EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho
NZ ACCOUNTING STANDARDS BOARD

NZASB EXPOSURE DRAFT 2018-X

PUBLIC BENEFIT ENTITY INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD 40 PBE COMBINATIONS (PBE IPSAS 40)

Issued [Date]

This [draft][1] Standard was issued on [date] by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 12(a) of the Financial Reporting Act 2013.

This [draft] Standard is a disallowable instrument for the purposes of the Legislation Act 2012, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on [date].

Reporting entities that are subject to this [draft] Standard are required to apply the [draft] Standard in accordance with the effective date set out in paragraph 126.1.

In finalising this [draft] Standard, the New Zealand Accounting Standards Board has carried out appropriate consultation in accordance with section 22(1) of the Financial Reporting Act 2013.

This [draft] New Zealand Tier 1 and Tier 2 Public Benefit Entity Accounting Standard has been issued as a result of a new International Public Sector Accounting Standard, IPSAS 40 *Public Sector Combinations*.

This [draft] Standard when applied, supersedes PBE IFRS 3 *Business Combinations*.

This is not the official version of NZASB Exposure Draft 2018-X.

This version shows, in marked-up form, the changes proposed to the underlying text of IPSAS 40.

1 References to “this Standard” throughout this Exposure Draft should be read as referring to “this draft Standard”.

PBE IPSAS 40 PBE COMBINATIONS

ISBN

PBE IPSAS 40—PBE COMBINATIONS

CONTENTS

Public Benefit Entity International Public Sector Accounting Standard 40 *PBE Combinations* is set out in paragraphs 1–134.1 and Appendices A and B. All the paragraphs have equal authority. PBE IPSAS 40 should be read in the context of its objective, the NZASB's Basis for Conclusions on PBE IPSAS 40, the IPSASB's Basis for Conclusions on IPSAS 40, the *Public Benefit Entities' Conceptual Framework* and Standard XRB A1 *Application of the Accounting Standards Framework*. PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

[2] For the purpose of this Exposure Draft, the IPSASB's Basis for Conclusions has been included. When the PBE Standard is issued, the IPSASB's Basis for Conclusions will be made available as additional material on the XRB website.

Objective

1. The objective of this Standard is to improve the relevance, faithful representativeness and comparability of the information that a reporting entity provides in its financial statements about a public benefit entity (PBE) ~~public sector~~ combination and its effects. To accomplish that, this Standard establishes principles and requirements for how:

   (a) A reporting entity classifies a PBE ~~public sector~~ combination as an amalgamation or an acquisition;

   (b) A resulting entity recognises and measures in its financial statements the ~~identifiable~~ assets received, the liabilities assumed and any non-controlling interest in an amalgamation;

   (c) A resulting entity recognises and measures components of net assets/equity and other adjustments recognised in an amalgamation;

   (d) An acquirer recognises and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquired operation;

   (e) An acquirer recognises and measures the goodwill acquired in, or the gain or loss arising from, an acquisition; and

   (f) A reporting entity determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of a PBE ~~public sector~~ combination.

Scope

1.1 **This Standard applies to Tier 1 and Tier 2 public benefit entities.**

1.2 **A Tier 2 entity is not required to comply with the requirements in this Standard denoted with an asterisk (*). Where a Tier 2 entity elects to apply a disclosure concession it shall comply with any RDR paragraphs associated with that concession.**

2. **An entity that prepares and presents financial statements ~~under the accrual basis of accounting~~ shall apply this Standard in accounting for PBE ~~public sector~~ combinations.**

3. **This Standard applies to a transaction or other event that meets the definition of a PBE ~~public sector~~ combination. This Standard does not apply to:**

   (a) **The accounting for the formation of a joint arrangement in the financial statements of the joint arrangement itself.**

   (b) **The acquisition or receipt of an asset or a group of assets (and any related liabilities) that does not constitute an operation. In such cases an entity shall identify and recognise the individual identifiable assets acquired or received (including those assets that meet the definition of, and recognition criteria for, intangible assets in PBE IPSAS 31 *Intangible Assets*) and liabilities assumed. Such a transaction or event does not give rise to goodwill.**

   (c) **The assumption of a liability or a group of liabilities that does not constitute an operation. In such cases an entity shall identify and recognise the individual liabilities assumed.**

4. **The requirements of this Standard do not apply to the acquisition by an investment entity, as defined in PBE IPSAS 35 *Consolidated Financial Statements*, of an investment in a controlled entity that is required to be measured at fair value through surplus or deficit.**

Definitions

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

   Public benefit entities are reporting entities whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders.

   A public benefit entity (PBE) ~~public sector~~ combination is the bringing together of separate operations into one public benefit ~~sector~~ entity.

   General definitions related to all PBE~~public sector~~ combinations

   For the purposes of this Standard, equity interests is used broadly to mean ownership interests of investor-owned entities and owner, member or participant interests of mutual entities. In the context

of this Standard equity interests may also mean ownership interests established by other mechanisms such as deed or statute.

An asset is identifiable if it either:

(a) Is separable, i.e., is capable of being separated or divided from the entity and sold, transferred, licensed, rented, or exchanged, either individually or together with a related binding arrangement, identifiable asset or liability, regardless of whether the entity intends to do so; or

(b) Arises from binding arrangements (including rights from contracts or other legal rights), regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

A mutual entity is an entity, other than an investor-owned entity, that provides dividends, lower costs or other economic benefits directly to its owners, members or participants. For example, a mutual insurance company, a credit union and a co-operative entity are all mutual entities.

An operation is an integrated set of activities and related assets and/or liabilities that is capable of being conducted and managed for the purpose of achieving an entity's objectives, by providing goods and/or services for community or social benefit, rather than a financial return to equity holders. In the context of this Standard, "operation" also includes an integrated set of activities that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.

For the purposes of this Standard, owners is used broadly to include those with an equity interest. ~~any party with quantifiable ownership interests in an operation.~~ This includes, but is not limited to, those with ~~holders of~~ an equity interests in~~of~~ investor-owned entities and owners or members of, or participants in, mutual entities.

A PBE ~~public sector~~ combination under common control is a PBE ~~public sector~~ combination in which all of the entities or operations involved are ultimately controlled by the same entity both before and after the PBE ~~public sector~~ combination.

Definitions related to amalgamations

An amalgamation gives rise to a resulting entity and is either:

(a) A PBE ~~public sector~~ combination in which no party to the combination gains control of one or more operations; or

(b) A PBE~~public sector~~ combination in which one party to the combination gains control of one or more operations, and in which there is evidence that the combination has the economic substance of an amalgamation.

~~(Paragraph AG1 provides additional guidance.)~~

The amalgamation date is the date on which the resulting entity obtains control of the combining operations.

A combining operation is an operation that combines with one or more other operations to form the resulting entity in an amalgamation.

A resulting entity is the entity that is the result of two or more operations combining in an amalgamation ~~(paragraph AG1 provides additional guidance)~~.

Definitions relating to acquisitions

An acquired operation is the operation that the acquirer gains control of in an acquisition.

An acquirer is the entity that gains control of one or more operations in an acquisition.

An acquisition is a PBE ~~public sector~~ combination in which one party to the combination gains control of one or more operations, and there is evidence that the combination is not an amalgamation.

The acquisition date is the date on which the acquirer gains control of the acquired operation.

Contingent consideration is usually an obligation of the acquirer to transfer additional assets or equity interests to the former owners of an acquired operation as part of the exchange for control of the acquired operation if specified future events occur or conditions are met. However, contingent consideration also may give the acquirer the right to the return of previously transferred consideration if specified conditions are met.

Goodwill is an asset representing the future economic benefits arising from other assets acquired in an acquisition that are not individually identified and separately recognised.

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

Identifying a PBE ~~public sector~~ Combination

6. **An entity shall determine whether a transaction or other event is a PBE ~~public sector~~ combination by applying the definitions in this Standard, which requires that the assets and liabilities constitute an operation. If the assets and liabilities do not constitute an operation, the entity shall account for the transaction or other event in accordance with other PBE Standards. Paragraphs AG2–AG9 provide guidance on identifying a PBE ~~public sector~~ combination.**

Classification of PBE~~public Sector~~ Combinations

7. **If no party to a PBE ~~public sector~~ combination gains control of one or more operations as a result of the combination, the combination shall be classified as an amalgamation. Paragraphs AG10–AG18 provide guidance on determining whether one party to a PBE ~~public sector~~ combination gains control of one or more operations as a result of that combination.**

8. **If one party to a PBE ~~public sector~~ combination gains control of one or more operations as a result of the combination, an entity shall consider the economic substance of the combination in classifying the combination as either an amalgamation or an acquisition. A combination in which one party gains control of one or more operations shall be classified as an acquisition, unless it has the economic substance of an amalgamation.**

9. **In determining the classification of the PBE ~~public sector~~ combination, an entity considers whether the resulting accounting treatment of the combination provides information that meets the objectives of financial reporting and that satisfies the qualitative characteristics (QCs). To assess the economic substance of the combination, an entity considers the indicators relating to consideration and to the decision-making process in paragraphs 12–13. These indicators, individually or in combination, will usually provide evidence that the economic substance of the combination is that of an amalgamation. A combination does not need to satisfy both of these indicators to be classified as an amalgamation. Paragraphs AG19–AG39 provide additional guidance.**

10. An analysis of the indicators relating to consideration and to the decision-making process in paragraphs 12−13 will usually produce a conclusive result and provide sufficient evidence about the economic substance of the PBE~~public sector~~ combination to determine whether the combination is an amalgamation. In such circumstances, the resulting classification and the associated accounting treatment will ensure that users have access to information that meets the objectives of financial reporting and that satisfies the QCs.

11. In exceptional circumstances, after applying the indicators in paragraphs 12–13, the results may be inconclusive or may not provide sufficient evidence about the economic substance of the PBE ~~public sector~~ combination. In such circumstances, an entity also considers which classification would provide information that best meets the objectives of financial reporting and that best satisfies the QCs, having regard to paragraph 14. Paragraphs AG40–AG41 provide additional guidance.

Indicators that May Provide Evidence that the Combination is an Amalgamation

Indicator~~s~~ Relating to Consideration

12. The absence of consideration paid to compensate those with an entitlement to the net assets of a transferred operation for giving up that entitlement may provide evidence that the combination is an amalgamation if the reasons for the absence of consideration do not provide evidence of an acquisition (paragraphs AG26–AG30 provide additional guidance).~~The following indicators may provide evidence that the combination is an amalgamation:~~

(a) [Not used] ~~Consideration is paid for reasons other than to compensate those with an entitlement to the net assets of a transferred operation for giving up that entitlement (paragraphs AG27–AG28 provide additional guidance);~~

(b) [Not used] ~~Consideration is not paid to those with an entitlement to the net assets of a transferred operation (paragraphs AG29–AG30 provide additional guidance); or~~

(c) [Not used] ~~Consideration is not paid because there is no one (whether an individual or an entity) with an entitlement to the net assets of a transferred entity (paragraph AG31 provides additional guidance).~~

Indicators Relating to the Decision-Making Process

13. The following indicators may provide evidence that the combination is an amalgamation:

(a) A PBE ~~public sector~~ combination is imposed by a third party without any party to the combination being involved in the decision-making process (paragraphs AG32–AG35 provide additional guidance);

(b) A PBE ~~public sector~~ combination is subject to approval by each party's citizens through referenda (paragraph AG36 provides additional guidance); or

(c) A PBE ~~public sector~~ combination under common control occurs (paragraphs AG37–AG39 provide additional guidance).

Additional matters to be taken into account where the indicators relating to consideration and the decision-making process do not provide sufficient evidence to determine whether the combination is an amalgamation

14. The analysis of the indicators relating to consideration and the decision-making process may, in exceptional circumstances, produce inconclusive results or not provide sufficient evidence to determine whether the combination is an amalgamation, based on the economic substance of the PBE ~~public sector~~ combination and the indicators in paragraphs 12–13. In such circumstances, an entity considers which classification and resulting accounting treatment would provide information that best meets the objectives of financial reporting. Paragraphs AG42–AG46 provide additional guidance. An entity also considers which classification and resulting accounting treatment would provide information that best satisfies the QCs of relevance, faithful representation, understandability, timeliness, comparability and verifiability. Paragraphs AG47–AG50 provide additional guidance.

Accounting for Amalgamations

15. **A resulting entity shall account for each amalgamation by applying the modified pooling of interests method of accounting.**

The Modified Pooling of Interests Method of Accounting

16. Applying the modified pooling of interests method of accounting requires:

(a) Identifying the resulting entity;

(b) Determining the amalgamation date;

(c) Recognising and measuring the ~~identifiable~~ assets received, the liabilities assumed and any non-controlling interest in the combining operations, consistent with the requirements in PBE Standards; and

(d) Recognising and measuring the components of net assets/equity and other adjustments from an amalgamation.

Identifying the Resulting Entity

17. **For each amalgamation, a resulting entity shall be identified.**

18. Paragraph 5 ~~of this Standard~~ defines a resulting entity as "the entity that is the result of two or more operations combining in an amalgamation." As explained in paragraph 8, one of the parties to the amalgamation may have gained control of one or more of the combining operations. The existence or absence of control determines whether the resulting entity is a new reporting entity or a continuing reporting entity. When none of the parties to the combination that existed prior to the combination gain

control over the combining operations, the resulting entity is a new reporting entity. When one of the parties to the combination that existed prior to the combination gains control of the other combining operations, the resulting entity is that continuing reporting entity. ~~The resulting entity shall thereafter be identified as the entity that obtains control of the combining operations as a result of the amalgamation.~~

Determining the Amalgamation Date

19. **The resulting entity shall identify the amalgamation date, which is the date on which it obtains control of the combining operations.**

20. The date on which the resulting entity obtains control of the combining operations may be the date on which the resulting entity receives the assets and assumes the liabilities of the combining operations. It is possible that the resulting entity will not receive legal title to the assets or assume legal responsibility for the liabilities of the combining operations. In these circumstances, the resulting entity will often obtain control of the assets and liabilities of the combining operations on the date on which responsibility for the assets and liabilities is formally delegated to the resulting entity. However, the resulting entity might obtain control on a different date. ~~For example, legislation or a written agreement may provide that the resulting entity obtains control of the assets and liabilities of the combining operations on a specified date.~~ A resulting entity shall consider all pertinent facts and circumstances in identifying the amalgamation date.

Recognising and Measuring the ~~Identifiable~~ Assets Received, Liabilities Assumed and any Non-Controlling Interests in the Combining Operations

Recognition Principle

20.1 **If, prior to the amalgamation date, all of the combining operations have previously applied PBE Standards, then the resulting entity shall apply paragraphs 21–35. If, prior to the amalgamation date, one or more of the combining operations have not previously applied PBE Standards, then the resulting entity shall apply ~~refer to~~ paragraphs 21–35 and paragraphs AG50.1–AG50.2 ~~for additional guidance.~~**

21. **As of the amalgamation date, the resulting entity shall~~,~~, in accordance with PBE Standards, recognise in the combined operation's financial statements the ~~identifiable~~ assets, liabilities and any non-controlling interests ~~that are recognised in the financial statements~~ of the combining operations as of the amalgamation date. Recognition of ~~identifiable~~ assets received and liabilities assumed ~~received~~ is subject to the conditions specified in paragraph~~s~~ 22~~–23~~ and the exceptions specified in paragraph 31.**

Recognition Condition~~s~~

22. **The effects of all transactions between the combining operations are eliminated in preparing the financial statements of the resulting entity (paragraphs AG51–AG52 provide related application guidance).**

23. [Not used] ~~To qualify for recognition as part of applying the modified pooling of interests method, the identifiable assets and liabilities must meet the definitions of assets and liabilities in the *Public Benefit Entities' Conceptual Framework* at the amalgamation date. For example, costs that the resulting entity expects, but is not obliged, to incur in the future to effect its plan to exit an activity of a combining operation or to terminate the employment of or relocate a combining operation's employees are not liabilities at the amalgamation date. Therefore, the resulting entity does not recognise those costs as part of applying the modified pooling of interests method. Instead, the resulting entity recognises those costs in its post-combination financial statements in accordance with other PBE Standards.~~

Classifying or Designating Assets and Liabilities in an Amalgamation

24. **At the amalgamation date, the resulting entity shall classify or designate the assets and liabilities received in an amalgamation using the classifications or designations previously applied by the combining operations. A resulting entity shall not adopt different classifications or designations on initial recognition, unless required to do so ~~even if this is permitted~~ by other PBE Standards.**

25. In some situations, PBE Standards provide for different accounting depending on how an entity classifies or designates a particular asset or liability. Examples of classifications or designations that the resulting entity shall make on the basis of the classifications or designations previously applied by the combining operations include, but are not limited to:

(a) Classification of particular financial assets and liabilities as measured at fair value or at amortised cost, in accordance with PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*;[3]

(b) Designation of a derivative instrument as a hedging instrument in accordance with PBE IPSAS 29; and

(c) Assessment of whether an embedded derivative should be separated from a host contract in accordance with PBE IPSAS 29 (which is a matter of 'classification' as this Standard uses that term).

Measurement Principle

26. **The resulting entity shall measure the ~~identifiable~~ assets and liabilities of the combining operations at their carrying amounts in the financial statements of the combining operations as of the amalgamation date, subject to the requirements of paragraph 27 (paragraph~~s~~ ~~AG53–~~AG54 provides related application guidance) and the exceptions specified in paragraph 31.**

27. **As of the amalgamation date, the resulting entity shall adjust the carrying amounts of the ~~identifiable~~ assets and liabilities of the combining operations where required to conform to the resulting entity's accounting policies.**

28. The modified pooling of interests method results in a single combined resulting entity. A single uniform set of accounting policies, consistent with the requirements of PBE Standards, is adopted by that entity, and the carrying amounts of the ~~identifiable~~ assets and liabilities of the combining operations are adjusted, where required, to conform to those accounting policies (paragraphs AG54.1–AG54.2 provide related application guidance).

29. The resulting entity shall measure any non-controlling interests in a combining operation at their carrying amounts in the financial statements of that combining operation as of the amalgamation date, adjusted for the non-controlling interests' proportionate share of the adjustments made in accordance with paragraph 27.

30. Paragraphs 33–35 specify the types of ~~identifiable~~ assets and liabilities that include items for which this Standard provides limited exceptions to the measurement principle.

Exceptions to the Recognition or Measurement Principles

31. This Standard provides limited exceptions to its recognition and measurement principles. Paragraphs 32–35 specify both the particular items for which exceptions are provided and the nature of those exceptions. The resulting entity shall account for those items by applying the requirements in paragraphs 32–35, which will result in some items being:

(a) Recognised either by applying recognition conditions in addition to those in paragraph~~s~~ 22~~–23~~ or by applying the requirements of other PBE Standards, with results that differ from applying the recognition principle and conditions.

(b) Measured at an amount other than their amalgamation date carrying amounts.

Exception to the Recognition Principle

Licences and Similar Rights Previously Granted by One Combining Operation to Another Combining Operation

32. A licence or similar right, previously granted by one combining operation to another combining operation and recognised as an intangible asset by the recipient combining operation shall be recognised by the resulting entity as an intangible asset. The licence or similar right shall not be eliminated in accordance with paragraph 22 (paragraphs AG55–AG56 provide related application guidance).

[3] If an entity applies this Standard and early adopts PBE IFRS 9 *Financial Instruments*, the references to PBE IPSAS 29 in this paragraph shall be read as references to PBE IFRS 9, including the classification of financial assets and financial liabilities in accordance with PBE IFRS 9.

Exceptions to both the Recognition and Measurement Principles

Income Taxes (where Included in the Terms of the Amalgamation)

33. Amalgamations involving public sector entities may result in a tax authority forgiving amounts of tax due as part of the terms of the amalgamation. The resulting entity shall not recognise any taxation items that are forgiven as a result of the terms of the amalgamation (paragraph~~s~~ AG57~~–AG58~~ provide related application guidance).

34. [Not used] ~~The resulting entity shall recognise and measure any remaining taxation items included in or arising from an amalgamation in accordance with the relevant international or national accounting standard dealing with income taxes. The resulting entity shall recognise and measure any remaining revenue from taxation included in or arising from an amalgamation in accordance with PBE IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)*.~~

Employee Benefits

35. The resulting entity shall recognise and measure a liability (or asset, if any) related to the combining operation's employee benefit arrangements in accordance with PBE IPSAS 39 *Employee Benefits*.

Recognising and Measuring Components of Net Assets/Equity Arising as a Result of an Amalgamation

36. **An amalgamation does not give rise to goodwill (paragraphs AG59–AG60 provide related application guidance).**

37. **The resulting entity shall recognise within net assets/equity the aggregate of~~amounts equal and opposite to the following items~~:**

    (a) **The carrying amounts of the combining operations' assets;**[4]

    (b) **The carrying amounts of the combining operations' liabilities; and**

    (c) **The carrying amounts of the combining operations' non-controlling interests.**

38. **The resulting entity shall recognise within net assets/equity the corresponding adjustments in respect of:**

    (a) **The elimination of transactions between combining operations~~entities~~ in accordance with paragraph 22;**

    (b) **Adjustments made to the carrying amounts of the ~~identifiable~~assets and liabilities of the combining operations where required to conform to the resulting entity's accounting policies, in accordance with paragraph 27; and**

    (c) **Adjustments made in respect of the exceptions to the recognition and/or measurement principles, in accordance with paragraphs 32–35.**

39. **The resulting entity may present the amounts recognised within net assets/equity in accordance with paragraphs 37 and 38 as either:**

    (a) **A single opening balance; or**

    (b) **As separate opening balances of components of net assets/equity, including any components of the combining operations retained by the resulting entity.**

Measurement Period

40. **If the initial accounting for an amalgamation is incomplete by the end of the reporting period in which the amalgamation occurs, the resulting entity shall report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the resulting entity shall retrospectively adjust the provisional amounts recognised at the amalgamation date to reflect new information obtained about facts and circumstances that existed as of the amalgamation date and, if known, would have affected the measurement of the amounts recognised as of that date. During the measurement period, the resulting entity shall also recognise additional assets or liabilities if new information is obtained about facts and circumstances that**

[4] In this paragraph the term "combining operations" refers to the operations being combined into the resulting entity rather than those that belong to the continuing reporting entity or new reporting entity.

existed as of the amalgamation date and, if known, would have resulted in the recognition of those assets and liabilities as of that date. The measurement period ends as soon as the resulting entity receives the information it was seeking about facts and circumstances that existed as of the amalgamation date or learns that more information is not obtainable. However, the measurement period shall not exceed one year from the amalgamation date.

41. The measurement period is the period after the amalgamation date during which the resulting entity may adjust the provisional amounts recognised for an amalgamation. The measurement period provides the resulting entity with a reasonable time to obtain the information necessary to identify and measure the ~~identifiable~~ assets, liabilities and any non-controlling interest in the combining operations as of the amalgamation date in accordance with the requirements of this Standard. The information necessary to identify and measure the ~~identifiable~~ assets, liabilities and any non-controlling interest in the combining operations will generally be available at the amalgamation date. However, this may not be the case where combining operations have previously prepared their financial statements using different accounting policies.

42. The resulting entity recognises an increase (decrease) in the provisional amount recognised for an ~~identifiable~~ asset (liability) by adjusting components of net assets/equity recognised in accordance with paragraphs 37–38. However, new information obtained during the measurement period may sometimes result in an adjustment to the provisional amount of more than one asset or liability. For example, the resulting entity might have assumed a liability to pay damages related to an accident in one of the combining operation's facilities, part or all of which is ~~are~~ covered by the combining operation's liability insurance policy. If the resulting entity obtains new information during the measurement period about the carrying amount of that liability, the adjustment to the gain or loss resulting from a change to the provisional amount recognised for the liability would be offset (in whole or in part) by a corresponding adjustment to the gain or loss resulting from a change to the provisional amount recognised for the claim receivable from the insurer.

43. During the measurement period, the resulting entity shall recognise adjustments to the provisional amounts as if the accounting for the amalgamation had been completed at the amalgamation date. Thus, the resulting entity shall revise comparative information for prior periods presented in financial statements as needed, including making any change in depreciation or amortisation recognised in completing the initial accounting.

