Republic of the Philippines
Professional Regulation Commission
Manila

PROFESSIONAL REGULATORY BOARD OF ACCOUNTANCY
Resolution No. 23
Series of 2018

WHEREAS, the Financial Reporting Standards Council (FRSC) has approved and submitted hereunder pronouncements to the Board for approval;

1. Prepayment Features with Negative Compensation (Amendments to PFRS 9)
2. Long-term Interests in Associates and Joint Ventures (Amendments to PAS 28)
3. PFRS Practice Statement 2: Making Materiality Judgments
4. Guidance on Financial Reporting (June 2017 edition)

WHEREAS, after study and review of the provisions of the above-stated pronouncements as adopted by the FRSC, the Board finds them to be well-taken and instructive for compliance by practicing Certified Public Accountants;

WHEREFORE, the Board **RESOLVES**, as it is hereby **RESOLVED,** to adopt the above-stated pronouncements as part of the Philippine Accounting Standards.

RESOLVED FURTHER, that this Resolution and the above-stated pronouncements shall take effect after fifteen (15) days following its full and complete publication in the Official Gazette or in any newspaper of general circulation in the Philippines.

Done in the City of Manila, this 4th day of April, 2018.

JOEL L. TAN-TORRES
Chairman

GLORIA T. BAYSA
Vice-Chairperson

GERARD B. SANVICTORES
Member

SAMUEL B. PADILLA
Member

ARLYN S. VILLANUEVA
Member

ELISEO A. AURELLADO
Member

GERVACIO I. PIATOR
Member

ATTESTED:

ATTY. LOVELIKA T. BAUTISTA
Chief
Secretariat to the Professional Regulatory Boards

DATE OF PUBLICATION IN THE OFFICIAL GAZETTE : JUNE 11, 2018
DATE OF EFFECTIVITY : JUNE 27, 2018

APPROVED:

TEOFILO S. PILANDO, JR.
Chairman

YOLANDA D. REYES
Commissioner

JOSE Y. CUETO, JR.
Commissioner

O-CH/O-COI/O-COII/PRB-ACC/D-LGL/D-SPRB
TSP//YDR/JYC/JLT/ERH/LTB/gnet

Financial Reporting Standards Council

November 10, 2017

Hon. Joel L. Tan-Torres
Chairman
Board of Accountancy
P. Paredes Street corner N. Reyes Street
Sampaloc, Manila

Dear Chairman Tan-Torres:

The Financial Reporting Standards Council (FRSC) has approved the adoption of the following pronouncements:

- Prepayment Features with Negative Compensation (Amendments to PFRS 9)
- Long-term Interests in Associates and Joint Ventures (Amendments to PAS 28)
- PFRS Practice Statement 2: Making Materiality Judgements
- Guidance on Financial Reporting (June 2017 edition)

We are submitting the aforementioned pronouncements to the Board of Accountancy and the Professional Regulation Commission (PRC) for approval.

Enclosed are the following:

- Copy of the aforementioned pronouncements
- FRSC letter addressed to PRC

Please provide us with a copy of the final Board Resolutions approving the pronouncements.

Thank you for your continued cooperation in this effort to establish financial reporting standards in the Philippines.

Very truly yours,

David L. Balangue
Chairman

PICPA Building, 700 Shaw Boulevard, Mandaluyong City
Tel. Nos. 723-0691 to 93; Fax No.: 723-6305

November 10, 2017

Hon. Teofilo S. Pilando, Jr.
Chairman
Professional Regulation Commission
P. Paredes Street corner N. Reyes Street
Sampaloc, Manila

Dear Chairman Pilando:

The Financial Reporting Standards Council (FRSC) has approved the adoption of the following pronouncements:

- Prepayment Features with Negative Compensation (Amendments to PFRS 9)
- Long-term Interests in Associates and Joint Ventures (Amendments to PAS 28)
- PFRS Practice Statement 2: Making Materiality Judgements
- Guidance on Financial Reporting (June 2017 edition)

We are submitting the aforementioned pronouncements for approval through the Board of Accountancy.

Thank you for your continued cooperation in this effort to establish financial reporting standards in the Philippines.

Very truly yours,

David L. Balangue
Chairman

Financial Reporting Standards Council

Prepayment Features with Negative Compensation
(Amendments to PFRS 9)

Prepayment Features with Negative Compensation (Amendments to PFRS 9)

Contents

FRSC PREFACE TO *PREPAYMENT FEATURES WITH NEGATIVE COMPENSATION* (AMENDMENTS TO PFRS 9)

1. The Financial Reporting Standards Council (FRSC) has approved on November 8, 2017 the adoption of amendments to IFRS 9 *Financial Instruments, Prepayment Features with Negative Compensation*, issued by the International Accounting Standards Board (IASB) in October 2017, as amendments to PFRS 9, *Financial Instruments, Prepayment Features with Negative Compensation.*

2. The amendments allow debt instruments with negative compensation prepayment features to be measured at amortized cost or fair value through other comprehensive income.

3. An entity shall apply these amendments for annual reporting periods beginning on or after January 1, 2019. Earlier application is permitted.

* * * * * * *

FRSC Members

David L. Balangue, Chairman

June Cheryl A. Cabal-Revilla	**Ester F. Ledesma**
Antonieta F. Ibe	**Michael D. Roxas**
Leonardo D. Cuaresma, Jr.	**Lyn I. Javier**
Concordio S. Quisaot	**Carmelita O. Antasuda**

PREPAYMENT FEATURES WITH NEGATIVE COMPENSATION (AMENDMENTS TO IFRS 9)

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October 2017

IFRS® Standards

Prepayment Features with Negative Compensation

Amendments to IFRS 9

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Prepayment Features with Negative Compensation (Amendments to IFRS 9) is issued by the International Accounting Standards Board (Board).

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Amendments to IFRS 9 *Financial Instruments*

Paragraph 7.1.7 is added. A new heading and paragraphs 7.2.29–7.2.34 are added.

Chapter 7 Effective date and transition

7.1 Effective date

...

7.1.7 *Prepayment Features with Negative Compensation* (Amendments to IFRS 9), issued in October 2017, added paragraphs 7.2.29–7.2.34 and B4.1.12A and amended paragraphs B4.1.11(b) and B4.1.12(b). An entity shall apply these amendments for annual periods beginning on or after 1 January 2019. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact.

7.2 Transition

...

Transition for *Prepayment Features with Negative Compensation*

7.2.29 An entity shall apply *Prepayment Features with Negative Compensation* (Amendments to IFRS 9) retrospectively in accordance with IAS 8, except as specified in paragraphs 7.2.30–7.2.34.

7.2.30 An entity that first applies these amendments at the same time it first applies this Standard shall apply paragraphs 7.2.1–7.2.28 instead of paragraphs 7.2.31–7.2.34.

7.2.31 An entity that first applies these amendments after it first applies this Standard shall apply paragraphs 7.2.32–7.2.34. The entity shall also apply the other transition requirements in this Standard necessary for applying these amendments. For that purpose, references to the date of initial application shall be read as referring to the beginning of the reporting period in which an entity first applies these amendments (date of initial application of these amendments).

7.2.32 With regard to designating a financial asset or financial liability as measured at fair value through profit or loss, an entity:

(a) shall revoke its previous designation of a financial asset as measured at fair value through profit or loss if that designation was previously made in accordance with the condition in paragraph 4.1.5 but that condition is no longer satisfied as a result of the application of these amendments;

(b) may designate a financial asset as measured at fair value through profit or loss if that designation would not have previously satisfied the condition in paragraph 4.1.5 but that condition is now satisfied as a result of the application of these amendments;

(c) shall revoke its previous designation of a financial liability as measured at fair value through profit or loss if that designation was previously made in accordance with the condition in paragraph 4.2.2(a) but that condition is no longer satisfied as a result of the application of these amendments; and

(d) may designate a financial liability as measured at fair value through profit or loss if that designation would not have previously satisfied the condition in paragraph 4.2.2(a) but that condition is now satisfied as a result of the application of these amendments.

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

7.2.33 An entity is not required to restate prior periods to reflect the application of these amendments. The entity may restate prior periods if, and only if, it is possible without the use of hindsight and the restated financial statements reflect all the requirements in this Standard. If an entity does not restate prior periods, the entity shall recognise any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the date of initial application of these amendments in the opening retained earnings (or other component of equity, as appropriate) of the annual reporting period that includes the date of initial application of these amendments.

7.2.34 In the reporting period that includes the date of initial application of these amendments, the entity shall disclose the following information as at that date of initial application for each class of financial assets and financial liabilities that were affected by these amendments:

(a) the previous measurement category and carrying amount determined immediately before applying these amendments;

(b) the new measurement category and carrying amount determined after applying these amendments;

(c) the carrying amount of any financial assets and financial liabilities in the statement of financial position that were previously designated as measured at fair value through profit or loss but are no longer so designated; and

(d) the reasons for any designation or de-designation of financial assets or financial liabilities as measured at fair value through profit or loss.

In Appendix B, paragraphs B4.1.11(b) and B4.1.12(b) are amended. Paragraph B4.1.12A is added. Paragraph B4.1.10 has not been amended but has been included for ease of reference. New text is underlined and deleted text is struck through.

Classification (Chapter 4)

Classification of financial assets (Section 4.1)

...

Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding

...

Contractual terms that change the timing or amount of contractual cash flows

B4.1.10 If a financial asset contains a contractual term that could change the timing or amount of contractual cash flows (for example, if the asset can be prepaid before maturity or its term can be extended), the entity must determine whether the contractual cash flows that could arise over the life of the instrument due to that contractual term are solely payments of principal and interest on the principal amount outstanding. To make this determination, the entity must assess the contractual cash flows that could arise both before, and after, the change in contractual cash flows. The entity may also need to assess the nature of any contingent event (ie the trigger) that would change the timing or amount of the contractual cash flows. While the nature of the contingent event in itself is not a determinative factor in assessing whether the contractual cash flows are solely payments of principal and interest, it may be an indicator. For example, compare a financial instrument with an interest rate that is reset to a higher rate if the debtor misses a particular number of payments to a financial instrument with an interest rate that is reset to a higher rate if a specified equity index reaches a particular level. It is more likely in the former case that the contractual cash flows over the life of the instrument will be solely payments of principal and interest on the principal amount outstanding because of the relationship between missed payments and an increase in credit risk. (See also paragraph B4.1.18.)

B4.1.11 The following are examples of contractual terms that result in contractual cash flows that are solely payments of principal and interest on the principal amount outstanding:

(a) a variable interest rate that consists of consideration for the time value of money, the credit risk associated with the principal amount outstanding during a particular period of time (the consideration for credit risk may be determined at initial recognition only, and so may be fixed) and other basic lending risks and costs, as well as a profit margin;

(b) a contractual term that permits the issuer (ie the debtor) to prepay a debt instrument or permits the holder (ie the creditor) to put a debt instrument back to the issuer before maturity and the prepayment amount substantially represents unpaid amounts of principal and interest on the principal amount outstanding, which may include reasonable ~~additional~~ compensation for the early termination of the contract; and

(c) a contractual term that permits the issuer or the holder to extend the contractual term of a debt instrument (ie an extension option) and the terms of the extension option result in contractual cash flows during the extension period that are solely payments of principal and interest on the principal amount outstanding, which may include reasonable additional compensation for the extension of the contract.

B4.1.12 Despite paragraph B4.1.10, a financial asset that would otherwise meet the condition in paragraphs 4.1.2(b) and 4.1.2A(b) but does not do so only as a result of a contractual term that permits (or requires) the issuer to prepay a debt instrument or permits (or requires) the holder to put a debt instrument back to the issuer before maturity is eligible to be measured at amortised cost or fair value through other comprehensive income (subject to meeting the condition in paragraph 4.1.2(a) or the condition in paragraph 4.1.2A(a)) if:

(a) the entity acquires or originates the financial asset at a premium or discount to the contractual par amount;

(b) the prepayment amount substantially represents the contractual par amount and accrued (but unpaid) contractual interest, which may include reasonable ~~additional~~ compensation for the early termination of the contract; and

(c) when the entity initially recognises the financial asset, the fair value of the prepayment feature is insignificant.

<u>B4.1.12A</u> <u>For the purpose of applying paragraphs B4.1.11(b) and B4.1.12(b), irrespective of the event or circumstance that causes the early termination of the contract, a party may pay **or** receive reasonable compensation for that early termination. For example, a party may pay or receive reasonable compensation when it chooses to terminate the contract early (or otherwise causes the early termination to occur).</u>

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Financial Reporting Standards Council

Long-term Interests in Associates and Joint Ventures (Amendments to PAS 28)

Long-term Interests in Associates and Joint Ventures (Amendments to PAS 28)

Contents

FRSC PREFACE TO *LONG-TERM INTERESTS IN ASSOCIATES AND JOINT VENTURES* (AMENDMENTS TO PAS 28)

1. The Financial Reporting Standards Council (FRSC) has approved on November 8, 2017 the adoption of amendments to IAS 28 *Investments in Associates and Joint Ventures*, *Long-term Interests in Associates and Joint Ventures*, issued by the International Accounting Standards Board (IASB) in October 2017, as amendments to PAS 28, *Investments in Associates and Joint Ventures*, *Long-term Interests in Associates and Joint Ventures*.

2. The amendments clarify that entities should account for long-term interests in an associate or joint venture to which the equity method is not applied using PFRS 9, *Financial Instruments*.

3. An entity shall apply these amendments for annual reporting periods beginning on or after January 1, 2019. Earlier application is permitted.

* * * * * * *

FRSC Members

David L. Balangue, Chairman

June Cheryl A. Cabal-Revilla

Ester F. Ledesma

Antonieta F. Ibe

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***LONG-TERM INTERESTS IN ASSOCIATES AND JOINT VENTURES* (AMENDMENTS TO IAS 28)**

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October 2017

IFRS® Standards

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Amendments to IAS 28 *Investments in Associates and Joint Ventures*

Paragraphs 14A and 45F–45J are added and paragraph 41 is deleted. Deleted text is struck through.

Equity method

...

14A An entity also applies IFRS 9 to other financial instruments in an associate or joint venture to which the equity method is not applied. These include long-term interests that, in substance, form part of the entity's net investment in an associate or joint venture (see paragraph 38). An entity applies IFRS 9 to such long-term interests before it applies paragraph 38 and paragraphs 40–43 of this Standard. In applying IFRS 9, the entity does not take account of any adjustments to the carrying amount of long-term interests that arise from applying this Standard.

...

Application of the equity method

...

41 [Deleted] ~~The entity applies the impairment requirements in IFRS 9 to its other interests in the associate or joint venture that are in the scope of IFRS 9 and that do not constitute part of the net investment.~~

...

Effective date and transition

...

45F *Long-term Interests in Associates and Joint Ventures*, issued in October 2017, added paragraph 14A and deleted paragraph 41. An entity shall apply those amendments retrospectively in accordance with IAS 8 for annual reporting periods beginning on or after 1 January 2019, except as specified in paragraphs 45G–45J. Earlier application is permitted. If an entity applies those amendments earlier, it shall disclose that fact.

45G An entity that first applies the amendments in paragraph 45F at the same time it first applies IFRS 9 shall apply the transition requirements in IFRS 9 to the long-term interests described in paragraph 14A.

45H An entity that first applies the amendments in paragraph 45F after it first applies IFRS 9 shall apply the transition requirements in IFRS 9 necessary for applying the requirements set out in paragraph 14A to long-term interests. For that purpose, references to the date of initial application in IFRS 9 shall be read as referring to the beginning of the annual reporting period in which the entity first applies the amendments (the date of initial application of the amendments). The entity is not required to restate prior periods to reflect the application of the amendments. The entity may restate prior periods only if it is possible without the use of hindsight.

45I When first applying the amendments in paragraph 45F, an entity that applies the temporary exemption from IFRS 9 in accordance with IFRS 4 *Insurance Contracts* is not required to restate prior periods to reflect the application of the amendments. The entity may restate prior periods only if it is possible without the use of hindsight.

45J If an entity does not restate prior periods applying paragraph 45H or paragraph 45I, at the date of initial application of the amendments it shall recognise in the opening retained earnings (or other component of equity, as appropriate) any difference between:

(a) the previous carrying amount of long-term interests described in paragraph 14A at that date; and

(b) the carrying amount of those long-term interests at that date.

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Financial Reporting Standards Council

PFRS Practice Statement 2

Making Materiality Judgements

PFRS Practice Statement 2
Making Materiality Judgements

Contents

FRSC PREFACE TO *PFRS PRACTICE STATEMENT 2 MAKING MATERIALITY JUDGEMENTS*

1. The Financial Reporting Standards Council (FRSC) has approved on November 8, 2017 the adoption of IFRS Practice Statement 2 *Making Materiality Judgements*, issued by the International Accounting Standards Board (IASB) in September 2017, as PFRS Practice Statement 2 *Making Materiality Judgements*.

2. The Practice Statement provides guidance on making materiality judgements when preparing general purpose financial statements in accordance with PFRSs. It proposes a four-step process for applying materiality to an entity's financial statements and includes guidance on how to make materiality judgements in specific circumstances.

3. The Practice Statement is not a PFRS. Consequently, entities applying PFRSs are not required to comply with the Practice Statement. Furthermore, non-compliance with the Practice Statement will not prevent an entity's financial statements from complying with PFRSs, if they otherwise do so.

Application date

4. An entity that chooses to apply the guidance in the Practice Statement is permitted to apply it to financial statements prepared from November 8, 2017.

****

FRSC Members

David L. Balangue, Chairman

June Cheryl A. Cabal-Revilla	**Ester F. Ledesma**
Antonieta F. Ibe	**Michael D. Roxas**
Leonardo D. Cuaresma, Jr.	**Lyn I. Javier**
Concordio S. Quisaot	**Carmelita O. Antasuda**

IFRS PRACTICE STATEMENT 2
MAKING MATERIALITY JUDGEMENTS

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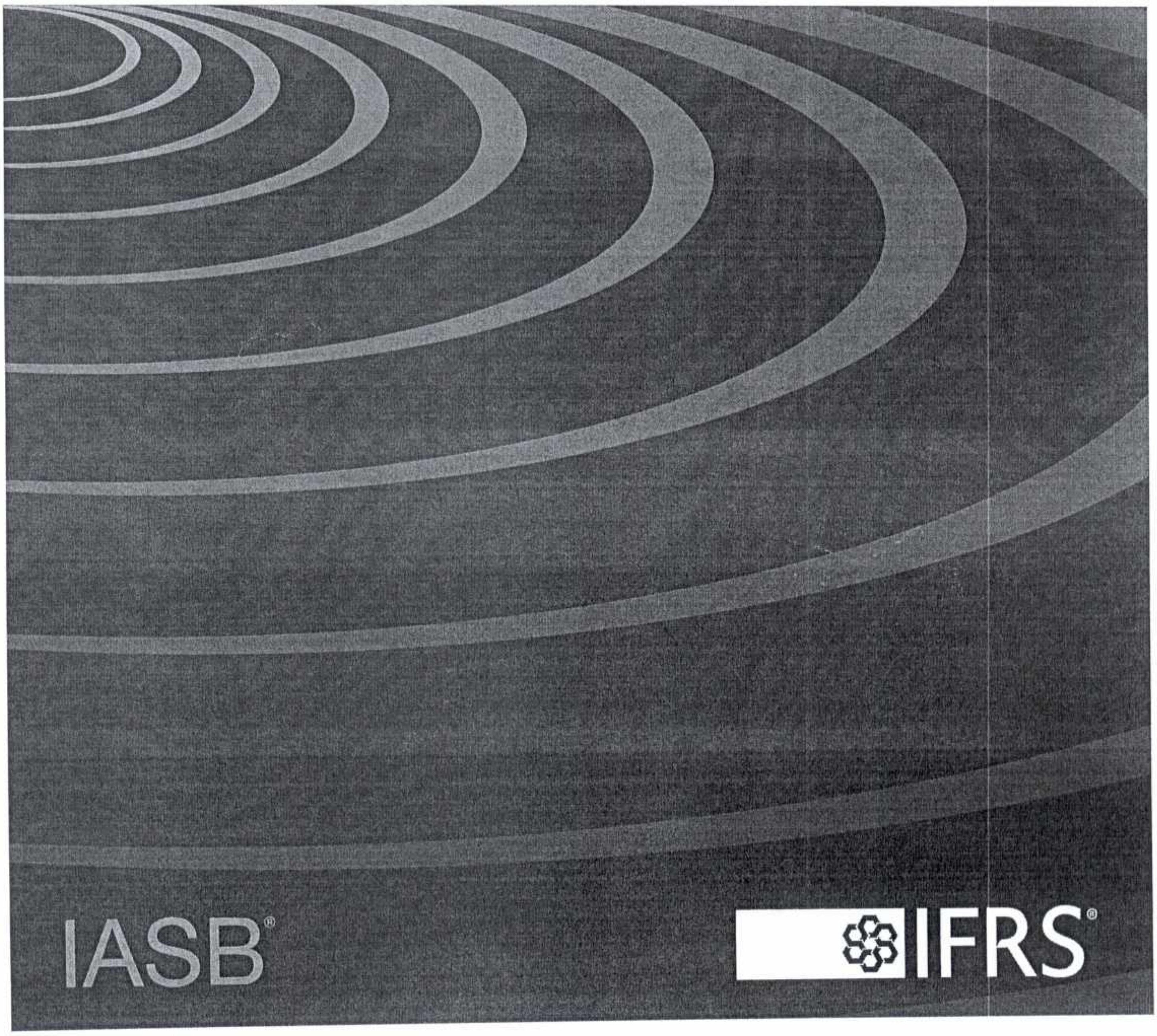
September 2017

IFRS® Practice Statement

Making Materiality Judgements

Practice Statement 2



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Introduction

IN1 The objective of general purpose financial statements is to provide financial information about a reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. The entity identifies the information necessary to meet that objective by making appropriate materiality judgements.

