cash balances of the controlling entity and its controlled entities are presented as that of a single entity.

Control of an entity: An entity controls another entity when the entity is exposed, or has rights, to variable benefits from its involvement with the other entity and has the ability to affect the nature or amount of those benefits through its power over the other entity.

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 controlling entity and its controlled entities.

Economic Entity

- 2.1.34 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. Other terms sometimes used to refer to an economic entity include administrative entity, financial entity, consolidated entity, and group. Factors to be considered in assessing whether one entity controls another entity for financial reporting purpose are outlined in IPSAS 35, *Consolidated Financial Statements*.
- 2.1.35 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.
- 2.1.36 The determination of the economic entity will need to be made having regard to the constitutional arrangements in a jurisdiction, in particular the ways in which government power is limited and allocated, and how the government system is set up and operates. For example, in jurisdictions with an executive, legislature and judiciary, these may collectively form an economic entity in respect of which there is a user need for consolidated financial statements. Such consolidated financial statements are commonly referred to as whole-of-government financial statements.

Scope of Consolidated Financial Statements

- 2.1.37 *A controlling entity, other than a controlling entity identified in paragraph 2.1.40 is encouraged to present consolidated financial statements which consolidates all its controlled entities, foreign and domestic by applying the following consolidation procedures:*
- (a) *Cash balances and cash transactions between entities within the economic entity are eliminated in full;*
 - (b) *When the financial statements used in a consolidation are drawn up to different reporting dates, adjustments are made for the effects of significant cash transactions that have occurred between those dates and the date of the controlling entity’s financial statements; and*
 - (c) *Consolidated financial statements are 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.*
- 2.1.38 *When a controlling entity, other than a controlling entity identified in paragraph 2.1.40, does not present financial statements that consolidated all its controlled entities, it is encouraged to present financial statements that consolidate those of its controlled entities which represent the budget sector, general government sector or other economic entity that represents core government activities and responds to users information needs.*
- 2.1.39 *An economic entity uses the term “consolidated financial statements” to describe financial statements which comprises the controlling entity and its controlled entities as identified in paragraph 2.1.37. Financial statements of an economic entity which do not comprise the controlling entity and all its controlled entities as identified in paragraph 2.1.37, are identified by a term that is readily understood and clearly describes the classes or (characteristics) of entities that make up the economic entity.*
- 2.1.40 *The preparation of consolidated financial statements is unnecessary for a controlling entity that meets all the following conditions:*
- (a) *It is itself a controlled entity and the information needs of users are met by its controlling entity’s consolidated financial statements and, in the case of a partially owned controlled entity, all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the entity not presenting consolidated financial statements;*
 - (b) *Its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);*

- (c) *It did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organization for the purpose of issuing any class of instruments in a public market; and*
- (d) *Its ultimate or any intermediate controlling entity produces consolidated financial statements that are available for public use and comply with the Cash Basis IPSAS or the accrual IPSAS.*

- 2.1.41 For accountability and decision-making purposes, users of the financial statements of a government or other public sector 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.
- 2.1.42 This Standard encourages governments and other public sector controlling entities to present financial statements which consolidate all controlled entities when users of such financial statements are likely to exist.
- 2.1.43 The consolidated financial statements of an economic entity that comprises a government and all its controlled entities will provide information about the cash resources controlled by the government directly and through its controlled entities at reporting date, and changes in those resources during the reporting period. The consolidated financial statements of other public sector economic entities such as, for example, a ministry of health or an education department, will provide information about the cash resources controlled by the ministry or department and changes in those resources during the reporting period.
- 2.1.44 The preparation of consolidated financial statements is not a cost-free process. Therefore, it is important that the benefits of preparing such statements justify the costs of their preparation. Preparation of consolidated financial statements by a controlling entity which is itself a controlled entity will often not be necessary in the circumstances identified in paragraph 2.1.40. This is because users' need for information presented in cash basis financial statements are often met by the consolidated financial statements of its controlling entity when such statements are prepared consistent with the requirement of the Cash Basis IPSAS or the accrual IPSAS, and the other circumstances identified in paragraph 2.1.40 apply. However, in other cases, consolidated financial statements at a whole-of-government level may not meet the information needs of users in respect of key sectors or activities of a government. In many jurisdictions, there are legislated financial reporting requirements intended to address the information needs of such users.
- 2.1.45 In some cases, an entity which has the power to direct the relevant activities of another entity may not be able to benefit from the activities of that other entity - for example, when the other entity is subject to severe external long-term restrictions which prevent the entity with the power to direct its activities from benefiting from those activities. The cash flows and balances of such entities are not included in consolidated financial statements. This is because consolidated financial statements present information about the cash resources of the government or other public sector reporting entity that can be used to support the delivery of goods and services or otherwise benefit the reporting entity.
- 2.1.46 Paragraph 2.1.40(d) acknowledges that the ultimate or intermediate controlling entity of an entity which adopts the cash basis IPSAS may prepare and present consolidated financial statements on an accrual basis. While this may occur in some jurisdictions, the ultimate or intermediate controlling entity is likely to face significant practical issues in compiling, in respect of controlled entities that adopt the cash basis, the information necessary to comply with the accrual IPSAS.

Transitioning to Consolidated Financial Statements

- 2.1.47 Governments and other public sector entities may control a large number of entities including government departments, agencies and commercial public sector entities. The preparation of consolidated financial statements that consolidate a controlling entity and all its controlled entities can be a complex and resource intensive process. Some governments and other public sector entities face significant obstacles in the preparation and presentation of consolidated financial statements and may not be able to prepare fully consolidated financial statements in the short to medium term as they commence the transition to the full accrual basis. This may be because of capacity constraints that limit the ability of a government or other entity to collect and process data from all controlled entities in a timely fashion, because of legislative or other requirements to present financial statements for a subgroup of controlled entities rather than for all controlled entities, or for other reasons.
- 2.1.48 As governments and other public sector entities that report on the cash basis transition to the accrual basis of financial reporting and develop the capacity, systems and the legislative frameworks to overcome obstacles to consolidation, the potential to include in cash basis financial statements information about additional controlled entities will increase. For governments, the preparation of financial statements that report information about the cash receipts, cash payments and cash balances of an economic entity that comprises the controlled entities that represents, for example, the budget sector, the general government sector or other representation of core government activities will provide information about key sectors of government that is useful to users for accountability and decision-making purposes. This Standard encourages

a controlling entity that does not present fully consolidated financial statements to present financial statements for such an economic entity as an interim step in the transition to the accrual basis of financial reporting and the presentation of fully consolidated financial statements in accordance with the accrual IPSAS. Government agencies which do not consolidate all their controlled entities are also encouraged to present financial statements which consolidate controlled entities which represent a subgroup of their activities useful to users for accountability and decision-making purposes.

- 2.1.49 The term “consolidated financial statements” is used to describe financial statements that present a “full consolidation” of all controlled entities as identified in paragraph 2.1.37 of this Standard. A term other than “consolidated financial statements” is to be used to describe financial statements that present information about an economic entity that does not include the controlling entity and all its controlled entities. That term is to be readily understood and to clearly describe the classes or (characteristics) of entities that make up the economic entity. The selection of an appropriate term is a matter of professional judgement. That judgment should be exercised in the context of the qualitative characteristics of financial reporting including that it be understandable and a faithful representation of the economic entity presented. For national, state/provincial or local governments that prepare such financial statements, terms such as, for example, the financial statements of the budget sector or the general government sector may be appropriate.

Consolidation Procedures

- 2.1.50 The consolidation procedures outlined in paragraph 2.1.37 provide the basis for preparing consolidated financial statements for all the entities within the economic entity as a single economic unit, as encouraged by this Standard.
- 2.1.51 The consolidated financial statements encouraged by this Standard 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 commercial public sector entity 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 in the preparation of whole-of-government consolidated financial statements would result in understating the cash balance of the whole-of-government economic entity and overstating its cash payments. However, the transaction would not be eliminated in financial statements prepared for a group entity that, for example, represented a general government sector which excluded the commercial public sector entity.
- 2.1.52 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

- 2.1.53 *An entity is encouraged to disclose in the notes to the consolidated financial statements of an economic entity prepared in accordance with the encouragements in paragraph 2.1.37:*
- (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);*
 - (b) *The reasons for not consolidating a controlled entity;*
 - (c) *The proportion of ownership interest in controlled entities and a description of how that ownership interest has been determined; and*
 - (d) *Where applicable, the factors considered in determining that the controlling entity:*
 - (i) *Controls another entity (or category of entities) even though it holds less than half of the voting rights of the other entity (or entities), together with an explanation of how control exists; and*
 - (ii) *Does not control another entity (or category of entities) even though it holds more than half of the voting rights of the other entity (or entities).*
- 2.1.54 *An entity which presents financial statements for an economic entity which consolidates some but not all controlled entities as is encouraged in paragraph 2.1.37, is encouraged to disclose in the notes to those financial statements the disclosures encouraged in paragraph 2.1.53 together with:*

- (a) *A description of the classes (or characteristics) of controlled entities that are included in, and excluded from, the group financial statements together with an explanation of the reason for the exclusion of any classes from the group accounts; and*
- (b) *A listing of significant entities that have been added to, or removed from, those included in the group financial statements since presentation of the previous period's financial statements.*

2.1.55 *A controlling entity which does not present a consolidated financial statement as encouraged in paragraph 2.1.37 is encouraged to disclose the reasons why the consolidated financial statements have not been presented together with the method used to account for controlled entities in its separate financial statements. It is also encouraged to disclose the name and the principal address of its controlling entity that publishes a consolidated financial statement.*

2.1.56 The disclosures encouraged in paragraphs 2.1.53 and 2.1.54 will provide users with information about the composition and key features of fully consolidated financial statements prepared in accordance with the encouragements in paragraph 2.1.37, and financial statements that consolidate a subset of its controlled entities in accordance with the encouragements in paragraph 2.1.38. The disclosures encouraged in paragraph 2.1.55 will enable users to determine whether a controlling entity prepares consolidated financial statements and, if not, the method used to account for controlled entities.

Acquisitions and Disposals of Controlled Entities and Other Operating Units

2.1.57 *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.*

2.1.58 *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.*

2.1.59 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.

2.1.60 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.

2.1.61 Paragraph 2.1.24 encourages the disclosure of assets, liabilities, revenues and expenses of the entity. Assets, liabilities, revenues and expenses other than cash or cash flows 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 1.3.32 of Part 1 of this Standard, where such disclosure is made, the assets, liabilities, revenues and expenses should be clearly identified and the basis on which they are measured and recognized explained.

Joint Arrangements

2.1.62 *An entity is encouraged to make disclosures about joint arrangements 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 the reporting date.*

2.1.63 A joint arrangement is an arrangement of which two or more parties have joint control. Many public sector entities establish joint arrangements 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 arrangement 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 arrangement and in the ongoing operations of the joint arrangement; and
- (b) As cash receipts, the cash received from the joint arrangement.

Disclosures about joint arrangements may include a listing and description of interests in significant joint arrangements. International Public Sector Accounting Standards IPSAS 36, *Investments in Associates and Joint Ventures* and IPSAS

37, *Joint Arrangements* in the accrual based series of IPSAS provides guidance on the different forms and structures that joint arrangements may take and potential additional disclosures that might be made. The definition and explanation of “control” in IPSAS 35 will need to be considered in determining whether an entity is an “associate” and whether an arrangement is a “joint arrangement” as defined in IPSAS 36 and IPSAS 37.

Financial Reporting in Hyperinflationary Economies

- 2.1.64 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.
- 2.1.65 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:
- 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;
 - 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;
 - 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;
 - Interest rates, wages and prices are linked to a price index; and
 - The cumulative inflation rate over three years is approaching, or exceeds, 100%.

The Restatement of Financial Statements

- 2.1.66 *An entity that reports in the currency of a hyperinflationary economy is encouraged to:*
- Restate its statement of cash receipts and payments and other financial statements in terms of the measuring unit current at the reporting date;*
 - 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*
 - 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.*
- 2.1.67 *The entity is encouraged to make the following disclosures:*
- 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*
 - 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.*
- 2.1.68 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.
- 2.1.69 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 2.1.66 and 2.1.67 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.
- 2.1.70 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.

- 2.1.71 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

- 2.1.72 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

- 2.1.73 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.
- 2.1.74 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

- 2.1.75 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.
- 2.1.76 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.

Payments by Third Parties on Behalf of the Entity

- 2.1.77 *When during the reporting period a reporting entity has been formally advised that payments have been made to directly settle its obligations or purchase goods and services for its benefit by third parties, or the entity has otherwise verified that such payments have been made, the entity is encouraged to disclose in notes to the financial statements:*
- (a) *Total payments made by such third parties; and*
 - (b) *A sub-classification of the total amount of such payments using a classification basis appropriate to the entity's operation.*
- 2.1.78 In some cases, third parties 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 another government rather than providing the funds directly to the government itself. These payments may be made by way of a grant, donation or other form of 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 recipient government benefits from the cash payments being made on its behalf.
- 2.1.79 The disclosure of information about the amount, and the classes of payments made by third parties (whether by nature, function or both) will provide additional information useful for accountability and decision-making purposes. In some cases, an entity may not have been formally advised or otherwise be aware of third party payments made on its behalf during the reporting period, or may be unable to verify that an expected payment has occurred. If an entity cannot have confidence that the amount of third party payments disclosed is a faithful representation of all such payments made on behalf of the entity during the period, the notes should advise users that such disclosures may not encompass all such third party payments.

- 2.1.80 Paragraph 2.1.77 encourages the disclosure of the total amount of third party payments made during the reporting period and the major classes of such payments. Third party payments will encompass amounts defined as external assistance and other assistance in paragraph 2.1.82 of this Standard. Paragraph 2.1.90(b) encourages the disclosure of the amount of external assistance provided to an entity in the form of third party payments. Paragraph 2.1.91 encourages that such disclosures also be made about other assistance where practicable.
- 2.1.81 The sub-classifications (or classes) of third party payments which may be disclosed in accordance with paragraphs 2.1.77(b) are a matter of professional judgment. The factors that will be considered in exercising that judgment are outlined in paragraph 1.3.17 of Part 1 of this Standard.

Recipients of External and Other Assistance

Definitions

- 2.1.82 *The following terms are used in this Standard with the meaning specified:*

Assistance means external assistance and other assistance.

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.

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

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 individuals.

Official Resources means all loans, grants, technical assistance, guarantees or other forms of 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.

Other Assistance means resources provided by non-governmental organizations (NGOs) and gifts and donations or other forms of assistance voluntarily provided by individuals and private sector organizations which the recipient can use or otherwise benefit from in pursuit of its objectives. Other assistance does not include official resources, taxes, fines and fees, resources provided in an exchange transaction or resources provided by the government or agencies of a government of the same nation as the recipient.

Assistance

- 2.1.83 “Assistance” is defined broadly in this Standard to encompass “external assistance” and “other assistance”. Key features of external assistance and other assistance are outlined below.

External assistance

- 2.1.84 External assistance is defined as all official resources which the recipient can use or otherwise benefit from in pursuit of its objectives. 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 it will be necessary to exercise professional judgment in determining whether the resources provided should be classified as external assistance.
- 2.1.85 Official resources are resources provided or 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 and assistance provided by non-governmental organizations (NGOs), even if such assistance is provided under a binding agreement, does not satisfy the definition of official resources and, therefore, is not external assistance.

2.1.86 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 to the recipient.

Other Assistance

2.1.87 Other assistance is defined as resources provided by NGO's and assistance that is voluntarily provided by, for example, individuals and charitable and other organizations. Taxes and other resources compulsorily paid or payable to public sector entities in accordance with laws or regulation, fines or other penalties imposed for breaches of laws or regulation, and fees for services provided by, or on behalf of, public sector entities are not other assistance as defined in paragraph 2.1.82. Similarly, resources provided in exchange transactions and transfers of resources between governments within the same nation are not classified as other assistance.

2.1.88 In most cases it will be clear whether resources are provided voluntarily and whether their intent is to provide assistance for purposes of, for example, emergency relief or to assist the entity in achieving economic development or welfare objectives, or for other purposes. However, in some cases, it will be necessary to exercise professional judgment in determining whether the resources provided should be classified as other assistance.

2.1.89 NGOs 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 or other assistance.

External Assistance Received

2.1.90 *An entity is encouraged to disclose separately in notes to the financial statements:*

- (a) *The total amount of external assistance received in cash during the period unless disclosed as a separate class of cash receipt on the face of the statement of cash receipts and payments;*
- (b) *The 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 when advised by the third party or otherwise verified by the recipient;*
- (c) *The total amount of external assistance received during the period as loans and the total amount received as grants;*
- (d) *The significant classes of providers of external assistance and the amount provided;*
- (e) *By significant class and amount, the purposes for which external assistance was received and used during the reporting period showing separately amounts provided by way of loans and grants; and*
- (f) *The balance of undrawn external assistance loans and grants available at reporting date to fund future operations 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:*
 - (i) *Total external assistance loans;*
 - (ii) *Total external assistance grants; and*
 - (iii) *The purposes for which the undrawn loan assistance and undrawn grant assistance may be used.*

Other Assistance Received

2.1.91 *Where practicable, an entity is encouraged to apply to other assistance received, the disclosures identified in paragraph 2.1.90 above.*

External Assistance and Other Assistance Received

2.1.92 Disclosure of the total amount of external assistance received and, separately, other assistance received in the form of cash and in the form of third party payments made on behalf of the entity can provide useful information about the extent to which the operations of the reporting entity are funded from taxes and/or internal sources, or are dependent upon external assistance and other assistance, and the form of that assistance – whether as cash or other benefit. The disclosure of external assistance and other assistance received in the form of payments made by third parties is encouraged when the entity has been formally advised, or otherwise verified, that such payments have been made during the reporting period.

2.1.93 Disclosure of the amount of external assistance and other assistance received by way of loan or grant will enable users to identify whether the entity has an obligation to repay the assistance provided at some time in the future.

2.1.94 Disclosure of the significant classes of providers of assistance such as, for example, multilateral donors, bilateral donors, international assistance organizations, NGOs, 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.

2.1.95 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.

2.1.96 Other assistance may also be provided for some of these purposes such as, for example, emergency relief and to support an entity's welfare objectives.

2.1.97 Disclosure by significant class of the purposes for which external assistance and other assistance was provided and used during the reporting period will further enhance the entity's accountability for its use of assistance received.

2.1.98 The amount of external assistance and assistance from NGO's and other sources currently committed under a binding agreement but not yet drawn may be significant. In some cases, the amount of 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. The disclosure of undrawn balances of external assistance and other assistance in these circumstances will provide information about the extent to which assistance made available to the entity has been drawn on during the reporting period and the amount of committed external and other assistance is available to support the ongoing development of particular projects.

2.1.99 In some cases, a donor 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. 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. In these cases, disclosure of the undrawn amounts is not encouraged by paragraph 2.1.90(f). 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 or other assistance is highly likely.

Goods and Services Received

2.1.100 *An entity is encouraged to disclose separately in the notes to the financial statements the value of assistance received during the period in the form of goods or service, and the basis on which that value is determined.*

- 2.1.101 Significant resources may be received as assistance 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 or by, for example, NGO's or private sector benefactors. It will also occur when food aid is provided to a government for distribution to its citizens as emergency relief under an external assistance agreement or by NGO's or other donors. For some recipients, goods or services may be the major form in which assistance is received.
- 2.1.102 Disclosure of the value of assistance received as goods and services during the reporting period will assist readers of the financial statements to better understand the full extent of 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 a unique nature, such as often occurs in respect of emergency assistance.
- 2.1.103 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 an external assistance agency or other donor. 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 assistance in the form of goods or services is disclosed, paragraph 2.1.100 encourages 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 willing parties in an arm's length transaction.

2.2 Governments and Other Public Sector Entities Completing the Transition to the Accrual Basis of Financial Reporting and Adoption of Accrual IPSAS

Presentation of the Statement of Cash Receipts and Payments

- 2.2.1 *An entity which is completing its transition to the accrual basis of financial reporting and adoption of accrual IPSAS is encouraged to present a statement of cash receipts and payments in the same format as that required by International Public Sector Accounting Standard 2 (IPSAS 2), Cash Flow Statements.*
- 2.2.2 As entities transition to the accrual basis of financial reporting they will need to progressively build the information and systems necessary to comply with each accrual IPSAS on issue prior to the formal adoption of the accrual IPSAS. The presentation of information in a format that replicates as far as possible that adopted by the accrual IPSAS will assist the transition process.
- 2.2.3 IPSAS 2 provides guidance on classifying cash flows as operating, financing and investing and includes requirements for preparing a cash flow statement 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.

Consolidated Financial Statements – The Economic Entity

- 2.2.4 This Standard encourages controlling entities to present consolidated financial statements which consolidates all controlled entities in accordance with generally accepted consolidation processes, and identifies some circumstances in which this may not be necessary. These circumstances reflect those in IPSAS 35, *Consolidated Financial Statements*. However, IPSAS 35 includes additional exemptions from the requirement to prepare consolidated financial statements for controlling entities that are investment entities and measure their controlled entities at fair value through surplus or deficit. This exemption is not applicable to controlling entities that are investment entities and apply the Cash Basis IPSAS.
- 2.2.5 When financial statements which consolidate all controlled entities are not presented, this Standard encourages the presentation of financial statements which present information about an economic entity that comprises subgroups of controlled entities such as those reflecting the budget sector or the general government sector or other representation of core government activities. While accrual IPSAS do not prohibit the presentation of information about such economic entities, they cannot be presented as an alternative to the full consolidation of all controlled entities as prescribed in IPSAS 35.
- 2.2.6 Entities completing the transition to the accrual basis of financial reporting and adoption of the accrual IPSAS will need to be aware of these differences in the consolidation requirements of the accrual and cash basis IPSAS.

Required and Encouraged Disclosures under the Cash Basis IPSAS

- 2.2.7 The requirements and encouragements of this Standard are not inconsistent with the requirements and encouragements of the equivalent accrual IPSAS to the extent they apply to financial reporting under the cash basis. However, in some cases this Standard encourages disclosures that are not required by the accrual IPSAS. This occurs in respect of, for example, encouraged disclosures about such matters as third party payments and external and other assistance. These disclosures are encouraged in this Standard to provide additional information useful in assessing how the entity is resourced. Such information is useful to all users of general purpose financial statements for accountability and decision-making purposes. It may also be relevant to the “special purpose” needs of, for example, providers of external and other assistance for information useful in monitoring the provision and use of assistance provided to the entity.

IPSAS 33—First-Time Adoption of Accrual Basis IPSAS

- 2.2.8 IPSAS 33, *First Time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* identifies transitional provisions that provide entities with relief from adoption of certain of the requirements of accrual IPSAS for three (3) years from the date of first adoption of accrual IPSAS. IPSAS 33 provides that on the date of adoption of IPSAS, a first-time adopter may elect to adopt one of more of the exemptions included in IPSAS 33 and, subject to the nature of the exemptions adopted, identify its financial statements as either:
- (a) *Transitional IPSAS financial statements*, when it adopts exemptions identified in IPSAS 33 as “Exemptions that Affect Fair Presentation and Compliance with Accrual Basis IPSAS”; or
 - (b) *Financial statements that comply with the accrual IPSAS*, when it adopts other of the exemptions identified in IPSAS 33. That is the exemptions identified in IPSAS 33 as “Exemptions that Do Not Affect Fair Presentation and Compliance with Accrual Basis IPSAS”¹.
- 2.2.9 Appendix A of IPSAS 33 lists the transitional exemptions and provisions that a first-time adopter is required to apply and/or can elect to apply on adoption of accrual basis IPSAS, and illustrates whether fair presentation and the first-time adopter’s ability to assert compliance with accrual basis IPSAS will be affected.

¹ IPSAS 33, Appendix A lists the transitional exemptions and provisions that a first-time adopter is required to apply and/or can elect to apply on adoption of accrual basis IPSAS and illustrates whether fair presentation and the first-time adopter’s ability to assert compliance with accrual basis IPSAS will be affected.

Basis for Conclusions – Cash Basis IPSAS Part 2

This Basis for Conclusions accompanies, but is not part of the IPSAS, Financial Reporting under the Cash Basis of Accounting.

Introduction — Removing obstacles to adoption of this IPSAS

- BC1 The requirements for preparation of consolidated financial statements and disclosure of information about external assistance and third party payments that were previously included in Part 1 of the Cash Basis IPSAS (2007) proved to be major obstacles to adoption of this Standard. To remove those obstacles these requirements were revised and recast as encouragements in Part 2 of the Standard.
- BC2 In the process of recasting these requirements as encouragements, additional amendments were made to strengthen the role of Part 2 of the Standard in supporting the transition to the accrual basis of financial reporting and adoption of accrual IPSAS.

Consolidation

- BC3 Part 2 of the Standard encourages controlling entities to present consolidated financial statements which consolidates all controlled entities. It also encourages controlling entities that do not consolidate all controlled entities, to prepare financial statements for an economic entity that represents the budget sector, the general government sector or other representation of core government activities as an interim step in the transition to the accrual basis of financial reporting and adoption of accrual IPSAS. Such financial statements will provide information useful to users for accountability and decision-making purposes and support an orderly and useful transition to full consolidation as required by the accrual IPSAS. The encouragement to present financial statements for an economic entity that comprises the controlled entities that represent the general government sector is also consistent with the IPSASB's strategic objective of supporting the convergence of public sector accounting standards and statistical bases of financial reporting where appropriate.
- BC4 To further support those entities transitioning to the accrual basis, key definitions and encouraged disclosures were revised where necessary to ensure that they did not conflict with IPSAS 34, *Separate Financial Statements*; IPSAS 35, *Consolidated Financial Statements*, IPSAS 36, *Investments in Associates and Joint Ventures*, IPSAS 37, *Joint Arrangements* and IPSAS 38, *Disclosure of Interests in Other Entities*.

External assistance

- BC5 Requirements to disclose information about external assistance that were included in Part 1 of the Cash Basis IPSAS (2007) have been revised and recast as encouragements in Part 2 of the Standard. In addition, disclosures that were previously required or encouraged have been reduced to focus primarily on encouragements to disclose information about external assistance received and used during the reporting period in the form of cash and third party payments, and the amount of undrawn assistance available to the reporting entity as at reporting date. This revised Cash Basis IPSAS (2017) also encourages the disclosure of information about such matters as significant terms and conditions of external assistance agreements, terms and conditions that have not been complied with and repayment terms and conditions of outstanding external assistance debt be removed from the Standard. Where practical, Part 2 of the Standard encourages a reporting entity to make disclosures about assistance provided to the entity in the form of cash and third party payments by, for example, NGOs and public and private sector donors.
- BC6 The IPSASB is of the view that the encouraged disclosures provide information useful for accountability and decision-making purposes, are more likely to be achievable and better reflect the general purpose nature intended for the cash basis financial statements.
- BC7 Part 2 of the Cash Basis IPSAS (2007) encouraged the disclosure of the value of goods and services received during the period in the form of external assistance. Part 1 of the Cash Basis IPSAS (2007) required that where an entity chose to disclose the value of external assistance received during the period in the form of goods and services it should also disclose the basis on which that value is determined. Such disclosures were encouraged, but not required, for assistance received from NGO's. Some constituents sought clarification of the relationship of these requirements and encouragements to those relating to third party payments. Some constituents also expressed concern that the disclosure of the basis on which the value of goods and services was determined was required when those goods and services were received as official resources under external assistance agreements, but only encouraged in other circumstances. The IPSASB responded to these concerns. In this revised Cash Basis IPSAS (2017) the relationship between external assistance and third party payments has been clarified and the requirement to disclose the basis of valuation of goods and services received has been recast as an encouragement in Part 2 of the IPSAS and broadened to apply to external assistance and other assistance received in the form of goods and services.

Third Party payments

- BC8 Part 1 of the Cash Basis IPSAS (2007) required the disclosure of certain information about payments made by third parties in a separate column on the face of the statement of cash receipts and payments. This revised Cash Basis IPSAS (2017) recasts this as an encouragement to include such disclosures in notes to the financial statements, rather than on the face of the financial statements. The recasting of the requirement to disclose information about third party payments as an encouragement was made because of concerns that information necessary to fully satisfy the requirements or encouragement would not be available to recipients on a timely basis. In such circumstances, the information included in the financial statements was likely to be incomplete and the potential for misinterpretation of its usefulness for accountability and decision-making purposes did not justify its disclosure in a separate column on the face of the financial statements.
- BC9 This revised Cash Basis IPSAS (2017) also makes changes to Part 1 to include an additional explanation of single account type arrangements to reflect the IPSASB's view that such arrangements do not give rise to third party payments. This explanation narrows the circumstances in which third party payments may arise.

Amendments to support Entities transitioning to the accrual basis of financial reporting and adoption of accrual IPSAS

- BC10 This revised Cash Basis IPSAS (2017) makes refinements to the encouragements in Part 2 to reinforce the role of the Standard in supporting governments and other public sector entities transitioning to the accrual basis of financial reporting and adoption of accrual IPSAS. These refinements include:
- (a) Updated definitions and encouraged disclosures to ensure that they are not contrary to the equivalent accrual IPSAS unless intended to be so to reflect the cash basis focus in this Standard; and
 - (b) Outlining the role of IPSAS 33, *First-Time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* in providing relief from complying with certain of the requirements of accrual IPSAS for a 3-year period from first adoption.
- BC11 Consistent with the role of Part 2 of the Standard in supporting entities transitioning to the accrual basis of financial reporting and adoption of the accrual IPSAS, the definitions of assets, liabilities, revenues and expenses included in this Standard are the same as those included in the accrual IPSAS. While encompassing essentially the same characteristics, the definitions of assets, liabilities, revenues and expenses in the "Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities" (The Conceptual Framework) have been further developed to clarify their key characteristics. The accrual IPSAS have not yet been updated to reflect the definitions of assets, liabilities, revenues and expenses in the Conceptual Framework and, consequently, the definitions in this Standard do not reflect those in the Framework.

Extraordinary Items

- BC12 This revised Cash Basis IPSAS (2017) no longer encourages the disclosure of information about extraordinary items and supporting definitions and explanations. IPSAS 1, *Presentation of Financial Statements* (issued in 2000), which was on issues when the previous Cash Basis IPSAS was issued, required certain disclosures about extraordinary items to be made on the face of the financial statements. IPSAS 2, *Cash Flow Statements* (issued in 2000) and IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors* (issued in 2000) also required separate disclosure of extraordinary items. These requirements have now been removed from the accrual IPSAS. The accrual IPSAS do not require, encourage or prohibit disclosure of extraordinary items. These amendments were made to align Part 2 of this Standard with the accrual IPSAS.

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 the financial statements of Government Entity ABC

Administered Transactions (paragraph 2.1.6)

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 Agency EF	Collection of taxation	X	X
	Collection of utility service fee	X	X
Cash transferred to respective entities		(X)	(X)
		-	-

Related Party Transactions (paragraph 2.1.22)

The key management personnel (as defined by International Public Sector Accounting Standard 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 millions.

Number of persons AQ persons.

Government X: Consolidated Statement of Cash Receipts and Payments of Government X and extracts from notes to the financial statements of Government X**Government X: Statement of Consolidated Cash Receipts and Payments:****Year Ended 31 December 200X (Paragraph 2.1.37)***(Receipts)*

(in thousands of currency units)	Note	200X Receipts/(Payments)	200X-1 Receipts/(Payments)
RECEIPTS			
<i>Taxation</i>			
Income tax		X	X
Value-added tax		X	X
Property tax		X	X
Other taxes		<u>X</u>	<u>X</u>
		X	X
External and Other Assistance	F	X	X
<i>Borrowings</i>			
Proceeds from Commercial Institutions		X	
Development Banks and similar organizations		X	
<i>Capital Receipts</i>			
Proceeds from disposal of plant and equipment		X	X
Proceeds from disposal of Financial Instruments		X	X
<i>Trading Activities</i>			
Receipts from trading activities		X	X
<i>Other receipts</i>		X	X
Total receipts		<u><u>X</u></u>	<u><u>X</u></u>

Government X: Statement of Consolidated Cash Receipts and Payments:**Year Ended 31 December 200X****(Payments)**

(in thousands of currency units)	Note	200X Receipts/(Payments)	200X-1 Receipts/(Payments)
PAYMENTS			
<i>Operations</i>			
Wages, salaries and employee benefits		(X)	(X)
Supplies and consumables		(X)	(X)
		(X)	(X)
<i>Transfers</i>			
Grants		(X)	(X)
Other transfer payments		(X)	(X)
		(X)	(X)
<i>Capital Payments</i>			
Purchase/construct plant and equipment		(X)	(X)
Purchase of financial instruments		(X)	(X)
		(X)	(X)
<i>Loan and Interest Repayments</i>			
Repayment of borrowings		(X)	(X)
Interest payments		(X)	(X)
		(X)	(X)
<i>Other payments</i>		(X)	(X)
Total payments		(X)	(X)
Increase/(Decrease) Cash		X	X
Cash at beginning of year		X	X
Increase/(Decrease) Cash		X	X
Cash at end of year		X	X

Notes to consolidated financial statements of Government X*(Extracts illustrating encouraged disclosures)***Note A: Controlled Entities (paragraph 2.1.53)**

Entity XYZ has rights to variable benefits from its involvement with controlled entities and has the ability to affect the nature or amount of those benefits through its power over those entities. All controlled entities are included in the consolidated financial statements. The significant controlled entities are identified below.