44. After the measurement period ends, the resulting entity shall revise the accounting for an amalgamation only to correct an error in accordance with PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Amalgamation-Related Costs

45. Amalgamation-related costs are costs the resulting entity or combining operations incur to effect an amalgamation. Those costs include advisory, legal, accounting, valuation and other professional or consulting fees; general administrative costs; and any costs of registering and issuing debt and equity securities. The resulting entity and combining operations shall account for amalgamation-related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception. The costs to issue debt or equity securities shall be recognised in accordance with PBE IPSAS 28 *Financial Instruments: Presentation*, and PBE IPSAS 29.[5]

Subsequent Measurement and Accounting

46. In general, a resulting entity shall subsequently measure and account for assets and liabilities received and equity instruments issued in an amalgamation in accordance with other applicable PBE Standards for those items, depending on their nature. However, this Standard provides guidance on subsequently measuring and accounting for the following assets received and liabilities assumed or incurred in an amalgamation:

(a) Licenses and similar rights previously granted by one combining operation to another combining operation;

[5] If an entity applies this Standard and early adopts PBE IFRS 9 *Financial Instruments*, the references to PBE IPSAS 29 in this paragraph shall be read as references to PBE IFRS 9.

(b) Transfers, concessionary loans and similar benefits received by a combining operation on the basis of criteria that change as a result of an amalgamation; and

(c) Income taxes (where not included in the terms of the amalgamation).

Licences and Similar Rights Previously Granted by One Combining Operation to Another Combining Operation

47. A licence or similar right, previously granted by one combining operation to another combining operation and recognised as an intangible asset shall be amortised over the remaining period of the binding arrangement in which the right was granted, where the right was granted for a finite period. Where the right was granted for an indefinite period, the resulting entity shall test the right for impairment at least annually, and whenever there is an indication that the right may be impaired. A resulting entity that subsequently sells this licence or similar right to a third party shall include the carrying amount of the intangible asset in determining the gain or loss on the sale.

Transfers, Concessionary Loans and Similar Benefits Received by a Combining Operation on the Basis of Criteria that may Change as a Result of an Amalgamation

48. A transfer, concessionary loan or similar benefit, previously received by a combining operation on the basis of criteria that change as a result of an amalgamation, shall be reassessed prospectively in accordance with other PBE Standards (paragraphs AG61–AG63 provide related application guidance).

Income Taxes (Where not Included in the Terms of the Amalgamation)

49. Amalgamations involving public sector entities may result in a tax authority forgiving amounts of tax subsequent to the amalgamation. The resulting entity shall account for the tax forgiven prospectively in accordance with PBE IAS 12 *Income Taxes* ~~the relevant international or national accounting standard dealing with income taxes~~.

Presentation of Financial Statements

50. **If, following a PBE combination, ~~Except where a~~the resulting entity is ~~not~~ a new reporting entity ~~following a public sector combination~~, the resulting entity's first set of financial statements following the amalgamation shall comprise:**

(a) **An opening statement of financial position as of the amalgamation date;**

(b) **A statement of financial position as at the reporting date;**

(c) **A statement of ~~financial performance~~ comprehensive revenue and expense for the period from the amalgamation date to the reporting date;**

(d) **A statement of changes in net assets/equity for the period from the amalgamation date to the reporting date;**

(e) **A cash flow statement for the period from the amalgamation date to the reporting date;**

(f) **~~If the entity makes publicly available its approved budget, a comparison of budget and actual amounts for the period from the amalgamation date to the reporting date, either as a separate additional financial statement or as a budget column in the financial statements~~When a public sector entity has published general purpose prospective financial statements for the period from the amalgamation date to the reporting date, the information specified in paragraph 148.1 of PBE IPSAS 1 *Presentation of Financial Reports* shall be presented on the face of the financial statements or as a separate statement. When a not-for-profit entity has published general purpose prospective financial statements for the period from the amalgamation date to the reporting date, the information specified in paragraph 148.1 of PBE IPSAS 1 shall be presented on the face of the financial statements, as a separate statement or in the notes; and**

(g) **Notes, comprising a summary of significant accounting policies and other explanatory notes.**

The resulting entity shall not present comparative information on the face of its financial statements for the periods prior to the amalgamation date. The resulting entity is permitted to disclose in the notes comparative information for the combining operations for the periods prior to the amalgamation date, in accordance with paragraph 54(g).

51. **If, following a PBE combination, ~~Where a~~ the resulting entity is ~~not~~ a continuing~~new~~ reporting entity ~~following a public sector combination~~, the resulting entity shall disclose as of the amalgamation date:**

(a) **The amounts recognised of each major class of assets and liabilities, and components of net assets/equity from combining operations included in the resulting entity;**

(b) **Any adjustments made to components of net assets/equity where required to conform the accounting policies of the combining operations with those of the resulting entity; and**

(c) **Any adjustments made to eliminate transactions between the combining operations.**

The resulting entity shall present comparative financial information, in respect of the continuing reporting entity only, for the period prior to the amalgamation date on the face of the financial statements but this information shall not be restated. The resulting entity is permitted to disclose in the notes comparative financial information for the combining operations for the periods prior to the amalgamation date, in accordance with paragraph 54(g).

52. Subject to the requirements in paragraphs 54 and 56, the resulting entity is permitted but not required to present financial statements for one or more of the combining operations for periods prior to the amalgamation date (paragraph~~s~~ AG64 ~~AG65~~ provides related application guidance). Where a resulting entity elects to present financial statements for the combining operations for periods prior to the amalgamation date, it shall disclose the information required by paragraph 54(g). The resulting entity shall not restate the combining operations' financial statements, but shall disclose the information on the same basis as previously used in the combining operations' financial statements. Where a resulting entity does not elect to present financial statements for the combining operations for periods prior to the amalgamation date, it shall meet the needs of users of the financial statements in one of the ways outlined in paragraph AG64.

Disclosures

*53. **The resulting entity shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of an amalgamation.**

RDR 53.1 **A Tier 2 entity is required to comply with the disclosures in paragraphs 54–57 that are not asterisked (*) as RDR concessions.**

54. To meet the objective in paragraph 53, the resulting entity shall disclose the following information for each amalgamation that occurs during the reporting period:

(a) The name and a description of each combining operation.

(b) The amalgamation date.

(c) The primary reasons for the amalgamation including, where applicable, the legal basis for the amalgamation.

(d) The amounts recognised as of the amalgamation date for each major class of assets and liabilities transferred.

(e) The adjustments made to the carrying amounts of assets and liabilities recorded by each combining operation as of the amalgamation date:

(i) To eliminate the effect of transactions between combining operations in accordance with paragraph 22; and

(ii) To conform to the resulting entity's accounting policies in accordance with paragraph 27.

*(f) An analysis of net assets/equity, including any components that are presented separately, and any significant adjustments such as revaluation surpluses or deficits, recognised in accordance with paragraphs 37–38.

(g) If a resulting entity elects to present financial statements for the combining operations for periods prior to the amalgamation date in accordance with paragraph 52, the resulting entity shall disclose the following information for each combining operation in the notes:

(i) A statement of financial position as at the end of the prior period(s);

(ii) A statement of ~~financial performance~~ comprehensive revenue and expense for the prior period(s);

(iii) A statement of changes in net assets/equity for the prior period(s);

(iv) A cash flow statement for the prior period(s); and

(v) Notes, comprising a summary of significant accounting policies and other explanatory notes.

The resulting entity shall not restate this information, but shall disclose the information on the same basis as previously used in the combining operations' financial statements. The resulting entity shall describe ~~disclose~~ the significant differences between the resulting entity's accounting policies and the accounting policies previously applied by the combining operations~~basis on which this information is presented~~. If the combining operations' prior period financial statements are not for the reporting period immediately prior to the amalgamation date the resulting entity shall also disclose the information specified in subparagraph (h) below.

(h) If, at the time the financial statements of the resulting entity are authorised for issue, the last reporting date of any of the combining operations does not immediately precede the amalgamation date, the resulting entity shall disclose the following information:

(i) The amounts of revenue and expense, and the surplus or deficit of each combining operation from the last reporting date of the combining operations until the amalgamation date. The amounts of revenue shall be analysed in a manner appropriate to the entity's operations, in accordance with paragraph 108 of PBE IPSAS 1 ~~*Presentation of Financial Statements*~~. The amounts of expense shall be analysed using a classification based on either the nature of expenses or their function within the entity, whichever provides information that is faithfully representative and more relevant, in accordance with paragraph 109 of PBE IPSAS 1.

(ii) The amounts reported by each combining operation immediately prior to the amalgamation date for each major class of assets and liabilities.

(iii) The amounts reported by each combining operation immediately prior to the amalgamation date in net assets/equity.

The resulting entity is not required to disclose this information where it has elected to present financial statements of the combining operations for the reporting period~~s~~ ending immediately prior to the amalgamation date as specified in subparagraph (g) above.

*55. **The resulting entity shall disclose information that enables users of its financial statements to evaluate the financial effects of adjustments recognised in the current reporting period that relate to amalgamations that occurred in the period or previous reporting periods.**

56. To meet the objective in paragraph 55, the resulting entity shall disclose the following information:

*(a) If the initial accounting for an amalgamation is incomplete (see paragraph 40) for particular assets or liabilities, and the amounts recognised in the financial statements for the amalgamation thus have been determined only provisionally:

(i) The reasons why the initial accounting for the amalgamation is incomplete;

(ii) The assets or liabilities for which the initial accounting is incomplete; and

(iii) The nature and amount of any measurement period adjustments recognised during the reporting period in accordance with paragraph 43.

(b) If amounts of tax due are forgiven as a result of the terms of the amalgamation (see paragraph~~s~~ 33~~–34~~):

(i) The amount of tax due that was forgiven; and

(ii) Where the resulting entity is the tax authority, details of the adjustment made to tax receivable.

RDR 56.1 For individually immaterial amalgamations occurring during the reporting period that are material collectively, the Tier 2 resulting entity shall disclose in aggregate the information required by paragraphs 54(d) and 56(b).

*57. If the specific disclosures required by this and other PBE Standards do not meet the objectives set out in paragraphs 53 and 55, the resulting entity shall disclose whatever additional information is necessary to meet those objectives.

Accounting for Acquisitions

58. **An acquirer shall account for each acquisition by applying the acquisition method of accounting.**

The Acquisition Method of Accounting

59. Applying the acquisition method of accounting requires:

(a) Identifying the acquirer;

(b) Determining the acquisition date;

(c) Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquired operation; and

(d) Recognising and measuring goodwill, a gain or a loss from an acquisition.

Identifying the Acquirer

60. **For each acquisition, the party to the combination that gains control of one or more operations shall be identified as the acquirer.**

61. The party to the combination that gains control of one or more operations is identified when determining the classification of the PBE~~public sector~~ combination in accordance with paragraphs 7, 8 and AG10−AG18.

Determining the Acquisition Date

62. **The acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquired operation.**

63. The date on which the acquirer obtains control of the acquired operation is generally the date on which the acquirer legally transfers the consideration and/or acquires the assets and assumes the liabilities of the acquired operation—the closing date. However, the acquirer might obtain control on a date that is either earlier or later than the closing date. For example, the acquisition date precedes the closing date if a written agreement provides that the acquirer obtains control of the acquired operation on a date before the closing date. An acquirer shall consider all pertinent facts and circumstances in identifying the acquisition date.

Recognising and Measuring the Identifiable Assets Acquired, the Liabilities Assumed and any Non-Controlling Interest in the Acquired Operation

Recognition Principle

64. **As of the acquisition date, the acquirer shall recognise, separately from any goodwill recognised, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquired operation. Recognition of identifiable assets acquired and liabilities assumed is subject to the conditions specified in paragraphs 65 and 66.**

Recognition Conditions

65. To qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in the *Public Benefit Entities' Conceptual Framework* at the acquisition date, and be capable of being measured in a way that achieves the qualitative characteristics and takes account of constraints on information in general purpose financial reporting. For example, costs the acquirer expects but is not obliged to incur in the future to effect its plan to exit an activity of an acquired operation or to terminate the employment of or relocate an acquired operation's employees are not liabilities at the acquisition date. Therefore, the acquirer does not recognise those costs as part of applying the acquisition method. Instead, the acquirer recognises those costs in its post-combination financial statements in accordance with other PBE Standards.

66. In addition, to qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must be part of what the acquirer and the acquired operation (or its former owners) exchanged in the acquisition transaction rather than the result of separate transactions. The acquirer shall apply the guidance in paragraphs 109–111 to determine which assets acquired or liabilities assumed are part of the exchange for the acquired operation and which, if any, are the result of separate transactions to be accounted for in accordance with their nature and the applicable PBE Standards.

67. The acquirer's application of the recognition principle and conditions may result in recognising some assets and liabilities that the acquired operation had not previously recognised as assets and liabilities in its financial statements. For example, the acquirer recognises the acquired identifiable intangible assets, such as a patent or a customer relationship, that the acquired operation did not recognise as assets in its financial statements because it developed them internally and charged the related costs to expense.

68. Paragraphs AG72–AG84 provide guidance on recognising operating leases and intangible assets. Paragraphs 76–82 specify the types of identifiable assets and liabilities that include items for which this Standard provides limited exceptions to the recognition principle and conditions.

Classifying or Designating Identifiable Assets Acquired and Liabilities Assumed in an Acquisition

69. **At the acquisition date, the acquirer shall classify or designate the identifiable assets acquired and liabilities assumed as necessary to subsequently apply other PBE Standards. The acquirer shall make those classifications or designations on the basis of the terms of the binding arrangement (including contractual terms), economic conditions, its operating or accounting policies and other pertinent conditions as they exist at the acquisition date.**

70. In some situations, PBE Standards provide for different accounting depending on how an entity classifies or designates a particular asset or liability. Examples of classifications or designations that the acquirer shall make on the basis of the pertinent conditions as they exist at the acquisition date include but are not limited to:

(a) Classification of particular financial assets and liabilities as measured at fair value or at amortised cost, in accordance with PBE IPSAS 29;[6]

(b) Designation of a derivative instrument as a hedging instrument in accordance with PBE IPSAS 29; and

(c) Assessment of whether an embedded derivative should be separated from a host contract in accordance with PBE IPSAS 29 (which is a matter of 'classification' as this Standard uses that term).

71. This Standard provides two exceptions to the principle in paragraph 69:

(a) Classification of a lease arrangement as either an operating lease or a finance lease in accordance with PBE IPSAS 13 *Leases*; and

(b) Classification of a contract as an insurance contract in accordance with PBE IFRS 4 *Insurance Contracts*~~the relevant international or national accounting standard dealing with insurance contracts~~.

The acquirer shall classify those binding arrangements on the basis of the terms and other factors at the inception of the binding arrangement (or, if the terms of the binding arrangement have been modified in a manner that would change its classification, at the date of that modification, which might be the acquisition date).

Measurement Principle

72. **The acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values.**

73. For each acquisition, the acquirer shall measure at the acquisition date components of non-controlling interests in the acquired operation that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation at either:

[6] If an entity applies this Standard and early adopts PBE IFRS 9 *Financial Instruments*, the references to PBE IPSAS 29 in this paragraph shall be read as references to PBE IFRS 9.

(a) Fair value; or

(b) The present ownership instruments' proportionate share in the recognised amounts of the acquired operation's identifiable net assets.

All other components of non-controlling interests shall be measured at their acquisition-date fair values, unless another measurement basis is required by PBE Standards.

74. Paragraphs 78–84 specify the types of identifiable assets and liabilities that include items for which this Standard provides limited exceptions to the measurement principle.

Exceptions to the Recognition or Measurement Principles

75. This Standard provides limited exceptions to its recognition and measurement principles. Paragraphs 76–84 specify both the particular items for which exceptions are provided and the nature of those exceptions. The acquirer shall account for those items by applying the requirements in paragraphs 76–84, which will result in some items being:

(a) Recognised either by applying recognition conditions in addition to those in paragraphs 65–66 or by applying the requirements of other PBE Standards, with results that differ from applying the recognition principle and conditions.

(b) Measured at an amount other than their acquisition-date fair values.

Exception to the Recognition Principle

Contingent Liabilities

76. PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*, defines a contingent liability as:

(a) A possible obligation that arises from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or

(b) A present obligation that arises from past events, but is not recognised because:

(i) It is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; or

(ii) The amount of the obligation cannot be measured with sufficient reliability.

77. The requirements in PBE IPSAS 19 do not apply in determining which contingent liabilities to recognise as of the acquisition date. Instead, the acquirer shall recognise as of the acquisition date a contingent liability assumed in an acquisition where consideration is transferred if it is a present obligation that arises from past events and its fair value can be measured reliably[7]. Therefore, contrary to PBE IPSAS 19, the acquirer recognises a contingent liability assumed in an acquisition where consideration is transferred at the acquisition date even if it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation. Paragraph 115 provides guidance on the subsequent accounting for contingent liabilities.

Exceptions to both the Recognition and Measurement Principles

Income Taxes (where Included in the Terms of the Acquisition)

78. Acquisitions by a public sector entity may result in a tax authority forgiving amounts of tax due as part of the terms of the acquisition. The acquirer shall not recognise any taxation items that are forgiven as a result of the terms of the acquisition (paragraphs AG85 and ~~–~~AG87 provide related application guidance).

79. [Not used] ~~The acquirer shall recognise and measure any remaining taxation items included in or arising from an acquisition in accordance with the relevant international or national accounting standard dealing with income taxes. The acquirer entity shall recognise and measure any remaining revenue from taxation included in or arising from an acquisition in accordance with IPSAS 23.~~

[7] Information that is reliable is free from material error and bias, and can be depended on by users to faithfully represent that which it purports to represent or could reasonably be expected to represent. Paragraph BC10 of PBE IPSAS 1 discusses the transitional approach to the explanation of reliability.

79.1 The acquirer shall recognise and measure a deferred tax asset or liability arising from the assets acquired and liabilities assumed in a PBE combination in accordance with PBE IAS 12.

79.2 The acquirer shall account for the potential tax effects of temporary differences and carryforwards of the acquired operation that exist at the acquisition date or arise as a result of the acquisition in accordance with PBE IAS 12.

Employee Benefits

80. The acquirer shall recognise and measure a liability (or asset, if any) related to the acquired operation's employee benefit arrangements in accordance with PBE IPSAS 39.

Indemnification Assets

81. The seller in an acquisition may contractually indemnify the acquirer for the outcome of a contingency or uncertainty related to all or part of a specific asset or liability. For example, the seller may indemnify the acquirer against losses above a specified amount on a liability arising from a particular contingency; in other words, the seller will guarantee that the acquirer's liability will not exceed a specified amount. As a result, the acquirer obtains an indemnification asset. The acquirer shall recognise an indemnification asset at the same time that it recognises the indemnified item measured on the same basis as the indemnified item, subject to the need for a valuation allowance for uncollectible amounts. Therefore, if the indemnification relates to an asset or a liability that is recognised at the acquisition date and measured at its acquisition-date fair value, the acquirer shall recognise the indemnification asset at the acquisition date measured at its acquisition-date fair value. For an indemnification asset measured at fair value, the effects of uncertainty about future cash flows because of collectibility considerations are included in the fair value measure and a separate valuation allowance is not necessary (paragraph AG88 provides related application guidance).

82. In some circumstances, the indemnification may relate to an asset or a liability that is an exception to the recognition or measurement principles. For example, an indemnification may relate to a contingent liability that is not recognised at the acquisition date because its fair value is not reliably measurable at that date. Alternatively, an indemnification may relate to an asset or a liability, for example, one that results from an employee benefit, that is measured on a basis other than acquisition-date fair value. In those circumstances, the indemnification asset shall be recognised and measured using assumptions consistent with those used to measure the indemnified item, subject to management's assessment of the collectibility of the indemnification asset and any contractual limitations on the indemnified amount. Paragraph 116 provides guidance on the subsequent accounting for an indemnification asset.

Exceptions to the Measurement Principle

Reacquired Rights

83. The acquirer shall measure the value of a reacquired right recognised as an intangible asset on the basis of the remaining term of the related binding arrangement regardless of whether market participants would consider potential renewals of binding arrangements when measuring its fair value. Paragraphs AG79–AG80 provide related application guidance.

Share-Based Payment Transactions

84. The acquirer shall measure a liability or an equity instrument related to share-based payment transactions of the acquired operation or the replacement of an acquired operation's share-based payment transactions with share-based payment transactions of the acquirer in accordance with the relevant international or national accounting standard dealing with share-based payments.

Assets Held for Sale

84.1 The acquirer shall measure an acquired non-current asset (or disposal group) that is classified as held for sale at the acquisition date in accordance with PBE IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* at fair value less costs to sell in accordance with paragraphs 15–18 of that Standard.

Recognising and Measuring Goodwill or a Gain from a Bargain Purchase

85. **The acquirer shall recognise goodwill as of the acquisition date measured as the excess of (a) over (b) below, subject to the requirements of paragraph 86:**

(a) **The aggregate of:**

(i) **The consideration transferred measured in accordance with this Standard, which generally requires acquisition-date fair value (see paragraph 95);**

(ii) **The amount of any non-controlling interest in the acquired operation measured in accordance with this Standard; and**

(iii) **In an acquisition achieved in stages (see paragraphs 99–100), the acquisition-date fair value of the acquirer's previously held equity interest in the acquired operation.**

(b) **The net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with this Standard.**

86. **The acquirer shall recognise goodwill only to the extent that ~~the acquisition will result in~~:**

(a) **The acquisition will result in the generation of net cash inflows ~~(such as the acquisition of a cash-generating operation)~~; and~~/or~~**

(b) **The goodwill arises from the acquisition of a cash-generating operation ~~A reduction in the net cash outflows of the acquirer~~.**

An acquirer shall recognise any further excess of (a) over (b) in paragraph 85 above as a loss in surplus or deficit. Paragraph AG93 provides related application guidance.

87. In an acquisition in which the acquirer and the acquired operation (or its former owners) exchange only equity interests, the acquisition-date fair value of the acquired operation's equity interests may be more reliably measurable than the acquisition-date fair value of the acquirer's equity interests. If so, the acquirer shall determine the amount of goodwill by using the acquisition-date fair value of the acquired operation's equity interests instead of the acquisition-date fair value of the equity interests transferred. To determine the amount of goodwill in an acquisition in which no consideration is transferred in those situations covered in paragraphs 101 and 102, the acquirer shall use the acquisition-date fair value of the acquirer's interest in the acquired operation in place of the acquisition-date fair value of the consideration transferred (paragraph 85(a)(i)). Paragraphs AG94–AG97 provide~~s~~ related application guidance.

Bargain Purchases

88. Occasionally in a PBE ~~public sector~~ combination classified as an acquisition, an acquirer will make a bargain purchase, which is an acquisition in which the amount in paragraph 85(b) exceeds the aggregate of the amounts specified in paragraph 85(a). If that excess remains after applying the requirements in paragraph 90, the acquirer shall recognise the resulting gain in surplus or deficit on the acquisition date. The gain shall be attributed to the acquirer.

89. A bargain purchase might happen, for example, in an acquisition that is a forced sale in which the seller is acting under economic compulsion. However, the recognition or measurement exceptions for particular items discussed in paragraphs 76–84 may also result in recognising a gain (or change the amount of a recognised gain) on a bargain purchase.

90. Before recognising a gain on a bargain purchase, the acquirer shall reassess whether it has correctly identified all of the assets acquired and all of the liabilities assumed and shall recognise any additional assets or liabilities that are identified in that review. The acquirer shall then review the procedures used to measure the amounts this Standard requires to be recognised at the acquisition date for all of the following:

(a) The identifiable assets acquired and liabilities assumed;

(b) The non-controlling interest in the acquired operation, if any;

(c) For an acquisition achieved in stages, the acquirer's previously held equity interest in the acquired operation; and

(d) The consideration transferred.

The objective of the review is to ensure that the measurements appropriately reflect consideration of all available information as of the acquisition date.

91. In the public and not-for-profit sectors, an entity sometimes obtains control of an operation in a non-exchange transaction in which it transfers consideration that is not approximately equal to the fair value of the acquired operation. Such circumstances include, but are not limited to:

(a) Compensated seizures of operations or entities; and

(b) The transfer of an operation to the acquirer by a donor for nominal consideration.