IN2 The aim of this IFRS Practice Statement 2 *Making Materiality Judgements* (Practice Statement) is to provide reporting entities with guidance on making materiality judgements when preparing general purpose financial statements in accordance with IFRS Standards. While some of the guidance in this Practice Statement may be useful to entities applying the *IFRS for SMEs*® Standard, the Practice Statement is not intended for those entities.

IN3 The need for materiality judgements is pervasive in the preparation of financial statements. An entity makes materiality judgements when making decisions about recognition and measurement as well as presentation and disclosure. Requirements in IFRS Standards only need to be applied if their effect is material to the complete set of financial statements.

IN4 This Practice Statement:

(a) provides an overview of the general characteristics of materiality.

(b) presents a four-step process an entity may follow in making materiality judgements when preparing its financial statements (materiality process). The description of the materiality process provides an overview of the role materiality plays in the preparation of financial statements, with a focus on the factors the entity should consider when making materiality judgements.

(c) provides guidance on how to make materiality judgements in specific circumstances, namely, how to make materiality judgements about prior-period information, errors and covenants, and in the context of interim reporting.

IN5 Whether information is material is a matter of judgement and depends on the facts involved and the circumstances of a specific entity. This Practice Statement illustrates the types of factors that the entity should consider when judging whether information is material.

IN6 A Practice Statement is non-mandatory guidance developed by the International Accounting Standards Board. It is not a Standard. Therefore, its application is not required to state compliance with IFRS Standards.

IN7 This Practice Statement includes examples illustrating how an entity might apply some of the guidance in the Practice Statement based on the limited facts presented. The analysis in each example is not intended to represent the only manner in which the guidance could be applied.

IFRS Practice Statement 2 *Making Materiality Judgements*

Objective

1 This IFRS Practice Statement 2 *Making Materiality Judgements* (Practice Statement) provides reporting entities with non-mandatory guidance on making materiality judgements when preparing general purpose financial statements in accordance with IFRS Standards.

2 The guidance may also help other parties involved in financial reporting to understand how an entity makes materiality judgements when preparing such financial statements.

Scope

3 The Practice Statement is applicable when preparing financial statements in accordance with IFRS Standards. It is not intended for entities applying the *IFRS for SMEs*® Standard.

4 The Practice Statement provides non-mandatory guidance; therefore, its application is not required to state compliance with IFRS Standards.

General characteristics of materiality

Definition of material

5 The *Conceptual Framework for Financial Reporting* (*Conceptual Framework*) provides the following definition of material information (IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provide similar definitions[1]):

> Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report.[2]

6 When making materiality judgements, an entity needs to take into account how information could reasonably be expected to influence the primary users of its

---

1 See paragraph 7 of IAS 1 *Presentation of Financial Statements* and paragraph 5 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

2 Paragraph QC11 of the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*). However, the Exposure Draft ED/2017/6 *Definition of Material (Proposed amendments to IAS 1 and IAS 8)* (Definition of Material ED) proposes to refine the definition of material to '[i]nformation is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of a specific reporting entity's general purpose financial statements make on the basis of those financial statements'. The Definition of Material ED also identifies consequential amendments to other IFRS Standards, including amendments to the definitions of material in the *Conceptual Framework*, IAS 1 and IAS 8.

financial statements—its primary users—when they make decisions[3] on the basis of those statements (see paragraphs 13–23).[4]

7 The objective of financial statements is to provide financial information about a reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.[5] The entity identifies the information necessary to meet that objective by making appropriate materiality judgements.

Materiality judgements are pervasive

8 The need for materiality judgements is pervasive in the preparation of financial statements. An entity makes materiality judgements when making decisions about recognition, measurement, presentation and disclosure. Requirements in IFRS Standards only need to be applied if their effect is material to the complete set of financial statements,[6] which includes the primary financial statements[7] and the notes. However, it is inappropriate for the entity to make, or leave uncorrected, immaterial departures from IFRS Standards to achieve a particular presentation of its financial position, financial performance or cash flows.[8]

Recognition and measurement

9 IFRS Standards set out reporting requirements that the International Accounting Standards Board (Board) has concluded will lead to financial statements that provide information about the financial position, financial performance and cash flows of an entity that is useful to the primary users of those statements. The entity is only required to apply recognition and measurement requirements when the effect of applying them is material.

Example A—materiality judgements on the application of accounting policies
Background An entity has a policy of capitalising expenditures on items of property, plant and equipment (PP&E) in excess of a specified threshold and recognising any smaller amounts as an expense. **Application** IAS 16 *Property, Plant and Equipment* requires that the cost of an item of PP&E is recognised as an asset when the criteria in paragraph 7 of IAS 16 are met.

continued...

3 Throughout this Practice Statement, the term 'decisions' refers to decisions about providing resources to the entity, unless specifically indicated otherwise.

4 See paragraph 7 of IAS 1.

5 See paragraph OB2 of the *Conceptual Framework*.

6 In this Practice Statement the phrases 'complete set of financial statements' and 'financial statements as a whole' are used interchangeably.

7 For the purposes of this Practice Statement, the primary financial statements comprise the statement of financial position, statement(s) of financial performance, statement of changes in equity and statement of cash flows.

8 See paragraph 8 of IAS 8.

...continued

The entity has assessed that its accounting policy—not capitalising expenditure below a specific threshold—will not have a material effect on the current-period financial statements or on future financial statements, because information reflecting the capitalisation and amortisation of such expenditure could not reasonably be expected to influence decisions made by the primary users of the entity's financial statements. Provided that such a policy does not have a material effect on the financial statements and was not set to intentionally achieve a particular presentation of the entity's financial position, financial performance or cash flows, the entity's financial statements comply with IAS 16. Such a policy is nevertheless reassessed each reporting period to ensure that its effect on the entity's financial statements remains immaterial.

Presentation and disclosure

10 An entity need not provide a disclosure specified by an IFRS Standard if the information resulting from that disclosure is not material. This is the case even if the Standard contains a list of specific disclosure requirements or describes them as 'minimum requirements'. Conversely, the entity must consider whether to provide information not specified by IFRS Standards if that information is necessary for primary users to understand the impact of particular transactions, other events and conditions on the entity's financial position, financial performance and cash flows.[9]

Example B—materiality judgements on disclosures specified by IFRS Standards
Background An entity presents property, plant and equipment (PP&E) as a separate line item in its statement of financial position. **Application** IAS 16 *Property, Plant and Equipment* sets out specific disclosure requirements for PP&E, including the disclosure of the amount of contractual commitments for the acquisition of PP&E (paragraph 74(c) of IAS 16). When preparing its financial statements, the entity assesses whether disclosures specified in IAS 16 are material information. Even if PP&E is presented as a separate line item in the statement of financial position, not all disclosures specified in IAS 16 will automatically be required. In the absence of any qualitative considerations (see paragraphs 46–51), if the amount of contractual commitments for the acquisition of PP&E is not material, the entity is not required to disclose this information.

9 See paragraphs 17(c) and 31 of IAS 1.

Example C—materiality judgements that lead to the disclosure of information in addition to the specific disclosure requirements in IFRS Standards

Background

An entity has its main operations in a country that, as part of an international agreement, is committed to introducing regulations to reduce the use of carbon-based energy. The regulations had not yet been enacted in the national legislation of that country at the end of the reporting period.

The entity owns a coal-fired power station in that country. During the reporting period, the entity recorded an impairment loss on its coal-fired power station, reducing the carrying amount of the power station to its recoverable amount. No goodwill or intangible assets with an indefinite useful life were included in the cash-generating unit.

Application

Paragraph 132 of IAS 36 *Impairment of Assets* does not require an entity to disclose the assumptions used to determine the recoverable amount of a tangible asset, unless goodwill or intangible assets with an indefinite useful life are included in the carrying amount of the cash-generating unit.

Nevertheless, the entity has concluded that the assumptions about the likelihood of national enactment of regulations to reduce the use of carbon-based energy, as well as about the enactment plan, it considered in measuring the recoverable amount of its coal-fired power station could reasonably be expected to influence decisions primary users make on the basis of the entity's financial statements. Hence, information about those assumptions is necessary for primary users to understand the impact of the impairment on the entity's financial position, financial performance and cash flows. Therefore, even though not specifically required by IAS 36, the entity concludes that its assumptions about the likelihood of national enactment of regulations to reduce the use of carbon-based energy, as well as about the enactment plan, constitute material information and discloses those assumptions in its financial statements.

Judgement

11 When assessing whether information is material to the financial statements, an entity applies judgement to decide whether the information could reasonably be expected to influence decisions that primary users make on the basis of those financial statements. When applying such judgement, the entity considers both its specific circumstances and how the information provided in the financial statements responds to the information needs of primary users.

12 Because an entity's circumstances change over time, materiality judgements are reassessed at each reporting date in the light of those changed circumstances.

Primary users and their information needs

13 When making materiality judgements, an entity needs to consider the impact information could reasonably be expected to have on the primary users of its financial statements. Those primary users are existing and potential investors, lenders and other creditors—those users who cannot require entities to provide information directly to them and must rely on general purpose financial statements for much of the financial information they need.[10] In addition to those primary users, other parties, such as the entity's management, regulators and members of the public, may be interested in financial information about the entity and may find the financial statements useful. However, the financial statements are not primarily directed at these other parties.[11]

14 Because primary users include potential investors, lenders and other creditors, it would be inappropriate for an entity to narrow the information provided in its financial statements by focusing only on the information needs of existing investors, lenders and other creditors.

Example D—existing and potential investors, lenders and other creditors

Background

An entity is 100 per cent owned by its parent. Its parent provides the entity with semi-finished products that the entity assembles and sells back to the parent. The entity is entirely financed by its parent. The current users of the entity's financial statements include the parent and the entity's creditors (mainly local suppliers).

Application

The entity refers to the *Conceptual Framework for Financial Reporting* to identify the primary users of its financial statements—existing and potential investors, lenders and other creditors who cannot require the entity to provide information directly to them and must rely on general purpose financial statements. When making materiality judgements in the preparation of its financial statements, the entity does not reduce its disclosures to only those of interest to its parent or its existing creditors. The entity also considers the information needs of potential investors, lenders and other creditors when making those judgements.

15 When making materiality judgements, an entity also considers that primary users are expected to have a reasonable knowledge of business and economic activities and to review and analyse the information included in the financial statements diligently.[12]

10 See paragraph OB5 of the *Conceptual Framework*.
11 See paragraphs OB9 and OB10 of the *Conceptual Framework*.
12 See paragraph QC32 of the *Conceptual Framework*.

Decisions made by primary users

16 An entity needs to consider what type of decisions its primary users make on the basis of the financial statements and, consequently, what information they need to make those decisions.

17 The primary users of an entity's financial statements make decisions about providing resources to the entity. Those decisions involve: buying, selling or holding equity and debt instruments, providing or settling loans and other forms of credit,[13] and exercising rights while holding investments (such as the right to vote on or otherwise influence management's actions that affect the use of the entity's economic resources).[14] Such decisions depend on the returns that primary users expect from an investment in those instruments.

18 The expectations existing and potential investors, lenders and other creditors have about returns, in turn, depend on their assessment of the amount, timing and uncertainty of the future net cash inflows to an entity,[15] together with their assessment of management's stewardship of the entity's resources.[16]

19 Consequently, an entity's primary users need information about:

(a) the resources of the entity (assets), claims against the entity (liabilities and equity) and changes in those resources and claims (income and expenses); and

(b) how efficiently and effectively the entity's management and governing board have discharged their responsibility to use the entity's resources.[17]

20 Financial information can make a difference in decisions if it has predictive value, confirmatory value or both.[18] When making materiality judgements, an entity needs to assess whether information could reasonably be expected to influence primary users' decisions, rather than assessing whether that information alone could reasonably be expected to change their decisions.

Meeting primary users' information needs

21 The objective of financial statements is to provide primary users with financial information that is useful to them in making decisions about providing resources to an entity. However, general purpose financial statements do not, and cannot, provide all the information that primary users need.[19] Therefore,

13 See paragraph OB2 of the *Conceptual Framework*.

14 The International Accounting Standards Board (Board) considers primary users' resource allocation decisions to include decisions needed to exercise rights while holding investments, such as rights to vote on or otherwise influence management's actions that affect the use of the entity's economic resources. The Board has tentatively decided to clarify this point, which was previously implicit in the phrase 'decisions to hold equity instruments', as part of its deliberations on the revised *Conceptual Framework*.

15 See paragraph OB3 of the *Conceptual Framework*.

16 Paragraph 1.3 of the Exposure Draft ED/2015/3 *Conceptual Framework for Financial Reporting* (Conceptual Framework ED) proposed to reintroduce the term 'stewardship' and to explain explicitly that investors', creditors' and other lenders' expectations about returns also depend on their assessment of management's stewardship of the entity's resources. The Board has tentatively decided to confirm this as part of its deliberations on the revised *Conceptual Framework*.

17 See paragraph OB4 of the *Conceptual Framework*.

18 See paragraph QC7 of the *Conceptual Framework*.

19 See paragraph OB6 of the *Conceptual Framework*.

the entity aims to meet the common information needs of its primary users. It does not aim to address specialised information needs—information needs that are unique to particular users.

Example E—primary users' unique or individual information requests
Background
Twenty investors each hold 5 per cent of an entity's voting rights. One of these investors is particularly interested in information about the entity's expenditure in a specific location because that investor operates another business in that location. Such information could not reasonably be expected to influence decisions that other primary users make on the basis of the entity's financial statements.
Application
In making its materiality judgements, the entity does not need to consider the specific information needs of that single investor. The entity concludes that information about its expenditure in the specific location is immaterial information for its primary users as a group and therefore decides not to provide it in its financial statements.

22 To meet the common information needs of its primary users, an entity first separately identifies the information needs that are shared by users within one of the three categories of primary users defined in the *Conceptual Framework*—for example investors (existing and potential)—then repeats the assessment for the two remaining categories—namely lenders (existing and potential) and other creditors (existing and potential). The total of the information needs identified is the set of common information needs the entity aims to meet.

23 In other words, the assessment of common information needs does not require identifying information needs shared across all existing and potential investors, lenders and other creditors. Some of the identified information needs will be common to all three categories, but others may be specific to only one or two of those categories. If an entity were to focus only on those information needs that are common to all categories of primary users, it might exclude information that meets the needs of only one category.

Impact of publicly available information

24 The primary users of financial statements generally consider information from sources other than just the financial statements. For example, they might also consider other sections of the annual report, information about the industry an entity operates in, its competitors and the state of the economy, the entity's press releases as well as other documents the entity has published.

25 However, the financial statements are required to be a comprehensive document that provides information about the financial position, financial performance and cash flows of an entity that is useful to primary users in making decisions about providing resources to the entity. Consequently, the entity assesses whether information is material to the financial statements, regardless of whether such information is also publicly available from another source.

26 Moreover, public availability of information does not relieve an entity of the obligation to provide material information in its financial statements.

Example F—impact of an entity's press release on materiality judgements

Background

An entity undertook a business combination in the reporting period. The acquisition doubled the size of the entity's operations in one of its main markets. On the acquisition date, the entity issued a press release providing an extensive explanation of the primary reasons for the business combination and a description of how it obtained control over the acquired business, together with other information related to the acquisition.

Application

In preparing its financial statements, the entity first considered the disclosure requirements in IFRS 3 *Business Combinations*. Paragraph B64(d) of IFRS 3 requires an entity to disclose, for each business combination that occurs during the reporting period, 'the primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree'.

The entity concludes that information about the business combination is material because the acquisition is expected to have a significant impact on the entity's operations, due to the overall size of the transaction compared with the size of the entity. In these circumstances, even though information relating to the primary reasons for the business combination and the description of how it obtained control is already included in a public statement, the entity needs to provide the information in its financial statements.

Interaction with local laws and regulations

27 An entity's financial statements must comply with the requirements in IFRS Standards, including requirements related to materiality (materiality requirements), for the entity to state its compliance with those Standards. Hence, an entity that wishes to state compliance with IFRS Standards cannot provide less information than the information required by the Standards, even if local laws and regulations permit otherwise.

28 Nevertheless, local laws and regulations may specify requirements that affect what information is provided in the financial statements. In such circumstances, providing information to meet local legal or regulatory requirements is permitted by IFRS Standards, even if that information is not material according to the materiality requirements in the Standards. However, such information must not obscure information that is material according to IFRS Standards.[20]

20 See paragraph 30A of IAS 1 and paragraph BC30F of the Basis for Conclusions on IAS 1.

Example G—information that is immaterial according to IFRS Standards required by local laws and regulations

Background

An entity is a food retailer operating in country ABC. In country ABC, investments in research and development (R&D) are generally limited across the industry; nonetheless, the government requires all entities to disclose, in their financial statements, the aggregate amount of R&D expenditure incurred during the period.

In the current reporting period, the entity recognised a small amount of expenditure on R&D activities as an expense. No R&D expenditure was capitalised during the period.

When preparing its financial statements, the entity assessed the disclosure of information about R&D expenditure incurred during the period as immaterial, for IFRS purposes.

Application

To comply with local regulations, the entity discloses in its financial statements information about R&D expenditure incurred during the period. IFRS Standards permit the entity to disclose that information in its financial statements, but the entity needs to organise its disclosures to ensure that material information is not obscured.

Example H—information that is material according to IFRS Standards not required by local laws and regulations

Background

An entity operates in a country where the government requires the disclosure of the details of property, plant and equipment (PP&E) disposals, but only if their carrying amounts exceed a specified percentage of total assets.

In the current reporting period, the entity disposed of PP&E below the threshold specified in the local regulation. This transaction was with a related party, which paid the entity less than the fair value of the item disposed.

When preparing its financial statements, the entity applied judgement and concluded that information about the details of the disposal was material, mainly because of the terms of the transaction and the fact it was with a related party.

Application

To comply with IFRS Standards, the entity discloses details of that disposal even though local regulations require disclosure of PP&E disposals only if their carrying amount exceeds a specified percentage of total assets.

Making materiality judgements

Overview of the materiality process

29 An entity may find it helpful to follow a systematic process in making materiality judgements when preparing its financial statements. The four-step process described in the following paragraphs is an example of such a process. This description provides an overview of the role materiality plays in the preparation of financial statements, with a focus on the factors the entity should consider when making materiality judgements. In this Practice Statement, this four-step process is called the 'materiality process'.

30 The materiality process describes how an entity could assess whether information is material for the purposes of presentation and disclosure, as well as for recognition and measurement. The process illustrates one possible way to make materiality judgements, but it incorporates the materiality requirements an entity must apply to state compliance with IFRS Standards. The materiality process considers potential omission and potential misstatement of information, as well as unnecessary inclusion of immaterial information and whether immaterial information obscures material information. In all cases, the entity needs to focus on how the information could reasonably be expected to influence decisions of the primary users of its financial statements.

31 Judgement is involved in assessing materiality when preparing financial statements. The materiality process is designed as a practice guide to help an entity apply judgement in an efficient and effective way.

32 The materiality process is not intended to describe the assessment of materiality for local legal and regulatory purposes. An entity refers to its local requirements to assess whether it is compliant with local laws and regulations.

A four-step materiality process

33 The steps identified as a possible approach to the assessment of materiality in the preparation of the financial statements are, in summary:

(a) Step 1—identify. Identify information that has the potential to be material.

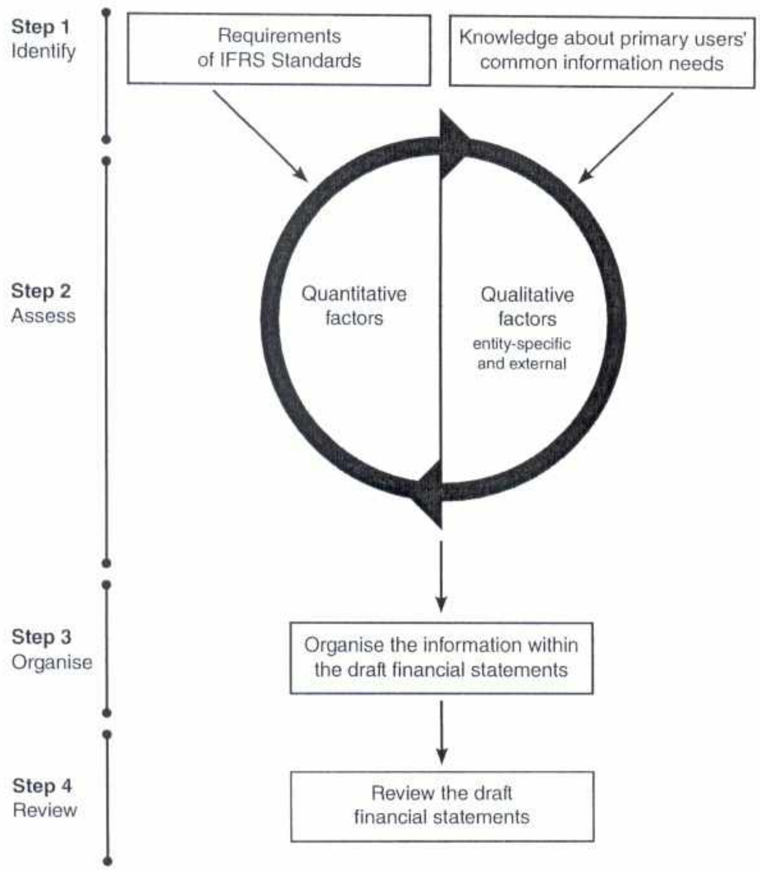
(b) Step 2—assess. Assess whether the information identified in Step 1 is, in fact, material.