Significant Controlled Entities**Jurisdiction**

Entity A
Entity B
Entity C
Entity D
Entity E
Entity F
Entity G

X

Entity H	X
Entity I	
Entity J	

Control of government entities arises by way of statute or other enabling legislation. Control of commercial public sector entities (commercial entities) arises by way of statute and in the case of commercial entities C and D, by way of ownership interest. The Government retains control of commercial entity J through legislative authority although the majority of the equity of commercial entity J has been sold to private investors.

Entity	Ownership Interest (%)	Voting Power (%)
Entity C	XX	XX
Entity D	XX	XX
Entity J	XX	XX

(Extract from notes to consolidated financial statements of Government X continued)

Acquisitions of Controlled Entities and Operating Units *(paragraphs 2.1.57 and 2.1.58)*

Names of Entities 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)
Entity C	XX	X	X	X
Entity D	XX	X	X	X
		X	X	X

Disposals of Controlled Entities and Other Operating Units

Name of Entities 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 H	XX	X	X	X

Note B: Significant Joint Arrangements *(paragraph 2.1.62)*

Name of Joint Arrangement	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 consolidated financial statements of Government X Continued)

Note C: Assets, Liabilities, Revenues and Expenses *(paragraph 2.1.24(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 jurisdiction (country, state, city) limits	X	X
Buildings at cost	X	X
Buildings at valuation	X	X
	X	X

Revenue and Expense

The Government continues to build data on revenues and expenses of the reporting period as it transitions to the accrual basis of financial reporting.

The Government maintains records of property taxes due and payable at reporting date based on property values as assessed by the revenue office on a three year rolling basis. It also estimates amounts of goods and services tax and [*identify industry*] royalties accruing based on sales and production returns and reports.

It is developing a statistical model for measuring income tax revenue on an accruals basis which draws on taxation statistics compiled since 200X-3 as well as other 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, 20XX.

(Extract from notes to consolidated financial statements of Government X Continued)

Accrued expenses comprise amounts due and payable for wages, salaries and rental and other costs due and payable as at reporting date.

(in thousands of currency units)	200X	200X-1
Accrued Revenue	X	X
Property taxes	X	X
Goods and services tax	X	X
Royalties	X	X
Accrued Expenses		
Wages and salaries	X	X
Rent	X	X
Other	X	X

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		

FINANCIAL REPORTING UNDER THE CASH BASIS OF ACCOUNTING

(in thousands of currency units)	200X	200X-1
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 consolidated financial statements of Government X continued)

Note D: Comparison with Budget when the entity does not make its budget publicly available (paragraph 2.1.24(b))

(in thousands of currency units)	Actual	Budget	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
Assistance – Aid Agreements			
International agencies	X	X	-
Other	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 Payments			
Purchase/construction of plant and equipment	(X)	(X)	(X)
Purchase of financial instruments	(X)	(X)	-
	(X)	(X)	(X)
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 consolidated financial statements of Government X continued)

Note D2: When the Entity Prepares a Biennial Budget**Biennial Budget On Cash Basis - For The Year Ended 31 December 200X (paragraph 2.1.30)**

(in thousands of currency units)	Original Biennial Budget Year	Target Budget for 1 st Year	Revised Budget in 1 st Year	1 st Year Actual on Comparable Basis	Balance Available for 2 nd Year	Target Budget for 2 nd Year	Revised Budget in 2 nd Year	2 nd 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 & equipment	X	X	X	X	X	X	X	X	X
Financial Instruments	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& 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)
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)
Environment Protection	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
General Public Services	(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 consolidated financial statements of Government X continued)

Note E: Payments by Third Parties (paragraph 2.1.77)

Government X benefits from payments made by third parties to purchase goods and services on its behalf during the period. These payments do not constitute cash receipts or payments by the government. They include payments for goods and services made by multilateral and bilateral aid agencies and non-governmental organizations. They form part of the support for government programs provided by way of external and other assistance – additional information about external assistance and other assistance is provided in Note F below. The government has verified that the following payments have been made by third parties to purchase goods and services during 200X and 200X-1.

THIRD PARTY PAYMENTS

(in thousands of currency units)	200X	200X-1
Wages and Salaries	X	X
Supplies and consumables	X	X
Capital Payments	X	X
Loan and interest repayment	X	X
Total third party payments	X	X

Note F: External Assistance and Other Assistance (paragraphs 2.1.90 and 2.1.91)

Assistance was received in the form of cash transfers and deposits to current and term deposit accounts and trusts fund accounts controlled by the government. It also encompasses amounts drawn by the government from accounts of donors consistent with external assistance and other assistance agreements and other authorizations. Assistance was also received in the form of third party payments.

External assistance comprises loans and grants from multilateral and bilateral donor agencies under agreements specifying the purposes for which the assistance will be utilized. Other assistance was provided for specified purposes by NGOs, private corporations and other donors.

The amounts, class of provider and purposes for which external assistance was provided during the period is outlined below.

(Extract from notes to consolidated financial statements of Government X continued)

External Assistance and Other Assistance received (paragraph 2.1.90(a), (b), (c) and (d) and paragraph 2.1.91)

	200X		200X-1
(in thousands of currency units)			
External Assistance			
Total cash receipts	X		X
Total third party payments	X		X
Total External Assistance	X		X
Multilateral aid agencies			
Cash receipts	X		X
Third party payments	X		X
Total multilateral aid agencies	X		X
Bilateral aid agencies			
Cash receipts	X		X
Third party payments	X		X
Total bilateral aid agencies	X		X
Other Assistance			
Total cash receipts	X		X
Total third party payments	X		X
Total Other Assistance	X		X
Non-Governmental Organizations (NGOs)			
Cash receipts	X		X
Third party payments	X		X
Total NGOs	X		X
Private corporations and other donors			
Cash receipts	X		X
Total private corporations and other donors	X		X

(Extract from notes to consolidated financial statements of Government X continued)

(in thousands of currency units)	200X		200X+1	
Loan Funds	X		X	
External assistance	X		X	
Total Loan Funds	X		X	
Grants and Donations				
External Assistance	X		X	
Other assistance	X		X	
Total Grants and Donations	X		X	

Purposes for which External Assistance and Other Assistance was provided and used (paragraph 2.1.90(e) and paragraph 2.1.91)

External Assistance

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

Other Assistance

During the reporting period other assistance was received as grants and donations from non-governmental organizations, private sector corporations and other donors for the following purposes:

	Development Assistance		Emergency Assistance		Total	
	200X	200X-1	200X	200X-1	200X	200X-1
Grants & Donations	X	X	X	X	X	X
Amount utilized	X	X	X	X	X	X

(Extract from notes to consolidated financial statements of Government X continued)

Undrawn External Assistance and Other Assistance (paragraph 2.1.90(f) and paragraph 2.1.91)

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. There were no amounts of undrawn assistance from NGOs or other providers of other assistance in 200X or 200X-1.

	Development Assistance		Emergency Assistance		Other		Total	
	200X	200X-1	200X	200X-1	200X	200X-1	200X	200X-1
Closing balance - Loans	X	X	-	-	X	X	X	X
Closing balance - Grants	X	X	-	-	X	X	X	X

Goods and Services Received (paragraph 2.1.100)

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, bilateral agencies, NGO's, private corporations and associations 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, food and clothing 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 estimated based on cost estimates provided by international aid agencies, NGO's and corporations that were major contributors 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.

Presentation of the Statement of Cash Receipts and Payments in the Format Required by IPSAS 2, Cash Flow Statements

Paragraph 2.2.1 of Part 2 of this Standard encourages an entity which is completing its transition to the accrual basis of financial reporting and adoption of accrual IPSAS to present a statement of cash receipts and payments in the same format as that required by IPSAS 2, Cash Flow Statements. IPSAS 2 is applied by an entity which reports on an accrual basis of financial reporting 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, Cash Flow Statements

1 IPSAS 2, *Cash Flow Statements* requires an entity which prepares and presents financial statements under the accrual basis of financial reporting **and adoption of accrual IPSAS** to prepare a cash flow statement which reports cash flows during the period classified by operating, investing and financing activities as defined below.

Definitions

2 *Financing activities* are activities that result in changes in the size and composition of the contributed capital and borrowings of the entity.

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

Operating activities are the activities of the entity that are not investing or financing activities.

Components of the Financial Statements

3 In presenting a statement of cash receipts and payments in this format it may be necessary to classify cash flows arising from a single transaction in different ways. (The term cash flow statement is used in the remainder of this appendix for a statement of cash receipts and payments presented in the same format as that required by IPSAS 2.) For example, when the cash repayment of a loan includes both interest and capital, the interest element may be classified as an operating activity and the capital element may be classified as a financing activity. An entity presenting information by way of a cash flow statement presents its cash flows from operating, investing and financing activities in a manner which is most appropriate to its activities.

4 A cash flow statement will include line items which present the following amounts:

- (a) Total receipts from operating activities;
- (b) Total payments on operating activities;
- (c) Net cash flows from operating activities;
- (d) Net cash flows from investing activities;
- (e) Net cash flows from financing activities;
- (f) Beginning and closing balances of cash; and
- (g) Net increase or decrease in cash.

Additional line items, headings and sub-totals will also be presented on the face of the statement when such presentation is necessary to present fairly the entity's cash flows.

5 An entity will also present on the face of the cash flow statement or in the notes:

- (a) Major classes of gross cash receipts and gross cash payments arising from operating, investing and financing activities, except to the extent that paragraph 1.3.13 of Part 1 of this Standard allows reporting on a net basis;
- (b) A sub-classification of total cash receipts from operations in a manner appropriate to an entity's operations; and

- (c) An analysis of payments on operating activities using a classification based on either the nature of payments or their function within the entity, as appropriate.

Separate disclosure of payments made for capital acquisitions and for interest and dividends is also consistent with the requirements of IPSAS 2.

- 6 Disclosure of information about such matters as whether cash is generated from taxes, fines, fees (operating activities), the sale of capital assets (investing activities) and/or borrowings (financing activities) and whether it was expended to meet operating costs, for the acquisition of capital assets (investing activities) or for the retirement of debt (financing activities) will enhance transparency and accountability of financial reports. These disclosures will also facilitate more informed analysis and assessments of the entity's current cash resources and the likely sources and sustainability of future cash inflows. Accordingly, this Standard encourages all entities to disclose this information in the financial statements and/or related notes.

Operating Activities

- 7 The amount of net cash flows arising from operating activities is a key indicator of the extent to which the operations of the entity are funded:

- (a) By way of taxes (directly and indirectly); and
- (b) From the recipients of goods and services provided by the entity.

The disclosure of the amount of net cash flows from operating activities also assists in identifying the extent to which operations of the entity generate cash that can be deployed to repay obligations, pay a dividend/distribution to its owner and make new investments without recourse to external sources of financing. The consolidated whole-of-government operating cash flows provide an indication of the extent to which a government has financed its current activities through taxation and charges. Information about the specific components of historical operating cash flows is useful, in conjunction with other information, in forecasting future operating cash flows.

- 8 Cash flows from operating activities are primarily derived from the principal cash-generating activities of the entity. Examples of cash flows from operating activities are:

- (a) Cash receipts from taxes, levies and fines;
- (b) Cash receipts from charges for goods and services provided by the entity;
- (c) Cash receipts from grants, or transfers and other appropriations or budget authorizations made by central government or other public sector entities, including those made for the acquisition of capital assets;
- (d) Cash receipts from royalties, fees and commissions;
- (e) Cash payments to other public sector entities to finance their operations (not including loans or equity injections);
- (f) Cash payments to suppliers for goods and services;
- (g) Cash payments to and on behalf of employees;
- (h) Cash receipts and cash payments of a public sector insurance entity for premiums and claims, annuities and other policy benefits;
- (i) Cash payments of local property taxes or income taxes (where appropriate) in relation to operating activities;
- (j) Cash receipts and payments from contracts held for dealing or trading purposes;
- (k) Cash receipts or payments from discontinuing operations; and
- (l) Cash receipts or payments in relation to litigation settlements.

- 9 An entity may hold securities and loans for dealing or trading purposes, in which case they are similar to inventory acquired specifically for resale. Therefore, cash flows arising from the purchase and sale of dealing or trading securities are classified as operating activities. Similarly, cash advances and loans made by public financial institutions are usually classified as operating activities since they relate to the main cash-generating activity of that entity.

- 10 In some jurisdictions, governments or other public sector entities will appropriate or authorize funds to entities to finance the operations of the entity, and no clear distinction is made for the disposition of those funds between current activities, capital works and contributed capital. Where an entity is unable to separately identify appropriations or budget authorizations as current activities, capital works (operating activities) and contributed capital (investing activities), IPSAS 2 explains that

the entity should classify the appropriation or budget authorization as cash flows from operations, and disclose this in the notes to the statement of cash flows.

Investing Activities

- 11 The separate disclosure of cash flows arising from investing activities identifies the extent to which cash outflows have been made for resources which are intended to contribute to the entity's future service delivery. Examples of cash flows arising from investing activities are:
- (a) Cash payments to acquire property, plant and equipment, intangibles and other long-term assets. These payments include those relating to capitalized development costs and self-constructed property, plant and equipment;
 - (b) Cash receipts from sales of property, plant and equipment, intangibles and other long-term assets;
 - (c) Cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes);
 - (d) Cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes);
 - (e) Cash advances and loans made to other parties (other than advances and loans made by a public financial institution);
 - (f) Cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a public financial institution);
 - (g) Cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities; and
 - (h) Cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.

When a contract is designated as a hedge of an identifiable position, the cash flows of the contract are classified in the same manner as the cash flows of the position being hedged.

Financing Activities

- 12 The separate disclosure of cash flows arising from financing activities is useful in predicting claims on future cash flows by providers of capital to the entity. Examples of cash flows arising from financing activities are:
- (a) Cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short or long-term borrowings;
 - (b) Cash repayments of amounts borrowed;
 - (c) Cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease; and
 - (d) Cash receipts and payments relating to the issue of and redemption of currency.

Interest and Dividends

- 13 IPSAS 2 requires the separate disclosure of cash flows from interest and dividends received and paid. IPSAS 2 also requires that where such disclosures are made they should be classified in a consistent manner from period to period as either operating, investing or financing activities.
- 14 The total amounts of interest and dividends paid and received during a period are disclosed in the cash flow statement. Interest paid and interest and dividends received are usually classified as operating cash flows for a public financial institution. However, there is no consensus on the classification of the cash flows associated with interest and dividends received and paid for other entities. Interest and dividends paid and interest and dividends received may be classified as operating cash flows. Alternatively, interest and dividends paid and interest and dividends received may be classified as financing cash flows and investing cash flows respectively, because they are costs of obtaining financial resources or returns on investments.

Reporting Major Classes of Receipts and Payments

- 15 The sub-classification of receipts depends upon the size, nature and function of the amounts involved. Depending upon the nature of the entity, the following sub-classifications may be appropriate:
- (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 Parts 1 and 2 of this Standard.

Qualitative Characteristics of Information Included in General Purpose Financial Reports

Paragraph 1.3.27 of Part 1 of this Standard requires that the financial statements provide information that meets the qualitative characteristics of information included in general purpose financial statements and satisfies the constraints on such information. This appendix summarizes the qualitative characteristics and constraints of general purpose financial reports as identified in paragraph 1.3.27. For a full explanation of the qualitative characteristics and constraints, readers should refer to “The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities”.

Qualitative characteristics are the attributes that make the information provided in financial statements useful to users and support the achievement of the objectives of financial reporting. The objectives of financial reporting are to provide information useful for accountability and decision-making purposes. They are applicable to financial statements, regardless of the basis of accounting used to prepare the financial statements. The qualitative characteristics are understandability, relevance, faithful representation, timeliness, comparability and verifiability. Pervasive constraints on information included in financial statements are materiality, cost-benefit, and achieving an appropriate balance between the qualitative characteristics.

Understandability

Understandability is the quality of information that enables users to comprehend its meaning. General Purpose Financial Statements (financial statements) of public sector entities should present information in a manner that responds to the needs and knowledge base of users, and to the nature of the information presented. 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 without assistance.

Relevance

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

Faithful Representation

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

Comparability

Information in financial statements is comparable when users are able to identify similarities in, and differences between, two sets of phenomena. Comparability is not a quality of an individual item of information, but rather a quality of the relationship between two or more items of information.

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.

Timeliness

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

Verifiability

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

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

Constraints on Information Included in General Purpose Financial Statements

Materiality

Information is material if its omission or misstatement could influence the discharge of accountability by the entity, or the decisions that users make on the basis of the entity's financial statements prepared for that reporting period. Materiality depends on both the nature and amount of the item judged in the particular circumstances of each entity.

Balance between Benefit and Cost

The balance between benefit and cost is a pervasive constraint. The benefits derived from information should justify the cost of providing it. Assessing whether the benefits of providing information justify the related costs is often a matter of judgment because it is often not possible to identify and/or quantify all the costs and all the benefits of information included in financial statements.

The costs of providing information include the costs of collecting and processing the information, the costs of verifying it and/or presenting the assumptions and methodologies that support it, and the costs of disseminating it. Users incur the costs of analysis and interpretation.

Preparers expend the majority of the effort to provide information in financial statements. However, service recipients and resource providers ultimately bear the cost of those efforts—because resources are redirected from service delivery activities to preparation of information for inclusion in financial statements. Users reap the majority of benefits from the information provided by financial statements. However, information prepared for financial statements may also be used internally by management and result in better decision-making by management.

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

Balance between Qualitative Characteristics

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

INTRODUCTION TO RECOMMENDED PRACTICE GUIDELINES

Recommended Practice Guidelines (RPGs) are developed and approved by the International Public Sector Accounting Standards Board (IPSASB).

The objective of the IPSASB is to serve the public interest by setting high-quality public sector accounting standards and by facilitating the adoption and implementation of these, thereby enhancing the quality and consistency of practice throughout the world and strengthening the transparency and accountability of public sector finances.

In meeting this objective the IPSASB sets International Public Sector Accounting Standards (IPSASs) and RPGs for use by public sector entities, including national, regional, and local governments, and related governmental agencies.

IPSASs relate to the general purpose financial statements (financial statements) and are authoritative. RPGs are pronouncements that provide guidance on good practice in preparing general purpose financial reports (GPFs) that are not financial statements. Unlike IPSASs RPGs do not establish requirements. Currently all pronouncements relating to GPFs that are not financial statements are RPGs. RPGs do not provide guidance on the level of assurance (if any) to which information should be subjected.

**RPG 1—REPORTING ON THE LONG-TERM SUSTAINABILITY OF
AN ENTITY’S FINANCES**

History of RPG

RPG 1, *Reporting on the Long-Term Sustainability of an Entity’s Finances* was issued in July 2013.

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

- *The Applicability of IPSASs* (issued April 2016)

Table of Amended Paragraphs in RPG 1

Paragraph Affected	How Affected	Affected By
5	Deleted	The Applicability of IPSASs April 2016
6	Amended	The Applicability of IPSASs April 2016
BC7A	New	Improvements to IPSAS, 2021
BC36	New	Improvements to IPSAS, 2021

**REPORTING ON THE LONG-TERM SUSTAINABILITY OF
AN ENTITY'S FINANCES**

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Objective

1. This Recommended Practice Guideline (RPG) provides guidance on reporting on the long-term sustainability of a public sector entity's finances ("reporting long-term fiscal sustainability information"¹). The RPG provides information on the impact of current policies and decisions made at the reporting date on future inflows and outflows and supplements information in the general purpose financial statements ("financial statements"). The aim of such reporting is to provide an indication of the projected long-term sustainability of an entity's finances over a specified time horizon in accordance with stated assumptions.

Status and Scope

2. The reporting of information in accordance with this RPG represents good practice. An entity reporting long-term fiscal sustainability information is encouraged to follow this RPG. Compliance with this RPG is not required in order for an entity to assert that its financial statements comply with International Public Sector Accounting Standards (IPSASs).
3. The scope of this RPG includes an entity's projected flows. It is not limited to those flows related to programs providing social benefits. Nevertheless, this RPG acknowledges that the flows relating to programs providing social benefits, including entitlement programs that require contributions from participants, can be a highly significant component of reporting long-term fiscal sustainability information for many entities.
4. This RPG does not directly address issues associated with the reporting of environmental sustainability. However, an entity should assess any financial impacts of environmental factors and take them into account when developing its projections.
5. [Deleted]
6. Although this RPG does not apply directly to commercial public sector entities, the future inflows and outflows related to a commercial public sector entity, controlled by the reporting entity, over the specified time horizon of the projections are within the scope of this RPG.
7. Long-term fiscal sustainability information should not be described as complying with this RPG unless it complies with all the requirements of this RPG.
8. This RPG outlines minimum information levels. The RPG does not preclude the presentation of additional information if such information is useful in meeting the objectives of financial reporting and meets the qualitative characteristics (QCs) of financial reporting.

Definitions

9. The following terms are used in this RPG with the meaning specified:

Current policy assumptions are those assumptions based on legislation or regulation in force at the reporting date with appropriate departures for defined circumstances.

Inflows are cash and cash equivalents projected to be received or accrued by the entity over the time horizon of the projections.

Long-term fiscal sustainability is the ability of an entity to meet service delivery and financial commitments both now and in the future.

Outflows are cash and cash equivalents projected to be paid or accrued by the entity over the time horizon of the projections.

A projection is forward-looking financial information prepared on the basis of the entity's current policy assumptions, and assumptions about future economic and other conditions.

Terms used in this RPG with the meanings specified in International Public Sector Accounting Standards (IPSASs) are set out in Appendix A.

Determining Whether to Report Long-Term Fiscal Sustainability Information

10. In determining whether to report long-term fiscal sustainability information, an entity needs to assess whether potential users exist for prospective financial information.

¹ The IPSASB acknowledges that in a number of jurisdictions the term "fiscal" has a narrow interpretation related to taxation. In this RPG the term is used with a broader meaning to include both inflows and outflows.

11. Long-term fiscal sustainability information is broader than information derived from the financial statements. It includes projected inflows and outflows related to the provision of goods and services and programs providing social benefits using current policy assumptions over a specified time horizon. It therefore takes into account decisions made by the entity on or before the reporting date that will give rise to future outflows that do not meet the definition of and/or recognition criteria for liabilities at the reporting date. Similarly it takes into account future inflows that do not meet the definition of and/or recognition criteria for assets at the reporting date.
12. Assessments of long-term fiscal sustainability use a broad range of data. These data include financial and non-financial information about future economic and demographic conditions, assumptions about country and global trends such as productivity, the relative competitiveness of the national, state or local economy and expected changes in demographic variables such as age, mortality, morbidity, fertility, gender, income, educational attainment and workforce participation.
13. The relevance of reporting long-term fiscal sustainability information should be considered in the context of that entity's funding and capacity to determine service delivery levels. There are likely to be users for long-term fiscal sustainability information for entities with one or more of the following characteristics:
 - (a) Significant tax and/or other revenue raising powers;
 - (b) Powers to incur significant debt; or
 - (c) The power and ability to determine the nature, level and method of service delivery including the introduction of new services.

Reporting Boundary

14. Use of the same reporting boundary as for the financial statements enhances the understandability of projections and increases their usefulness to the users of general purpose financial reports (GPFs).
15. An entity may report long-term fiscal sustainability information using another reporting boundary, such as the General Government Sector (GGS). This may be to enhance consistency and comparability with other jurisdictions or because there are other indicators that are used to assess long-term fiscal sustainability based on another reporting boundary. Entities providing information on the GGS are encouraged to also present information in accordance with IPSAS 22, *Disclosure of Financial Information about the General Government Sector*.

Reporting Long-Term Fiscal Sustainability Information

16. Long-term fiscal sustainability information prepared in accordance with this RPG should enable users to assess various aspects of the long-term fiscal sustainability of the entity, including the nature and extent of financial risks that the entity faces.
17. The form and content of an entity's long-term fiscal sustainability information will vary depending on the nature of the entity and the regulatory environment in which it operates. A single presentation approach is unlikely to satisfy the objectives of financial reporting. To meet the objectives² and QCs of financial reporting while taking into account the constraints³, long-term fiscal sustainability information will usually include the following components:
 - (a) Projections of future inflows and outflows, which can be displayed in tabular statements or graphical formats, and a narrative discussion explaining the projections (see paragraphs 21–26 and 56);
 - (b) A narrative discussion of the dimensions of long-term fiscal sustainability including any indicators used to portray the dimensions (see paragraphs 27–40 and 57); and
 - (c) A narrative discussion of the principles, assumptions and methodology underlying the projections (see paragraphs 41–53 and 58).
18. The projections reported in long-term fiscal sustainability information generally reflect conditions of uncertainty. The projections are derived from models that rely on assumptions around which there is some uncertainty. In order for long-

² The objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users of general purpose financial reports for accountability purposes and for decision-making purposes. See Chapter 2 of the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the *Conceptual Framework*) for further details.

³ The qualitative characteristics of financial reporting are relevance, faithful representation, understandability, timeliness, comparability and verifiability. The constraints on information are materiality, cost-benefit and the balance between the qualitative characteristics. See Chapter 3 of the *Conceptual Framework* for further details.

term fiscal sustainability information to faithfully represent an entity's projected future flows, assumptions used should be based on the best available information.

19. Long-term fiscal sustainability information may be published as a separate report or as part of another report. It may be published at the same time as the entity's GPFs or at a different time.
20. A controlled entity should ensure that the information reported is consistent with information reported by its controlling entity.

Presenting Projections of Future Inflows and Outflows

21. An entity should present projections of future inflows and outflows, including capital expenditure. The projections should be prepared on the basis of current policy assumptions, and assumptions about future economic and other conditions.
22. An entity should assess the extent to which it can draw on the assumptions, projections and indicators prepared by other entities, such as Ministries of Finance, or from other sources of information, rather than preparing the information itself, as this can reduce the cost of reporting. Such an assessment considers whether such information meets the QCs. Where an entity has a budget or forecast that meets the definition of a projection, this information can be used for the relevant time period or periods.
23. Projections can be displayed in tabular statements or graphical formats providing details of the programs and activities giving rise to outflows and identifying the sources of inflows. In determining the format of tabular statements entities need to balance considerations of understandability and relevance. Presentation of a large number of time periods between the reporting date and the end of the time horizon provides a more complete information set, but increases the risk of information overload and the impairment of understandability.
24. An entity should ensure that its choice and presentation of projections is not skewed to present a misleadingly favorable or unfavorable picture. The formats and terms used should also be consistent between reporting periods.

Time Horizon

25. In selecting an appropriate time horizon an entity needs to balance the QCs of verifiability, faithful representation and relevance. The further the end of the time horizon is from the reporting date, the more future events are captured. However, as the time horizon increases, the assumptions underpinning the projections become less robust and potentially less verifiable. Conversely, excessively short time horizons may increase the risk that the consequences of events outside the time horizon may be ignored, thereby reducing the relevance of projections.
26. The length of the time horizon will reflect the characteristics of the entity. It is likely to be influenced by the characteristics of the entity, including aspects such as the longevity of key programs, the level of dependence on other entities for funding, the estimated lives of major items of property, plant, and equipment, such as infrastructure networks, and the time horizons adopted by other comparable entities providing prospective information.

Addressing the Dimensions of Long-Term Fiscal Sustainability

27. An entity reporting long-term fiscal sustainability information should include a narrative discussion on each of the dimensions of long-term fiscal sustainability. This RPG discusses three inter-related dimensions of long-term fiscal sustainability, as follows:
 - Service;
 - Revenue; and
 - Debt.
28. The dimensions are inter-related as changes in one dimension affect the other dimensions. For example, future services and entitlements to beneficiaries (the service dimension) are funded by revenue and/or debt. A single dimension can be analyzed by holding the other two dimensions constant. For example, by holding the existing levels of services and revenues constant an entity can illustrate the effect of such assumptions on the level of debt. The relationships between the dimensions of long-term fiscal sustainability are illustrated in Appendix B.
29. There are two aspects to each dimension: capacity and vulnerability. Capacity is the ability of the entity to change or influence the dimension, and vulnerability is the extent of the entity's dependence on factors outside its control or influence.

30. An entity can use indicators to present the dimensions of long-term fiscal sustainability. An entity should choose its indicators based on their relevance to the entity. Examples of indicators are provided in the Glossary of Indicators in Appendix C.

Service Dimension

31. The service dimension considers the volume and quality of services to recipients and entitlements to beneficiaries over the period of the projections, given current policy assumptions on revenue from taxation and other sources, while remaining within debt constraints. This dimension focuses attention on the capacity of an entity to maintain or vary the volume and quality of services it provides or the entitlement programs it delivers. It also focuses attention on whether the entity is vulnerable to factors such as the willingness of recipients and beneficiaries to accept reductions in services and entitlements or vulnerable because it does not have the ability to determine or vary service levels, for example where another level of government determines the level of services to be provided.
32. By reflecting the impact of current policy assumptions on revenue from taxation and other sources, and on debt, long-term fiscal sustainability information can present the amounts available for the provision of goods and services. Users can contrast this information with the entity's service delivery commitments, and thereby evaluate the sustainability of the provision of services.
33. A factor to consider in making such comparisons is the extent to which expenditure on certain programs is likely to increase more steeply than the overall levels of expenditure of the entity. This may be because the number of beneficiaries is projected to increase for a particular program or because costs associated with certain programs, such as healthcare, are projected to increase more quickly than the general inflation rate. For example, due to demographic and technological changes, the cost of healthcare as a proportion of overall government expenditures might be projected to increase over the period of projections.
34. For capital intensive activities the service dimension also involves an assessment of the useful lives and replacement cycles of items of property, plant, and equipment.

Revenue Dimension

35. The revenue dimension considers taxation levels and other revenue sources over the period of the projections, given current policy assumptions on the provision of services to recipients and entitlements for beneficiaries, while remaining within debt constraints. This dimension focuses attention on the capacity of an entity to vary existing taxation levels or other revenue sources or introduce new revenue sources. It also focuses attention on factors such as whether the entity is vulnerable to the unwillingness of taxpayers to accept increases in taxation levels, and the extent of its dependence upon revenue sources outside its control or influence.
36. An example of an indicator of the revenue dimension is the proportion of total revenues that are received from entities at other levels of government or from international organizations. For example, a local government entity may be able to maintain or increase property taxes, but be partially dependent upon a mixture of general grants and specific grants from national and/or state governments. As policies for the provision of services and for managing debt are projected, the level of revenue required to fund such policies can be presented. This information assists users in assessing the entity's ability to maintain or increase its levels of revenue and thereby in evaluating the sustainability of its sources of revenue.
37. Generally, an entity which has a limited ability to vary levels of revenue from taxation and other sources is likely to be highly dependent upon funding decisions by entities at other levels of government. If inter-governmental transfers have constitutional or other legal underpinning, this may make the entity less susceptible to sudden adverse funding decisions by other entities and therefore increase the probability of continuing to receive stable revenues. This information assists users in assessing the entity's vulnerability to decisions outside its control.

Debt Dimension

38. The debt dimension considers debt levels over the period of the projections, given current policy assumptions on the provision of services to recipients and entitlements for beneficiaries, and revenue from taxation and other sources. This dimension focuses attention on the capacity of the entity to meet its financial commitments as they come due or to refinance or increase debt as necessary. It also focuses attention on whether the entity is vulnerable to market and lender confidence and interest rate risk.
39. The level of net debt is important for an assessment of the debt dimension, as, at any reporting date, it represents the amount expended on the past provision of goods and services that has to be financed in the future. Therefore, this indicator is likely to be relevant for many entities. By projecting current policy assumptions for the provision of goods and services,

and for revenue from taxation and other sources, projected levels of net debt can be presented. This information assists users in assessing the entity's ability to meet its financial commitments as they come due or to maintain, refinance or increase its levels of debt and thereby evaluate the sustainability of the entity's debt.

40. At national levels a factor to consider in presenting such projections is whether to distinguish between: (a) the primary balance, which is total projected government spending, excluding interest payable on debt, minus tax revenues, and (b) the overall balance, which is the primary balance including outflows related to interest payable on debt. At sub-national levels or for international organizations the focus may be on net debt as a percentage of total revenues. Increases in this indicator show that an increasing proportion of revenues will be required for debt servicing, thereby diverting resources from service delivery, and that the projected level of an entity's debt may be unsustainable.