92. Where the economic substance of the PBE~~public sector~~ combination is that of an acquisition, such non-exchange acquisitions are treated as bargain purchases and accounted for in accordance with paragraphs 88–90.

A Non-Exchange Acquisition without the Transfer of Consideration

93. In the public and not-for-profit sectors, an entity sometimes obtains control of an operation in a non-exchange transaction in which it transfers no consideration. Such circumstances include, but are not limited to:

(a) Uncompensated seizures of operations or entities (also known as forced nationalisations).

(b) The transfer of an operation to the entity by a donor for no consideration. Such transfers may take the form of a bequest.

And

(c) The transfer of an operation to the entity where the operation has net liabilities. The entity may accept the transfer of net liabilities to prevent the cessation of the operation. Such transactions are sometimes known as "bailouts".

94. Where the economic substance of the PBE~~public sector~~ combination is that of an acquisition, the acquirer that obtains control of an acquired operation in a non-exchange transaction in which it transfers no consideration does not recognise goodwill. The acquirer recognises a gain or a loss in surplus or deficit~~, in accordance with paragraph 86~~.

Consideration Transferred

95. The consideration transferred in an acquisition shall be measured at fair value, which shall be calculated as the sum of the acquisition-date fair values of the assets transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquired operation and the equity interests issued by the acquirer. (However, any portion of the acquirer's share-based payment awards exchanged for awards held by the acquired operation's employees that is included in consideration transferred in the acquisition shall be measured in accordance with paragraph 84 rather than at fair value.) Examples of potential forms of consideration include cash, other assets, an operation or a controlled entity of the acquirer, contingent consideration, ordinary or preference equity instruments, options, warrants and member interests of mutual entities.

96. The consideration transferred may include assets or liabilities of the acquirer that have carrying amounts that differ from their fair values at the acquisition date (for example, non-monetary assets or an operation of the acquirer). If so, the acquirer shall remeasure the transferred assets or liabilities to their fair values as of the acquisition date and recognise the resulting gains or losses, if any, in surplus or deficit. However, sometimes the transferred assets or liabilities remain within the combined entity after the acquisition (for example, because the assets or liabilities were transferred to the acquired operation rather than to its former owners), and the acquirer therefore retains control of them. In that situation, the acquirer shall measure those assets and liabilities at their carrying amounts immediately before the acquisition date and shall not recognise a gain or loss in surplus or deficit on assets or liabilities it controls both before and after the acquisition.

Contingent Consideration

97. The consideration the acquirer transfers in exchange for the acquired operation includes any asset or liability resulting from a contingent consideration arrangement (see paragraph 95). The acquirer shall recognise the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquired operation.

98. The acquirer shall classify an obligation to pay contingent consideration that meets the definition of a financial instrument as a financial liability or as a component of net assets/equity on the basis of the definitions of an equity instrument and a financial liability in paragraph 9 of PBE IPSAS 28. The acquirer shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met. Paragraph 117 provides guidance on the subsequent accounting for contingent consideration.

An Acquisition Achieved in Stages

99. An acquirer sometimes obtains control of an acquired operation in which it held an equity interest immediately before the acquisition date. For example, on 31 December 20X1, Entity A holds a 35 percent non-controlling equity interest in Entity B. On that date, Entity A purchases an additional 40 percent interest in Entity B, which gives it control of Entity B. This Standard refers to such a transaction as an acquisition achieved in stages, sometimes also referred to as a step acquisition.

100. In an acquisition achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquired operation at its acquisition-date fair value and recognise the resulting gain or loss, if any, in surplus or deficit or in ~~net assets/equity~~other comprehensive revenue and expense, as appropriate. In prior reporting periods, the acquirer may have recognised changes in the value of its equity interest in the acquired operation in ~~net assets/equity~~other comprehensive revenue and expense (for example, because the investment was classified as available for sale). If so, the amount that was recognised in ~~net assets/equity~~other comprehensive revenue and expense shall be recognised on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest.

100A. When a party to a joint arrangement (as defined in PBE IPSAS 37 *Joint Arrangements*) obtains control of an operation that is a joint operation (as defined in PBE IPSAS 37), and had rights to the assets and obligations for the liabilities relating to that joint operation immediately before the acquisition date, the transaction is an acquisition achieved in stages. The acquirer shall therefore apply the requirements for an acquisition achieved in stages, including remeasuring its previously held interest in the joint operation in the manner described in paragraph 100. In doing so, the acquirer shall remeasure its entire previously held interest in the joint operation.[8]

Additional Guidance for Applying the Acquisition Method where an Acquisition is Achieved Through Changes in Voting Rights, by Contract Alone, and Similar Circumstances in which no Consideration is Transferred

An Acquisition Achieved Through Changes in Voting Rights, by Contract Alone, and Similar Circumstances not Involving the Transfer of Consideration

101. An acquirer sometimes obtains control of an acquired operation without transferring consideration. The acquisition method of accounting for an acquisition applies to those PBE~~public sector~~ combinations. Such circumstances include:

    (a) The acquired operation repurchases a sufficient number of its own shares for an existing investor (the acquirer) to obtain control.

    (b) Minority veto rights lapse that previously kept the acquirer from controlling an acquired operation in which the acquirer held the majority voting rights.

    (c) The acquirer and acquired operation agree to combine their operations by contract alone. The acquirer transfers no consideration in exchange for control of an acquired operation and holds no equity ~~quantifiable ownership~~ interests in the acquired operation, either on the acquisition date or previously.

102. In an acquisition achieved by contract alone, the acquirer shall attribute to the owners of the acquired operation the amount of the acquired operation's net assets recognised in accordance with this Standard. In other words, the equity ~~quantifiable ownership~~ interests in the acquired operation held by parties other than the acquirer are a non-controlling interest in the acquirer's post-combination financial statements even if the result is that all of the equity ~~quantifiable ownership~~ interests in the acquired operation are attributed to the non-controlling interest.

Measurement Period

103. **If the initial accounting for an acquisition is incomplete by the end of the reporting period in which the acquisition occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognised at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date and, if**

[8] Paragraph 100A aligns with proposed amendments to PBE IFRS 3 *Business Combinations* (see NZASB ED 2018-3 *2018 Omnibus Amendments to PBE Standards*) and IPSAS 40 (see IPSASB ED 65 *Improvements to IPSAS, 2018*).

known, would have affected the measurement of the amounts recognised as of that date. During the measurement period, the acquirer shall also recognise additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date and, if known, would have resulted in the recognition of those assets and liabilities as of that date. The measurement period ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable. However, the measurement period shall not exceed one year from the acquisition date.

104. The measurement period is the period after the acquisition date during which the acquirer may adjust the provisional amounts recognised for an acquisition. The measurement period provides the acquirer with a reasonable time to obtain the information necessary to identify and measure the following as of the acquisition date in accordance with the requirements of this Standard:

(a) The identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquired operation;

(b) The consideration transferred for the acquired operation (or the other amount used in measuring goodwill);

(c) In an acquisition achieved in stages, the equity interest in the acquired operation previously held by the acquirer; and

(d) The resulting goodwill, loss, or gain on a bargain purchase.

105. The acquirer shall consider all pertinent factors in determining whether information obtained after the acquisition date should result in an adjustment to the provisional amounts recognised or whether that information results from events that occurred after the acquisition date. Pertinent factors include the date when additional information is obtained and whether the acquirer can identify a reason for a change to provisional amounts. Information that is obtained shortly after the acquisition date is more likely to reflect circumstances that existed at the acquisition date than is information obtained several months later. For example, unless an intervening event that changed its fair value can be identified, the sale of an asset to a third party shortly after the acquisition date for an amount that differs significantly from its provisional fair value measured at that date is likely to indicate an error in the provisional amount.

106. The acquirer recognises an increase (decrease) in the provisional amount recognised for an identifiable asset (liability) by means of a decrease (increase) in goodwill, subject to the requirements for recognition of goodwill in paragraph 86. However, new information obtained during the measurement period may sometimes result in an adjustment to the provisional amount of more than one asset or liability. For example, the acquirer might have assumed a liability to pay damages related to an accident in one of the acquired operation's facilities, part or all of which is~~are~~ covered by the acquired operation's liability insurance policy. If the acquirer obtains new information during the measurement period about the acquisition-date fair value of that liability, the adjustment to goodwill resulting from a change to the provisional amount recognised for the liability would be offset (in whole or in part) by a corresponding adjustment to goodwill resulting from a change to the provisional amount recognised for the claim receivable from the insurer.

107. During the measurement period, the acquirer shall recognise adjustments to the provisional amounts as if the accounting for the acquisition had been completed at the acquisition date. Thus, the acquirer shall revise comparative information for prior periods presented in financial statements as needed, including making any change in depreciation, amortisation or other income effects recognised in completing the initial accounting.

108. After the measurement period ends, the acquirer shall revise the accounting for an acquisition only to correct an error in accordance with PBE IPSAS 3.

Determining what is Part of the Acquisition Transaction

109. **The acquirer and the acquired operation may have a pre-existing relationship or other arrangement before negotiations for the acquisition began, or they may enter into an arrangement during the negotiations that is separate from the acquisition. In either situation, the acquirer shall identify any amounts that are not part of what the acquirer and the acquired operation (or its former owners) exchanged in the acquisition, i.e., amounts that are not part of the exchange for the acquired operation. The acquirer shall recognise as part of applying the acquisition method only the consideration transferred for the acquired operation and the assets acquired and liabilities assumed**

in the exchange for the acquired operation. Separate transactions shall be accounted for in accordance with the relevant PBE Standards.

110. A transaction entered into by or on behalf of the acquirer or primarily for the benefit of the acquirer or the combined entity, rather than primarily for the benefit of the acquired operation (or its former owners) before the acquisition, is likely to be a separate transaction. The following are examples of separate transactions that are not to be included in applying the acquisition method:

(a) A transaction that in effect settles pre-existing relationships between the acquirer and acquired operation;

(b) A transaction that remunerates employees or former owners of the acquired operation for future services; and

(c) A transaction that reimburses the acquired operation or its former owners for paying the acquirer's acquisition-related costs.

Paragraphs AG99–AG106 provide related application guidance.

Acquisition-Related Costs

111. Acquisition-related costs are costs the acquirer incurs to effect an acquisition. Those costs include finder's fees; advisory, legal, accounting, valuation and other professional or consulting fees; general administrative costs, including the costs of maintaining an internal acquisitions department; and costs of registering and issuing debt and equity securities. The acquirer shall account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception. The costs to issue debt or equity securities shall be recognised in accordance with PBE IPSAS 28 and PBE IPSAS 29.[9]

Subsequent Measurement and Accounting

112. **In general, an acquirer shall subsequently measure and account for assets acquired, liabilities assumed or incurred and equity instruments issued in an acquisition in accordance with other applicable PBE Standards for those items, depending on their nature. However, this Standard provides guidance on subsequently measuring and accounting for the following assets acquired, liabilities assumed or incurred and equity instruments issued in an acquisition:**

(a) **Reacquired rights;**

(b) **Contingent liabilities recognised as of the acquisition date;**

(c) **Indemnification assets;**

(d) **Contingent consideration; and**

(e) **Income taxes (where not included in the terms of the acquisition).**

Paragraphs AG107–AG108 provide related application guidance.

Reacquired Rights

113. A reacquired right recognised as an intangible asset shall be amortised over the remaining period of the binding arrangement in which the right was granted, where the right was granted for a finite period. Where the right was granted for an indefinite period, the resulting entity shall test the right for impairment at least annually, and whenever there is an indication that the right may be impaired. An acquirer that subsequently sells a reacquired right to a third party shall include the carrying amount of the intangible asset in determining the gain or loss on the sale.

Transfers, Concessionary Loans and Similar Benefits Received by an Acquirer or Acquired Operation on the Basis of Criteria that may Change as a Result of an Acquisition

114. A transfer, concessionary loan or similar benefit, previously received by an acquirer or an acquired operation on the basis of criteria that change as a result of an acquisition, shall be reassessed prospectively in accordance with other PBE Standards (paragraphs AG109–AG111 provide related application guidance).

[9] If an entity applies this Standard and early adopts PBE IFRS 9 *Financial Instruments*, the references to PBE IPSAS 29 in this paragraph shall be read as references to PBE IFRS 9.

Contingent Liabilities

115. After initial recognition and until the liability is settled, cancelled or expires, the acquirer shall measure a contingent liability recognised in an acquisition at the higher of:

(a) The amount that would be recognised in accordance with PBE IPSAS 19; and

(b) The amount initially recognised less, if appropriate, cumulative amortisation recognised in accordance with PBE IPSAS 9 *Revenue from Exchange Transactions*.

This requirement does not apply to contracts accounted for in accordance with PBE IPSAS 29.[10]

Indemnification Assets

116. At the end of each subsequent reporting period, the acquirer shall measure an indemnification asset that was recognised at the acquisition date on the same basis as the indemnified liability or asset, subject to any contractual limitations on its amount and, for an indemnification asset that is not subsequently measured at its fair value, management's assessment of the collectibility of the indemnification asset. The acquirer shall derecognise the indemnification asset only when it collects the asset, sells it or otherwise loses the right to it.

Contingent Consideration

117. Some changes in the fair value of contingent consideration that the acquirer recognises after the acquisition date may be the result of additional information that the acquirer obtained after that date about facts and circumstances that existed at the acquisition date. Such changes are measurement period adjustments in accordance with paragraphs 103–107. However, changes resulting from events after the acquisition date, such as meeting an earnings target, reaching a specified share price or reaching a milestone on a research and development project, are not measurement period adjustments. The acquirer shall account for changes in the fair value of contingent consideration that are not measurement period adjustments as follows:

(a) Contingent consideration classified as a component of net assets/equity shall not be remeasured and its subsequent settlement shall be accounted for within net assets/equity.

(b) Other contingent consideration that:

(i) Is within the scope of PBE IPSAS 29[11] shall be measured at fair value at each reporting date and changes in fair value shall be recognised in surplus or deficit in accordance with PBE IPSAS 29.

(ii) Is not within the scope of PBE IPSAS 29 shall be measured at fair value at each reporting date and changes in fair value shall be recognised in surplus or deficit.

Income Taxes (where not Included in the Terms of the Acquisition)

118. Acquisitions involving public sector entities may result in a tax authority forgiving amounts of tax subsequent to the acquisition. The acquirer shall account for the tax forgiven prospectively in accordance with PBE IAS 12 ~~the relevant international or national accounting standard dealing with income taxes~~.

Disclosures

*119. **The acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of an acquisition that occurs either:**

(a) **During the current reporting period; or**

(b) **After the end of the reporting period but before the financial statements are authorised for issue.**

RDR 119.1 A Tier 2 entity is required to comply with the disclosures in paragraphs 120–124 that are not asterisked (*) as RDR concessions.

[10] If an entity applies this Standard and early adopts PBE IFRS 9 *Financial Instruments*, the references to PBE IPSAS 29 in this paragraph shall be read as references to PBE IFRS 9.

[11] If an entity applies this Standard and early adopts PBE IFRS 9 *Financial Instruments*, the references to PBE IPSAS 29 in this paragraph shall be read as references to PBE IFRS 9.

120. To meet the objective in paragraph 119, the acquirer shall disclose the following information for each acquisition that occurs during the reporting period:

(a) The name and a description of the acquired operation.

(b) The acquisition date.

(c) The percentage of voting equity interests or equivalent acquired.

*(d) The primary reasons for the acquisition and a description of how the acquirer obtained control of the acquired operation including, where applicable, the legal basis for the acquisition.

*(e) A qualitative description of the factors that make up the goodwill recognised, such as expected synergies from combining the operations of the acquired operation and the acquirer, intangible assets that do not qualify for separate recognition or other factors.

(f) The acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration, such as:

(i) Cash;

(ii) Other tangible or intangible assets, including an operation or controlled entity of the acquirer;

(iii) Liabilities incurred, for example, a liability for contingent consideration; and

(iv) Equity interests of the acquirer, including the number of instruments or interests issued or issuable and the method of measuring the fair value of those instruments or interests.

(g) For contingent consideration arrangements and indemnification assets:

(i) The amount recognised as of the acquisition date;

(ii) A description of the arrangement and the basis for determining the amount of the payment; and

(iii) An estimate of the range of outcomes (undiscounted) or, if a range cannot be estimated, that fact and the reasons why a range cannot be estimated. If the maximum amount of the payment is unlimited, the acquirer shall disclose that fact.

*(h) For acquired receivables:

(i) The fair value of the receivables;

(ii) The gross amounts receivable in accordance with a binding arrangement; and

(iii) The best estimate at the acquisition date of the cash flows in accordance with a binding arrangement not expected to be collected.

The disclosures shall be provided by major class of receivable, such as loans, direct finance leases and any other class of receivables.

(i) The amounts recognised as of the acquisition date for each major class of assets acquired and liabilities assumed.

(j) For each contingent liability recognised in accordance with paragraph 77, the information required in paragraph 98 of PBE IPSAS 19. If a contingent liability is not recognised because its fair value cannot be measured reliably, the acquirer shall disclose:

*(i) The information required by paragraph 100 of PBE IPSAS 19; and

*(ii) The reasons why the liability cannot be measured reliably.

*(k) The total amount of goodwill that is expected to be deductible for tax purposes.

*(l) For transactions that are recognised separately from the acquisition of assets and assumption of liabilities in the acquisition in accordance with paragraph 109:

(i) A description of each transaction;

(ii) How the acquirer accounted for each transaction;

(iii) The amounts recognised for each transaction and the line item in the financial statements in which each amount is recognised; and

(iv) If the transaction is the effective settlement of a pre-existing relationship, the method used to determine the settlement amount.

*(m) The disclosure of separately recognised transactions required by (l) shall include the amount of acquisition-related costs and, separately, the amount of those costs recognised as an expense and the line item or items in the statement of ~~financial performance~~ comprehensive revenue and expense in which those expenses are recognised. The amount of any issue costs not recognised as an expense and how they were recognised shall also be disclosed.

(n) In an acquisition in which a loss is recognised in surplus or deficit (see paragraph 86):

(i) The amount of the loss recognised in accordance with paragraph 86 and the line item in the statement of ~~financial performance~~ comprehensive revenue and expense in which the loss is recognised; and

*(ii) A description of the reasons why the transaction resulted in a loss.

(o) In a bargain purchase (see paragraphs 88–90):

(i) The amount of any gain recognised in accordance with paragraph 88 and the line item in the statement of ~~financial performance~~ comprehensive revenue and expense in which the gain is recognised; and

*(ii) A description of the reasons why the transaction resulted in a gain.

(p) For each acquisition in which the acquirer holds less than 100 percent of the equity ~~quantifiable ownership~~ interests or equivalent in the acquired operation at the acquisition date:

(i) The amount of the non-controlling interest in the acquired operation recognised at the acquisition date and the measurement basis for that amount; and

(ii) For each non-controlling interest in an acquired operation measured at fair value, the valuation technique(s) and significant inputs used to measure that value.

(q) In an acquisition achieved in stages:

(i) The acquisition-date fair value of the equity interest in the acquired operation held by the acquirer immediately before the acquisition date; and

(ii) The amount of any gain or loss recognised as a result of remeasuring to fair value the equity interest in the acquired operation held by the acquirer before the acquisition (see paragraph 100) and the line item in the statement of ~~financial performance~~ comprehensive revenue and expense in which that gain or loss is recognised.

*(r) The following information:

(i) The amounts of revenue and expense, and the surplus or deficit of the acquired operation since the acquisition date included in the consolidated statement of ~~financial performance~~ comprehensive revenue and expense for the reporting period; and

(ii) The revenue and expense, and the surplus or deficit of the combined entity for the current reporting period as though the acquisition date for all acquisitions that occurred during the year had been as of the beginning of the annual reporting period.

If disclosure of any of the information required by this subparagraph is impracticable, the acquirer shall disclose that fact and explain why the disclosure is impracticable. This Standard uses the term 'impracticable' with the same meaning as in PBE IPSAS 3.

RDR 120.1 A Tier 2 entity is not required to make the disclosures required by paragraph 120(j)(i) and (ii) if a contingent liability is not recognised in accordance with paragraph 77 because its fair value cannot be measured reliably.

*121. For individually immaterial acquisitions occurring during the reporting period that are material collectively, the acquirer shall disclose in aggregate the information required by paragraph 120(e)–(r).

RDR 121.1 For individually immaterial acquisitions occurring during the reporting period that are material collectively, a Tier 2 acquirer shall disclose in aggregate the information required by paragraphs 120(f), 120(g), 120(i), 120(n)(i), 120(o)(i), 120(p)(i), 120(q) and the first sentence of paragraph 120(j).

*122. If the acquisition date of an acquisition is after the end of the reporting period but before the financial statements are authorised for issue, the acquirer shall disclose the information required by paragraph 120 unless the initial accounting for the acquisition is incomplete at the time the financial statements are authorised for issue. In that situation, the acquirer shall describe which disclosures could not be made and the reasons why they cannot be made.

*123. **The acquirer shall disclose information that enables users of its financial statements to evaluate the financial effects of adjustments recognised in the current reporting period that relate to acquisitions that occurred in the period or previous reporting periods.**

124. To meet the objective in paragraph 123, the acquirer shall disclose the following information for each material acquisition or in the aggregate for individually immaterial acquisitions that are material collectively:

*(a) If the initial accounting for an acquisition is incomplete (see paragraph 103) for particular assets, liabilities, non-controlling interests or items of consideration and the amounts recognised in the financial statements for the acquisition thus have been determined only provisionally:

(i) The reasons why the initial accounting for the acquisition is incomplete;

(ii) The assets, liabilities, equity ~~quantifiable ownership~~ interests (or equivalent) or items of consideration for which the initial accounting is incomplete; and

(iii) The nature and amount of any measurement period adjustments recognised during the reporting period in accordance with paragraph 107.

*(b) For each reporting period after the acquisition date until the entity collects, sells or otherwise loses the right to a contingent consideration asset, or until the entity settles a contingent consideration liability or the liability is cancelled or expires:

(i) Any changes in the recognised amounts, including any differences arising upon settlement;

(ii) Any changes in the range of outcomes (undiscounted) and the reasons for those changes; and

(iii) The valuation techniques and key model inputs used to measure contingent consideration.

*(c) For contingent liabilities recognised in an acquisition, the acquirer shall disclose the information required by paragraphs 97 and 98 of PBE IPSAS 19 for each class of provision.[12]

(d) A reconciliation of the carrying amount of goodwill at the beginning and end of the reporting period showing separately:

(i) The gross amount and accumulated impairment losses at the beginning of the reporting period.

(ii) Additional goodwill recognised during the reporting period, except goodwill included in a disposal group that, on acquisition, meets the criteria to be classified as held for sale in accordance with PBE IFRS 5.

(iii) Adjustments resulting from the subsequent recognition of amounts during the reporting period in accordance with PBE IAS 12~~the relevant international or national accounting standard dealing with income taxes~~.

(iv) Goodwill included in a disposal group classified as held for sale in accordance with PBE IFRS 5 and g~~G~~oodwill derecognised during the reporting period without having previously been included in a disposal group classified as held for sale.

(v) Impairment losses recognised during the reporting period in accordance with PBE IPSAS 26 *Impairment of Cash-Generating Assets*. (PBE IPSAS 26 requires disclosure of information about the recoverable amount and impairment of goodwill in addition to this requirement.)

(vi) Net exchange rate differences arising during the reporting period in accordance with PBE IPSAS 4 *The Effects of Changes in Foreign Exchange Rates*.

(vii) Any other changes in the carrying amount during the reporting period.

(viii) The gross amount and accumulated impairment losses at the end of the reporting period.

[12] See PBE IPSAS 19 paragraph 97 for disclosure concessions for Tier 2 entities.

*(e) The amount and an explanation of any gain or loss recognised in the current reporting period that both:

(i) Relates to the identifiable assets acquired or liabilities assumed in an acquisition that was effected in the current or previous reporting period; and

(ii) Is of such a size, nature or incidence that disclosure is relevant to understanding the combined entity's financial statements.