(c) Step 3—organise. Organise the information within the draft financial statements in a way that communicates the information clearly and concisely to primary users.

(d) Step 4—review. Review the draft financial statements to determine whether all material information has been identified and materiality considered from a wide perspective and in aggregate, on the basis of the complete set of financial statements.

34 When preparing its financial statements, an entity may rely on materiality assessments from prior periods, provided that it reconsiders them in the light of any change in circumstances and of any new or updated information.

Diagram—the four-step materiality process



Step 1—identify

35 An entity identifies information about its transactions, other events and conditions that primary users might need to understand to make decisions about providing resources to the entity.

36 In identifying this information, an entity considers, as a starting point, the requirements of the IFRS Standards applicable to its transactions, other events and conditions. This is the starting point because, when developing a Standard, the Board identifies the information it expects will meet the needs of a broad range of primary users for a wide variety of entities in a range of circumstances.[21]

37 When the Board develops a Standard, it also considers the balance between the benefits of providing information and the costs of complying with the requirements in that Standard. However, the cost of applying the requirements

21 See paragraph OB8 of the *Conceptual Framework*.

in the Standards is not a factor for an entity to consider when making materiality judgements—the entity should not consider the cost of complying with requirements in IFRS Standards, unless there is explicit permission in the Standards.

38 An entity also considers its primary users' common information needs (as explained in paragraphs 21–23) to identify any information—in addition to that specified in IFRS Standards—necessary to enable primary users to understand the impact of the entity's transactions, other events and conditions on the entity's financial position, financial performance and cash flows (see paragraph 10). Existing and potential investors, lenders and other creditors need information about the resources of the entity (assets), claims against the entity (liabilities and equity) and changes in those resources and claims (income and expenses), and information that will help them assess how efficiently and effectively the entity's management and governing board have discharged their responsibility to use the entity's resources.[22]

39 The output of Step 1 is a set of potentially material information.

Step 2—assess

40 An entity assesses whether the potentially material information identified in Step 1 is, in fact, material. In making this assessment, the entity needs to consider whether its primary users could reasonably be expected to be influenced by the information when making decisions about providing resources to the entity on the basis of the financial statements. The entity performs this assessment in the context of the financial statements as a whole.

41 An entity might conclude that an item of information is material for various reasons. Those reasons include the item's nature or size, or a combination of both, judged in relation to the particular circumstances of the entity.[23] Therefore, making materiality judgements involves both quantitative and qualitative considerations. It would not be appropriate for the entity to rely on purely numerical guidelines or to apply a uniform quantitative threshold for materiality (see paragraphs 53–55).

42 The following paragraphs describe some common 'materiality factors' that an entity should use to help identify when an item of information is material. These factors are organised into the following categories:

(a) quantitative; and

(b) qualitative—either entity-specific or external.

43 The output of Step 2 is a preliminary set of material information. For presentation and disclosure, this involves decisions about what information an entity needs to provide in its financial statements, and in how much detail[24] (including identifying appropriate levels of aggregation an entity provides in the financial statements). For recognition and measurement, the output of Step 2

22 See paragraph OB4 of the *Conceptual Framework*.

23 See paragraph 7 of IAS 1 and paragraph 5 of IAS 8.

24 See paragraph 29 of IAS 1.

involves the identification of information that, if not recognised or otherwise misstated, could reasonably be expected to influence primary users' decisions.

Quantitative factors

44 An entity ordinarily assesses whether information is quantitatively material by considering the size of the impact of the transaction, other event or condition against measures of the entity's financial position, financial performance and cash flows. The entity makes this assessment by considering not only the size of the impact it recognises in its primary financial statements but also any unrecognised items that could ultimately affect primary users' overall perception of the entity's financial position, financial performance and cash flows (eg contingent liabilities or contingent assets). The entity needs to assess whether the impact is of such a size that information about the transaction, other event or condition could reasonably be expected to influence its primary users' decisions about providing resources to the entity.

45 Identifying the measures against which an entity makes this quantitative assessment is a matter of judgement. That judgement depends on which measures are of great interest to the primary users of the entity's financial statements. Examples include measures of the entity's revenues, the entity's profitability, financial position ratios and cash flow measures.

Qualitative factors

46 For the purposes of this Practice Statement, qualitative factors are characteristics of an entity's transactions, other events or conditions, or of their context, that, if present, make information more likely to influence the decisions of the primary users of the entity's financial statements. The mere presence of a qualitative factor will not necessarily make the information material, but is likely to increase primary users' interest in that information.

47 In making materiality judgements, an entity considers both entity-specific and external qualitative factors. These factors are described separately in the following paragraphs. However, in practice, the entity may need to consider them together.

48 An entity-specific qualitative factor is a characteristic of the entity's transaction, other event or condition. Examples of such factors include, but are not limited to:

(a) involvement of a related party of the entity;

(b) uncommon, or non-standard, features of a transaction or other event or condition; or

(c) unexpected variation or unexpected changes in trends. In some circumstances, the entity might consider a quantitatively immaterial amount as material because of the unexpected variation compared to the prior-period amount provided in its financial statements.

49 The relevance of information to the primary users of an entity's financial statements can also be affected by the context in which the entity operates. An external qualitative factor is a characteristic of the context in which the entity's

transaction, other event or condition occur that, if present, makes information more likely to influence the primary users' decisions. Characteristics of the entity's context that might represent external qualitative factors include, but are not limited to, the entity's geographical location, its industry sector, or the state of the economy or economies in which the entity operates.

50 Due to the nature of external qualitative factors, entities operating in the same context might share a number of external qualitative factors. Moreover, external qualitative factors could remain constant over time or could vary.

51 In some circumstances, if an entity is not exposed to a risk to which other entities in its industry are exposed, that fact could reasonably be expected to influence its primary users' decisions; that is, information about the lack of exposure to that particular risk could be material information.

Interaction of qualitative and quantitative factors

52 An entity could identify an item of information as material on the basis of one or more materiality factors. In general, the more factors that apply to a particular item, or the more significant those factors are, the more likely it is that the item is material.

53 Although there is no hierarchy among materiality factors, assessing an item of information from a quantitative perspective first could be an efficient approach to assessing materiality. If an entity identifies an item of information as material solely on the basis of the size of the impact of the transaction, other event or condition, the entity does not need to assess that item of information further against other materiality factors. In these circumstances, a quantitative threshold—a specified level, rate or amount of one of the measures used in assessing size—can be a helpful tool in making a materiality judgement. However, a quantitative assessment alone is not always sufficient to conclude that an item of information is not material. The entity should further assess the presence of qualitative factors.

54 The presence of a qualitative factor lowers the thresholds for the quantitative assessment. The more significant the qualitative factors, the lower those quantitative thresholds will be. However, in some cases an entity might decide that, despite the presence of qualitative factors, an item of information is not material because its effect on the financial statements is so small that it could not reasonably be expected to influence primary users' decisions.

55 In some other circumstances, an item of information could reasonably be expected to influence primary users' decisions regardless of its size—a quantitative threshold could even reduce to zero. This might happen when information about a transaction, other event or condition is highly scrutinised by the primary users of an entity's financial statements. Moreover, a quantitative assessment is not always possible: non-numeric information might only be assessed from a qualitative perspective.

Example I—information about a related party transaction assessed as material

Background

An entity has identified measures of its profitability as the measures of great interest to the primary users of its financial statements. In the current reporting period, the entity signed a five-year contract with company ABC. Company ABC will provide the entity with maintenance services for the entity's offices for an annual fee. Company ABC is controlled by a member of the entity's key management personnel. Hence, company ABC is a related party of the entity.

Application

IAS 24 *Related Party Disclosures* requires an entity to disclose, for each related party transaction that occurred during the period, the nature of the related party relationship as well as information about the transaction and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements.

When preparing its financial statements, the entity assessed whether information about the transaction with company ABC was material.

The entity started its assessment from a quantitative perspective and evaluated the impact of the related party transaction against measures of the entity's profitability. Having initially concluded that the impact of the related party transaction was not material from a purely quantitative perspective, the entity further assessed the presence of any qualitative factors.

As the Board noted in developing IAS 24, related parties may enter into transactions that unrelated parties would not enter into, and the transactions may be priced at amounts that differ from the price for transactions between unrelated parties.

The entity identified the fact that the maintenance agreement was concluded with a related party as a characteristic that makes information about that transaction more likely to influence the decisions of its primary users.

The entity further assessed the transaction from a quantitative perspective to determine whether the impact of the transaction could reasonably be expected to influence primary users' decisions when considered with the fact that the transaction was with a related party (ie the presence of a qualitative factor lowers the quantitative threshold). Having considered that the transaction was with a related party, the entity concluded that the impact was large enough to reasonably be expected to influence primary users' decisions. Hence, the entity assessed information about the transaction with company ABC as material and disclosed that information in its financial statements.

Example J—information about a related party transaction assessed as immaterial

Background

An entity has identified measures of its profitability as the measures of great interest to the primary users of its financial statements. The entity owns a large fleet of vehicles. In the current reporting period, the entity sold an almost fully depreciated vehicle to company DEF. The entity transferred the vehicle for total consideration consistent with its market value and its carrying amount. Company DEF is controlled by a member of the entity's key management personnel. Hence, company DEF is a related party of the entity.

Application

When preparing its financial statements, the entity assessed whether information about the transaction with company DEF was material.

As in **Example I**, the entity started its assessment from a quantitative perspective and evaluated the impact of the related party transaction against measures of the entity's profitability. Having initially concluded that the impact of the related party transaction was not material from a purely quantitative perspective, the entity further assessed the presence of any qualitative factors.

The entity transferred the vehicle for a total consideration consistent with its market value and its carrying amount. However, the entity identified the fact that the vehicle was sold to a related party as a characteristic that makes information about that transaction more likely to influence the decisions of its primary users.

The entity further assessed the transaction from a quantitative perspective but concluded that its impact was too small to reasonably be expected to influence primary users' decisions, even when considered with the fact that the transaction was with a related party. Information about the transaction with company DEF was consequently assessed as immaterial and not disclosed in the entity's financial statements.

Example K—influence of external qualitative factors on materiality judgements

Background

An international bank holds a very small amount of debt originating from a country whose national economy is currently experiencing severe financial difficulties. Other international banks that operate in the same sector as the entity hold significant amounts of debt originating from that country and, hence, are significantly affected by the financial difficulties in that country.

continued...

...continued

Application

Paragraph 31 of IFRS 7 *Financial Instruments: Disclosures* requires an entity to disclose information that enables users of its financial statements to evaluate the nature and extent of risk arising from financial instruments to which the entity is exposed at the end of the reporting period.

When preparing its financial statements, the bank assessed whether the fact that it holds a very small amount of debt originating from that country was material information.

In making that assessment, the bank considered the exposure to that particular debt faced by other international banks operating in the same sector (external qualitative factor).

In these circumstances, the fact that the bank is holding a very small amount of debt (or even no debt at all) originating from that country, while other international banks operating in the same sector have significant holdings, provides the entity's primary users with useful information about how effective management has been at protecting the bank's resources from unfavourable effects of the economic conditions in that country.

The bank assessed the information about the lack of exposure to that particular debt as material and disclosed that information in its financial statements.

Step 3—organise

56 Classifying, characterising and presenting information clearly and concisely makes it understandable.[25] An entity exercises judgement when deciding how to communicate information clearly and concisely. For example, the entity is more likely to clearly and concisely communicate the material information identified in Step 2 by organising it to:

(a) emphasise material matters;

(b) tailor information to the entity's own circumstances;

(c) describe the entity's transactions, other events and conditions as simply and directly as possible without omitting material information and without unnecessarily increasing the length of the financial statements;

(d) highlight relationships between different pieces of information;

(e) provide information in a format that is appropriate for its type, eg tabular or narrative;

(f) provide information in a way that maximises, to the extent possible, comparability among entities and across reporting periods;

25 See paragraph QC30 of the *Conceptual Framework*.

(g) avoid or minimise duplication of information in different parts of the financial statements; and

(h) ensure material information is not obscured by immaterial information.

57 Financial statements are less understandable for primary users if information is organised in an unclear manner. Similarly, financial statements are less understandable if an entity aggregates material items that have different natures or functions, or if material information is obscured,[26] for example, by an excessive amount of immaterial information.

58 Furthermore, an entity considers the different roles of primary financial statements and notes in deciding whether to present an item of information separately in the primary financial statements, to aggregate it with other information or to disclose the information in the notes.

59 The output of Step 3 is the draft financial statements.

Step 4—review

60 An entity needs to assess whether information is material both individually and in combination with other information[27] in the context of its financial statements as a whole. Even if information is judged not to be material on its own, it might be material when considered in combination with other information in the complete set of financial statements.

61 When reviewing its draft financial statements, an entity draws on its knowledge and experience of its transactions, other events and conditions to identify whether all material information has been provided in the financial statements, and with appropriate prominence.

62 This review gives an entity the opportunity to 'step back' and consider the information provided from a wider perspective and in aggregate. This enables the entity to consider the overall picture of its financial position, financial performance and cash flows. In performing this review, the entity also considers whether:

(a) all relevant relationships between different items of information have been identified. Identifying new relationships between information might lead to that information being identified as material for the first time.

(b) items of information that are individually immaterial, when considered together, could nevertheless reasonably be expected to influence primary users' decisions.

(c) the information in the financial statements is communicated in an effective and understandable way, and organised to avoid obscuring material information.

(d) the financial statements provide a fair presentation of the entity's financial position, financial performance and cash flows.[28]

26 See paragraph 30A of IAS 1.
27 See paragraph 7 of IAS 1 and paragraph 5 of IAS 8.
28 See paragraph 15 of IAS 1.

63 The review may lead to:

(a) additional information being provided in the financial statements;

(b) greater disaggregation of information that had already been identified as material;

(c) information that had already been identified as immaterial being removed from the financial statements to avoid obscuring material information; or

(d) information being reorganised within the financial statements.

64 The review in Step 4 may also lead an entity to question the assessment performed in Step 2 and decide to re-perform that assessment. As a result of re-performing its assessment in Step 2, the entity might conclude that information previously identified as material is, in fact, immaterial, and remove it from the financial statements.

65 The output of Step 4 is the final financial statements.

Specific topics

Prior-period information

66 An entity makes materiality judgements on the complete set of financial statements, including prior-period[29] information provided in the financial statements.

67 IFRS Standards require an entity to present information in respect of the preceding period for all amounts reported in the current-period financial statements.[30] Furthermore, the Standards require the entity to provide prior-period information for narrative and descriptive information if it is relevant to understanding the current-period financial statements.[31] Finally, the Standards require the entity to present, as a minimum, two statements of financial position, two statements of profit or loss and other comprehensive income, two statements of profit or loss (if presented separately), two statements of cash flows, two statements of changes in equity, and related notes.[32] These requirements are the minimum comparative information identified by the Standards.[33]

68 Assessing whether prior-period information is material to the current-period financial statements might lead an entity to:

(a) provide more prior-period information than was provided in the prior-period financial statements (see paragraph 70); or

29 For this Practice Statement, 'prior-period' should be read as 'prior-periods' if financial statements include amounts and disclosures for more than one prior period.

30 Except when IFRS Standards permit or require otherwise. See paragraph 38 of IAS 1.

31 See paragraph 38 of IAS 1.

32 See paragraph 38A of IAS 1.

33 Paragraph 10(f) of IAS 1 also requires an entity to provide a statement of financial position as at the beginning of the preceding period when the entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements in accordance with paragraphs 40A–40D of IAS 1.

(b) provide less prior-period information than was provided in the prior-period financial statements (see paragraph 71).

69 An entity also needs to consider any local laws or regulations, in respect of the prior-period information to be provided in financial statements, when making decisions on what prior-period information to provide in the current-period financial statements. Those local laws or regulations might require the entity to provide in the financial statements prior-period information in addition to the minimum comparative information required by the Standards. The Standards permit the inclusion of such additional information, but require that it is prepared in accordance with the Standards[34] and does not obscure material information.[35] However, an entity that wishes to state compliance with IFRS Standards cannot provide less information than required by the Standards, even if local laws and regulations permit otherwise.

Prior-period information not previously provided

70 An entity must provide prior-period information needed to understand the current-period financial statements,[36] regardless of whether that information was provided in the prior-period financial statements—this requirement is not conditional on whether the prior-period information was provided in the prior-period financial statements. Consequently, the inclusion of prior-period information not previously included would be required if this is necessary for the primary users to understand the current-period financial statements.

Example L—prior-period information not previously provided

Background

In the prior period, an entity had a very small amount of debt outstanding. Information about this debt was appropriately assessed as immaterial in the prior period, and so the entity did not disclose any maturity analysis showing the remaining contractual maturities or other information that would otherwise be required by paragraph 39(a) of IFRS 7 *Financial Instruments: Disclosures*.

In the current period, the entity issued a large amount of debt. The entity concluded that information about debt maturity was material information and disclosed it, in the form of a table, in the current-period financial statements.

Application

The entity might conclude that including a prior-period debt maturity analysis in the financial statements would be necessary for primary users to understand the current-period financial statements. In these circumstances, a narrative description of the maturity of the prior-period balances of the outstanding debt might be sufficient.

34 See paragraph 38C of IAS 1.
35 See paragraph 30A of IAS 1 and paragraph BC30F of the Basis for Conclusions on IAS 1.
36 See paragraph 38 of IAS 1.

Summarising prior-period information

71 Except to the extent required to comply with any local laws or regulations affecting the preparation of financial statements or their audit, an entity does not automatically reproduce in the current-period financial statements all the information provided in the prior-period financial statements. Instead, the entity may summarise prior-period information, retaining the information necessary for primary users to understand the current-period financial statements.

Example M—summarising prior-period information

Background

An entity disclosed, in the prior-period financial statements, details of a legal dispute which led to the recognition, in that period, of a provision. In accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* the entity disclosed in the prior-period financial statements a detailed description of uncertainties about the amount and timing of possible cash outflows, in respect of the dispute, together with the major assumptions made concerning future events.

Most of the uncertainties have been resolved in the current period, and, even though the liability has not been settled, a court pronouncement confirmed the amount already recognised in the financial statements by the entity.

The entity considered the relevant local laws, regulations and other reporting requirements and concluded that there were no locally prescribed obligations relating to the inclusion of prior-period information in the current-period financial statements.

Application

In these circumstances, on the basis of the requirements in IFRS Standards, the entity may not need to reproduce in the current-period financial statements all of the information about the legal dispute provided in the prior-period financial statements. Because most of the uncertainties have been resolved, users of the financial statements for the current period may no longer need detailed information about those uncertainties. Instead, information about those uncertainties might be summarised and updated to reflect the current-period events and circumstances and the resolution of previously reported uncertainties.

Errors

72 Errors are omissions from and/or misstatements in an entity's financial statements arising from a failure to use, or misuse of, reliable information that is available, or could reasonably be expected to be obtained.[37] Material errors are errors that individually or collectively could reasonably be expected to influence decisions that primary users make on the basis of those financial statements.

37 See paragraph 5 of IAS 8 (derived from the definition of prior-period errors).

Errors may affect narrative descriptions disclosed in the notes as well as amounts reported in the primary financial statements or in the notes.

73 An entity must correct all material errors, as well as any immaterial errors made intentionally to achieve a particular presentation of its financial position, financial performance or cash flows, to ensure compliance with IFRS Standards.[38] The entity should refer to IAS 8 for guidance on how to correct an error.

74 Immaterial errors, if not made intentionally to achieve a particular presentation, do not need to be corrected to ensure compliance with IFRS Standards. However, correcting all errors (including those that are not material) in the preparation of the financial statements lowers the risk that immaterial errors will accumulate over reporting periods and become material.

75 An entity assesses whether an error is material by applying the same considerations as outlined in the description of the materiality process. Making materiality judgements about errors involves both quantitative and qualitative considerations. The entity identifies information that, if misstated or omitted, could reasonably be expected to influence primary users' decisions (as described in Step 1 and Step 2 of the materiality process). The entity also considers whether any identified errors are material on a collective basis (as described in Step 4 of the materiality process).

76 If an error is judged not to be material on its own, it might be regarded as material when considered in combination with other information. However, in general, if an error is individually assessed as material to an entity's financial statements, the existence of other errors that affect the entity's financial position, financial performance or cash flows in the opposite way, does not make the error immaterial, nor does it eliminate the need to correct the error.

Example N—individual and collective assessment of errors

Background

An entity has identified measures of its profitability as the measures of great interest to the primary users of its financial statements. During the current reporting period, the entity recognised:

(a) an expense accrual of CU100[(a)] that should not have been recognised. The accrual affected the line item 'cost of services'.

(b) the reversal of a provision of CU80 recognised in the previous period that should not have been reversed. The reversal affected the line item 'other operating income (expense)'.

continued...

38 See paragraph 41 of IAS 8.

...continued

Application

In assessing whether these errors are material to its financial statements, the entity did not identify the presence of any qualitative factors and thus made its materiality judgement solely from a quantitative perspective. The entity concluded that both errors were individually material because of their impact on its profit.

In these circumstances, it would be inappropriate to consider the quantitative effect of the errors on a net basis, ie as a CU20 overstatement of expenses, thereby concluding that the identified errors do not need to be corrected. If an error is individually assessed as material to the entity's financial statements, the existence of other errors that affect the entity's financial position, financial performance or cash flows in an opposite way, does not eliminate the need to correct it, or make the error immaterial.

(a) In this example, currency amounts are denominated in 'currency units' (CU).

Cumulative errors

77 An entity may, over a number of reporting periods, accumulate errors that were immaterial, both in individual prior periods and cumulatively over all prior periods. Uncorrected errors that have accumulated over more than one period are sometimes called 'cumulative errors'.