Principles and Methodologies

Updating Projections and Frequency of Reporting

41. While regular updates are desirable, this RPG acknowledges that annual updating may not be realistic for all entities. However, there is generally an inverse relationship between the robustness of assumptions on which projections are made and the amount of time since they were made. During periods of global financial volatility the risk of projections made some time before the reporting date becoming outdated increases, with a consequent reduction of the ability of such information to meet the objectives of accountability and decision making. In this situation, an entity should consider updating its projections on a more frequent basis. An entity should also consider updating its projections after significant or major unexpected events such as natural disasters or other emergencies.

Impact of Legal Requirements and Policy Frameworks

42. In some jurisdictions reporting long-term fiscal sustainability information is governed by a legal or regulatory framework that applies at the national or state level or through international arrangements. There may also be legal requirements for local government. These might include balanced budget requirements. These requirements are likely to specify or otherwise affect the principles, assumptions and methodologies an entity should use in calculating and disclosing its projections.

Current Policy, Demographic and Economic Assumptions

43. Where flows for particular programs and activities are individually modeled, the policy assumptions should be based on the continuation of current legislation or regulation with departures where appropriate. Those assumptions (referred to as "current policy assumptions") should be applied consistently through-out the entire projection period. The starting point for current policy assumptions should be legislation or regulation currently in force. However, there may be instances where a departure from current legislation or regulation may be appropriate, for example:
- (a) Where changes to current legislation or regulation have been enacted before the reporting date, and where those changes have a specific implementation date within the time horizon of the projections;
 - (b) Where the provisions in current legislation or regulation are internally inconsistent; or
 - (c) Where current legislation or regulation has a termination date, e.g., "sunset provisions".
44. Current policy assumptions may be affected by legal changes that have been enacted before the reporting date, which have a specific implementation date within the time horizon of the projections. In these circumstances, assuming current legislation or regulation remains in force for the entire projection period will not be appropriate.
45. An example of current legislation or regulation that is internally inconsistent is a social security program which has legal provisions that make it unlawful to make payments once an earmarked fund is exhausted, although entitlements of beneficiaries will continue after the exhaustion of that fund. Assuming that the fund will not meet obligations once it is exhausted might reflect a strict legal position, but an entity may need to assess whether the presentation of projections on such a basis underestimates projected outflows and therefore the extent of the fiscal challenge facing the social security program. In this situation an entity may calculate its projections based on current policy assumptions despite legal restrictions.
46. Current legislation or regulation may have a termination date, e.g., sunset provisions, whereby it terminates after a specific period. In many cases there may be a strong probability that such programs will be replaced by similar programs. Adopting a strict legal termination principle could underestimate projected outflows, and therefore impair the usefulness of the information.

Approach to Revenue Inflows

47. Significant revenue inflows from taxation and other sources, such as inter-governmental transfers, may be individually modeled based on current policy assumptions. Significant sources of taxation and other revenue inflows that are not modeled individually are projected to grow (or diminish) in relation to a variable such as gross domestic product (GDP) or a specified inflation index.
48. Other revenue inflows, such as royalties from natural resources, may also be projected to grow in line with GDP or an index. They may also be individually modeled to address specific circumstances, such as when the natural resource is expected to be depleted.

Approach to Age-Related and Non-Age-Related Programs

49. Age-related programs are often subject to eligibility criteria such as age and other demographic factors. In making projections, programs and activities that are age-related may be distinguished from non-age-related programs. Age-related programs may be individually modeled while non-age-related programs may be projected to increase in line with other variables, such as GDP, or to be constant in real terms. Such an approach to non-age-related programs provides some flexibility, as it allows above GDP/real terms increases in some programs and activities to be offset by lower increases or spending declines in other areas.

Demographic and Economic Assumptions

50. Demographic assumptions are likely to include fertility, mortality and migration rates, and workforce participation rates. Economic assumptions are likely to include economic growth rates and inflation. Other economic assumptions may include environmental factors, such as the impact of the depletion and degradation of ecosystems and the depletion of water and finite natural resources on economic growth.

Reasonableness of Assumptions

51. Projections of inflows and outflows should be based on current policy assumptions and economic and demographic assumptions, which are reasonable in the context of the factors discussed in paragraph 18.

Inflation and Discount Rates

52. There are two main approaches to incorporating the effect of price inflation in projections. Inflation may be taken into account in making projections or projections may be made at current prices (i.e., prices prevailing at the reporting date). If the projections include inflation, then the discount rate should also include inflation. If the projections are at current prices, the discount rate should exclude inflation.

Sensitivity Analysis

53. Many assumptions on which projections are based are inherently uncertain. In some cases small changes in variables can have significant impacts on the projections. The use of sensitivity analysis will help users to understand the impact of significant changes in demographic and economic assumptions on the projections.

Disclosures

54. The entity should disclose information that enables users of its long-term fiscal sustainability information to assess the projected long-term fiscal sustainability of the entity. An entity should make any additional disclosures necessary to meet the objectives of financial reporting.
55. An entity should disclose the following information:
- (a) The name of the entity;
 - (b) The financial statements to which the long-term fiscal sustainability information relates;
 - (c) Where different, the names of the entities within the reporting boundary for long-term fiscal sustainability information that are different to those for the financial statements;
 - (d) Where the entity is a controlled entity, the identity of the controlling entity;
 - (e) The date at which a full set of projections was made;
 - (f) The basis and timing of subsequent updating of that full set of projections; and

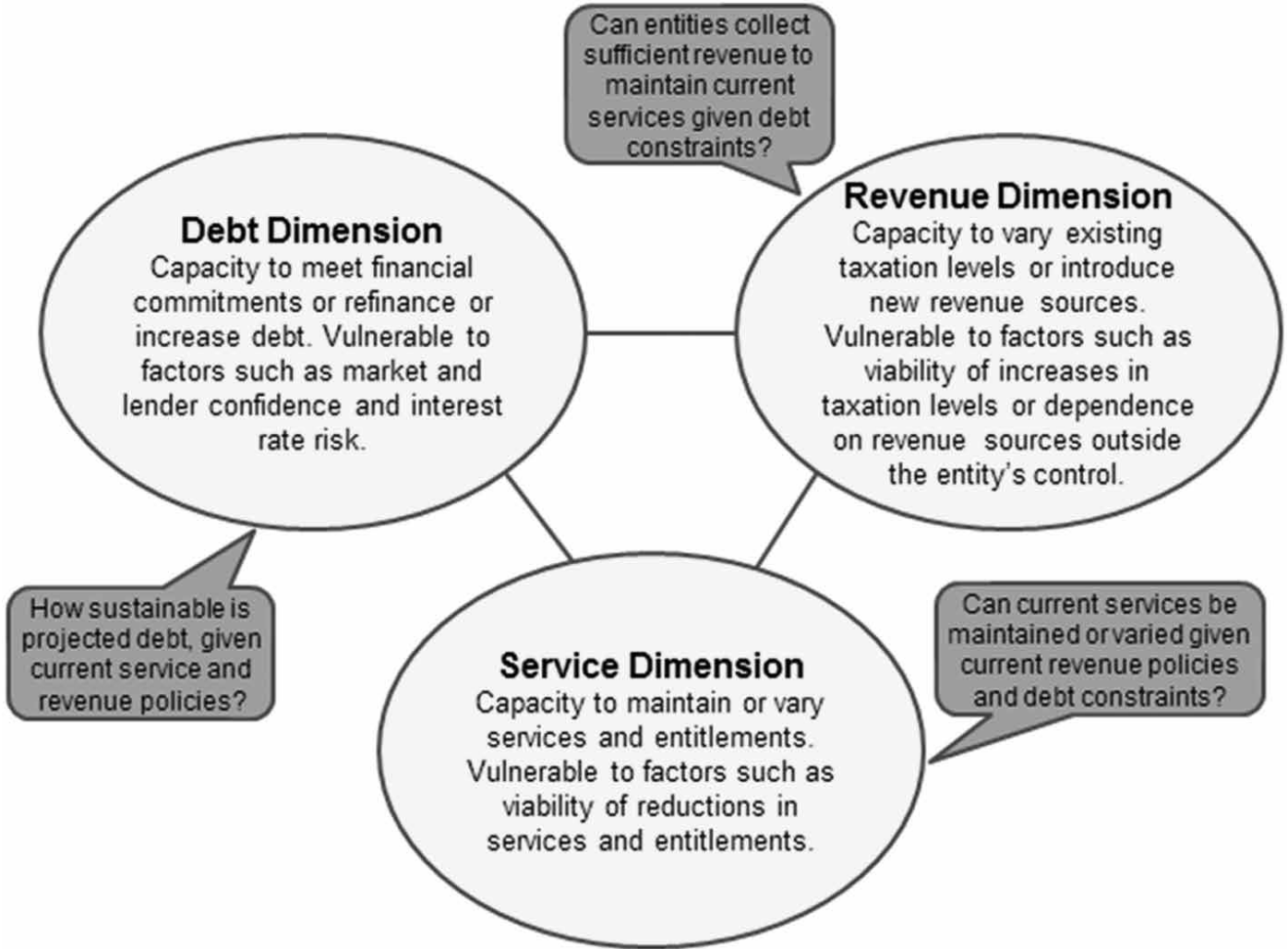
- (g) When an entity uses projections and indicators prepared by other entities or from other sources of information, the names of those entities or other sources, and the information that has been used.
56. The narrative discussion of the projections should include disclosure of the following information:
- (a) The sources of significant revenue inflows from taxation and other sources;
 - (b) An overview of the current policy assumptions for significant revenue inflows from taxation and other sources, such as taxation threshold levels and allowances;
 - (c) The sources of significant outflows including capital expenditure;
 - (d) An overview of the current policy assumptions for the significant outflows including capital expenditure;
 - (e) Whether the projections are modeled individually or in aggregate;
 - (f) An explanation of the changes in projections between reporting dates and the reasons for those changes;
 - (g) An explanation that projections are not forecasts and that it is unlikely that projections over the specified time horizon will match the actual outcome and the extent of the difference will depend upon a range of factors, including the future actions of the entity in meeting any identified fiscal challenge;
 - (h) An explanation of any modifications of formats between reporting periods and the reasons for such changes;
 - (i) The time horizon used for the projections and the reasons for selecting that time horizon; and
 - (j) Where an entity changes the time horizon from that used in the previous reporting period, the reason for such a change.
57. The narrative discussion of the dimensions of long-term fiscal sustainability should include disclosure of the following information:
- (a) An analysis of significant changes in the indicators compared with those of the previous reporting period;
 - (b) Changes in the indicators used to report long-term fiscal sustainability information from the previous reporting period, and the reasons for such changes; and
 - (c) Where an entity uses indicators that are based on amounts derived from non-IPSAS-based information and the indicators affected.
58. An entity should disclose the principles, assumptions and methodology that underpin the projections including the following information:
- (a) Key aspects of governing legislation and regulation;
 - (b) Underlying macro-economic policy and fiscal frameworks, including details of where other publicly available reports on these policies and frameworks can be accessed, including documents outside the GPFRs;
 - (c) The key current policy assumptions and the key demographic and economic assumptions that underpin the projections;
 - (d) Its policy for reviewing and updating current policy assumptions and, demographic and economic assumptions;
 - (e) An explanation of any significant current policy assumptions that depart from current legislation or regulation;
 - (f) An explanation of significant changes in the principles, assumptions and methodologies from the previous reporting period, the nature and extent of these changes, and the reasons for such changes;
 - (g) The results of any sensitivity analyses that could have a significant impact on the projections;
 - (h) The discount rates applied and the basis on which the discount rate has been determined; and
 - (i) The approach to inflation and the reason for this approach.

Terms in this RPG Defined in IPSASs

Term	Definition
Assets	Resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity.
Cash	Comprises cash on hand and demand deposits.
Cash equivalents	Short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.
Controlled entity	An entity, including an unincorporated entity such as a partnership, which is under the control of another entity (known as the controlling entity).
Controlling entity	An entity that has one or more controlled entities.
General government sector	Comprises all organizational entities of the general government as defined in statistical bases of financial reporting.
Liabilities	Present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.
Reporting date	The date of the last day of the reporting period to which the financial statements relate.
Revenue	The gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets/equity, other than increases relating to contributions from owners.

Relationships Between the Dimensions of Long-Term Fiscal Sustainability

This Appendix illustrates the two aspects (capacity and vulnerability) of each of the three dimensions and the relationship between the three dimensions.



Glossary of Indicators

This Appendix lists examples of indicators. It is not intended to be an exhaustive list.

Government Finance Statistics Reporting Guidelines

Where an indicator includes a defined term, that term is shown in *italics* and its definition is shown after the indicators.

- **Gross debt, total:** Total gross debt—often referred to as “total debt” or “total debt liabilities”—consists of all *liabilities* that are *debt instruments*. A debt instrument is defined as a financial claim that requires payment(s) of interest and/or principal by the debtor to the creditor at a date, or dates, in the future.⁴
- **Net debt:** Net debt is calculated as gross debt minus *financial assets* corresponding to *debt instruments*.⁴
- **Net financial worth:** Net financial worth of an *institutional unit* (or grouping of units) is the total value of its *financial assets* minus the total value of its outstanding *liabilities*.⁴
- **Net worth:** Net worth of an *institutional unit* (or grouping of units) is the total value of its *assets* minus the total value of its outstanding *liabilities*.⁴
- **Overall balance:** This term corresponds to the GFS 1986 terminology of “Overall Deficit/Surplus,” which is defined as revenue plus grants received less expenditure less “lending minus repayments.” The balance so defined is equal (with an opposite sign) to the sum of net borrowing by the government, plus the net decrease in government cash, deposits, and securities held for liquidity purposes. The basis of this balance concept is that government policies are held to be deficit- or surplus-creating, and thus the revenue or expenditures associated with these policies are “above the line.” Borrowing or a rundown of liquid assets, however, is deficit financing or “below the line.” It should be noted that the term “lending minus repayments” included above the line covers government transactions in debt and equity claims on others undertaken for purposes of public policy rather than for management of government liquidity or earning a return.⁵
- **Primary balance:** The overall balance, excluding interest payments. Since interest payments represent the cost of past debt, and the determinants of future debt that are under policy control of government are other spending and revenue measures exclusive of interest payment, the primary balance is of particular importance as an indicator of the fiscal position in countries with high levels of debt.⁵

Underlying Definitions

- **Debt instrument:** A debt instrument is defined as a financial claim that requires payment(s) of interest and/or principal by the debtor to the creditor at a date, or dates, in the future.⁴
- **Economic assets:** Economic assets are entities (i) over which economic ownership rights are enforced by institutional units, individually or collectively, and (ii) from which economic benefits may be derived by their owners by holding them or using them over a period of time.⁴
- **Financial assets:** Financial assets consist of financial claims plus gold bullion held by monetary authorities as a reserve asset. A financial claim is an asset that typically entitles the owner of the asset (the creditor) to receive funds or other resources from another unit, under the terms of a liability.⁶
- **Institutional unit:** An institutional unit is an economic entity that is capable, in its own right, of owning assets, incurring liabilities, and engaging in economic activities and in transactions with other entities.⁶
- **Liability:** A liability is established when one unit (the debtor) is obliged, under specific circumstances, to provide funds or other resources to another unit (the creditor).⁶

Other Sources

- **Fiscal gap:** The fiscal gap is the change in non-interest spending and/or receipts that would be necessary to maintain public debt at or below a target percentage of gross domestic product (GDP).⁷ More specifically, the fiscal gap is the net present value

⁴ Source: International Monetary Fund: *Public Sector Debt Statistics—Guide for Compilers and Users* 2011.

⁵ Source: International Monetary Fund: *Manual on Fiscal Transparency* (2007).

⁶ Source: International Monetary Fund: *Public Sector Debt Statistics—Guide for Compilers and Users* 2011.

⁷ GDP is the total market value of all final goods and services produced domestically during a given period of time. The components of GDP are: private sector consumption and investment, government consumption and investment, and net exports (exports-imports).

of projected spending⁸ minus projected receipts, adjusted by the decrease (or increase) in public debt required to maintain public debt at or below the target percentage of GDP for the stated projection period. (Source: US Federal Accounting Standards Advisory Board: Statement of Federal Financial Accounting Standards 36: *Comprehensive Long-Term Projections for the U.S. Government* 2009).

- **Inter-temporal budget constraint:** The inter-temporal budget constraint is satisfied if the projected outflows of the government (current public debt and the discounted value of all future expenditure, including the projected increase in age-related expenditure) are covered by the discounted value of all future government revenue. (Source European Commission: *Sustainability Report*: 2009).
- **Net Debt/Total Revenues:** Net debt as a proportion of total revenues. (Source Canadian Public Sector Accounting Board (PSAB): Statement of Recommended Practice 4 (SORP 4), *Indicators of Financial Condition*: 2009).

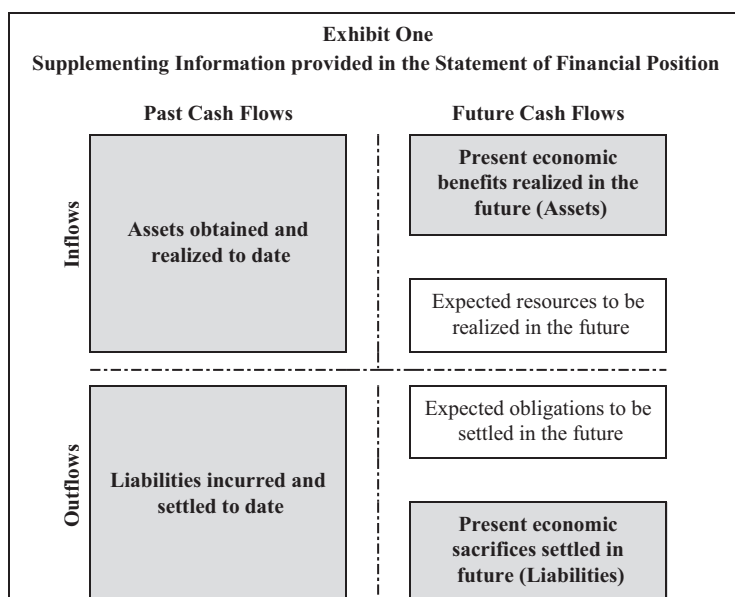
⁸ Since interest is factored into the present value calculation, the fiscal gap as a share of spending is expressed as a share of spending excluding interest (“non-interest spending”).

Basis for Conclusions

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

Background

- BC1. The IPSASB initially launched a project on accounting for social policy obligations (subsequently re-termed social benefits) in 2002. This led to the publication of an Invitation to Comment (ITC), *Accounting for Social Policies of Governments*, in January 2004. Following an analysis of responses to that ITC, the IPSASB began to develop proposals for accounting for obligations related to different sub-categories of social benefits. In late 2006, due to failure to agree on recognition points and measurement requirements for liabilities, the IPSASB decided not to develop further proposals on recognition and measurement at that time.
- BC2. As an interim step the IPSASB developed proposals for the disclosure of amounts to be transferred to those eligible at the reporting date for cash transfers (benefits settled in cash). It expressly did not propose the disclosure of obligations and liabilities. ED 34, *Social Benefits: Disclosure of Cash Transfers to Individuals or Households*, was issued in March 2008.
- BC3. The deliberations on identifying the point at which liabilities for social benefits arise had led the IPSASB to the view that the financial statements cannot provide all the information that users need on social benefits. This is illustrated in Exhibit One below where the shaded boxes indicate information provided in the financial statements. The IPSASB considered that before launching any further project it should consult constituents. Therefore the IPSASB raised this issue in a further Consultation Paper, *Social Benefits: Issues in Recognition and Measurement*, and issued a Project Brief, *Long-Term Fiscal Sustainability Reporting*. Both these documents were issued at the same time as ED 34.



- BC4. In October 2008 the IPSASB reviewed responses to all of the above documents. In the light of these responses, it was decided not to develop ED 34 into an IPSAS. The IPSASB also noted that a large majority of respondents agreed that the financial statements cannot convey sufficient information to users about the long-term financial implications of governmental programs providing social benefits.⁹ In light of this view the IPSASB decided to initiate a project on long-term fiscal sustainability (subsequently re-termed “Reporting on the Long-Term Sustainability of Public Finances”). This led to the issue of a Consultation Paper, *Reporting on the Long-Term Sustainability of Public Finances*, in November 2009. Drawing on existing practice the Consultation Paper put forward the case for reporting long-term fiscal sustainability information, made suggestions on how such information might be presented and sought the views of constituents. The majority of respondents to the Consultation Paper favored the continuation of the project, although many said that they preferred the IPSASB to develop guidelines rather than requirements.

⁹ Further work on proposals for the recognition and measurement of liabilities arising from obligations to deliver social benefits has progressed indirectly in Phase 2 of the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* project. This phase deals with elements, and includes the development of the definition of a liability and other relevant issues such as whether the power to tax is an asset. This work is likely to influence the approach to recognizing and measuring liabilities related to social benefits. The IPSASB decided to reactivate its project on social benefits at its June 2013 meeting.

- BC5. In light of the responses to the Consultation Paper, the IPSASB developed ED 46.RPG, *Reporting on the Long-Term Sustainability of a Public Sector Entity's Finances*, which was issued in October 2011. This ED proposed non-authoritative guidance for public sector entities reporting long-term fiscal sustainability information.
- BC6. The IPSASB has further developed its thinking on reporting long-term fiscal sustainability information in the course of its project on *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* and, in particular, in Chapter 2 of that Framework. Chapter 2: *Objectives and Users of General Purpose Financial Reporting* reflects the view that, although the financial statements are at the core of financial reporting, a more comprehensive scope is necessary to meet the needs of users. That scope includes prospective financial information. The IPSASB has also noted that projected outflows relating to obligations as a result of past decisions and projected inflows related to sovereign powers and taxation powers may not be recognized or may only be partially recognized in the statement of financial position and the statement of financial performance. Therefore, in order to meet the financial reporting objectives of accountability and decision making, an entity should provide users with information on future inflows and outflows that supplements information on the entity's financial position in the financial statements.
- BC7. The IPSASB acknowledges that the rationale for reporting long-term fiscal sustainability information in paragraph BC6 might indicate that for some entities such reporting should be required. However, the IPSASB concluded that it would be premature to issue an authoritative pronouncement, because reporting long-term fiscal sustainability information in GPFs is an area where practice is developing and the IPSASB wishes to encourage innovative and flexible approaches. This approach is consistent with the views of the majority of respondents to ED 46. The IPSASB notes that paragraph 4 of the RPG notes that it is good practice to follow this RPG.

Completion of the Conceptual Framework and the Social Benefits projects

- BC7A. The IPSASB recognized linkages between its work in developing RPG 1, the Conceptual Framework and accounting for social benefits. RPG 1 was published in 2013 when the work on the Conceptual Framework and Social Benefits projects were ongoing. In October 2014 and January 2019, the IPSASB finished these projects by publishing the Conceptual Framework and IPSAS 42, *Social Benefits*, respectively.

Scope

- BC8. The IPSASB considered whether the scope of the RPG should be limited to the consolidated national and whole-of-government levels. The IPSASB acknowledged that reporting long-term fiscal sustainability information is particularly relevant at these levels, but concluded that there might be significant user demand for such information at sub-national levels. The IPSASB therefore concluded that a narrow scope limited to the national and whole-of-government levels is not justified. The factors considered by the Board in determining whether an entity should report long-term fiscal sustainability information are discussed in paragraphs BC14-BC17.

Definitions

Long-Term Fiscal Sustainability

- BC9. The Consultation Paper noted that there is no universally accepted definition of long-term fiscal sustainability and included a working definition that long-term fiscal sustainability is "the ability of government to meet its service delivery and financial commitments both now and in the future." The IPSASB acknowledged the view that this definition is insufficiently rigorous and that a definition should be adopted that provides users with a clearer indication whether an entity's current economic position is sustainable. Such an approach might involve (a) linking current service delivery obligations to the maintenance of current taxation levels and (b) focusing on projected debt paths. An entity that can only meet current service delivery obligations and financial obligations by increasing taxation or current debt levels is identified as being in an unsustainable position. Macro-economists tend to adopt this more rigorous approach and focus on "explosive" debt paths, which is a term that connotes that existing service levels and existing benefits from entitlement programs cannot be sustained without major increases in levels of indebtedness.
- BC10. When this RPG was issued, the IPSASB decided to retain the definition of long-term fiscal sustainability used in the Consultation Paper for ED 46 and subsequently for this RPG, except for widening the scope to reflect that it can apply to all public sector entities (except [Government Business Enterprises]) (the term in square brackets is no longer used following the issue of *The Applicability of IPSASs* in April 2016) rather than limiting it to governments. In coming to this conclusion the IPSASB noted the need for governments and public sector entities to both (a) provide services and meet obligations relating to entitlement programs and (b) meet financial obligations, principally debt servicing. The IPSASB also noted that many governments have sovereign powers to enact legislation for new taxation sources and to vary the levels of existing taxation, while acknowledging that in a global environment the ability to increase taxation might be practically constrained

by a number of considerations. The IPSASB took the view that, provided an entity gives appropriate attention to the dimensions of long-term fiscal sustainability, as explained in paragraphs 27–40, users will be given adequate information about whether an entity can maintain existing service levels, meet obligations to the current and future beneficiaries of entitlement programs and meet financial obligations without increasing revenue from taxation and other sources or increasing borrowing.

Projections, Forecasts and Budgets

- BC11. Several respondents to ED 46 suggested that the relationship between projections, forecasts and budgets should be clarified. Given that there are no universally accepted definitions of these terms, the IPSASB decided to develop a definition of a projection to clarify the characteristics of information that should be used in calculating the projections and to ensure that only calculations that meet these characteristics are within the scope of the RPG.
- BC12. In developing its definition of a projection the IPSASB considered whether forward-looking financial information should be based on a strict adherence to legislation or regulation in force at the reporting date, or whether specific departures from legislation or regulation in force at the reporting date might be appropriate. The IPSASB recognized that there may be limited cases where departures from current legislation or regulation may be appropriate in order to provide more relevant information. A projection is therefore defined as “forward-looking financial information prepared on the basis of the entity’s current policy assumptions, and assumptions about future economic and other conditions.” Current policy assumptions are those “assumptions based on legislation or regulation in force at the reporting date with appropriate departures for defined circumstances.” Circumstances where departures from current legislation or regulation are appropriate are detailed in paragraph 43 and discussed in paragraphs BC31-34.
- BC13. Budgets and forecasts aim to provide details of intended outcomes. In contrast projections are not intended to provide approximations of actual outcomes. A budget is a plan of an entity’s anticipated revenues or receipts and anticipated expenses or expenditure over a specified period. It may be related to service outputs or outcomes in the period. A forecast provides prospective information that includes anticipated actions and interventions by the entity although these may not be reflected in current legislation or regulation or within the limited departures inherent in the definition of a projection. The IPSASB agreed that some of the information in budgets or forecasts might also be used for projections.

Determining Whether to Report Long-Term Fiscal Sustainability Information

- BC14. As discussed in paragraph BC8 the IPSASB concluded that the scope of the RPG should not be limited to particular levels of government. However, the IPSASB acknowledged that reporting long-term fiscal sustainability information might not be appropriate for all entities.
- BC15. The Consultation Paper questioned whether reporting long-term fiscal sustainability information is appropriate for individual controlled entities. This reservation was based on a tentative view that (a) the cost of producing the information for such entities is likely to be greater than the benefits to users, (b) the production of separate reports and disclosures by individual entities within an economic entity might be confusing to users and (c) it could be misleading if entities with limited tax-raising powers and a dependence on resources from entities at other tiers of government provide projections that are contingent on taxation decisions over which they have little or no control. Some respondents to the Consultation Paper challenged this view and suggested that there are cases where users for long-term fiscal sustainability information of controlled entities can be identified. The example of a local government entity controlled by a state or provincial government was cited. These respondents proposed that the test for whether an entity reports long-term fiscal sustainability information should be to assess whether potential users exist for this type of information. The IPSASB was persuaded by these arguments and the RPG reflects these views in paragraphs 12 and 13.
- BC16. The IPSASB acknowledged that direct evidence of the existence of users of long-term fiscal sustainability information might not be readily available. The IPSASB sought to identify characteristics which might indicate the existence of users across the three dimensions of long-term fiscal sustainability. The IPSASB had reservations about whether there would be significant numbers of users to justify the costs of reporting if entities did not have one or more of the following characteristics:
- (a) Significant tax and/or other revenue raising powers;
 - (b) Powers to incur significant debt; or
 - (c) The power and ability to determine the nature, level and method of service delivery including the introduction of new services.

BC17. The IPSASB believes that reporting long-term fiscal sustainability information is likely to be relevant at the whole of government level, consolidated national level, and for major sub-national entities such as regions, provinces, states and large local government entities (for examples, cities), which have tax raising powers enabling them to generate a significant proportion of their total revenues. The IPSASB remains of the view that reporting long-term sustainability information is unlikely to be appropriate for individual government departments and entities. This is because often they do not have tax raising powers, their expenditure is controlled through appropriations, and they do not have powers to incur debt.

Presenting Projections of Future Inflows and Outflows

BC18. The Consultation Paper considered three models for reporting long-term fiscal sustainability information and suggested that (a) the provision of additional statements providing details of projections and (b) summarized projections in narrative reporting were appropriate. Some respondents suggested that, although the Consultation Paper acknowledged that these reporting approaches were not mutually exclusive, the IPSASB should highlight that reporting long-term fiscal sustainability information just by displaying projections in statements is insufficient to meet user needs and that other presentation methods need to be deployed. The IPSASB was persuaded by this view and agreed to reflect this in paragraph 17 of the RPG).

BC19. The IPSASB considered whether it should recommend time horizons for projections for entities at particular levels of government. It acknowledged the view that standard time horizons for particular types of public sector entity might enhance comparability. The IPSASB decided that such benchmarks would be over-prescriptive and impractical. The scope of the RPG is such that standard time horizons would have to be determined for a wide range of entities, including individual reporting entities.¹⁰ In addition the fiscal autonomy of entities at the same level of government can differ markedly between jurisdictions. The IPSASB concluded, however, that it is good practice for entities to explain the reason for the time horizons that they select. The IPSASB considers that the extent of an entity's dependence on other entities for funding will have an impact on time horizons; the higher the level of dependence, the higher the likelihood of shorter time horizons.

BC20. The Consultation Paper included illustrative examples of tabular statements showing 75 year projections for key programs and activities. The IPSASB noted the view of some respondents that a focus on the position at the end of the time horizon may obscure events between the reporting date and the end of the time horizon. The IPSASB accepted this view and included guidance on the need to balance the QCs of verifiability, faithful representation and relevance in displaying projections in paragraph 25 of the RPG.

Addressing the Dimensions of Long-Term Fiscal Sustainability

BC21. The IPSASB considered that providing a flexible framework for the disclosure of information might help entities to organize the way in which they communicate information and ensure that information is a faithful representation of an entity's long-term fiscal sustainability information.

BC22. ED 46 included three dimensions of long-term fiscal sustainability, as follows:

- Fiscal capacity;
- Service capacity; and
- Vulnerability.

BC23. The description of vulnerability was derived from the definition of vulnerability in Statement of Recommended Practice 4 (SORP-4), *Indicators of Financial Condition* issued by the Canadian Public Sector Accounting Board (PSAB). The definition in SORP-4 is "the degree to which a government is dependent on sources of funding outside its control or influence or is exposed to risks that could impair its ability to meet its existing financial obligations both in respect of its service commitments to the public and financial commitments to creditors, employees and others." The IPSASB considered that a variant of this notion is particularly important for entities at sub-national levels which have limited taxation powers and are therefore exposed to decisions, over which they have no or very limited control, taken by other entities at other levels of government.

BC24. The descriptions of the other two dimensions in ED 46 were derived from the US Governmental Accounting Standards Board's (GASB)¹¹ definitions of "fiscal capacity" and "service capacity." The GASB defines fiscal capacity as "the government's ability and willingness to meet its financial obligations as they come due on an ongoing basis" and service capacity as "the government's ability and willingness to meet its commitments to provide services on an ongoing basis."

¹⁰ For example, such entities might include school boards or bodies responsible for water and drainage.

¹¹ *Preliminary Views of the Governmental Accounting Standards Board on Major Issues related to Economic Condition Reporting: Financial Projections.* (Governmental Accounting Standards Board: Norwalk, CT, USA, November 2011).

