

# **International Financial Reporting Standards**

## **A Pocket Guide – 2006**



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*Audit Committees – Good Practices for Meeting Market Expectations*

*Building the European Capital Market – Common Principles for a Capital Market*

*Financial instruments under IFRS*

*IAS 39 – Achieving hedge accounting in practice*

*IFRS Disclosure Checklist 2006*

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*Similarities and Differences – A comparison of IFRS and US GAAP*

*Understanding IAS 29 – Financial Reporting in Hyperinflationary Economies*

*World Watch – Governance and Corporate Reporting*

These publications and the latest news on IFRS can be found at [www.pwc.com/ifrs](http://www.pwc.com/ifrs)

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# International Financial Reporting Standards

## A pocket guide

This pocket guide provides a summary of the recognition and measurement requirements of International Financial Reporting Standards issued up to September 2006. It does not address most disclosure requirements. Detailed guidance on disclosure requirements can be found in the PwC publication *IFRS Disclosure Checklist 2006*.

The information in this guide is arranged into 12 sections:

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More detailed information and guidance on these matters can be found in other publications from PricewaterhouseCoopers. A list of all IFRS publications is provided on the inside front cover.

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### 1 Accounting framework

#### 1.1 International Financial Reporting Standards

Financial statements prepared in accordance with International Financial Reporting Standards (IFRS) should comply with all the IFRS requirements. The term IFRS includes all applicable IFRSs, IFRIC Interpretations, International Accounting Standards (IAS) and SIC Interpretations.

#### 1.2 Historical cost

Historical cost is the main accounting convention. Items are usually accounted for at their historical cost. However, IFRS permits the revaluation of intangible assets, property, plant and equipment (PPE), and investment property to their fair value. IFRS also requires certain categories of financial instrument and certain biological assets to be valued at their fair value. All items, other than those carried at fair value through profit or loss, are subject to impairment.

#### 1.3 Concepts

Financial statements should be prepared on an accruals basis and on the assumption that the entity is a going concern and will continue in operation in the foreseeable future (which is at least, but is not limited to, 12 months from the balance sheet date).

The four principal qualitative characteristics that make the information provided in financial statements useful to users are understandability, relevance (this is guided by the nature and materiality of the information), reliability (including faithful representation, substance over form, neutrality, prudence and completeness) and comparability.

#### Materiality

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

#### 1.4 True and fair view/fair presentation

Financial statements should show a true and fair view, or present fairly the financial position, of an entity's performance and changes in financial position. This is achieved by the application of the appropriate IFRS and of the principal qualitative characteristics stated above (Section 1.3).

## 1 Accounting framework (continued)

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### 1.5 Fair presentation override

Entities may depart from IFRS in extremely rare circumstances in which management concludes that compliance with an IFRS requirement would be so misleading as to conflict with the objective of the financial statements. The nature, reason and financial impact of the departure should be explained in the financial statements. The override does not apply where there is a conflict between local company law and IFRS.

### 1.6 First-time adoption

First-time adoption requires full retrospective application of all IFRSs effective at the reporting date for an entity's first IFRS financial statements. There are 14 exemptions and four exceptions to the requirement for retrospective application.

The exemptions relate to business combinations; property, plant and equipment, and other assets; employee benefits; cumulative translation differences; compound financial instruments; assets and liabilities of subsidiaries, associates and joint ventures; designation of previously recognised financial instruments; share-based payment transactions; comparatives for financial instruments; decommissioning liabilities; arrangements containing leases; comparatives for insurance contracts; fair value measurement of no-active market financial instruments at initial recognition; and comparatives for exploration for and evaluation of mineral resources.

The exceptions relate to derecognition of financial assets and financial liabilities; hedge accounting; estimates; and assets classified as held for sale and discontinued operations.

Comparative information must be prepared and presented on the basis of IFRS. Almost all adjustments arising from the first-time application of IFRS must be adjusted against opening retained earnings of the first period that is presented on an IFRS basis.



### 2 Financial statements

The objective of financial statements is to provide information for economic decisions. A complete set of financial statements should comprise a balance sheet, income statement, statement of changes in equity, cash flow statement and explanatory notes (including accounting policies).

There is no prescribed standard format for the financial statements, although examples and guidance are usually provided. There are minimum disclosures to be made on the face of the financial statements as well as in the notes.

Financial statements should disclose corresponding information for the preceding period ('comparatives'), unless there are other specific requirements.

#### 2.1 Balance sheet

The balance sheet presents an entity's financial position at a specific point in time. Management may use its judgement regarding the form of presentation in many areas, such as the use of a vertical or a horizontal format, how detailed sub-classifications are to be presented and what information is to be disclosed on the face of the balance sheet or in the notes in addition to the minimum requirements.

##### Items to be presented on the face of the balance sheet

The following items, as a minimum, have to be presented on the face of the balance sheet.

- **Assets** – Property, plant and equipment; investment property; intangible assets; financial assets; investments accounted for using the equity method; biological assets; deferred tax assets; current tax assets; inventories; trade and other receivables; and cash and cash equivalents.
- **Equity** – Issued capital and reserves attributable to equity holders of the parent; and minority interest.
- **Liabilities** – Deferred tax liabilities; current tax liabilities; financial liabilities; provisions; and trade and other payables.
- **Assets and liabilities held for sale** – The total of assets classified as held for sale and assets included in disposal groups classified as held for sale; and liabilities included in disposal groups classified as held for sale in accordance with IFRS 5.

## 2 Financial statements (continued)

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### Current/non-current distinction

Current and non-current assets and current and non-current liabilities should be presented as separate classifications on the face of the balance sheet, unless presentation based on liquidity provides information that is reliable and more relevant.

An asset is classified as current if it is: expected to be realised, sold or consumed in the entity's normal operating cycle (irrespective of length); primarily held for the purpose of being traded; expected to be realised within 12 months after the balance sheet date; or cash and cash equivalent (without restrictions beyond 12 months after the balance sheet date).

A liability is classified as current if: it is expected to be settled in the entity's normal operating cycle; it is primarily held for the purpose of being traded; it is expected to be settled within 12 months after the balance sheet date; or the entity does not have an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date (even if the original term was for a period of longer than 12 months and an agreement to refinance is completed after the balance sheet date).

### 2.2 Income statement

The income statement presents an entity's financial performance over a specific period of time. Management may use its judgement regarding the form of presentation in many areas (such as how detailed sub-classifications are to be presented and, except for certain minimum requirements, what information is to be disclosed on the face of the income statement or in the notes).

#### Items to be presented on the face of the income statement

The following items, as a minimum, must be presented on the face of the income statement: revenue; finance costs; share of the profit or loss of associates and joint ventures, accounted for using the equity method; tax expense; post-tax profit or loss of discontinued operations, and post-tax gain or loss recognised on the measurement to fair value less costs to sell (or on the disposal) of the assets or disposal group(s) constituting the discontinued operation; and profit or loss for the period.

Profit or loss for the period should be allocated on the face of the income statement to the amount attributable to minority interest and to the parent's equity holders. Additional line items or subheadings should be presented on

## 2 Financial statements (continued)

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the face of the income statement when such presentation is relevant to an understanding of the entity's financial performance.

An analysis of total expenses should be presented either on the face of the income statement or in the notes, using a classification based on either the nature or function of expenses.

### Exceptional items

IFRS does not use the term 'exceptional items' but requires the separate disclosure of items of income and expenses that are material. Disclosure may be on the face of the income statement or in the notes. Such income/expenses may include: restructuring costs; write-downs of inventories or property, plant and equipment (PPE); discontinued operations; litigation settlements; reversals of provisions; and gains or losses on disposals of PPE and investments.

### Extraordinary items

All items of income and expense are deemed to arise from an entity's ordinary activities. This categorisation is therefore prohibited.

## 2.3 Statement of changes in equity

The statement of changes in equity presents a reconciliation of equity items between the beginning and end of the period.

### Items to be presented on the face of the statement of changes in equity

The following items must be presented on the face of the statement of changes in equity:

- (a) profit or loss for the period; each of the items of income or expense recognised directly in equity (ie, revaluation gains on property, plant and equipment (PPE), fair value gains/losses on available-for-sale securities, currency translation differences arising on the translation of the financial statements from the functional to the presentation currency) and their total; total income/ expense for the period (the sum of the first two items); and the effects of changes in accounting policies and corrections of material prior-period errors.
- (b) amounts of transactions with equity holders (ie, share issue and dividend distribution); the balance of each reserve and retained earnings at the beginning and end of the period and the changes during the period.

## 2 Financial statements (continued)

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### 2.4 Statement of recognised income and expense

This statement is an alternative to the 'Statement of changes in equity'. It is mandatory when an entity uses the option in IAS 19 (revised 2004) to recognise all actuarial gains and losses directly in equity. The items in Section 2.3(a) above should be presented on the face of the statement of recognised income and expense; the items in 2.3(b) should be disclosed in the notes to the financial statements.

### 2.5 Cash flow statement

The cash flow statement presents the generation and use of cash by category (operating, investing and finance) over a specific period of time. It provides the users with a basis to assess the entity's ability to generate and utilise its cash.

Investing activities are the acquisition and disposal of non-current assets (including business combinations) and investments that are not cash equivalents. Financing activities are changes in the equity and borrowings. Operating activities are the entity's revenue-producing activities.

Entities may present their operating cash flows by using either the direct (gross cash receipts/payments) or the indirect method (adjusting net profit or loss for non-operating and non-cash transactions; and for changes in working capital). Non-cash transactions include impairment losses/reversals; depreciation; amortisation; fair value gains/losses; and income statement charges for provisions.

Cash flows from investing and financing activities should be reported separately gross (ie, gross cash receipts and gross cash payments) unless they meet certain specified criteria.

Separate disclosure should be made of movements in cash equivalents and details of significant non-cash transactions (such as the issue of equity for the acquisition of a subsidiary).

### 2.6 Notes to the financial statements

The notes are an integral part of the financial statements. Information presented in an entity's balance sheet, income statements, statement of changes in equity (or statement of recognised income and expense) and cash flow statement should be cross-referenced to the relevant notes wherever possible.

## 2 Financial statements (continued)

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Notes provide additional information to the amounts disclosed on the face of the 'primary' statements. The disclosures are required by IFRS. All entities should have at least the following disclosures within the notes to the financial statements: a statement of compliance with IFRS; accounting policies; and critical accounting estimates and judgements. Entities should also disclose, where applicable: changes in accounting policies; material prior-period errors; and changes in accounting estimates.