And

(f) If amounts of tax due are forgiven as a result of the terms of the acquisition (see paragraphs 78~~–79~~):

(i) The amount of tax due that was forgiven; and

(ii) Where the acquirer is the tax authority, details of the adjustment made to tax receivable.

RDR 124.1 A Tier 2 entity is not required to disclose the reconciliation specified in paragraph 124(d) for prior periods.

*125. If the specific disclosures required by this and other PBE Standards do not meet the objectives set out in paragraphs 119 and 123, the acquirer shall disclose whatever additional information is necessary to meet those objectives.

Transitional Provisions

125.1 Except as provided in paragraph 125.3, this Standard shall be applied prospectively to PBE combinations for which the amalgamation date or acquisition date is on or after [date].

125.2 Except as provided in paragraph 125.3, an entity shall not restate PBE combinations that occurred from any date before the effective date in paragraph 126.1.

Limited Retrospective Application

125.3 An entity is permitted to apply the requirements of this Standard to PBE combinations that occurred before the effective date in paragraph 126.1, provided that on first-time application of this Standard it is also a first-time adopter of PBE Standards and has adopted PBE FRS 47 *First-time Adoption of PBE Standards by Entities Other Than Those Previously Applying NZ IFRS.*

Effective Date and Transition

Effective Date

126. [Not used]~~This Standard shall be applied prospectively to public sector combinations for which the amalgamation date or acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2019. Earlier application is encouraged. If an entity applies this Standard before January 1, 2019, it shall disclose that fact~~.

126.1 A public benefit entity shall apply this Standard for annual financial statements covering periods beginning on or after [date]. Earlier application is permitted. If a public benefit entity applies this Standard for a period beginning before [date], it shall disclose that fact.

Transition

127–134. [Not used] ~~Assets and liabilities that arose from public sector combinations whose acquisition dates or amalgamation dates preceded the application of this Standard shall not be adjusted upon application of this Standard.~~

~~128. Contingent consideration balances arising from acquisitions whose acquisition dates preceded the date when an entity first applied this Standard shall not be adjusted upon first application of this Standard. Paragraphs 129–132 shall be applied in the subsequent accounting for those balances. Paragraphs 129–132 shall not apply to the accounting for contingent consideration balances arising from acquisitions with acquisition dates on or after the date when the entity first applied this Standard. In paragraphs 129–132 acquisitions refers exclusively to acquisitions whose acquisition date preceded the application of this Standard.~~

~~129. If an acquisition agreement provides for an adjustment to the cost of the acquisition contingent on future events, the acquirer shall include the amount of that adjustment in the cost of the acquisition at the acquisition date if the adjustment is probable and can be measured reliably.~~

~~130. An acquisition agreement may allow for adjustments to the cost of the acquisition that are contingent on one or more future events. The adjustment might, for example, be contingent on a specified level of profit being maintained or achieved in future periods, or on the market price of the instruments issued being maintained. It is usually possible to estimate the amount of any such adjustment at the time of initially accounting for the acquisition without impairing the reliability of the information, even though some uncertainty exists. If the future events do not occur or the estimate needs to be revised, the cost of the acquisition shall be adjusted accordingly.~~

~~131. However, when an acquisition agreement provides for such an adjustment, that adjustment is not included in the cost of the acquisition at the time of initially accounting for the acquisition if it either is not probable or cannot be measured reliably. If that adjustment subsequently becomes probable and can be measured reliably, the additional consideration shall be treated as an adjustment to the cost of the acquisition.~~

~~132. In some circumstances, the acquirer may be required to make a subsequent payment to the seller as compensation for a reduction in the value of the assets given, equity instruments issued or liabilities incurred or assumed by the acquirer in exchange for control of the acquired operation. This is the case, for example, when the acquirer guarantees the market price of equity or debt instruments issued as part of the cost of the acquisition and is required to issue additional equity or debt instruments to restore the originally determined cost. In such cases, no increase in the cost of the acquisition is recognised. In the case of equity instruments, the fair value of the additional payment is offset by an equal reduction in the value attributed to the instruments initially issued. In the case of debt instruments, the additional payment is regarded as a reduction in the premium or an increase in the discount on the initial issue.~~

~~133. An entity, such as a mutual entity, that has not yet applied this Standard and had one or more public sector combinations that were accounted for using the purchase method (which involves the amortisation of goodwill) shall apply the transition provisions in paragraphs AG114–AG115.~~

~~*Income Taxes*~~

~~134. For public sector combinations in which the acquisition date or amalgamation date was before this Standard is applied, the acquirer or resulting entity shall apply the requirements of the relevant international or national accounting standard dealing with income taxes prospectively. From the date when this Standard is applied, the acquirer or resulting entity shall recognise any changes required by the relevant international or national accounting standard dealing with income taxes as an adjustment to surplus or deficit (or, if required by the relevant international or national accounting standard dealing with income taxes, outside surplus or deficit).~~

Withdrawal and Replacement of PBE IFRS 3 (2014)

134.1 This Standard supersedes PBE IFRS 3 *Business Combinations* (2014). PBE IFRS 3 remains applicable until PBE IPSAS 40 is applied or becomes effective, whichever is earlier.

Appendix A

Application Guidance

This Appendix is an integral part of PBE IPSAS 40

Definitions (see paragraph 5)

AG1. [Not used] ~~Paragraph 5 of this Standard defines a resulting entity as "the entity that is the result of two or more operations combining in an amalgamation." A resulting entity is not initially a party to the public sector combination. A resulting entity may have the legal form of a new entity, or may retain the legal identity of one of the combining operations. However, a resulting entity usually has the economic substance of a new entity. In a combination in which one party to the combination gains control of one or more operations, and in which the economic substance is that of an amalgamation, the nature of the combination is usually that the resulting entity has the substance of a new entity.~~

Identifying a PBE ~~public sector~~ Combination (see paragraph 6)

AG2. Paragraph 5 ~~of this Standard~~ defines a PBE ~~public sector~~ combination as "the bringing together of separate operations into one public benefit entity ~~public sector entity~~." The reference to one public benefit entity ~~public sector entity~~ may be to a single entity or to an economic entity. Some public sector or not-for-profit sector reorganisations may involve more than one entity~~public sector~~ combination. The circumstances in which a PBE ~~public sector~~ combination might occur include:

(a) By mutual agreement; and

(b) By compulsion (for example by legislation).

AG3. Paragraph 5 ~~of this Standard~~ defines an operation as "an integrated set of activities and related assets and/or liabilities that is capable of being conducted and managed for the purpose of achieving an entity's objectives, by providing goods and/or services."

AG4. An operation consists of inputs and processes applied to those inputs that have the ability to create outputs. Although operations usually have outputs, outputs are not required for an integrated set of activities and related assets and/or liabilities to qualify as an operation. For the purposes of this standard, the three elements of an operation are defined as follows:

(a) **Input**: Any economic resource that creates, or has the ability to create, outputs when one or more processes are applied to it. Examples include non-current assets (including intangible assets or rights to use non-current assets), intellectual property, the ability to obtain access to necessary materials or rights and employees.

(b) **Process**: Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates or has the ability to create outputs. Examples include strategic management processes, operational processes and resource management processes. These processes typically are documented, but an organised workforce having the necessary skills and experience following rules and conventions may provide the necessary processes that are capable of being applied to inputs to create outputs. (Accounting, billing, payroll and other administrative systems typically are not processes used to create outputs.)

(c) **Output**: The result of inputs and processes applied to those inputs that provide, or have the ability to provide a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants. Outputs may also be in the form of goods and services for community or social benefit~~, goods and/or services~~.

AG5. To be capable of being conducted and managed for the purposes defined, an integrated set of activities and assets and/or liabilities requires two essential elements—inputs and processes applied to those inputs, which together are or will be used to create outputs. However, an operation need not include all of the inputs or processes that the transferor used in operating that operation if the entity that receives the operation or operations is capable of continuing to produce outputs, for example, by integrating the operation with its own inputs and processes.

AG6. The nature of the elements of an operation varies by sector and by the structure of an entity's operations (activities), including the entity's stage of development. Established operations often have many different types of inputs, processes and outputs, whereas new operations often have few inputs and processes and sometimes only a single output (product). Nearly all operations also have liabilities, but an operation need not have liabilities.

AG7. An integrated set of activities and assets and/or liabilities in the development stage might not have outputs. In these cases, the entity that receives the operation should consider other factors to determine whether the set is an operation. Those factors include, but are not limited to, whether the set:

(a) Has begun planned principal activities;

(b) Has employees, intellectual property and other inputs and processes that could be applied to those inputs;

(c) Is pursuing a plan to produce outputs; and

(d) Will be able to obtain access to service recipients that will receive the outputs.

Not all of those factors need to be present for a particular integrated set of activities and assets and/or liabilities in the development stage to qualify as an operation.

AG8. Determining whether a particular set of activities and assets and/or liabilities is an operation should be based on whether the integrated set is capable of being conducted and managed as an operation by another entity. Thus, in evaluating whether a particular set is an operation, it is not relevant whether a transferor operated the set as an operation or whether the acquirer intends to operate the set as an operation.

AG9. In the absence of evidence to the contrary, a particular set of activities and assets and/or liabilities in which goodwill is present shall be presumed to be an operation. However, an operation need not have goodwill.

Classification of PBE~~public sector~~ Combinations (see paragraphs 7–14)

Assessment of Control (see paragraphs 7–8)

AG10. Where a party to a PBE ~~public sector~~ combination gain controls of one or more operations as a result of that combination, the combination is classified as either an amalgamation or an acquisition, depending on the economic substance of the combination. If no party to the combination gains control, the combination is classified as an amalgamation. In making this assessment the first step is to determine whether one of the entities that existed prior to the PBE ~~public sector~~ combination has gained control of one or more operations. Because this determination is made by reference to the entities that existed prior to the PBE ~~public sector~~ combination, it differs from the assessment of control made in accordance with PBE IPSAS 35 *Consolidated Financial Statements*,[13] where the assessment of control is made by reference to the entities that exist after a PBE ~~public sector~~ combination has taken place.

AG11. In determining whether one party to a PBE ~~public sector~~ combination gains control of one or more operations as a result of the combination, an entity applies the principles and guidance in PBE IPSAS 35. In applying the principles and guidance, references to "an entity controls" are read as "an entity gains control of" and references to "another entity" are read as "an operation". For example, in determining whether one party to a PBE ~~public sector~~ combination gains control of one or more operations as a result of the combination for the purposes of this Standard, paragraph 20 of PBE IPSAS 35 should be read as follows (amended text is shown in italics):

> Thus, an entity *gains control of an operation* if and only if the entity *gains* all the following:
>
> (a) Power over the operation (see paragraphs 23–29);
>
> (b) Exposure, or rights, to variable benefits from its involvement with the operation (see paragraphs 30–34); and
>
> (c) The ability to use its power over the operation to affect the nature or amount of the benefits from its involvement with the operation (see paragraphs 35–37).

[13] If an entity applies this Standard before it applies PBE IPSAS 35 *Consolidated Financial Statements*, any reference to PBE IPSAS 35 shall be read as a references to PBE IPSAS 6 *Consolidated and Separate Financial Statements* (PS) or PBE IPSAS 6 *Consolidated and Separate Financial Statements* (NFP).

AG12. In applying the principles and guidance in PBE IPSAS 35, an entity has regard to paragraphs AG13–AG18.

AG13. A PBE ~~public sector~~ combination effected primarily by the transfer of consideration (i.e., by transferring cash or other assets or by incurring liabilities) usually results in one entity gaining control of one or more operations.

AG14. A PBE ~~public sector~~ combination effected primarily by exchanging equity interests usually results in one entity gaining control of one or more operations. Combinations involving an exchange of equity interests usually results in one entity having sufficient voting rights to gain control of one or more operations. This may occur without the entity having a majority of the voting rights where the entity has a large minority voting interest and no other owner or organised group of owners has a significant voting interest. Other pertinent facts and circumstances shall also be considered in assessing whether one entity (and, if so, which entity) has gained control of one or more operations, including:

(a) The composition of the governing body of the combined operation – The acquirer is usually the combining operation whose owners have the ability to elect a majority of the members of the governing body of the combined operations.

(b) The composition of the senior management of the combined operation – The acquirer is usually the combining operation whose (former) management dominates the management of the combined operations.

AG15. A PBE ~~public sector~~ combination involving the issuance of equity interests may give rise to a reverse acquisition (see paragraphs AG66–AG71). An entity considers this possibility in determining whether one party to a PBE ~~public sector~~ combination gains control of operations.

AG16. In a PBE ~~public sector~~ combination involving more than two entities, the party to the PBE ~~public sector~~ combination that initiates the combination (if any) is more likely to gain control of operations than the other parties to the combination.

AG17. In a PBE ~~public sector~~ combination in which a new entity is formed to effect the combination, but the combination is not effected by exchanging equity interests (see paragraph AG14), that new entity may gain control of operations only where it ~~the entity~~ exists prior to the combination taking place. Where this new entity does not exist prior to the combination taking place, an entity considers other pertinent facts and circumstances (see paragraph AG14) in deciding whether one of the parties to the combination that existed prior to the combination taking place gains control of operations.

AG17.1 A PBE combination in which operations not under common control voluntarily agree to combine could be classified as either an amalgamation or an acquisition. The operations could combine to improve services to their recipients or to reduce operating costs. In this type of combination, if the combining operations are ~~may be~~ uniting rather than one party gaining control of the other party, this could be classified as an amalgamation. This type of combination is more frequent in the not-for-profit sector than the public sector.

AG18. If the application of this guidance identifies one party to the combination as gaining control of one or more operations, the combination is classified as either an amalgamation or an acquisition, depending on the economic substance of the combination. An entity considers the guidance in paragraphs 9–14 and AG19–AG50 to determine whether the economic substance of the combination is that of an amalgamation. If the application of the guidance does not identify one party to the combination as gaining control of one or more operations, the combination shall be classified as an amalgamation.

Assessment of the Classification of a ~~-~~ PBE~~public sector~~ Combination (see paragraphs 9–14)

AG19. If one party to a PBE ~~public sector~~ combination gains control of one or more operations as a result of the combination, the combination shall be classified as either an amalgamation or an acquisition, depending on the economic substance of the combination. In assessing whether the economic substance of the combination is that of an amalgamation, an entity considers the economic substance of the PBE~~public sector~~ combination and the indicators in paragraphs 12–14. A combination that does not have the economic substance of an amalgamation shall be classified as an acquisition. In making this assessment, an entity considers the following guidance.

Economic Substance (see paragraph 9)

AG20. Usually, an analysis of the indicators in paragraphs 12–13, individually or on combination, will produce a conclusive result and provide sufficient evidence to determine whether the economic substance of the combination is that of an amalgamation. A combination does not need to satisfy both of these indicators to be classified as an amalgamation.

AG21. Where consideration of the indicators in paragraphs 12–13 produces inconclusive results or does not provide sufficient evidence to clearly determine the economic substance of the combination, an entity considers the additional matters in paragraph 14.

AG22. [Not used]~~The economic substance of an amalgamation is usually that a new entity is formed, irrespective of the legal form of the resulting entity. This applies equally to a combination in which one party to the combination gains control of one or more operations. If the economic substance of a public sector combination is that one of the parties to the combination continues to exist, this may provide evidence that the economic substance of the combination is that of an acquisition. In combinations of operations under common control, the fact that the ultimate controlling entity controls the operations both before and after the combination reduces the significance of this factor.~~

AG23. An amalgamation involves the integration of the operations that are part of the PBE ~~public sector~~ combination. Generally~~In other words~~, an amalgamation does not give rise to a controlling entity/controlled entity relationship between parties to a combination. If, following the combination, any of the operations operate as controlled entities of a party to the combination, this may provide evidence that the economic substance of the combination is that of an acquisition. However, there could be circumstances where a controlling entity/controlled entity relationship between parties to a combination remains after the combination. For example, there could be legal, tax or administrative reasons for leaving the existing operations of the combining operations within their respective existing legal entity structure, which could entail establishing a controlled entity/controlling entity structure as part of the combination, but that outcome does not necessarily mean that the economic substance of the combination is an acquisition.

AG24. An acquisition is usually a mutual agreement between two or more parties, and usually has commercial substance. However, it is possible for an acquisition to occur without mutual agreement (for example, a forced nationalisation). ~~in the public sector, a party to the combination may be able to impose a public sector combination on the other party to the combination~~. ~~Where this results in the entity gaining access to economic benefits or service potential that are similar to those that could have been obtained by mutual agreement, it is probable that the economic substance of the public sector combination is that of an acquisition. For example, a central government may centralize a service for which it had been providing funding, by requiring local government entities to transfer operations to the central government in order to achieve economies of scale. Where the entity does not gain access to economic benefits or service potential that are similar to those that could have been obtained in a voluntary transaction, it is probable that the economic substance of the public sector combination is that of an amalgamation.~~

AG25. [Not used] ~~Where, after consideration of the indicators and the nature of the public sector combination, there is insufficient evidence that the public sector combination has the economic substance of an amalgamation, the combination shall be classified as an acquisition.~~

Indicator~~s~~ Relating to Consideration (see paragraph 12)

AG26. Amalgamations usually do not involve the payment of consideration to compensate a seller for giving up its~~their~~ entitlement to the net assets of an operation. By contrast, acquisitions usually involve an exchange of consideration between those gaining control of the operations and those losing control of the operations.

AG27. However, there may be a number of reasons why consideration is either paid or not paid. In assessing the impact of consideration on the classification of a combination as an acquisition or an amalgamation, it is necessary to consider those reasons. ~~The payment of consideration that is intended to compensate those with an entitlement to the net assets of the transferred operation for giving up that entitlement provides evidence that the economic substance of the public sector combination is an acquisition. In such cases, the combination is classified as an acquisition.~~

AG28. The payment of consideration to compensate those with an entitlement to the net assets of the transferred operation for giving up that entitlement provides evidence that the economic substance of the PBE combination is an acquisition. In such cases, the combination is classified as an acquisition. If ~~The payment of~~ consideration ~~that is not intended~~is paid for reasons other than to compensate the seller for giving up its~~their~~ entitlement to the net assets of an operation, ~~but is,~~ (for example, ~~intended~~ to reimburse the~~m~~ seller for costs incurred in effecting the PBE ~~public sector~~ combination), this may provide evidence that the economic substance of the combination is that of an amalgamation.

AG29. ~~Acquisitions may occur without an exchange of consideration, for example where an individual bequeaths an operation to a government entity. Consequently,~~ T~~t~~he absence of consideration does not in itself provide evidence of the economic substance of the PBE~~public sector~~ combination. Acquisitions may occur without an exchange of consideration. If those with an entitlement to the net assets of an operation have voluntarily given up their entitlement in order to donate the net assets of the operation to an unrelated entity (for example, an individual bequeaths an operation to a government entity) this would suggest that the combination is an acquisition. If those with an entitlement to the net assets of an operation have their entitlement extinguished through compulsion (for example, in an uncompensated seizure by a public sector entity), this would suggest that the combination is an acquisition. ~~In assessing consideration, an entity also considers the reasons why consideration was either paid or not paid.~~

AG30. ~~Where a public sector combination does not include the payment of consideration, an entity considers the reasons why no consideration has been paid.~~ In contrast, if there was no compensation paid because the combining operations are under common control and hence no compensation is necessary, this would suggest that the combination is an amalgamation. Similarly, in a combination that occurs as part of a local government reorganisation, the payment of compensation may not be necessary because the citizens served by the combining operations will continue to be served by the combined operations, which would suggest that the combination is an amalgamation. ~~If the former owner has given up their entitlement to the net assets of an operation, or has had their entitlement extinguished through compulsion (for example, in an uncompensated seizure), there may be evidence that the combination is an acquisition.~~

AG31. [Not used]~~Where a public sector combination does not include the payment of consideration because there is no party with an entitlement to the net assets of an operation, the economic substance of the combination will usually be that of an amalgamation. An acquisition involves a transfer of an operation from its former owner to its new owner. If there is no party with an entitlement to the net assets of an operation, there is no former owner, and the combination is usually not an acquisition. This scenario will only arise where a complete entity is being transferred; where an individual operation is being transferred, the entity transferring the operation will be the former owner and will be entitled to the net assets of the operation. Examples of entities where there will be no former owner(s) include municipalities and some not-for-profit organisations.~~

Indicators Relating to the Decision-Making Process (see paragraph 13)

AG32. An acquisition usually requires the voluntary participation of all the parties to the combination. Consequently, where a PBE ~~public sector~~ combination is imposed by a third party without any party to the combination being involved in the decision-making process, this may provide evidence that the economic substance of the combination is an amalgamation.

AG33. In other circumstances, the parties to the PBE~~public sector~~ combination will be able to influence the terms of the combination to different degrees even when the combination is imposed by a third party. As the degree of influence the parties to the combination have increases, particularly the influence of the party that gains control of one or more operations, it becomes less likely that a conclusion regarding the economic substance of the combination can be drawn.

AG34. For example, the parties to the combination may be directed to combine by a regulator, but the regulator allows the parties to determine the terms of the combination. The economic substance of this PBE~~public sector~~ combination is likely to be determined by the terms of the combination agreed by the parties rather than by the decision of the regulator that the parties must combine.

AG35. Where the party to the PBE~~public sector~~ combination that gains control of one or more operations is able to impose the combination on the other party, this does not provide evidence that the economic substance of the combination is that of an amalgamation. For example, a government may decide to nationalise a private sector entity, contrary to the wishes of the shareholders. The fact that the government (a party to the combination) is able to impose the nationalisation, for example through legislation, does not provide evidence that the economic substance of the combination is an amalgamation. Where the party to the combination that gains control of one or more operations is able to impose the combination on the other party, this provides evidence that the economic substance of the combination is that of an acquisition.

AG36. Where a PBE ~~public sector~~ combination is subject to approval by each party's citizens through referenda, this may provide evidence that the economic substance of the combination is that of an amalgamation. Such a requirement provides evidence that the parties to the combination do not have freedom to voluntarily effect the combination and that the ultimate decision as to whether the combination takes place is taken by third parties. However, it is possible for citizens to approve, through referenda, a combination whose terms are those of an acquisition.

AG37. Where a PBE ~~public sector~~ combination takes place between two parties that are under common control, this may provide evidence that the economic substance of the combination is that of an amalgamation. PBE~~Public sector~~ combinations under common control are often instigated by and on behalf of the controlling entity, and the controlling entity will often determine the terms of the combination. For example, a government may decide to combine two ministries for administrative or political reasons, and specify the terms of the combination. In such circumstances, the ultimate decision as to whether the combination takes place, and the terms of the combination, are determined by the controlling entity. This provides evidence that the economic substance of the combination is an amalgamation.

AG38. In some circumstances, two operations under common control may agree to combine voluntarily. However, this decision will usually be subject to the approval of the controlling entity, whether this approval is given explicitly or not. Where the approval of the controlling entity is required, this provides evidence that the ultimate decision as to whether the combination takes place, and the terms of the combination, are determined by the controlling entity. Consequently, this provides evidence that the economic substance of the combination is that of an amalgamation.

AG39. Only where there is no evidence that the controlling entity is involved in the PBE~~public sector~~ combination, either by instigating the combination, determining the terms of the combination, or approving (whether explicitly or implicitly) the combination, will there be no evidence that the economic substance of the combination is that of an amalgamation. In such circumstances, the entity considers all other factors in determining the classification of the PBE~~public sector~~ combination.

Additional Matters to be Considered where the Indicators Relating to Consideration and the Decision-Making Process do not Provide Sufficient Evidence to Determine whether the Economic Substance of the Combination is that of an Amalgamation (see paragraph 14)

AG40. Where an analysis of the indicators relating to consideration and the decision-making process produces inconclusive results or does not provide sufficient evidence to determine whether the economic substance of the combination is that of an amalgamation, an entity considers which classification and resulting accounting treatment would provide information that:

(a) Best meets the objectives of financial reporting; and

(b) Best satisfies the qualitative characteristics (QCs).