- BC25. When developing the RPG based on ED 46, the IPSASB considered whether the notion of vulnerability in the ED was too narrow and whether vulnerability is a more pervasive factor in the analysis of the long-term fiscal sustainability of an entity's finances. The IPSASB concluded that vulnerability is an aspect of all three dimensions. Therefore, the IPSASB decided to (a) explain how the notion of vulnerability affects each dimension of long-term fiscal sustainability and (b) change the name of the vulnerability dimension to the revenue dimension because its description relates to changes in revenues.
- BC26. The IPSASB also noted that the dictionary definition of "fiscal" includes revenue¹² while the description of fiscal capacity relates to the ability of the entity to meet financial commitments, in other words, its ability to maintain and service its debt. Therefore the IPSASB decided that the name of this dimension should be changed to the debt dimension to more closely reflect the description. The renaming of these two dimensions required a modification to the service capacity dimension so that the wording of the three dimensions is consistent. The IPSASB acknowledged that the dimensions are inter-related.
- BC27. The IPSASB noted that the approach taken by the PSAB and the GASB had similarities to the "dimensions" of sustainability developed by Allen Schick¹³ and discussed in the Consultation Paper.
- BC28. One of the dimensions that Schick discussed was "economic growth." The IPSASB considered that explicitly introducing a dimension of economic growth was inappropriate because the determinants of economic growth are complex and not under the control of the reporting entity. However, assumptions about economic growth will be critical to the development of projections and are likely to feature heavily in sensitivity analyses.

Principles and Methodologies

- BC29. The Consultation Paper discussed the principles that should be adopted for the inclusion of programs and activities in reporting long-term fiscal sustainability information and methodologies central to the outcome of projections. The areas addressed included whether projections should be based on current or future policy, the approach to revenue inflows, the approach to age-related and non-age-related programs and the approach to sensitivity analysis. The IPSASB considered whether, in order to meet the qualitative characteristic of comparability, the IPSASB should make firm recommendations on good practice.
- BC30. The IPSASB did not consider it appropriate to make firm recommendations on good practice because (a) the scope of the RPG includes all public sector entities and practice that is appropriate at one level of government may not be suitable elsewhere in the public sector, (b) while reporting long-term fiscal sustainability information has become a feature of financial management in an increasing number of jurisdictions it is at an early stage of development and (c) it is not the intention of the IPSASB to usurp the role of other professional groups with expertise in this area. In some cases the IPSASB has considered it appropriate to express a view on a preferred high level approach. For example, the IPSASB has taken the view that projections are likely to be most useful when they are based on current policy assumptions and encompass both inflows as well as outflows. The IPSASB also noted that, at the national level, the Organisation for Economic Cooperation and Development has recommended that projections should be updated on an annual basis.

Current Policy Assumptions

- BC31. Paragraphs 40–42 of ED 46 explained that an entity can depart from using current policy to calculate its projections (a) where there is a conflict between current policy and legal obligations and (b) where a policy has "sunset provisions."
- BC32. The IPSASB introduced the term "current policy assumptions" to clarify that current policy means current legislation or regulation with departures where appropriate. Current policy assumptions are applied to the entire projection period for inflows or outflows that are individually projected. The RPG gives examples of where a departure may be appropriate in paragraphs 44-46. The IPSASB noted that paragraph 58(e) of the RPG recommends that any departures from current legislation or regulation be disclosed together with the reasons for such departures.
- BC33. A respondent to ED 46 raised a concern that the concept of current policy should be broader than that proposed in the ED to deal with issues such as fiscal drag. Fiscal drag refers to the phenomenon that income tax inflows grow faster than the income it is levied on because, as an individual's income grows, an increasing proportion of it is taxed at a higher rate. Fiscal drag occurs if the rates and thresholds for the taxation of individuals are not adjusted over time, and is often addressed by governments through periodic increasing of tax thresholds.
- BC34. The IPSASB concluded that the issue of fiscal drag is addressed in paragraph 47 of the RPG because it permits current policy assumptions to be applied to the demographic and economic assumptions, including assumptions over inflation.

¹² The definition of fiscal is "of or relating to taxation, public revenues, or public debt" (Webster's Ninth New Collegiate Dictionary, 1984).

¹³ Allen Schick, *Sustainable Budget Policy: Concepts and Approaches* (OECD: Paris, 2005).

When a flow such as tax is modeled it may be based on a percentage of a variable such as GDP or reflect the application of current policy assumptions to the changing circumstances reflected in the demographic and economic assumptions.

Revision of RPG 1 as a result of the IPSASB's *The Applicability of IPSASs*, issued in April 2016

BC35. The IPSASB issued *The Applicability of IPSASs* in April 2016. This pronouncement amends references in all IPSASs as follows:

- (a) Removes the standard paragraphs about the applicability of IPSASs to “public sector entities other than GBEs” from the scope section of each Standard;
- (b) Replaces the term “GBE” with the term “commercial public sector entities”, where appropriate; and
- (c) Amends paragraph 10 of the *Preface to International Public Sector Accounting Standards* by providing a positive description of public sector entities for which IPSASs are designed.

The reasons for these changes are set out in the Basis for Conclusions to IPSAS 1.

Revision of RPG 1 as a result of *Improvements to IPSAS, 2021*

BC36. Stakeholders noted that the Basis for Conclusions (paragraphs BC1-BC7) in RPG 1 provided a background that highlighted the linkages between RPG 1, the Conceptual Framework and Social Benefits projects. RPG 1 indicated these projects as ongoing when RPG 1 was issued in July 2013. Since these projects have been completed, the IPSASB agreed to add paragraph BC7A in *Improvements to IPSAS, 2021* to indicate that the Conceptual Framework and Social Benefits projects were completed in October 2014 and January 2019, respectively.

**RPG 2—FINANCIAL STATEMENT DISCUSSION AND
ANALYSIS**

History of RPG

RPG 2, *Financial Statement Discussion and Analysis* was issued in July 2013.

Since then, RPG 2 has been amended by the following IPSASs:

- *The Applicability of IPSASs* (issued April 2016)

Table of Amended Paragraphs in RPG 2

Paragraph Affected	How Affected	Affected By
6	Deleted	The Applicability of IPSASs April 2016

FINANCIAL STATEMENT DISCUSSION AND ANALYSIS

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Objective

1. This Recommended Practice Guideline (RPG) provides guidance for preparing and presenting financial statement discussion and analysis. Financial statement discussion and analysis will assist users to understand the financial position, financial performance and cash flows presented in the general purpose financial statements (hereafter referred to as “financial statements”).

Status and Scope

2. The reporting of information in accordance with this RPG represents good practice. An entity preparing and presenting financial statement discussion and analysis is encouraged to follow this RPG. Compliance with this RPG is not required in order for an entity to assert that its financial statements comply with International Public Sector Accounting Standards (IPSASs).
3. Financial statement discussion and analysis should be presented at least annually and should use the same reporting period as that covered by the financial statements.
4. The reporting boundary for financial statement discussion and analysis should be the same as that used for the financial statements.
5. Financial statement discussion and analysis should be issued with the financial statements.
6. [Deleted]
7. Financial statement discussion and analysis should not be described as complying with this RPG unless it complies with all the requirements of this RPG.
8. In some jurisdictions, preparation and presentation of financial statement discussion and analysis is a legislative or regulatory requirement, or required by other externally imposed regulations. Entities are encouraged to disclose information about the impact of such requirements on compliance with this RPG.

Definition

9. The following term is used in this RPG with the meaning specified:

Financial statement discussion and analysis is an explanation of the significant items, transactions and events presented in an entity’s financial statements and the factors that influenced them.

Terms used in this RPG with the meanings specified in International Public Sector Accounting Standards (IPSASs) are set out in Appendix A.

Identification of Financial Statement Discussion and Analysis

10. Financial statement discussion and analysis should be clearly identified, and distinguished from the financial statements and from other information.
11. Separate identification of financial statement discussion and analysis enables users to distinguish:
 - (a) Financial statements prepared and presented under the accrual basis of accounting in accordance with IPSASs;
 - (b) Financial statement discussion and analysis prepared in accordance with this RPG; and
 - (c) Other information presented in an annual report or other document that may be useful to users but is not the subject of requirements in IPSASs or recommendations in RPGs (but could be the subject of guidance in other RPGs).
12. Financial statement discussion and analysis should identify the financial statements to which it relates.

Presenting Financial Statement Discussion and Analysis

13. Financial statement discussion and analysis provides information useful to users for accountability and decision-making purposes by enabling users to gain an insight into the operations of the entity from the perspective of the entity itself. It also provides the opportunity to reflect the entity’s interpretation of significant items, transactions and events affecting the financial position, financial performance and cash flows of the entity. Therefore, financial statement discussion and analysis complements the information in the financial statements.

14. Information in financial statement discussion and analysis should meet the qualitative characteristics of financial reporting taking into account the constraints on information included in general purpose financial reports (GPFRs)¹.

Content of Financial Statement Discussion and Analysis

15. The content of financial statement discussion and analysis should be consistent with the financial statements and the underlying items, transactions and events, as well as assumptions such as those relating to recognition and measurement.
16. Financial statement discussion and analysis should include the following, without merely replicating information in the financial statements:
- (a) An overview of the entity's operations and the environment in which it operates;
 - (b) Information about the entity's objectives and strategies;
 - (c) An analysis of the entity's financial statements including significant changes and trends in an entity's financial position, financial performance and cash flows; and
 - (d) A description of the entity's principal risks and uncertainties that affect its financial position, financial performance and cash flows, an explanation of changes in those risks and uncertainties since the last reporting date and its strategies for bearing or mitigating those risks and uncertainties.
17. The form and specific content of an entity's financial statement discussion and analysis should reflect the nature of the entity and the regulatory environment in which it operates.
18. Where financial statement discussion and analysis includes information that is also in the financial statements, it should not merely repeat what is in the financial statements, but should analyze and explain how items, transactions and events affect the entity's financial position, financial performance and cash flows. Financial statement discussion and analysis should include cross-references to the financial statements where appropriate to avoid duplication of information.

Overview of the Entity's Operations and Environment

19. An overview of the entity helps users to understand the entity's operations and how the environment in which it operates affects its financial statements. This information assists users' understanding of an entity's financial statements. Information provided about an entity's operations in financial statement discussion and analysis may include current information, and changes from the prior period, relating to:
- (a) The entity's mission and vision;
 - (b) The entity's governance (e.g., legislative or regulatory structure, management structure);
 - (c) The entity's relationships with other entities, with a focus on relationships that could significantly affect the entity's financial position, financial performance and cash flows (e.g., funding arrangements);
 - (d) External trends, events and developments in the legal, regulatory, social, political and macro-economic environment specific to the entity, which have or may have a significant impact on the entity's financial position, financial performance and cash flows (e.g., the impact of events in international markets on employment, the tax base, or interest rates); and
 - (e) The entity's main operations, including service delivery methods (e.g., outsourcing, service concession arrangements) and significant changes in them.

Information about the Entity's Objectives and Strategies

20. Financial statement discussion and analysis should discuss the entity's objectives and strategies relating to its financial position, financial performance and cash flows in a way that enables users of the financial statements to understand the entity's priorities and to identify the resources that must be managed to achieve these objectives and strategies. For example, such objectives and strategies could include managing surplus/deficit, and managing the levels of debt and reserves. Financial statement discussion and analysis should explain how achievement of the entity's objectives would be measured and over what time period progress would be measured.

¹ The qualitative characteristics of financial reporting are relevance, faithful representation, understandability, timeliness, comparability and verifiability. The constraints on information are materiality, cost-benefit and the balance between the qualitative characteristics. See Chapter 3 of the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* for further details.

21. Financial statement discussion and analysis should discuss significant changes in an entity's objectives and strategies from the previous period or periods.

Analysis of the Entity's Financial Statements

22. Financial statement discussion and analysis should include an analysis of significant changes and trends in an entity's financial position, financial performance and cash flows. An analysis of trends includes those financial statement items that are important and significant to gaining a better understanding of an entity's financial position, financial performance and cash flows and changes in financial position, financial performance and cash flows over a period of time.
23. Financial statement discussion and analysis should describe the significant items, transactions and events that have affected the financial position, financial performance and cash flows, without simply reiterating the information presented in the financial statements. Judgment is required in identifying the significant items, transactions and events.
24. If information from the financial statements has been adjusted for inclusion in financial statement discussion and analysis, that fact should be disclosed along with the nature of and reasons for the adjustments. When financial performance measures are derived from the financial statements, those measures should be reconciled to measures presented in the financial statements that have been prepared in accordance with IPSASs.
25. Comparative information should be disclosed for amounts presented in financial statement discussion and analysis when it is relevant to an understanding of the current period's financial statement discussion and analysis.
26. When an entity is required or elects to make its approved budget(s) publicly available, IPSAS 24, *Presentation of Budget Information in Financial Statements* requires a comparison of budget and actual amounts in the financial statements. IPSAS 24 also requires an explanation of material differences between the budgeted and actual amounts and permits an entity to disclose this information either in the notes to the financial statements or in other public reports. When an entity elects to include this information in its financial statement discussion and analysis, it should apply the guidance in IPSAS 24 to these disclosures.

Risks and Uncertainties

27. Financial statement discussion and analysis should discuss the entity's principal risks and uncertainties that affect its financial position, financial performance and cash flows and include an explanation of how this relates to the objectives and strategies of the entity. This information would help users to evaluate the impact of those risks in the current period (e.g., contingent liabilities disclosed in the financial statements or the use of foreign currency hedges to mitigate risk) as well as expected outcomes.
28. The principal risks and uncertainties can be external or internal risks; any description of these risks and uncertainties should cover exposures to both negative consequences and potential opportunities.
29. A discussion of how the entity manages its risks and uncertainties helps users obtain a faithful representation of the entity's exposure to risks that directly affect financial statement items, which allows them to evaluate the entity's financial position, financial performance and cash flows. Such disclosure may include the entity's decision to "self-insure" in respect of some risks, or to mitigate risk by transferring or sharing it through insurance.
30. A discussion of these risks and uncertainties would provide relevant information to users about exposure or vulnerability to concentrations of risks such as significant loans to particular regions or industries, or dependence on a particular source of revenue.
31. Risks and uncertainties that affect the financial position, financial performance and cash flows may have a pervasive effect on the financial statements. Therefore, information relating to these risks and uncertainties may be reported separately, or in relevant sections throughout financial statement discussion and analysis.

Terms in this RPG Defined in IPSASs

Term	Definition
Approved budget	The expenditure authority derived from laws, appropriation bills, government ordinances, and other decisions related to the anticipated revenue or receipts for the budgetary period.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, RPG 2.

Background

- BC1. The IPSASB approved a project in March 2008 to address “narrative reporting”. In developing this RPG, the IPSASB clarified that the scope of the project was to address only those reports that provide discussion and analysis specifically relating to an entity’s general purpose financial statements (“financial statements”) as set out in IPSAS 1, *Presentation of Financial Statements* and not broader types of reports that may be considered general purpose financial reports as envisaged in the IPSASB’s *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the *Conceptual Framework*). The IPSASB considers that it is important to provide narrative information related directly to the financial statements since this provides useful information for accountability and decision-making by users of financial statements.
- BC2. In undertaking this project, the IPSASB considered, under its *Process for Reviewing and Modifying IASB Documents*, whether to develop guidance that was converged with *Management Commentary*, an IFRS Practice Statement. The IPSASB did not consider this approach to be appropriate because the users identified in the Practice Statement are investors whereas Chapter 2 of the *Conceptual Framework* identifies different users, which results in different information needs related to the financial statements. On this basis the IPSASB decided it was important to develop guidance on financial statement discussion and analysis specific to the public sector. Financial statement discussion and analysis assists users of public sector entities’ financial statements by complementing and supplementing the financial statement explanations with insights and perspectives.
- BC3. Financial statement discussion and analysis is intended to address similar matters to reports that may be termed “management discussion and analysis” and “management commentary” in various jurisdictions. However, the IPSASB did not consider those terms to accurately describe the nature of the report in relation to the financial statements. The IPSASB decided it was important to link financial statement discussion and analysis to the financial statements because financial statement discussion and analysis is intended to explain the financial statements, and not to stand alone. The IPSASB considers the term “financial statement discussion and analysis” clearly defines the scope of applicability of this RPG and its close linkage to the financial statements.

Exposure Draft 47, *Financial Statement Discussion and Analysis*

- BC4. The IPSASB developed Exposure Draft (ED) 47, *Financial Statement Discussion and Analysis* which was issued in March 2012. This ED proposed that entities that prepare and present their financial statements in accordance with IPSASs should be required to prepare financial statement discussion and analysis. This meant that financial statement discussion and analysis would have the same level of authority as accrual-based IPSASs even though it related to a GPFR.
- BC5. In developing the ED the IPSASB considered that financial statement discussion and analysis provides additional information necessary to meet the objectives of financial statements. Furthermore, the IPSASB considered that the benefits of providing financial statement discussion and analysis would outweigh the costs of preparing it, as the information is used in the preparation of the financial statements, and tailored to the specific circumstances of the entity. The IPSASB therefore proposed that financial statement discussion and analysis should be prepared by all entities that prepare their financial statements in accordance with IPSASs.
- BC6. Some respondents to the ED raised the concern that entities might not be able to assert compliance with IPSASs applicable to the financial statements if they did not follow the proposed requirements in the ED (if issued as an IPSAS). In particular, respondents were concerned that financial statement discussion and analysis might still be considered to be a part of the IPSAS reporting framework even though the ED explicitly stated that financial statement discussion and analysis is not a component of the financial statements. Some of these respondents suggested that this would not be an issue if the ED was developed into non-authoritative guidance, e.g., a Recommended Practice Guideline (RPG).
- BC7. The IPSASB considered whether the ED should be developed as an IPSAS or an RPG. The IPSASB considered this issue in the context of whether or not authoritative pronouncements could be developed for GPFRs, an issue on which members had varying views. The IPSASB noted that the scope of its *Conceptual Framework* is not limited to general purpose financial statements.
- BC8. Respondents to the ED were split on this issue with a slight majority favoring the material not becoming an IPSAS. Of those not in favor of issuing an IPSAS, the majority of respondents expressed a clear view that it should be issued as guidance similar to the proposed RPG *Reporting on the Long-Term Sustainability of an Entity’s Finances*.

- BC9. As a well-established area of GPFs, an authoritative pronouncement on financial statement discussion and analysis would help entities meet the accountability objective of financial reporting since it would enable users to gain an insight into the operations of the entity from the perspective of the entity itself. Financial statement discussion and analysis is an explanation of the financial statements but is not part of the financial statements and therefore it is not required for the fair presentation of the financial statements.
- BC10. On balance the IPSASB decided that the ED should be developed into an RPG. The IPSASB considers that this RPG provides useful guidance for entities and its flexible application could benefit entities in jurisdictions that have local requirements or regulations. It will also promote comparability across entities that present financial statement discussion and analysis. Furthermore, the IPSASB considers that the RPG might encourage entities that are not accustomed to presenting financial statement discussion and analysis to provide users with this information.
- BC11. Because financial statement discussion and analysis contributes to meeting the accountability objective of financial reporting, the IPSASB decided that it should consider the authority of this pronouncement on financial statement discussion and analysis in the future.

Forward-Looking Information

- BC12. The IPSASB considered whether it should recommend that an entity disclose forward-looking information, such as forecasts. The IPSASB acknowledged concerns that in some jurisdictions providing forward-looking information might be seen as signaling political intent or committing a public sector entity to certain future actions. In addition, whether forward-looking information can be included in financial statement discussion and analysis will vary depending upon the regulatory and budgetary reporting environment in which the entity operates. Some members expressed the opinion that not including forward-looking information could have an impact on the ability of financial discussion and analysis to support decision-making of users and therefore its inclusion should be recommended. However, on balance the IPSASB decided not to recommend that an entity disclose forward-looking information, though such information may be provided if an entity so chooses.

Implementation Guidance and Illustrative Examples

- BC13. ED 47 included Implementation Guidance on qualitative characteristics, and illustrative examples of information about the entity's financial statements and variances and trends. The IPSASB decided to delete the implementation guidance and illustrative examples on the basis that entities preparing financial statement discussion and analysis should focus on the guidance in the RPG. Moreover, the IPSASB observed that best-practice examples are available from other sources.

Revision of RPG 2 as a result of the IPSASB's *The Applicability of IPSASs*, issued in April 2016

- BC14. The IPSASB issued *The Applicability of IPSASs* in April 2016. This pronouncement amends references in all IPSASs as follows:
- (a) Removes the standard paragraphs about the applicability of IPSASs to “public sector entities other than GBEs” from the scope section of each Standard;
 - (b) Replaces the term “GBE” with the term “commercial public sector entities”, where appropriate; and
 - (c) Amends paragraph 10 of the *Preface to International Public Sector Accounting Standards* by providing a positive description of public sector entities for which IPSASs are designed.

The reasons for these changes are set out in the Basis for Conclusions to IPSAS 1.

**RPG 3—REPORTING SERVICE PERFORMANCE
INFORMATION**

History of RPG

RPG 3, *Reporting Service Performance Information* was issued in March 2015.

Since then, RPG 3 has been amended by the following IPSASs:

- *The Applicability of IPSASs* (issued April 2016)

Table of Amended Paragraphs in RPG 3

Paragraph Affected	How Affected	Affected By
3	Deleted	The Applicability of IPSASs April 2016

REPORTING SERVICE PERFORMANCE INFORMATION
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Objective

1. This Recommended Practice Guideline (RPG) provides guidance on reporting service performance information in General Purpose Financial Reports (GPFRs). Service performance information is information on the services that the entity provides, an entity's service performance objectives and the extent of its achievement of those objectives. Service performance information assists users of GPFRs (hereafter termed "users") to assess the entity's service efficiency and effectiveness.

Status and Scope

2. The reporting of information in accordance with this RPG represents good practice. An entity reporting service performance information should aim to achieve the principles set out in this RPG. Compliance with this RPG is not required in order for an entity to assert that its financial statements comply with International Public Sector Accounting Standards (IPSASs).
3. Although this RPG does not apply directly to commercial public sector entities, the services provided by a commercial public sector entity controlled by the reporting entity are within the scope of this RPG.
4. Service performance information should not be described as complying with this RPG unless it complies with all the principles in this RPG.
5. This RPG outlines information to be presented. An entity may present additional information if such information is useful in meeting the objectives of financial reporting and meets the qualitative characteristics of financial reporting.
6. In some jurisdictions the presentation of service performance information is a legislative or regulatory requirement. Entities are encouraged to disclose information about the impact of such requirements on compliance with this RPG.
7. A jurisdiction may have established service performance reporting requirements that extend beyond the guidelines in this RPG. These could include, for example, greater specification of required information organization, requirements for a larger set of information to display or disclose, and/or specific performance indicators or specific types of performance that are required to be presented. In that case the entity is encouraged to ensure that information identified through application of both this guideline and jurisdictional requirements is presented.

Definitions

8. The following terms are used in this RPG with the meanings specified:

Effectiveness is the relationship between actual results and service performance objectives.

Efficiency is the relationship between (a) inputs and outputs, or (b) inputs and outcomes.

Inputs are the resources used by an entity to provide outputs.

Outputs are the services provided by an entity to recipients external to the entity.

Outcomes are the impacts on society, which occur as a result of, or are reasonably attributable to, the entity's outputs.

Performance indicators are quantitative measures, qualitative measures, and/or qualitative descriptions of the nature and extent to which an entity is using resources, providing services, and achieving its service performance objectives.

A service performance objective is a description of the planned result(s) that an entity is aiming to achieve expressed in terms of inputs, outputs, outcomes or efficiency.

9. The Implementation Examples that accompany RPG 3 illustrate the terms defined above.

Effectiveness

10. When reporting on its effectiveness the entity reports the extent to which one or more of its service performance objectives has been achieved. The more effectively an entity operates as a service provider, the better will be its actual results when measured against its planned results.

Efficiency

11. An efficiency indicator can be used to show when a service is being provided more (or less) efficiently compared to a reference such as:
 - (a) Previous reporting periods;

- (b) Expectations;
- (c) Comparable service providers; or,
- (d) Benchmarks.

12. If the same quantity and quality of outputs can be produced at less cost than before then production efficiency has improved and an efficiency indicator designed to report that type of efficiency gain will show an improvement. Similarly, if the quality of a service improves so that the outcomes achieved are better than those previously attained, with other variables such as service quantity (outputs) and cost holding constant, then this represents an increase in efficiency, and an efficiency indicator designed to capture that type of efficiency gain will show an improvement. The converse—quality decreases so that outcomes are worse, with other variables such as service quantity (outputs) and cost holding constant—would indicate less efficient service provision.

Inputs

13. Resources used to produce outputs may include:

- (a) Human resources or labor;
- (b) Capital assets such as land, buildings and vehicles;
- (c) Cash and other financial assets; and,
- (d) Intangible assets such as intellectual property.

14. Inputs can be reported in terms of costs incurred or quantities used to produce outputs.

Outputs

15. Services provided by an entity to external recipients include:

- (a) Services provided directly to individuals and institutions—for example, health or education services or the provision of goods such as food or books;
- (b) Services provided indirectly to individuals and institutions—for example, services which aim to develop, promote, protect or defend a community, institution, country, or community values and rights;
- (c) Transfers to individuals and institutions—for example, cash transfers and the provision of economic incentives such as tax incentives;
- (d) Policies, regulations or legislation to achieve public policy goals, which includes, for example, revenue related legislation and the enforcement of such legislation; and
- (e) Collection of taxes and other revenues.

16. The receipt of services by recipients external to the entity is a critical factor in deciding whether services are outputs, rather than services consumed internally as part of an entity's production of outputs.

Outcomes

17. An entity's outcomes could be impacts affecting society as a whole or impacts on particular groups or institutions within society. Outcomes could be relatively direct impacts on recipients of the entity's services. They could also be impacts on others that are not recipients of the entity's services but who benefit indirectly from those services.

18. Outcomes may include, for example, changes to educational achievements within society, changes to poverty and crime levels, or changes to the health of different groups within society.

19. There may be a strong, direct causal link between an entity's actions and its outcomes, but this will not always be the case. Factors beyond the entity's control may intervene to either hinder or facilitate the entity's achievement of outcomes.

Performance Indicators

20. Inputs, outputs, outcomes, efficiency and effectiveness are types of performance indicators.

21. Performance indicators may be quantitative measures—for example, the number of outputs produced, the cost of services, the time taken to provide a service, or a numerical target for an outcome. Performance indicators may be qualitative

measures—for example descriptors such as poor/good/excellent or satisfactory/unsatisfactory, which could include service quality ratings by service recipients, citizens or experts. Use of quantitative and qualitative measures may help users with:

- (a) Their assessment of whether service performance objectives have been achieved; and,
- (b) Inter-period and inter-entity comparisons of service performance.

22. A performance indicator could also be in the form of a qualitative description. A qualitative description may be necessary to provide users with relevant and understandable information on service performance where there is a high level of complexity and judgment involved in a particular service.

Service Performance Objectives

23. Service performance objectives may be expressed using performance indicators of inputs, outputs, outcomes or efficiency, or through a combination of one or more of these four performance indicators. A service performance objective may also be expressed using a narrative description of a desired future state resulting from provision of services.
24. Service performance objectives will generally be specific, measurable, achievable, realistic and time-bound.
25. An entity's service performance objectives may all be expressed in the same type of performance indicator; for example, all expressed in outcomes. They may also be expressed in different types of performance indicators; for example, some of the service performance objectives may be expressed in outcomes, while others are expressed in outputs and/or inputs.
26. A single service may contribute to achievement of one or more service performance objectives. Several services may contribute to the same service performance objective.

Reporting Boundary

27. For reporting service performance information the reporting boundary of the entity should be the same as that used for the financial statements.
28. The performance indicators presented will be relevant to the controlling entity's own service performance objectives. Unlike consolidated financial statements, which combine the finances of controlled entities, service performance information reported by a controlling entity is not usually a combination of the services reported by its controlled entities.

Annual Reporting and Reporting Period

29. Service performance information should be reported at least annually.
30. Service performance information should cover the same reporting period as that covered by the financial statements. However, a consideration of users' needs and an assessment of costs and benefits may indicate that the reporting period should be different from that covered by the entity's financial statements. This may be the case, for example, when service performance information presented by a controlling entity is based on service performance information reported by controlled entities that have a different reporting period.
31. Service performance objectives may require periods longer than one year to achieve. Users will need information on progress towards such multi-year service performance objectives. Paragraph 53 addresses the type of service performance information that can be presented to show annual progress towards multi-year service performance objectives.

Principles for Presentation of Service Performance Information

32. An entity should present service performance information that is useful to users for accountability and decision making purposes. Presentation should enable users to assess the extent, efficiency and effectiveness of the entity's service performance. It should be appropriate to the entity's service performance objectives and make the relationship between the entity's service performance objectives and its service performance achievements clear.
33. When used in combination with the information in an entity's financial statements, service performance information should enable users to assess the entity's finances in the context of its achievement of service performance objectives and vice versa.
34. The service performance information presented should take account of the entity's specific circumstances, such as:
- (a) The services that the entity provides;
 - (b) The nature of the entity; and,
 - (c) The regulatory environment in which the entity operates.

35. The presentation of service performance information should achieve the qualitative characteristics of financial reporting, while applying the pervasive constraints on information in GPFs. (The *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the Conceptual Framework) describes the qualitative characteristics and pervasive constraints.)
36. Aggregation or disaggregation of service performance information should be at a level that conveys a meaningful understanding of the entity's service performance achievements. The level of aggregation should not be so high as to conceal or obscure performance, while the level of disaggregation should not be so low as to result in detailed listings that also obscure performance and reduce understandability. Information reported should be sufficiently specific for users to hold the entity accountable for its service performance, particularly its performance with respect to its service performance objectives.
37. Comparability to other entities can be difficult to achieve in the context of service performance information since diverse services are provided. Even where two entities provide exactly the same service they may have different service performance objectives with the result that they need to report different, non-comparable performance indicators. Inter-entity comparability may need to be traded off against relevance, so that service performance objectives and their related performance indicators are chosen to be relevant to the service performance situation of the entity. Alternatively the needs of users may indicate that performance indicators that are comparable with those of other entities delivering the same services are relevant to the entity, and the two qualitative characteristics—comparability and relevance—are aligned.

Selection of Service Performance Information

Information for Display

38. The following information should be displayed:
- (a) Service performance objectives;
 - (b) Performance indicators; and,
 - (c) Total costs of the services.
39. With respect to performance indicators and the total costs of the services, the entity should display:
- (a) Planned and actual information for the reporting period; and
 - (b) Actual information for the previous reporting period.
40. Where service performance information includes information that is also in the financial statements, cross-references to the financial statements should be presented so that users can assess the information within the context of the financial information reported in the financial statements.
41. Information found in an entity's legislation and planning documents (budget statement, mission statement, strategic plan, funding agreements, corporate plan, etc.) will usually help to identify the service performance objectives and performance indicators that are relevant to the entity.

Service Performance Objectives

42. Where the entity's service performance objectives change, the information presented should reflect the change. For example, an entity may initially have service performance objectives related to increasing either the inputs or outputs related to its services, and then later re-focus its performance towards improving either the services' efficiency or effectiveness. That change should be reflected in the service performance information that the entity presents.

Performance Indicators

43. Judgment is needed to determine the most suitable set of performance indicators to be reported. The overriding principle is that indicators should be selected on the basis of their importance to users and their usefulness in assessing the entity's achievements in terms of its service performance objectives. For performance indicators to be relevant they should link directly to one or more of the entity's service performance objectives. Alignment between the different indicators presented—for example between input, output and/or outcome performance indicators—and the service performance objectives helps users to assess the relationship between resources and results, and how resource availability may have influenced achievement of service performance objectives.
44. The performance indicators presented should allow users to assess how efficiently and effectively the entity has used its resources to deliver services and achieve its service performance objectives.

45. Where an entity has publicly reported planned performance indicators the actual performance indicators presented will usually be consistent with those previously made public. Those entities that publish their budget information and apply IPSAS 24, *Presentation of Budget Information in Financial Statements*, should consider the relationship between that information and the service performance information that they report.
46. An entity is encouraged to display information about its intended outcomes and its achievements with respect to those outcomes.
47. There may be a large number of performance indicators that can be presented for an entity's service performance objectives. To ensure that the information is understandable and to avoid overwhelming users, entities generally will need to identify only those few key performance indicators that will best meet the needs of users for information that meets the objectives of financial reporting.
48. Performance indicators that involve quantification should be able to be measured reliably. Where performance indicators can be generated by a transaction processing system the use of such a system will support the verifiability and timeliness of reported information.
49. When selecting performance indicators entities should ensure that the indicators presented will provide a representationally faithful description of the achievement of service performance objectives. There may be trade-offs between different aspects of service performance, such that one aspect improves while another aspect deteriorates. Information presented should be neutral. Entities should avoid any tendency to present performance indicators that are biased towards reporting positive results. This helps to ensure that the qualitative characteristics are met and users can be confident that the performance indicators faithfully represent the entity's service performance.
50. Ease of measurement is likely to be a consideration when selecting performance indicators, but it should be secondary to the needs of users. The performance indicators presented should not over-emphasize easily measured dimensions.
51. In some situations a qualitative description (also called narrative information) should be presented as a performance indicator. This could be the case where service performance achievements cannot be reduced to a small set of quantitative or qualitative measures because the service:
- (a) Is complex;
 - (b) Involves interrelated factors; and
 - (c) Involves a large number of different possible indicators of success or progress, all of which involve judgment as to their relative importance.
52. Information reported on any particular service may include one or more different types of performance indicators; quantitative measures, qualitative measures and/or qualitative descriptions.