### Compliance with IFRS

Entities should disclose an explicit and unreserved statement of compliance with IFRS. This statement should only be made if the financial statements comply with all IFRS requirements.

### Accounting policies

Management should apply the most relevant IFRS guidance to transactions incurred by the entity. Where IFRS does not contain specific requirements, management should use its judgement in developing and applying an accounting policy that results in information that meets the qualitative characteristics stated in Section 1.3. If there is no IFRS standard or guidance, management should consider the applicability of the following sources in descending order: the requirements and guidance in IFRS on similar and related issues; and the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework. Management may also consider the most recent pronouncements of other standard-setting bodies, other accounting literature and accepted industry practices to the extent that these do not conflict with the concepts of IFRS and the Framework.

Some standards provide a choice of accounting policy but do not clarify how that choice should be exercised. An entity should choose and apply consistently one of the available accounting policies. Accounting policies should be applied consistently to similar transactions and events.

### Changes in accounting policies

Changes in accounting policies made on adoption of a new standard should be accounted for in accordance with the transitional provisions contained within that standard. If specific transitional provisions do not exist, an entity should follow the same procedures as for 'material prior-period errors' explained below.

## 2 Financial statements (continued)

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### Issue of new/revised standards

Standards are normally published well in advance of a required implementation date. In the intervening period, entities should disclose the fact that a new standard has been issued but is not yet effective, together with known or reasonably estimable information relevant to assessing the possible impact that the application of the standard will have on the entity's financial statements in the period of initial recognition.

Where an IFRS is applied before its effective date, this fact should be disclosed, together with its effect on the current and comparative financial information.

### Critical accounting estimates and judgements

Management should disclose:

- the nature and carrying amount of those assets and liabilities in which estimates and assumptions have a significant risk of causing a material adjustment to the carrying amounts within the next financial period; and
- the judgements made in applying the entity's accounting policies that have the most significant effect on the amounts recognised in the financial statements.

### Changes in accounting estimates

Changes in accounting estimates should be recognised prospectively by including the effects in profit or loss in the period that is affected (the period of the change and future periods) except if the change in estimate gives rise to changes in assets, liabilities or equity. In this case, it should be recognised by adjusting the carrying amount of the related asset, liability or equity in the period of the change.

### Material prior-period errors

Errors may arise from mistakes and oversights or misinterpretation of available information.

Material prior-period errors should be adjusted retrospectively (ie, adjust opening retained earnings and the related comparatives) unless it is impracticable to determine either the period-specific effects or the cumulative effect of the error. In this case, management should correct such errors prospectively from the earliest date practicable.

The error and effect of its correction on the financial statements should be disclosed.

### 3 Currencies

#### 3.1 Functional currency

All the components of the financial statements should be measured in the currency of the primary economic environment in which the entity operates (its functional currency). Functional currency should be determined by considering the currency that determines the pricing of transactions, as opposed to the currency in which transactions are denominated. All transactions entered into in currencies other than the functional currency should be treated as transactions in foreign currencies.

If the functional currency of an entity is the currency of a hyperinflationary economy, the financial statements should be restated (see below).

#### Foreign currency transactions

A transaction in a foreign currency is recorded in the functional currency using the exchange rate at the date of the transaction (average rates may be used if they do not fluctuate significantly). At the balance sheet date, foreign currency monetary balances are reported using the exchange rate at the balance sheet date. Non-monetary balances denominated in a foreign currency and carried at cost must be reported using the exchange rate at the date of the transaction. Non-monetary items denominated in a foreign currency and carried at fair value must be reported using the exchange rate at the date when the fair values were determined.

Exchange differences are recognised as income or expense for the period, except for those differences arising on a monetary item that forms part of an entity's net investment in a foreign entity (subject to strict criteria of what qualifies as net investment), or on a foreign currency liability (such as a borrowing) accounted for as a hedge of an entity's net investment in a foreign entity. Such exchange differences are classified separately in equity until the disposal of the net investment, at which time they are included in the income statement as part of the gain or loss on disposal.

#### 3.2 Hyperinflation

Management should exercise its judgement in determining whether or not a currency is that of a hyperinflationary economy. There are various indicators of a hyperinflationary economy (for example, the general population prefers to keep its wealth in non-monetary assets or in a relatively stable currency; and the cumulative inflation rate over three years is approaching or exceeds 100%).

### 3 Currencies (continued)

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Where an entity's functional currency is the currency of a hyperinflationary economy, the financial statements must be restated to take account of inflation. All non-monetary assets and liabilities are restated to their current value at the balance sheet date using an appropriate price index. Monetary assets and liabilities are not restated given that they are already expressed in terms of the monetary unit current at the balance sheet date (although comparative amounts are restated by using the yearly conversion factor). However, an entity holding net monetary assets/(liabilities) loses/(gains) purchasing power. The net gain or loss arising from holding such monetary assets and liabilities is included in the income statement for the period.

The entity should, in the period in which it identifies the existence of hyperinflation in the economy of its functional currency, not having been hyperinflationary in the prior period, apply the requirements of IAS 29 as if the economy had always been hyperinflationary. In relation to non-monetary items measured at historical cost, the entity's opening balance sheet at the beginning of the earliest period presented should therefore be restated to reflect the effect of inflation from the date the assets were acquired and the liabilities were incurred or assumed until the closing balance sheet date of the reporting period. For non-monetary items carried in the opening balance sheet at amounts current at dates other than those of acquisition or incurrence, the restatement should reflect the effect of inflation from the dates those carrying amounts were determined until the closing balance sheet date of the reporting period. Special rules apply to deferred tax figures.

#### 3.3 Presentation currency

An entity may choose to present its financial statements in any currency or currencies. If the presentation currency differs from the functional currency, an entity should translate its results and financial position into the presentation currency.

The translation process depends on whether or not the functional currency is the currency of a hyperinflationary economy. If the functional currency is not the currency of a hyperinflationary economy, the assets and liabilities are translated at the closing rate at the balance sheet date; the income statement is translated at exchange rates at the dates of the transactions (the use of average rates is allowed if the rates do not fluctuate significantly). All resulting exchange differences are recognised as a separate component of equity.



The financial statements of a foreign entity that has the currency of a hyperinflationary economy as functional currency are first restated, as explained in Section 3.2. All components are then translated to the presentation currency at the closing rate at the balance sheet date.

#### Consolidated financial statements/equity accounting/proportionate consolidation

When preparing financial statements that involve more than one entity, it is usual to deal with entities that have different functional currencies. The financial statements of all entities should be translated into the reporting entity's presentation currency, as explained above. The exchange differences arising from the translation are recycled to the income statement on disposal of these entities.

#### Goodwill/fair value adjustments

Goodwill and fair value adjustments arising from business combinations are considered components of the acquiree and are therefore denominated in the acquiree's functional currency. In the consolidated financial statements, they are translated to the presentation currency of the reporting entity.

## 4 Assets

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### 4 Assets

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

#### Recognition

The recognition of an asset depends first on whether it is probable that any future economic benefit associated with the item will flow to or from the entity, and second on whether the item has a cost or value that can be measured reliably.

When an entity incurs expenditure, it may provide evidence that future economic benefits were sought, but this is not conclusive proof that an item satisfying the definition of an asset has been obtained.

Similarly, the absence of related expenditure (such as donated PPE) does not preclude an item from satisfying the definition of an asset.

#### 4.1 Intangible assets

An intangible asset is an identifiable non-monetary asset without physical substance. The identifiability criterion is met when the intangible asset is separable (ie, it can be sold, transferred or licensed), or where it arises from contractual or other legal rights.

#### Recognition and initial measurement

Expenditure on intangibles should be recognised as an asset when it meets the recognition criteria of an asset.

#### Separately acquired intangible assets

Intangible assets are measured initially at cost. Cost includes (a) the fair value of the consideration given to acquire the asset, and (b) any costs directly attributable to the transaction, such as relevant professional fees or taxes.

#### Internally generated intangible assets

The cost of an internally generated intangible asset comprises only the expenditure incurred from the date when the intangible asset first meets the recognition criteria. Expenditure previously recognised as an expense should not be included in the cost of the asset.

Intangible assets arising from the research phase of an internal project should not be recognised. Intangible assets arising from the development phase of an internal project should be recognised when the entity can demonstrate: its technical feasibility, its intention to complete the developments, how the intangible asset will generate probable future economic benefits (for example, the existence of a market for the output of the intangible asset or for the intangible asset itself), the availability of resources to complete the development, and its ability to measure the attributable expenditure reliably.

The recognition criteria are strict. This means that most costs relating to internally generated intangible items will not be allowable for capitalisation and should therefore be expensed as incurred. Examples of such costs include research costs, start-up costs and advertising costs. Expenditure on internally generated brands, mastheads, customer lists, publishing titles and goodwill should not be recognised as assets. Expenditure paid in advance of receiving the related goods or services can be recognised as a prepayment irrespective of its future treatment.

### Intangible assets acquired in a business combination

Items that meet the definition of an intangible asset acquired in a business combination, regardless of whether they have been previously recognised in the acquiree's financial statements, should be recognised separately if their fair value can be reliably measured. Probability of economic benefits should be included in the fair value and not assessed separately.

### Subsequent measurement

Intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses (the cost model), or at a revalued amount – being the fair value at the date of revaluation less any subsequent accumulated amortisation and impairment losses (the revaluation model). The revaluation model can only be used when the fair value can be determined by reference to an active market and should be applied to the whole category of assets.

Intangible assets (including those that are revalued) are amortised unless they have an indefinite useful life (indefinite does not necessarily mean infinite). Amortisation should be carried out on a systematic basis over the useful lives of the intangibles. The residual value of such assets at the end of their useful lives must be assumed to be zero, unless there is either a

## 4 Assets (continued)

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commitment by a third party to purchase the asset or there is an active market for the asset. Management should reassess at every year-end the expected useful lives of the intangible assets.

An intangible asset has an indefinite useful life when, based on an analysis of all the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.

Intangible assets with definite useful lives are considered for impairment where there is an indication that the asset has been impaired. Intangible assets with indefinite useful lives should be tested annually for impairment and whenever there is an indication of impairment.

Subsequent expenditure relating to intangible assets should be evaluated under the general recognition provisions above.

### 4.2 Property, plant and equipment

#### Recognition and initial measurement

PPE should be recognised when it meets the recognition criteria of an asset.

PPE is measured initially at cost. Cost includes the fair value of the consideration given to acquire the asset (net of discounts and rebates) and any directly attributable cost of bringing the asset to working condition for its intended use (inclusive of import duties and non-refundable purchase taxes).