AG41. An analysis of the indicators relating to consideration and the decision-making process will usually produce a conclusive result and provide sufficient evidence to determine whether the economic substance of the combination is that of an amalgamation. This is because the indicators relating to consideration and the decision-making process will provide evidence of the economic substance of a PBE~~public sector~~ combination in all but exceptional circumstances. As a result, where it is clear that the indicators have been met, the additional matters set out in paragraph 14 are not considered in determining the classification.

AG42. Where an analysis of the indicators relating to consideration and the decision-making process provides inconclusive results or does not provide sufficient evidence to determine whether the economic substance of the combination is that of an amalgamation, an entity considers which classification would provide information that best meets the objectives of financial reporting. The determination of whether a PBE ~~public sector~~ combination is classified as an acquisition or an amalgamation can significantly affect the financial reporting of the combination. Consequently, it is important to consider the information each method provides and the principal users of that information.

AG43. The modified pooling of interests method views the combination from the perspective of each of the combining operations ~~entities~~ and their owners or constituents who are uniting their interests in the resulting entity. Using the modified pooling of interests method of accounting, the combining operations measure the reported assets and liabilities at their carrying amounts in the financial statements of the combining operations as of the amalgamation date. Such information may assist users in assessing the performance of the resulting entity based upon the combined historical assets and liabilities of the combining operations at the date of the amalgamation and in comparing operating results with prior periods. However, this comparability may be reduced where adjustments to achieve consistent accounting policies are required. ~~It does not include information about the market's expectation of the value of the future cash flows associated with assets and liabilities, other than assets and liabilities recorded at fair value prior to the date of the amalgamation.~~

AG44. The acquisition method views a combination from the perspective of the acquirer—the entity that gains control of the other operations. The acquirer purchases or otherwise gains control over net assets and recognises in its financial statements the assets acquired and liabilities assumed, including those not previously recognised by the acquired operation. Such information assists users of the financial statements in assessing the initial investments made, where paid, and the subsequent performance of those investments and comparing them with the performance of other entities based on the investment made by the acquirer. ~~It also includes information about the market's expectation of the value of the future cash flows associated with those assets and liabilities.~~ While it revalues the assets and liabilities of the acquired operation, it does not affect the valuation of assets and liabilities held by the acquirer prior to the acquisition. Further, depending on the relationship between the amounts in paragraph 85(a) and 85(b) and other factors (for example, a bargain purchase), it may result in the immediate recognition of a gain or loss through surplus or deficit.

AG45. The information provided by each approach is summarised in the following table.

	Amalgamation	**Acquisition**
Perspective	Perspective of each of the combining operations and their owners or constituents.	Perspective of the acquirer.
User information	Assists users of the financial statements in assessing the performance of the resulting entity based upon the combined historical assets and liabilities of the combining operations at the date of the amalgamation and in comparing operating results with prior periods.	Assists users of the financial statements in assessing the initial investments made, where paid, and the subsequent performance of those investments.
Basis of reported values	Measures the reported assets and liabilities at their carrying amounts in the financial statements of the combining operations as of the amalgamation date.	Revalues the identifiable assets and liabilities of the acquired operation but does not affect the valuation of assets and liabilities held by the acquirer. ~~Includes information about the market's expectation of the value of the future cash flows associated with those assets and liabilities.~~
Ability to compare to operating results of prior periods	May facilitate the comparison of operating results with prior periods. Comparability may be reduced where adjustments to achieve consistent accounting policies are required.	Difficult to compare operating results with prior periods.

AG46. Consideration of which classification would provide information that best meets the objectives of financial reporting provides evidence of the economic substance of the PBE~~public sector~~ combination where an analysis of the indicators relating to consideration and the decision-making process provides inconclusive results or does not provide sufficient evidence to determine whether the economic substance of the combination is that of an amalgamation.

AG47. Where an analysis of the indicators relating to consideration and the decision-making process provides inconclusive results or does not provide sufficient evidence to determine the classification of the combination, an entity considers which classification would provide information that best satisfies the QCs of relevance, faithful representation, understandability, timeliness, comparability and verifiability. In making this assessment, an entity also considers the constraints on information included in general purpose financial reports, which are materiality, cost-benefit and the balance between the QCs.

AG48. When considering the classification of a PBE ~~public sector~~ combination, some QCs will be more significant than others. For example, timeliness will be less significant than understandability when considering whether a combination is an amalgamation or an acquisition.

AG49. An entity considers the QCs and the constraints on information from the perspective of the users of the financial statements. This will include consideration of the following questions; this list is not exhaustive.

(a) Which classification most faithfully represents the economic substance of the PBE~~public sector~~ combination, which may be different from its legal form? Does that classification faithfully represent an entity's financial performance and financial position?

(b) Which classification will help users understand the nature of the PBE~~public sector~~ combination? For example, in an amalgamation, any difference between the total recognised assets and total recognised liabilities is recognised in net assets/equity, whereas in an acquisition, the acquirer recognises goodwill, or a gain or loss in the reporting period. Which approach best helps the user to understand the nature of the combination?

(c) Users' needs are best served when the information provided in respect of a transaction is comparable. How are similar PBE~~public sector~~ combinations classified?

AG50. Consideration of which classification would provide information that best meets the QCs provides evidence of the economic substance of the PBE~~public sector~~ combination where an analysis of the indicators relating to consideration and the decision-making process provides inconclusive results or does not provide sufficient evidence to determine whether the economic substance of the combination is that of an amalgamation.

Accounting for Amalgamations

Combining Operations that Have not Previously Applied PBE Standards (see paragraph 20.1)

AG50.1 Where the resulting entity is a continuing reporting entity and has previously applied PBE Standards prior to the amalgamation but one or more of the combining operations have not previously applied PBE Standards prior to the amalgamation, the resulting entity shall:

(a) Prepare an opening statement of financial position as at the amalgamation date (this shall be the date of transition to PBE Standards) in accordance with paragraphs 10–23 of PBE FRS 47 *First-time Adoption of PBE Standards by Entities Other Than Those Previously Applying NZ IFRS* for each of the combining operations that have not previously applied PBE Standards; and

(b) Use the same accounting policies for those combining operations as are already being applied by the continuing reporting entity.

After preparing the combining operations' statements of financial position the resulting entity shall then apply the requirements in paragraphs 21–35.

AG50.2 Where the resulting entity is a new reporting entity and one or more of the combining operations have not previously applied PBE Standards prior to the amalgamation, the resulting entity shall:

(a) Apply XRB A1 *Application of the Accounting Standards Framework* to determine the appropriate tier of reporting for the resulting entity. It shall not apply the requirements for moving between tiers in XRB A1 as it was not in existence as a reporting entity prior to the amalgamation;

(b) Prepare an opening statement of financial position as at the amalgamation date (this shall be the date of transition to PBE Standards) in accordance with paragraphs 10–23 of PBE FRS 47 for each of the combining operations that have not previously applied PBE Standards; and

(c) Use the same accounting policies as were previously used by those combining operations that have previously applied PBE Standards.

After preparing the combining operations' statements of financial position the resulting entity shall then apply the requirements in paragraphs 21–35.

Eliminating Transactions Between the Combining Operations (see paragraph 22)

AG51. A resulting entity eliminates the effects of all transactions between the combining operations. For many transactions, elimination will take place automatically. For example, one combining operation provided services for a fee to another combining operation prior to the amalgamation date. The revenue of the combining operation that provided the services is reflected in that combining operation's ~~accumulated surplus or deficit~~accumulated comprehensive revenue and expense at the amalgamation date. The expense of the combining operation receiving the services is reflected in that combining operation's ~~accumulated surplus or deficit~~accumulated comprehensive revenue and expense at the amalgamation date. The resulting entity will recognise both amounts in net assets/equity.

AG52. Elimination may not take place automatically where one combining operation has recognised an asset, and another combining operation has recognised a corresponding liability as a result of the transaction between two combining operations. The resulting entity eliminates both the asset and the liability, and recognises any difference between the asset and liability in net assets/equity.

Carrying Amounts to be Used (see paragraphs 26–27)

AG53. [Not used] ~~Where a combining operation has previously been acquired in an acquisition (i.e., it was previously an acquired operation), the carrying amounts of the combining operation's assets and liabilities in its separate financial statements may be different to the carrying amounts of those assets and liabilities in the controlling entity's financial statements. In an acquisition, the controlling entity would measure the combining operation's assets and liabilities at their fair value. However, where the combining operation (i.e., the previously acquired operation) continues to prepare separate financial statements, it would use its previous carrying amounts. The fair value measurements in the financial statements of the controlling entity are not pushed down to the combining operation.~~

AG54. To meet the requirements in paragraphs 26–27, a resulting entity measures the ~~identifiable~~ assets and liabilities of the combining operations at their carrying amounts in the financial statements of the combining operations as of the amalgamation date, subject to the requirement to adjust the carrying amounts to conform to the resulting entity's accounting policies. ~~The resulting entity does not measure the assets and liabilities at the carrying amounts in the financial statements of the controlling entity.~~

Accounting Policies to be Used (see paragraph 28)

AG54.1 Where the resulting entity is a new reporting entity and the combining operations have applied different accounting policies for similar transactions and events, the resulting entity shall select the accounting policies that result in the financial statements providing the most relevant and faithfully representative information, subject to the requirements in paragraphs 31–35. If a resulting entity has transactions, other events or conditions that differ in substance from those previously occurring, that did not previously occur, or that were previously immaterial, it shall select or develop accounting policies in accordance with PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors*.

AG54.2 Where the resulting entity is a continuing reporting entity, it shall continue to apply its previous accounting policies to transactions and events, subject to the requirements in paragraphs 31–35. There are some limited circumstances in which a resulting entity that is a continuing reporting entity may need to apply PBE IPSAS 3 in preparing its first set of financial statements following the amalgamation. These include:

(a) The identification of a prior period error, in which case PBE IPSAS 3 (paragraphs 46–54) applies; or

(b) The resulting entity voluntarily changes an accounting policy, including the selection of a different option permitted under PBE Standards, in which case PBE IPSAS 3 (paragraphs 17–34) applies; or

(c) The resulting entity will have transactions, other events or conditions that differ in substance from those previously occurring, that did not previously occur, or that were previously immaterial, in which case PBE IPSAS 3 (paragraphs 9–15) applies.

Licences and Similar Rights Previously Granted by One Combining Operation to Another Combining Operation (see paragraph 32)

AG55. As part of an amalgamation, a resulting entity may receive a licence or similar right that had previously been granted by one combining operation to another combining operation to use one or more of the grantor's recognised or unrecognised assets. Examples of such rights include a right to use the acquirer's technology under a technology licencing agreement. The resulting entity recognises this licence or similar right as an identifiable intangible asset, and measures the intangible asset at its carrying amount in the financial statements of the combining operation as of the amalgamation date. Because the licence or similar right has previously been part of a binding arrangement, the licence satisfies both the separability and binding arrangement criteria in PBE IPSAS 31 *Intangible Assets*. Paragraph 47 provides guidance on the subsequent accounting for a licence or similar right previously granted by one combining operation to another combining operation.

AG56. The resulting entity assesses both the licence or similar right previously granted by one combining operation to another combining operation, and the underlying asset (where the underlying asset is a recognised asset) for impairment in accordance with PBE IPSAS 21 *Impairment of Non-Cash-Generating Assets* and/or PBE IPSAS 26 *Impairment of Cash-Generating Assets*, at the amalgamation date.

Forgiveness of Amounts of Tax Due in an Amalgamation (where Included in the Terms of the Amalgamation) (see paragraph~~s~~ 33~~–34~~)

AG57. The resulting entity shall not recognise any amounts in respect of a combining operation's tax due where these amounts have been forgiven by a tax authority as part of the terms of the amalgamation. Where tax forgiveness occurs subsequent to an amalgamation, the resulting entity applies the requirements in paragraph 49. In applying the modified pooling of interests method of accounting, the resulting entity shall treat those amounts included in the terms of the amalgamation as having been derecognised prior to the amalgamation. The resulting entity shall account for a combining operation's tax due that has not been forgiven by a tax authority in accordance with PBE IAS 12~~the relevant international or national accounting standard dealing with income taxes~~.

AG58. [Not used] ~~Where, as a result of the amalgamation, the resulting entity becomes the tax authority, it shall derecognise any tax receivable relating to the combining operation's tax due that has been forgiven in accordance with PBE IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)*.~~

Recognition of Goodwill (see paragraph 36)

AG59. Amalgamations do not give rise to goodwill, and consequently a resulting entity does not recognise goodwill arising from an amalgamation. Paragraphs 37–38 specify the treatment of the net assets/equity arising as a result of the amalgamation.

AG60. Where a combining operation has previously recognised goodwill as a result of a previous acquisition, the resulting entity recognises this goodwill in its opening statement of financial position.

Subsequent Measurement of Transfers, Concessionary Loans and Similar Benefits Received by a Combining Operation on the Basis of Criteria that may Change as a Result of an Amalgamation (see paragraph 48)

AG61. Prior to an amalgamation taking place, a combining operation may receive a transfer from a third party, based on specified criteria. For example, a national government may provide grants to those municipalities where the average household income is below a threshold. An amalgamation of two municipalities may involve one municipality which met the criteria and received the grant, and one municipality which did not meet the criteria and which did not receive the grant. Following the amalgamation, the average household income of the new, combined municipality will either be above or below the threshold, which may cause the grantor to reassess the amount of grant given.

AG62. The resulting entity shall not account for any revisions to the grant amount as part of the amalgamation, but shall account for any revisions at the point the grantor makes its intentions known in accordance with other PBE Standards.

AG63. Similar circumstances may arise in respect of concessionary loans and other benefits. The resulting entity shall not account for any revisions to those transactions as part of the amalgamation, but shall account for any revisions at the point the grantor makes its intentions known in accordance with other PBE Standards.

Amalgamations Occurring During a Reporting Period (see paragraphs 50–52)

AG64. To meet the requirements of paragraphs 50–52, the resulting entity is not required to present financial statements of the combining operations for periods prior to the amalgamation date, although it may elect to do so by making the disclosures specified in paragraph 54(g). Where the resulting entity does not elect to present financial statements of the combining operations for periods prior to the amalgamation date, it meets the needs of the users of its financial statements for information about the combining operations prior to the amalgamation ~~by~~ in one of two ways:

(a) Directing the users of its financial statements to the financial statements issued on behalf of each of the combining operations. This is appropriate w~~W~~here financial statements have been issued on behalf of the combining operations for a reporting period ending immediately prior to the amalgamation date (which may be a partial period)~~, directing the users of its financial statements to the financial statements issued on behalf of the combining operations~~.

(b) Making the disclosures required by paragraph 54(h) in respect of each of the combining operations. This is appropriate w~~W~~here no financial statements have been issued on behalf of the combining operations for a reporting period ending immediately prior to the amalgamation date (which may be a partial period)~~, making the disclosures required by paragraph 54(h)~~.

AG65. [Not used] ~~To satisfy the requirements of a regulator, it may be necessary for the combining operations and/or the resulting entity to present or disclose information in addition to that required by this Standard.~~

Accounting for Acquisitions

Reverse Acquisitions

AG66. A reverse acquisition occurs when the entity that issues securities (the legal acquirer) is identified as the acquired operation for accounting purposes on the basis of the guidance in paragraphs AG10–AG18. The entity whose equity interests are acquired (the legal acquired operation) must be the acquirer for accounting purposes for the transaction to be considered a reverse acquisition. For example, reverse acquisitions sometimes occur when an unlisted ~~public sector~~ entity wants to become a listed entity but does not want to register its equity shares. To accomplish that, the unlisted ~~public sector~~ entity will arrange for a listed entity to acquire its equity interests in exchange for the equity interests of the listed entity. In this example, the listed entity is the legal acquirer because it issued its equity interests, and the unlisted ~~public sector~~ entity is the legal acquired operation because its equity interests were acquired. However, application of the guidance in paragraphs AG10–AG18 results in identifying:

(a) The listed entity as the acquired operation for accounting purposes (the accounting acquired operation)–i.e., the listed entity does not gain control of one or more operations; and

(b) The unlisted ~~public sector~~ entity as the acquirer for accounting purposes (the accounting acquirer)–i.e., the unlisted ~~public sector~~ entity does gain control of one or more operations.

The accounting acquired operation must meet the definition of an operation for the transaction to be accounted for as a reverse acquisition, and all of the recognition and measurement principles in this Standard, including the requirement to recognise goodwill, apply.

Measuring the Consideration Transferred

AG67. In a reverse acquisition, the accounting acquirer usually issues no consideration for the acquired operation. Instead, the accounting acquired operation usually issues its equity shares to the owners of the accounting acquirer. Accordingly, the acquisition-date fair value of the consideration transferred by the accounting acquirer for its interest in the accounting acquired operation is based on the number of equity interests the legal controlled entity would have had to issue to give the owners of the legal controlling entity the same percentage equity interest in the combined entity that results from the reverse acquisition. The fair value of the number of equity interests calculated in that way can be used as the fair value of consideration transferred in exchange for the acquired operation.

Preparation and Presentation of Consolidated Financial Statements

AG68. Consolidated financial statements prepared following a reverse acquisition are issued under the name of the legal controlling entity (accounting acquired operation) but described in the notes as a continuation of the financial statements of the legal controlled entity (accounting acquirer), with one adjustment, which is to adjust retroactively the accounting acquirer's legal capital to reflect the legal capital of the accounting acquired operation. That adjustment is required to reflect the capital of the legal controlling entity (the accounting acquired operation). Comparative information presented in those consolidated financial statements also is retroactively adjusted to reflect the legal capital of the legal controlling entity (accounting acquired operation).

AG69. Because the consolidated financial statements represent the continuation of the financial statements of the legal controlled entity except for its capital structure, the consolidated financial statements reflect:

(a) The assets and liabilities of the legal controlled entity (the accounting acquirer) recognised and measured at their pre-combination carrying amounts.

(b) The assets and liabilities of the legal controlling entity (the accounting acquired operation) recognised and measured in accordance with this Standard.

(c) The ~~accumulated surplus or deficit~~accumulated comprehensive revenue and expense and other equity balances of the legal controlled entity (accounting acquirer) before the acquisition.

(d) The amount recognised as issued equity interests in the consolidated financial statements determined by adding the issued equity interest of the legal controlled entity (the accounting acquirer) outstanding immediately before the acquisition to the fair value of the legal controlling entity (accounting acquired operation). However, the equity structure (i.e., the number and type of equity interests issued) reflects the equity structure of the legal controlling entity (the accounting acquired operation), including the equity interests the legal controlling entity issued to effect the acquisition. Accordingly, the equity structure of the legal controlled entity (the accounting acquirer) is restated using the exchange ratio established in the acquisition agreement to reflect the number of shares of the legal controlling entity (the accounting acquired operation) issued in the reverse acquisition.

(e) The non-controlling interest's proportionate share of the legal controlled entity's (accounting acquirer's) pre-acquisition carrying amounts of accumulated comprehensive revenue and expense ~~retained earnings~~ and other equity interests as discussed in paragraphs AG70 and AG71.

Non-Controlling Interest

AG70. In a reverse acquisition, some of the owners of the legal acquired operation (the accounting acquirer) might not exchange their equity interests for equity interests of the legal controlling entity (the accounting acquired operation). Those owners are treated as a non-controlling interest in the consolidated financial statements after the reverse acquisition. That is because the owners of the legal acquired operation that do not exchange their equity interests for equity interests of the legal acquirer have an interest in only the results and net assets of the legal acquired operation—not in the results and net assets of the combined entity. Conversely, even though the legal acquirer is the acquired operation for accounting purposes, the owners of the legal acquirer have an interest in the results and net assets of the combined entity.

AG71. The assets and liabilities of the legal acquired operation are measured and recognised in the consolidated financial statements at their pre-combination carrying amounts (see paragraph AG69(a)). Therefore, in a reverse acquisition the non-controlling interest reflects the non-controlling shareholders' proportionate interest in the pre-acquisition carrying amounts of the legal acquired operation's net assets even if the non-controlling interests in other acquisitions are measured at their fair value at the acquisition date.

Recognising Particular Assets Acquired and Liabilities Assumed in an Acquisition (see paragraphs 64–68)

Operating Leases

AG72. The acquirer shall recognise no assets or liabilities related to an operating lease in which the acquired operation is the lessee except as required by paragraphs AG73–AG74.

AG73. The acquirer shall determine whether the terms of each operating lease in which the acquired operation is the lessee are favourable or unfavourable. The acquirer shall recognise an intangible asset if the terms of an operating lease are favourable relative to market terms and a liability if the terms are unfavourable relative to market terms. Paragraph AG89 provides guidance on measuring the acquisition-date fair value of assets subject to operating leases in which the acquired operation is the lessor.

AG74. An identifiable intangible asset may be associated with an operating lease, which may be evidenced by market participants' willingness to pay a price for the lease even if it is at market terms. For example, a lease of gates at an airport or of retail space in a prime shopping area might provide entry into a market or other future economic benefits or service potential that qualify as identifiable intangible assets, for example, as a relationship with users of a service. In that situation, the acquirer shall recognise the associated identifiable intangible asset(s) in accordance with paragraph AG75.

Intangible Assets

AG75. The acquirer shall recognise, separately from goodwill, the identifiable intangible assets acquired in an acquisition. An intangible asset is identifiable if it meets either the separability criterion or the binding arrangement criterion.

AG76. An intangible asset that meets the binding arrangement criterion is identifiable even if the asset is not transferable or separable from the acquired operation or from other rights and obligations. For example:

(a) An acquired operation leases a facility under an operating lease that has terms that are favourable relative to market terms. The lease terms explicitly prohibit transfer of the lease (through either sale or sublease). The amount by which the lease terms are favourable compared with the terms of current market transactions for the same or similar items is an intangible asset that meets the binding arrangement criterion for recognition separately from goodwill, even though the acquirer cannot sell or otherwise transfer the lease arrangement.

(b) An acquired operation owns and operates a nuclear power plant. The licence to operate that power plant is an intangible asset that meets the binding arrangement criterion for recognition separately from goodwill, even if the acquirer cannot sell or transfer it separately from the acquired power plant. An acquirer may recognise the fair value of the operating licence and the fair value of the power plant as a single asset for financial reporting purposes if the useful lives of those assets are similar.

(c) An acquired operation owns a technology patent. It has licensed that patent to others for their exclusive use outside the domestic market, receiving a specified percentage of future foreign revenue in exchange. Both the technology patent and the related licence agreement meet the binding arrangement criterion for recognition separately from goodwill even if selling or exchanging the patent and the related licence agreement separately from one another would not be practical.

AG77. The separability criterion means that an acquired intangible asset is capable of being separated or divided from the acquired operation and sold, transferred, licensed, rented or exchanged, either individually or together with a related binding arrangement, identifiable asset or liability. An intangible asset that the acquirer would be able to sell, license or otherwise exchange for something else of value meets the separability criterion even if the acquirer does not intend to sell, license or otherwise exchange it. An acquired intangible asset meets the separability criterion if there is evidence of exchange transactions for that type of asset or an asset of a similar type, even if those transactions are infrequent and regardless of whether the acquirer is involved in them. For example, lists of users of a service are frequently licensed and thus meet the separability criterion. Even if an acquired operation believes its lists of users of a service have characteristics different from other lists of users of a service, the fact that lists of users of a service are frequently licensed generally means that the acquired list of users of a service meets the separability criterion. However, a list of users of a service acquired in an acquisition would not meet the separability criterion if the terms of confidentiality or other agreements prohibit an entity from selling, leasing or otherwise exchanging information about its users of a service.

AG78. An intangible asset that is not individually separable from the acquired operation or combined entity meets the separability criterion if it is separable in combination with a related binding arrangement, identifiable asset or liability. For example, an acquired operation owns a registered trademark and documented but unpatented technical expertise used to manufacture the trademarked product. To transfer ownership of a trademark, the owner is also required to transfer everything else necessary for the new owner to produce a product or service indistinguishable from that produced by the former owner. Because the unpatented technical expertise must be separated from the acquired operation or combined entity and sold if the related trademark is sold, it meets the separability criterion.