Multi-year Service Performance Objectives and Performance Indicators

53. The extended timeframe of multi-year service performance objectives should not be a deterrent to reporting multi-year objectives and disclosing progress towards their achievement, although ways to report on progress in a cost-effective way may need to be developed. Alternative or proxy measures that indicate progress towards achievement of the service performance objective may be able to be presented in the short-term, until information on achievement of the multi-year service performance objective is available. For example, where an entity establishes both annual outputs and longer term, multi-year outcomes for one or more service area there may be scope to treat annual reporting against outputs as indicative of progress towards achievement of the outcomes, with actual outcomes reported less frequently.

Total Costs of Services and Disaggregated Cost Information

54. In addition to display of the total costs of services, an entity may also choose to present disaggregated cost information. Disaggregated cost information could, for example, be costs related to individual service performance objectives, outcomes, service areas, individual services, the costs of outputs, or costs related to particular inputs. Users' assessment of efficiency may be supported through provision of costs related to either outputs or outcomes.

Planned and Actual Service Performance

55. Planned and actual service performance information should be reported consistently so that users' assessments of effectiveness are facilitated. Wherever possible, entities should report on the same performance indicators, with the same methodology and parameters for their computation, as that established before the start of the reporting period. This enables users to compare actual performance with planned performance at the end of the reporting period.

56. Consistency of performance indicators over several years facilitates long-term trend analysis. But such consistency should not be pursued at the expense of:
- (a) Improving the quality of performance indicators; or,
 - (b) Aligning indicators with changed expectations from stakeholders.
57. An entity may need to address the issue of how to report on changes to planned service performance that occurred during the reporting period. This situation may arise, for example, when stakeholders revise their service performance expectations during the reporting period, resulting in an amendment to service performance objectives. Service performance objectives may also change as a result of a public sector combination, where accountability for services is transferred from one entity to another or reporting needs to be on services previously provided by two different entities and now provided by a single, merged entity. In these situations it may be possible for the entity to report against both the original and the revised service performance objectives. The reason for, and the impact of, these changes could be outlined in narrative discussion and analysis, so that users have the information they need to understand reasons for variances between service performance objectives at the beginning of the reporting period and actual achievements, while also understanding the degree of actual achievement against the more up-to-date, revised service performance objectives.

Information for Disclosure

58. Judgment is needed to decide what information should be disclosed so that users:
- (a) Understand the basis of the displayed service performance information; and,
 - (b) Receive a concise overview of the entity's service performance, which highlights the main issues relevant to their assessment of that service performance.

Basis of Displayed Service Performance Information

59. An entity should disclose sufficient information on the basis of displayed service performance information to enable users to evaluate whether the information on service performance objectives, performance indicators and total costs achieves the qualitative characteristics of financial reporting.
60. An entity should disclose information on the sources of displayed service performance information.
61. The following information should be disclosed:
- (a) An explanation of the displayed service performance objectives, which describes how they have been established, the need for them to be achieved, and the relationship(s) between the service performance objectives and:
 - (i) The displayed performance indicators, and
 - (ii) The entity's overall objectives.
 - (b) An explanation of the relationship(s) between related performance indicators. (For example, information on the extent of alignment between input, output and/or outcome indicators, where the inputs and outputs contribute to achievement of a particular outcome.)
 - (c) An explanation of the basis for information aggregation (or disaggregation), which addresses the level of detail reported.

Disaggregated Information on Costs

62. If an entity chooses to present disaggregated information on costs then the basis for cost determination should be disclosed.
63. Cost determination information includes information such as:
- (a) Cost allocation policies;
 - (b) The treatment of direct and indirect service related expenses; and/or
 - (c) A reconciliation or a comparison between the costs of services presented and total expenses.

Controlling Entity Disclosures

64. Where a controlling entity reports on services provided by its controlled entities the controlling entity should disclose information that explains the respective roles and responsibilities for service performance within the economic entity.

Disclosures when Reporting Period is Different

65. When the service performance information covers a reporting period different from that for the entity's financial statements, the following information should be disclosed:
- (a) The fact that the reporting period is not the same as that for the financial statements;
 - (b) Why there is a difference; and,
 - (c) If financial information is included in the service performance report, either
 - (i) The reporting period of the financial statements from which the information has been derived, along with information to facilitate access to those financial statements; or
 - (ii) The source of the financial information reported, if the information has not been derived from the entity's financial statements, along with information to facilitate access to that source.
66. When the reporting period for information on some services is different from the reporting period of the entity's service performance report the following information should be considered for disclosure:
- (a) The services affected,
 - (b) The applicable reporting period(s), and
 - (c) An explanation for the difference(s).

Disclosures when Separate from the Financial Statements

67. Paragraphs 72–75 below address the location of service performance information in a GPFR. Where service performance information is presented separately from the GPFR that includes the financial statements, the following information should be presented:
- (a) The name of the entity;
 - (b) Where the entity is a controlling entity, a description of the group of entities controlled by the reporting entity;
 - (c) Where the entity is a controlled entity, the identity of the controlling entity;
 - (d) The reporting date and the reporting period covered by the service performance information;
 - (e) The financial statements to which the service performance information relates and sufficient information necessary for users to locate the financial statements;
 - (f) The presentation currency, as defined in IPSAS 4, *The Effects of Changes in Foreign Exchange Rates*; and,
 - (g) The level of rounding used.
68. Where service performance information is presented in the GPFR that includes the financial statements, the applicable IPSAS(s) establishes that this information should be presented.

Narrative Discussion and Analysis

69. The entity should disclose narrative discussion and analysis on its service performance information. Narrative discussion and analysis complements the displayed service performance information by enabling users to gain insight from the entity on:
- (a) Aspects of service performance that the entity considers should be highlighted; and
 - (b) Factors that affected service performance achievements during the reporting period.
70. Narrative discussion and analysis should provide a concise overview of the entity's service performance that:
- (a) Discusses the degree to which service performance objectives have been met;
 - (b) Provides balanced explanations of the information displayed, which cover both positive and negative aspects of the entity's service performance; and
 - (c) Facilitates users' assessments of the efficiency and effectiveness of the entity's service performance.
71. The Implementation Examples that accompany RPG 3 illustrate types of information that could be included in narrative discussion and analysis.

Location of Service Performance Information

72. An entity may present service performance information either:
- As part of a GPFR that includes the financial statements; or,
 - In a separately issued GPFR.
73. The following factors should be considered when making this decision:
- The extent to which the service performance information needs to be reviewed within the context of information in the financial statements, including information on budget-actual comparisons;
 - Whether the needs of users and the qualitative characteristics are enhanced if the service performance information is included in the same GPFR as the financial statements or in a separate GPFR;
 - Application of the pervasive constraints on information, including whether the benefits of including the information in the same GPFR as the financial statements justify the additional costs (if any) involved; and,
 - Jurisdiction-specific requirements which could specify either that service performance information should be located in the same GPFR as the financial statements or in a separate GPFR.
74. With respect to point (a) in paragraph 73 above, an important factor in this decision is likely to be whether the primary objective of providing the service performance information is:
- To inform assessments on resource allocation decisions for the provision of services, in which case there is likely to be value in associating the reporting of service performance information with the financial statements that are compared to budget allocations; or
 - To inform assessments on policy or strategy decisions, in which case there is likely to be value in associating the reporting of service performance information with information on policies or strategy.
75. Where an entity chooses to present its service performance information in a separate GPFR from the financial statements the separate GPFR should be issued on a timely basis, which will usually be demonstrated through issuance at the same time as the financial statements or, if not at the same time, then very close to issuance of the financial statements.

Organization of Service Performance Information

76. The organization of service performance information within a GPFR should enable users to:
- Understand an entity's service performance, including its achievement of service performance objectives;
 - Assess the entity's service efficiency and effectiveness; and
 - Use the service performance information for the purposes of accountability and decision making.
77. The service performance information should be organized so that connections are clear between displayed information and:
- Disclosures on the basis of the displayed information, and
 - Narrative discussion and analysis.
78. One way to organize service performance information is in a "statement of service performance", which involves organizing information into a tabular or statement form. A statement of service performance can support understandability and comparability when the performance indicators presented are quantitative measures or qualitative measures reported on multiple services.
79. Where service performance information is presented through narrative or case studies a tabular approach is unlikely to be appropriate. In some cases a mixture of case studies and one or more tables or statements will be appropriate.
80. Entities may use several levels of reporting in order to achieve a balance between being:
- Concise enough to be understandable; and,
 - Providing sufficient detail with respect to multiple aspects related to each service performance objective.
81. The use of several levels of reporting allows the display of concise reporting at higher levels, and display or disclosure of more detailed coverage at lower levels, where service areas, for example, could be disaggregated into two or more individual services.
82. IPSAS 18, *Segment Reporting*, applies to entities' identification of segments. It describes service segments and identifies factors that should be considered when grouping services into segments for financial reporting purposes.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, RPG 3.

Background

Project Initiation, Consultation Paper and Decision to Develop Guidance

BC1. The IPSASB's project on reporting service performance information began with a review of national standards, guidance, and regulatory requirements for service performance reporting (or its equivalent) from selected national jurisdictions, the United Nations, and the Organization for Economic Co-operation and Development. No two jurisdictions have identical service performance reporting frameworks, but there are similarities in the service performance information that is reported. Consideration of these similarities and of commonly used terms provided the basis for the Consultation Paper (CP), Reporting Service Performance Information, issued in 2011. The CP proposed a principles based framework for reporting service performance information and a standard terminology.

Development of a Recommended Practice Guideline

BC2. In 2013 the IPSASB decided that information additional to that included in the financial statements should presently be addressed through development of a Recommended Practice Guideline (RPG). Therefore a draft RPG, ED 54, Reporting Service Performance Information, was developed for reporting service performance information. This RPG is based on the service performance reporting framework developed for the CP, revised for the IPSASB's decisions during its review of responses to the CP and its subsequent review of responses to ED 54. This RPG is underpinned by the Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities (the Conceptual Framework).

Overall Approach of RPG—Guidance on Decisions and Minimum Characteristics

- BC3. During development of this RPG, the IPSASB considered whether its overall approach should aim to:
- (a) Establish minimum characteristics of service performance information, consistent with an RPG's role as providing guidelines on good practice and requirements; or
 - (b) Provide a framework that identifies decisions that preparers need to make and guidance on those decisions, consistent with the framework approach in the CP and an RPG's function as guidance.
- BC4. Given the diversity of services and reporting contexts, the IPSASB decided that the RPG should not attempt to standardize service performance reporting, but focus on achievement of principles. At the same time, the core type of service performance information that should be presented. This approach was decided on the basis that guidelines are needed on what type of information should be presented and it is possible to identify broad categories of information—for example, information on service performance objectives—that are applicable to all entities that report service performance information.
- BC5. In developing an RPG for reporting service performance information the IPSASB acknowledged the challenge in developing guidance that would be useful when applied to diverse services, diverse service performance objectives, and diverse accountability and decision-making contexts world-wide. Arguably service performance reporting quality depends in part on the extent to which it meets the particular information needs arising from the services provided and the context for their provision. For example, a report that tells the story of factors influencing progress toward critical targets may look quite different to a report that provides an account of services delivered for the resources provided. The IPSASB considered these matters and was of the view that it would be most helpful to develop an RPG that identifies the decisions that preparers will need to make, then provides guidance on how such decisions should be made, rather than an RPG that establishes minimum standards.
- BC6. The IPSASB's view is that principles applicable to reporting service performance information provide useful guidance, without attempting to establish global requirements that may not be appropriate for the variety of different services and different service delivery contexts that exist globally. Service performance information is a developing area, which means that the RPG should not be overly prescriptive.
- BC7. Some respondents to the ED were concerned about an apparent contradiction between RPGs as pronouncements that do not establish requirements and paragraph 5 of the ED, which stated that compliance with the RPG involves compliance with all of its requirements. The IPSASB decided that the phrase "compliance with requirements" in this paragraph should be replaced with "compliance with principles". The basis for this is twofold. First, the RPG establishes principles which entities then use to guide their decisions on what service performance information they report. Second, while the paragraph still uses the idea of "compliance", the IPSASB considers that this is consistent with the RPG's role as a recommended

guideline. The nature of an RPG as a guideline is established by the allowance for entities to not follow a particular RPG—in its entirety—without impacting negatively on the entity’s IPSAS compliance. Preparers (or jurisdictions) may also choose to apply part of the RPG and, for example, progressively move towards full compliance, at which point compliance can be asserted. Nonetheless the specific content of an RPG involves a set of principles that establish good practice. An RPG may also, depending on the topic addressed, involve more flexibility of application than is the case for an IPSAS. This is the case for this RPG which includes options as to presentation and uses principles to guide preparers’ decisions on what information to present.

Scope

- BC8. When this RPG was issued, the IPSASB considered whether the RPG should apply to [Government Business Enterprises (GBEs)] (the term in square brackets is no longer used following the issue of *The Applicability of IPSASs* in April 2016). While acknowledging that GBEs provide services and may report service performance information on those services the IPSASB decided that this RPG should apply to all public sector entities other than GBEs. When this RPG was issued, this was consistent with the Preface to International Public Sector Accounting Standards, which stated that the IPSASB developed accounting standards and other publications for use by public sector entities, other than GBEs. This exclusion from the scope should not be read as implying that the guidance could not be applied by GBEs or that there is any barrier to GBEs applying this guidance.
- BC9. In reaching this conclusion the IPSASB noted that where a controlling entity reports service performance information according to the recommendations in this RPG it may provide information on services provided by one or more controlled GBEs. Although the GBEs’ own reporting was not within the scope of this RPG, the IPSASB decided that the information reported by the controlling entity—about the GBEs’ services—needed to follow the RPG’s requirements, if the controlling entity was to assert compliance with the RPG.
- BC10. The IPSASB considered whether this RPG should apply to entities in national jurisdictions which already have extensive service performance information reporting requirements for their public sector entities—requirements that may extend beyond the principles approach to information which is set out in the RPG. The IPSASB’s view is that, in such circumstances, the entity will need to ensure that jurisdictional requirements are met. While the RPG does not set out detailed comprehensive and specific requirements, this does not represent an encouragement to report less than is already reported under national or other requirements, nor is this viewed as in conflict with more extensive reporting. Paragraphs 6–7 of the RPG addresses the relationship between the RPG and jurisdictional requirements for service performance information, explaining that the RPG does not preclude the presentation of additional information and more extensive jurisdictional requirements would apply in addition to the guidelines in the RPG. The IPSASB concluded that the RPG adequately addresses this issue and the RPG should be able to be applied to entities in jurisdictions where extensive service performance information reporting requirements already exist.

Definitions of Terms

- BC11. In reaching its view on the need for standardized service performance terminology the IPSASB noted that although entities use some terminology consistently, many of those entities have not defined some or all of the terms they use. Moreover, the same terms sometimes have different meanings in different jurisdictions. On this basis, the IPSASB concluded that a standardized service performance terminology was necessary to support the understandability and comparability of service performance information reported by entities in GPFRs.
- BC12. The IPSASB developed the defined terms in the RPG, by basing them, as far as possible, on terms already used in jurisdictions with a well thought through and explicit approach to, and extensive experience in, service performance reporting.
- BC13. During the review of responses on the CP and the ED, and then during subsequent development of the RPG the IPSASB revised the definition of an effectiveness indicator. The CP definition was: “Effectiveness indicators are measures of the relationship between outputs and outcomes.” This implies that the relationship between outputs and outcomes is relatively simple to measure. After further consideration the IPSASB considered that the relationship between outputs and outcomes is likely, in many situations, to be more complex than the simple relationship underpinning the original definition. Furthermore, the IPSASB considered that effectiveness is better understood to be the degree to which an entity is successful in achieving its service performance objectives. On this basis the IPSASB decided that effectiveness indicators show the extent to which an entity has achieved its services performance objectives
- BC14. During development of the CP and ED 54, and the subsequent review of responses to ED 54, the IPSASB considered whether to include “economy indicators” in the RPG’s set of defined terms. IPSASB members decided to exclude economy indicators because the term is both confusing and unnecessary given other terms defined in the RPG.

“Economy indicators” do not represent something additional to the ideas conveyed by either inputs or efficiency, for which the RPG establishes clear definitions. The IPSASB noted that the RPG’s approach to selection of service performance information allows jurisdictions to assess “economy”, whatever the meaning that a particular national jurisdiction gives that word. For example, the RPG supports the presentation of information on costs, on other inputs, and on efficiency.

- BC15. Economy is a commonly used term in the context of service performance reporting. However different jurisdictions have different meanings for economy. For some jurisdictions economy means lower costs for service delivery without reference to impact on quantity and/or quality of services delivered. Other jurisdictions consider that this first view is not really economy and that using “economy” to describe situations where costs are reduced but service quantity and/or quality is negatively impacted could be misleading to users of GPFs. A second view of economy is that it is only achieved if service delivery is maintained or enhanced, when costs or other inputs are reduced. This second view of economy fits the definition of “efficiency” in the RPG. Indeed, there is a third group of national jurisdictions that does not use the term “economy” on the basis that the term can be confusing and it overlaps with efficiency. Therefore the RPG does not define “economy indicators” and does not use the term “economy”.

Reporting Entity

- BC16. Service performance information should support the users of the GPFs as they hold the entity accountable for its service provision and use of resources and make decisions affecting that entity. On that basis a majority of the IPSASB considered that service performance information should be prepared for the same reporting entity as for the financial statements. To be consistent with coverage in RPGs 1 and 2 (see paragraph 14 of RPG 1 and paragraph 4 of RPG 2) the wording in RPG 3 focuses on “reporting boundary” rather than reporting entity. In reaching this conclusion the IPSASB also noted that the RPG’s accountability and decision making focus is not designed to apply to supply chains, networks or other combinations of individual entities that may be able to influence each other but do not have the ability to control.
- BC17. Several respondents to the ED suggested that the RPG should also provide guidance for reporting on programs or policies that involve a group of entities that are not under common control, that is, “cross-boundary” reporting. The IPSASB acknowledged that there is a trade-off between service performance reporting that applies the same reporting entity boundary as for the financial statements and flexible boundaries that provide scope for cross-boundary reporting. A focus on the same reporting entity as for the financial statements has the benefit of following lines of control and supporting organization-focused accountability, while also facilitating both collection of service performance information and the integration of such information with financial information in the entity’s financial statements. However there are cases where no single entity is accountable for a program or policy and requiring cross-boundary reporting, aligned with the program or policy, would provide information that better explains service performance related to that program or policy. The IPSASB considered expanding the RPG’s scope to also include guidance for cross-boundary reporting on “programs” or “sets of activities that contribute to the same outcome(s)”. The IPSASB decided that the RPG should remain focused on reporting by the same entity as that for the financial statements. This does not prevent national jurisdictions from adapting the RPG’s principles and guidance for application to cross-boundary reporting.
- BC18. The IPSASB considered concerns expressed by respondents to the CP and the ED over controlling entities being required to report all services provided by their controlled entities. That could have the result that information becomes too detailed and lengthy to meet the qualitative characteristics and support users’ assessments for accountability and decision making. The IPSASB decided to include further explanation in the RPG to address this concern. On this basis the RPG states that controlling entities should report against their own service performance objectives rather than attempt to aggregate all those services provided by controlled entities.

Annual Reporting and Reporting Period

- BC19. The IPSASB considered whether service performance information should be reported annually, when service performance objectives, whether expressed in outcomes, outputs or inputs, may require periods longer than one year to achieve. The majority of IPSASB members considered that service performance information should be reported annually because this is important to ensure that users’ have the information they need for the purposes of accountability and decision-making. To address the existence of multi-year service performance objectives the IPSASB decided that the RPG could encourage entities to disclose information on their progress towards multi-year service performance objectives. The IPSASB noted that responses to the ED indicated generally strong support for annual reporting. The IPSASB confirmed that service performance information should be presented annually and use the same reporting period as that for the financial statements, unless users’ needs require a different period.

Scope to Report More Frequently

BC20. Some respondents to the ED were concerned that it did not allow entities to report more frequently than annually. The IPSASB agreed with respondents who argued in favor of scope for more frequent reporting, noting that this is likely to increase transparency and accountability. As one respondent stated, more frequent reporting also can encourage “management dialogue between all those involved in the evaluated public policy mission and improves the management process by increasing the accountability of the public manager.” The IPSASB decided to use the phrase “should be reported at least annually”, which allows for more frequent reporting and is the same phrase as that used in IPSAS 1, Presentation of Financial Statements, to address reporting frequency.

Reporting Against Multi-Year Performance Objectives

BC21. The IPSASB considered concerns raised by some respondent to the ED that annual reporting could have negative consequences for outcome reporting, including the possibility that annual reporting could have the unintended effect of reducing the extent to which entities report outcomes. The IPSASB noted that for some outcomes annual measurement is very expensive and measurable change showing progress towards outcome achievement will not emerge for two or more years. One respondent noted that annual reporting in such cases may even be misleading. This problem is not restricted to service performance objectives focused on outcomes, but can also occur for outputs and input reporting. To address this concern the RPG includes explicit coverage on use of proxy measures and provides scope for entities to report outputs or inputs as indicative of progress towards achievement of outcomes or other types of multi-year service performance objectives.

Service Performance Information Issued at Same Time as the Financial Statements

BC22. The IPSASB considered whether the RPG should state that service performance information should be issued at the same time as the financial statements. The IPSASB noted that issuance at the same time as the financial statement supports timeliness, but may be very difficult for some entities to achieve. The IPSASB decided that, while acknowledging that it is desirable for service performance to be reported at the same time as the financial statements, the RPG should not state that this is necessary.

Controlling Entity and Controlled Entities with a Different Reporting Period

BC23. The IPSASB considered situations in which a controlling entity includes information on services that are provided by controlled entities with a different reporting period from that of the controlling entity. Ideally all the service performance information reported should cover the same reporting period. However there are situations where the benefits of aligning the information with the controlling entity’s reporting period do not outweigh the costs involved. For example, some public sector entities provide service performance reports to donors who require a different reporting period from that for the entities’ financial statements. The additional costs of preparing service performance reports for each reporting period (donors and financial statements) may not justify the benefits. On this basis the IPSASB decided that the RPG should acknowledge the possibility that some of the service performance information reported may be for a different reporting period and address this through additional disclosures.

Two Approaches for Reporting Service Performance Information

BC24. In developing this RPG the IPSASB acknowledged that there are differing approaches to reporting service performance information, including approaches that are more output-focused and approaches that are more outcome-focused. A more outputs-focused approach reports information about the services provided. This type of information is oriented towards resource providers and aims primarily to report on the services received for resources provided and whether resources have been used efficiently, although there is scope to widen the focus to include information about outcomes. A more outcome-focused approach tells a performance story, which generally reports on the achievement of outcomes, although there is scope to relate this performance story back to the costs of services. The information reported explains how well the entity is doing in terms of achieving its objectives, where those objectives are described in terms of outcomes.

BC25. The IPSASB considered whether the RPG should include guidance specifically tailored for each approach, but decided against this on the basis that the RPG’s focus on achievement of objectives can be applied to either approach. Allowing entities to tailor their reporting to their objectives means that entities or jurisdictions do not need to fit their individual approach into either an output-focused approach or an outcome-focused approach in order to apply the RPG. This means that the RPG’s content will be useful to a variety of entities applying different approaches. Entities’ service performance objectives may even relate to inputs, when their reporting of service performance information is at an early stage. However, the ideal to which entities should, over time, aspire is the reporting of service performance information that reports comprehensively on both outcomes and outputs, along with information that allows users to assess the efficiency

and effectiveness of both. This is consistent with the IPSASB's view, discussed below, that the performance indicators presented should form a holistic system such that they communicate a coherent, integrated view of the entity's service performance.

Principles for Presentation of Service Performance Information

BC26. The RPG sets out principles applicable to the presentation of service performance information, which includes principles applicable to decisions on information selection, location and organization. The RPG identifies factors that should be considered when making presentation decisions and generally proposes information that should be considered for presentation, in light of those principles, rather than prescribing an extensive list of information requirements. This principles-based approach is consistent with the IPSASB's decisions on the RPG's overall approach, developed during the consultation phase and further considered during both development of the ED and the IPSASB's review of responses to the ED. Although the RPG identifies the type of information that all entities should present, it does not prescribe an extensive set of information. The IPSASB has maintained the principles based approach proposed in the CP and then exposed in the ED on the basis that the principles-based approach:

- (a) Allows entities the flexibility they need to report service performance information that is relevant and appropriate to their service performance objectives and will meet the needs of users of the information;
- (b) Reduces the risk of "disclosure overload", which undermines the extent to which a report on service performance meets the needs of users and does not achieve either the qualitative characteristics or provide benefits in excess of the costs; and
- (c) Requires entities to apply principles that will result in the presentation of the service performance information that users need for the purpose of accountability and decision-making.

BC27. The IPSASB determined that the key principles for reporting service performance information should be based on the users' needs that such information should meet, as established through consultation and with reference to the experience of different jurisdictions. The principles are consistent with the Conceptual Framework and have involved application of the Conceptual Framework to the reporting of service performance information.

Presentation of Service Performance Information

Consultation Paper's Dimensions and Components of Service Performance Information

BC28. The CP explained that there are four dimensions of service performance on which information should be presented. The four dimensions—why, what, how and when—relate to an entity's:

- (a) Service performance objectives;
- (b) Performance indicators;
- (c) Comparison between planned and actual performance; and
- (d) Time series that allow users to assess either changes in service provision over time or progress towards a multi-year goal.

BC29. The RPG's coverage of information selection addresses these four dimensions when it establishes that an entity should report:

- (a) Information on an entity's service performance objectives, including the need or demand for these objectives to be achieved (the "why" dimension);
- (b) Performance indicators to show achievements with respect to service performance objectives (the "what" dimension);
- (c) Comparisons of actual performance to planned (or targeted) results, including information on the factors that influence results (the "how" dimension); and
- (d) Annually on service performance information presenting actual information for the current and the previous reporting period (the "when" dimension).

BC30. The CP also established components of service performance information, which relate to these four dimensions. The RPG's coverage of information selection addresses the CP's components, which are:

- (a) Narrative discussion of the achievement of objectives;
- (b) Information on the "parameters" of the service performance information reported (termed "basis" in the RPG); and

- (c) Information on the entity's service performance objectives, and its achievement of those service performance objectives.

Principles Rather than Specific Requirements

BC31. The IPSASB acknowledged that entities' presentation of service performance information will vary, depending on:

- (a) The services that the entity provides;
- (b) The nature of the entity; and
- (c) The regulatory environment or other context within which the entity operates.

BC32. Because services provided, service performance objectives, and applicable service performance indicators depend on these different factors, the IPSASB decided that the RPG should not identify specific performance indicators that must be presented. Instead, it should identify broad types of information that should be reported and provide guidance on achievement of the qualitative characteristics when selecting service performance information.

BC33. The RPG identifies different types of performance indicators that could be presented, but does not require that particular performance indicators be presented. While efficiency and effectiveness indicators directly address those aspects of performance, the RPG's objective of providing information for users to assess efficiency and effectiveness does not mean that those two types of performance indicators must be presented. For example, efficiency can be calculated using information about outputs and their cost. Effectiveness can be assessed using information on service performance objectives and results achieved against those service performance objectives.

Information that Conveys a Coherent, Integrated View of the Entity's Service Performance

BC34. The IPSASB considered that the principles focused approach was appropriate because it allows entities at an early stage of developing service performance reporting to meet the RPG's guidelines and report service performance information consistent with their existing reporting capabilities. Nonetheless, the IPSASB's view is that good quality service performance information needs to be reported so that users can assess an entity's service performance, including both its achievement of objectives and the extent to which it has used resources efficiently and effectively to deliver outputs and achieve outcomes. Ideally the set of performance indicators presented should form a holistic system such that they communicate a coherent, integrated view of the entity's service performance.

Selection of Performance Indicators

BC35. The IPSASB considered whether the RPG should require entities to report all five types of performance indicators—inputs, outputs, outcomes, efficiency and effectiveness—for the services that they provide. This would result in comprehensive coverage of an entity's service performance, but it might not reflect an entity's actual service performance focus. In practice it is likely that an entity's service performance objectives will change over time. For example, service performance objectives may initially focus on inputs, then outputs and efficiency, and then outcomes. If an entity is able to adjust its reporting of performance indicators to align them with its service performance objectives, then the information presented is more likely to be useful to users and meet the qualitative characteristics, while supporting achievement of the financial reporting objectives. On that basis the IPSASB decided that the RPG should not require reporting of all five types of indicators but should instead provide guidance on how an entity should choose the types of performance indicators that it reports.

BC36. The IPSASB also considered whether the RPG should require entities to report outcome indicators. Outcome information is important to users, because it focuses on the ultimate reason for service provision, which is the impact that services have on the community. However outcome information can be very difficult for entities to provide, particularly when they are at an early stage in developing their services performance reporting or in situations where the reporting entity is one of many entities contributing to the same outcome(s). On that basis the IPSASB decided that the RPG should encourage but not require entities to present information on outcomes.

Total Costs of Services

BC37. The IPSASB considered providing guidelines on what costs should be included in the total costs of services. Costing of services involves management accounting considerations. The meaning of total costs of services may be jurisdiction specific and/or entity specific. Entities may report total costs of services that are equivalent to the total expense they present in their financial statements. Alternatively entities may exclude some costs, for example overhead, or some expense types, for example borrowing costs, with the result that the total costs of services differs from the total expenses presented in the financial statements. On this basis the IPSASB decided not to stipulate what is meant by the total costs of services.

Location of Service Performance Information

BC38. The IPSASB considered whether service performance information should be located in the same report as the financial statements or in a separate GPFR. It noted that while many national jurisdictions treat service performance information as different in nature and therefore preferably kept separate from information provided with the financial statements, there are also jurisdictions that integrate service performance information into the same report as the financial statements, treating the two sets of information as complimentary. There are benefits to both approaches. In order to allow for jurisdictional differences the IPSASB decided that the RPG should allow entities to report service performance information either in the same report as the financial statements or in a separate report.

Organization of Service Performance Information

BC39. The IPSASB considered whether the RPG should:

- (a) Propose one way that service performance information should be organized, with the main method considered being a tabular form, described as a “statement of service performance”; or
- (b) Provide principles that should be applied to guide jurisdictions and/or preparers when they choose between different possible information organization approaches.

BC40. The IPSASB noted that in some jurisdictions there are requirements that service performance information be reported in a “statement of service performance”. In other jurisdictions preparers apply principles to identify how best to organize information, with reference to the particular types of services, desired outcomes, or planned achievements on which information needs to be reported. Organizing information into a tabular or statement form can support understandability and comparability when numerical or “summary descriptive” performance indicators (e.g. “satisfactory or unsatisfactory”) are reported on multiple services. But service achievements could be misrepresented or poorly described if a statement format is the only form of presentation permitted.

BC41. The IPSASB decided that the RPG should focus on principles applicable to this decision. By focusing on principles rather than stipulating a standard reporting structure, the RPG allows the choice of information organization to be tailored to:

- (a) The nature of the services on which performance information is presented;
- (b) The needs of users, so that it supports achievement of the objectives and qualitative characteristics of financial reporting; and
- (c) The regulatory context, including the regulatory environment in which the entity operates.

BC42. Although this could result in less standardization, and reduced comparability between entities, service performance information differs from financial statements information due to the diversity of services reported. Unless the performance indicators themselves are comparable, a single presentation format will not provide the benefits of inter-entity comparability, but will sacrifice the benefits to be gained from allowing the organization of information to be tailored to an entity’s service performance objectives and services provided so that it meets the needs of users.

Revision of RPG 3 as a result of the IPSASB’s *The Applicability of IPSASs*, issued in April 2016

BC43. The IPSASB issued *The Applicability of IPSASs* in April 2016. This pronouncement amends references in all IPSASs as follows:

- (a) Removes the standard paragraphs about the applicability of IPSASs to “public sector entities other than GBEs” from the scope section of each Standard;
- (b) Replaces the term “GBE” with the term “commercial public sector entities”, where appropriate; and
- (c) Amends paragraph 10 of the *Preface to International Public Sector Accounting Standards* by providing a positive description of public sector entities for which IPSASs are designed.