Directly attributable costs are the cost of site preparation, delivery, installation costs, relevant professional fees, and the estimated cost of dismantling and removing the asset and restoring the site (to the extent that such a cost is recognised as a provision). The cost of PPE may also include transfers from equity of gains/losses on qualifying cash flow hedges (basis adjustment) that are directly related to the acquisition of PPE.

#### Subsequent measurement

Classes of PPE should be carried at historical cost less accumulated depreciation and any accumulated impairment losses (the cost model), or at a revalued amount less any accumulated depreciation and subsequent accumulated impairment losses (the revaluation model). The depreciable amount of PPE (being the gross carrying value less the estimated residual value) should be depreciated on a systematic basis over its useful life.

Subsequent expenditure relating to an item of PPE should be evaluated under the general recognition provisions above.

PPE may have parts with different useful lives. Depreciation should be calculated based on each individual part's life. In case of replacement of one part, the new part should be capitalised to the extent that it meets the recognition criteria of an asset, and the carrying amount of the parts replaced should be derecognised appropriately.

The cost of a major inspection or overhaul of an item occurring at regular intervals over the useful life of the item is capitalised to the extent that it meets the recognition criteria of an asset. The carrying amount of the parts replaced should be derecognised.

### Revaluation

The fair value of PPE is its open market value rather than market value on an existing use basis. Where there is no evidence of market value because of the specialised nature of the plant and equipment, PPE is valued at its depreciated replacement cost, being the depreciated current acquisition cost of a similar asset.

When an item of PPE is revalued, its entire class should be revalued. Revaluations should be made with sufficient regularity to ensure that the carrying amount of the items does not differ materially from their fair value at the balance sheet date.

The increase of the carrying amount of an asset as a result of a revaluation should be credited directly to equity (under the heading 'revaluation surplus'), unless it reverses a revaluation decrease previously recognised as an expense, in which case it should be credited in the income statement. A revaluation decrease should be charged directly against any related revaluation surplus, with any excess being recognised as an expense in the income statement.

Each year an entity may transfer from revaluation surplus reserve to retained earnings reserve the difference between the depreciation charge calculated based on the revalued amount and the depreciation charge calculated based on the asset's original historical cost. This is a reserve movement and does not affect the income statement.

## 4 Assets (continued)

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The profit or loss on disposal of an asset is determined as the difference between the net disposal proceeds and the carrying amount of the asset. On disposal of a revalued asset, the relevant revaluation surplus included in equity is transferred directly to retained earnings (reserve movement).

### 4.3 Borrowing costs

#### Recognition and measurement

Interest expense is recognised on an accrual basis. Where interest expense includes a discount or premium arising on the issue of a debt instrument, the discount or premium is amortised using the effective interest rate method. The effective interest rate is the rate that discounts the estimated future cash payments through the expected life of the debt instrument to the carrying amount of the debt instrument.

An entity can choose, as its accounting policy, to capitalise borrowing costs where they are directly attributable to the acquisition, construction or production of a qualifying asset. A qualifying asset is an asset that takes a substantial period of time to get ready for its intended use or sale. Specific and general borrowing costs can be capitalised. Amounts capitalised in any period cannot exceed the borrowing costs incurred during the period, and the resulting carrying amount of the qualifying asset cannot exceed its recoverable amount.

Capitalisation commences when expenditures and borrowings are being incurred for the asset, and ceases when activities that are necessary to prepare the asset for its intended use or sale are in progress. Capitalisation should be suspended when development of the asset is interrupted for extended periods. It should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

The accounting policy for borrowing costs must be followed consistently for all qualifying assets. It is not acceptable to capitalise borrowing costs in relation to some qualifying assets and expense them in relation to others.

### 4.4 Investment properties

Investment property is property (land or a building, or part of a building, or both) held by an entity to earn rentals and/or for capital appreciation.

In the consolidated financial statements, investment property excludes property occupied by the parent or a subsidiary or fellow subsidiaries. It includes property that is leased to an associate or joint venture that occupies the property.

Properties held for use in the production or supply of goods or services, or for administrative purposes are accounted for as PPE; properties held for sale in the ordinary course of business are accounted for as inventories.

### Recognition and initial measurement

For an investment property to be recognised, it should meet the recognition criteria of an asset.

The cost of a purchased investment property is the fair value of its purchase price plus any directly attributable costs, such as professional fees for legal services, property transfer taxes and other transaction costs. The cost of a self-constructed investment property is its cost at the date when construction or development is complete. The investment property is classified and measured as PPE until that date (see Section 4.2).

### Subsequent measurement

An entity may choose, as its accounting policy, to carry investment properties at fair value or cost. However, when an investment property is held by a lessee under an operating lease, the entity should follow the fair value model for all its investment properties.

The fair value model requires measurement of all of the investment properties at fair value (except when the fair value cannot be measured reliably on a continuing basis).

Changes in the fair value should be recognised in profit or loss in the period in which they arise.

The cost model is consistent with the treatment of PPE. Under this model, investment properties are carried at cost less accumulated depreciation and any accumulated impairment losses. Special rules apply to transfers to or from investment properties. Investment property that is held for sale is measured under the cost model at the lower of its carrying amount and fair value less costs to sell.

## 4 Assets (continued)

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### 4.5 Cash equivalents

Cash equivalents are short-term, highly liquid investments that are readily convertible to a known amount of cash. There should be little risk of changes in their value. 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. A money market fund qualifies as a cash equivalent only when: (a) all investments held in the fund qualify individually as cash equivalents; or (b) the application of strict fund management policies and limits (usually established by a local regulator and a process exists to ensure effective application of the policies) lead the fund to meet the definition of cash equivalents.

### 4.6 Inventories

#### Recognition and initial measurement

Inventories should be recognised when the risks and rewards of ownership are transferred to the entity and the asset recognition criteria are met.

Assets held in an entity's premises may not qualify as inventories if they are held on consignment (ie, on behalf of another entity and no liability to pay for the goods exists unless they are sold).

Inventories should initially be recognised at cost. Cost of inventories includes import duties, non-refundable taxes, transport and handling costs and any other directly attributable costs less trade discounts, rebates and subsidies.

#### Subsequent measurement

Inventories should be valued at the lower of cost and net realisable value (NRV). NRV is the estimated selling price in the ordinary course of business, less the costs of completion and selling expenses.

The cost of inventories used should be assigned by using either the first-in, first-out (FIFO) or weighted average cost formula. Last-in, first-out (LIFO) is not permitted. An entity should use the same cost formula for all inventories that have a similar nature and use to the entity. Where inventories have a different nature or use, different cost formulas may be justified. The cost formula used should be applied on a consistent basis from period to period.

### 4.7 Financial assets

A financial asset is: cash; a contractual right to receive cash or another financial asset; a contractual right to exchange financial assets or liabilities



with another entity under conditions that are potentially favourable; or an equity instrument of another entity.

There are four categories of financial asset:

- **At fair value through profit or loss** – all financial assets acquired for the purpose of generating a profit from short-term fluctuations in price, or part of a portfolio with a pattern of short-term profit taking; or those financial assets designated in this category by management at initial recognition. Designation by management is allowed only if it results in more relevant information (it reduces a measurement or recognition inconsistency arising from measuring assets or liabilities on different bases, or a group of financial assets is managed on a fair value basis in accordance with a documented risk management or investment strategy), or the financial asset contains one or more embedded derivatives that significantly modify the cash flows of the host contract.
- **Held-to-maturity** – non-derivative financial assets with fixed or determinable payments and maturity that an entity has the positive intention and ability to hold to maturity (conditions for this category are tightly defined in IAS 39);
- **Loans and receivables** – non-derivative financial assets with fixed or determinable payments that are not quoted in an active market; and
- **Available-for-sale** – the remainder; or those financial assets designated in this category by management.

### Recognition and initial measurement

A financial asset is recognised when the entity becomes a party to its contractual provisions.

Financial assets should be measured initially at fair value, plus, in the case of a financial asset not at fair value through profit or loss, transaction costs (such as advisers' and agents' fees and commissions, duties and levies by regulatory agencies) that are directly attributable to the acquisition of the financial asset. Transaction costs are recognised in the income statement when the financial asset is carried at fair value through profit or loss.

The fair value of a financial asset on initial recognition is normally the transaction price unless the fair value is evidenced by comparison with other observable current market transactions or data from observable markets.

Regular way purchases and sales of financial assets should either be recognised at trade date (commitment date) or settlement date (delivery

## 4 Assets (continued)

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date). When settlement date is used, the entity should account for any change in the fair value of the asset to be received during the period between the trade date and the settlement date. The chosen policy should be applied consistently for all purchases and sales.

### Subsequent measurement

The classification of financial assets drives their subsequent measurement, which is as follows:

- **At fair value through profit or loss** – carried at fair value with gains and losses reported in income;
- **Held-to-maturity** – carried at amortised cost;
- **Loans and receivables** – carried at amortised cost; and
- **Available-for-sale** – carried at fair value with gains and losses reported in equity. The only exemption to the use of fair value is in rare cases in which the fair value of such an equity instrument cannot be measured reliably, in which case they are carried at cost less impairment.

### Tainting of held-to-maturity financial assets

Special provisions apply where an entity sells or reclassifies 'more than an insignificant' amount of held-to-maturity investments.

### Reclassifications

Reclassifications are rare. Reclassification into and out of the 'fair value through profit or loss' category are generally prohibited.

### 4.8 Impairment of assets

Assets are subject to an impairment test, with the following exceptions: inventories, construction contract assets, deferred tax assets, employee benefit assets, non-current assets classified as held for sale; various financial assets; investment properties carried at fair value; biological assets carried at fair value less point of sale costs; deferred acquisition costs; and intangibles assets arising from an insurer's contractual right under an insurance contract within the scope of IFRS 4.

An asset or a cash-generating unit (CGU) (the smallest identifiable group of assets that generates inflows that are largely independent from the cash flows from other CGUs) is impaired when its carrying amount exceeds its recoverable amount.

Intangible assets with indefinite useful lives, capitalised intangibles not yet available for use and CGUs including goodwill are tested for impairment on an annual basis. Other assets subject to impairment should be considered for impairment where there is an indication that the asset may be impaired.

Goodwill arising on a business combination (see Section 11) should be allocated among the group's CGUs that are expected to benefit from synergies as a result of the business combination. This allocation is based on management's assessment of the synergies gained and is not dependent on the location of the acquired assets.