78 Materiality judgements about cumulative errors in prior-period financial statements that an entity made at the time those statements were authorised for issue need not be revisited in subsequent periods unless the entity failed to use, or misused, information that:

(a) was available when financial statements for those periods were authorised for issue; and

(b) could reasonably be expected to have been obtained and taken into account in the preparation of those financial statements.[39]

79 To assess whether a cumulative error has become material to the current-period financial statements, an entity considers whether, in the current period:

(a) the entity's circumstances have changed, leading to a different materiality assessment for the current period; or

(b) further accumulation of a current-period error onto the cumulative error has occurred.

80 An entity must correct cumulative errors if they have become material to the current-period financial statements.

39 See paragraph 5 of IAS 8.

Example O—current-period assessment of cumulative errors
Background
An entity, three years ago, purchased a plant. The plant has a useful life of 50 years and a residual value amounting to 20 per cent of the plant cost. The entity started to use the plant three years ago, but has not recognised any depreciation for it (cumulative error). In each prior period, the entity assessed the error of not depreciating its plant as being individually and cumulatively immaterial to the financial statements for that period. There is no indication that the materiality judgements of prior periods were wrong.
In the current period, the entity started depreciating the plant.
In the same period, the entity experienced a significant reduction in profitability (the type of circumstance referred to in paragraph 79(a) of the Practice Statement).
Application
When making its materiality judgements in the preparation of the current-period financial statements, the entity concluded that the cumulative error was material to the current-period financial statements.
In this scenario, the entity does not need to revisit the materiality assessments it made in prior periods. However, because in the current period the cumulative error has become material to the current-period financial statements, the entity must apply the requirements in IAS 8 to correct it.

Information about covenants

81 An entity assesses the materiality of information about the existence and terms of a loan agreement clause (covenant), or of a covenant breach, to decide whether to provide information related to the covenant in the financial statements. This assessment is made in the same way as for other information, that is, by considering whether that information could reasonably be expected to influence decisions that its primary users make on the basis of the entity's financial statements (see 'A four-step materiality process', from paragraph 33).

82 In particular, when a covenant exists, an entity considers both:

(a) the consequences of a breach occurring, that is, the impact a covenant breach would have on the entity's financial position, financial performance and cash flows. If those consequences would affect the entity's financial position, financial performance or cash flows in a way that could reasonably be expected to influence primary users' decisions, then the information about the existence of the covenant and its terms is likely to be material. Conversely, if the consequences of a covenant breach would not affect the entity's financial position, financial performance or cash flows in such a way, then disclosures about the covenant might not be needed.

(b) the likelihood of a covenant breach occurring. The more likely it is that a covenant breach would occur, the more likely it is that information about the existence and terms of the covenant would be material.

83 In assessing whether information about a covenant is material, a combination of the considerations in paragraph 82(a)–82(b) applies. Information about a covenant for which the consequences of a breach would affect an entity's financial position, financial performance or cash flows in a way that could reasonably be expected to influence primary users' decisions, but for which there is only a remote likelihood of the breach occurring, is not material.

Example P—assessing whether information about covenants is material

Background

An entity has rapidly grown over the past five years and recently suffered some liquidity problems. A long-term loan was granted to the entity in the current reporting period. The loan agreement includes a clause that requires the entity to maintain a ratio of debt to equity below a specified threshold, to be measured at each reporting date (the covenant). According to the loan agreement, the debt-to-equity ratio has to be calculated on the basis of debt and equity figures as presented in the entity's IFRS financial statements. If the entity breaches the covenant, the entire loan becomes payable on demand. The disclosure of covenant terms in an entity's financial statements is not required by any local laws or regulations.

Application

Paragraph 31 of IFRS 7 *Financial Instruments: Disclosures* requires an entity to disclose information that enables users of its financial statements to evaluate the nature and extent of risk arising from financial instruments to which the entity is exposed at the end of the reporting period.

In the preparation of its financial statements, the entity assesses whether information about the existence of the covenant and its terms is material information, considering both the consequences and the likelihood of a breach occurring.

In these circumstances, the entity concluded that, considering its recent liquidity problem, any acceleration of the long-term loan repayment plan (the consequence of the covenant breach occurring) would affect the entity's financial position and cash flows in a way that could reasonably be expected to influence primary users' decisions.

The entity also considered the likelihood of a breach occurring.

continued...

...continued

Scenario 1—the lender defined the covenant threshold on the basis of the three-year business plan prepared by the entity, adding a 10 per cent tolerance to the forecast figures

In this scenario, even though the entity has historically met its past business plans, it assessed the likelihood of a breach occurring as higher than remote. Therefore, information about the existence of the covenant and its terms was assessed as material and disclosed in the entity's financial statements.

Scenario 2—the lender defined the covenant threshold on the basis of the three-year business plan prepared by the entity, adding a 200 per cent tolerance to the forecast figures

In this scenario, the entity assessed the likelihood of a breach occurring as remote, on the basis of its historical track record of meeting its past business plans and the magnitude of the tolerance included in the covenant threshold. Therefore, although the consequences of the covenant breach would affect the entity's financial position and cash flows in a way that could reasonably be expected to influence primary users' decisions, the entity concluded that information about the existence of the covenant and its terms was not material.

Materiality judgements for interim reporting

84 An entity makes materiality judgements in preparing both annual financial statements and interim financial reports prepared in accordance with IAS 34 *Interim Financial Reporting*. In either case, the entity could apply the materiality process described in paragraphs 29–65. For its interim financial report, the entity considers the same materiality factors as in its annual assessment. However, it takes into consideration that the time period and the purpose of an interim financial report differ from those of the annual financial statements.

85 In making materiality judgements on its interim financial report, an entity focuses on the period covered by that report, that is:

(a) it assesses whether information in the interim financial report is material in relation to the interim period financial data, not annual data.[40]

(b) it applies the materiality factors on the basis of both the current interim period data and also, whenever there is more than one interim period (eg in the case of quarterly reporting), the data for the current financial year to date.[41]

40 See paragraphs 23 and 25 of IAS 34 *Interim Financial Reporting*.

41 Paragraph 20 of IAS 34 requires an entity to include in the interim financial report the statements of profit or loss and other comprehensive income for both periods, the current interim period and the current financial year to date.

(c) it may consider whether to provide in the interim financial report information that is expected to be material to the annual financial statements. However, information that is expected to be material to the annual financial statements need not be provided in the interim financial report if it is not material to the interim financial report.

Example Q—information that is expected to be material to the annual financial statements

Background

An entity sells mainly standardised products to private customers in its home market. In the first half of the reporting period, 98 per cent of the entity's revenue was generated by sales of Product X. The remaining revenue was principally derived from a pilot sale of a new product line—Product Y—that the entity planned to launch in the third quarter of the year. The entity expects revenue from Product Y to increase significantly by the end of the annual reporting period, so that Product Y will provide approximately 20 per cent of the entity's revenue for the full annual period.

Application

Paragraph 114 of IFRS 15 *Revenue from Contracts with Customers* requires an entity to disaggregate revenue recognised from contracts into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors.

The entity did not identify any qualitative factors that made the amount of revenues from Product Y material to the interim period.

In these circumstances, the entity concluded that the information about disaggregation of revenue by product lines was not material to the interim financial report and did not disclose it. In the preparation of the interim financial report, the entity is not required to disaggregate its revenue by product lines even if a greater level of disaggregation is expected to be required for the subsequent annual financial statements. In other words, although the entity expects that revenue by product lines will be material information for the annual financial statements, that fact does not influence the materiality assessment in the preparation of the entity's interim financial report.

86 Similarly, an entity may consider whether to provide information in the annual financial statements that is only material to the interim financial report. However, if information is material to the interim financial report, it need not be presented or disclosed subsequently in the annual financial statements if it is not material to those statements.

Example R—information that is only material to the interim financial report

Background

An entity has identified measures of its profitability and cash flows as the measures of great interest to the primary users of its financial statements. During the interim period, the entity constructed a new chemical handling process to enable it to comply with environmental requirements for the production and storage of dangerous chemicals. Such an item of property, plant and equipment (PP&E) qualifies for recognition as an asset in accordance with paragraph 11 of IAS 16 *Property, Plant and Equipment*.

Application

Paragraph 74(b) of IAS 16 requires the disclosure of the expenditure recognised in the carrying amount of an item of PP&E in the course of its construction.

In the preparation of the interim financial report, the entity assessed, both from a quantitative and qualitative perspective, the information about expenditure recognised in the carrying amount of the chemical handling process, concluded that information was material to the interim financial report and disclosed it.

The entity incurred no further expenditure related to the chemical handling process in the second half of the annual reporting period. In the preparation of its annual financial statements, the entity assessed the expenditure recognised in the carrying amount of the chemical handling process against its annual profitability and cash flow measures and concluded that this information was not material to the annual financial statements. In reaching that conclusion, the entity did not identify any qualitative factors leading to a different assessment.

The entity is not required to disclose information about the expenditure recognised in the carrying amount of its chemical handling process in its annual financial statements.

87 In assessing materiality, an entity also considers the purpose of interim financial reports, which differs from the purpose of annual financial statements. An interim financial report is intended to provide an update on the latest complete set of annual financial statements.[42] Information that is material to the interim period, but was already provided in the latest annual financial statements, does not need to be reproduced in the interim financial report, unless something new occurs or an update is needed.[43]

Interim reporting estimates

88 When an entity concludes that information about estimation uncertainty is material, the entity needs to disclose that information. Measurements included

42 See paragraph 6 of IAS 34.

43 See paragraphs 15–15A of IAS 34.

in interim financial reports often rely more on estimates than measurements included in the annual financial statements.[44] That fact does not, in itself, make the estimated measurements material. Nevertheless, relying on estimates for interim financial data to a greater extent than for annual financial data might result in more disclosures about such uncertainties being material, and thus being provided in the interim financial report, compared with the annual financial statements.

Application date

89 This Practice Statement does not change any requirements in IFRS Standards or introduce any new requirements. An entity that chooses to apply the guidance in the Practice Statement is permitted to apply it to financial statements prepared from 14 September 2017.

44 See paragraph 41 of IAS 34.

Appendix
References to the *Conceptual Framework for Financial Reporting* and IFRS Standards

Extracts from the *Conceptual Framework for Financial Reporting*[45]

Paragraph OB2

Referred to in paragraphs 7 and 17 of the Practice Statement

> The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit.

Paragraph OB3

Referred to in paragraph 18 of the Practice Statement

> Decisions by existing and potential investors about buying, selling or holding equity and debt instruments depend on the returns that they expect from an investment in those instruments, for example dividends, principal and interest payments or market price increases. Similarly, decisions by existing and potential lenders and other creditors about providing or settling loans and other forms of credit depend on the principal and interest payments or other returns that they expect. Investors', lenders' and other creditors' expectations about returns depend on their assessment of the amount, timing and uncertainty of (the prospects for) future net cash inflows to the entity. Consequently, existing and potential investors, lenders and other creditors need information to help them assess the prospects for future net cash inflows to an entity.

Paragraph OB4

Referred to in paragraphs 19 and 38 of the Practice Statement

> To assess an entity's prospects for future net cash inflows, existing and potential investors, lenders and other creditors need information about the resources of the entity, claims against the entity, and how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources. Examples of such responsibilities include protecting the entity's resources from unfavourable effects of economic factors such as price and technological changes and ensuring that the entity complies with applicable laws, regulations and contractual provisions. Information about management's discharge of its responsibilities is also useful for decisions by existing investors, lenders and other creditors who have the right to vote on or otherwise influence management's actions.

45 References to the *Conceptual Framework for Financial Reporting* in this Practice Statement will be updated once the revised *Conceptual Framework* is issued.

Paragraph OB5

Referred to in paragraph 13 of the Practice Statement

> Many existing and potential investors, lenders and other creditors cannot require reporting entities to provide information directly to them and must rely on general purpose financial reports for much of the financial information they need. Consequently, they are the primary users to whom general purpose financial reports are directed.

Paragraph OB6

Referred to in paragraph 21 of the Practice Statement

> However, general purpose financial reports do not and cannot provide all of the information that existing and potential investors, lenders and other creditors need. Those users need to consider pertinent information from other sources, for example, general economic conditions and expectations, political events and political climate, and industry and company outlooks.

Paragraph OB8

Referred to in paragraph 36 of the Practice Statement

> Individual primary users have different, and possibly conflicting, information needs and desires. The Board, in developing financial reporting standards, will seek to provide the information set that will meet the needs of the maximum number of primary users. However, focusing on common information needs does not prevent the reporting entity from including additional information that is most useful to a particular subset of primary users.

Paragraph OB9

Referred to in paragraph 13 of the Practice Statement

> The management of a reporting entity is also interested in financial information about the entity. However, management need not rely on general purpose financial reports because it is able to obtain the financial information it needs internally.

Paragraph OB10

Referred to in paragraph 13 of the Practice Statement

> Other parties, such as regulators and members of the public other than investors, lenders and other creditors, may also find general purpose financial reports useful. However, those reports are not primarily directed to these other groups.

Paragraph QC7

Referred to in paragraph 20 of the Practice Statement

> Financial information is capable of making a difference in decisions if it has predictive value, confirmatory value or both.

Paragraph QC11

Referred to in paragraph 5 of the Practice Statement

> Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report. Consequently, the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.

Paragraph QC30

Referred to in paragraph 56 of the Practice Statement

> Classifying, characterising and presenting information clearly and concisely makes it *understandable*.

Paragraph QC32

Referred to in paragraph 15 of the Practice Statement

> Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. At times, even well-informed and diligent users may need to seek the aid of an adviser to understand information about complex economic phenomena.

Extracts from IAS 1 *Presentation of Financial Statements*

Paragraph 7 (and paragraph 5 of IAS 8)

Referred to in paragraphs 5, 41 and 60 of the Practice Statement

> ***Material*** **Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.**

Paragraph 7

Referred to in paragraph 6 of the Practice Statement

> Assessing whether an omission or misstatement could influence economic decisions of users, and so be material, requires consideration of the characteristics of those users. [...] Therefore, the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making economic decisions.

Paragraph 15

Referred to in paragraph 62 of the Practice Statement

> **Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework. The application of IFRSs, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation.**

Paragraph 17

Referred to in paragraph 10 of the Practice Statement

> In virtually all circumstances, an entity achieves a fair presentation by compliance with applicable IFRSs. A fair presentation also requires an entity:
>
> (a) to select and apply accounting policies in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. IAS 8 sets out a hierarchy of authoritative guidance that management considers in the absence of an IFRS that specifically applies to an item.
>
> (b) to present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information.
>
> (c) to provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

Paragraph 29

Referred to in paragraph 43 of the Practice Statement

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

Paragraph 30A

Referred to in paragraphs 28, 57 and 69 of the Practice Statement

> When applying this and other IFRSs an entity shall decide, taking into consideration all relevant facts and circumstances, how it aggregates information in the financial statements, which include the notes. An entity shall not reduce the understandability of its financial statements by obscuring material information with immaterial information or by aggregating material items that have different natures or functions.

Paragraph 31

Referred to in paragraph 10 of the Practice Statement

> Some IFRSs specify information that is required to be included in the financial statements, which include the notes. An entity need not provide a specific disclosure required by an IFRS if the information resulting from that disclosure is not material. This is the case even if the IFRS contains a list of specific requirements or describes them as minimum requirements. An entity shall also consider whether to provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users of financial statements to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

Paragraph 38

Referred to in paragraphs 67 and 70 of the Practice Statement

> **Except when IFRSs permit or require otherwise, an entity shall present comparative information in respect of the preceding period for all amounts reported in the current period's financial statements. An entity shall include comparative information for narrative and descriptive information if it is relevant to understanding the current period's financial statements.**

Paragraph 38A

Referred to in paragraph 67 of the Practice Statement

> **An entity shall present, as a minimum, two statements of financial position, two statements of profit or loss and other comprehensive income, two separate statements of profit or loss (if presented), two statements of cash flows and two statements of changes in equity, and related notes.**

Paragraph 38C

Referred to in paragraph 69 of the Practice Statement

> An entity may present comparative information in addition to the minimum comparative financial statements required by IFRSs, as long as that information is prepared in accordance with IFRSs. This comparative information may consist of one or more statements referred to in paragraph 10, but need not comprise a complete set of financial statements. When this is the case, the entity shall present related note information for those additional statements.

Paragraph BC30F of the Basis for Conclusions

Referred to in paragraphs 28 and 69 of the Practice Statement

> Paragraph 30A was added to IAS 1 to highlight that when an entity decides how it aggregates information in the financial statements, it should take into consideration all relevant facts and circumstances. Paragraph 30A emphasises that an entity should not reduce the understandability of its financial statements by providing immaterial information that obscures the material information in financial statements or by aggregating material items that have different natures or functions. Obscuring material information with immaterial information in financial statements makes the material information less visible and therefore makes the financial statements less understandable. The amendments do not actually prohibit entities from disclosing immaterial information, because the Board thinks that such a requirement would not be operational; however, the amendments emphasise that disclosure should not result in material information being obscured.

Extracts from IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

Paragraph 5 (and paragraph 7 of IAS 1)

Referred to in paragraphs 5, 41 and 60 of the Practice Statement

> ***Material*** **Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.**

Paragraph 5

Referred to in paragraphs 72 and 78 of the Practice Statement

> ***Prior period errors*** **are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:**
>
> **(a) was available when financial statements for those periods were authorised for issue; and**
>
> **(b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.**
>
> **Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.**

Paragraph 8

Referred to in paragraph 8 of the Practice Statement

> IFRSs set out accounting policies that the IASB has concluded result in financial statements containing relevant and reliable information about the transactions, other events and conditions to which they apply. Those policies need not be applied when the effect of applying them is immaterial. However, it is inappropriate to make, or leave uncorrected, immaterial departures from IFRSs to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

Paragraph 41

Referred to in paragraph 73 of the Practice Statement

> Errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with IFRSs if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are authorised for issue. However, material errors are sometimes not discovered

until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period (see paragraphs 42–47).

Extracts from IAS 34 *Interim Financial Reporting*

Paragraph 6

Referred to in paragraph 87 of the Practice Statement

In the interest of timeliness and cost considerations and to avoid repetition of information previously reported, an entity may be required to or may elect to provide less information at interim dates as compared with its annual financial statements. This Standard defines the minimum content of an interim financial report as including condensed financial statements and selected explanatory notes. The interim financial report is intended to provide an update on the latest complete set of annual financial statements. Accordingly, it focuses on new activities, events, and circumstances and does not duplicate information previously reported.

Paragraph 15

Referred to in paragraph 87 of the Practice Statement

An entity shall include in its interim financial report an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period. Information disclosed in relation to those events and transactions shall update the relevant information presented in the most recent annual financial report.

Paragraph 15A

Referred to in paragraph 87 of the Practice Statement

A user of an entity's interim financial report will have access to the most recent annual financial report of that entity. Therefore, it is unnecessary for the notes to an interim financial report to provide relatively insignificant updates to the information that was reported in the notes in the most recent annual financial report.

Paragraph 20

Referred to in paragraph 85 of the Practice Statement

Interim reports shall include interim financial statements (condensed or complete) for periods as follows:

(a) **statement of financial position as of the end of the current interim period and a comparative statement of financial position as of the end of the immediately preceding financial year.**

(b) **statements of profit or loss and other comprehensive income for the current interim period and cumulatively for the current financial year to date, with comparative statements of profit or loss and other comprehensive income for the comparable interim periods (current and year-to-date) of the immediately preceding financial year. As permitted by IAS 1 (as amended in 2011), an**

interim report may present for each period a statement or statements of profit or loss and other comprehensive income.

(c) **statement of changes in equity cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year.**

(d) **statement of cash flows cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year.**

Paragraph 23

Referred to in paragraph 85 of the Practice Statement

In deciding how to recognise, measure, classify, or disclose an item for interim financial reporting purposes, materiality shall be assessed in relation to the interim period financial data. In making assessments of materiality, it shall be recognised that interim measurements may rely on estimates to a greater extent than measurements of annual financial data.

Paragraph 25

Referred to in paragraph 85 of the Practice Statement

While judgement is always required in assessing materiality, this Standard bases the recognition and disclosure decision on data for the interim period by itself for reasons of understandability of the interim figures. Thus, for example, unusual items, changes in accounting policies or estimates, and errors are recognised and disclosed on the basis of materiality in relation to interim period data to avoid misleading inferences that might result from non-disclosure. The overriding goal is to ensure that an interim financial report includes all information that is relevant to understanding an entity's financial position and performance during the interim period.

Paragraph 41

Referred to in paragraph 88 of the Practice Statement

The measurement procedures to be followed in an interim financial report shall be designed to ensure that the resulting information is reliable and that all material financial information that is relevant to an understanding of the financial position or performance of the entity is appropriately disclosed. While measurements in both annual and interim financial reports are often based on reasonable estimates, the preparation of interim financial reports generally will require a greater use of estimation methods than annual financial reports.

IFRS®

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Introduction

When it comes to accounting for their transactions and disclosing the required information in their financial statements, companies in the Philippines have been consistently applying Philippine Financial Reporting Standards or PFRSs since the adoption of these standards in 2005. However, preparers of financial statements oftentimes encounter instances where there is no explicit guidance in the PFRSs applicable to specific transactions. Thus, there is a need to supplement PFRSs through the issuance of PIC Q&As which are approved and adopted by the Financial Reporting Standards Council (FRSC).