The reasons for these changes are set out in the Basis for Conclusions to IPSAS 1.

Illustrative Examples

These examples accompany, but are not part of, RPG 3.

- IE1. The examples in this appendix portray hypothetical situations. Although some aspects of the examples may be present in actual situations, all facts and circumstances of a particular situation would need to be evaluated when applying RPG 3. Where a cost is identified the amount is expressed in “currency units” (CU).
- IE2. The first part of this appendix lists examples of terms defined in the RPG. It is not intended to be an exhaustive list of examples for all defined terms. The examples illustrate the meaning of different terms usually through reference to an entity that provides health services. The examples focus on one service—the provision of vaccinations to infants in order to prevent measles. The entity uses a range of inputs to produce its outputs (measles vaccinations). Those outputs are then expected to cause (directly or indirectly) the desired outcome(s).
- IE3. The second part of this appendix provides an illustrative list of information that could be included in an entity’s service performance narrative analysis and discussion.

Part 1: Examples of Defined Terms

- **Service Performance Objectives (SPO):**

RPG 3 states that service performance objectives may be expressed using performance indicators of inputs, outputs, outcomes or efficiency, or through a combination of one or more of these four performance indicators. The following are examples of service performance objectives that have these different forms of expression. The first example is of a service performance objective that has a focus on inputs, the second has a focus on outputs, the third has a focus on outcomes, and then the last example has a focus on efficiency.

- To apply 1,200 full-time equivalent days of medical staff time to vaccination services.
- To provide 20,000 vaccinations to infants.
- To reduce the percentage of infants who contract measles annually from 65% to 2% within five years i.e. by the end 20XX.
- To reduce the total cost per vaccination from CU5 to CU4.

- **Input:** The number of full-time equivalent staff days used to provide vaccinations against measles.

- **Outputs:** The number of infants vaccinated against measles.

- **Outcome:** A reduction in the number of infants that contract measles. (The reduction could be expressed in absolute terms (5,000 fewer incidents of measles) or as a percentage reduction (a 35% percentage reduction in infants contracting measles).

RPG 3 states that outcomes could be impacts affecting society as a whole or impacts on particular groups or institutions within society. Outcomes could be relatively direct impacts on recipients of the entity’s services. They could also be impacts on others that are not recipients of the entity’s services but who benefit indirectly from those services. RPG 3 also states that factors beyond the entity’s control may intervene to either hinder or facilitate the entity’s achievement of outcomes. The first example below illustrates an outcome that affects a particular group within society. The second and third examples illustrate a direct impact on service recipients and an indirect impact on non-recipients. The fourth example illustrates a situation where factors beyond the entity’s control intervenes to facilitate the entity’s achievement of an outcome.

- A 35% reduction in the incidence of measles for infants within the lowest socio-economic decile.
- A reduction in the number of incidents of measles experienced by recipients of measles vaccinations provided by the entity is an example of a direct impact on the recipients of the entity’s services.
- Children going to the same schools as those that vaccinated children attend but who have not received a vaccination will also be impacted indirectly by the entity’s vaccination services, because their risk of contracting measles is reduced.
- An outbreak of measles in a nearby region leads to extensive media coverage of measles related health risks and an increased vaccination rate in that nearby region covered by another health services provider. These factors facilitate achievement of the entity’s outcome to reduce the incidence of measles in its own region. The factors evident in the other region (measles outbreak, media coverage and increased vaccination rate) are outside of the control of the entity.

- **Efficiency:**

RPG 3 states that efficiency is the relationship between (a) inputs and outputs, or (b) inputs and outcomes. The two examples in the first bullet point below illustrate efficiency expressed as the relationship between inputs and outputs. The example in the second bullet point illustrates efficiency expressed in terms of inputs and outcomes.

- “Cost per infant vaccinated” is an example of an efficiency indicator that relates outputs (vaccinations) to an input (cost). Efficiency may also be expressed in terms of other inputs such as, for example, number of staff or staff time. For example, 1,000 vaccinations annually per qualified medical staff member.
- “Cost per reduction in number of infants contracting measles” is an example of an efficiency indicator that relates an outcome (reduction in number of infants contracting measles) to an input (cost).

- **Effectiveness:**

RPG 3 states that effectiveness is the relationship between actual results and service performance objectives. Therefore an assessment of effectiveness depends on the type of service performance objectives that the entity has presented. The three examples below illustrate effectiveness for different service performance objectives. The first example illustrates effectiveness where the service performance objective was expressed in terms of inputs, the second in terms of outputs, and the third in terms of an outcome.

- The service performance objective was to dedicate 20,000 hours of medical staff time to provision of measles vaccinations during the year ended 31 March 20XX. The actual result achieved was 18,000 hours of medical staff time. Therefore the entity effectiveness in this area was 90%.
- The service performance objective was to provide 100,000 measles vaccinations to infants during the year ended 31 March 20XX. The actual result achieved was 99,000 vaccinations. Therefore the entity’s effectiveness in this area was 99%.
- The service performance objective was to reduce the number of infants that contract measles by 3,000 compared to the previous year. The actual result achieved was a 3,000 reduction in infants contracting measles. Therefore the entity’s effectiveness in this area was 100%.

- **Performance indicator—Qualitative Description:**

RPG 3 states that performance indicators are quantitative measures, qualitative measures, and/or qualitative descriptions of the nature and extent to which an entity is using resources, providing services, and achieving its service performance objectives. The example below illustrates a performance indicator expressed as a qualitative description:

A government department (the Ministry) responsible for supporting the government’s relationships with other nations, including trade relationships, uses the following qualitative description as one of its performance indicators:

Engagement with Latin America during this year is expected to include several successful ministerial-led business missions to national governments and ministerial engagement in two regional forums. The Ministry will provide host and other support for ministerial level visits from several countries in the region, and undertake bilateral foreign policy consultations. Consultations will include advocacy of free trade agreements. The diplomatic network in several Latin America countries will be expanded through additional consulates and honorary consuls.

Part 2: Narrative Discussion and Analysis—Types of Information

The following list provides examples of the different types of information that could be included in narrative discussion and analysis to help users’ assessment of an entity’s service performance:

- Particular service performance achievements, deficiencies and issues.
- Identification and discussion of the factors that may have influenced achievement (or non-achievement) of service performance objectives.
- Effectiveness indicators.
- Discussions of differences between planned and actual achievements.
- Comparisons of indicators:
 - Over time;
 - To milestones; and/or,
 - Between actual and planned results.

- (f) Reasons for change(s), if the service performance objectives or performance indicators presented have changed compared to those presented for the previous year.
- (g) Where an entity has multi-year service performance objectives, narrative about progress towards their achievement.
- (h) Where outcomes are reported, information on the extent to which outcomes can be attributed to the entity's activities.
- (i) Significant lessons learned during the reporting period with respect to the entity's service performance including, where relevant, plans on ways to address issues affecting service performance and areas that require further evaluation.
- (j) Identification and discussion of the risks associated with the delivery of services and, if risk assessments for services have been carried out, information on how such risk trade-off decisions are informed and managed.
- (k) Identification and discussion of the consequences—intended and unintended, direct and indirect—of the services provided.

If an entity provides a discussion of differences between planned and actual achievements this discussion could include, for example:

- (a) Identification of the size of the variances; and
- (b) Factors contributing to the variances. (For example, external factors, efficiencies or inefficiencies in internal processes, resource availability, or government service delivery decisions.)

The achievement of outcomes is often influenced by factors outside of the entity's control. If an entity provides narrative discussion and analysis on outcomes the disclosures should be sufficient to ensure that users do not overestimate the entity's role with respect to either improving or worsening outcomes. Where outcome information is displayed, information on the following may be useful for users:

- (a) The extent to which the outcomes can be attributed to the entity's activities, and
- (b) Other factors that may have influenced the outcomes.

The delivery of public services often follows a risk assessment, involving clear parameters around tolerance of different types of risks, including the risk of false positives and false negatives with respect to intervention decisions. Information on how an entity assesses risks as part of service delivery can support users' understanding of an entity's service performance.

GLOSSARY OF DEFINED TERMS

This Glossary contains all terms defined in the 42 accrual basis International Public Sector Accounting Standards (IPSASs) approved up to January 31, 2022. A list of these IPSASs is located on the inside back cover of the Glossary. This Glossary does not include terms defined in the Cash Basis IPSAS, *Financial Reporting under the Cash Basis of Accounting*. Users should refer to that Cash Basis IPSAS for these terms.

Definitions

References to accrual basis IPSASs are by Standard number and paragraph number. For example, 1.7 refers users to IPSAS 1, *Presentation of Financial Statements*, paragraph 7. References set out in brackets indicate a minor variation in wording.

Term	Definition	Location
12-month expected credit loss Applicable for periods beginning on or after January 1, 2023.	The portion of lifetime expected credit losses that represent the expected credit losses that result from default events on a financial instrument that are possible within the 12 months after the reporting date.	41.9
accounting policies	The specific principles, bases, conventions, rules, and practices applied by an entity in preparing and presenting financial statements.	3.7
accrual basis	A basis of accounting under which transactions and other events are recognized when they occur (and not only when cash or its equivalent is received or paid). Therefore, the transactions and events are recorded in the accounting records and recognized in the financial statements of the periods to which they relate. The elements recognized under accrual accounting are assets, liabilities, net assets/equity, revenue, and expenses.	1.7
acquired operation	The operation that the acquirer gains control of in an acquisition.	40.5
acquirer	The entity that gains control of one or more operations in an acquisition.	40.5
acquisition	A public sector combination in which one party to the combination gains control of one or more operations, and there is evidence that the combination is not an amalgamation.	40.5
acquisition date	The date on which the acquirer gains control of the acquired operation.	40.5
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	Changes in the present value of the defined benefit obligation resulting from: (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.	39.8
agricultural activity	The management by an entity of the biological transformation and harvest of biological assets for: • Sale; • Distribution at no charge or for a nominal charge; or • Conversion into agricultural produce or into additional biological assets for sale or for distribution at no charge or for a nominal charge.	27.9
agricultural produce	The harvested produce of the entity's biological assets.	27.9
amalgamation	Gives rise to a resulting entity and is either: (a) A public sector combination in which no party to the combination gains control of one or more operations; or (b) A public sector combination in which one party to the combination gains control of one or more operations, and in which there is evidence that the combination has the economic substance of an amalgamation.	40.5

Term	Definition	Location
amalgamation date	The date on which the resulting entity obtains control of the combining operations.	40.5
amortization	The systematic allocation of the depreciable amount of an intangible asset over its useful life.	31.16
amortized cost of a financial asset or financial liability Applicable for periods beginning on or after January 1, 2023.	The amount at which the financial asset or financial liability is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any loss allowance.	41.9
annual budget	An approved budget for one year. It does not include published forward estimates or projections for periods beyond the budget period.	24.7
appropriation	An authorization granted by a legislative body to allocate funds for purposes specified by the legislature or similar authority	24.7
approved budget	The expenditure authority derived from laws, appropriation bills, government ordinances, and other decisions related to the anticipated revenue or receipts for the budgetary period.	24.7
assets	Resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity.	1.7
asset ceiling	The present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.	39.8
assets held by a long-term employee benefit fund	Assets (other than non-transferable financial instruments issued by the reporting entity) that: <ul style="list-style-type: none"> (a) Are held by an entity (a fund) that is legally separate from the reporting entity and exists solely to pay or fund employee benefits; and (b) Are available to be used only to pay or fund employee benefits, are not available to the reporting entity's own creditors (even in bankruptcy), and cannot be returned to the reporting entity, unless either: <ul style="list-style-type: none"> (i) The remaining assets of the fund are sufficient to meet all the related employee benefit obligations of the plan or the reporting entity; or (ii) The assets are returned to the reporting entity to reimburse it for employee benefits already paid. 	39.8
bearer plant	A living plant that: <ul style="list-style-type: none"> (a) Is used in the production or supply of agricultural produce: (b) Is expected to bear produce for more than one period: and (c) Has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales. 	17.13, 27.9
benefits	The advantages an entity obtains from its involvement with other entities. Benefits may be financial or non-financial. The actual impact of an entity's involvement with another entity can have positive or negative aspects.	35.14
binding arrangement (for a service concession arrangement)	Describes contracts and other arrangements that confer similar rights and obligations on the parties to it as if they were in the form of a contract.	32.8
binding arrangement (for a joint arrangement)	An arrangement that confers enforceable rights and obligations on the parties to it as if it were in the form of a contract. It includes rights from contracts or other legal rights.	35.14
biological asset	A living animal or plant.	27.9
biological transformation	Comprises the processes of growth, degeneration, production, and procreation that cause qualitative or quantitative changes in a biological asset.	27.9

Term	Definition	Location
borrowing costs	Interest and other expenses incurred by an entity in connection with the borrowing of funds.	5.5
budgetary basis	The accrual, cash, or other basis of accounting adopted in the budget that has been approved by the legislative body.	24.7
carrying amount (of an intangible asset)	The amount at which an asset is recognized after deducting any accumulated amortization and accumulated impairment losses.	31.16
carrying amount (of investment property)	The amount at which an asset is recognized in the statement of financial position.	16.7
carrying amount (of property, plant, and equipment)	The amount at which an asset is recognized after deducting any accumulated depreciation and accumulated impairment losses.	17.13
carrying amount of a liability	The amount at which a liability is recognized in the statement of financial position.	10.7
carrying amount of an asset	The amount at which an asset is recognized in the statement of financial position, after deducting any accumulated depreciation and accumulated impairment losses thereon.	10.7
cash	Comprises cash on hand and demand deposits.	2.8
cash equivalents	Short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.	2.8
cash flows	Inflows and outflows of cash and cash equivalents.	2.8
cash-generating assets	Assets held with the primary objective of generating a commercial return.	21.14
cash-generating unit	The smallest identifiable group of assets held with the primary objective of generating a commercial return that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets.	26.13
change in accounting estimate	An adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not correction of errors.	3.7
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
collective services	Services provided by a public sector entity simultaneously to all members of the community that are intended to address the needs of society as a whole.	19.18
combining operation	An operation that combines with one or more other operations to form the resulting entity in an amalgamation.	40.5
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
Applicable up to periods beginning on or before December 31, 2024.		
commencement date of the lease	The date on which a lessor makes an underlying asset available for use by a lessee.	43.5
Applicable for periods beginning on or after January 1, 2025		
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

Term	Definition	Location
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 in which the assets, liabilities, net assets/equity, revenue, expenses and cash flows of the controlling entity and its controlled entities are presented as those of a single economic entity.	34.6
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
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 consideration	Usually an obligation of the acquirer to transfer additional assets or equity interests to the former owners of an acquired operation as part of the exchange for control of the acquired operation if specified future events occur or conditions are met. However, contingent consideration also may give the acquirer the right to the return of previously transferred consideration if specified conditions are met.	40.5
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 Applicable up to periods beginning on or before December 31, 2024.	That portion of the lease payments that is not fixed in amount, but is based on the future amount of a factor that changes other than with the passage of time (e.g., percentage of future sales, amount of future use, future price indices, future market rates of interest).	13.8
contract Applicable for periods beginning on or after January 1, 2025	For the purpose of this Standard, is an agreement between two or more parties that creates enforceable rights and obligations.	43.5
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 (i) distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to (ii) distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or (b) Can be sold, exchanged, transferred, or redeemed.	1.7

Term	Definition	Location
control	An entity controls another entity when the entity is exposed, or has rights, to variable benefits from its involvement with the other entity and has the ability to affect the nature or amount of those benefits through its power over the other entity.	2.8
control of an asset	Arises when the entity can use or otherwise benefit from the asset in pursuit of its objectives, and can exclude or otherwise regulate the access of others to that benefit.	23.7
controlled entity	An entity that is controlled by another entity.	35.14
controlling entity	An entity that controls one or more entities.	35.14
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
cost plus or cost- based contract	A construction contract in which the contractor is reimbursed for allowable or otherwise defined costs and, in the case of a commercially based contract, an additional percentage of these costs or a fixed fee, if any.	11.4
costs of disposal	Incremental costs directly attributable to the disposal of an asset, excluding finance costs and income tax expense.	21.14
costs to sell	The incremental costs directly attributable to the disposal of an asset, excluding finance costs and income taxes. Disposal may occur through sale or through distribution at no charge or for a nominal charge.	27.9
credit-adjusted effective interest rate	The rate that exactly discounts the estimated future cash payments or receipts through the expected life of the financial asset to the amortized cost of a financial asset that is a purchased or originated credit-impaired financial asset. When calculating the credit-adjusted effective interest rate, an entity shall estimate the expected cash flows by considering all contractual terms of the financial asset (for example, prepayment, extension, call and similar options) and expected credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate (see [IPSAS 41] paragraphs AG156–AG158), transaction costs, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the cash flows or the remaining life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments).	41.9
Applicable for periods beginning on or after January 1, 2023.		
credit-impaired financial asset	A financial asset that is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred. Evidence that a financial asset is credit-impaired include observable data about the following events: <ul style="list-style-type: none"> (a) Significant financial difficulty of the issuer or the borrower; (b) A breach of contract, such as a default or past due event; (c) The lender(s) of the borrower, for economic or contractual reasons relating to the borrower’s financial difficulty, having granted to the borrower a concession(s) that the lender(s) would not otherwise consider; (d) It is becoming probable that the borrower will enter bankruptcy or other financial reorganization; (e) The disappearance of an active market for that financial asset because of financial difficulties; or (f) The purchase or origination of a financial asset at a deep discount that reflects the incurred credit losses. <p>It may not be possible to identify a single discrete event—instead, the combined effect of several events may have caused financial assets to become credit-impaired.</p>	41.9
Applicable for periods beginning on or after January 1, 2023.		

Term	Definition	Location
credit loss Applicable for periods beginning on or after January 1, 2023.	The difference between all contractual cash flows that are due to an entity in accordance with the contract and all the cash flows that the entity expects to receive (i.e., all cash shortfalls), discounted at the original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets). An entity shall estimate cash flows by considering all contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) through the expected life of that financial instrument. The cash flows that are considered shall include cash flows from the sale of collateral held or other credit enhancements that are integral to the contractual terms. There is a presumption that the expected life of a financial instrument can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the expected life of a financial instrument, the entity shall use the remaining contractual term of the financial instrument.	41.9
credit risk	The risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.	30.8
credit risk rating grades	A rating of credit risk based on the risk of a default occurring on the financial instrument	30.8
currency risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.	30.8
current replacement cost	The cost the entity would incur to acquire the asset on the reporting date.	12.9
date of adoption of IPSASs	The date an entity adopts accrual basis IPSASs for the first time, and is the start of the reporting period in which the first-time adopter adopts accrual basis IPSASs and for which the entity presents its first transitional IPSAS financial statements or its first IPSAS financial statements.	33.9
decision maker	An entity with decision-making rights that is either a principal or an agent for other parties.	35.14
deemed cost	An amount used as a surrogate for acquisition cost or depreciated cost at a given date.	33.9
deficit or surplus	Is: (a) The present value of the defined benefit obligation less (b) The fair value of plan assets (if any).	39.8
defined benefit plans	Post-employment benefit plans other than defined contribution plans.	39.8
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.	39.8
depreciable amount	The cost of an asset, or other amount substituted for cost, less its residual value.	17.13
depreciation	The systematic allocation of the depreciable amount of an asset over its useful life.	17.13
derecognition Applicable for periods beginning on or after January 1, 2023.	The removal of a previously recognized financial asset or financial liability from an entity's statement of financial position.	41.9
derivative Applicable for periods beginning on or after January 1, 2023.	A financial instrument or other contract within the scope of this Standard with all three of the following characteristics. (a) Its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying').	41.9

Term	Definition	Location
	(b) It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.	
	(c) It is settled at a future date.	
development	The application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.	31.16
distributions to owners	Future economic benefits or service potential distributed by the entity to all or some of its owners, either as a return on investment or as a return of investment.	1.7
dividends or similar distributions	Distributions to holders of equity instruments in proportion to their holdings of a particular class of capital	41.9
Applicable for periods beginning on or after January 1, 2023.		
economic entity	A controlling entity and its controlled entities.	1.7, 35.14
economic life	Either:	13.8
Applicable up to periods beginning on or before December 31, 2024.		
	(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.	
economic life	Either:	43.5
Applicable for periods beginning on or after January 1, 2025.		
	(a) The period over which an asset is expected to be economically usable by one or more users; or	
	(b) The number of production or similar units expected to be obtained from an asset by one or more users.	
effective date of the modification	The date when both parties agree to a lease modification	43.5
Applicable for periods beginning on or after January 1, 2025		
effective interest method	The method that is used in the calculation of the amortized cost of a financial asset or a financial liability and in the allocation and recognition of the interest revenue or interest expense in surplus or deficit over the relevant period.	41.9
Applicable for periods beginning on or after January 1, 2023.		
effective interest rate	The rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset or to the amortized cost of a financial liability. When calculating the effective interest rate, an entity shall estimate the expected cash flows by considering all the contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) but shall not consider the expected credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate (see [IPSAS 41] paragraphs AG156–AG158), transaction costs, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the cash flows or the expected life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments).	41.9
Applicable for periods beginning on or after January 1, 2023.		
employee benefits	All forms of consideration given by an entity in exchange for service rendered by employees or for the termination of employment.	39.8

Term	Definition	Location
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 interests	For the purposes of this Standard, is used broadly to mean ownership interests of investor-owned entities and owner, member or participant interests of mutual entities.	40.5
equity instrument	Any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.	28.9
equity method (relating to interests in other entities)	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 the investee's net assets/equity of the associate or joint venture. The investor's surplus or deficit includes its share of the investee's surplus or deficit and the investor's net assets/equity includes its share of changes in the investee's net assets/equity that have not been recognized in the investee's surplus or deficit.	36.8
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 translating a given number of units of one currency into another currency at different exchange rates.	4.10
exchange rate	The ratio of exchange for two currencies.	4.10
exchange transactions	Transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.	9.11
executory contracts	Contracts under which neither party has performed any of its obligations, or both parties have partially performed their obligations to an equal extent.	19.18
expected credit loss	The weighted average of credit losses with the respective risks of a default occurring as the weights.	41.9
	Applicable for periods beginning on or after January 1, 2023.	
expenses	Decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrences of liabilities that result in decreases in net assets/equity, other than those relating to distributions to owners.	1.7
expenses paid through the tax system	Amounts that are available to beneficiaries regardless of whether or not they pay taxes.	23.7
fair value	The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.	9.11
fair value	For the purpose of applying the lessor accounting requirements in this Standard, is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.	43.5
	Applicable for periods beginning on or after January 1, 2025.	
fair value less costs to sell	The amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.	21.14
final budget	The original budget, adjusted for all reserves, carry-over amounts, transfers, allocations, supplemental appropriations, and other authorized legislative or similar authority changes applicable to the budget period	24.7

Term	Definition	Location
finance lease Applicable up to periods beginning on or before December 31, 2024.	A lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred.	13.8
finance lease Applicable for periods beginning on or after January 1, 2025.	A lease that transfers substantially all the risks and rewards incidental to ownership of an underlying asset.	43.5
financial asset	Any asset that is: <ul style="list-style-type: none"> (a) Cash; (b) An equity instrument of another entity; (c) A contractual right: <ul style="list-style-type: none"> (i) To receive cash or another financial asset from another entity; or (ii) To exchange financial assets or financial liabilities with another entity under conditions that are potentially favorable to the entity; or (d) A contract that will or may be settled in the entity's own equity instruments and is: <ul style="list-style-type: none"> (i) A non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or (ii) A derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include puttable financial instruments classified as equity instruments in accordance with paragraphs 15 and 16, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 17 and 18, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments. 	28.9
financial guarantee contract Applicable for periods beginning on or after January 1, 2023.	A contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.	41.9
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.	28.9
financial liability	Any liability that is: <ul style="list-style-type: none"> (a) A contractual obligation: <ul style="list-style-type: none"> (i) To deliver cash or another financial asset to another entity; or (ii) To exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the entity; or (b) A contract that will or may be settled in the entity's own equity instruments and is: <ul style="list-style-type: none"> (i) A non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or 	28.9

Term	Definition	Location
	(ii) A derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose, rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. Also, for these purposes the entity's own equity instruments do not include puttable financial instruments classified as equity instruments in accordance with [IPSAS 28] paragraphs 15 and 16, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 17 and 18, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.	
	As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraphs 15 and 16 or paragraphs 17 and 18.	
financial liability at fair value through surplus or deficit	A financial liability that meets one of the following conditions: (a) It meets the definition of held for trading. (b) Upon initial recognition it is designated by the entity as at fair value through surplus or deficit in accordance with [IPSAS 41] paragraph 46 or 51. (c) It is designated either upon initial recognition or subsequently as at fair value through surplus or deficit in accordance with [IPSAS 41] paragraph 152.	41.9
Applicable for periods beginning on or after January 1, 2023.		
financing activities	Activities that result in changes in the size and composition of the contributed capital and borrowings of the entity.	2.8
fines	Economic benefits or service potential received or receivable by public sector entities, as determined by a court or other law enforcement body, as a consequence of the breach of laws or regulations.	23.7
firm commitment	A binding agreement for the exchange of a specified quantity of resources at a specified price on a specified future date or dates.	41.9
Applicable for periods beginning on or after January 1, 2023.		
first IPSAS financial statements	The first annual financial statements in which an entity complies with the accrual basis IPSASs and can make an explicit and unreserved statement of compliance with those IPSASs because it adopted one or more of the transitional exemptions in this IPSAS that do not affect the fair presentation of the financial statements and its ability to assert compliance with accrual basis IPSASs.	33.9
first-time adopter	An entity that adopts accrual basis IPSASs for the first time and presents its first transitional IPSAS financial statements or its first IPSAS financial statements.	33.9
fixed payments	Payments made by a lessee to a lessor for the right to use an underlying asset during the lease term, excluding variable lease payments	43.5
Applicable for periods beginning on or after January 1, 2025.		
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

GLOSSARY

Term	Definition	Location
forecast transaction	An uncommitted but anticipated future transaction.	41.9
Applicable for periods beginning on or after January 1, 2023.		
foreign currency	A currency other than the functional currency of the entity.	4.10
foreign operation	An entity that is a controlled entity, associate, joint venture, or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity.	4.10
functional currency	The currency of the primary economic environment in which the entity operates.	4.10
general government sector	Comprises all organizational entities of the general government as defined in statistical bases of financial reporting	22.15
goodwill	An asset representing the future economic benefits arising from other assets acquired in an acquisition that are not individually identified and separately recognized.	40.5
grantor (in a service concession arrangement)	Is the entity that grants the right to use the service concession asset to the operator.	32.8
gross carrying amount of a financial asset	The amortized cost of a financial asset, before adjusting for any loss allowance.	41.9
Applicable for periods beginning on or after January 1, 2023.		
gross investment in the lease	The aggregate of:	13.8
Applicable up to periods beginning on or before December 31, 2024.	(a) The minimum lease payments receivable by the lessor under a finance lease; and (b) Any unguaranteed residual value accruing to the lessor.	
gross investment in the lease	The sum of:	43.5
Applicable for periods beginning on or after January 1, 2025.	(a) The lease payments receivable by the lessor under a finance lease; and (b) Any unguaranteed residual value accruing to the lessor.	
group of biological assets	An aggregation of similar living animals or plants.	27.9
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
Applicable up to periods beginning on or before December 31, 2024.		
harvest	The detachment of produce from a biological asset or the cessation of a biological asset's life processes.	27.9
hedged item	An asset, liability, firm commitment, highly probable forecast transaction or net investment in a foreign operation that (a) exposes the entity to risk of changes in fair value or future cash flows and (b) is designated as being hedged ([IPSAS 29] paragraphs 87–94 and Appendix A paragraphs AG131–AG141 elaborate on the definition of hedged items).	29.10
hedge effectiveness	The degree to which changes in the fair value or cash flows of the hedged item that are attributable to a hedged risk are offset by changes in the fair value or cash flows of the hedging instrument (see [IPSAS 29] Appendix A paragraphs AG145–AG156).	29.10

Term	Definition	Location
hedging ratio Applicable for periods beginning on or after January 1, 2023.	The relationship between the quantity of the hedging instrument and the quantity of the hedged item in terms of their relative weighting.	41.9
hedging instrument	A designated derivative or (for a hedge of the risk of changes in foreign currency exchange rates only) a designated non-derivative financial asset or non-derivative financial liability whose fair value or cash flows are expected to offset changes in the fair value or cash flows of a designated hedged item ([IPSAS 29] paragraphs 81–86 and Appendix A paragraphs AG127–AG130 elaborate on the definition of a hedging instrument).	29.10
held for trading Applicable for periods beginning on or after January 1, 2023.	A financial asset or financial liability that: (a) Is acquired or incurred principally for the purpose of selling or repurchasing it in the near term; (b) On initial recognition is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or (c) Is a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).	41.9
identifiable	An asset is identifiable if it either: (a) Is separable, i.e., is capable of being separated or divided from the entity and sold, transferred, licensed, rented, or exchanged, either individually or together with a related binding arrangement, identifiable asset or liability, regardless of whether the entity intends to do so; or (b) Arises from binding arrangements (including rights from contracts or other legal rights), regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.	40.5
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 gain or loss Applicable for periods beginning on or after January 1, 2023.	Recognized in surplus or deficit in accordance with [IPSAS 41] paragraph 80 and that arises from applying the impairment requirements in [IPSAS 41] paragraphs 73–93.	41.9
impairment loss of a cash-generating asset	The amount by which the carrying amount of an asset exceeds its recoverable amount.	17.13
impairment loss of a non-cash-generating asset	The amount by which the carrying amount of an asset exceeds its recoverable service amount.	17.13
impracticable (1)	Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.	1.7
impracticable (2)	Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so. For a particular prior period, it is impracticable to apply a change in an accounting policy retrospectively or to make a retrospective restatement to correct an error if: (a) The effects of the retrospective application or retrospective restatement are not determinable; (b) The retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period; or	3.7

Term	Definition	Location
	<p>(c) The retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that:</p> <p>(i) Provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognized, measured, or disclosed; and</p> <p>(ii) Would have been available when the financial statements for that prior period were authorized for issue;</p> <p>from other information.</p>	
inception of the lease Applicable up to periods beginning on or before December 31, 2024.	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:	13.8
	<p>(a) A lease is classified as either an operating or a finance lease; and</p> <p>(b) In the case of a finance lease, the amounts to be recognized at the commencement of the lease term are determined.</p>	
inception date of the lease Applicable for periods beginning on or after January 1, 2025.	The earlier of the date of a lease agreement and the date of commitment by the parties to the principal terms and conditions of the lease.	43.5
individual services	Goods and services provided to individuals and/or households by a public sector entity that are intended to address the needs of society as a whole.	19.18
initial direct costs Applicable up to periods beginning on or before December 31, 2024.	Incremental costs that are directly attributable to negotiating and arranging a lease, except for such costs incurred by manufacturer or trader lessors.	13.8
initial direct costs Applicable for periods beginning on or after January 1, 2025.	Incremental costs of obtaining a lease that would not have been incurred if the lease had not been obtained.	43.5
intangible asset	An identifiable non-monetary asset without physical substance.	31.16
interest in another entity	Refers to involvement by way of binding arrangements or otherwise that exposes an entity to variability of benefits from the performance of the other entity. An interest in another entity can be evidenced by, but is not limited to, the holding of equity or debt instruments as well as other forms of involvement such as the provision of funding, liquidity support, credit enhancement and guarantees. It includes the means by which an entity has control or joint control of, or significant influence over, another entity. An entity does not necessarily have an interest in another entity solely because of a typical funder/recipient or customer/supplier relationship.	37.7
interest rate implicit in the lease Applicable up to periods beginning on or before December 31, 2024.	The discount rate that, at the inception of the lease, causes the aggregate present value of:	13.8
	<p>(a) The minimum lease payments; and</p> <p>(b) The unguaranteed residual value</p> <p>to be equal to the sum of (i) the fair value of the leased asset, and (ii) any initial direct costs of the lessor.</p>	
interest rate implicit in the lease Applicable for periods beginning on or after January 1, 2025.	The rate of interest that causes the present value of (a) the lease payments and (b) the unguaranteed residual value to equal the sum of (i) the fair value of the underlying asset and (ii) any initial direct costs of the lessor.	43.5