Goodwill should be allocated to CGUs as soon as practicable but in any event before the end of the period subsequent to the acquisition. If some of the goodwill allocated to a CGU was acquired in a business combination during the current annual period, that CGU should be tested for impairment before the end of the current period.

External indications of impairment include: a decline in an asset's market value; significant adverse changes in the technological, market, economic or legal environment; increases in market interest rates; or when the entity's net asset value is above its market capitalisation.

Internal indications include: evidence of obsolescence or physical damage of an asset; changes in the way an asset is used (for example, due to restructuring or discontinued operations); or evidence from internal reporting that the economic performance of an asset is, or will be, worse than expected.

When performing the impairment test of an asset, the entity should estimate the recoverable amount of the asset and if necessary recognise an impairment loss for the excess of the carrying amount over the recoverable amount. Recoverable amount is the higher of the asset's fair value less cost to sell (FVLCTS) and its value in use (VIU). FVLCTS is the amount obtainable from a sale of an asset or cash-generating unit in an arm's length transaction between knowledgeable, willing parties, less costs of disposal. VIU requires entities to make estimates of the future cash flows to be derived from the particular asset, and discount them using a pre-tax market rate that reflects current assessments of the time value of money and the risks specific to the asset.

Cash flow projections should use reliable budgets or forecasts for a period no longer than five years. Cash flows beyond the five years are extrapolated

## 4 Assets (continued)

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using a steady or declining growth rate for subsequent years. Where cash flows are not readily identifiable as being specific to a particular asset, cash flows should be collected at the CGU level. Identification of an asset's CGU often requires judgement and may include the consideration of how management monitors the entity's operations or how it makes decisions regarding allocations of resources.

Corporate assets and liabilities (for example, head office) that can be allocated to a group of CGUs on a reasonable and consistent basis must be taken into consideration.

Impairment losses should first be charged against goodwill. If the impairment loss exceeds the book value of goodwill, management must follow complex allocation rules. Reversals of impairment losses are permitted only in certain circumstances and never against goodwill.

### Impairment of financial assets

Where there are indicators of impairment, all financial assets except those carried at fair value through profit or loss should be subject to an impairment test. The indicators should provide objective evidence of impairment as a result of a past event that occurred subsequent to the initial recognition of the asset. Expected losses as a result of future events are not recognised, no matter how likely.

Indicators of impairment of debt instruments include significant financial difficulty of the issuer, high probability of bankruptcy, granting of concessions to the issuer, the disappearance of an active market because of financial difficulties, breach of contract or an adverse change in observable data (for example, an increase in unemployment).

Indicators of impairment of equity instruments include significant changes with an adverse effect on general economic factors (such as technological changes), or significant or prolonged decline in the fair value below its cost. As equity represents a residual interest in an entity's net assets, equity instruments are likely to be impaired before debt securities.

### 4.9 Contingent assets

Contingent assets are possible assets whose existence will be confirmed only on the occurrence or non-occurrence of uncertain future events outside the entity's control. Contingent assets are not recognised. When the

realisation of income is virtually certain, the related asset is not a contingent asset, and it is recognised as an asset.

Contingent assets should be disclosed and described in the notes to the financial statements, including an estimate of their potential financial effect if the inflow of economic benefits is probable.

## 5 Liabilities

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### 5 Liabilities

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

A present obligation may be legally enforceable as a consequence of a binding contract or statutory requirement or an entity's policy/past practice (such as to rectify faulty products beyond the warranty period).

Recognition of liabilities depends first on whether it is probable (ie, more likely than not) that any future economic benefit associated with the item will flow from the entity; and second on whether the item has a cost or value that can be measured with reliability.

#### Financial liabilities

Items are classified as financial liabilities when the issuer has a contractual obligation to deliver cash or another financial asset to the holder of the instrument or to issue a variable number of own shares to settle a fixed amount, regardless of its legal form (for example, mandatorily redeemable preference shares should be classified as liabilities).

Financial liabilities are recognised initially at fair value plus, in the case of a financial liability not at fair value through profit or loss, transactions costs that are directly attributable to the issuance of the financial liability.

An instrument should be classified as a financial liability where the settlement method (ie, either cash or equity) of an instrument depends on the outcome of uncertain future events or circumstances that are beyond the issuer's control. However, where the possibility of the issuer being required to settle in cash or another financial asset is remote at the time of issuance, the contingent settlement provision should be ignored and the instrument classified as equity.

#### Commitments

A decision by management to acquire assets in the future does not in itself give rise to a present obligation. An entity may be committed to acquire tangible or intangible assets in order to use PPE under operating lease agreements for a future period. A commitment may not therefore be recognised, but the amount should be disclosed.

### 5.1 Income taxes

#### Recognition and measurement

Deferred tax should be provided in full, using the liability method, for all temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements, except for the following: (a) initial recognition of goodwill; (b) initial recognition of an asset or liability in a transaction that is not a business combination and that affects neither accounting profit nor taxable profit; and (c) investments in subsidiaries, branches, associates and joint ventures, but only where certain criteria apply on retention of undistributed profits and reversal of temporary differences.

Current and deferred tax is recognised in the income statement, unless the tax arises from a business combination that is an acquisition or a transaction or event that is recognised, in the same or different period, directly in equity. The tax consequences that accompany, for example, a change in tax rates or tax laws, a reassessment of the recoverability of deferred tax assets or a change in the expected manner of recovery of an asset, is recognised in the income statement, except to the extent that it relates to items previously charged or credit to equity.

Deferred tax assets and liabilities should be measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that apply or have been enacted or substantively enacted by the balance sheet date. Discounting of deferred tax assets and liabilities is not permitted.

The measurement of deferred tax liabilities and deferred tax assets should reflect the tax consequences that would follow from the manner in which the entity expects, at the balance sheet date, to recover or settle the carrying amount of its assets and liabilities. When a non-depreciable asset (such as land) is revalued, the deferred tax arising from that revaluation is determined based on the tax rate applicable to the recovery of the carrying amount of that asset through its sale.

Management should recognise a deferred tax asset for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised. The same principles apply to recognition of deferred tax assets for unused tax losses carried forward.

## 5 Liabilities (continued)

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Where an entity is subject to different tax rates depending on whether the profits are distributed, the current and deferred tax assets and liabilities are measured at the tax rate applicable to undistributed profits. The income tax consequences of the payment of dividends are recognised in net profit or loss for the period in which a liability to pay the dividend is recognised, unless the income tax consequences of dividends arise either from a transaction or event that is recognised directly in equity or from a business combination that is an acquisition.

Tax relating to dividends that is paid or payable to taxation authorities on behalf of the shareholders (for example, withholding tax) is charged to equity as part of the dividends.

Current tax assets and liabilities should be offset only if the entity has a legally enforceable right to offset and intends to either settle on a net basis or to realise the asset and settle the liability simultaneously. An entity is able to offset deferred tax assets and liabilities only if it is able to offset current tax balances and the deferred balances relate to income taxes levied by the same taxation authority.

### 5.2 Employee benefits

Employee benefits are all forms of consideration given by an entity in exchange for services rendered by its employees. These benefits include salary-related benefits (such as wages, salaries, profit-sharing, bonuses, long-service leave and share-based compensation plans), termination benefits (such as severance or redundancy pay) and post-employment benefits (such as retirement benefit plans).

Post-employment benefits include pensions, termination indemnity, and post-employment life insurance and medical care. Pensions and termination indemnities are provided to employees either through defined contribution plans or defined benefit plans.

Whether an arrangement is a defined contribution plan or a defined benefit plan depends on the substance of the transaction rather than the form of the agreement. For example, a termination indemnity scheme, whereby employee benefits are payable regardless of the reason for the employee's departure, is accounted for as a defined benefit plan. Special consideration needs to be given to multi-employer plans.



### Recognition and measurement

Recognition and measurement for many of these short-term benefits is straightforward. However long-term benefits, particularly post-employment benefits, give rise to more complicated measurement issues.

### Defined contribution plans

The cost of defined contribution plans is the contribution payable by the employer for that accounting period.

### Defined benefit plans

The use of an accrued benefit valuation method (the projected unit credit method) is required for calculating defined benefit obligations. This method takes account of employee service rendered to the balance sheet date but incorporates assumptions about future salary increases.

The defined benefit obligation should be recorded at present values using as discount rate the interest rate on high-quality corporate bonds with a maturity consistent with the expected maturity of the obligations. In countries where no deep market in high-quality corporate bonds exists, the interest rate on government bonds should be used.

Where defined benefit plans are funded, the plan assets should be measured at fair value using discounted cash flow estimates if market prices are not available. Plan assets are tightly defined, requiring the following conditions: the assets must be held by an entity (a fund) that is legally separate from the reporting entity and that was established solely to pay or fund employee benefits; the assets must be available to be used only to pay or fund the employee benefits; the assets should not be available to the entity's own creditors even in bankruptcy. The assets cannot be returned to the reporting entity unless either the fund's remaining assets are sufficient to meet all the related employee benefit obligations of the plan or the reporting entity, or the assets are returned to the reporting entity to reimburse it for paying employee benefits. Plan assets that do not meet these requirements cannot be offset against the plan's defined benefit obligations.

Actuarial gains and losses may be recognised using a 'corridor' approach. Any actuarial gains and losses (arising from both defined benefit obligations and any related plan assets) that fall outside the higher of 10% of the present value of the defined benefit obligation or 10% of the fair value of the plan assets (if any) should be amortised over no more than the remaining working

## 5 Liabilities (continued)

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life of the employees. However, an entity is permitted to adopt systematic methods that result in faster recognition of such gains and losses, including immediate recognition of all actuarial gains and losses.

An alternative introduced by amendments to IAS 19 in 2004 permits immediate recognition of actuarial gains and losses outside of profit or loss. If this policy is adopted, actuarial gains and losses should be recognised in a Statement of Recognised Income and Expense as described in Section 2.4; the alternative of presenting a statement of changes in equity as described in Section 2.3 is not permitted.

The accounting policy for recognising actuarial gains and losses must be disclosed.

Past service costs that arise on pension plan amendments are recognised as an expense on a straight-line basis over the average period until the benefits become vested. If the benefits are already vested, the past service cost is recognised as an expense immediately. Gains and losses on the curtailment or settlement of a defined benefit plan are recognised in the income statement when the curtailment or settlement occurs.

### Early termination obligation

Early termination obligations should be recognised as a liability when the entity is 'demonstrably committed' to terminating the employment before the normal retirement date.

An entity is 'demonstrably committed' when, and only when, it has a detailed formal plan for the early termination without realistic possibility of withdrawal. Where such benefits are long term, they should be discounted using the same rate as above for defined benefit obligations. 'Normal' termination obligations should be accrued as the obligation arises from past service.