To further provide guidance on recurring financial reporting issues, the PIC has decided to issue this Financial Reporting Guidance (FRG), which is, in large part, based on the final decisions and rejection notices of the IFRS Interpretations Committee (IFRIC), the interpretations body supporting the IASB. Through this FRG, the PIC aims to:

- Provide continuous and up-to-date guidance on emerging issues elevated to the IASB or the IFRIC and for which these two bodies have already expressed their views;
- Provide additional guidance to both the preparers and the users of the financial statements, including those in the academe, about complex financial reporting issues; and,
- Provide guidance, with a simplified discussion of the basis for the final decisions reached by the IASB and IFRIC, for ease of reference and understanding.

This FRG is meant to be 'organic' in the sense that it will change and adapt accordingly as our financial reporting landscape evolves. We anticipate that this document will be updated on an annual basis to keep readers up-to-date on any future changes in our financial reporting framework.

PIC

Philippine Interpretations Committee

Date approved by PIC: May 24, 2017

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Date approved by FRSC: November 8, 2017

PFRS 2, *Share-based Payment*

PFRS 2 – Price difference between the institutional offer price and the retail offer price for shares in an initial public offering

Issue

Should an entity account for a price difference between the institutional offer price and the retail offer price for shares issued in an initial public offering (IPO) within the scope of PFRS 2, *Share-based Payment*?

Background

In an IPO, the final retail price could be different from the institutional price because of:

a. an unintentional difference arising from the book-building process; or

b. an intentional difference arising from a discount given to retail investors by the issuer of the equity instruments as indicated in the prospectus.

There are situations in which the issuer needs to fulfil a minimum number of shareholders to qualify for a listing under the stock exchange's regulations in its jurisdiction. In achieving this minimum number, the issuer may offer shares to retail investors at a discount from the price at which shares are sold to institutional investors.

Consensus

To consider whether the transaction is a share-based payment transaction within the scope of PFRS 2, it must involve the receipt of identifiable or unidentifiable goods or services from the retail shareholder group.

Paragraph 13A of PFRS 2 requires that if consideration received by the entity appears to be less than the fair value of the equity instruments granted or liability incurred, then this situation typically indicates that other consideration (i.e. unidentified goods or services) has been (or will be) received by the entity.

Applying this guidance requires judgment and consideration of the specific facts and circumstances of each transaction.

In the circumstances underlying the transaction, the entity issues shares at different prices to two different groups of investors (retail and institutional) for the purpose of raising funds, and that the difference, if any, between the retail price and the institutional price of the shares in the fact pattern appears to relate to the existence of different markets (one that is accessible to retail investors only and another one accessible to institutional investors only) instead of the receipt of additional goods or services, because the only relationship between the entity and the parties to whom the shares are issued is that of investee-investors.

Consequently, the guidance in PFRS 2 is not applicable because there is no share-based payment transaction.

In the fact pattern considered, the listing is not received from the institutional or retail shareholders. The fact that a regulatory requirement is met by virtue of issuing the retail shares does not indicate that unidentifiable goods or services were received from the purchasers.

PFRS 3, *Business Combinations*

PFRS 3 and PFRS 2 – Accounting for reverse acquisitions that do not constitute a business

Issue

How should transactions in which the former shareholders of a non-listed operating entity become the majority shareholders of the combined entity by exchanging their shares for new shares of a listed non-operating entity be accounted for?

The transaction is structured such that the listed non-operating entity acquires the entire share capital of the non-listed operating entity.

Background

The transaction has some features of a reverse acquisition under PFRS 3, *Business Combinations*, because the former shareholders of the legal subsidiary obtain control of the legal parent.

In the absence of a Standard that specifically applies to the transaction, it is appropriate to apply by analogy, in accordance with paragraphs 10-12 of PAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, the guidance in paragraphs B19–B27 of PFRS 3 for reverse acquisitions.

Application of the reverse acquisitions guidance by analogy would result in the non-listed operating entity being identified as the accounting acquirer, and the listed non-operating entity being identified as the accounting acquiree. In applying the reverse acquisition guidance in paragraph B20 of PFRS 3 by analogy, the accounting acquirer is deemed to have issued shares to obtain control of the acquiree.

If the listed non-operating entity qualifies as a business on the basis of the guidance in paragraph B7 of PFRS 3, PFRS 3 would be applicable to the transaction. However, if the listed non-operating entity is not a business, the transaction is not a business combination and is therefore not within the scope of PFRS 3.

Consensus

Based on the above discussion, the transaction is not within the scope of PFRS 3 and is therefore a share-based payment transaction which should be accounted for in accordance with PFRS 2, *Share-based Payment*.

On the basis of the guidance in paragraph 13A of PFRS 2, any difference in the fair value of the shares deemed to have been issued by the accounting acquirer and the fair value of the accounting acquiree's identifiable net assets represents a service received by the accounting acquirer.

Regardless of the level of monetary or non-monetary assets owned by the non-listed operating entity, the entire difference should be considered to be payment for a service of a stock exchange listing for its shares, and that no amount should be considered a cost of raising capital. The service received in the form of a stock exchange listing does not meet the definition of an intangible asset because it is not "identifiable" in accordance with paragraph 12 of PAS 38 (i.e. it is not separable). The service received also does not meet the definition of an asset that should be recognized in accordance with other Standards and the Conceptual Framework.

On the basis of the guidance in paragraph 8 of PFRS 2 which states that "when the goods or services received or acquired in a share-based payment transaction do not qualify for recognition as assets, they shall be recognized as expenses", the cost of the service received is recognized as an expense.

PFRS 3 – Continuing employment

Issue

In accordance with PFRS 3, *Business Combinations*, what is the accounting for contingent payments to selling shareholders in circumstances in which those selling shareholders become, or continue as, employees?

Background

Paragraph B55(a) of PFRS 3 states that:

> "The terms of continuing employment by the selling shareholders who become key employees may be an indicator of the substance of a contingent consideration arrangement. The relevant terms of continuing employment may be included in an employment agreement, acquisition agreement or some other document. A contingent consideration arrangement in which the payments are automatically forfeited if employment terminates is remuneration for post-combination services. Arrangements in which the contingent payments are not affected by employment termination may indicate that the contingent payments are additional consideration rather than remuneration."

Some asked for clarification whether paragraph B55(a) of PFRS 3 is conclusive in determining that payments to an employee that are forfeited upon termination of employment are remuneration for post-combination services and not part of the consideration for an acquisition. The question arose because they asserted that paragraph B55 introduces subparagraphs (a) - (h) as indicators, but paragraph B55(a) uses conclusive language stating that the arrangement described is remuneration for post-combination services.

Consensus

An arrangement in which contingent payments are automatically forfeited if employment terminates would lead to a conclusion that the arrangement is compensation for post-combination services rather than additional consideration for an acquisition, unless the service condition is not substantive. This conclusion is reached on the basis of the conclusive language used in paragraph B55(a) of PFRS 3.

PFRS 3 – Identification of the acquirer in accordance with PFRS 3 and the parent in accordance with PFRS 10, *Consolidated Financial Statements*, in a stapling arrangement

Issue

Is an acquirer identified for the purpose of PFRS 3 (as revised 2008) considered a parent for the purpose of PFRS 10 in circumstances in which a business combination is achieved by contract alone, such as a stapling arrangement, with no combining entity obtaining control of the other combining entities?

Background

PFRS 3 (as revised 2008) defines a business combination as "a transaction or other event in which an acquirer obtains control of one or more businesses". In addition, PFRS 3 (as revised 2008) refers to PFRS 10 for the meaning of the term 'control'. PFRS 10 states that an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. It is observed that an investment is not needed in order for an entity to control another entity.

The definition of a business combination in PFRS 3 (as revised 2008) includes transactions in which an acquirer obtains control of one or more businesses. It also includes transactions that are sometimes referred to as 'true mergers' or 'mergers of equals'. In other words, it includes transactions in which none of the combining entities obtains control of the other combining entities. If the stapling arrangement combines separate entities and businesses by the unification of ownership and voting interests in the combining entities, then such a transaction is a business combination as defined by PFRS 3 (as revised 2008).

Consensus

Notwithstanding the fact that PFRS 3 (as revised 2008) includes business combinations in which none of the combining entities obtains control of the other combining entities, paragraph 6 of PFRS 3 (as revised 2008) requires that one of the combining entities in a business combination must be identified as the acquirer. Paragraphs B14–B18 of PFRS 3 (as revised 2008) provides additional guidance for identifying the acquirer if the guidance in PFRS 10 does not clearly indicate which combining entity is the acquirer.

Paragraph B15(a) of PFRS 3 (as revised 2008) provides guidance on identifying the acquirer by assessing the relative voting rights in the combined entity after the combination – this guidance explains that the acquirer is usually the combining entity whose owners, as a group, receive the largest portion of the voting rights in the combined entity. This guidance is consistent with the observation that the definition of a business combination includes transactions in which none of the combining entities or businesses is identified as having control of the other combining entities. This guidance would be relevant to identifying which of the combining entities is the acquirer in the stapling transaction considered.

The intended interaction between PFRS 3 (issued in 2004) and PAS 27 *Consolidated and Separate Financial Statements* is that an entity that is identified as the 'acquirer' of another entity in accordance with PFRS 3 (issued in 2004) is a 'parent' for the purposes of PAS 27. The meaning of the term 'acquirer' has not changed since 2004 and that the term 'control' is used consistently between PFRS 3 (as revised in 2008) and PFRS 10. It also noted that the notion in PFRS 3 (as revised in 2008) that a business combination could occur even if none of the combining entities obtains control of the other combining entities has not changed from PFRS 3 (issued in 2004). Accordingly, the interaction between PFRS 3 (issued in 2004) and PAS 27 remains valid in respect of the interaction between PFRS 3 (as revised in 2008) and PFRS 10. Consequently, the combining entity in the stapling arrangement that is identified as the acquirer for the purpose of PFRS 3 (as revised in 2008) should prepare consolidated financial statements of the combined entity in accordance with PFRS 10.

PFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*

PFRS 5 – Classification in conjunction with a planned IPO, but where the prospectus has not been approved by the securities regulator

Issue

Would a disposal group qualify as held for sale before the prospectus is approved by the securities regulator, assuming that all of the other criteria in PFRS 5, *Non-current Assets Held for Sale and Discontinued Operations* have been fulfilled?

Background

This Q&A deals with the application of the guidance in PFRS 5 regarding the classification of a non-current asset (or disposal group) as held for sale, in the case of a disposal plan that is intended to be achieved by means of an initial public offering (IPO), but where the prospectus (i.e., the legal document with an initial offer) has not yet been approved by the securities regulator.

Consensus

Paragraph 7 of PFRS 5 requires that the asset (or disposal group) must be available for immediate sale in its present condition, subject only to terms that are usual and customary for sales of such assets (or disposal groups) and its sale must be highly probable.

An entity should apply the guidance in paragraphs 8-9 of PFRS 5 to assess whether the sale of a disposal group by means of an IPO is highly probable. Terms that are "usual and customary" is a matter of judgment based on the facts and circumstance of each sale.

The following criteria in paragraph 8 of PFRS 5 represent events that must have occurred:

a. the appropriate level of management must be committed to a plan to sell the asset (or disposal group);

b. an active programme to locate a buyer and complete the plan must have been initiated; and

c. the asset (or disposal group) must be actively marketed for sale at a price that is reasonable in relation to its current fair value.

The following criteria would be assessed based on expectations of the future, and their probability of occurrence would be included in the assessment of whether a sale is highly probable:

a. the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification (except as permitted by paragraph 9);

b. actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn; and

c. the probability of shareholders' approval (if required in the jurisdiction) should be considered as part of the assessment of whether the sale is highly probable.

PFRS 10, *Consolidated Financial Statements*

PFRS 10: Investment Entities Amendment – The definition of investment-related services or activities

Issue

Can 'tax optimization' be considered as investment-related services or activities?

Background

An investment entity provides investment-related services or activities, either directly or through a subsidiary. If an investment entity provides investment-related services or activities through a subsidiary, the investment entity shall consolidate that subsidiary.

Some investment entities establish wholly-owned intermediate subsidiaries in some jurisdictions, which own all or part of the portfolio of investments in the group structure. The sole purpose of the intermediate subsidiaries is to minimize the tax paid by investors in the 'parent' investment entity. There is no activity within the subsidiaries and the tax advantage comes about because of returns being channeled through the jurisdiction of the intermediate subsidiary. A question was raised on whether such 'tax optimization' should be considered investment-related services or activities.

According to paragraph BC272 of PFRS 10, *Consolidated Financial Statements*, the fair value measurement of all of an investment entity's subsidiaries would provide the most useful information, except for subsidiaries providing investment-related services or activities. One of the characteristics of 'tax optimization' subsidiaries is "that there is no activity within the subsidiary".

Consensus

Accordingly, the parent should not consolidate such subsidiaries, because they do not provide investment-related services or activities, and do not meet the requirements to be consolidated in accordance with paragraph 32 of PFRS 10. The parent should therefore account for such an intermediate subsidiary at fair value.

PFRS 10 – Classification of puttable instruments that are non-controlling interests

Issue

How should puttable instruments that are issued by a subsidiary but that are not held, directly or indirectly, by the parent be classified in the consolidated financial statements of a group?

Background

This Q&A deals with puttable instruments classified as equity instruments in the financial statements of the subsidiary in accordance with paragraphs 16A-16B of PAS 32 ('puttable instruments') that are not held, directly or indirectly, by the parent. This discusses whether these instruments should be classified as equity or liability in the parent's consolidated financial statements.

Some claim that paragraph 22 of PFRS 10 is not consistent with paragraph AG29A of PAS 32, because:

a) PFRS 10 defines non-controlling interests (NCI) as equity in a subsidiary not attributable, directly or indirectly, to a parent;

b) according to paragraph 22 of PFRS 10 a parent shall present non-controlling interests (NCI) in the consolidated statement of financial position within equity; but

c) according to paragraph AG29A of PAS 32, instruments classified as equity instruments in accordance with paragraphs 16A-16D of PAS 32 in the separate or individual financial statements of the subsidiary that are NCI are classified as liabilities in the consolidated financial statements of the group.

Consensus

Paragraphs 16A-16D of PAS 32 state that puttable instruments and instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation meet the definition of a financial liability. These instruments are classified as equity in the financial statements of the subsidiary as an exception to the definition of a financial liability if all relevant requirements are met. Paragraph AG29A clarifies that this exception applies only to the financial statements of the subsidiary and does not extend to the parent's consolidated financial statements. Consequently, these financial instruments should be classified as financial liabilities in the parent's consolidated financial statements.

PFRS 10 – Effect of protective rights on an assessment of control

Issue

Should the assessment of control be reassessed when facts and circumstances change in such a way that rights, previously determined to be protective, change (for example upon the breach of a covenant in a borrowing arrangement that causes the borrower to be in default) or whether, instead, such rights are never included in the reassessment of control upon a change in facts and circumstances?

Background

This Q&A deals with the guidance relating to protective rights and the effect of those rights on the power over the investee.

Consensus

Paragraph 8 of PFRS 10, *Consolidated Financial Statements*, requires an investor to reassess whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control.

A breach of a covenant that results in rights becoming exercisable constitutes such a change. It noted that PFRS 10 does not include an exemption for any rights from this need for reassessment.

The intention of PFRS 10 was that rights initially determined to be protective should be included in a reassessment of control whenever facts and circumstances indicate that there are changes to one or more of the three elements of control.

Accordingly, the conclusion about which party controlled the investee would need to be reassessed after the breach occurred. It also noted that the reassessment may or may not result in a change to the outcome of the assessment of control, depending on the individual facts and circumstances.

PFRS 10 – Non-cash acquisition of a non-controlling interest by a controlling shareholder in the consolidated financial statements

Issue

What is the accounting for the purchase of a non-controlling interest (NCI) by the controlling shareholder when the consideration includes non-cash items? Should the difference between the fair value of the consideration given and the carrying amount of such consideration be recognized in equity or in profit or loss?

Background

According to paragraph B96 of PFRS 10 *Consolidated Financial Statements*, the difference described should be recognized in equity, whereas applying Philippine Interpretation IFRIC-17, *Distributions of Non-cash Assets to Owners*, by analogy the difference should be recognized in profit or loss.

Consensus

Paragraph B96 of PFRS 10 deals solely with the difference between the carrying amount of NCI and the fair value of the consideration given; this difference is required to be recognized in equity. This paragraph does not deal with the difference between the fair value of the consideration given and the carrying amount of such consideration.

The difference between the fair value of the assets transferred and their carrying amount arises from the derecognition of those assets. PFRSs generally require an entity to recognize, in profit or loss, any gain or loss arising from the derecognition of an asset.

PFRS 10 and PFRS 11 – Transition provisions in respect of impairment, foreign exchange and borrowing costs

Issue

What are the transition provisions in PFRS 10 and 11 in in respect of impairment, foreign exchange and borrowing costs?

Background

The transition provisions of PFRS 10 and PFRS 11 include exemptions from retrospective application in specific circumstances. However, PFRS 10 and PFRS 11 do not provide specific exemptions from retrospective application in respect of the application of PAS 21, *The Effects of Changes in Foreign Exchange Rates*, PAS *23 Borrowing Costs* or PAS 36, *Impairment of Assets.*

Consensus

When PFRS 10 is applied for the first time, it must be applied retrospectively, except for the specific circumstances for which exemptions from retrospective application are given. When PFRS 10 is applied retrospectively, there may be consequential accounting requirements arising from other Standards (such as PAS 21, PAS 23 and PAS 36). These requirements must also be applied retrospectively in order to measure the investee's assets, liabilities and non-controlling interests, as described in paragraph C4 of PFRS 10, or the interest in the investee, as described in paragraph C5 of PFRS 10. If retrospective application of the requirements of PFRS 10 is impracticable because it is impracticable to apply retrospectively the requirements of other Standards, then PFRS 10 (paragraphs C4A and C5A) provides exemption from retrospective application.

Although the meaning of the term 'joint control' as defined in PFRS 11 is different from its meaning in PAS 31, *Interests in Joint Ventures (2003)*, because of the new definition of 'control' in PFRS 10, nevertheless the outcome of assessing whether control is held 'jointly' would in most cases be the same in accordance with PFRS 11 as it was in accordance with PAS 31. As a result, typically, the changes resulting from the initial application of PFRS 11 would be to change from proportionate consolidation to equity accounting or from equity accounting to recognizing a share of assets and a share of liabilities. In those situations, PFRS 11 already provides exemption from retrospective application.

PFRS 10 – Single-asset, single lessee lease vehicles

Issue

Should the lessee (or lender in the case of a finance lease) consolidate a Structured Entity that was created to lease a single asset to the said lessee (or lender)?

Background

A Structured Entity (SE) is created on behalf of a manufacturer. The SE holds a single asset manufactured by the manufacturer, which is subsequently leased to a single customer.

If the lease is considered an operating lease, the question was whether the lessee should consolidate the SE. If the lease is considered a finance lease, the question was whether the lender should consolidate the SE.

Consensus

Paragraph 10 of PFRS 10 states that an investor has power over an investee when the investor has existing rights that give the investor the current ability to direct the relevant activities, or those activities that significantly affect the investee's returns.

Upon entering into a lease, regardless of whether such a lease is a finance or an operating lease, the SE or the lessor would have the following rights:

1. A right to receive lease payments; and,
2. A right to the residual value of the leased asset at the end of the lease

Consequently, the SE's relevant activities would be those that relate to managing the returns derived from these rights (e.g., managing the credit risk associated with the lease payments or managing the leased asset at the end of the lease term). How the decision-making relating to those activities would significantly affect the SE's returns would depend on the specific facts and circumstances.

By itself, the lessee's right to use the leased asset over a period of time would not typically give the lessee (or the lender) decision-making rights over the relevant activities of the SE. However, this does not mean that a lessee (or lender) can never control the lessor. The lessee (or lender) would need to consider all of the rights that it has in relation to the SE to determine whether it has power over the SE. This would include rights in contractual arrangements other than the lease contract (i.e., contractual arrangements for loans made to the SE), as well as rights included within the lease contract. These rights include those that go beyond simply providing the lessee (or lender) with the right to use the land.

PFRS 11, *Joint Arrangements*

PFRS 11 – Classification of joint arrangements

Issue

How should the assessment of 'other facts and circumstances' described in PFRS 11, *Joint Arrangements* affect the classification of a joint arrangement as a joint operation or a joint venture?

Background

It was considered whether the assessment of 'other facts and circumstances' should be undertaken with a view only towards whether those facts and circumstances create enforceable rights to the assets and obligations for the liabilities or whether that assessment should also consider the design and purpose of the joint arrangement, the entity's business needs and the entity's past practices.

Paragraph 14 of PFRS 11 requires the classification of a joint arrangement as a joint operation or a joint venture to depend on rights to the assets and obligations for the liabilities of the parties to the arrangement, and that rights and obligations, by nature, are enforceable.

Paragraph B30 of PFRS 11 describes that when 'other facts and circumstances' give the parties rights to the assets, and obligations for the liabilities, relating to the arrangement, the assessment of 'other facts and circumstances' would lead to the joint arrangement being classified as a joint operation.

Consensus

The assessment of 'other facts and circumstances' should focus on whether those facts and circumstances create rights to the assets and obligations for the liabilities.

PFRS 11 – Classification of joint arrangements: the assessment of 'other facts and circumstances'

Issue

How should the assessment of 'other facts and circumstances' as noted in paragraph 17 of PFRS 11 be performed? Should the assessment of 'other facts and circumstances' be undertaken with a view only towards whether those facts and circumstances create enforceable rights to the assets and obligations for the liabilities, or whether that assessment should also consider the design and purpose of the joint arrangement, the entity's business needs and the entity's past practices?