Term	Definition	Location
interest rate risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.	30.8
inventories	Assets: (a) In the form of materials or supplies to be consumed in the production process; (b) In the form of materials or supplies to be consumed or distributed in the rendering of services; (c) Held for sale or distribution in the ordinary course of operations; or (d) In the process of production for sale or distribution.	12.9
investing activities	The acquisition and disposal of long-term assets and other investments not included in cash equivalents.	2.8
investment entity	An entity that: (a) Obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services; (b) Has the purpose of investing funds solely for returns from capital appreciation, investment revenue, or both; and (c) Measures and evaluates the performance of substantially all of its investments on a fair value basis.	35.14
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
joint arrangement	An arrangement of which two or more parties have joint control.	36.8
joint control	The agreed sharing of control of an arrangement by way of a binding arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.	36.8
joint operation	A joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement.	37.7
joint operator	A party to a joint operation that has joint control of that joint operation.	37.7
joint venture	A joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.	36.8
joint venturer	A party to a joint venture that has joint control of that joint venture.	36.8
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

Term	Definition	Location
lease Applicable up to periods beginning on or before December 31, 2024.	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 Applicable for periods beginning on or after January 1, 2025.	A contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration.	43.5
lease incentives Applicable for periods beginning on or after January 1, 2025.	Payments made by a lessor to a lessee associated with a lease, or the reimbursement or assumption by a lessor of costs of a lessee.	43.5
lease modification Applicable for periods beginning on or after January 1, 2025.	A change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease (for example, adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term).	43.5
lease payments Applicable for periods beginning on or after January 1, 2025.	Payments made by a lessee to a lessor relating to the right to use an underlying asset during the lease term, comprising the following: <ul style="list-style-type: none"> (a) Fixed payments (including in-substance fixed payments), less any lease incentives; (a) Variable lease payments that depend on an index or a rate; (b) The exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and (c) Payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease. 	43.5
lease term Applicable up to periods beginning on or before December 31, 2024.	The non-cancelable period for which the lessee has contracted to lease the asset, together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.	13.8
lease term Applicable for periods beginning on or after January 1, 2025.	The non-cancellable period for which a lessee has the right to use an underlying asset, together with both: <ul style="list-style-type: none"> (a) Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and (b) Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option. 	43.5
legal obligation	An obligation that derives from: <ul style="list-style-type: none"> (a) A contract (through its explicit or implicit terms); (b) Legislation; or (c) Other operation of law. 	19.18
lessee Applicable for periods beginning on or after January 1, 2025.	An entity that obtains the right to use an underlying asset for a period of time in exchange for consideration.	43.5

Term	Definition	Location
lessee's incremental borrowing rate of interest Applicable up to periods beginning on or before December 31, 2024.	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
lessee's incremental borrowing rate Applicable for periods beginning on or after January 1, 2025.	The rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment.	43.5
lessor Applicable for periods beginning on or after January 1, 2025.	An entity that provides the right to use an underlying asset for a period of time in exchange for consideration.	43.5
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
lifetime expected credit losses Applicable for periods beginning on or after January 1, 2023.	The expected credit losses that result from all possible default events over the expected life of a financial instrument.	41.9
liquidity risk	The risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.	30.8
loans payable	Financial liabilities, other than short-term trade payables on normal credit terms.	30.8
loss allowance Applicable for periods beginning on or after January 1, 2023.	The allowance for expected credit losses on financial assets measured in accordance with paragraph 40, lease receivables, the accumulated impairment amount for financial assets measured in accordance with [IPSAS 41] paragraph 41 and the provision for expected credit losses on loan commitments and financial guarantee contracts.	41.9
market risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk, and other price risk.	30.8
material	Omissions or misstatements of items are material if they could, individually or collectively, influence the decisions or assessments of users made on the basis of the financial statements. Materiality depends on the nature and size of the omission or misstatement judged in the surrounding circumstances. The nature or size of the item, or a combination of both, could be the determining factor.	1.7
minimum lease payments Applicable up to periods beginning on or before December 31, 2024.	The payments over the lease term that the lessee is, or can be, required to make, excluding contingent rent, costs for services and, where appropriate, taxes to be paid by and reimbursed to the lessor, together with: (a) For a lessee, any amounts guaranteed by the lessee or by a party related to the lessee; or (b) For a lessor, any residual value guaranteed to the lessor by: (i) The lessee; (ii) A party related to the lessee; or (iii) An independent third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee.	13.8

Term	Definition	Location
modification gain or loss	<p>However, if the lessee has an option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised, the minimum lease payments comprise the minimum payments payable over the lease term to the expected date of exercise of this purchase option and the payment required to exercise it.</p> <p>The amount arising from adjusting the gross carrying amount of a financial asset to reflect the renegotiated or modified contractual cash flows. The entity recalculates the gross carrying amount of a financial asset as the present value of the estimated future cash payments or receipts through the expected life of the renegotiated or modified financial asset that are discounted at the financial asset's original effective interest rate (or the original credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets) or, when applicable, the revised effective interest rate calculated in accordance with [IPSAS 41] paragraph 139. When estimating the expected cash flows of a financial asset, an entity shall consider all contractual terms of the financial asset (for example, prepayment, call and similar options) but shall not consider the expected credit losses, unless the financial asset is a purchased or originated credit-impaired financial asset, in which case an entity shall also consider the initial expected credit losses that were considered when calculating the original credit-adjusted effective interest rate.</p>	41.9
Applicable for periods beginning on or after January 1, 2023.		
monetary items	Units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency.	4.10
multi-employer plans	<p>Defined contribution plans (other than state plans) or defined benefit plans (other than state plans) that:</p> <ul style="list-style-type: none"> (a) Pool the assets contributed by various entities that are not under common control; and (b) Use those assets to provide benefits to employees of more than one entity, on the basis that contribution and benefit levels are determined without regard to the identity of the entity that employs the employees. 	39.8
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
mutual entity	An entity, other than an investor-owned entity, that provides dividends, lower costs or other economic benefits directly to its owners, members or participants. For example, a mutual insurance company, a credit union and a co-operative entity are all mutual entities.	40.5
net assets/equity	<p>The residual interest in the assets of the entity after deducting all its liabilities.</p> <p>The components of net assets/equity are contributed capital, accumulated surpluses or deficits, reserves, and non-controlling interests. Types of reserves include:</p> <ul style="list-style-type: none"> (a) Changes in revaluation surplus (see IPSAS 17, <i>Property, Plant, and Equipment</i> and IPSAS 31, <i>Intangible Assets</i>); (b) Remeasurements of defined benefit plans (see IPSAS 39, <i>Employee Benefits</i>); (c) Gains and losses arising from translating the financial statements of a foreign operation (see IPSAS 4, <i>The Effects of Changes in Foreign Exchange Rates</i>); (d) Gains and losses from investments in equity instruments designated at fair value through net assets/equity in accordance with paragraph 106 of IPSAS 41, <i>Financial Instruments</i>; (e) Gains and losses on financial assets measured at fair value through net assets/equity in accordance with paragraph 41 of IPSAS 41; 	1.7

Term	Definition	Location
	(f) The effective portion of gains and losses on hedging instruments in a cash flow hedge and the gains and losses on hedging instruments that hedge investments in equity instruments measured at fair value through net assets/equity in accordance with paragraph 106 of IPSAS 41 (see paragraphs 113–155 of IPSAS 41);	
	(g) For particular liabilities designated as at fair value through surplus or deficit, the amount of the change in fair value that is attributable to changes in the liability's credit risk (see paragraph 108 of IPSAS 41);	
	(h) Changes in the value of the time value of options when separating the intrinsic value and time value of an option contract and designating as the hedging instrument only the changes in the intrinsic value (see paragraphs 113–155 of IPSAS 41); and	
	(i) Changes in the value of the forward elements of forward contracts when separating the forward element and spot element of a forward contract and designating as the hedging instrument only the changes in the spot element, and changes in the value of the foreign currency basis spread of a financial instrument when excluding it from the designation of that financial instrument as the hedging instrument (see paragraphs 113–155 of IPSAS 41).	
net defined benefit liability (asset)	The deficit or surplus, adjusted for any effect of limiting a net defined benefit asset to the asset ceiling.	39.8
net interest on the net defined benefit liability (asset)	The change during the period in the net defined benefit liability (asset) that arises from the passage of time.	39.8
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
Applicable up to periods beginning on or before December 31, 2024.		
net investment in the lease	The gross investment in the lease discounted at the interest rate implicit in the lease.	43.5
Applicable for periods beginning on or after January 1, 2025.		
net realizable value	The estimated selling price in the ordinary course of operations, less the estimated costs of completion and the estimated costs necessary to make the sale, exchange or distribution.	12.9
non-cancelable lease	A lease that is cancelable only:	13.8
Applicable up to periods beginning on or before December 31, 2024.	(a) Upon the occurrence of some remote contingency;	
	(b) With the permission of the lessor;	
	(c) If the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or	
	(d) Upon payment by the lessee of such an additional amount that, at inception of the lease, continuation of the lease is reasonably certain.	
non-cash-generating assets	Assets other than cash-generating assets.	21.14
non-controlling interest	The net assets/equity in a controlled entity not attributable, directly or indirectly, to a controlling entity.	35.14

Term	Definition	Location
non-exchange transactions	Transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.	9.11
non-monetary items	Items that are not monetary items.	10.7
notes	Contain information in addition to that presented in the statement of financial position, statement of financial performance, statement of changes in net assets/equity and cash flow statement. Notes provide narrative descriptions or disaggregations of items disclosed in those statements and information about items that do not qualify for recognition in those statements.	1.7
obligating event	An event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.	19.18
onerous contract	A contract for the exchange of assets or services in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits or service potential expected to be received under it.	19.18
operating activities	The activities of the entity that are not investing or financing activities.	2.8
operating lease	A lease other than a finance lease.	13.8
Applicable up to periods beginning on or before December 31, 2024.		
operating lease	A lease that does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset.	43.5
Applicable for periods beginning on or after January 1, 2025.		
operation	An integrated set of activities and related assets and/or liabilities that is capable of being conducted and managed for the purpose of achieving an entity's objectives, by providing goods and/or services.	40.5
operator (in a service concession arrangement)	Is the entity that uses the service concession asset to provide public services subject to the grantor's control of the asset.	32.8
optional lease payments	Payments to be made by a lessee to a lessor for the right to use an underlying asset during periods covered by an option to extend or terminate a lease that are not included in the lease term.	43.5
Applicable for periods beginning on or after January 1, 2025.		
original budget	The initial approved budget for the budget period.	24.7
other long-term employee benefits	All employee benefits other than short-term employee benefits, post-employment benefits and termination benefits.	39.8
other price risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.	30.8
oversight	The supervision of the activities of an entity, with the authority and responsibility to control, or exercise significant influence over, the financial and operating decisions of the entity.	20.4
owner-occupied property	Property held (by the owner or by the lessee under a finance lease) for use in the production or supply of goods or services, or for administrative purposes.	16.7

Term	Definition	Location
owners	For the purposes of this Standard, is used broadly to include any party with quantifiable ownership interests in an operation. This includes, but is not limited to, holders of equity interests of investor-owned entities and owners or members of, or participants in, mutual entities.	40.5
party to a joint arrangement	An entity that participates in a joint arrangement, regardless of whether that entity has joint control of the arrangement.	37.7
past due	A financial asset is past due when a counterparty has failed to make a payment when that payment was contractually due.	41.9
Applicable for periods beginning on or after January 1, 2023.		
period of use	The total period of time that an asset is used to fulfill a contract with a customer (including any non-consecutive periods of time).	43.5
Applicable for periods beginning on or after January 1, 2025.		
plan assets	Comprise: (a) Assets held by a long-term employee benefit fund; and (b) Qualifying insurance policies.	39.8
post-employment benefit plans	Formal or informal arrangements under which an entity provides post-employment benefits for one or more employees.	39.8
post-employment benefits	Employee benefits (other than termination benefits and short-term employee benefits) that are payable after the completion of employment.	39.8
power	Consists of existing rights that give the current ability to direct the relevant activities of another entity.	35.14
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.	39.8
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, faithfully representative information that: (a) Was available when financial statements for those periods were authorized for issue; and (b) Could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements. Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.	3.7
property, plant, and equipment	Tangible items that: (a) Are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and (b) Are expected to be used during more than one reporting period.	17.13
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

Term	Definition	Location
protective rights	Rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate.	35.14
provision	A liability of uncertain timing or amount.	19.18
public sector combination	The bringing together of separate operations into one public sector entity.	40.5
public sector combination under common control	Is a public sector combination in which all of the entities or operations involved are ultimately controlled by the same entity both before and after the public sector combination.	40.5
purchased or originated credit-impaired financial asset	Credit-impaired on initial recognition.	41.9
Applicable for periods beginning on or after January 1, 2023.		
puttable instrument	A financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset or is automatically put back to the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder.	28.9
qualifying asset	An asset that necessarily takes a substantial period of time to get ready for its intended use or sale.	5.5
qualifying insurance policy	An insurance policy ¹ issued by an insurer that is not a related party (as defined in IPSAS 20) of the reporting entity, if the proceeds of the policy: <ul style="list-style-type: none"> (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: <ul style="list-style-type: none"> (i) The proceeds represent surplus assets that are not needed for the policy to meet all the related employee benefit obligations; or (ii) The proceeds are returned to the reporting entity to reimburse it for employee benefits already paid. 	39.8
reclassification date	The first day of the first reporting period following the change in management model that results in an entity reclassifying financial assets.	41.9
Applicable for periods beginning on or after January 1, 2023.		
recoverable amount (of an asset or a cash-generating unit)	The higher of an asset's or a cash-generating unit's fair value less costs to sell and its value in use.	26.13
recoverable amount (of property, plant, and equipment)	The higher of a cash-generating asset's fair value less costs to sell and its value in use.	17.13
recoverable service amount	The higher of a non-cash-generating asset's fair value less costs to sell and its value in use.	21.14
regular way purchase or sale	A purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned.	41.9
Applicable for periods beginning on or after January 1, 2023.		

¹ A qualifying insurance policy is not necessarily an insurance contract (see the relevant international ornational standard dealing with insurance contracts).

Term	Definition	Location
related party	Parties are considered to be related if one party has the ability to (a) control the other party, or (b) exercise significant influence over the other party in making financial and operating decisions, or if the related party entity and another entity are subject to common control. Related parties include: <ul style="list-style-type: none"> (a) Entities that directly, or indirectly through one or more intermediaries, control, or are controlled by, the reporting entity; (b) Associates (see IPSAS 7, <i>Investments in Associates</i>); (c) Individuals owning, directly or indirectly, an interest in the reporting entity that gives them significant influence over the entity, and close members of the family of any such 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
relevant rights	Activities of the potentially controlled entity that significantly affect the nature or amount of the benefits that an entity receives from its involvement with that other entity.	35.14
remeasurements of the net defined benefit liability (asset)	Comprise: <ul style="list-style-type: none"> (a) Actuarial gains and losses; (b) The return on plan assets, excluding amounts included in net interest on the net defined benefit liability (asset); and (c) Any change in the effect of the asset ceiling, excluding amounts included in net interest on the net defined benefit liability (asset). 	39.8
removal rights	Rights to deprive the decision maker of its decision-making authority.	35.14
remuneration of key management personnel	Any consideration or benefit derived directly or indirectly by key management personnel from the reporting entity for services provided in their capacity as members of the governing body, or otherwise as employees of the reporting entity.	20.4
reporting date	The date of the last day of the reporting period to which the financial statements relate.	2.8
research	Original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.	31.16
residual value (of property, plant, and equipment or an intangible asset)	The estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.	17.13
residual value guarantee	A guarantee made to a lessor by a party unrelated to the lessor that the value (or part of the value) of an underlying asset at the end of a lease will be at least a specified amount.	43.5
Applicable for periods beginning on or after January 1, 2025.		
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: <ul style="list-style-type: none"> (a) The scope of an entity's activities; or (b) The manner in which those activities are carried out. 	19.18

Term	Definition	Location
resulting entity	The entity that is the result of two or more operations combining in an amalgamation	40.5
retrospective application	Applying a new accounting policy to transactions, other events, and conditions as if that policy had always been applied.	3.7
retrospective restatement	Correcting the recognition, measurement and disclosure of amounts of elements of financial statements as if a prior period error had never occurred.	3.7
return on plan assets	The interest, dividends or similar distributions and other revenue derived from the plan assets, together with realized and unrealized gains or losses on the plan assets, less: <ul style="list-style-type: none"> (a) Any costs of managing the plan assets; and (b) Any tax payable by the plan itself, other than tax included in the actuarial assumptions used to measure the present value of the defined benefit obligation. 	39.8
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
revenue from a structured entity	Includes, but is not limited to, recurring and non-recurring fees, interest, dividends or similar distributions, gains or losses on the remeasurement or derecognition of interests in structured entities and gains or losses from the transfer of assets and liabilities to the structured entity.	38.7
right-of-use asset	An asset that represents a lessee's right to use an underlying asset for the lease term.	43.5
	Applicable for periods beginning on or after January 1, 2025.	
segment	A distinguishable activity or group of activities of an entity for which it is appropriate to separately report financial information for the purpose of (a) evaluating the entity's past performance in achieving its objectives and (b) making decisions about the future allocation of resources.	18.9
segment accounting policies	Accounting policies adopted for preparing and presenting the financial statements of the consolidated group or entity as well as those accounting policies that relate specifically to segment reporting.	18.27
segment assets	Are those operating assets that are employed by a segment in its operating activities, and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis. <p>If a segment's segment revenue includes interest or dividend revenue, its segment assets include the related receivables, loans, investments, or other revenue-producing assets.</p> <p>Segment assets do not include income tax or income tax-equivalent assets that are recognized in accordance with accounting standards dealing with obligations to pay income tax or income tax equivalents.</p> <p>Segment assets include investments accounted for under the equity method only if the net surplus (deficit) from such investments is included in segment revenue. Segment assets include a joint venturer's share of the operating assets of a jointly controlled entity that is accounted for by proportionate consolidation in accordance with IPSAS 8, <i>Interests in Joint Ventures</i>.</p> <p>Segment assets are determined after deducting related allowances that are reported as direct offsets in the entity's statement of financial position.</p>	18.27

Term	Definition	Location
segment expense	<p>An expense resulting from the operating activities of a segment that is directly attributable to the segment, and the relevant portion of an expense that can be allocated on a reasonable basis to the segment, including expenses relating to the provision of goods and services to external parties and expenses relating to transactions with other segments of the same entity. Segment expense does not include:</p> <ul style="list-style-type: none"> (a) Interest, including interest incurred on advances or loans from other segments, unless the segment's operations are primarily of a financial nature; (b) Losses on sales of investments or losses on extinguishment of debt, unless the segment's operations are primarily of a financial nature; (c) An entity's share of net deficit or losses of associates, joint ventures, or other investments accounted for under the equity method; (d) Income tax or income tax-equivalent expense that is recognized in accordance with accounting standards dealing with obligations to pay income tax or income tax equivalents; or (e) General administrative expenses, head office expenses, and other expenses that arise at the entity level and relate to the entity as a whole. However, costs are sometimes incurred at the entity level on behalf of a segment. Such costs are segment expenses if they relate to the segment's operating activities and they can be directly attributed or allocated to the segment on a reasonable basis. <p>Segment expense includes a joint venturer's share of the expenses of a jointly controlled entity that is accounted for by proportionate consolidation in accordance with IPSAS 8.</p> <p>For a segment's operations that are primarily of a financial nature, interest revenue and interest expense may be reported as a single net amount for segment reporting purposes only if those items are netted in the consolidated or entity financial statements.</p>	18.27
segment liabilities	<p>Those operating liabilities that result from the operating activities of a segment, and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis.</p> <p>If a segment's segment expense includes interest expense, its segment liabilities include the related interest-bearing liabilities.</p> <p>Segment liabilities include a joint venturer's share of the liabilities of a jointly controlled entity that is accounted for by proportionate consolidation in accordance with IPSAS 8.</p> <p>Segment liabilities do not include income tax or income tax equivalent liabilities that are recognized in accordance with accounting standards dealing with obligations to pay income tax or income tax equivalents.</p>	18.27
segment revenue	<p>Is revenue reported in the entity's statement of financial performance that is directly attributable to a segment, and the relevant portion of entity revenue that can be allocated on a reasonable basis to a segment, whether from budget appropriations or similar, grants, transfers, fines, fees, or sales to external customers or from transactions with other segments of the same entity. Segment revenue does not include:</p> <ul style="list-style-type: none"> (a) Interest or dividend revenue, including interest earned on advances or loans to other segments, unless the segment's operations are primarily of a financial nature; or (b) Gains on sales of investments or gains on extinguishment of debt, unless the segment's operations are primarily of a financial nature. 	18.27

Term	Definition	Location
	<p>Segment revenue includes an entity's share of net surplus (deficit) of associates, joint ventures, or other investments accounted for under the equity method, only if those items are included in consolidated or total entity revenue.</p> <p>Segment revenue includes a joint venturer's share of the revenue of a jointly controlled entity that is accounted for by proportionate consolidation in accordance with IPSAS 8.</p>	
separate financial statements	Those presented by an entity, in which the entity could elect, subject to the requirements in this Standard, to account for its investments in controlled entities, joint ventures and associates either at cost, in accordance with IPSAS 29, <i>Financial Instruments: Recognition and Measurement</i> or using the equity method as described in IPSAS 36, <i>Investments in Associates and Joint Ventures</i> .	34.6
separate vehicle	A separately identifiable financial structure, including separate legal entities or entities recognized by statute, regardless of whether those entities have a legal personality.	37.7
service concession arrangement	<p>Is a binding arrangement between a grantor and an operator in which:</p> <p>(a) The operator uses the service concession asset to provide a public service on behalf of the grantor for a specified period of time; and</p> <p>(b) The operator is compensated for its services over the period of the service concession arrangement.</p>	32.8
service concession asset	<p>It is an asset used to provide public services in a service concession arrangement that:</p> <p>(a) Is provided by the operator which:</p> <p>(i) The operator constructs, develops, or acquires from a third party; or</p> <p>(ii) Is an existing asset of the operator; or</p> <p>(b) Is provided by the grantor which:</p> <p>(i) Is an existing asset of the grantor; or</p> <p>(ii) Is an upgrade to an existing asset of the grantor.</p>	32.8
service cost	<p>Comprises:</p> <p>(a) Current service cost, which is the increase in the present value of the defined benefit obligation resulting from employee service in the current period;</p> <p>(b) Past service cost, which is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting from a plan amendment (the introduction or withdrawal of, or changes to, a defined benefit plan) or a curtailment (a significant reduction by the entity in the number of employees covered by a plan); and</p> <p>(c) Any gain or loss on settlement.</p>	39.8
settlement	A transaction that eliminates all further legal or constructive obligations for part or all of the benefits provided under a defined benefit plan, other than a payment of benefits to, or on behalf of, employees that is set out in the terms of the plan and included in the actuarial assumptions.	39.8
short-term employee benefits	Employee benefits (other than termination benefits) that are due to be settled wholly before twelve months after the end of the reporting period in which the employees render the related service.	39.8
short-term lease	A lease that, at the commencement date, has a lease term of 12 months or less. A lease that contains a purchase option is not a short-term lease.	43.5

Applicable for periods beginning on or after January 1, 2025.

Term	Definition	Location
significant influence (relating to related party transactions)	The power to participate in the financial and operating policy decisions of an entity, but not control those policies. Significant influence may be exercised in several ways, usually by representation on the board of directors or equivalent governing body but also by, for example, participation in (a) the policy making process, (b) material transactions between entities within an economic entity, (c) interchange of managerial personnel, or (d) dependence on technical information. Significant influence may be gained by an ownership interest, statute, or agreement. With regard to an ownership interest, significant influence is presumed in accordance with the definition contained in IPSAS 7.	20.4
significant influence (relating to interests in other entities)	The power to participate in the financial and operating policy decisions of another entity but is not control or joint control of those policies.	36.8
social benefits	Are cash transfers provided to:	42.5
Applicable for periods beginning on or after January 1, 2023.	(a) Specific individuals and/or households who meet eligibility criteria; (b) Mitigate the effect of social risks; and (c) Address the needs of society as a whole	
social risks	Are events or circumstances that:	42.5
Applicable for periods beginning on or after January 1, 2023.	(a) Relate to the characteristics of individuals and/or households – for example, age, health, poverty and employment status; and (b) May adversely affect the welfare of individuals and/or households, either by imposing additional demands on their resources or by reducing their income.	
spot exchange rate	The exchange rate for immediate delivery.	4.10
state plans	Plans established by legislation that operate as if they are multi-employer plans for all entities in economic categories laid down in legislation.	39.8
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
structured entity	Is:	38.7
	(a) In the case of entities where administrative arrangements or legislation are normally the dominant factors in deciding who has control of an entity, an entity that has been designed so that administrative arrangements or legislation are not the dominant factors in deciding who controls the entity, such as when binding arrangements are significant to determining control of the entity and relevant activities are directed by means of binding arrangements; or (b) In the case of entities where voting or similar rights are normally the dominant factor in deciding who has control of an entity, an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of binding arrangements.	
sublease	A transaction for which an underlying asset is released by a lessee ('intermediate lessor') to a third party, and the lease ('head lease') between the head lessor and lessee remains in effect.	43.5
Applicable for periods beginning on or after January 1, 2025.		
tax expenditures	Preferential provisions of the tax law that provide certain taxpayers with concessions that are not available to others.	23.7
taxable event	The event that the government, legislature, or other authority has determined will be subject to taxation.	23.7

Term	Definition	Location
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	Are employee benefits provided in exchange for the termination of an employee's employment 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 an offer of benefits in exchange for the termination of employment.	39.8
transaction costs Applicable for periods beginning on or after January 1, 2023.	Incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability (see [IPSAS 41] paragraph AG163). An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.	41.9
transfers	Inflows of future economic benefits or service potential from non-exchange transactions, other than taxes.	23.7
underlying asset Applicable for periods beginning on or after January 1, 2025.	An asset that is the subject of a lease, for which the right to use that asset has been provided by a lessor to a lessee.	43.5
unearned finance revenue	The difference between: (a) The gross investment in the lease; and (b) The net investment in the lease.	13.8; 43.5
unguaranteed residual value Applicable up to periods beginning on or before December 31, 2024.	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
unguaranteed re-sidual value Applicable for periods beginning on or after January 1, 2025.	That portion of the residual value of the underlying asset, the realization of which by a lessor is not assured or is guaranteed solely by a party related to the lessor.	43.5
useful life (of a lease) Applicable up to periods beginning on or before December 31, 2024.	The estimated remaining period, from the commencement of the lease term, without limitation by the lease term, over which the economic benefits or service potential embodied in the asset are expected to be consumed by the entity.	13.8
useful life (of a non-cash-generating asset)	Either: (a) The period of time over which an asset is expected to be used by the entity; or (b) The number of production or similar units expected to be obtained from the asset by the entity.	21.14
useful life (of property, plant, and equipment or an intangible asset)	Either: (a) The period over which an asset is expected to be available for use by an entity; or (b) The number of production or similar units expected to be obtained from the asset by an entity.	17.13

GLOSSARY

Term	Definition	Location
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
variable lease payments	The portion of payments made by a lessee to a lessor for the right to use an underlying asset during the lease term that varies because of changes in facts or circumstances occurring after the commencement date, other than the passage of time.	43.5
Applicable for periods beginning on or after January 1, 2025		

Accrual IPSASs Issued as at January 31, 2022

Table A: List of IPSASs effective as at January 1, 2022

The 2022 Handbook includes all IPSASs. IPSASs show the latest amended text. Where an IPSAS includes paragraphs that are not yet effective these paragraphs are listed.

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective				Handbook with Original Para
			Paras not yet Effective	How Affected	Origin of Amendment		
IPSAS 1—Presentation of Financial Statements (revised)	December 2006	January 1, 2008	7	Amended	IPSAS 41	2018	
			79	Amended	IPSAS 41	2018	
			82	Amended	IPSAS 41	2018	
			88	Amended	IPSAS 42	2018	
			94	Amended	IPSAS 42	2018	
			101	Amended	IPSAS 41	2018	
			102	Amended	IPSAS 41	2018	
			112	Amended	IPSAS 42	2018	
			113	Amended	IPSAS 42	2018	
			114	Amended	IPSAS 42	2018	
			115	Amended	IPSAS 42	2018	
			125A	New	IPSAS 41	2018	
			125B	New	IPSAS 41	2018	
			125C	New	IPSAS 41	2018	
IPSAS 2—Cash Flow Statements	May 2000	July 1, 2001	138	Amended	IPSAS 41	2018	
			153L	Amended	COVID-19: Deferral of Effective Dates	2020	
			153M	New	IPSAS 42	2018	
			22	Amended	IPSAS 42	2018	
			26	Amended	IPSAS 43	2021	
			55	Amended	IPSAS 43	2021	
			63G	New	IPSAS 42	2018	
			63H	New	IPSAS 43	2021	
			IE	Amended	IPSAS 42	2018	
			IPSAS 3—Accounting Policies, Changes in Accounting Estimates and Errors (revised)	December 2006	January 1, 2008		
IPSAS 4—The Effects of Changes in Foreign Exchange Rates (revised)	April 2008	January 1, 2010	3	Amended	IPSAS 41	2018	
			4	Amended	IPSAS 41	2018	
			5	Amended	IPSAS 41	2018	
			17	Amended	IPSAS 43	2021	
			31	Amended	IPSAS 41	2018	

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective			Handbook with Original Para
			Paras not yet Effective	How Affected	Origin of Amendment	
			61	Amended	IPSAS 41	2018
			71D	Amended	COVID-19: Deferral of Effective Dates	2020
			71F	New	IPSAS 43	2021
IPSAS 5—Borrowing Costs	May 2000	July 1, 2001	6	Amended	IPSAS 43	2021
			42E	Amended	COVID-19: Deferral of Effective Dates	2020
			42F	New	IPSAS 43	2021
IPSAS 9—Revenue from Exchange Transactions	July 2001	July 1, 2002	10	Amended	IPSAS 41	2018
			41D	Amended	COVID-19: Deferral of Effective Dates	2020
			IG12	Amended	IPSAS 41	2018
IPSAS 10—Financial Reporting in Hyperinflationary Economies	July 2001	July 1, 2002				
IPSAS 11—Construction Contracts	July 2001	July 1, 2002				
IPSAS 12—Inventories (revised)	December 2006	January 1, 2008	2	Amended	IPSAS 41	2018
			20	Amended	IPSAS 43	2021
			51E	Amended	COVID-19: Deferral of Effective Dates November 2020	2020
			51F	New	IPSAS 43	2021
IPSAS 13—Leases (revised)	December 2006	January 1, 2008				
IPSAS 14—Events After the Reporting Date (revised)	December 2006	January 1, 2008	11	Amended	IPSAS 41	2018
			32F	Amended	COVID-19: Deferral of Effective Dates	2020
IPSAS 16—Investment Property (revised)	December 2006	January 1, 2008	5	Deleted	IPSAS 43	2021
			7	Amended	IPSAS 43	2021
			8	Deleted	IPSAS 43	2021
			10	Amended	IPSAS 43	2021
			12	Amended	IPSAS 43	2021
			13	Amended	IPSAS 43	2021
			20	Amended	IPSAS 43	2021
			25A	New	IPSAS 43	2021
			26	Amended	IPSAS 43	2021
			27	Amended	IPSAS 43	2021
			34	Deleted	IPSAS 43	2021
			35	Deleted	IPSAS 43	2021
			38A	New	IPSAS 43	2021

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective			
			Paras not yet Effective	How Affected	Origin of Amendment	Handbook with Original Para
			39	Amended	IPSAS 43	2021
			41A	New	IPSAS 43	2021
			41B	New	IPSAS 43	2021
			41C	New	IPSAS 43	2021
			43	Deleted	IPSAS 43	2021
			49	Amended	IPSAS 43	2021
			49A	New	IPSAS 43	2021
			50	Amended	IPSAS 43	2021
			59	Amended	IPSAS 43	2021
			62	Amended	IPSAS 43	2021
			62A	Amended	IPSAS 43	2021
			63	Amended	IPSAS 43	2021
			65	Amended	IPSAS 43	2021
			71	Amended	IPSAS 43	2021
			72	Amended	IPSAS 43	2021
			73	Amended	IPSAS 43	2021
			78	Amended	IPSAS 43	2021
			80	Amended	IPSAS 43	2021
			85	Amended	IPSAS 43	2021
			86	Amended	IPSAS 43	2021
			88	Amended	IPSAS 43	2021
			89	Amended	IPSAS 43	2021
			100A	New	IPSAS 43	2021
			101H	New	IPSAS 43	2021
IPSAS 17—Property, Plant, and Equipment (revised)	December 2006	January 1, 2008	7	Deleted	IPSAS 43	2021
			8	Amended	IPSAS 43	2021
			19	Amended	IPSAS 43	2021
			31	Amended	Improvements to IPSAS, 2021	2021
			34A	New	Improvements to IPSAS, 2021	2021
			41	Deleted	IPSAS 43	2021
			60	Amended	IPSAS 43	2021
			83	Amended	IPSAS 43	2021
			84	Amended	IPSAS 43	2021
			89	Amended	Improvements to IPSAS, 2021	2021