Reacquired Rights

AG79. As part of an acquisition, an acquirer may reacquire a right that it had previously granted to the acquired operation to use one or more of the acquirer's recognised or unrecognised assets. Examples of such rights include a right to use the acquirer's trade name under a network or partner agreement or a right to use the acquirer's technology under a technology licensing agreement. A reacquired right is an identifiable intangible asset that the acquirer recognises separately from goodwill or a gain from a bargain purchase. Paragraph 83 provides guidance on measuring a reacquired right and paragraph 113 provides guidance on the subsequent accounting for a reacquired right.

AG80. If the terms of the binding arrangement giving rise to a reacquired right are favourable or unfavourable relative to the terms of current market transactions for the same or similar items, the acquirer shall recognise a settlement gain or loss. Paragraph AG100 provides guidance for measuring that settlement gain or loss.

Assembled Workforce and Other Items that are not Identifiable

AG81. The acquirer subsumes into goodwill the value of an acquired intangible asset that is not identifiable as of the acquisition date. For example, an acquirer may attribute value to the existence of an assembled workforce, which is an existing collection of employees that permits the acquirer to continue to operate an acquired operation from the acquisition date. An assembled workforce does not represent the intellectual capital of the skilled workforce—the (often specialised) knowledge and experience that employees of an acquired operation bring to their jobs. Because the assembled workforce is not an identifiable asset to be recognised separately from goodwill or a gain from a bargain purchase, any value attributed to it is subsumed into goodwill or a gain from a bargain purchase.

AG82. The acquirer also subsumes into goodwill or a gain from a bargain purchase any value attributed to items that do not qualify as assets at the acquisition date. For example, the acquirer might attribute value to potential binding arrangements the acquired operation is negotiating with prospective new customers at the acquisition date. Because those potential binding arrangements are not themselves assets at the acquisition date, the acquirer does not recognise them separately from goodwill or a gain from a bargain purchase. The acquirer should not subsequently reclassify the value of those binding arrangements from goodwill for events that occur after the acquisition date. However, the acquirer should assess the facts and circumstances surrounding events occurring shortly after the acquisition to determine whether a separately recognis~~z~~able intangible asset existed at the acquisition date.

AG83. After initial recognition, an acquirer accounts for intangible assets acquired in an acquisition in accordance with the provisions of PBE IPSAS 31. However, as described in paragraph 6 of PBE IPSAS 31, the accounting for some acquired intangible assets after initial recognition is prescribed by other PBE Standards.

AG84. The identifiability criteria determine whether an intangible asset is recognised separately from goodwill. However, the criteria neither provide guidance for measuring the fair value of an intangible asset nor restrict the assumptions used in measuring the fair value of an intangible asset. For example, the acquirer would take into account the assumptions that market participants would use when pricing the intangible asset, such as expectations of future renewals of binding arrangements, in measuring fair value. It is not necessary for the renewals themselves to meet the identifiability criteria. (However, see paragraph 83, which establishes an exception to the fair value measurement principle for reacquired rights recognised in an acquisition.) Paragraphs 39D~~.4D~~ and 39E~~.5E~~ of PBE IPSAS 31 provide guidance for determining whether intangible assets should be combined into a single unit of account with other intangible or tangible assets.

Forgiveness of Amounts of Tax Due in an Acquisition (where Included in the Terms of the Acquisition) (see paragraphs 78–79.2)

AG85. The acquirer shall not recognise any amounts in respect of an acquired operation's tax due where these amounts have been forgiven by a tax authority as part of the terms of the acquisition. Where tax forgiveness occurs subsequent to an acquisition, the resulting entity applies the requirements in paragraph 118. The acquirer shall account for an acquired operation's tax due that has not been forgiven by a tax authority in accordance with PBE IAS 12~~the relevant international or national accounting standard dealing with income taxes~~.

AG86. [Not used] ~~If the acquirer is itself the tax authority, it shall derecognise any tax receivable relating to the acquired operation's tax due that has been forgiven in accordance with PBE IPSAS 23.~~

AG87. If, as a consequence of the terms of an acquisition, a tax authority forgives an amount of the acquirer's tax due, the acquirer shall derecognise those amounts in accordance with PBE IAS 12~~the relevant international or national accounting standard dealing with income taxes~~.

Measuring the Fair Value of Particular Identifiable Assets and a Non-Controlling Interest in an Acquired Operation in an Acquisition (see paragraphs 72–73)

Assets with Uncertain Cash Flows (Valuation Allowances)

AG88. The acquirer shall not recognise a separate valuation allowance as of the acquisition date for assets acquired in an acquisition that are measured at their acquisition-date fair values because the effects of uncertainty about future cash flows are included in the fair value measure. For example, because this Standard requires the acquirer to measure acquired receivables, including loans, at their acquisition-date fair values in accounting for an acquisition, the acquirer does not recognise a separate valuation allowance for the cash flows of the binding arrangement that are deemed to be uncollectible at that date.[14]

Assets Subject to Operating Leases in which the Acquired Operation is the Lessor

AG89. In measuring the acquisition-date fair value of an asset such as a building that is subject to an operating lease in which the acquired operation is the lessor, the acquirer shall take into account the terms of the lease. In other words, the acquirer does not recognise a separate asset or liability if the terms of an operating lease are either favourable or unfavourable when compared with market terms as paragraph AG73 requires for leases in which the acquired operation is the lessee.

Assets that the Acquirer Intends not to use or to use in a Way that is Different from the Way Other Market Participants would use them

AG90. To protect its competitive position, or for security or other reasons, the acquirer may intend not to use an acquired non-financial asset actively, or it may not intend to use the asset according to its highest and best use. For example, that might be the case for an acquired research and development intangible asset that the acquirer plans to use defensively by preventing others from using it. Nevertheless, the acquirer shall measure the fair value of the non-financial asset assuming its highest and best use by market participants in accordance with the appropriate valuation premise, both initially and when measuring fair value less costs of disposal for subsequent impairment testing.

Non-Controlling Interest in an Acquired Operation

AG91. This Standard allows the acquirer to measure a non-controlling interest in the acquired operation at its fair value at the acquisition date. Sometimes an acquirer will be able to measure the acquisition-date fair value of a non-controlling interest on the basis of a quoted price in an active market for the equity shares (i.e., those not held by the acquirer). In other situations, however, a quoted price in an active market for the equity shares will not be available. In those situations, the acquirer would measure the fair value of the non-controlling interest using other valuation techniques.

AG92. The fair values of the acquirer's interest in the acquired operation and the non-controlling interest on a per-share basis might differ. The main difference is likely to be the inclusion of a control premium in the per-share fair value of the acquirer's interest in the acquired operation or, conversely, the inclusion of a discount for lack of control (also referred to as a non-controlling interest discount) in the per-share fair value of the non-controlling interest if market participants would take into account such a premium or discount when pricing the non-controlling interest.

[14] If an entity that applies this Standard and early adopts PBE IFRS 9, this paragraph should be read as follows:

The acquirer shall not recognise a separate valuation allowance as of the acquisition date for assets acquired in an acquisition that are measured at their acquisition-date fair values because the effects of uncertainty about future cash flows are included in the fair value measure. For example, because this Standard requires the acquirer to measure acquired receivables, including loans, at their acquisition-date fair values in accounting for an acquisition, the acquirer does not recognise a separate valuation allowance for the cash flows of the binding arrangement that are deemed to be uncollectible at that date. or a loss allowance for expected credit losses.

Measuring Goodwill or a Gain from a Bargain Purchase in an Acquisition (see paragraphs 85–98)

Relationship between Goodwill and Cash Flows (see paragraph 86)

AG93. The acquirer shall recognise goodwill only to the extent that the acquirer estimates there will be favourable changes to its net cash flows, either from increased cash inflows or decreased cash outflows, and the goodwill relates to the acquisition of a cash-generating operation. An acquirer shall not recognise goodwill related to service potential other than cash flows nor goodwill related to the acquisition of a non-cash-generating operation.

Measuring the Acquisition-Date Fair Value of the Acquirer's Interest in the Acquired Operation Using Valuation Techniques (see paragraph 87)

AG94. In an acquisition achieved without the transfer of consideration, the acquirer must substitute the acquisition-date fair value of its interest in the acquired operation for the acquisition-date fair value of the consideration transferred to measure goodwill, a loss or a gain on a bargain purchase (see paragraphs 85–87).

Special Considerations in Applying the Acquisition Method to Combinations of Mutual Entities (Application of paragraph 87)

AG95. When two mutual entities combine, the fair value of the equity or member interests in the acquired operation (or the fair value of the acquired operation) may be more reliably measurable than the fair value of the member interests transferred by the acquirer. In that situation, paragraph 87 requires the acquirer to determine the amount of goodwill by using the acquisition-date fair value of the acquired operation's equity interests instead of the acquisition-date fair value of the acquirer's equity interests transferred as consideration. In addition, the acquirer in a combination of mutual entities shall recognise the acquired operation's net assets as a direct addition to capital or equity in its statement of financial position, not as an addition to accumulated ~~surplus or deficit~~ comprehensive revenue and expense, which is consistent with the way in which other types of entities apply the acquisition method.

AG96. Although they are similar in many ways to other entities, mutual entities have distinct characteristics that arise primarily because their members are both customers and owners. Members of mutual entities generally expect to receive benefits for their membership, often in the form of reduced fees charged for goods and services or patronage dividends. The portion of patronage dividends allocated to each member is often based on the amount of business the member did with the mutual entity during the year.

AG97. A fair value measurement of a mutual entity should include the assumptions that market participants would make about future member benefits as well as any other relevant assumptions market participants would make about the mutual entity. For example, a present value technique may be used to measure the fair value of a mutual entity. The cash flows used as inputs to the model should be based on the expected cash flows of the mutual entity, which are likely to reflect reductions for member benefits, such as reduced fees charged for goods and services.

Determining what is Part of the Acquisition Transaction (see paragraphs 109–111)

AG98. The acquirer should consider the following factors, which are neither mutually exclusive nor individually conclusive, to determine whether a transaction is part of the exchange for the acquired operation or whether the transaction is separate from the acquisition:

(a) The reasons for the transaction. Understanding the reasons why the parties to the acquisition (the acquirer and the acquired operation and their owners, directors and managers—and their agents) entered into a particular transaction or arrangement may provide insight into whether it is part of the consideration transferred and the assets acquired or liabilities assumed. For example, if a transaction is arranged primarily for the benefit of the acquirer or the combined entity rather than primarily for the benefit of the acquired operation or its former owners before the combination, that portion of the transaction price paid (and any related assets or liabilities) is less likely to be part of the exchange for the acquired operation. Accordingly, the acquirer would account for that portion separately from the acquisition.

(b) Who initiated the transaction. Understanding who initiated the transaction may also provide insight into whether it is part of the exchange for the acquired operation. For example, a transaction or other event that is initiated by the acquirer may be entered into for the purpose of providing future economic benefits to the acquirer or combined entity with little or no benefit received by the acquired operation or its former owners before the combination. On the other hand, a transaction or arrangement initiated by the acquired operation or its former owners is less likely to be for the benefit of the acquirer or the combined entity and more likely to be part of the acquisition transaction.

(c) The timing of the transaction. The timing of the transaction may also provide insight into whether it is part of the exchange for the acquired operation. For example, a transaction between the acquirer and the acquired operation that takes place during the negotiations of the terms of an acquisition may have been entered into in contemplation of the acquisition to provide future economic benefits to the acquirer or the combined entity. If so, the acquired operation or its former owners before the acquisition are likely to receive little or no benefit from the transaction except for benefits they receive as part of the combined entity.

Effective Settlement of a Pre-Existing Relationship between the Acquirer and Acquired Operation in an Acquisition (see paragraph 110(a))

AG99. The acquirer and acquired operation may have a relationship that existed before they contemplated the acquisition, referred to here as a ‘pre-existing relationship’. A pre-existing relationship between the acquirer and acquired operation may arise from a binding arrangement (for example, vendor and customer or licensor and licensee) or may arise outside of a binding arrangement (for example, plaintiff and defendant).

AG100. If the acquisition in effect settles a pre-existing relationship, the acquirer recognises a gain or loss, measured as follows:

(a) For a pre-existing relationship arising outside of a binding arrangement (such as a lawsuit), fair value.

(b) For a pre-existing relationship arising from a binding arrangement, the lesser of (i) and (ii):

(i) The amount by which the binding arrangement is favourable or unfavourable from the perspective of the acquirer when compared with terms for current market transactions for the same or similar items. (An unfavourable binding arrangement is a binding arrangement that is unfavourable in terms of current market terms. It is not necessarily an onerous binding arrangement in which the unavoidable costs of meeting the obligations under the binding arrangement exceed the economic benefits expected to be received under it.)

(ii) The amount of any stated settlement provisions in the binding arrangement available to the counterparty to whom the binding arrangement is unfavourable.

If (ii) is less than (i), the difference is included as part of the acquisition accounting.

The amount of gain or loss recognised may depend in part on whether the acquirer had previously recognised a related asset or liability, and the reported gain or loss therefore may differ from the amount calculated by applying the above requirements.

AG101. A pre-existing relationship may be a binding arrangement that the acquirer recognises as a reacquired right. If the binding arrangement includes terms that are favourable or unfavourable when compared with pricing for current market transactions for the same or similar items, the acquirer recognises, separately from the acquisition, a gain or loss for the effective settlement of the binding arrangement, measured in accordance with paragraph AG100.

Arrangements for Contingent Payments to Employees or Selling Shareholders (see paragraph 110(b))

AG102. Whether arrangements for contingent payments to employees or selling shareholders are contingent consideration in the acquisition or are separate transactions depends on the nature of the arrangements. Understanding the reasons why the acquisition agreement includes a provision for contingent payments, who initiated the arrangement and when the parties entered into the arrangement may be helpful in assessing the nature of the arrangement.

AG103. If it is not clear whether an arrangement for payments to employees or selling shareholders is part of the exchange for the acquired operation or is a transaction separate from the acquisition, the acquirer should consider the following indicators:

(a) Continuing employment. 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.

(b) Duration of continuing employment. If the period of required employment coincides with or is longer than the contingent payment period, that fact may indicate that the contingent payments are, in substance, remuneration.

(c) Level of remuneration. Situations in which employee remuneration other than the contingent payments is at a reasonable level in comparison with that of other key employees in the combined entity may indicate that the contingent payments are additional consideration rather than remuneration.

(d) Incremental payments to employees. If selling shareholders who do not become employees receive lower contingent payments on a per-share basis than the selling shareholders who become employees of the combined entity, that fact may indicate that the incremental amount of contingent payments to the selling shareholders who become employees is remuneration.

(e) Number of shares owned. The relative number of shares owned by the selling shareholders who remain as key employees may be an indicator of the substance of the contingent consideration arrangement. For example, if the selling shareholders who owned substantially all of the shares in the acquired operation continue as key employees, that fact may indicate that the arrangement is, in substance, a profit-sharing arrangement intended to provide remuneration for post-combination services. Alternatively, if selling shareholders who continue as key employees owned only a small number of shares of the acquired operation and all selling shareholders receive the same amount of contingent consideration on a per-share basis, that fact may indicate that the contingent payments are additional consideration. The pre-acquisition ownership interests held by parties related to selling shareholders who continue as key employees, such as family members, should also be considered.

(f) Linkage to the valuation. If the initial consideration transferred at the acquisition date is based on the low end of a range established in the valuation of the acquired operation and the contingent formula relates to that valuation approach, that fact may suggest that the contingent payments are additional consideration. Alternatively, if the contingent payment formula is consistent with prior profit-sharing arrangements, that fact may suggest that the substance of the arrangement is to provide remuneration.

(g) Formula for determining consideration. The formula used to determine the contingent payment may be helpful in assessing the substance of the arrangement. For example, if a contingent payment is determined on the basis of a multiple of earnings, that might suggest that the obligation is contingent consideration in the acquisition and that the formula is intended to establish or verify the fair value of the acquired operation. In contrast, a contingent payment that is a specified percentage of earnings might suggest that the obligation to employees is a profit-sharing arrangement to remunerate employees for services rendered.

(h) Other agreements and issues. The terms of other arrangements with selling shareholders (such as agreements not to compete, executory contracts, consulting contracts and property lease agreements) and the income tax treatment of contingent payments may indicate that contingent payments are attributable to something other than consideration for the acquired operation. For example, in connection with the acquisition, the acquirer might enter into a property lease arrangement with a significant selling shareholder. If the lease payments specified in the lease arrangement are significantly below market, some or all of the contingent payments to the lessor (the selling shareholder) required by a separate arrangement for contingent payments might be, in substance, payments for the use of the leased property that the acquirer should recognise separately in its post-combination financial statements. In contrast, if the lease arrangement specifies lease payments that are consistent with market terms for the leased property, the arrangement for contingent payments to the selling shareholder may be contingent consideration in the acquisition.

Acquirer Share-Based Payment Awards Exchanged for Awards held by the Acquired Operation's Employees (see paragraph 110(b))

AG104. An acquirer may exchange its share-based payment awards for awards held by employees of the acquired operation. The acquirer shall account for exchanges of share options or other share-based payment awards in conjunction with an acquisition in accordance with the relevant international or national accounting standard dealing with share-based payments.

AG105. In situations in which acquired operation awards would expire as a consequence of an acquisition and if the acquirer replaces those awards when it is not obliged to do so, the acquirer shall recognise any costs as remuneration cost in the post-combination financial statements in accordance with the relevant international or national accounting standard dealing with share-based payments. The cost of those awards shall not be included in measuring the consideration transferred in the acquisition.

Equity-Settled Share-Based Payment Transactions of the Acquired Operation

AG106. The acquired operation may have outstanding share-based payment transactions that the acquirer does not exchange for its share-based payment transactions. If vested, those acquired operation share-based payment transactions are part of the non-controlling interest in the acquired operation. If unvested, they are measured as if the acquisition date were the grant date. Share-based payment transactions are measured in accordance with the relevant international or national accounting standard dealing with share-based payments.

Subsequent Measurement and Accounting (see paragraph 112)

AG107. Examples of other PBE Standards that provide guidance on subsequently measuring and accounting for assets acquired and liabilities assumed or incurred in an acquisition include:

(a) PBE IPSAS 31 prescribes the accounting for identifiable intangible assets acquired in an acquisition. The acquirer measures goodwill at the amount recognised at the acquisition date less any accumulated impairment losses. PBE IPSAS 26 prescribes the accounting for impairment losses.

(b) PBE IPSAS 35 provides guidance on accounting for changes in a controlling entity's ownership interest in a controlled entity after control is obtained.

(c) PBE IFRS 4 provides guidance on the subsequent accounting for an insurance contract acquired in an acquisition.

(d) PBE IAS 12 prescribes the subsequent accounting for deferred tax assets (including unrecognised deferred tax assets) and liabilities acquired in an acquisition.

AG108. An acquirer should refer to the relevant international or national accounting standard~~s~~ for guidance on subsequently measuring and accounting for ~~insurance contracts, income taxes and~~ share-based payments.

Subsequent Measurement of Transfers, Concessionary Loans and Similar Benefits Received by an Acquirer or Acquired Operation on the Basis of Criteria that may Change as a Result of an Acquisition (see paragraph 114)

AG109. Prior to an acquisition taking place, an acquirer or an acquired operation may receive a transfer from a third party, based on specified criteria. For example, a national government may provide grants to those municipalities where the municipality's revenue per head of population is below a threshold. An acquisition by a municipality of a cash-generating operation may increase the revenue per head of population of the municipality so that it is above the threshold. This may cause the government to review the grant.

AG110. The acquirer shall not account for any revisions to the grant amount as part of the acquisition, but accounts for any revisions at the point the grantor makes its intentions known in accordance with other PBE Standards.

AG111. Similar circumstances may arise in respect of concessionary loans and other benefits. The acquirer shall not account for any revisions to those transactions as part of the acquisition, but accounts for any revisions at the point the grantor makes its intentions known in accordance with other PBE Standards.

Acquisitions Occurring During a Reporting Period

AG112. The resulting entity meets the needs of the users of its financial statements for information about the acquired operations prior to the acquisition by making the disclosures in paragraph 120(r).

AG113. [Not used] ~~To satisfy the requirements of a regulator, it may be necessary for the acquirer to present or disclose information in addition to that required by this Standard.~~

Transitional Provisions for PBE ~~public sector~~ Combinations Involving only Mutual Entities or by Contract Alone ~~(see paragraph 133)~~

AG114–AG115. [Not used] ~~Paragraph 126 provides that this Standard applies prospectively to public sector combinations for which the acquisition date or amalgamation date is on or after the beginning of the first annual reporting period beginning on or after [date]. Earlier application is permitted.~~

~~AG115. The requirement to apply this Standard prospectively has the following effect for a public sector combination involving only mutual entities or by contract alone if the acquisition date or amalgamation date for that public sector combination is before the application of this Standard:~~

~~(a) Classification. An entity shall continue to classify the prior public sector combination in accordance with the entity's previous accounting policies for such combinations.~~

~~(b) Previously recognised goodwill. At the beginning of the first annual period in which this Standard is applied, the carrying amount of goodwill arising from the prior public sector combination shall be its carrying amount at that date in accordance with the entity's previous accounting policies. In determining that amount, the entity shall eliminate the carrying amount of any accumulated amortisation of that goodwill and the corresponding decrease in goodwill. No other adjustments shall be made to the carrying amount of goodwill.~~

~~(c) Goodwill previously recognised as a deduction from equity. The entity's previous accounting policies may have resulted in goodwill arising from the prior public sector combination being recognised as a deduction from equity. In that situation the entity shall not recognise that goodwill as an asset at the beginning of the first annual period in which this Standard is applied. Furthermore, the entity shall not recognise in surplus or deficit any part of that goodwill when it disposes of all or part of the operation to which that goodwill relates or when a cash-generating unit to which the goodwill relates becomes impaired.~~

~~(d) Subsequent accounting for goodwill. From the beginning of the first annual period in which this Standard is applied, an entity shall discontinue amortising goodwill arising from the prior public sector combination and shall test goodwill for impairment in accordance with PBE IPSAS 26.~~

~~(e) Previously recognised negative goodwill. An entity that accounted for the prior public sector combination by applying the purchase method may have recognised a deferred credit for an excess of its interest in the net fair value of the acquired operation's identifiable assets and liabilities over the cost of that interest (sometimes called negative goodwill). If so, the entity shall derecognise the carrying amount of that deferred credit at the beginning of the first annual period in which this Standard is applied with a corresponding adjustment to the opening balance of accumulated surplus or deficit at that date.~~

Appendix B

Amendments to Other Standards

Except where otherwise stated, an entity shall apply the amendments in this Appendix when it applies PBE IPSAS 40 issued in [Date].

The amendments to other standards in this Appendix are based on the text of those other standards, including any amendments to those standards set out in:

(a) PBE FRS 48 *Service Performance Reporting*, issued November 2017 and effective from 1 January 2021; and

(b) NZASB ED 2018-3 *2018 Omnibus Amendments to PBE Standards,* which is expected to be issued as an amending standard in 2018 and effective from 1 January 2019.

PBE IPSAS 4 *The Effects of Changes in Foreign Exchange Rates* (as amended by 2018 Omnibus Amendments to PBE Standards)

Paragraph 72.5 is added. New text is underlined.

72.5 **PBE IPSAS 40, issued in [date], amended paragraph A5. An entity shall apply that amendment when it applies PBE IPSAS 40.**

In Appendix A paragraph A5 is amended.[15] New text is underlined and deleted text is struck through.

A5. This Appendix does not apply when an entity measures the related asset, expense or revenue on initial recognition:

(a) At fair value; or

(b) At the fair value of the consideration paid or received at a date other than the date of initial recognition of the non-monetary asset or non-monetary liability arising from advance consideration (for example, the measurement of goodwill applying PBE IPSAS 40 ~~IFRS 3~~ *PBE* ~~*Business*~~ *Combinations*).

PBE IPSAS 10 *Financial Reporting in Hyperinflationary Economies*

Paragraph 22 is amended and paragraph 39.3 is added. New text is underlined and deleted text is struck through.