Background

Paragraph 14 of PFRS 11 requires the classification of a joint arrangement as a joint operation or a joint venture to depend on each party's rights to the assets and obligations for the liabilities of the joint arrangement, and that the rights and obligations are enforceable. Paragraph B30 of PFRS 11 explains that the assessment of other facts and circumstances would lead to the joint arrangement being classified as a joint operation when those other facts and circumstances give each party both rights to the assets, and obligations for the liabilities, relating to the arrangement.

Consensus

Consequently, the assessment of other facts and circumstances should focus on whether those facts and circumstances create enforceable rights to the assets and obligations for the liabilities.

The following paragraphs describe how and why particular facts and circumstances create rights to the assets and obligations for the liabilities.

How and why particular facts and circumstances create rights and obligations that result in the joint arrangement being classified as a joint operation, when the joint arrangement is structured through a separate vehicle whose legal form causes the separate vehicle to be considered in its own right.

The assessment of other facts and circumstances is performed when there is no contractual arrangement to reverse or modify the rights and obligations conferred by the legal form of the separate vehicle through which the arrangement has been structured. The assessment of other facts and circumstances thus focuses on whether the other facts and circumstances establish, for each party to the joint arrangement, rights to the assets and obligations for the liabilities relating to the joint arrangement.

Paragraphs B31–B32 of PFRS 11 state that parties to the joint arrangement have rights to the assets of the joint arrangement through other facts and circumstances when they:

a. have rights to substantially all of the economic benefits (for example, 'output') of assets of the arrangement; and
b. have obligations to acquire those economic benefits and thus assume the risks relating to those economic benefits (for example, the risks relating to the output).

Paragraphs B14 and B32–B33 of PFRS 11 state that parties to the joint arrangement have obligations for liabilities of the joint arrangement through other facts and circumstances when:

(a) as a consequence of their rights to, and obligations for, the assets of the joint arrangement, they provide cash flows that are used to settle liabilities of the joint arrangement; and
(b) settlement of the liabilities of the joint arrangement occurs on a continuous basis.

On the basis of these paragraphs, when each party to a joint arrangement meets the criteria and therefore has both rights to the assets of the joint arrangement and obligations for the liabilities of the joint arrangement through other facts and circumstances, a joint arrangement structured through a separate vehicle is a joint operation.

Consequently, in order to classify the joint arrangement as a joint operation as a result of assessing other facts and circumstances, it is necessary to demonstrate that:
(a) each party to the joint arrangement has rights and obligations relating to economic benefits of the assets of the arrangement; and
(b) each party is obliged to provide cash to the arrangement through enforceable obligations, which is used to settle the liabilities of the joint arrangement on a continuous basis.

Implication of 'economic substance'

Some observed that the concept of 'economic substance' may not be consistently understood or applied in practice with regard to the assessment of other facts and circumstances.

As discussed above, the assessment of other facts and circumstances should focus on whether each party to the joint arrangement has rights to the assets, and obligations for the liabilities, relating to the joint arrangement. Consequently, in reference to paragraph BC43 of PFRS 11, it is noted that the consideration of other facts and circumstances is not a test of whether each party to the joint arrangement is closely or fully involved with the operation of the separate vehicle, but is instead a test of whether other facts and circumstances override the rights and obligations conferred upon the party by the legal form of the separate vehicle.

On the basis of this analysis, the assessment of other facts and circumstances should be undertaken with a view towards whether those facts and circumstances create enforceable rights to assets and obligations for liabilities.

PFRS 11 – Classification of joint arrangements: application of 'other facts and circumstances' to specific fact patterns

Issue

How should 'other facts and circumstances' be applied to some specific fact patterns?

Background

This Q&A identified four different cases and considered how particular features of those fact patterns would affect the classification of the joint arrangement when assessing other facts and circumstances.

Consensus

1. **Output sold at a market price**

   This case discusses whether the fact that the output from the joint arrangement is sold to the parties of the joint arrangement at a market price prevents the joint arrangement from being classified as a joint operation, when assessing other facts and circumstances.

   It is concluded that the sale of output from the joint arrangement to the parties at market price, on its own, is not a determinative factor for the classification of the joint arrangement. The parties would need to consider, among other things, whether the cash flows provided to the joint arrangement through the parties' purchase of the output from the joint arrangement at market price, along with any other funding that the parties are obliged to provide, would be sufficient to enable the joint arrangement to settle its liabilities on a continuous basis.

   Exercising judgment is needed in this situation in order to determine whether the arrangement is a joint operation based on other facts and circumstances.

2. **Financing from a third party**

   This case discusses whether financing from a third party prevents a joint arrangement from being classified as a joint operation.

   If the cash flows to the joint arrangement from the sale of output to the parties, along with any other funding that the parties are obliged to provide, satisfy the joint arrangement's liabilities, then third-party financing alone would not affect the classification of the joint arrangement, irrespective of whether the financing occurs at inception or during the course of the joint arrangement's operations. In this situation, the joint arrangement will, or may, settle some of its liabilities using cash flows from third-party financing, but the resulting obligation to the third-party finance provider will, in due course, be settled using cash flows that the parties are obliged to provide.

3. Nature of output (i.e. fungible or bespoke output)

This case discusses whether the nature of the output (i.e. fungible or bespoke output) produced by the joint arrangement determines the classification of a joint arrangement when assessing other facts and circumstances.

It is concluded whether the output that is produced by the joint arrangement and purchased by the parties is fungible or bespoke is not a determinative factor for the classification of the joint arrangement. The focus of 'obligation for the liabilities' in PFRS 11 is on the existence of cash flows flowing from the parties to satisfy the joint arrangement's liabilities as a consequence of the parties' rights to, and obligations for, the assets of the joint arrangement, regardless of the nature of the product (i.e. fungible or bespoke output).

4. Determining the basis for 'substantially all of the output'

This case discusses whether volumes or monetary values of output should be the basis for determining whether the parties to the joint arrangement are taking 'substantially all of the output' from the joint arrangement when assessing other facts and circumstances.

Referring to paragraphs B31–B32 of PFRS 11, parties to the joint arrangement have rights to the assets of the joint arrangement through other facts and circumstances when they:

(a) have rights to substantially all of the economic benefits (for example, 'output') of the assets of the arrangement; and

(b) have obligations to acquire those economic benefits and thus assume the risks relating to those economic benefits (for example, the risks relating to the output).

It is also noted from paragraphs B31–B32 of PFRS 11 that in order to meet the criteria for classifying the joint arrangement as a joint operation through the assessment of other facts and circumstances:

(a) the parties to the joint arrangement should have rights to substantially all the economic benefits of the assets of the joint arrangement; and

(b) the joint arrangement should be able to settle its liabilities from the 'cash flows' received as a consequence of the parties' rights to and obligations for the assets of the joint arrangement, along with any other funding that the parties are obliged to provide.

Therefore, the economic benefits of the assets of the joint arrangement would relate to the cash flows arising from the parties' rights to, and obligations for, the assets. Consequently, it noted that the assessment is based on the monetary value of the output, instead of physical quantities.

PFRS 11 – Classification of joint arrangements: consideration of two joint arrangements with similar features that are classified differently

Issue

Can two joint arrangements with similar features, apart from the fact that one is structured through a separate vehicle and the other is not (in circumstances in which the legal form confers separation between the parties and the separate vehicle) be classified differently?

Background

Two such joint arrangements could be classified differently because:

(a) the legal form of a joint arrangement structured through a separate vehicle must be overridden by other contractual arrangements or specific other facts and circumstances for the joint arrangement to be classified as a joint operation; but

(b) a joint arrangement that is not structured through a separate vehicle is classified as a joint operation.

Consensus

PFRS 11 could lead to two joint arrangements being classified differently if one is structured through a separate vehicle and the other is not, but in other respects they have apparently similar features. This is because the legal form of the separate vehicle could affect the rights and obligations of the parties to the joint arrangement. The legal form of the separate vehicle is relevant in assessing the type of joint arrangement, as noted, for example, in paragraphs B22 and BC43 of PFRS 11.

Such different accounting would not conflict with the concept of economic substance. This is because, according to the approach adopted in PFRS 11, the concept of economic substance means that the classification of the joint arrangement should reflect the rights and obligations of the parties to the joint arrangement and the presence of a separate vehicle plays a significant role in determining the nature of those rights and obligations.

The requirements of PFRS 11 provide the principles necessary for determining the classification of joint arrangements, including assessing the impact of a separate vehicle.

The assessment of the classification would depend on specific contractual terms and conditions and requires a full analysis of features involving the joint arrangement.

PFRS 11 – Accounting by the joint operator: recognition of revenue by a joint operator

Issue

Should a joint operator recognize revenue in relation to the output purchased from the joint operation by the parties?

Background

This issue relates to the application of paragraph 20(d) of PFRS 11, which requires a joint operator to recognize its share of the revenue from the sale of the output by the joint operation.

Consensus

Examining paragraph 20(d) of PFRS 11, it is noted that if the joint arrangement is structured through a separate vehicle and the assessment of other facts and circumstances results in the joint arrangement being classified as a joint operation, in circumstances in which the parties take all the output of the joint arrangement in proportion to their rights to the output, the application of paragraph 20(d) of PFRS 11 would not result in the recognition of revenue by the parties. This is because, if the joint operators purchase all the output from the joint operation in proportion to their rights to the output, they would recognize 'their revenue' only when they sell the output to third parties.

In other words, the joint operators would not recognize any amount in relation to the 'share of the revenue from the sale of the output by the joint operation'. This is because a joint operator that has an obligation to purchase the output from the joint operation has rights to the assets of the joint operation. Accordingly, the sale of the output by the joint operation to the joint operator would mean selling output to itself and, therefore, the joint operator would not recognize a share of the revenue from the sale of that output by the joint operation.

Consequently, paragraph 20(d) of PFRS 11 would result in the recognition of revenue by a joint operator only when the joint operation sells its output to third parties. For this purpose, third parties do not include other parties who have rights to the assets and obligations for the liabilities relating to the joint operation.

PFRS 11 – Accounting by the joint operator: the accounting treatment when the joint operator's share of output purchased differs from its share of ownership interest in the joint operation

Issue

What is the accounting treatment in the circumstance in which the joint operator's share of the output purchased differs from its share of ownership interest in the joint operation?

Background

This Q&A considered a fact pattern in which the joint arrangement is structured through a separate vehicle and for which the parties to the joint arrangement have committed themselves to purchase substantially all of the output produced at a price designed to achieve a break-even result. In this fact pattern, the parties to the joint arrangement would be considered to have rights to the assets and obligations for the liabilities. Such a joint arrangement is presented in Example 5 of the application guidance to PFRS 11 and is classified as a joint operation. A variation of such a fact pattern could (and does) arise in circumstances in which the parties' percentage ownership interest in the separate vehicle differs from the percentage share of the output produced, which each party is obliged to purchase.

Consensus

Referring to paragraph 20 of PFRS 11, it can be noted that the joint operators of such a joint operation would account for their assets, liabilities, revenues and expenses in accordance with the shares specified in the contractual arrangement. However, when an assessment of other facts and circumstances has concluded that the joint arrangement is a joint operation, and the joint arrangement agreement does not specify the allocation of assets, liabilities, revenues or expenses, the question arises about what share of assets, liabilities, revenue and expenses each joint operator should recognize. Specifically, should the share of assets, liabilities, revenue and expenses recognized reflect the percentage of ownership of the legal entity, or should it reflect the percentage of output purchased by each joint operator?

There could be many different scenarios in which the joint operator's share of the output purchased differs from its share of ownership interest in the joint operation: for example, when the share of output purchased by each party varies over the life of the joint arrangement. A key issue that arises in this situation is over what time horizon should the share of output be considered.

If the joint operators made a substantial investment in the joint operation that differed from their ownership interest, there may be other elements of the arrangements that could explain why there is a difference between the percentage of ownership interest and the percentage share of the output produced, which each party is obliged to purchase. The identification of the other elements may provide relevant information to determine how to account for the difference between the two.

Consequently, it is important to understand why the share of the output purchased differs from the ownership interests in the joint operation. Judgment will therefore be needed to determine the appropriate accounting.

PFRS 11 – Accounting in separate financial statements: accounting by the joint operator in its separate financial statements

Issue

How should a joint operator account for in its separate financial statements its share of assets and liabilities of a joint operation when that joint operation is structured through a separate vehicle?

Consensus

PFRS 11 requires the joint operator to account for its rights and obligations in relation to the joint operation. It also noted that those rights and obligations, in respect of that interest, are the same regardless of whether separate or consolidated financial statements are prepared, by referring to paragraph 26 of PFRS 11. Consequently, the same accounting is required in the consolidated financial statements and in the separate financial statements of the joint operator.

PFRS 11 requires the joint operator to account for its rights and obligations, which are its share of the assets held by the entity and its share of the liabilities incurred by it. Accordingly, the joint operator would not additionally account in its separate or consolidated financial statements its shareholding in the separate vehicle, whether at cost in accordance with PAS 27 *Separate Financial Statements* or at fair value in accordance with PFRS 9 *Financial Instruments*.

PFRS 11 – Accounting by the joint operation: accounting by the joint operation that is a separate vehicle in its financial statements

Background and Issue

A joint operator recognizes in both its consolidated and separate financial statements its share in the assets and liabilities of a joint operation that is a separate vehicle. Should the joint operation recognize the same assets and liabilities in its own financial statements?

Consensus

PFRS 11 applies only to the accounting by the joint operators and not to the accounting by the separate vehicle that is a joint operation. The financial statements of the separate vehicle would therefore be prepared in accordance with the applicable PFRS.

Company law often requires a legal entity/separate vehicle to prepare financial statements. Consequently, the reporting entity for the financial statements would include the assets, liabilities, revenues and expenses of that legal entity/separate vehicle. However, when identifying the assets and liabilities of the separate vehicle, it is necessary to understand the joint operators' rights and obligations relating to those assets and liabilities and how those rights and obligations affect those assets and liabilities.

PFRS 11 and PFRS 10 – Transition provisions in respect of impairment, foreign exchange and borrowing costs

Issue

What are the transition provisions in PFRS 10 and 11 in in respect of impairment, foreign exchange and borrowing costs?

Background

The transition provisions of PFRS 10 and PFRS 11 include exemptions from retrospective application in specific circumstances. However, PFRS 10 and PFRS 11 do not provide specific exemptions from retrospective application in respect of the application of PAS 21 *The Effects of Changes in Foreign Exchange Rates*, PAS 23 *Borrowing Costs* or PAS 36 *Impairment of Assets*.

Consensus

When PFRS 10 is applied for the first time, it must be applied retrospectively, except for the specific circumstances for which exemptions from retrospective application are given. When PFRS 10 is applied retrospectively, there may be consequential accounting requirements arising from other Standards (such as PAS 21, PAS 23 and PAS 36). These requirements must also be applied retrospectively in order to measure the investee's assets, liabilities and non-controlling interests, as described in paragraph C4 of PFRS 10, or the interest in the investee, as described in paragraph C5 of PFRS 10. If retrospective application of the requirements of PFRS 10 is impracticable because it is impracticable to apply retrospectively the requirements of other Standards, then PFRS 10 (paragraphs C4A and C5A) provides exemption from retrospective application.

Although the meaning of the term 'joint control' as defined in PFRS 11 is different from its meaning in PAS 31 *Interests in Joint Ventures (2003)* because of the new definition of 'control' in PFRS 10, nevertheless the outcome of assessing whether control is held 'jointly' would in most cases be the same in accordance with PFRS 11 as it was in accordance with PAS 31. As a result, typically, the changes resulting from the initial application of PFRS 11 would be to change from proportionate consolidation to equity accounting or from equity accounting to recognizing a share of assets and a share of liabilities. In those situations, PFRS 11 already provides exemption from retrospective application.

PFRS 12, *Disclosure of Interests in Other Entities*

PFRS 12 – Disclosure of summarized financial information about material joint ventures and associates

Issues

1. How should an entity apply the disclosure requirements in paragraph 21(b)(ii) of PFRS 12 on summarized financial information on material joint ventures and associates? How do the disclosure requirements interact with the aggregation principle in paragraphs 4 and B2-B6 of PFRS 12?

2. Would an investor be excused from disclosing summarized financial information when the information relates to a listed joint venture or associate, and local regulatory requirements prevent the investor from disclosing such information until the joint venture or associate has released its own financial statements?

Background

Paragraph 21(b)(ii) of PFRS 12 requires an entity to disclose summarized financial information about the joint venture or associate as specified in paragraphs B12 and B13.

Paragraph 4 of PFRS 12 requires an entity to consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the requirements in PFRS 12. It shall aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics (see paragraph B2-B6 of PFRS 12).

Some assert that there are two ways to interpret the application of those paragraphs. Either the information required in paragraph 21(b)(ii) of PFRS 12 can be disclosed in aggregate for all material joint ventures or such information should be disclosed individually for each material joint venture or associate.

Paragraph BC50 of PFRS 12's Basis for Conclusions states that:

"The Board observed that the requirement to present the amounts on a '100 per cent' basis would be appropriate only when the information is disclosed for individual joint ventures and associates. This is because presenting the financial information on a '100 per cent' basis when aggregating that information for all joint ventures or associates would not result in useful information when the entity holds different percentage ownership interests in its joint ventures or associates. In addition, some users and respondents to ED 9 recommended that the disclosures for associates should be aligned with those for joint ventures because investments in associates can be material and are often strategic to an investor with significant influence. Accordingly, the Board decided that summarized financial information should also be provided for each material associate."

Consensus

1. **How should an entity apply the disclosure requirements in paragraph 21(b)(ii) of PFRS 12 on summarized financial information on material joint ventures and associates? How do the disclosure requirements interact with the aggregation principle in paragraphs 4 and B2-B6 of PFRS 12?**

   It is expected that the requirement in paragraph 21(b)(ii) of PFRS 12 shall lead to the disclosure of summarized information on an individual basis for each joint venture or associate that is material to the reporting entity.

   This also reflects the intentions of the International Accounting Standards Board (IASB or the Board) as described in paragraph BC50 of PFRS 12's Basis for Conclusions.

2. **Would an investor be excused from disclosing summarized financial inform when the information relates to a listed joint venture or associate, and local regulatory requirements would prevent the investor from disclosing such information until the joint venture or associate has released its own financial statements?**

   There is no provision in PFRS 12 that permits non-disclosure of the information required in paragraph 21(b)(ii) of PFRS 12.

PFRS 12 – Disclosures for a subsidiary with a material non-controlling interest

Issue

Should the information required by paragraphs 12(e) - (g) of PFRS 12 should be provided:

i. at the subsidiary level (i.e. the 'legal' entity) and be based on the separate financial statements of the individual subsidiary; or
ii. at a subgroup level for the subgroup of the subsidiary together with its investees and be based either on
   (i) the amounts of the subgroup included in the consolidated financial statements of the reporting entity; or
   (ii) the amounts included in consolidated financial statements of the subgroup; noting that transactions and balances between the subgroup and other entities outside the subgroup would not be eliminated.

Background

Paragraph 12 (e) – (g) of PFRS 12 state that:

An entity shall disclose for each of its subsidiaries that have non-controlling interests that are material to the reporting entity:

...

(e) the profit or loss allocated to non-controlling interests of the subsidiary during the reporting period.

(f) accumulated non-controlling interests of the subsidiary at the end of the reporting period.
(g) summarized financial information about the subsidiary.

Consensus

Within the context of the disclosure objective in paragraph 10 of PFRS 12, materiality should be assessed by the reporting entity on the basis of the consolidated financial statements of the reporting entity. In this assessment, a reporting entity would consider both quantitative considerations (i.e. the size of the subsidiary) and qualitative considerations (i.e. the nature of the subsidiary).

The decision on which approach is used to present the disclosures required by paragraphs 12(e)–(g) should reflect the one that best meets the disclosure objective of paragraph 10 of PFRS 12 in the circumstances. According to this objective, 'An entity shall disclose information that enables users of its consolidated financial statements to understand (i) the composition of the group; and (ii) the interest that non-controlling interests have in the group's activities and cash flows'.

This judgment would be made separately for each subsidiary or subgroup that has a material non-controlling interest.

Disclosures required by paragraphs 12(e) and (f) of PFRS 12

A reporting entity would meet the requirements in paragraphs 12(e) and (f) by disclosing disaggregated information from the amounts included in the consolidated financial statements of the reporting entity in respect of subsidiaries that have non-controlling interests that are material to the reporting entity. A reporting entity should apply judgment in determining the level of disaggregation of this information; that is, whether:

(a) the entity presents this information about the subgroup of the subsidiary that has a material non-controlling interest (present the required information on the basis of the subsidiary together with its investees); or

(b) it is necessary in achieving the disclosure objective in paragraph 10 of PFRS 12 to disaggregate the information further to present information about individual subsidiaries that have material non-controlling interests within that subgroup.

Disclosures required by paragraph 12(g) of PFRS 12

It is observed that:

(a) paragraph 12(g) requires summarized information about the subsidiaries that have non-controlling interests that are material to the reporting entity;

(b) paragraph B10(b) states that an entity shall disclose 'summarized financial information about the assets, liabilities, profit or loss and cash flows of the subsidiary that enables users to understand the interest that non-controlling interests have in the group's activities and cash flows. That information might include but is not limited to, for example, current assets, non-current assets, current liabilities, non-current liabilities, revenue, profit or loss and total comprehensive income'; and

(c) paragraph B11 states that the 'summarized financial information required by paragraph B10(b) shall be the amounts before inter-company eliminations'.

In order to meet the disclosure objective in paragraph B10(b), that information would need to be prepared on a basis that was consistent with the information included in the consolidated financial statements of the reporting entity. This is understood to mean that the information would be prepared from the perspective of the reporting entity. For example, if the subsidiary was acquired in a business combination, the amounts disclosed should reflect the effects of the acquisition accounting.