### Equity compensation benefits

See 'Share-based payment' (Section 9.6).

## 5.3 Financial liabilities

A financial liability is a contractual obligation to deliver cash or another financial asset or to exchange financial instruments with another entity under conditions that are potentially unfavourable.

### Recognition and initial measurement

A financial instrument (see Section 9.1) is recognised when the entity becomes a party to its contractual provisions.

There are two categories of financial liability:

- **At fair value through profit or loss** - liabilities acquired for the purpose of generating a profit from short-term fluctuations in price or part of a portfolio with a pattern of short-term profit taking; or designated in this category by management at initial recognition. Designation by management is allowed only if it results in more relevant information (it reduces a measurement or recognition inconsistency arising from measuring assets or liabilities on different bases, or a group of financial liabilities is managed on a fair value basis in accordance with a documented risk management or investment strategy), or the financial liability contains one or more embedded derivatives that significantly modify the cash flows of the host contract.
- **Other liabilities** – the remainder.

Financial liabilities follow the same initial measurement requirements as financial assets.

### Subsequent measurement

The classification of financial liabilities drives their subsequent measurement, which is as follows:

- **At fair value through profit or loss** – carried at fair value, with gains and losses reported in income.
- **Other liabilities** – carried at amortised cost.

## 5.4 Provisions and contingencies

### Recognition and initial measurement

A provision should be recognised only when: the entity has a present obligation to transfer economic benefits as a result of past events; it is probable (more likely than not) that such a transfer will be required to settle the obligation; and a reliable estimate of the amount of the obligation can be made.

The amount recognised as a provision should be the best estimate of the unavoidable expenditure required to settle in full the present obligation, and should be discounted at a pre-tax rate that reflects current market assessment of the time value of money and those risks specific to the liability that have not been reflected in the estimated cash flows.

## 5 Liabilities (continued)

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A present obligation arises from an obligating event and may take the form of either a legal obligation or a constructive obligation. An obligating event leaves the entity no realistic alternative to settling the obligation. If the entity can avoid the future expenditure by its future actions, it has no present obligation, and no provision is required. For example, an entity cannot recognise a provision based solely on the intent to incur expenditure at some future date.

An obligation does not have to take the form of a 'legal' obligation before a provision is recognised. An entity may have an established pattern of past practice that indicates to other parties that it will accept certain responsibilities and as a result has created a valid expectation on the part of those other parties that it will discharge those responsibilities (ie, the entity is under a constructive obligation).

### Future operating losses

Provisions for future operating losses are strictly prohibited. However, an expectation for future operating losses is an indication that certain assets (CGUs) may be impaired (see Section 4.8).

### Onerous contracts

If an entity has an onerous contract (the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it), the present obligation under the contract should be recognised as a provision.

### Restructuring provisions

There are specific requirements as to which events would meet the definition of restructuring when a provision for restructuring is recorded and what costs are included in the provision. The entity should demonstrate a constructive obligation to restructure. The constructive obligation should be demonstrated by: (a) a detailed formal plan identifying at least five main features of the restructuring; and (b) raising a valid expectation to those affected that it will carry out the restructuring by starting to implement the plan or by announcing its main features to those affected.

A restructuring plan does not create a present obligation at the balance sheet date if it is announced after that date, even if it is announced before the financial statements are approved. No obligation arises for the sale of

an operation until the entity is committed to the sale (ie, there is a binding sale agreement).

The provision should only include incremental costs necessarily entailed by the restructuring and not those associated with the entity's ongoing activities. Any expected gains on the sale of assets should not be considered in measuring a restructuring provision.

### Provisions for waste management costs

Obligations to contribute to the cost of waste management for historical electrical and electronic household equipment do not give rise to the recognition of a provision unless and until the producers of such equipment have realised a share in the respective market during the measurement period. See IFRIC 6 for further details.

### Reimbursements

Where the entity expects to recover from a third party some or all of the amounts required to settle a provision and has no obligation for that part of the expenditure to be met by the third party, the amount payable by the third party should not be included in the provisions.

In all other cases, the provision and any anticipated recovery should be presented separately as a liability and an asset respectively; however, an asset can only be recognised if it is virtually certain that settlement of the provision will result in a reimbursement, and the amount recognised for the reimbursement should not exceed the amount of the provision. The amount of any expected reimbursement should be disclosed. Net presentation is permitted in the income statement.

### Decommissioning, restoration and environmental rehabilitation funds

Entities with obligations to pay for decommissioning costs having interests in decommissioning, restoration and environmental rehabilitation funds should recognise their obligations (provision) and their interests in the fund separately unless they have no liability, even if the fund fails to pay (see IFRIC 5 for further details).

### Subsequent measurement

Management should perform an exercise at each balance sheet date to identify the best estimate of the expenditure required to settle in full the

## 5 Liabilities (continued)

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present obligation, discounted at an appropriate rate. The increase in provision due to the passage of time is recognised as interest expense.

### 5.5 Contingent liabilities

Contingent liabilities are possible obligations whose existence will be confirmed only on the occurrence or non-occurrence of uncertain future events outside the entity's control, or present obligations that are not recognised because: (a) it is not probable that an outflow of economic benefits will be required to settle the obligation; or (b) the amount carried cannot be measured reliably.

Contingent liabilities are recognised as liabilities where there is a present obligation, it is probable (more likely than not) that a transfer of economic benefits will result from past events and a reliable estimate can be made.

Contingencies that are not capable of meeting the recognition tests should still be disclosed and described in the notes to the financial statements, including an estimate of their potential financial effect and uncertainties relating to the amount or timing of any outflow, unless the possibility of settlement is remote.

## 6 Equity

Equity is the residual interest in the entity's assets after deducting all its liabilities. Equity is calculated based on the requirements of IFRS and the accounting policies used by the entity. Normally, therefore, the aggregate amount of equity corresponds only by coincidence with the aggregate market value of the entity's shares or the sum that could be raised by disposing of either the net assets on a piecemeal basis or the entity as a whole on a going-concern basis.

### 6.1 Share issue costs

External transaction costs are tightly defined, and only those directly attributable to an equity transaction that itself results in a net increase or decrease in equity are recognised as a deduction from equity. If an entity issues a compound instrument that contains a liability and an equity element, transaction costs should be allocated to the component parts consistent with the allocation of proceeds.

### 6.2 Treasury shares

Treasury shares should be presented in the balance sheet either as a one-line adjustment to equity, or the par value (if any) may be shown as deduction from share capital with adjustments against other categories of equity. Transaction costs are accounted for as a deduction from equity (net of any related income tax benefit) to the extent that they are incremental costs directly attributable to the equity transaction. Subsequent resale of the shares does not give rise to gain or loss and is therefore not part of net income for the period. The sales consideration should be presented as an increase in equity.

## 7 Income

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### 7 Income

The definition of income encompasses revenue and gains. Revenue arises in the course of an entity's ordinary activities and is referred to by a variety of different names, including sales, fees, interest, dividends, royalties and rent. Gains represent other items that meet the definition of income and are often reported net of related expenses.

#### Recognition

Income is generally recognised when earned. Recognition of income depends on whether:

- an increase in future economic benefits related to an asset that can be measured reliably has arisen; or
- a decrease of a liability that has arisen can be measured reliably.

#### 7.1 Revenue

Revenue should be measured at the fair value of the consideration received or receivable. Revenue should be recognised when it is probable that economic benefits will flow to the entity and these benefits can be measured reliably.

Revenue arising from the sale of goods should be recognised when an entity transfers the significant risks and rewards of ownership and control, and the amount of revenue and costs are measured reliably.

Revenue from the rendering of services should be recognised by reference to the stage of completion of the transaction at the balance sheet date using rules similar to those for construction contracts (see Section 7.2).

Revenue is recognised in the accounting periods in which the services are rendered under the percentage-of-completion method. The recognition of revenue on this basis provides useful information on the extent of service activity and performance during a period.

The transaction is not a sale and revenue is not recognised when: the entity retains an obligation for unsatisfactory performance not covered by normal warranty provisions; the receipt of revenue from a particular sale is contingent on the derivation of revenue by the buyer from its sale of the goods; the buyer has the power to rescind the purchase for a reason specified in the sales contract; or the entity is uncertain about the probability of return.



In order to reflect the substance of the transaction, it may be necessary to apply the recognition criteria to the separately identifiable components of a single transaction. When a product's selling price includes an identifiable amount for subsequent servicing, that amount is deferred and recognised as revenue over the period during which the service is performed. Fees such as up-front fees, even if non-refundable, are earned as the products and/or services are delivered and/or performed over the term of the arrangement or the expected period of performance, and should be deferred and recognised systematically over the periods that the fees are earned.

Interest income is recognised using the effective interest rate method. Royalties are recognised on an accrual basis in accordance with the substance of the relevant agreement. Dividends are recognised when the shareholder's right to receive payment is established.

### **7.2 Construction contracts**

Revenue and expenses on construction contracts should be recognised using the percentage-of-completion method.

When the outcome of the contract cannot be estimated reliably, revenue should be recognised only to the extent of costs incurred that it is probable will be recovered; contract costs should be recognised as an expense as incurred. When it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately.

## 8 Expenses

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### 8 Expenses

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

Expenses that arise in the course of the entity's ordinary activities include, cost of goods sold, employee benefit expenses, advertising costs, amortisation and depreciation. They usually take the form of an outflow or depletion of assets such as cash and cash equivalents, inventory and property, plant and equipment.

Losses represent other items that meet the definition of expenses.

#### Recognition

Recognition of expenses depends on whether:

- a decrease in future economic benefits related to an asset that can be measured reliably has arisen; or
- an increase of a liability that can be measured reliably has arisen.

Cost of goods sold are usually recognised in the income statement on the basis of a direct association between the costs incurred and the earning of specific items of income. This process, commonly referred to as the matching of costs with revenues, involves the simultaneous or combined recognition of revenues and expenses that result directly and jointly from the same transactions or other events. However, the application of the matching concept does not allow the recognition of items in the balance sheet that do not meet the definition of assets or liabilities.

Expenses should be disclosed on the face of the income statement either by function (an entity should disclose in the notes details of expenses by nature under this method) or by nature.

#### 8.1 Employee benefits

See 'Employee benefits' (Section 5.2).

#### 8.2 Share-based payments

See 'Share-based payments' (Section 9.6).

#### 8.3 Interest expense

See 'Borrowing costs' (Section 4.3).