22. To determine whether the restated amount of a non-monetary item has become impaired and should be reduced an entity applies relevant impairment tests in PBE IPSAS 21 *Impairment of Non-Cash-Generating Assets* or ~~and~~ PBE IPSAS 26 *Impairment of Cash-Generating Assets*. For example, restated amounts of property, plant and equipment, goodwill, patents and trademarks are reduced to recoverable amount or recoverable service amount where appropriate, and restated amounts of inventories are reduced to net realisable value or current replacement cost. An investee that is accounted for under the equity method may report in the currency of a hyperinflationary economy. The statement of financial position and statement of comprehensive revenue and expense of such an investee are restated in accordance with this Standard in order to calculate the investor's share of its net assets/equity and comprehensive revenue and expense. Where the restated financial statements of the investee are expressed in a foreign currency they are translated at closing rates.

…

39.3 **PBE IPSAS 40 *PBE Combinations* issued in [date], amended paragraph 22. An entity shall apply that amendment when it applies PBE IPSAS 40.**

[15] This amendment is to the text of paragraph A5 of PBE IPSAS 4, as proposed in NZASB ED 2018-3 *2018 Omnibus Amendments to PBE Standards* issued in July 2018. ED 2018-3 proposes to add Appendix A *Foreign Currency Transactions and Advance Consideration* to PBE IPSAS 4.

PBE IPSAS 14 *Events After the Reporting Date*

Paragraph 31 is amended and paragraph 33.3 is added. New text is underlined and deleted text is struck through.

31. The following are examples of non-adjusting events after the reporting date that would generally result in disclosure:

…

(c) A major PBE combination after the reporting date (PBE IPSAS 40 *PBE Combinations* requires specific disclosures in such cases), a~~An acquisition or~~ disposal of a major controlled entity or the outsourcing of all or substantially all of the activities currently undertaken by an entity after the reporting date;

…

33.3 **PBE IPSAS 40, issued in [date], amended paragraph 31. An entity shall apply that amendment when it applies PBE IPSAS 40.**

PBE IPSAS 16 *Investment Property*

Paragraphs 18.1, 87, 90 and the heading before paragraph 100.1 are amended and paragraphs 18A and 102.6 are added. New text is underlined and deleted text is struck through.

18A. [Not used]

18.1 Judgement is also needed to determine whether the acquisition of investment property is the acquisition of an asset or a group of assets or a PBE ~~business~~ combination within the scope of PBE IPSAS 40 *PBE Combinations* ~~PBE IFRS 3 *Business Combinations*~~. Reference should be made to PBE IPSAS 40 ~~IFRS 3~~ to determine whether it is a PBE ~~business~~ combination. The discussion in paragraphs 9–18 of this Standard relates to whether or not property is owner-occupied property or investment property and not to determining whether or not the acquisition of property is a PBE ~~business~~ combination as defined in PBE IPSAS 40 ~~IFRS 3~~. Determining whether a specific transaction meets the definition of a PBE ~~business~~ combination as defined in PBE IPSAS 40 ~~IFRS 3~~ and includes an investment property as defined in this Standard requires the separate application of both Standards.

…

87. **In addition to the disclosures required by paragraph 86, an entity that applies the fair value model in paragraphs 42–64 shall disclose a reconciliation between the carrying amounts of investment property at the beginning and end of the period, showing the following:**

…

(b) **Additions resulting from acquisitions through PBE ~~entity~~ combinations;**

…

90. **In addition to the disclosures required by paragraph 86, an entity that applies the cost model in paragraph 65 shall disclose:**

…

(d) **The reconciliation of the carrying amount of investment property at the beginning and end of the period, showing the following:**

(i) **Additions, disclosing separately those additions resulting from acquisitions and those resulting from subsequent expenditure recognised as an asset;**

(ii) **Additions resulting from acquisitions through PBE ~~entity~~ combinations;**

…

PBE~~Business~~ Combinations

100.1 ….

…

102.6 **PBE IPSAS 40, issued in [date], amended paragraphs 18.1, 87, 90 and the heading before paragraph 100.1 and added paragraph 18A. An entity shall apply those amendments when it applies PBE IPSAS 40.**

In the Basis for Conclusions, paragraph BC8 is amended. New text is underlined and deleted text is struck through.

2015 Omnibus Amendments to PBE Standards

BC8. In the IASB®~~'s~~ *Annual Improvements to IFRSs Cycle 2011-2013* the IASB amended IAS 40 *Investment Property* to clarify the relationship between IFRS 3 *Business Combinations* and IAS 40 when classifying property as investment property or owner-occupied property. The IPSASB did not make an equivalent amendment to IPSAS 16 in its *Improvements to IPSASs 2014* because, at that point, there was no IPSAS equivalent to IFRS 3. The NZASB noted that the IPSASB proposes to develop requirements for public sector combinations and may subsequently consider the IASB's amendment, but considered that the amendment would improve clarity and should be incorporated in PBE IPSAS 16. The NZASB therefore included an equivalent amendment in its *2015 Omnibus Amendments to PBE Standards.*[1]

[1] In January 2017 the IPSASB issued IPSAS 40 *Public Sector Combinations* and incorporated the IASB's amendment in IPSAS 16. In [date] the NZASB issued PBE IPSAS 40 *PBE Combinations* (which superseded PBE IFRS 3). PBE IPSAS 16 and IPSAS 16 are now broadly aligned in relation to this matter.

PBE IPSAS 17 *Property, Plant and Equipment*

Paragraphs 60 and 88 are amended and paragraph 108.11 is added. New text is underlined and deleted text is struck through.

60. An entity allocates the amount initially recognised in respect of an item of property, plant and equipment to its significant parts and depreciates separately each such part. For example, in most cases, it would be required to depreciate separately the pavements, formation, kerbs and channels, footpaths, bridges, and lighting within a road system. Similarly, it may be appropriate to depreciate separately the airframe and engines of an aircraft, whether owned or subject to a finance lease. If an entity acquires property, plant and equipment subject to an operating lease in which it is the lessor, it may also be appropriate to depreciate separately amounts reflected in the cost of that item that are attributable to favourable or unfavourable lease terms relative to market terms.

…

88. The financial statements shall disclose, for each class of property, plant and equipment recognised in the financial statements:

…

(e) A reconciliation of the carrying amount at the beginning and end of the period showing:

(i) Additions;

(ii) Disposals;

(iii) Acquisitions through PBE~~entity~~ combinations;

…

108.11 **PBE IPSAS 40 *PBE Combinations*, issued in [date], amended paragraphs 60 and 88. An entity shall apply those amendments when it applies PBE IPSAS 40.**

PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*

Paragraph 1 is amended and paragraphs 4A and 112.7 are added. New text is underlined and deleted text is struck through.

1. An entity that prepares and presents financial statements shall apply this Standard in accounting for provisions, contingent liabilities, and contingent assets, except:

…

(f) Those arising in relation to income taxes or income tax equivalents; and

(g) Those arising from employee benefits, except employee termination benefits that arise as a result of a restructuring, as dealt with in this Standard.~~; and~~

(h) [Deleted by NZASB] ~~Contingent consideration of an acquirer in a business combination (see PBE IFRS 3 *Business Combinations*).~~

…

4A. This Standard does not apply to the contingent consideration of an acquirer in a PBE combination which is within the scope of PBE IPSAS 40 *PBE Combinations*.

…

112.7 **PBE IPSAS 40, issued in [date], amended paragraph 1 and added paragraph 4A. An entity shall apply those amendments when it applies PBE IPSAS 40.**

PBE IPSAS 21 *Impairment of Non-Cash-Generating Assets*[16]

Paragraph 14 is amended and paragraphs 20A and 83.7 are added. New text is underlined and deleted text is struck through.

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

…

Cash-generating assets are assets held with the primary objective of generating a commercial return. For the purposes of impairment, goodwill is considered a cash-generating asset.

…

20A. For the purposes of impairment, goodwill is considered a cash-generating asset. Goodwill does not generate economic benefits independently of other assets, and is assessed for impairment as part of a group of assets. This Standard deals with the assessment of individual assets. Goodwill is recognised only where it gives rise to net cash inflows and it relates to the acquisition of a cash-generating operation. An entity shall not recognise goodwill related to service potential other than cash flows nor goodwill related to the acquisition of a non-cash-generating operation. The recoverable service amount used to assess impairment in this Standard includes service potential. Consequently, an entity applies PBE IPSAS 26 rather than this Standard to determine whether to impair goodwill.

…

83.7 **PBE IPSAS 40 *PBE Combinations*, issued in [date], amended paragraph 14 and added paragraph 20A. An entity shall apply those amendments when it applies PBE IPSAS 40.**

[16] The IPSASB's explanation for these changes is set out in IPSAS 21 *Impairment of Non-Cash-Generating Assets* paragraph BC5A.

Comparison with IPSAS 21

New text is underlined and deleted text is struck through.

PBE IPSAS 21 *Impairment of Non-Cash-Generating Assets* is drawn from IPSAS 21 *Impairment of Non-Cash-Generating Assets*. The significant differences between PBE IPSAS 21 and IPSAS 21 are:

(a) PBE Standards require the presentation of a statement of comprehensive revenue and expense. IPSASs require the presentation of a statement of financial performance. ~~Other than the impact of this difference, there are no significant differences between PBE IPSAS 21 and IPSAS 21.~~

(b) PBE IPSAS 21 does not contain the requirements for the recognition of goodwill related to the acquisition of a non-cash generating operation.

PBE IPSAS 23 *Revenue from Non-Exchange Transactions*

Paragraphs 1 and 2 are amended and paragraph 125.5 is added. New text is underlined and deleted text is struck through.

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

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

…

125.5 **PBE IPSAS 40 *PBE Combinations*, issued in [date], amended paragraphs 1 and 2. An entity shall apply those amendments when it applies PBE IPSAS 40.**

PBE IPSAS 26 *Impairment of Cash-Generating Assets*[17]

Paragraphs 90.1–90.15 are renumbered as paragraphs 90A–90O.
Paragraphs 111.1–111.2 are renumbered as paragraphs 111A–111B.
Paragraph 122.1 is renumbered as paragraph 122A.
Paragraphs 21, 26, 28, 37, 71 and its related heading, 76, 88, 90A, 90B, 90C, 90E, 90F, 90I, 90J, 90K, 90L, 91, 92, 97B, 97H, 98, 103, 120, 122A and 123–125 are amended.
Paragraph 123(a.1) is moved to paragraph 123(a) and the remaining subparagraphs are renumbered.
Paragraph 124(a.1) is moved to paragraph 124(a) and the remaining subparagraphs are renumbered.
Paragraphs AG22–AG29 and their related headings are moved to follow paragraph 97 and renumbered as paragraphs 97A–97H.
Paragraphs 18A, 20A, 23, 90A.1, 97B.1 and 127.8 are added.
Paragraphs 2(i), 7, 23.1, 91.1 and 96 and the examples after paragraphs 90G and 90H are deleted.
New text is underlined and deleted text is struck through.

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

   …

   (i) ~~[Not used]~~[Deleted by IPSASB];

   …

7. ~~[Not used]~~[Deleted by IPSASB]

[17] The IPSASB's explanation for these changes is set out in IPSAS 26 *Impairment of Cash-Generating Assets* paragraphs BC8A–BC8B.

…

18A. For the purposes of impairment, goodwill is considered a cash-generating asset. Goodwill does not generate economic benefits independently of other assets, and is assessed for impairment as part of a group of assets. PBE IPSAS 21 deals with the assessment of individual assets. Goodwill is recognised only where it gives rise to net cash inflows and it relates to the acquisition of a cash-generating operation . An entity shall not recognise goodwill related to service potential other than cash flows nor goodwill related to the acquisition of a non-cash-generating operation. The recoverable service amount used to assess impairment in PBE IPSAS 21 includes service potential. Consequently, an entity applies this Standard to determine whether to impair goodwill.

…

20A. Paragraphs 21–30 specify when recoverable amount shall be determined. These requirements use the term 'an asset' but apply equally to an individual asset or a cash-generating unit. The remainder of this Standard is structured as follows:

(a) Paragraphs 31–70 set out the requirements for measuring recoverable amount. These requirements also use the term 'an asset' but apply equally to an individual asset and a cash-generating unit.

(b) Paragraphs 71–97 set out the requirements for recognising and measuring impairment losses. Recognition and measurement of impairment losses for individual assets other than goodwill are dealt with in paragraphs 71–75. Paragraphs 76–97 deal with the recognition and measurement of impairment losses for cash-generating units and goodwill.

(c) Paragraphs 98–105 set out the requirements for reversing an impairment loss recognised in prior periods for an asset or a cash-generating unit. Again, these requirements use the term 'an asset' but apply equally to an individual asset or a cash-generating unit. Additional requirements for an individual asset are set out in paragraphs 106–109, for a cash-generating unit in paragraphs 110–111, and for goodwill in paragraphs 111A and 111B.

(d) Paragraphs 112–113 set out the requirements for the redesignation of an asset from a cash-generating asset to a non-cash-generating asset or from a non-cash-generating asset to a cash-generating asset.

(e) Paragraphs 114–122A specify the information to be disclosed about impairment losses and reversals of impairment losses for assets and cash-generating units. Paragraphs 123–125 specify additional disclosure requirements for cash-generating units to which goodwill or intangible assets with indefinite useful lives have been allocated for impairment testing purposes.

21. An asset is impaired when its carrying amount exceeds its recoverable amount. Paragraphs 25–27 describe some indications that an impairment loss may have occurred. If any of those indications is present, an entity is required to make a formal estimate of recoverable amount. Except for the circumstances described in paragraph 23~~.1~~, this Standard does not require an entity to make a formal estimate of recoverable amount if no indication of an impairment loss is present.

23. ~~[Not used]~~**Irrespective of whether there is any indication of impairment, an entity shall also:**

(a) **Test an intangible asset with an indefinite useful life or an intangible asset not yet available for use for impairment annually by comparing its carrying amount with its recoverable amount. This impairment test may be performed at any time during an annual period, provided it is performed at the same time every year. Different intangible assets may be tested for impairment at different times. However, if such an intangible asset was initially recognised during the current annual period, that intangible asset shall be tested for impairment before the end of the current annual period.**

(b) **Test goodwill received or acquired in a PBE combination for impairment annually in accordance with paragraphs 90A–90O.**

23.1 [Deleted by NZASB]~~**Irrespective of whether there is any indication of impairment, an entity shall also:**~~

~~(a)~~ ~~**Test an intangible asset with an indefinite useful life or an intangible asset not yet available for use for impairment annually by comparing its carrying amount with its recoverable amount. This impairment test may be performed at any time during an annual period, provided it is performed at the same time every year. Different intangible assets may be tested**~~

~~**for impairment at different times. However, if such an intangible asset was initially recognised during the current annual period, that intangible asset shall be tested for impairment before the end of the current annual period.**~~

~~(b) **Test goodwill acquired in a business combination for impairment annually in accordance with paragraphs 90.1–90.15.**~~

…

26. The list in paragraph 25 is not exhaustive. An entity may identify other indications that an asset may be impaired, and these would also require the entity to determine the asset's recoverable amount or, in the case of goodwill, perform an impairment test in accordance with paragraphs 90K~~.11~~–90O~~.15~~.

…

28. As indicated in paragraph 23~~.1~~, this Standard requires an intangible asset with an indefinite useful life or an intangible asset that is not yet available for use and goodwill to be tested for impairment, at least annually. Apart from when the requirements in paragraph 23~~.1~~ apply, the concept of materiality applies in identifying whether the recoverable amount of an asset needs to be estimated. For example, if previous calculations show that an asset's recoverable amount is significantly greater than its carrying amount, the entity need not re-estimate the asset's recoverable amount if no events have occurred that would eliminate that difference. Similarly, previous analysis may show that an asset's recoverable amount is not sensitive to one (or more) of the indications listed in paragraph 25.

…

37. Paragraph 23~~.1~~ requires an intangible asset with an indefinite useful life to be tested for impairment annually by comparing its carrying amount with its recoverable amount, irrespective of whether there is any indication that it may be impaired. However, the most recent detailed calculation of such an asset's recoverable amount made in a preceding period may be used in the impairment test for that asset in the current period, provided all of the following criteria are met:

…

Recognising and Measuring an Impairment Loss ~~of an Individual Asset~~

71. Paragraphs 72–75 set out the requirements for recognising and measuring impairment losses for an individual asset other than goodwill. The recognition and measurement of impairment losses for cash-generating units and goodwill are dealt with in paragraphs 76–97H.

…

76. Paragraphs 77–97H set out the requirements for identifying the cash-generating unit to which an asset belongs and determining the carrying amount of, and recognising impairment losses for, cash-generating units and goodwill.

…

88. When assets are grouped for recoverability assessments, it is important to include in the cash-generating unit all assets that generate, or are used to generate, the relevant stream of cash inflows. Otherwise, the cash-generating unit may appear to be fully recoverable when in fact an impairment loss has occurred. The Illustrated Decision Tree provides a flow diagram illustrating the treatment of individual assets that are part of cash-generating units. In some cases, although some assets contribute to the estimated future cash flows of a cash-generating unit, they cannot be allocated to the cash-generating unit on a reasonable and consistent basis. This might be the case for goodwill. Paragraphs 90A~~.1~~–90O~~.15~~ explain how to deal with these assets in testing a cash-generating unit for impairment.

…

90A~~.1~~ **For the purpose of impairment testing, goodwill acquired in an acquisition ~~business combination~~ shall, from the acquisition date, be allocated to each of the acquirer's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquired operation ~~acquiree~~ are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated shall:**

(a) **Represent the lowest level within the entity at which the goodwill is monitored for internal management purposes.**

(b) [Not used]

90A.1 **For the purpose of impairment testing, goodwill previously recognised by one of the combining operations in an amalgamation shall be allocated to each of the resulting entity's cash-generating units, or group of cash-generating units, within which those combining operations are integrated. If the resulting entity reorganises the combining operations containing the previously recognised goodwill, as part of integrating the combining operations into the resulting entity either during or shortly after the amalgamation, the entity shall refer to paragraph 90H for guidance.**

90B.~~2~~ Goodwill recognised in an acquisition ~~business combination~~ is an asset representing the future economic benefits arising from other assets acquired in an acquisition ~~business combination~~ that are not individually identified and separately recognised. Goodwill does not generate cash flows independently of other assets or groups of assets, and often contributes to the cash flows of multiple cash-generating units. Goodwill sometimes cannot be allocated on a non-arbitrary basis to individual cash-generating units, but only to groups of cash-generating units. As a result, the lowest level within the entity at which the goodwill is monitored for internal management purposes sometimes comprises a number of cash-generating units to which the goodwill relates, but to which it cannot be allocated. References in paragraphs 90D~~.4~~–90O~~.15~~ and 97A–97H ~~the Application Guidance~~ to a cash-generating unit to which goodwill is allocated should be read as references also to a group of cash-generating units to which goodwill is allocated.

90C.~~3~~ Applying the requirements in paragraphs 90A~~.1~~ and 90A.1 result~~s~~ in goodwill being tested for impairment at a level that reflects the way an entity manages its operations and with which the goodwill would naturally be associated. Therefore, the development of additional reporting systems is typically not necessary.

90D.~~4~~ …

90E.~~5~~ **If the initial allocation of goodwill acquired in an acquisition ~~business combination~~ cannot be completed before the end of the annual period in which the acquisition ~~business combination~~ is effected, that initial allocation shall be completed before the end of the first annual period beginning after the acquisition date.**

90F.~~6~~ In accordance with PBE IPSAS 40 ~~IFRS 3~~ *PBE* ~~*Business*~~ *Combinations*, if the initial accounting for an acquisition ~~business combination~~ can be determined only provisionally by the end of the period in which the combination is effected, the acquirer:

(a) Accounts for the acquisition ~~combination~~ using those provisional values; and

(b) Recognises any adjustments to those provisional values as a result of completing the initial accounting within the measurement period, which shall not exceed twelve months from the acquisition date.

In such circumstances, it might also not be possible to complete the initial allocation of the goodwill recognised in the acquisition ~~combination~~ before the end of the annual period in which the combination is effected. When this is the case, the entity discloses the information required by paragraph 122A~~.1~~.

90G.~~7~~ …

~~**Example**~~
~~An entity sells for CU100 an operation that was part of a cash-generating unit to which goodwill has been allocated. The goodwill allocated to the unit cannot be identified or associated with an asset group at a level lower than that unit, except arbitrarily. The recoverable amount of the portion of the cash-generating unit retained is CU300.~~ ~~Because the goodwill allocated to the cash-generating unit cannot be non-arbitrarily identified or associated with an asset group at a level lower than that unit, the goodwill associated with the operation disposed of is measured on the basis of the relative values of the operation disposed of and the portion of the unit retained. Therefore, 25 per cent of the goodwill allocated to the cash-generating unit is included in the carrying amount of the operation that is sold.~~

90H.~~8~~ …

~~**Example**~~
~~Goodwill had previously been allocated to cash-generating unit A. The goodwill allocated to A cannot be identified or associated with an asset group at a level lower than A, except arbitrarily. A is to be divided and integrated into three other cash-generating units, B, C and D.~~ ~~Because the goodwill allocated to A cannot be non-arbitrarily identified or associated with an asset group at a level lower than A, it is reallocated to units B, C and D on the basis of the relative values of the three portions of A before those portions are integrated with B, C and D.~~

Testing Cash-Generating Units with Goodwill for Impairment

90I.~~9~~ **When, as described in paragraph 90B~~.2~~, goodwill relates to a cash-generating unit but has not been allocated to that unit, the unit shall be tested for impairment, whenever there is an indication that the unit may be impaired, by comparing the unit's carrying amount, excluding any goodwill, with its recoverable amount. Any impairment loss shall be recognised in accordance with paragraph 91~~.1~~.**

90J.~~10~~ If a cash-generating unit described in paragraph 90I~~.9~~ includes in its carrying amount an intangible asset that has an indefinite useful life or is not yet available for use and that asset can be tested for impairment only as part of the cash-generating unit, paragraph 23~~.1~~ requires the unit also to be tested for impairment annually.

90K.~~11~~ **A cash-generating unit to which goodwill has been allocated shall be tested for impairment annually, and whenever there is an indication that the unit may be impaired, by comparing the carrying amount of the unit, including the goodwill, with the recoverable amount of the unit. If the recoverable amount of the unit exceeds the carrying amount of the unit, the unit and the goodwill allocated to that unit shall be regarded as not impaired. If the carrying amount of the unit exceeds the recoverable amount of the unit, the entity shall recognise the impairment loss in accordance with paragraph 91~~.1~~.**

90L.~~12~~ **The annual impairment test for a cash-generating unit to which goodwill has been allocated may be performed at any time during an annual period, provided the test is performed at the same time every year. Different cash-generating units may be tested for impairment at different times. However, if some or all of the goodwill allocated to a cash-generating unit was acquired in an acquisition ~~business combination~~ during the current annual period, that unit shall be tested for impairment before the end of the current annual period.**

90M.~~13~~ …

90N.~~14~~ …

90O.~~15~~ …

91. ~~[Not used]~~ **An impairment loss shall be recognised for a cash-generating unit (the smallest group of cash-generating units to which goodwill has been allocated) if, and only if, the recoverable amount of the unit (group of units) is less than the carrying amount of the unit (group of units). The impairment loss shall be allocated to reduce the carrying amount of the assets of the unit (group of units) in the following order:**

(a) **First, to reduce the carrying amount of any goodwill allocated to the cash-generating unit (group of units); and**

(b) **Then, to the other assets of the unit (group of units) pro rata on the basis of the carrying amount of each asset in the unit (group of units).**

These reductions in carrying amounts shall be treated as impairment losses on individual assets and recognised in accordance with paragraph 73.

91.1 [Deleted by NZASB] ~~**An impairment loss shall be recognised for a cash-generating unit (the smallest group of cash-generating units to which goodwill has been allocated) if, and only if, the recoverable amount of the unit (group of units) is less than the carrying amount of the unit (group of units). The impairment loss shall be allocated to reduce the carrying amount of the assets of the unit (group of units) in the following order:**~~

~~(a) **First, to reduce the carrying amount of any goodwill allocated to the cash-generating unit (group of units); and**~~

~~(b) **Then, to the other assets of the unit (group of units) pro rata on the basis of the carrying amount of each asset in the unit (group of units).**~~

92. **In allocating an impairment loss in accordance with paragraph 91~~.1~~, an entity shall not reduce the carrying amount of an asset below the highest of:**

(a) **Its fair value less costs to sell (if determinable);**

(b) **Its value in use (if determinable); and**

(c) **Zero.**

The amount of the impairment loss that would otherwise have been allocated to the asset shall be allocated pro rata to the other cash-generating assets of the unit (group of units).