It is further observed that in providing the information required by paragraph 12(g) the entity would apply judgment in determining whether:

(a) the entity presents this information about the subgroup of the subsidiary that has a material non-controlling interest (i.e., it presents the required information on the basis of the subsidiary together with its investees); or

(b) it is necessary in achieving the disclosure objective in paragraph 10 of PFRS 12 to disaggregate the information further to present information about individual subsidiaries that have material non-controlling interests within that subgroup.

However, the information provided in respect of paragraph 12(g) would include transactions between the subgroup/subsidiary and other members of the reporting entity's group without elimination in order to meet the requirements in paragraph B11 of PFRS 12. The transactions within the subgroup would be eliminated.

PFRS 13, *Fair Value Measurement*

PFRS 13 – Fair value hierarchy when third-party consensus prices are used

Issue

Under what circumstances prices that are provided by third parties would qualify as Level 1 in the fair value hierarchy in accordance with PFRS 13 *Fair Value Measurement*?

Consensus

When assets or liabilities are measured on the basis of prices provided by third parties, the classification of those measurements within the fair value hierarchy will depend on the evaluation of the inputs used by the third party to derive those prices, instead of on the pricing methodology used. In other words, the fair value hierarchy prioritizes the inputs to valuation techniques, not the valuation techniques used to measure fair value. In accordance with PFRS 13, only unadjusted quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date qualify as Level 1 inputs.

Consequently, a fair value measurement that is based on prices provided by third parties may only be categorized within Level 1 of the fair value hierarchy if the measurement relies solely on unadjusted quoted prices in an active market for an identical instrument that the entity can access at the measurement date.

PAS 1, *Presentation of Financial Statements*

PAS 1 – Disclosure requirements relating to assessment of going concern

Issue

Are disclosures required for judgments made in relation to material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern?

Background

This Q&A deals in a situation in which management of an entity has considered events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern.

Having considered all relevant information, including the feasibility and effectiveness of any planned mitigation, management concluded that there are no material uncertainties that require disclosure in accordance with paragraph 25 of PAS 1, *Presentation of Financial Statements*. However, reaching the conclusion that there was no material uncertainty involved significant judgment.

Paragraph 25 of PAS 1 requires that when preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.

Consensus

Paragraph 122 of PAS 1 requires that an entity shall disclose, in the summary of significant accounting policies or other notes, the judgments, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognized in the financial statements.

The disclosure requirements of paragraph 122 of PAS 1 shall apply to the judgments made in concluding that there remain no material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern.

PAS 1 and PAS 12 – Presentation of payments on non-income taxes

Issue

Should production based royalty payments payable to one taxation authority that are claimed as an allowance against taxable profit for the computation of income tax payable to another taxation authority be presented as an operating expense or a tax expense in the statement of comprehensive income?

Background

On the basis of the assumption that the production-based royalty payments are, in themselves, outside the scope of PAS 12, *Income Taxes* while the income tax payable to the other taxation authority is within the scope of PAS 12, this Q&A clarifies whether the production-based royalty payments can be viewed as prepayment of the income tax payable.

Consensus

The line item of 'tax expense' that is required by paragraph 82(d) of PAS 1, *Presentation of Financial Statements*, is intended to require an entity to present taxes that meet the definition of income taxes under PAS 12.

It is the basis of calculation determined by the relevant tax rules that determines whether a tax meets the definition of an income tax. Neither the manner of settlement of a tax liability nor the factors relating to recipients of the tax is a determinant of whether an item meets that definition.

Production-based royalty payments should not be treated differently from other expenses that are outside the scope of PAS 12, all of which may reduce income tax payable. Accordingly, it is inappropriate to consider the royalty payments to be prepayment of the income tax payables. Because the production-based royalties are not income taxes, the royalty payments should not be presented as an income tax expense in the statement of comprehensive income.

PAS 7, *Cash Flow Statements*

PAS 7 – Identification of cash equivalents

Issue

What is the basis of classification of investments as cash equivalents?

Background

This Q&A deals with the basis of classification of financial assets as cash equivalents in accordance with PAS 7.

Some argue that the classification of investments as cash equivalents on the basis of the remaining period to maturity as at the balance sheet date would lead to a more consistent classification rather than the current focus on the investment's maturity from its acquisition date.

Consensus

On the basis of paragraph 7 of PAS 7, financial assets held as cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. This paragraph further states that an investment is classified as a cash equivalent, only when it has a short maturity from the date of acquisition.

Paragraph 7 of PAS 7 promotes consistency between entities in the classification of cash equivalents.

PAS 10, *Events after the Reporting Period*

PAS 10 – Reissuing previously issued financial statements

Issue

Does PAS 10, *Events after the Reporting Period*, permit only one date of authorization for issue (i.e. 'dual dating' is not permitted) when considered within the context of reissuing previously issued financial statements in connection with an offering document?

Background

This Q&A deals with the accounting implications of applying PAS 10, *Events after the Reporting Period*, when previously issued financial statements are reissued in connection with an offering document.

The issue arose in jurisdictions in which securities laws and regulatory practices require an entity to reissue its previously issued annual financial statements in connection with an offering document, when the most recently filed interim financial statements reflect matters that are accounted for retrospectively under the applicable accounting standards. In these jurisdictions, securities law and regulatory practices do not require or permit the entity, in its reissued financial statements, to recognize events or transactions that occur between the time the financial statements were first authorized for issuance and the time the financial statements are reissued, unless the adjustment is required by national regulation; instead security and regulatory practices require the entity to recognize in its reissued financial statements only those adjustments that would ordinarily be made to the comparatives in the following year's financial statements. These adjustments would include, for example, adjustments for changes in accounting policy that are applied retrospectively, but would not include changes in accounting estimates. This approach is called 'dual dating'.

Consensus

The scope of PAS 10 is the accounting for, and disclosure of, events after the reporting period and that its objective is to prescribe:

a) when an entity should adjust its financial statements for events after the reporting period; and

b) the disclosures that an entity should give about the date when the financial statements were authorized for issue and about events after the reporting period.

Financial statements prepared in accordance with PAS 10 should reflect all adjusting and non-adjusting events up to the date that the financial statements were authorized for issue.

PAS 10 does not address the presentation of re-issued financial statements in an offering document when the originally issued financial statements have not been withdrawn, but the re-issued financial statements are provided either as supplementary information or a re-presentation of the original financial statements in an offering document in accordance with regulatory requirements.

PAS 12, *Income Taxes*

PAS 12 – Recognition of current income tax on uncertain tax position

Issue

Should PAS 12, *Income Taxes*, or PAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, be applied to determine whether to recognize an asset for the payment in relation to uncertain tax position?

Background

There are situations in which tax laws require an entity to make an immediate payment when a tax examination results in an additional charge, even if the entity intends to appeal against the additional charge. The entity expects, but is not certain, to recover some or all of the amount paid.

This Q&A deals with the guidance to be applied in the recognition of an asset for the payment.

Consensus

Paragraph 12 of PAS 12 provides guidance on the recognition of current tax assets and current tax liabilities. In particular, it states that:

a) current tax for current and prior periods shall, to the extent unpaid, be recognized as a liability; and

b) if the amount already paid in respect of current and prior periods exceeds the amount due for those periods, the excess shall be recognized as an asset.

In the specific fact pattern described above, an asset is recognized if the amount of cash paid (which is a certain amount) exceeds the amount of tax expected to be due (which is an uncertain amount). The timing of payment should not affect the amount of current tax expense recognized.

The reference to PAS 37 in paragraph 88 of PAS 12 in respect of tax-related contingent liabilities and contingent assets may have been understood by some to mean that PAS 37 applies to the recognition of such items.

However, it should be noted that paragraph 88 of PAS 12 provides guidance only on disclosures required for such items, and that PAS 12, not PAS 37, provides the relevant guidance on recognition.

PAS 12 – Recognition of deferred tax for a single asset in a corporate wrapper

Issue

How should deferred tax be accounted for in the consolidated financial statements of the parent, when a subsidiary has only one asset within it (the asset inside) and the parent expects to recover the carrying amount of the asset inside by selling the shares in the subsidiary (the shares)?

Background

Paragraph 11 of PAS 12 requires the entity to determine temporary differences in the consolidated financial statements by comparing the carrying amounts of assets and liabilities in the consolidated financial statements with the appropriate tax base. In the case of an asset or a liability of a subsidiary that files separate tax returns, this is the amount that will be taxable or deductible on the recovery (settlement) of the asset (liability) in the tax returns of the subsidiary.

The requirement in paragraph 11 of PAS 12 is complemented by the requirement in paragraph 38 of PAS 12 to determine the temporary difference related to the shares held by the parent in the subsidiary by comparing the parent's share of the net assets of the subsidiary in the consolidated financial statements, including the carrying amount of goodwill, with the tax base of the shares for purposes of the parent's tax returns.

Consensus

Paragraphs 11 and 28 of PAS 12 require a parent to recognize both the deferred tax related to the asset inside and the deferred tax related to the shares, if:

a) tax law attributes separate tax bases to the asset inside and to the shares;

b) in the case of deferred tax assets, the related deductible temporary differences can be utilized as specified in paragraphs 24-31 of PAS 12; and

c) no specific exceptions in PAS 12 apply.

PAS 12 – Impact of an internal reorganization on deferred tax amounts related to goodwill

Issue

In accordance with PAS 12, *Income Taxes*, how should an entity calculate deferred tax following an internal reorganization transaction in its consolidated financial statements?

Background

An entity (Entity H) recognized goodwill that had resulted from the acquisition of a group of assets (Business C) that meets the definition of a business in PFRS 3, *Business Combinations*. Entity H subsequently recorded a deferred tax liability relating to goodwill deducted for tax purposes.

Against this background, Entity H effects an internal reorganization in which:

a) Entity H sets up a new wholly-owned subsidiary (Subsidiary A);

b) Entity H transfers Business C, including the related (accounting) goodwill to Subsidiary A; however,

c) for tax purposes, the (tax) goodwill is retained by Entity H and not transferred to Subsidiary A.

Consensus

When entities in the same consolidated group file separate tax returns, separate temporary differences will arise in those entities in accordance with paragraph 11 of PAS 12. When an entity prepares its consolidated financial statements, deferred tax balances would be determined separately for those temporary differences, using the applicable tax rates for each entity's tax jurisdiction.

When calculating the deferred tax amount for the consolidated financial statements:

a) the amount used as the carrying amount by the 'receiving' entity (in this case, Subsidiary A that receives the (accounting) goodwill) for an asset or a liability is the amount recognized in the consolidated financial statements; and

b) the assessment of whether an asset or a liability is being recognized for the first time for the purpose of applying the initial recognition exception described in paragraphs 15 and 24 of PAS 12 is made from the perspective of the consolidated financial statements.

Transferring the goodwill to Subsidiary A would not meet the initial recognition exception described in paragraphs 15 and 24 of PAS 12 in the consolidated financial statements.

Consequently, deferred tax would be recognized in the consolidated financial statements for any temporary differences arising in each separate entity by using the applicable tax rates for each entity's tax jurisdiction (subject to meeting the recoverability criteria for recognizing deferred tax assets described in PAS 12).

If there is a so-called 'outside basis difference' (i.e. a temporary difference between the carrying amount of the investment in Subsidiary A and the tax base of the investment) in the consolidated financial statements, deferred tax for such a temporary difference would also be recognized subject to the limitations and exceptions applying to the recognition of a deferred tax asset (in accordance with paragraph 44 of PAS 12) and a deferred tax liability (in accordance with paragraph 39 of PAS 12).

Transferring assets between the entities in the consolidated group would affect the consolidated financial statements in terms of recognition, measurement and presentation of deferred tax, if the transfer affects the tax base of assets or liabilities, or the tax rate applicable to the recovery or settlement of those assets or liabilities. Such a transfer could also affect:

a) the recoverability of any related deductible temporary differences and thereby affect the recognition of deferred tax assets; and

b) the extent to which deferred tax assets and liabilities of different entities in the group are offset in the consolidated financial statements.

PAS 12 – Recognition and measurement of deferred tax assets when an entity is loss-making

Issues

1. Does PAS 12, *Income Taxes*, require that a deferred tax asset be recognized for the carryforward of unused tax losses when there are suitable reversing taxable temporary differences, regardless of an entity's expectations of future tax losses?

2. How should the guidance in PAS 12 be applied when tax laws limit the extent to which tax losses brought forward can be recovered against future taxable profits?

In the tax systems considered for the second issue, the amount of tax losses brought forward that can be recovered in each tax year is limited to a specified percentage of the taxable profits of that year.

Consensus

According to paragraphs 28 and 35 of PAS 12:

a) A deferred tax asset is recognized for the carryforward of unused tax losses to the extent of the existing taxable temporary differences, of an appropriate type, that reverse in an appropriate period. The reversal of those taxable temporary differences enables the utilization of the unused tax losses and justifies the recognition of deferred tax assets. Consequently, future tax losses are not considered.

b) When tax laws limit the extent to which unused tax losses can be recovered against future taxable profits in each year, the amount of deferred tax assets recognized from unused tax losses as a result of suitable existing taxable temporary differences is restricted as specified by the tax law. This is because when the suitable taxable temporary differences reverse, the amount of tax losses that can be utilized by that reversal is reduced as specified by the tax law. Also, in this case future tax losses are not considered.

c) In both cases, if the unused tax losses exceed the amount of suitable existing taxable temporary differences (after taking into account any restrictions), an additional deferred tax asset is recognized only if the requirements in paragraphs 29 and 36 of PAS 12 are met (i.e. to the extent that it is probable that the entity will have appropriate future taxable profit, or to the extent that tax planning opportunities are available to the entity that will create appropriate taxable profit).

PAS 12 – Accounting for market value uplifts on assets that are to be introduced by a new income tax regime

Issue

What is the accounting for market value uplifts introduced in a new income tax regime in a jurisdiction?

Background

In calculating taxable profit under the tax regime, entities are permitted to calculate tax depreciation for certain mining assets using the market value of the assets as of a particular date as the 'starting base allowance', rather than the cost or carrying amount of the assets. If there is insufficient profit against which the annual tax depreciation can be used, it is carried forward and can be used as a deduction against taxable profit in future years.

Consensus

The starting base allowance, including the part that is attributable to the market value uplift, is attributed to the related assets under the tax regime and will become the basis for depreciation expense for tax purposes.

Consequently, the market value uplift forms part of the related asset's 'tax base', as defined in paragraph 5 of PAS 12, *Income Taxes*. PAS 12 requires an entity to reflect an adjustment to the tax base of an asset that is due to an increase in the deductions available as a deductible temporary difference. Accordingly, a deferred tax asset should be recognized to the extent that it meets the recognition criteria in paragraph 24 of PAS 12.

PAS 12 – Selection of applicable tax rate for the measurement deferred tax relating to an investment in an associate

Issue

What is the applicable tax rate for the measurement of deferred tax relating to an investment in an associate in a multi-tax rate jurisdiction?

Background

This Q&A discusses how the tax rate should be selected when local tax legislation prescribes different tax rates for different manners of recovery (for example, dividends, sale, liquidation, etc.). This Q&A describes a situation in which the carrying amount of an investment in an associate could be recovered by:

(a) receiving dividends (or other distribution of profit);

(b) sale to a third party; or

(c) receiving residual assets upon liquidation of the associate.

Consensus

Paragraph 51A of PAS 12 states that an entity measures deferred tax liabilities and deferred tax assets using the tax rate and the tax base that are consistent with the expected manner of recovery or settlement.

Accordingly, the tax rate should reflect the expected manner of recovery or settlement. If one part of the temporary difference is expected to be received as dividends, and another part is expected to be recovered upon sale or liquidation (for example, an investor has a plan to sell the investment later and expects to receive dividends until the sale of the investment), different tax rates would be applied to the parts of the temporary difference in order to be consistent with the expected manner of recovery.

PAS 12 – Recognition of deferred taxes when acquiring a single-asset entity that is not a business

Issue

Should an acquirer recognize, in its consolidated financial statements, deferred tax liability on initial recognition of an acquisition on entity that does not qualify as a business and only has a single asset (e.g., investment property)?

Background

An entity acquires all the shares of another entity that has an investment property as its only asset. The acquisition does not meet the definition of a business combination in PFRS 3, *Business Combinations*, because the acquired entity is not a business. The acquiring entity applies the fair value model in PAS 40, *Investment Property*.

Consensus

Because the transaction is not a business combination, paragraph 2(b) of PFRS 3, therefore, requires the acquiring to allocate, in its consolidated financial statements, the purchase price to the assets acquired and liabilities assumed. In addition, paragraph 15(b) of PAS 12 states that an entity does not recognize a deferred tax liability for taxable temporary differences that arise from the initial recognition of an asset or liability in a transaction that is not a business combination and that, at the time of the transaction, affects neither accounting profit or loss nor taxable profit or tax loss.

Accordingly, upon acquisition, the acquiring entity should only recognize the investment property and not a deferred tax liability in its consolidated financial statements. The entire purchase price should therefore be allocated to the investment property.

PAS 16, *Property, Plant and Equipment*

PAS 16 – Disclosure of carrying amounts under the cost model

Issue

Is an entity required to reflect the capitalization of borrowing costs to meet the disclosure requirement in paragraph 77(e) of PAS 16 *Property, Plant and Equipment*, for assets stated at revalued amounts for which borrowing costs are not capitalized in accordance with paragraph 4(a) of PAS 23, *Borrowing Costs*?

Background

Paragraph 77(e) of PAS 16 requires that if items of property, plant and equipment are stated at revalued amounts, the carrying amount that would have been recognized had the assets been carried under the cost model shall be disclosed for each revalued class of property, plant and equipment.

Paragraph 4(a) of PAS 23 states that an entity is not required to apply PAS 23 to borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset measured at fair value.

Some assert that the capitalization of borrowing costs for these assets to meet disclosure requirements is burdensome and suggested that it should not be a requirement of PAS 16 to capitalize these costs.

Consensus

The requirements in paragraph 77(e) of PAS 16 are clear. This paragraph requires an entity to disclose the amount at which assets stated at revalued amounts would have been stated at had those assets been carried under the cost model. The amount to be disclosed includes borrowing costs capitalized in accordance with PAS 23.

PAS 17, *Leases*

PAS 17 – Meaning of 'incremental costs'

Issue

Can salary costs of permanent staff involved in negotiating and arranging new leases qualify as 'incremental costs' within the context of PAS 17, *Leases*?

Background

PAS 17 defines initial direct costs as incremental costs that are directly attributable to negotiating and arranging a lease, except for such costs incurred by a manufacturer or dealer lessors.

Initial direct costs incurred by lessors in negotiating an operating lease are added to the carrying amount of the leased asset and recognized over the lease term on the same basis as the lease income.

Consensus

Internal fixed costs, including costs of permanent staff involved in negotiating and arranging new leases, do not qualify as 'incremental costs'. Only those costs that would not have been incurred if the entity had not negotiated and arranged a lease should be included in the initial measurement of the finance lease receivable.

PAS 17, PAS 38 and PAS 16 – Purchase of right to use land

Issue

Should a purchase of a right to use land be accounted for as a:
- a) purchase of property, plant and equipment;
- b) purchase of an intangible asset; or
- c) lease of land?

Fact Pattern

In some jurisdictions, the laws and regulations stipulate that only individual citizens are allowed to have freehold title of land. They do not permit entities to own freehold title to land. Instead, entities can purchase the right to cultivate or build on land, for which agreement is approved by the government. The government determines the legal relationship between the land and the right holder, where the government acts as the administrator and the regulator for the State.

The payment, which is generally based on the fair value of the land, is made directly to the individual owner to purchase the right. Once the entity purchases the right, the owner will not retain any rights over the land. Only the government can revoke the entity's right. There are two grounds for revocation: based on public interest or if the entity fails to meet the administrative requirements.

The right can be extended and renewed indefinitely at only an insignificant cost (administrative fees and related taxes) to be paid to the government. An entity has a legally protected right to obtain the extension / renewal, provided that all the legal and administrative requirements are met and that the land is not claimed by the government to be used for public interest purposes.

Adequate compensation will be provided for the assets (i.e., building) on the surface of the land in any circumstances. However, compensation for the land based on the fair value will be provided only if the government revokes the entity's right during the period of the contract. No compensation will be provided for the land if the government revokes the entity's right when the period of the right has ended or expired or if the application to extend or renew the right is declined by the government.

The right can be used as collateral for debts and can be transferred to another party through sale, exchange, in-kind capital contribution, grant or inheritance.

In these jurisdictions, there is diversity in practice on how to account for a land right.

Consensus

In the fact pattern considered, characteristics of a lease can be identified, in accordance with the definition of a lease as defined in PAS 17. A lease could be indefinite via extensions or renewals and, therefore, the existence of an indefinite period does not prevent the 'right to use' from qualifying as a lease in accordance with PAS 17.

The lessee has the option to renew the right and that the useful life for depreciation purposes might include renewal periods. Judgment will need to be applied in making the assessment of the appropriate length of the depreciation period.

PAS 17 – Refundable security deposit related to lease

Background

Philippine Accounting Standards (PAS) 17, *Leases*, requires a lease to be classified as either a finance lease or an operating lease, depending on the substance of the transaction, and accounted for in accordance with this classification. Paragraph 10 of PAS 17 enumerates examples of situations that "individually or in combination would normally lead to a lease being classified as a finance lease". One such example under Paragraph 10(d) is that "at the inception of the lease the present value of the **minimum lease payments** amounts to at least substantially all of the fair value of the leased asset" (Emphasis added).