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective				Handbook with Original Para
			Paras not yet Effective	How Affected	Origin of Amendment		
			89A	New	Improvements to IPSAS, 2021	2021	
			106B	New	Improvements to IPSAS, 2021	2021	
			107Q	New	Improvements to IPSAS, 2021	2021	
			107R	New	IPSAS 43	2021	
IPSAS 18—Segment Reporting	June 2002	July 1, 2003	33	Amended	IPSAS 43	2021	
			35	Amended	IPSAS 43	2021	
			76F	New	IPSAS 43	2021	
			1	Amended	IPSAS 42	2018	
			4	New	IPSAS 41	2018	
IPSAS 19—Provisions, Contingent Liabilities and Contingent Assets	October 2002	January 1, 2004	6A	New	Collective and Individual Services (Amendments to IPSAS 19)	2019	
			7	Deleted	IPSAS 42	2018	
			8	Deleted	IPSAS 42	2018	
			9	Deleted	IPSAS 42	2018	
			10	Deleted	IPSAS 42	2018	
			11	Deleted	IPSAS 42	2018	
			12	Amended	IPSAS 42	2018	
			13	Amended	IPSAS 43	2021	
			18	Amended	Collective and Individual Services (Amendments to IPSAS 19)	2019	
			19	Amended	IPSAS 42	2018	
			77	Amended	IPSAS 42	2018	
			79A	New	Improvements to IPSAS, 2021	2021	
			80	Amended	Improvements to IPSAS, 2021	2021	
99	Deleted	IPSAS 42	2018				
104	Deleted	IPSAS 42	2018				
110A	New	Improvements to IPSAS, 2021	2021				

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective			Handbook with Original Para
			Paras not yet Effective	How Affected	Origin of Amendment	
			111H	Amended	COVID-19: Deferral of Effective Dates	2020
			111I	New	IPSAS 42	2018
			111J	Amended	COVID-19: Deferral of Effective Dates	2020
			111K	New	Improvements to IPSAS, 2021	2021
			111L	New	IPSAS 43	2021
			AG1	New	Collective and Individual Services (Amendments to IPSAS 19)	2019
			AG2	New	Collective and Individual Services (Amendments to IPSAS 19)	2019
			AG3	New	Collective and Individual Services (Amendments to IPSAS 19)	2019
			AG4	New	Collective and Individual Services (Amendments to IPSAS 19)	2019
			AG5	New	Collective and Individual Services (Amendments to IPSAS 19)	2019
			AG6	New	Collective and Individual Services (Amendments to IPSAS 19)	2019
			AG7	New	Collective and Individual Services (Amendments to IPSAS 19)	2019

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective			Handbook with Original Para
			Paras not yet Effective	How Affected	Origin of Amendment	
			AG8	New	Collective and Individual Services (Amendments to IPSAS 19)	2019
			AG9	New	Collective and Individual Services (Amendments to IPSAS 19)	2019
			AG10	New	Collective and Individual Services (Amendments to IPSAS 19)	2019
			AG11	New	Collective and Individual Services (Amendments to IPSAS 19)	2019
			AG12	New	Collective and Individual Services (Amendments to IPSAS 19)	2019
			AG13	New	Collective and Individual Services (Amendments to IPSAS 19)	2019
			AG14	New	Collective and Individual Services (Amendments to IPSAS 19)	2019
			AG15	New	Collective and Individual Services (Amendments to IPSAS 19)	2019
			AG16	New	Collective and Individual Services (Amendments to IPSAS 19)	2019

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective			Handbook with Original Para
			Paras not yet Effective	How Affected	Origin of Amendment	
			AG17	New	Collective and Individual Services (Amendments to IPSAS 19)	2019
			AG18	New	Collective and Individual Services (Amendments to IPSAS 19)	2019
			AG19	New	Collective and Individual Services (Amendments to IPSAS 19)	2019
			AG20	New	Collective and Individual Services (Amendments to IPSAS 19)	2019
			AG3	New	Collective and Individual Services (Amendments to IPSAS 19)	2019
			IG13	Deleted	IPSAS 43	2021
			IG14	Deleted	IPSAS 41	2018
IPSAS 20—Related Party Disclosures	October 2002	January 1, 2004				
IPSAS 21—Impairment of Non- Cash-Generating Assets	December 2004	January 1, 2006	2	Amended	IPSAS 41	2018
			9	Amended	IPSAS 41	2018
			13	Amended	IPSAS 41	2018
			82I	Amended	COVID-19: Deferral of Effective Dates	2020
IPSAS 22—Disclosure of Information About the General Government Sector	December 2006	January 1, 2008	5	Amended	Improvements to IPSAS, 2021	2021
			18	Amended	Improvements to IPSAS, 2021	2021
			28	Amended	Improvements to IPSAS, 2021	2021
			47F	New	Improvements to IPSAS, 2021	2021

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective				Handbook with Original Para
			Paras not yet Effective	How Affected	Origin of Amendment		
IPSAS 23—Revenue from Non-Exchange Transactions (Taxes and Transfers)	December 2006	June 30, 2008	2	Amended	IPSAS 42	2018	
			43	Amended	IPSAS 41	2018	
			105A	Amended	IPSAS 41	2018	
			124F	Amended	COVID-19: Deferral of Effective Dates	2020	
			124G	New	IPSAS 42	2018	
			IG54	Amended	IPSAS 41	2018	
			IG55	New	IPSAS 41	2018	
			IG56	New	IPSAS 41	2018	
			IG57	New	IPSAS 41	2018	
			IG58	New	IPSAS 41	2018	
IG59	New	IPSAS 41	2018				
IPSAS 24—Presentation of Budget Information in Financial Statements	December 2006	January 1, 2009	48	Amended	IPSAS 42	2018	
			54E	New	IPSAS 42	2018	
IPSAS 26 — Impairment of Cash-Generating Assets	February 2008	April 1, 2009	IE	Amended	IPSAS 42	2018	
			2	Amended	IPSAS 41	2018	
			9	Amended	IPSAS 41	2018	
			12	Amended	IPSAS 41	2018	
IPSAS 27—Agriculture	December 2009	April 1, 2011	126K	Amended	COVID-19: Deferral of Effective Dates	2020	
			3	Amended	IPSAS 43	2021	
			56G	New	IPSAS 43	2021	
IPSAS 28—Financial Instruments: Presentation	January 2010	January 1, 2013	2	Amended	IPSAS 41	2018	
			3	Amended	IPSAS 41	2018	
			4	Amended	IPSAS 41	2018	
			9	Amended	IPSAS 41	2018	
			10	Amended	IPSAS 41	2018	
			14	Amended	IPSAS 41	2018	
			28	Amended	IPSAS 41	2018	
			36	Amended	IPSAS 41	2018	
			47	Amended	IPSAS 41	2018	
			48	Amended	IPSAS 41	2018	
60F	Amended	COVID-19: Deferral of Effective Dates	2020				
60G	New	IPSAS 42	2018				

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective			
			Paras not yet Effective	How Affected	Origin of Amendment	Handbook with Original Para
			60H	New	IPSAS 43	2021
			AG2	Amended	IPSAS 41	2018
			AG16	Amended	IPSAS 43	2021
			AG17	Amended	IPSAS 43	2021
			AG23	Amended	IPSAS 42	2018
			AG55	Amended	IPSAS 41	2018
			AG63	Deleted	IPSAS 41	2018
			AG63A	New	IPSAS 41	2018
			AG63B	New	IPSAS 41	2018
			AG63C	New	IPSAS 41	2018
			AG63D	New	IPSAS 41	2018
			AG63E	New	IPSAS 41	2018
			AG63F	New	IPSAS 41	2018
			B19	Amended	IPSAS 41	2018
			B21	Amended	IPSAS 41	2018
			IE1	Amended	IPSAS 41	2018
			IE5	Amended	IPSAS 41	2018
IPSAS 29—Financial Instruments: Recognition and Measurement	January 2010	January 1, 2013	1	Deleted	IPSAS 41	2018
			2	Amended	IPSAS 41	2018
			3	Deleted	IPSAS 41	2018
			4	Deleted	IPSAS 41	2018
			5	Deleted	IPSAS 41	2018
			6	Deleted	IPSAS 41	2018
			9	Amended	IPSAS 41	2018
			10	Amended	IPSAS 41	2018
			11–79	Deleted	IPSAS 41	2018
			80	Amended	IPSAS 41	2018
			88	Deleted	IPSAS 41	2018
			98	Amended	IPSAS 41	2018
			99	Amended	IPSAS 41	2018

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective				Handbook with Original Para
			Paras not yet Effective	How Affected	Origin of Amendment		
			101	Amended	IPSAS 41	2018	
			102	Amended	IPSAS 41	2018	
			107	Amended	IPSAS 41	2018	
			108	Amended	IPSAS 41	2018	
			109	Amended	IPSAS 41	2018	
			111	Amended	IPSAS 41	2018	
			112	Amended	IPSAS 41	2018	
			113	Amended	IPSAS 41	2018	
			125A	Amended	IPSAS 43	2021	
			125H	Amended	COVID-19: Deferral of Effective Dates	2020	
			AG1-AG126	Deleted	IPSAS 41	2018	
			AG128	Amended	IPSAS 41	2018	
			AG129	Deleted	IPSAS 41	2018	
			AG134	Amended	IPSAS 41	2018	
			AG156A	New	IPSAS 41	2018	
			AG157	Amended	IPSAS 41	2018	
			AG161	Amended	IPSAS 41	2018	
			B1-B7	Deleted	IPSAS 41	2018	
			A.1-G.2	Deleted	IPSAS 41	2018	
			IE32-IE50	Deleted	IPSAS 41	2018	
IPSAS 30—Financial Instruments: Disclosures	January 2010	January 1, 2013	2	Amended	IPSAS 41	2018	
			3	Amended	IPSAS 41	2018	
			4	Amended	IPSAS 41	2018	
			5	Amended	IPSAS 41	2018	
			5A	New	IPSAS 41	2018	
			8	Amended	IPSAS 41	2018	
			11	Amended	IPSAS 41	2018	
			12	Amended	IPSAS 41	2018	
			13	Amended	IPSAS 41	2018	
			13A	New	IPSAS 41	2018	
			14	Amended	IPSAS 41	2018	

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective			Handbook with Original Para
			Paras not yet Effective	How Affected	Origin of Amendment	
			14A	New	IPSAS 41	2018
			14B	New	IPSAS 41	2018
			15	Deleted	IPSAS 41	2018
			15A	New	IPSAS 41	2018
			15B	New	IPSAS 41	2018
			15C	New	IPSAS 41	2018
			16	Deleted	IPSAS 41	2018
			17	Deleted	IPSAS 41	2018
			17A	New	IPSAS 41	2018
			17B	New	IPSAS 41	2018
			17C	New	IPSAS 41	2018
			17D	New	IPSAS 41	2018
			17E	New	IPSAS 41	2018
			17F	New	IPSAS 41	2018
			18	Amended	IPSAS 41	2018
			20	Deleted	IPSAS 41	2018
			20A	New	IPSAS 41	2018
			24	Amended	IPSAS 41	2018
			24A	New	IPSAS 41	2018
			25A	New	IPSAS 41	2018
			25B	New	IPSAS 41	2018
			25C	New	IPSAS 41	2018
			25D	New	IPSAS 41	2018
			26	Deleted	IPSAS 41	2018
			26A	New	IPSAS 41	2018
			26B	New	IPSAS 41	2018
			26C	New	IPSAS 41	2018
			27	Deleted	IPSAS 41	2018
			27A	New	IPSAS 41	2018
			27B	New	IPSAS 41	2018
			27C	New	IPSAS 41	2018

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective				Handbook with Original Para
			Paras not yet Effective	How Affected	Origin of Amendment		
			27D	New	IPSAS 41	2018	
			27E	New	IPSAS 41	2018	
			27F	New	IPSAS 41	2018	
			28	Deleted	IPSAS 41	2018	
			28A	New	IPSAS 41	2018	
			28B	New	IPSAS 41	2018	
			28C	New	IPSAS 41	2018	
			28D	New	IPSAS 41	2018	
			28E	New	IPSAS 41	2018	
			28F	New	IPSAS 41	2018	
			28G	New	IPSAS 41	2018	
			34	Amended	IPSAS 41	2018	
			35	Amended	IPSAS 41 IPSAS 43	2018 2021	
			36	Amended	IPSAS 41	2018	
			37	Amended	IPSAS 41	2018	
			37A	New	IPSAS 41	2018	
			39A	New	IPSAS 41	2018	
			41	Amended	IPSAS 41	2018	
			42A	New	IPSAS 41	2018	
			42B	New	IPSAS 41	2018	
			42C	New	IPSAS 41	2018	
			42D	New	IPSAS 41	2018	
			42E	New	IPSAS 41	2018	
			42F	New	IPSAS 41	2018	
			42G	New	IPSAS 41	2018	
			42H	New	IPSAS 41	2018	
			42I	New	IPSAS 41	2018	
			42J	New	IPSAS 41	2018	
			42K	New	IPSAS 41	2018	
			42L	New	IPSAS 41	2018	

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective			Handbook with Original Para
			Paras not yet Effective	How Affected	Origin of Amendment	
			42M	New	IPSAS 41	2018
			42N	New	IPSAS 41	2018
			43	Amended	IPSAS 41	2018
			44	Deleted	IPSAS 41	2018
			45	Amended	IPSAS 41	2018
			49A	New	IPSAS 41	2018
			49B	New	IPSAS 41	2018
			49C	New	IPSAS 41	2018
			49D	New	IPSAS 41	2018
			49E	New	IPSAS 41	2018
			49F	New	IPSAS 41	2018
			49G	New	IPSAS 41	2018
			49H	New	IPSAS 41	2018
			49I	New	IPSAS 41	2018
			49J	New	IPSAS 41	2018
			49K	New	IPSAS 41	2018
			49L	New	IPSAS 41	2018
			49M	New	IPSAS 41	2018
			49N	New	IPSAS 41	2018
			49O	New	IPSAS 41	2018
			49P	New	IPSAS 41	2018
			49Q	New	IPSAS 41	2018
			49R	New	IPSAS 41	2018
			49S	New	IPSAS 41	2018
			52F	Amended	COVID-19: Deferral of Effective Dates	2020
			52G	Amended	COVID-19: Deferral of Effective Dates	2020
			52L	New	IPSAS 43	2021
			AG1	Amended	IPSAS 41	2018
			AG4	Deleted	IPSAS 41	2018

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective			Handbook with Original Para
			Paras not yet Effective	How Affected	Origin of Amendment	
			AG5	Amended	IPSAS 41	2018
			AG8A	New	IPSAS 41	2018
			AG8B	New	IPSAS 41	2018
			AG8C	New	IPSAS 41	2018
			AG8D	New	IPSAS 41	2018
			AG8E	New	IPSAS 41	2018
			AG8F	New	IPSAS 41	2018
			AG8G	New	IPSAS 41	2018
			AG8H	New	IPSAS 41	2018
			AG8I	New	IPSAS 41	2018
			AG8J	New	IPSAS 41	2018
			AG9	Amended	IPSAS 41	2018
			AG10	Amended	IPSAS 41	2018
			AG16	Amended	IPSAS 43	2021
			AG24	Amended	IPSAS 41	2018
			AG29	Amended	IPSAS 41	2018
			AG31	New	IPSAS 41	2018
			AG32	New	IPSAS 41	2018
			AG32A	New	IPSAS 41	2018
			AG33	New	IPSAS 41	2018
			AG34	New	IPSAS 41	2018
			AG35	New	IPSAS 41	2018
			AG36	New	IPSAS 41	2018
			AG37	New	IPSAS 41	2018
			AG38	New	IPSAS 41	2018
			AG39	New	IPSAS 41	2018
			AG40	New	IPSAS 41	2018
			AG41	New	IPSAS 41	2018
			AG42	New	IPSAS 41	2018
			AG43	New	IPSAS 41	2018

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective			Handbook with Original Para
			Paras not yet Effective	How Affected	Origin of Amendment	
			AG44	New	IPSAS 41	2018
			AG45	New	IPSAS 41	2018
			AG46	New	IPSAS 41	2018
			AG47	New	IPSAS 41	2018
			AG48	New	IPSAS 41	2018
			AG49	New	IPSAS 41	2018
			AG50	New	IPSAS 41	2018
			AG51	New	IPSAS 41	2018
			AG52	New	IPSAS 41	2018
			AG53	New	IPSAS 41	2018
			AG54	New	IPSAS 41	2018
			AG55	New	IPSAS 41	2018
			IG3	Deleted	IPSAS 41	2018
			IG4	Deleted	IPSAS 41	2018
			IG7	Deleted	IPSAS 41	2018
			IG8	Deleted	IPSAS 41	2018
			IG9	Deleted	IPSAS 41	2018
			IG10	Deleted	IPSAS 41	2018
			IG11	Deleted	IPSAS 41	2018
			IG14	Amended	IPSAS 41	2018
			IG15	Amended	IPSAS 41	2018
			IG16	Amended	IPSAS 41	2018
			IG25	Deleted	IPSAS 41	2018
			IG26	Deleted	IPSAS 41	2018
			IG27	Deleted	IPSAS 41	2018
			IG28	Deleted	IPSAS 41	2018
			IG29	Deleted	IPSAS 41	2018
			IG30	Deleted	IPSAS 41	2018
			IG31	Deleted	IPSAS 41	2018
			IG36	Amended	IPSAS 41	2018
			IG41	New	IPSAS 41	2018

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective			Handbook with Original Para
			Paras not yet Effective	How Affected	Origin of Amendment	
			IG42	New	IPSAS 41	2018
			IG43	New	IPSAS 41	2018
			IG44	New	IPSAS 41	2018
			IG45	New	IPSAS 41	2018
IPSAS 31—Intangible Assets	January 2010	April 1, 2011	6	Amended	IPSAS 43	2021
			9	Amended	IPSAS 43	2021
			112	Amended	IPSAS 43	2021
			113	Amended	IPSAS 43	2021
			132K	New	IPSAS 43	2021
			AG6	Amended	IPSAS 43	2021
IPSAS 32—Service Concession Arrangements: Grantor	October 2011	January 1, 2014	20	Amended	IPSAS 41	2018
			29	Amended	IPSAS 41	2018
			36D	Amended	COVID-19: Deferral of Effective Dates	2020
			36E	New	IPSAS 43	2021
			AG37	Amended	IPSAS 41	2018
			AG45	Amended	IPSAS 41	2018
IPSAS 33—First-time Adoption of Accrual Basis IPSASs	January 2015	January 1, 2017	AG52	Amended	IPSAS 41	2018
			AG53	Amended	IPSAS 41	2018
			IG2	Amended	IPSAS 41	2018
			IG4	Amended	IPSAS 43	2021
			36	Amended	IPSAS 41	2018
				Amended	IPSAS 42	2018
			IPSAS 43	2021		
			46	Amended	IPSAS 43	2021
			47	Amended	IPSAS 43	2021
			64	Amended	IPSAS 41	2018
			72	Amended	IPSAS 43	2021
			85B	New	Improvements to IPSAS, 2021	2021
			95	Amended	IPSAS 43	2021
			96	Deleted	IPSAS 43	2021

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective			Handbook with Original Para
			Paras not yet Effective	How Affected	Origin of Amendment	
			96A	New	IPSAS 43	2021
			96B	New	IPSAS 43	2021
			96C	New	IPSAS 43	2021
			96D	New	IPSAS 43	2021
			114A	New	IPSAS 41	2018
			115	Amended	IPSAS 41	2018
			116	Amended	IPSAS 41	2018
			117	Amended	IPSAS 41	2018
			118	Amended	IPSAS 41	2018
			119	Amended	IPSAS 41	2018
			119A	New	IPSAS 41	2018
			119B	New	IPSAS 41	2018
			119C	New	IPSAS 41	2018
			119D	New	IPSAS 41	2018
			120	Amended	IPSAS 41	2018
			122	Amended	IPSAS 41	2018
			122A	New	IPSAS 41	2018
			122B	New	IPSAS 41	2018
			122C	New	IPSAS 41	2018
			122D	New	IPSAS 41	2018
			124	Amended	IPSAS 41	2018
			134A	New	IPSAS 42	2018
			134B	New	IPSAS 42	2018
			148	Amended	IPSAS 43	2021
			154D	Amended	COVID-19: Deferral of Effective Dates	2020
			154G	New	IPSAS 42	2018
			154H	Amended	COVID-19: Deferral of Effective Dates	2020
			154I	New	Improvements to IPSAS, 2021	2021
			154J	New	IPSAS 43	2021
			IG20	Amended	IPSAS 43	2021
			IG21	Amended	IPSAS 43	2021

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective				Handbook with Original Para
			Paras not yet Effective	How Affected	Origin of Amendment		
			IG51	Amended	IPSAS 43	2021	
			IG52	Amended	IPSAS 43	2021	
			IG67	Amended	IPSAS 41	2018	
			IG68	Amended	IPSAS 41	2018	
			IG69	Amended	IPSAS 41	2018	
			IG70	Amended	IPSAS 41	2018	
			IG71	Amended	IPSAS 41	2018	
			IG74	Amended	IPSAS 41	2018	
			IG91	Amended	IPSAS 41 IPSAS 42 IPSAS 43	2018 2018 2021	
			Appendix	Amended	IPSAS 41	2018	
IPSAS 34—Separate Financial Statements	January 2015	January 1, 2017	6	Amended	IPSAS 41	2018	
			12	Amended	IPSAS 41	2018	
			13	Amended	IPSAS 41	2018	
			14	Amended	IPSAS 41	2018	
			15	Amended	IPSAS 41	2018	
			22	Amended	IPSAS 41	2018	
			26	Amended	IPSAS 41	2018	
			30	Amended	IPSAS 41	2018	
			32B	Amended	COVID-19: Deferral of Effective Dates	2020	
IPSAS 35—Consolidated Financial Statements	January 2015	January 1, 2017	22	Amended	IPSAS 41	2018	
			45	Amended	IPSAS 41	2018	
			52	Amended	IPSAS 41	2018	
			55A	Amended	IPSAS 41	2018	
			56	Amended	IPSAS 41	2018	
			57	Amended	IPSAS 41	2018	
			58	Amended	IPSAS 41	2018	
			79E	Amended	COVID-19: Deferral of Effective Dates	2020	
			AG105	Amended	IPSAS 41	2018	

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective			Handbook with Original Para
			Paras not yet Effective	How Affected	Origin of Amendment	
IPSAS 36—Investments in Associates and Joint Ventures	January 2015	January 1, 2017	20	Amended	IPSAS 41	2018
			20A	New	Long-term Interests in Associates and Joint Ventures (Amendments to IPSAS 36) and Prepayment Features with Negative Compensation (Amendments to IPSAS 41)	2018
			24	Amended	IPSAS 41	2018
			25	Amended	IPSAS 41	2018
			26	Amended	IPSAS 41	2018
			43	Amended	IPSAS 41	2018
			44	Deleted	Long-term Interests in Associates and Joint Ventures (Amendments to IPSAS 36) and Prepayment Features with Negative Compensation (Amendments to IPSAS 41)	2018
			44A	New	IPSAS 41	2018
			44B	New	IPSAS 41	2018
			44C	New	IPSAS 41	2018
			45	Amended	IPSAS 41	2018
			51D	Amended	COVID-19: Deferral of Effective Dates	2020
			51F	Amended	COVID-19: Deferral of Effective Dates	2020

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective			Handbook with Original Para
			Paras not yet Effective	How Affected	Origin of Amendment	
			51G	New	Long-term Interests in Associates and Joint Ventures (Amendments to IPSAS 36) and Prepayment Features with Negative Compensation (Amendments to IPSAS 41)	2018
			51H	New	Long-term Interests in Associates and Joint Ventures (Amendments to IPSAS 36) and Prepayment Features with Negative Compensation (Amendments to IPSAS 41)	2018
			51I	New	Long-term Interests in Associates and Joint Ventures (Amendments to IPSAS 36) and Prepayment Features with Negative Compensation (Amendments to IPSAS 41)	2018
			Illustrative Example	New	Long-term Interests in Associates and Joint Ventures (Amendments to IPSAS 36) and Prepayment Features with Negative Compensation (Amendments to IPSAS 41)	2018

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective			Handbook with Original Para
			Paras not yet Effective	How Affected	Origin of Amendment	
IPSAS 37—Joint Arrangements	January 2015	January 1, 2017	28	Amended	IPSAS 41	2018
			30	Amended	IPSAS 41	2018
			41	Amended	IPSAS 41	2018
			42D	New	IPSAS 41	2018
			AG11	Amended	IPSAS 41	2018
			AG33A	Amended	IPSAS 41	2018
IPSAS 38—Disclosures in Interests in Other Entities	January 2015	January 1, 2017	4	Amended	IPSAS 41	2018
			61C	Amended	COVID-19: Deferral of Effective Dates	2020
IPSAS 39—Employee Benefits	July 2016	January 1, 2018	3	Amended	Improvements to IPSAS, 2021	2021
			4	Amended	Improvements to IPSAS, 2021	2021
			176B	Amended	Improvements to IPSAS, 2021	2021
			25	Amended	IPSAS 41	2018
IPSAS 40—Public Sector Combinations	January 2017	January 1, 2019	45	Amended	IPSAS 41	2018
			68	Amended	IPSAS 43	2021
			70	Amended	IPSAS 41	2018
			71	Amended	IPSAS 43	2021
			82A	New	IPSAS 43	2021
			82B	New	IPSAS 43	2021
			111	Amended	IPSAS 41	2018
			115	Amended	IPSAS 41	2018
			117	Amended	IPSAS 41	2018
			120	Amended	IPSAS 43	2021
IPSAS 41—Related Parties	January 2015	January 1, 2017	126A	Amended	COVID-19: Deferral of Effective Dates	2020
			126E	New	IPSAS 43	2021
			AG72	Deleted	IPSAS 43	2021

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective			Handbook with Original Para
			Paras not yet Effective	How Affected	Origin of Amendment	
			AG73	Deleted	IPSAS 43	2021
			AG74	Deleted	IPSAS 43	2021
			AG76	Amended	IPSAS 43	2021
			AG88	Amended	IPSAS 41	2018
			AG89	Amended	IPSAS 43	2021
			IE224	Amended	IPSAS 43	2021

Table B: List of IPSASs not yet Effective as at January 1, 2022

IPSAS	Issued	Original Effective Date On or After	Other IPSASs Affected
IPSAS 41—Financial Instruments	August 2018	January 1, 2023	IPSAS 1 IPSAS 4 IPSAS 9 IPSAS 12 IPSAS 14 IPSAS 19 IPSAS 21 IPSAS 23 IPSAS 26 IPSAS 28 IPSAS 29 IPSAS 30 IPSAS 32 IPSAS 33 IPSAS 34 IPSAS 35 IPSAS 36 IPSAS 37 IPSAS 38 IPSAS 40
IPSAS 42—Social Benefits	January 2019	January 1, 2023	IPSAS 1 IPSAS 2 IPSAS 19 IPSAS 23 IPSAS 24 IPSAS 28 IPSAS 33

IPSAS	Issued	Original Effective Date On or After	Other IPSASs Affected
IPSAS 43—Leases	January 2022	January 1, 2025	IPSAS 2 IPSAS 4 IPSAS 5 IPSAS 12 IPSAS 16 IPSAS 17 IPSAS 18 IPSAS 19 IPSAS 27 IPSAS 28 IPSAS 30 IPSAS 31 IPSAS 32 IPSAS 33 IPSAS 40 IPSAS 41

Table C: List of IPSAS not yet effective as at January 1, 2022-Paragraphs Amended by Other IPSASs

IPSAS	Issued	Original Effective Date On or After	Paragraphs Amended by Other IPSAS			Handbook with Original Para
			Paras not yet Effective	How Affected	Origin of Amendment	
IPSAS 41—Financial Instruments	August 2018	January 1, 2023	2	Amended	IPSAS 43	2021
			72A	New	Improvements to IPSAS 2021	2021
			72B	New	Improvements to IPSAS 2021	2021
			72C	New	Improvements to IPSAS 2021	2021
			72D	New	Improvements to IPSAS 2021	2021
			72E	New	Improvements to IPSAS 2021	2021
			87	Amended	IPSAS 43	2021
			155A	New	Improvements to IPSAS 2021	2021
			155B	New	Improvements to IPSAS 2021	2021
			155C	New	Improvements to IPSAS 2021	2021
			155D	New	Improvements to IPSAS 2021	2021
			155E	New	Improvements to IPSAS 2021	2021
			155F	New	Improvements to IPSAS 2021	2021
			155G	New	Improvements to IPSAS 2021	2021
			155H	New	Improvements to IPSAS 2021	2021
155I	New	Improvements to IPSAS 2021	2021			
155J	New	Improvements to IPSAS 2021	2021			
155K	New	Improvements to IPSAS 2021	2021			

IPSAS Issued	Original Effective Date On or After	Paragraphs Amended by Other IPSAS			Handbook with Original Para
		Paras not yet Effective	How Affected	Origin of Amendment	
		155L	New	Improvements to IPSAS 2021	2021
		155M	New	Improvements to IPSAS 2021	2021
		155N	New	Improvements to IPSAS 2021	2021
		155O	New	Improvements to IPSAS 2021	2021
		155P	New	Improvements to IPSAS 2021	2021
		155Q	New	Improvements to IPSAS 2021	2021
		155R	New	Improvements to IPSAS 2021	2021
		155S	New	Improvements to IPSAS 2021	2021
		155T	New	Improvements to IPSAS 2021	2021
		155U	New	Improvements to IPSAS 2021	2021
		155V	New	Improvements to IPSAS 2021	2021
		155W	New	Improvements to IPSAS 2021	2021
		155X	New	Improvements to IPSAS 2021	2021
		155Y	New	Improvements to IPSAS 2021	2021
		155Z	New	Improvements to IPSAS 2021	2021
		156	Amended	COVID-19: Deferral of Effective Dates	2020
		156A	Amended	COVID-19: Deferral of Effective Dates	2020

IPSAS	Issued	Original Effective Date On or After	Paragraphs Amended by Other IPSAS			Handbook with Original Para
			Paras not yet Effective	How Affected	Origin of Amendment	
			156B	New	Improvements to IPSAS 2021	2021
			156C	New	Improvements to IPSAS 2021	2021
			156D	New	Improvements to IPSAS 2021	2021
			156E	New	IPSAS 43	2021
			184	Amended	Improvements to IPSAS 2021	2021
			191	New	Improvements to IPSAS 2021	2021
			192	New	Improvements to IPSAS 2021	2021
			193	New	Improvements to IPSAS 2021	2021
			194	New	Improvements to IPSAS 2021	2021
			195	New	Improvements to IPSAS 2021	2021
			AG46	Amended	Improvements to IPSAS 2021	2021
			AG46A	New	Improvements to IPSAS 2021	2021
			AG198	Amended	IPSAS 43	2021
			AG210	Amended	IPSAS 43	2021
			4A	New	COVID-19: Deferral of Effective Dates	2020
			35	Amended	COVID-19: Deferral of Effective Dates	2020
			35A	Amended	COVID-19: Deferral of Effective Dates	2020
IPSAS 42—Social Benefits	January 2019	January 1, 2023				

Table D: List of IPSASs no Longer Effective at January 1, 2021

This Table is a list of those IPSASs that are no longer applicable as they have been superseded and/or removed.

IPSAS	Issued	Original Effective Date On or After	Reason and Date No Longer Effective
IPSAS 6—Consolidated and Separate Financial Statements (revised)	December 2006	January 1, 2008	IPSAS 6 is superseded by IPSASs 34–35 from periods beginning on or after January 1, 2017.
IPSAS 7—Investments in Associates (revised)	December 2006	January 1, 2008	IPSAS 7 is superseded by IPSASs 36 from periods beginning on or after January 1, 2017.
IPSAS 8—Interests in Joint Ventures (revised)	December 2006	January 1, 2008	IPSAS 8 is superseded by IPSASs 37 from periods beginning on or after January 1, 2017.
IPSAS 15—Financial Instruments: Disclosure and Presentation	December 2001	January 1, 2003	IPSAS 15 is superseded by IPSASs 28–30 from periods beginning on or after January 1, 2013.
IPSAS 25—Employee Benefits	February 2008	January 1, 2011	IPSAS 25 is superseded by IPSAS 39 from periods beginning on or after January 1, 2018.

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