### 9 Other financial reporting topics

#### 9.1 Financial instruments

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

A financial instrument is recognised when the entity becomes a party to its contractual provisions. The initial recognition and measurement of financial assets, financial liabilities and equity are explained in Sections 4.7, 5.3 and 6 respectively.

#### Compound financial instruments

The issuer of a financial instrument that contains a right to be converted to equity (for example, a convertible debt) should identify the instrument's component parts and account for them separately, allocating the proceeds between liabilities and shareholders' equity.

#### Puttable instrument

A financial instrument such as a share that gives the holder the right to put it back to the issuer for cash or another financial asset is a financial liability of the issuer. When the issuer has an unconditional right to avoid redemption, the instrument should be classified as an equity instrument.

#### Derivatives

A derivative is a financial instrument with all of the following characteristics:

- 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 (sometimes called 'underlying');
- 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.

All contractual rights or obligations under derivatives should be recognised on the balance sheet as financial assets or liabilities. Gains and losses on derivatives should be recognised in the income statement unless they qualify for cash flow or net investment hedge accounting; in this case, such gains and losses are deferred in equity.

## 9 Other financial reporting topics (continued)

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### Embedded derivatives

An embedded derivative is a component of a combined financial instrument that also includes a non-derivative host contract, with the effect that some of the cash flows of the combined instrument vary in a similar way to a stand-alone derivative. Embedded derivatives that are not closely related to the host contract must be separated from the host contract and accounted for as stand-alone derivatives.

### Derecognition of financial assets

There are complicated steps that help management to establish whether a financial asset should be derecognised. The five-step approach should be followed in the prescribed order only.

The tests are summarised as follows:

- 1) Should the special purpose entity (Section 11.2) established for the disposal (if applicable) be consolidated?
- 2) What part of the asset(s) is subject to the derecognition criteria?
- 3) Have the rights to the cash flows from the assets expired?
- 4) Have the rights to the cash flows from the assets been transferred?
- 5) Has the entity transferred substantially all the risks and rewards, or retained all the risks and rewards, or retained control of the asset?

The above tests may indicate that management should (a) not derecognise the asset; (b) derecognise the asset; or (c) continue to recognise the asset to the extent of the continuing involvement.

### Derecognition of financial liabilities

Financial liabilities are derecognised when they are extinguished – ie, when the obligation is discharged, cancelled, expired or when the debtor is legally released from the liability by law or the creditor.

### Offsetting

The ability to offset financial assets and financial liabilities is severely restricted. They can only be offset in those rare situations where an entity has a legally enforceable right to offset the recognised amounts and it intends to either settle on a net basis or to realise the asset and liability simultaneously.

### Hedge accounting

To qualify for hedge accounting, an entity should (a) document at the inception of the hedge the relationship between hedging instruments and

## 9 Other financial reporting topics (continued)

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hedging items; and (b) have the risk management objective and strategy for undertaking various hedge transactions.

The entity should document its assessment, both at hedge inception and on an ongoing basis, of whether the hedging instruments that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

Hedging instruments can generally be used as: (a) hedges of the fair value of recognised assets or liabilities, or a firm commitment; or (b) hedges of highly probable forecast transactions (cash flow hedges) or hedges of net investment in foreign operations.

Gains and losses on instruments qualifying as cash flow hedges are included in equity and recycled to the income statement when the hedged item affects the income statement, or is used to adjust the carrying amount of an asset or liability at acquisition.

Hedges of a net investment in a foreign operation should be accounted for similarly to cash flow hedges.

For a fair value hedge, the hedged item is adjusted for the gain or loss attributable to the hedged risk, and that element is included in income to offset the income statement impact of the hedging instrument.

### 9.2 Earnings per share

All entities with listed ordinary shares or potential listed ordinary shares (for example, convertible debt and preference shares) are required to disclose with equal prominence on the face of the income statement both basic and diluted earnings per share (EPS).

Basic EPS is calculated by dividing the profit or loss for the period attributable to the equity holders of the parent by the weighted average number of ordinary shares outstanding (including adjustments for bonus and rights issues).

All financial instruments or contracts that may result in the issuance of ordinary shares of the reporting entity, for example convertible debt and share options, are potential ordinary shares of the entity. Such financial instruments or contracts should therefore be considered in calculating the diluted EPS.

## 9 Other financial reporting topics (continued)

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Diluted EPS is calculated by adjusting the profit or loss and the weighted average number of ordinary shares by taking into account the conversion of any dilutive potential ordinary shares.

Comparative EPS figures (both basic and diluted) should be adjusted retrospectively for the effect of capitalisations, bonus issues or share splits. Current and prior-period EPS calculations should also take account of any capitalisations, bonus issues or share splits that occur subsequent to year-end but before the authorisation of the financial statements that affect the number of ordinary or potential ordinary shares outstanding.

### 9.3 Related parties

Related parties include subsidiaries, fellow subsidiaries, associates, joint ventures' and the entity's and its parent's key management personnel (including close members of their families), parties with control/joint control/significant influence over the entity (including close members of their families, where applicable) and post-employment benefit plans. They exclude, for example, finance providers and governments in the course of their normal dealings with the entity.

The name of the ultimate parent entity should be disclosed if it is not mentioned elsewhere in information published with the financial statements. The names of the immediate and the ultimate controlling parties (which could be an individual or a group of individuals) should be disclosed irrespective of whether there have been transactions with those related parties.

Where there have been related-party transactions, disclosure should be made of the nature of the relationship, the amount of transactions, and outstanding balances and other elements necessary for a clear understanding of the financial statements (for example, volume and amounts of transactions, amounts outstanding and pricing policies). The disclosure should be made by certain categories of related parties and by major types of transaction. Items of a similar nature may be disclosed in aggregate (for example, total directors' emoluments) except when separate disclosure is necessary for an understanding of the effects of related-party transactions on the reporting entity's financial statements.

Disclosures that related-party transactions were made on terms equivalent to those that prevail at arms length transactions are made only if such terms can be substantiated.

## 9 Other financial reporting topics (continued)

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Wholly-owned subsidiaries with parents incorporated in the same country and state-controlled entities are required to disclose related-party transactions.

### 9.4 Segment reporting

All entities with listed equity or debt securities or that are in the process of obtaining a listing are required to disclose segment information. A two-tier approach to segment reporting is required, and an entity should determine its primary and secondary segment reporting formats (ie, business or geographical, but not a mixture) based on the dominant source of the entity's business risks and returns.

Reportable segments are determined by identifying separate profiles of risks and returns and then using a threshold test. The majority of the segment revenue must be earned from external customers, and the segment must account for 10% or more of either total revenue, total profit or loss, or total assets. Additional segments must be reported (even if they do not meet the threshold test) until at least 75% of consolidated revenue is included in reportable segments.

The disclosures concentrate mainly on the segments in the primary reporting format, with only limited information being presented on the secondary segment. Disclosures for reportable segments in the primary reporting format include by segment: revenue, result, assets, liabilities, capital expenditure, depreciation and amortisation, the total amount of significant non-cash expenses and impairment losses. Disclosures for reportable segments in the secondary segment include segment revenue, assets and capital expenditure. Segment result is not required to be shown for secondary segments.

Reconciliation should be provided between the information disclosed for reportable segments and the totals shown in the financial statements.

### 9.5 Leases

A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or a series of payments the right to use an asset for an agreed period of time. Other arrangements may contain a lease if fulfilment of the arrangement is dependent on the use of a specific asset and the arrangement conveys a right to control the use of the asset. For example, if the purchaser/lessee takes almost all of the output of an asset, the right to control might be conveyed.

## 9 Other financial reporting topics (continued)

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A lease is classified as a finance lease if it transfers to the lessee substantially all of the risks and rewards incidental to ownership. All other leases are treated as operating leases. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the legal form of the contract.

Examples of situations in which a lease would be classified as a finance lease are: there is transfer of ownership by the end of the lease term; a bargain purchase option has been extended to the lessee; the lease term is a major part of the useful life; the present value of the minimum lease payments (including guaranteed residuals) is substantially equal to the fair value of the leased asset; or the leased assets are of such a specialised nature that only the lessee can use them without major modifications being made.

For sale and leaseback transactions resulting in a leaseback of a finance lease, any gain realised on the transaction is deferred and amortised through the income statement over the lease term. Separate rules apply where the transaction results in an operating lease.

Careful consideration needs to be given to special purpose entities (see Section 11.2) acting as lessors that may need to be consolidated by lessees.

### The lessee

A lessee in a finance lease records an asset and a liability in its financial statements and depreciates this asset in accordance with the lessee's normal depreciation policy for similar assets or the lease term if shorter. The lessee in an operating lease records as expense the rental payments on a straight-line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

### The lessor

The lessor records an asset leased under a finance lease as a receivable at an amount equal to the net investment in the lease. The net investment in the lease is the total of the minimum lease payments (including any unguaranteed residual value accruing to the lessor) less unearned finance income. Finance income is recognised based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the lease.



## 9 Other financial reporting topics (continued)

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The lessor records operating lease assets as property, plant and equipment and depreciates it on a basis consistent with the normal depreciation policy for similar owned assets. Rental income should be recognised on a straight-line basis over the lease term unless another systematic basis is more representative of the time pattern over which the benefit of the leased asset is diminished.

### Lease incentives

Incentives provided by a lessor to a lessee to enter into an operating lease should be recognised as an integral part of the consideration agreed for the use of the leased asset, irrespective of the nature of the incentive or the timing of payments. Such incentives would include cash payments to the lessee, relocation costs of the lessee borne by the lessor and rent-free or reduced rent periods. Lessors recognise the cost of lease incentives as a reduction in rental income over the term of the lease, usually on a straight-line basis. Lessees recognise the benefit of the incentives received as a reduction of rental expense over the term of the lease, usually on a straight-line basis.

### 9.6 Share-based payments

Share-based payments cover transactions to be settled:

- by shares, share options or other equity instruments (granted to employees or other parties); or
- in cash or other assets (cash-settled transactions) when the amount payable is based on the price of the entity's shares.

### Recognition and initial measurement

All transactions involving share-based payments are recognised as assets or expenses, as appropriate, over any vesting period.

Equity-settled share-based payment transactions are measured at the grant date fair value for employee services and at the fair value of the goods or services received at the date on which the entity recognises the goods or services for non-employee transactions. If the fair value of goods or services cannot be estimated reliably – such as employee services or circumstances in which the goods or services cannot be specifically identified (for example, where the identifiable consideration received for the equity instruments is less than their fair value) – the entity should use the fair value of the equity instruments granted.