In most lease contracts, a lessee is required to pay a deposit to the lessor at the inception of the lease. The deposit is refundable at the termination of the contract, to the extent that it has not been applied by the lessor to remedy the breach of any provisions in the contract or to indemnify any consequential costs or losses related to the leased property that are properly chargeable to the lessee. During the term of the lease contract, the lessee will not receive any interest for its deposit or, if there is any interest, the interest rate is lower than the market interest rate.

Issue

Should a refundable security deposit be considered a component of minimum lease payments (MLP)?

Consensus

The refundable security deposit meets the definition of a financial asset (for the lessee) and a financial liability (for the lessor) under Paragraph 11 of PAS 32, Financial Instruments: Presentation, thus, it is within the scope of PAS 39, *Financial Instruments: Recognition and Measurement*, and must initially be accounted for at fair value in accordance with paragraph 43 of that standard. The fair value of the deposit is determined based on the prevailing market rate of interest for a similar loan, considering the credit worthiness of the lessor and, depending on facts and circumstances, any additional security available to the lessee.

The excess between the amount of the deposit over its fair value is within the scope of PAS 17, *Leases*. Paragraph 4 of PAS 17 defines MLP as "the payments over the lease term that the lessee is or can be required to make". The difference between the present value and the amount of the deposit paid at inception is therefore regarded as an additional amount payable by the lessee / receivable by the lessor. It is therefore taken into account for purposes of calculating the MLP and, consequently, in determining whether the lease is an operating lease or a finance lease.

PAS 19, *Employee Benefits*

PAS 19 – Pre-tax or post-tax discount rate

Issue

Is the discount rate used to calculate a defined benefit obligation a pre-tax or post-tax rate in accordance with PAS 19, *Employee Benefits* (Revised)?

Background

This Q&A deals with the guidance on the calculation of defined benefit obligations. In particular, this clarifies whether, in accordance with PAS 19, the discount rate used to calculate a defined benefit obligation should be a pre-tax or post-tax rate.

The tax regime considered in this Q&A can be summarized as follows:

a) the entity receives a tax deduction for contributions that are made to the plan;

b) the plan pays tax on the contributions received and on the investment income earned; but

c) the plan does not receive a tax deduction for the benefits paid.

Consensus

It should be noted that:

a) paragraph 76(b)(iv) of PAS 19 mentions only taxes on contributions and benefits payable within the context of measuring the defined benefit obligation;

b) paragraph 130 of PAS 19 states that: "in determining the return on plan assets, an entity deducts the costs of managing the plan assets and any tax payable by the plan itself, other than tax included in the actuarial assumptions used to measure the defined benefit obligation"; and

c) according to paragraph BC130 of PAS 19 the measurement of the obligation should be independent of the measurement of any plan assets actually held by a plan.

Consequently, the discount rate used to calculate a defined benefit obligation should be a pre-tax discount rate.

PAS 24, *Related Party Disclosures*

PAS 24 – Definition of close members of the family of a person

Issue

Can parents of a person be considered as close members of the family of a person in accordance with paragraph 9 of PAS 24?

Background

The definition of close members of the family of a person in paragraph 9 of PAS 24 does not specify that the parents of a person could be included in this definition. Some think that this definition should include a person's parents, because in their view they are among the closest members of the family of a person who may be expected to influence, or be influenced by, that person in their dealings with the entity. Some observes that local regulations in some jurisdictions include the parents of a person within the definition of 'close members of the family of a person'.

Consensus

The definition of close members of the family of a person in paragraph 9 of PAS 24:

- is expressed in a principle-based manner and involves the use of judgment to determine whether members of the family of a person (including that person's parents) are related parties or not; and
- includes a list of family members that are always considered close members of the family of a person.

The list of family members in paragraph 9(a)–(c) of PAS 24 is not exhaustive and does not preclude other family members from being considered as close members of the family of a person.

Consequently, other family members, including parents or grandparents, could qualify as close members of the family depending on the assessment of specific facts and circumstances.

PAS 28, *Investment in Associates and Joint Ventures*

PAS 28 – Impairment of investments in associates in separate financial statements

Issue

Should an entity apply the provisions of PAS 36, *Impairment of Assets*, or PAS 39, *Financial Instruments: Recognition and Measurement*, to test its investments in subsidiaries, joint ventures, and associates carried at cost for impairment in its separate financial statements?

Background

According to paragraph 10 of PAS 27, *Consolidated and Separate Financial Statements* (2011) an entity, in its separate financial statements, shall account for investments in subsidiaries, joint ventures and associates either at cost or in accordance with PAS 39 or PFRS 9, *Financial Instruments*.

According to paragraphs 4 and 5 of PAS 36 and paragraph 2(a) of PAS 39, investments in subsidiaries, joint ventures, and associates that are not accounted for in accordance with PAS 39 are within the scope of PAS 36 for impairment purposes.

Consensus

In its separate financial statements, an entity should apply the provisions of PAS 36 to test for impairment its investments in subsidiaries, joint ventures, and associates that are carried at cost in accordance with paragraph 10(a) of PAS 27.

PAS 32, *Financial Instruments: Presentation*

PAS 32 – Accounting for a financial instrument that is mandatorily convertible into a variable number of shares subject to a cap and a floor

Issue

How should an entity classify a financial instrument that is mandatorily convertible into a variable number of shares subject to a cap and a floor in accordance with PAS 32, *Financial Instruments: Presentation*, and PAS 39, *Financial Instruments: Recognition and Measurement*, or PFRS 9, *Financial Instruments*?

Background

The financial instrument has a stated maturity date and, at maturity, the issuer must deliver a variable number of its own equity instruments to equal a fixed cash amount – subject to a cap and a floor, which limit and guarantee, respectively, the number of equity instruments to be delivered.

Consensus

The issuer's obligation to deliver a variable number of the entity's own equity instruments is a non-derivative that meets the definition of a financial liability in paragraph 11(b)(i) of PAS 32 in its entirety.

Paragraph 11(b)(i) of the definition of a liability does not have any limits or thresholds regarding the degree of variability that is required. Therefore, the contractual substance of the instrument is a single obligation to deliver a variable number of equity instruments at maturity, with the variation based on the value of those equity instruments. Such a single obligation to deliver a variable number of own equity instruments cannot be subdivided into components for the purposes of evaluating whether the instrument contains a component that meets the definition of equity. Even though the number of equity instruments to be delivered is limited and guaranteed by the cap and the floor, the overall number of equity instruments that the issuer is obliged to deliver is not fixed and therefore the entire obligation meets the definition of a financial liability.

Furthermore, the cap and the floor are embedded derivative features whose values change in response to the price of the issuer's equity share. Therefore, assuming that the issuer has not elected to designate the entire instrument under the fair value option, the issuer must separate those features and account for the embedded derivative features separately from the host liability contract at fair value through profit or loss in accordance with PAS 39 or PFRS 9.

PAS 32 – A financial instrument that is mandatorily convertible into a variable number of shares (subject to a cap and a floor) but gives the issuer the option to settle by delivering the maximum (fixed) number of shares

Issue

How should an issuer assess the substance of a particular early settlement option included in a financial instrument in accordance with PAS 32, *Financial Instruments: Presentation*?

Background

The instrument has a stated maturity date and at maturity, the issuer must deliver a variable number of its own equity instruments to equal a fixed cash amount, subject to a cap and a floor. The cap and the floor limit and guarantee, respectively, the number of equity instruments to be delivered. The issuer is required to pay interest at a fixed rate.

The issuer has the contractual right to settle the instrument at any time before maturity. If the issuer chooses to exercise that early settlement option, it must:

a) deliver the maximum number of equity instruments specified in the contract; and

b) pay in cash all of the interest that would have been payable if the instrument had remained outstanding until its maturity date.

Consensus

The definitions of financial asset, financial liability and equity instrument in PAS 32 are based on the financial instrument's contractual rights and contractual obligations. However, paragraph 15 of PAS 32 requires the issuer of a financial instrument to classify the instrument in accordance with the substance of the contractual arrangement. Consequently, if a contractual term of a financial instrument lacks substance, that contractual term would be excluded from the classification assessment of the instrument.

The issuer cannot assume that a financial instrument (or its components) meets the definition of an equity instrument simply because the issuer has the contractual right to settle the financial instrument by delivering a fixed number of its own equity instruments.

Judgment will be required to determine whether the issuer's early settlement option is substantive and thus should be considered in determining how to classify the instrument. If the early settlement option is not substantive, that term would not be considered in determining the classification of the financial instrument.

The guidance in paragraph 20(b) of PAS 32 is relevant because it provides an example of a situation in which one of an instrument's settlement alternatives is excluded from the classification assessment. Specifically, the example in that paragraph describes an instrument that the issuer will settle by delivering either cash or its own shares and states that one of the settlement alternatives should be excluded from the classification assessment in some circumstances.

To determine whether the early settlement option is substantive, the issuer will need to understand whether there are actual economic or other business reasons that the issuer would exercise the option. In making that assessment, the issuer could consider, along with other factors, whether the instrument would have been priced differently if the issuer's early settlement option had not been included in the contractual terms.

Factors such as the term of the instrument, the width of the range between the cap and the floor, the issuer's share price and the volatility of the share price could be relevant to the assessment of whether the issuer's early settlement option is substantive. For example, the early settlement option may be less likely to have substance – especially if the instrument is short-lived – if the range between the cap and the floor is wide and the current share price would equate to the delivery of a number of shares that is close to the floor (i.e., the minimum). That is because the issuer may have to deliver significantly more shares to settle early than it may otherwise be obliged to deliver at maturity.

PAS 32 – Classification of financial instruments that give the issuer the contractual right to choose the form of settlement

Issue

How should financial instruments that give the issuer the contractual right to choose the form of settlement be classified in accordance with PAS 32, *Financial Instruments: Presentation*?

Background

This Q&A clarifies how an issuer would classify three financial instruments in accordance with PAS 32. None of the financial instruments had a maturity date but each gave the holder the contractual right to redeem at any time. The holder's redemption right was described differently for each of the three financial instruments; however in each case the issuer had the contractual right to choose to settle the instrument in cash or a fixed number of its own equity instruments if the holder exercised its redemption right. The issuer was not required to pay dividends on the three instruments but could choose to do so at its discretion.

Paragraph 15 of PAS 32 requires the issuer of a financial instrument to classify the instrument in accordance with the substance of the contractual arrangement. Consequently, the issuer cannot achieve different classification results for financial instruments with the same contractual substance simply by describing the contractual arrangements differently.

Paragraph 11 of PAS 32 sets out the definitions of both a financial liability and an equity instrument. Paragraph 16 describes in more detail the circumstances in which a financial instrument meets the definition of an equity instrument.

Consensus

A non-derivative financial instrument that gives the issuer the contractual right to choose to settle in cash or a fixed number of its own equity instruments meets the definition of an equity instrument in PAS 32 as long as the instrument does not establish an obligation to deliver cash (or another financial asset) indirectly through its terms and conditions. Paragraph 20(b) of PAS 32 provides the example that an indirect contractual obligation would be established if a financial instrument provides that on settlement the entity will deliver either cash or its own equity instruments whose value is determined to exceed substantially the value of the cash.

Financial instruments, in particular those that are more structured or complex, require careful analysis to determine whether they contain equity and non-equity components that must be accounted for separately in accordance with PAS 32.

If the issuer has a contractual obligation to deliver cash, that obligation meets the definition of a financial liability.

PAS 34, *Interim Financial Reporting*

PAS 34 – Condensed statement of cash flows

Issue

How should an entity apply the requirements of PAS 34, *Interim Financial Reporting*, regarding the presentation and content of the condensed statement of cash flows in the interim financial statements?

Background

There are divergent views on the presentation and content of the condensed statement of cash flows. One view is that an entity should present a detailed structure of the condensed statement of cash flows showing cash flows by nature. Another view is that an entity may present a three-line condensed statement of cash flows showing only a total for each of operating, investing and financing cash flow activities.

A condensed statement of cash flows is one of the primary statements that is included as part of an interim financial report as prescribed by paragraph 8 of PAS 34. Paragraph 10 of PAS 34 specifies that each of the condensed statements shall include, at a minimum, each of the headings and subtotals that were included in the most recent annual financial statements. Paragraph 10 of PAS 34 also requires additional line items to be included if their omission would make the interim financial statements misleading.

In an interim financial report:

a) an entity shall include an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period. Information disclosed in relation to those events and transactions shall update the relevant information presented in the most recent annual financial report (see paragraph 15 of PAS 34).

b) the overriding goal is to ensure that an interim financial report includes all information that is relevant to understanding an entity's financial position and performance during the interim period (see paragraph 25 of PAS 34). The Interpretations Committee further noted that in accordance with paragraph OB20 of the *Conceptual Framework*, information about cash flows helps users to understand a reporting entity's operations, evaluate its financing and investing activities, assess its liquidity or solvency and interpret other information about financial performance.

Consensus

To meet the requirements in paragraphs 10, 15 and 25 of PAS 34, a condensed statement of cash flows should include all information that is relevant in understanding the entity's ability to generate cash flows and the entity's needs to utilize those cash flows. A three-line presentation alone would not meet the requirements in PAS 34.

PAS 39, *Financial Instruments: Recognition and Measurement*

PAS 39 – Income and expenses arising on financial instruments with a negative yield – presentation in the statement of comprehensive income

Issue

How should an expense arising on a financial asset because of a negative effective interest rate be presented in the statement of comprehensive income?

Background

This Q&A discusses the ramifications of the economic phenomenon of negative interest rates for the presentation of income and expenses in the statement of comprehensive income.

Consensus

Interest resulting from a negative effective interest rate on a financial asset does not meet the definition of interest revenue in PAS 18, *Revenue*, because it reflects a gross outflow, instead of a gross inflow, of economic benefits. Also, this amount is not an interest expense because it arises on a financial asset instead of on a financial liability of the entity.

Consequently, the expense arising on a financial asset because of a negative effective interest rate should not be presented as interest revenue or interest expense, but in some other appropriate expense classification. In accordance with paragraphs 85 and 112(c) of PAS 1, *Presentation of Financial Statements*, the entity is required to present additional information about such an amount if that is relevant to an understanding of the entity's financial performance or to an understanding of this item.

PAS 39 – Accounting for embedded foreign currency derivatives in host contracts

Issue

Is an embedded foreign currency derivative in a license agreement closely related to the economic characteristics of the host contract, on the basis that the currency in which the license agreement is denominated is the currency in which commercial transactions in that type of license agreement are routinely denominated around the world (i.e., the 'routinely-denominated' criterion in paragraph AG33(d)(ii) of PAS 39)?

Consensus

It can be noted that the issue is related to a contract for a specific type of item. The assessment of the routinely-denominated criterion is based on evidence of whether or not such commercial transactions are denominated in that currency all around the world and not merely in one local area.

The assessment is a question of fact and is based on an assessment of available evidence.

Philippine Interpretation IFRIC-14, *PAS 19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*

Philippine Interpretation IFRIC-14 and PAS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction

Issue

Should an entity assume continuation of a minimum funding requirement for contributions relating to future service?

Background

The issue relates to whether the future minimum funding requirement for contributions to a defined benefit plan to cover future service would apply for only the fixed period that had been agreed between the entity and the pension trustees or would also apply beyond that period. The conclusion on this issue could affect how the economic benefit available as a reduction in future contributions is determined, which could in turn affect the amount of the net defined benefit liability or asset to be recognized in the entity's statement of financial position.

In the circumstances described above, neither a plan wind-up nor a plan closure to future accrual has been decided upon at the end of the reporting period. In addition, a pension regulation or a contractual agreement, or both, specify that:

a) the pension trustees are required to prepare, and from time to time review and if necessary revise, a statement of funding principles that documents the pension trustees' policy for ensuring that a required funding objective is met;
b) the statement of funding principles sets out, among other things, the methods to be used to determine the assumptions that are used to calculate the liabilities that determine contributions to be paid;
c) the pension trustees are required to prepare a schedule of contributions that is negotiated with the entity and that is consistent with the statement of funding principles;
d) the amounts specified in the schedule of contributions must then be paid for a fixed period;
e) the entity and the pension trustees are required to renew the schedule of contributions as the fixed period comes to an end if the plan is continued;
f) the schedule of contributions does not need to be renewed if the plan is wound up; and
g) the entity can decide to wind up or close the plan to future accrual, if this is agreed with the pension trustees.

Consensus

The future minimum funding requirement for contributions to a defined benefit plan to cover future service would apply for the fixed period that had been agreed between the entity and the pension trustee and beyond that period.

It should be observed that although the level of contributions after the fixed period will be subject to future negotiations, if the plan continues after the fixed period, the entity must continue to make contributions for future service that are consistent with the statement of funding principles.

Paragraph 18 of Philippine Interpretation IFRIC-14 requires an entity to analyze its minimum funding requirements at a given date into the contributions that are required to cover:

- any existing shortfall for past service on the minimum funding basis; and

- future service.

Paragraph 19 of Philippine Interpretation IFRIC-14 explains that contributions to cover any existing shortfall for past service do not affect future contributions for future service.

Also, paragraph 23 of Philippine Interpretation IFRIC-14 requires an entity to determine whether contributions payable to cover an existing shortfall for past service will be available as a refund or reduction in future contributions.

It should be noted that the issue raised relates only to the minimum funding requirement for contributions to cover future service.

In the circumstances described, the pension trustees determine some or all of the factors (or funding principles) establishing the minimum funding basis (as that term is used in Philippine Interpretation IFRIC-14) and record them in the statement of funding principles. Accordingly, when the entity estimates the future minimum funding requirement contributions, it should (i) include the amounts in the schedule of contributions for the fixed period specified by the schedule; and (ii) beyond that period, make an estimate that assumes a continuation of those factors establishing the minimum funding basis as determined by the pension trustees. This is because:

- paragraphs 21 and BC30 of Philippine Interpretation IFRIC-14 explain that an entity's estimate of future minimum funding requirement contributions shall not include the effect of expected changes in the terms and conditions of the minimum funding basis that are not substantively enacted or contractually agreed at the end of the reporting period; and

- in the circumstances described, those factors establishing the minimum funding basis that are determined by the pension trustees and recorded in the statement of funding principles are equivalent to a legal requirement or contractual agreement. Accordingly, the estimate of future minimum funding requirement contributions for future service should not assume any changes to those factors if such changes require future negotiations with the pension trustees.

Further, for any factors affecting the estimation of future minimum funding requirements that are not determined by the trustees (for example, the remaining life of the plan is not specified by the existing funding principles), the assumptions used to estimate future minimum funding requirement contributions for future service beyond the fixed period must be consistent with those used for determining future service costs. This is because paragraphs 17 and 21 of Philippine Interpretation IFRIC-14 require an entity to use assumptions that are consistent with those used to determine the defined benefit obligation and with the situation that exists at the end of the reporting period.

Philippine Interpretation IFRIC-21, *Levies*

Philippine Interpretation IFRIC-21 – Identification of a present obligation to pay a levy that is subject to a pro rata activity threshold as well as an annual activity threshold

Issue

How should the requirements in paragraph 8 of Philippine Interpretation IFRIC-21, *Levies*, be interpreted in identifying an obligating event for a levy?

Background

Philippine Interpretation IFRIC-21, which is effective for annual periods beginning on or after January 1, 2014, was adopted in June 2013. It provides an interpretation of the requirements in PAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, for the recognition of liabilities for obligations to pay levies that are within the scope of Philippine Interpretation IFRIC-21.

There are tax regimes in which an obligation to pay a levy arises as a result of activity during a period but is not payable until a minimum activity threshold, as identified by the legislation, is reached. The threshold is set as an annual threshold, but this threshold is reduced, pro rata to the number of days in the year that the entity participated in the relevant activity, if its participation in the activity started or stopped during the course of the year.

Paragraph 8 of Philippine Interpretation IFRIC-21 provides that the obligating event that gives rise to a liability to pay a levy is the activity that triggers the payment of the levy, as identified by the legislation. For example, if the activity that triggers the payment of the levy is the generation of revenue in the current period and the calculation of that levy is based on the revenue that was generated in a previous period, the obligating event for that levy is the generation of revenue in the current period. The generation of revenue in the previous period is necessary, but not sufficient, to create a present obligation.

This Q&A deals with how the thresholds stated in the legislation should be taken into consideration when deciding "the activity that triggers the payment of the levy" in paragraph 8 of Philippine Interpretation IFRIC-21.

Consensus

In the circumstance described above, the payment of the levy is triggered by the reaching of the annual threshold as identified by the legislation.

The entity would be subject to a threshold that is lower than the threshold that applies at the end of the annual assessment period if, and only if, the entity stops the relevant activity before the end of the annual assessment period.

Accordingly, in the light of the guidance in paragraph 12 of Philippine Interpretation IFRIC-21, the obligating event for the levy is the reaching of the threshold that applies at the end of the annual assessment period.

It should be noted that there is a distinction between a levy with an annual threshold that is reduced pro rata when a specified condition is met and a levy for which an obligating event occurs progressively over a period of time as described in paragraph 11 of Philippine Interpretation IFRIC-21; until the specified condition is met, the pro rata reduction in the threshold does not apply.

Philippine Interpretation IFRIC-21 – Levies raised on production property, plant and equipment

Issue

Should levies raised on production property, plant and equipment (PPE) be classified as:
1. an administrative cost to be recognized as an expense as it is incurred; or
2. a fixed production overhead to be recognized as part of the cost of the entity's inventory in accordance with PAS 2, *Inventories*?

Consensus

Paragraph 3 of Philippine Interpretation IFRIC-21 states that the Interpretation does not provide guidance on accounting for the costs arising from recognizing a levy. Philippine Interpretation IFRIC-21 notes that entities should apply other Standards to decide whether the recognition of an obligation for a levy gives rise to an asset or to an expense.