Cash-settled share-based payments are measured at the fair value of the liability.

## 9 Other financial reporting topics (continued)

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### Subsequent measurement

Equity-settled share-based payments are not re-measured. The liability arising from cash-settled share-based payments is re-measured at each balance sheet date and at the date of settlement, with changes in fair value recognised in profit or loss.

### 9.7 Non-current assets held for sale and discontinued operations

#### Recognition and initial measurement

A non-current asset (or disposal group) should be classified as 'held for sale' where: its carrying amount will be recovered principally through a sale transaction rather than through continuing use; the asset is available for its immediate sale in its present condition; and its sale is highly probable (ie, there is evidence of management commitment; there is an active programme to locate a buyer and complete the plan; the asset is actively marketed for sale at a reasonable price; and the sale will normally be completed within 12 months from the date of classification).

A disposal group is a group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction.

Assets (or disposal groups) classified as held for sale are:

- a) carried at the lower of the carrying amount and fair value less costs to sell;
- b) not depreciated or amortised; and
- c) presented separately on the face of the balance sheet.

A discontinued operation is a component of an entity that represents a separate major line of business or geographical area that can be distinguished operationally and financially and that the entity has disposed of or classified as 'held for sale'. It could also be a subsidiary acquired exclusively for resale.

An operation is classified as discontinued at the date on which the operation meets the criteria to be classified as held for sale or when the entity has disposed of the operation. When the criteria for that classification are not met until after the balance sheet date, there is no retroactive classification.

Discontinued operations are presented separately in the income statement and the cash flow statement. There are additional disclosure requirements in relation to discontinued operations.

## 9 Other financial reporting topics (continued)

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### 9.8 Events after the balance sheet date

Events after the balance sheet date may qualify as adjusting events or non-adjusting events. Adjusting events provide further evidence of conditions that existed at the balance sheet date. Non-adjusting events relate to conditions that arose after the balance sheet date.

The carrying amounts of assets and liabilities at the balance sheet date should be adjusted only for adjusting events or events that indicate that the going-concern assumption in relation to the whole entity is not appropriate. Significant non-adjusting post-balance-sheet events, such as the issue of shares or debentures, should be disclosed.

Dividends proposed or declared after the balance sheet date but before the financial statements have been authorised for issue should not be recognised as a liability at the balance sheet date. Details of these dividends should, however, be appropriately disclosed.

An entity should disclose the date on which the financial statements were authorised for issue and the persons authorising the issue and, where necessary, the fact that the owners or other persons have the ability to amend the financial statements after issue.

### 9.9 Government grants

Government grants should be recognised when there is reasonable assurance that the entity will comply with the conditions related to them and that the grants will be received.

Grants related to income should be recognised in the income statement over the periods necessary to match them with the related costs that they are intended to compensate. The timing of such recognition in the income statement will depend on the fulfilment of any conditions or obligations attaching to the grant.

Grants related to assets should either be offset against the carrying amount of the relevant asset or presented as deferred income in the balance sheet. The income statement will be affected either by reduced depreciation charge or by deferred income being recognised as income systematically over the useful life of the related asset.

## 10 Industry-specific topics

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### 10 Industry-specific topics

#### 10.1 Banks and similar financial institutions

Banks and similar financial institutions should account for their transactions in accordance with the applicable standards. However, they have specific disclosure requirements, a summary of which is shown below.

A bank or similar financial institution is required to disclose:

- Income, expenses, assets and liabilities by nature;
- The principal types of income and expenses, in the income statement;
- Assets and liabilities, on the balance sheet, in an order that reflects their relative liquidity; and
- Other specific items, including:
  - the fair values of each class of its financial assets and liabilities, consistently with the requirements for other financial instruments;
  - an analysis of assets and liabilities by relevant maturity groupings;
  - significant concentrations of assets, liabilities and off-balance-sheet items by geographical area, customer or industry group, or other concentrations of risk;
  - details of losses on loans;
  - amounts set aside for general banking risks;
  - details of contingencies and commitments;
  - the aggregate amount of secured liabilities, and the nature and carrying amount of pledged assets;
  - the extent of trust activities; and
  - specific related-party disclosures.

With the introduction of IFRS 7, which has to be applied for annual periods beginning on or after 1 January 2007, the specific disclosure requirements of IAS 30 as described above will be superseded. IFRS 7 is applicable to all entities and requires disclosures relating to the nature and the risks arising from financial instruments.

#### 10.2 Insurance

IFRS 4 is applicable to periods beginning on or after 1 January 2005 and deals with accounting for insurance contracts issued and reinsurance contracts held. It also covers the intangible assets (such as deferred acquisition costs) associated with insurance and reinsurance contracts. IFRS 4 defines an insurance contract as a contract that transfers significant insurance risk to the insurer from another party defined as the policyholder. Insurance risk is the obligation for the insurer to compensate the

## 10 Industry-specific topics (continued)

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policyholder if an uncertain future event adversely affects it. The contract becomes a reinsurance contract when the policyholder is itself an insurer and the uncertain future event arises from insurance contracts it issued.

IFRS 4 also covers presentation, recognition and measurement of financial instruments with a discretionary participation feature (DPF). Disclosure requirements for these instruments are specified under IAS 32 (and, with effect from 1 January 2007, IFRS 7). A DPF is a form of remuneration used to compensate holders of insurance contracts and financial instruments where the holder receives a supplemental return above a guaranteed rate that is determined discretionally by the issuer. The discretion is exercised within the actual return of specified assets (or other similar variable) set out in the contract.

All contracts within the scope of IFRS 4 that meet the definition of insurance (other than those that are specifically scoped out of IFRS 4) are measured under the entity's existing accounting policies. These policies are exempted from the normal requirements under IFRS for developing accounting policies subject to five minimum requirements:

- 1) the entity must perform a liability adequacy test and recognise any loss in income immediately;
- 2) the entity must perform an impairment test on reinsurance assets and recognise any loss in income immediately;
- 3) provisions for future claims costs on future contracts are prohibited (for example, equalisation reserves);
- 4) amounts arising from reinsurance contracts cannot be offset against the amounts of the insurance contracts they cover; and
- 5) insurance liabilities can be de-recognised only when the obligation is extinguished, cancelled or expires.

Insurers are exempt from separating and fair valuing derivatives embedded in insurance contracts where certain conditions are met. However, deposit components bundled in insurance and reinsurance contracts must be separated and measured under IAS 39 where they can be measured reliably and where the entity's accounting policies do not otherwise require all obligations and rights arising from them to be recognised.

IFRS 4 sets out the framework within which entities can change their accounting policies for contracts under IFRS 4. The overriding principle is that all the changes must make the financial statements more relevant and

## 10 Industry-specific topics (continued)

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no less reliable or more reliable and no less relevant than under previous accounting policies.

IFRS 4 requires extensive disclosures for insurance and reinsurance contracts including the amount, timing and uncertainty of cash flows arising from those contracts.

### 10.3 Agriculture

Agricultural activity is defined as the managed biological transformation of biological assets (living animals and plants) for sale, into agricultural produce (harvested product of biological assets) or into additional biological assets.

All biological assets should be measured at fair value less estimated point-of-sale costs, with the change in the carrying amount reported as part of profit or loss from operating activities. Agricultural produce harvested from an entity's biological assets should be measured at fair value less estimated point-of-sale costs at the point of harvest.

Point-of-sale costs include commissions to brokers and dealers, levies by regulatory agencies and commodity exchanges, and transfer taxes and duties. Point-of-sale costs exclude transport and other costs necessary to get assets to market.

The fair value is the quoted price in any available market. However, if an active market does not exist for biological assets or harvested agricultural produce, the following may be used in determining fair value: the most recent transaction price (provided that there has not been a significant change in economic circumstances between the date of that transaction and the balance sheet date); market prices for similar assets, with adjustments to reflect differences; and sector benchmarks, such as the value of an orchard expressed per export tray, bushel or hectare, and the value of cattle expressed per kilogram of meat. When any of this information is not available, the entity will use the present value of the expected net cash flows from the asset discounted at a current market-determined pre-tax rate.

### 10.4 Retirement benefit plans

When retirement benefit plans prepare financial statements in accordance with IFRS, they should comply with the requirements.

For a defined contribution plan, the report must include: a statement of net assets available for benefits; a statement of changes in net assets available for benefits; a summary of significant accounting policies; a description of the plan and the effect of any changes in the plan during the period; and a description of the funding policy.

For a defined benefit plan, the report must include: either a statement that shows the net assets available for benefits, the actuarial present value of promised retirement benefits and the resulting excess or deficit, or a reference to this information in an accompanying actuarial report; a statement of changes in net assets available for benefits; a summary of significant accounting policies; and a description of the plan and the effect of any changes in the plan during the period. The report should also explain the relationship between the actuarial present value of promised retirement benefits and the net assets available for benefits, and the policy for the funding of promised benefits.

Investments held by all retirement plans (whether defined benefit or defined contribution) should be carried at fair value.

### 10.5 Extractive industries

IFRS 6 comes into force for years beginning on or after 1 January 2006; early application is encouraged. It addresses the financial reporting for the exploration for and evaluation of mineral resources; it does not address other aspects of accounting by entities engaged in the exploration for and evaluation of mineral reserves (such as activities before an entity has acquired the legal right to explore or after the technical feasibility and commercial viability to extract resources have been demonstrated). The activities outside the scope of IFRS 6 should be accounted for according to the respective standards (such as IAS 16, IAS 37 and IAS 38).

The accounting policy adopted for the recognition of exploration and evaluation assets should fulfil the requirements of IAS 8 paragraph 10. It states that the accounting policy should result in information that is relevant and reliable. IAS 8 paragraphs 11 and 12 need not be applied. The accounting policy may be changed only if the change makes the

## 10 Industry-specific topics (continued)

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financial statements more relevant and no less reliable, or more reliable and no less relevant - in other words, if the new accounting policy takes it closer to the Framework requirements.

Exploration and evaluation assets should initially be measured at cost. Exploration and evaluation assets should be classified as tangible or intangible assets, according to the nature of the assets acquired. Management should apply that classification consistently.

After recognition, an entity should apply either the cost model or the revaluation model to the exploration and evaluation assets, based on IAS 16 or IAS 38 according to nature of the assets. As soon as technical feasibility and commercial viability are demonstrable, the assets should no longer be classified as exploration and evaluation assets.

The exploration and evaluation assets should be tested for impairment when facts and circumstances suggest that the carrying amounts may not be recovered. The assets should also be tested for impairment before reclassification out of exploration and evaluation. The impairment should be measured, presented and disclosed according to IAS 36, except that exploration and evaluation assets should be allocated to cash-generating units or groups of cash-generating units no larger than a segment.

Management should disclose the accounting policy adopted as well as the amount of assets, liabilities, income and expense and investing cash flows arising from the exploration and evaluation of mineral resources.



### 11 Business combinations

Business combinations are the bringing together of separate entities or businesses into one reporting entity. A business is a set of activities and assets applied and managed together in order to provide a return or any other economic benefit to its investors. It consists of inputs, processes and outputs used to generate revenues.

In all business combinations, one entity (the acquirer) obtains control of one or more other entities or businesses (the acquiree)

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

If an entity obtains control of one or more other entities that are not businesses, the bringing together of those entities is not a business combination. The entity should therefore allocate the cost of acquisition between the individual identifiable assets and liabilities acquired based on their relative fair values at the date of acquisition.

#### Structures

A business combination may be structured in a variety of ways for legal, taxation or other reasons. It may involve the purchase of another entity; the purchase of all the net assets of another entity; the assumption of the liabilities of another entity; or the purchase of some of the net assets of another entity that together form one or more businesses. It may be achieved by the issue of equity instruments, the transfer of cash, cash equivalents or other assets, the incurring of liabilities, or a combination thereof.

The transaction may be between the shareholders of the combining entities or between one entity and the shareholders of another entity. It may involve the establishment of a new entity to control the combining entities (where the new entity is formed and issues shares to effect the business combination, it is not the acquirer) or net assets transferred, or the restructuring of one or more of the combining entities.

#### Purchase method

All business combinations within IFRS 3's scope should be accounted for by applying the purchase method. The acquirer should measure the cost of the business combination at the acquisition date (the date on which the acquirer obtains control over the net assets of the acquiree), and compare it with the

## 11 Business combinations (continued)

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fair value of the acquiree's identifiable net assets/liabilities. The difference between the two represents goodwill.

The cost of acquisition includes cash paid or the fair value at the date of exchange (the date on which the investment is recognised in the financial statements) of the non-cash consideration given, including any directly attributable costs. Shares issued as consideration are measured at fair value at the date of exchange. The published price of a share quoted in an active market is deemed the best evidence of the share's fair value and must be used, unless there is evidence that a thin market affected the price. In such cases, alternative valuation methods should be applied.

When control is obtained at a single stage, the date of acquisition is the same as the date of exchange. Complex rules apply when the acquisition is achieved in several stages. Each exchange transaction should be treated separately to determine goodwill on that transaction, using cost and fair value information at the date of each exchange transaction.

The criteria for recognition of items acquired are as follows:

- Assets other than intangible assets should be recognised when it is probable that any associated future economic benefits will flow to the acquirer and their fair value can be measured reliably;
- Liabilities other than contingent liabilities should be recognised when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and their fair value can be measured reliably; and
- Intangible assets or contingent liabilities should be recognised when their fair value can be measured reliably.

There is a one-year hindsight period for confirming the fair values that were determined at the acquisition date. If the adjustment to identifiable assets and liabilities is made within 12 months from the acquisition date, all related balances should be adjusted retrospectively. After initial accounting is complete, other adjustments to goodwill or negative goodwill should be made only if they qualify as material corrections of an error (Section 2.6).

Minority interest is recorded at its proportion of the fair values of such net assets. No goodwill is attributed to minority interest.

## 11 Business combinations (continued)

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Goodwill (the excess of the cost of acquisition over the acquirer's interest in the fair value of the identifiable assets, liabilities and contingent liabilities acquired) must be recognised as an intangible asset and tested annually for impairment (Section 4.8). The goodwill is not amortised. Negative goodwill should be recognised in the income statement immediately after management has reassessed the identification and measurement of identifiable items arising on acquisition and the cost of the business combination.

### Business combinations between entities under common control

Business combinations between entities under common control are not covered by IFRS. There are two basic methods of accounting for business combinations: the purchase method and the pooling-of-interests method. Management can elect to apply purchase accounting or the pooling-of-interests method to a business combination between entities under common control. The method should be consistently applied once chosen. Disclosures are used to explain the impact of transactions with related parties on the financial statements.

### 11.1 Consolidated financial statements

A subsidiary is an entity that is controlled by the parent. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. It is presumed to exist when the investor holds more than 50% of the investee's voting power; this presumption may be rebutted if there is clear evidence to the contrary.

All subsidiaries should be consolidated. Consolidation of a subsidiary takes place from the date of acquisition, which is the date on which control of the net assets and operations of the acquiree is effectively transferred to the acquirer.

An entity with one or more subsidiaries (a parent) should present consolidated financial statements unless it is itself a subsidiary (subject to the approval of all shareholders); its debt or equity are not publicly traded; it is not in the process of issuing securities to the public; and the ultimate or intermediate parent of the entity publishes IFRS consolidated financial statements.

From the date of acquisition, the parent (the acquirer) should incorporate into the consolidated income statement the financial performance of the acquiree and recognise in the consolidated balance sheet the acquired assets and liabilities (at fair value), including any goodwill arising on the

## 11 Business combinations (continued)

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acquisition. The exception is for non-current assets that are classified as held for sale in accordance with IFRS 5. These should be recognised at fair value less cost to sell.

In the separate (non-consolidated) financial statements of a parent entity, the investments in subsidiaries should be carried at cost or as financial assets in accordance with IAS 39.

### Special purpose entities

A special purpose entity (SPE) is an entity created to accomplish a narrow, well defined objective. It may operate in a predetermined way so that no other party has explicit decision-making authority over its activities after formation.

An entity should consolidate an SPE when the substance of the relationship between the entity and the SPE indicates that the SPE is controlled by the entity. Control may arise at the outset through the predetermination of the activities of the SPE or otherwise. An entity may be deemed to control an SPE if it is exposed to the majority of risks and rewards incidental to its activities or its assets.

### 11.2 Associates

An associate is an entity in which the investor has significant influence, but which is neither a subsidiary nor a joint venture of the investor. Significant influence is the power to participate in the financial and operating policy decisions of the investee but not to control those policies. It is presumed to exist when the investor holds at least 20% of the investee's voting power and not to exist when less than 20% is held; these presumptions may be rebutted if there is clear evidence to the contrary.

All associates should be accounted for using the equity method unless an associate meets the criteria to be classified as 'held for sale' (Section 9.7). Under the equity method, the investment in the associate is initially carried at cost and then adjusted for the post-acquisition change in the investor's share of the net assets of the associate.

Investments in associates should be classified as non-current assets and presented as one line item in the balance sheet (inclusive of goodwill arising on acquisition). Investment in associates are subject to the impairment rules under IAS 36 if there are impairment indicators under IAS 39 (Section 4.8).

## 11 Business combinations (continued)

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If an investor's share of its associate's losses exceeds the carrying amount of the investment, the carrying amount of the investment is reduced to nil and recognition of further losses should be discontinued, unless the investor has an obligation to fund the investee or the investor has guaranteed to support the associate. The investor continues to recognise its share of the investee's losses to the extent that the investor has incurred such obligations. Continuing losses of an associate should be considered objective evidence that a receivable from the associate may be impaired.

In the separate (non-consolidated) financial statements of the investor, the investments in associates should be carried at cost as financial assets in accordance with IAS 39.

### 11.3 Joint ventures

A joint venture is a contractual agreement whereby two or more parties (the venturers) undertake an economic activity that is subject to joint control. Joint control is defined as the contractually agreed sharing of control of an economic activity. A venturer should account for its investment based on the type of joint venture: jointly controlled operations, jointly controlled assets, or jointly controlled entities.

#### Jointly controlled entities

The most common type of joint venture is a jointly controlled entity. For such entities, the venturer reports in its consolidated financial statements its interest using either proportional consolidation (benchmark) or the equity method (allowed alternative). Proportional consolidation is a method whereby a venturer's share of each of the assets, liabilities, income and expenses of a jointly controlled entity is combined on a line-by-line basis with similar items in the venturer's financial statements, or they are reported as separate line items. Either of these methods should be followed unless the interest is classified as held for sale (see Section 9.7).

Gains and losses on transfers of assets in exchange for an interest in a jointly controlled entity should be recognised to the extent of the interests of the other venturers except when the significant risks and rewards of ownership of the contributed assets have not been transferred to the joint venture, the gain or loss cannot be reliably measured or the transaction lacks commercial substance.

## 11 Business combinations (continued)

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If the venturer receives additional consideration in the form of cash or dissimilar non-monetary assets, the appropriate portion of the gain on the transaction should be recognised by the venturer as income.

### Jointly controlled operations

Two or more venturers may combine their operations, resources and expertise to manufacture, market and distribute jointly a particular product where different parts of the manufacturing process are carried out by each of the venturers.

Each venturer has to recognise in its financial statements the assets that it controls and the liabilities that it incurs, as well as the expenses that it incurs and its share of the income that it earns from the sale of goods or services by the joint venture.

### Jointly controlled assets

In some cases, each venturer may have control over its share of future economic benefits through its share of a jointly controlled asset contributed or acquired for the purpose of the joint venture.

A venturer should recognise in its financial statements its share of the jointly controlled assets; any liabilities that it has incurred; its share of any liabilities incurred jointly with the other venturers in relation to the joint venture; any income from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture; and any expenses that it has incurred in respect of its interest in the joint venture.

### 12 Interim financial statements

There is no IFRS requirement for an entity to publish interim financial statements. However, entities may be required by other regulations or may elect to publish interim financial statements.

Interim financial statements may be prepared in full compliance with IFRS or in a condensed form. Condensed financial statements should include a condensed balance sheet, a condensed income statement, a condensed cash flow statement, a condensed statement of changes in equity and selected note disclosures.

An entity should generally use the same accounting policies for recognising and measuring assets, liabilities, revenues, expenses, and gains and losses at interim dates as those to be used in the next annual financial statements.

There are special measurement rules for items such as tax (which are computed annually), revenue and costs earned/incurred unevenly over the financial year, and the use of estimates in the interim financials. Impairment loss recognised in a previous interim period in respect of goodwill, or an investment in an unquoted equity instrument carried at cost, should not be reversed.

Current period and comparative figures should be disclosed as follows:

- **balance sheet** – as of the current interim period end with comparatives for the immediately preceding year end;
- **income statement** – current interim period, financial year to date and comparatives for the same preceding periods (interim and year to date); and
- **cash flow statement and statement of changes in equity** – financial year to date with comparatives for the same year to date period of the preceding year.

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