96. [Deleted by IPSASB]~~[Not used]~~

Impairment Testing Cash-Generating Units with Goodwill and Non-Controlling Interests

97A~~AG22~~. In accordance with PBE IPSAS 40 ~~IFRS 3~~, the acquirer measures and recognises goodwill as of the acquisition date as the excess of (a) over (b) below:

(a) The aggregate of:

(i) The consideration transferred measured in accordance with PBE IPSAS 40 ~~IFRS 3~~, which generally requires acquisition-date fair value;

(ii) The amount of any non-controlling interest in the acquired operation ~~acquiree~~ measured in accordance with PBE IPSAS 40 ~~IFRS 3~~; and

(iii) In an acquisition achieved in stages, the acquisition-date fair value of the acquirer's previously held equity interest in the acquired operation ~~acquiree~~.

(b) The net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed measured in accordance with PBE IPSAS 40 ~~IFRS 3~~.

Allocation of Goodwill

97B~~AG23~~. Paragraph 90A~~.1~~ of this Standard requires goodwill acquired in an acquisition ~~business combination~~ to be allocated to each of the acquirer's cash-generating units, or groups of cash-generating units, expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquired operation ~~acquiree~~ are assigned to those units, or groups of units. It is possible that some of the synergies resulting from an acquisition ~~business combination~~ will be allocated to a cash-generating unit in which the non-controlling interest does not have an interest.

97B.1 Paragraph 90A.1 of this Standard requires goodwill previously recognised by one of the combining operations in an amalgamation to be allocated to each of the resulting entity's cash-generating units, or group of cash-generating units, within which those combining operations are integrated. It is possible that the goodwill will be allocated to a cash-generating unit in which the non-controlling interest does not have an interest.

Testing for Impairment

97C~~AG24~~. Testing for impairment involves comparing the recoverable amount of a cash-generating unit with the carrying amount of the cash-generating unit.

97D~~AG25~~. If an entity measures non-controlling interests as its proportionate interest in the net identifiable assets of a controlled entity at the acquisition date, rather than at fair value, goodwill attributable to non-controlling interests is included in the recoverable amount of the related cash-generating unit but is not recognised in the controlling entity's consolidated financial statements. As a consequence, an entity shall gross up the carrying amount of goodwill allocated to the unit to include the goodwill attributable to the non-controlling interest. This adjusted carrying amount is then compared with the recoverable amount of the unit to determine whether the cash-generating unit is impaired.

Allocating an Impairment Loss

97E~~AG26~~. Paragraph 91~~.1~~ requires any identified impairment loss to be allocated first to reduce the carrying amount of goodwill allocated to the unit and then to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit.

97F~~AG27~~. If a controlled entity, or part of a controlled entity, with a non-controlling interest is itself a cash-generating unit, the impairment loss is allocated between the controlling entity and the non-controlling interest on the same basis as that on which surplus or deficit is allocated.

97G~~AG28~~. If a controlled entity, or part of a controlled entity, with a non-controlling interest is part of a larger cash-generating unit, goodwill impairment losses are allocated to the parts of the cash-generating unit that have a non-controlling interest and the parts that do not. The impairment losses should be allocated to the parts of the cash-generating unit on the basis of:

(a) To the extent that the impairment relates to goodwill in the cash-generating unit, the relative carrying values of the goodwill of the parts before the impairment; and

(b) To the extent that the impairment relates to identifiable assets in the cash-generating unit, the relative carrying values of the net identifiable assets of the parts before the impairment. Any such impairment is allocated to the assets of the parts of each unit pro rata on the basis of the carrying amount of each asset in the part.

In those parts that have a non-controlling interest, the impairment loss is allocated between the controlling entity and the non-controlling interest on the same basis as that on which surplus or deficit is allocated.

97H~~AG29~~. If an impairment loss attributable to a non-controlling interest relates to goodwill that is not recognised in the controlling entity's consolidated financial statements (see paragraph 97D~~AG25~~), that impairment is not recognised as a goodwill impairment loss. In such cases, only the impairment loss relating to the goodwill that is allocated to the controlling entity is recognised as a goodwill impairment loss.

Reversing an Impairment Loss

98. Paragraphs 99–105 set out the requirements for reversing an impairment loss recognised for an asset or a cash-generating unit in prior periods. These requirements use the term "an asset," but apply equally to an individual asset or a cash-generating unit. Additional requirements for an individual asset are set out in paragraphs 106–109, for a cash-generating unit in paragraphs 110 and 111, and for goodwill in paragraphs 111A~~.1~~ and 111B~~.2~~.

…

103. **An impairment loss recognised in prior periods for an asset other than goodwill shall be reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If this is the case, the carrying amount of the asset shall, except as described in paragraph 106, be increased to its recoverable amount. That increase is a reversal of an impairment loss.**

…

Reversing an Impairment Loss for Goodwill

111A~~.1~~ **…**

111B~~.2~~ …

…

*120. **An entity shall disclose the following for each material impairment loss recognised or reversed during the period for a cash-generating asset~~,~~ (including goodwill)~~,~~ or a cash-generating unit:**

…

(e) **Whether the recoverable amount of the asset (cash-generating unit) is its fair value less costs to sell or its value in use;**

…

122A.~~1~~ **If, in accordance with paragraph 90E~~.5~~, any portion of the goodwill acquired in an acquisition ~~business combination~~ during the period has not been allocated to a cash-generating unit (group of units) at the end of the reporting period ~~date~~, the amount of the unallocated goodwill shall be disclosed together with the reasons why that amount remains unallocated.**

*123. **An entity shall disclose the information required by (a)–~~(e)~~(f) for each cash-generating unit (group of units) for which the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to that unit (group of units) is significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives:**

(a) **The carrying amount of goodwill allocated to the unit (group of units);**

~~(a)~~(b) **The carrying amount of intangible assets with indefinite useful lives allocated to the unit (group of units);**

~~(a.1) **The carrying amount of goodwill allocated to the unit (group of units);**~~

~~(b)~~(c) **The basis on which the unit's (group of units') recoverable amount has been determined (i.e., value in use or fair value less costs to sell);**

~~(c)~~(d) **If the unit's (group of units') recoverable amount is based on value in use:**

…

~~(d)~~(e) **If the unit's (group of units') recoverable amount is based on fair value less costs to sell, the methodology used to determine fair value less costs to sell. If fair value less costs to sell is not determined using an observable market price for the unit, the following information shall also be disclosed:**

…

~~(e)~~(f) **If a reasonably possible change in a key assumption on which management has based its determination of the unit's (group of units') recoverable amount would cause the unit's carrying amount to exceed its recoverable amount:**

…

*124. **If some or all of the carrying amount of goodwill or intangible assets with indefinite useful lives is allocated across multiple cash-generating units (groups of units), and the amount so allocated to each unit (group of units) is not significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives, that fact shall be disclosed, together with the aggregate carrying amount of goodwill or intangible assets with indefinite useful lives allocated to those units (groups of units). In addition, if the recoverable amounts of any of those units (groups of units) are based on the same key assumption(s), and the aggregate carrying amount of goodwill or intangible assets with indefinite useful lives allocated to them is significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives, an entity shall disclose that fact, together with:**

(a) **The aggregate carrying amount of goodwill allocated to those units (groups of units);**

~~(a)~~(b) **The aggregate carrying amount of intangible assets with indefinite useful lives allocated to those units (groups of units);**

~~(a.1) **The aggregate carrying amount of goodwill allocated to those units (groups of units);**~~

~~(b)~~(c) **A description of the key assumption(s);**

~~(c)~~(d) **A description of management's approach to determining the value(s) assigned to the key assumption(s), whether those value(s) reflect past experience or, if appropriate, are consistent with external sources of information, and if not, how and why they differ from past experience or external sources of information;**

~~(d)~~(e) **If a reasonably possible change in the key assumption(s) would cause the aggregate of the units' (groups of units') carrying amounts to exceed the aggregate of their recoverable amounts:**

…

125. The most recent detailed calculation made in a preceding period of the recoverable amount of a cash-generating unit (group of units) may, in accordance with paragraph 37 or 90O, be carried forward and used in the impairment test for that unit (group of units) in the current period, provided specified criteria are met. When this is the case, the information for that unit (group of units) that is incorporated into the disclosures required by paragraphs 123 and 124 relate to the carried forward calculation of recoverable amount.

…

127.8 **PBE IPSAS 40, issued in [date], renumbered paragraphs 90.1–90.15 as 90A–90O and paragraphs 111.1–111.2 as 111A–111B and paragraph 122.1 as 122A, amended paragraphs 21, 26, 28. 37, 71 and its related heading, 76, 88, 90A, 90B, 90C, 90E, 90F, 90I, 90J, 90K, 90L, 91, 92, 97B, 97H, 98, 103, 120, 122A and 123–125, moved paragraph 123(a.1) to paragraph 123(a) and paragraph 124(a.1) to paragraph 124(a) and renumbered the remaining subparagraphs, moved paragraphs AG22–AG29 and their related headings after paragraph 97 and renumbered as paragraphs 97A–97H, added paragraphs 18A, 20A, 23, 90A.1 and 97B.1 and deleted paragraphs 2(i), 7, 23.1, 91.1 and 96 and the examples after paragraphs 90G and 90H. An entity shall apply those amendments when it applies PBE IPSAS 40.**

In the Application Guidance, paragraphs AG22–AG29 and their related headings are moved into the body of the Standard (as paragraphs 97A–97H). New text is underlined.

AG22–AG29 [Moved into the body of the Standard as paragraphs 97A–97H]

~~**Impairment Testing Cash-Generating Units with Goodwill and Non-Controlling Interests**~~

~~AG22. In accordance with PBE IFRS 3, the acquirer measures and recognises goodwill as of the acquisition date as the excess of (a) over (b) below:~~

~~(a) The aggregate of:~~

~~(i) The consideration transferred measured in accordance with PBE IFRS 3, which generally requires acquisition-date fair value;~~

~~(ii) The amount of any non-controlling interest in the acquiree measured in accordance with PBE IFRS 3; and~~

~~(iii) In a business combination achieved in stages, the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree.~~

~~(b) The net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed measured in accordance with PBE IFRS 3.~~

~~*Allocation of Goodwill*~~

~~AG23 Paragraph 90.1 of this Standard requires goodwill acquired in a business combination to be allocated to each of the acquirer's cash-generating units, or groups of cash generating units, expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units, or groups of units. It is possible that some of the synergies resulting from a business combination will be allocated to a cash-generating unit in which the non-controlling interest does not have an interest.~~

~~*Testing for Impairment*~~

~~AG24 Testing for impairment involves comparing the recoverable amount of a cash-generating unit with the carrying amount of the cash-generating unit.~~

~~AG25 If an entity measures non-controlling interests as its proportionate interest in the net identifiable assets of a controlled entity at the acquisition date, rather than at fair value, goodwill attributable to non-controlling interests is included in the recoverable amount of the related cash-generating unit but is not recognised in the controlling entity's consolidated financial statements. As a consequence, an entity shall gross up the carrying amount of goodwill allocated to the unit to include the goodwill attributable to the non-controlling interest. This adjusted carrying amount is then compared with the recoverable amount of the unit to determine whether the cash-generating unit is impaired.~~

~~*Allocating an Impairment Loss*~~

~~AG26 Paragraph 91.1 requires any identified impairment loss to be allocated first to reduce the carrying amount of goodwill allocated to the unit and then to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit.~~

~~AG27 If a controlled entity, or part of a controlled entity, with a non-controlling interest is itself a cash-generating unit, the impairment loss is allocated between the controlling entity and the non-controlling interest on the same basis as that on which surplus or deficit is allocated.~~

~~AG28 If a controlled entity, or part of a controlled entity, with a non-controlling interest is part of a larger cash-generating unit, goodwill impairment losses are allocated to the parts of the cash-generating unit that have a non-controlling interest and the parts that do not. The impairment losses should be allocated to the parts of the cash-generating unit on the basis of:~~

~~(a) To the extent that the impairment relates to goodwill in the cash-generating unit, the relative carrying values of the goodwill of the parts before the impairment; and~~

~~(b) To the extent that the impairment relates to identifiable assets in the cash-generating unit, the relative carrying values of the net identifiable assets of the parts before the impairment. Any such impairment is allocated to the assets of the parts of each unit pro rata on the basis of the carrying amount of each asset in the part.~~

~~In those parts that have a non-controlling interest, the impairment loss is allocated between the controlling entity and the non-controlling interest on the same basis as that on which surplus or deficit is allocated.~~

~~AG29 If an impairment loss attributable to a non-controlling interest relates to goodwill that is not recognised in the controlling entity's consolidated financial statements (see paragraph AG25), that impairment is not recognised as a goodwill impairment loss. In such cases, only the impairment loss relating to the goodwill that is allocated to the controlling entity is recognised as a goodwill impairment loss.~~

In the Basis for Conclusions, paragraphs BC7.1 and BC7.2 are added. Paragraph BC7 is deleted. New text is underlined and deleted text is struck through. Paragraph BC6 has not been amended but has been included for context when reading paragraph BC7.1.

Goodwill

BC6. As a consequence of including PBE IFRS 3 *Business Combinations* in the PBE Standards, requirements and guidance regarding the allocation of goodwill to cash-generating units, testing cash-generating assets with goodwill for impairment and reversing an impairment loss for goodwill have been included in PBE IPSAS 26. This additional material is identical to the requirements and guidance in NZ IAS 36 *Impairment of Assets*.

BC7. [Deleted by NZASB] ~~An illustrative example of impairment testing cash-generating units with goodwill is available in the additional material for NZ IAS 36 on the XRB website at **www.xrb.govt.nz**.~~

BC7.1 <u>The IPSASB issued IPSAS 40 *Public Sector Combinations* in January 2017 and incorporated the guidance on (a) the impairment of goodwill, (b) the allocation of goodwill to cash-generating units, and (c) testing cash-generating units with goodwill for impairment from IAS 36 *Impairment of Assets* in IPSAS 26. The NZASB incorporated this guidance in PBE IPSAS 26 when it bought PBE IFRS 3 into the suite of PBE Standards. The NZASB issued PBE IPSAS 40 *PBE Combinations* (which superseded PBE IFRS 3) based on IPSAS 40. PBE IPSAS 26 and IPSAS 26 are now broadly aligned in relation to this matter.</u>

<u>BC7.2 IPSAS 26 does not contain requirements for the accounting for goodwill previously recognised by one of the combining operations in an amalgamation. The NZASB thought it would be helpful to add requirements on how goodwill is allocated and tested for impairment in this situation (see paragraphs 90A.1 and 97B.1).</u>

In the Implementation Guidance, paragraphs IG24A–IG24D and their related headings are added.

Including Goodwill in the Carrying Amount of an Operation on Disposal

Background

IG24A. A municipality sells for CU100 an operation that was part of a cash-generating unit to which goodwill has been allocated. The goodwill allocated to the unit cannot be identified or associated with an asset group at a level lower than that unit, except arbitrarily. The recoverable amount of the portion of the cash-generating unit retained is CU300.

Accounting Treatment

IG24B. Because the goodwill allocated to the cash-generating unit cannot be non-arbitrarily identified or associated with an asset group at a level lower than that unit, the goodwill associated with the operation disposed of is measured on the basis of the relative values of the operation disposed of and the portion of the unit retained. Therefore, 25 percent of the goodwill allocated to the cash-generating unit is included in the carrying amount of the operation that is sold.

Reallocation of Goodwill when a Cash-Generating Unit is Restructured

Background

IG24C. Goodwill had previously been allocated to cash-generating unit A. The goodwill allocated to A cannot be identified or associated with an asset group at a level lower than A, except arbitrarily. A is to be divided and integrated into three other cash-generating units: B, C and D.

Accounting Treatment

IG24D. Because the goodwill allocated to A cannot be non-arbitrarily identified or associated with an asset group at a level lower than A, it is reallocated to units B, C and D on the basis of the relative values of the three portions of A before those portions are integrated with B, C and D.

Comparison with IPSAS 26

New text is underlined and deleted text is struck through.

PBE IPSAS 26 *Impairment of Cash-Generating Assets* is drawn from IPSAS 26 *Impairment of Cash-Generating Assets*.

The significant differences between PBE IPSAS 26 and IPSAS 26 are:

~~(a) PBE IPSAS 26 includes requirements and guidance regarding goodwill acquired in a business combination, the impairment of that goodwill and the reversal of any impairment loss of goodwill. PBE IPSAS 26 also requires disclosures regarding this goodwill.~~

(a)~~(b)~~ PBE Standards require the presentation of a statement of comprehensive revenue and expense. IPSASs require the presentation of a statement of financial performance.

(b) PBE IPSAS 26 does not contain requirements for the accounting of goodwill related to the acquisition of a non-cash generating operation.

(c) PBE IPSAS 26 contains requirements for the accounting for goodwill previously recognised by one of the combining operations in an amalgamation.

PBE IPSAS 27 *Agriculture*

Paragraph 48 is amended and paragraph 57.5 is added. New text is underlined and deleted text is struck through.

48. **An entity shall present a reconciliation of changes in the carrying amount of biological assets between the beginning and the end of the current period. The reconciliation shall include:**

…

(g) **Increases resulting from PBE ~~entity~~ combinations;**

…

57.5 **PBE IPSAS 40 *PBE Combinations* issued in [date], amended paragraph 48. An entity shall apply that amendment when it applies PBE IPSAS 40.**

PBE IPSAS 29 *Financial Instruments: Recognition and Measurement* (if an entity has not adopted PBE IFRS 9 early)

Paragraphs 2 and 10 are amended and paragraph 126.7 is added. New text is underlined and deleted text is struck through. The lead in text for paragraph 10(aa) has not been amended but has been included for context when reading this paragraph.

2. **This Standard shall be applied by all entities to all types of financial instruments, except:**

…

(f) **Any forward contracts between an acquirer and seller to buy or sell an acquired operation ~~acquiree~~ that will result in a~~n~~ PBE ~~entity~~ combination at a future acquisition date. The term of the forward contract should not exceed a reasonable period normally necessary to obtain any required approvals and to complete the transaction.**

…

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

Definitions of four categories of financial instruments

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

…

(aa) **It is contingent consideration of an acquirer in a PBE ~~business~~ combination to which PBE IPSAS 40 ~~IFRS 3 Business~~ *PBE Combinations* applies.**

…

126.7 **PBE IPSAS 40, issued in [date], amended paragraphs 2, 10, AG35, AG131 and B4. An entity shall apply those amendments when it applies PBE IPSAS 40.**

In Appendix A, paragraphs AG35 and AG131 are amended. New text is underlined and deleted text is struck through.

AG35. Sales before maturity could satisfy the condition in paragraph 10 – and therefore not raise a question about the entity's intention to hold other investments to maturity – if they are attributable to any of the following:

…

(c) A major PBE ~~entity~~ combination or major disposition (such as a sale of a segment) that necessitates the sale or transfer of held-to-maturity investments to maintain the entity's existing interest rate risk position or credit risk policy (although the PBE ~~entity~~ combination is an event within the entity's control, the changes to its investment portfolio to maintain an interest rate risk position or credit risk policy may be consequential rather than anticipated).

…

AG131. A firm commitment to acquire an entity or an integrated set of activities in a~~n~~ PBE ~~entity~~ combination cannot be a hedged item, except for foreign exchange risk, because the other risks being hedged cannot be specifically identified and measured. These other risks are general operational risks.

In Appendix B, paragraph B4 is amended. New text is underlined and deleted text is struck through.

B4. This Appendix applies to all embedded derivatives within the scope of PBE IPSAS 29 except the acquisition of contracts with embedded derivatives in a~~n~~ PBE ~~entity~~ combination or their possible reassessment at the date of acquisition.

In the Implementation Guidance, example F.2.3 is amended. New text is underlined and deleted text is struck through.

F.2.3 Hedge Accounting: Core Deposit Intangibles

Is hedge accounting treatment permitted for a hedge of the fair value exposure of core deposit intangibles?

It depends on whether the core deposit intangible is generated internally or acquired (e.g., as part of a~~n~~ PBE ~~entity~~ combination).

…

PBE IPSAS 31 *Intangible Assets*[18]

Paragraphs 39.1–39.5 are renumbered as paragraphs 39A–39E.
Paragraphs 39.6–39.8 are renumbered as paragraphs 39.1–39.3.
Paragraphs 6, 18, 24, 39A–39D and the related headings, 40, 41, 66, 67, 93 and 117 are amended.
Paragraphs 18A, 26A, 93A, 114A and 133.8 and a heading above paragraph 18 are added.
Paragraphs 3(e), 3(f) and 114.1 are deleted.
New text is underlined and deleted text is struck through.

3. **This Standard shall be applied in accounting for intangible assets, except:**

…

(e) [Deleted by IPSASB] ~~[Not used]~~

(f) [Deleted by IPSASB] ~~**Goodwill acquired in a business combination (see PBE IFRS 3 *Business Combinations*);**~~

…

6. If another PBE Standard prescribes the accounting for a specific type of intangible asset, an entity applies that PBE Standard instead of this Standard. For example, this Standard does not apply to:

…

(d) Financial assets as defined in PBE IPSAS 28. The recognition and measurement of some financial assets are covered by PBE IPSAS 34 *Separate Financial Statements*, PBE IPSAS 35 *Consolidated Financial Statements* and PBE IPSAS 36 *Investments in Associates and Joint Ventures;* ~~and~~

(e) Recognition and initial measurement of service concession assets that are within the scope of PBE IPSAS 32 *Service Concession Assets: Grantor*. However, this Standard applies to the subsequent measurement and disclosure of such assets~~.~~; and

(f) Goodwill (see PBE IPSAS 40 *PBE Combinations*).

…

Identifiability

18. Not all the items described in paragraph 17 meet the definition of an intangible asset, i.e., identifiability, control over a resource, and existence of future economic benefits or service potential. If an item within the scope of this Standard does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred. However, if the item is acquired in an acquisition, it forms part of the goodwill recognised at the acquisition date (see paragraph 66).

[18] The IPSASB's explanation for these changes is set out in IPSAS 31 *Intangible Assets* paragraph BC4A.

18A. The definition of an intangible asset requires an intangible asset to be identifiable to distinguish it from goodwill. Goodwill recognised in an acquisition is an asset representing the future economic benefits arising from other assets acquired in an acquisition that are not individually identified and separately recognised. The future economic benefits may result from synergy between the identifiable assets acquired or from assets that, individually, do not qualify for recognition in the financial statements.

…

24. An entity may have a portfolio of users of its services or its success rate in reaching intended users of its services and expect that, because of its efforts in building relationships with users of its services, those users will continue to use its services. However, in the absence of legal rights to protect, or other ways to control the relationships with users of a service or the loyalty of those users, the entity usually has insufficient control over the expected economic benefits or service potential from relationships with users of a service and loyalty for such items (e.g., portfolio of users of a service, market shares or success rates of a service, relationships with, and loyalty of, users of a service) to meet the definition of intangible assets. In the absence of legal rights to protect such relationships, exchange transactions for the same or similar non-contractual customer relationships (other than as part of an acquisition) provide evidence that the entity is nonetheless able to control the expected future economic benefits or service potential flowing from the relationships with the users of a service. Because such exchange transactions also provide evidence that the relationships with users of a service are separable, those relationships meet the definition of an intangible asset.

…

26A. Paragraphs 32–39 deal with the application of the recognition criteria to separately acquired intangible assets, and paragraphs 39.1–41 deal with their application to intangible assets acquired in a PBE combination. Paragraphs 42–43 deal with the initial measurement of intangible assets acquired through non-exchange transactions, paragraphs 44–45 with exchanges of intangible assets, and paragraphs 46–48 with the treatment of internally generated goodwill. Paragraphs 49–65 deal with the initial recognition and measurement of internally generated intangible assets.

…

Acquisition of an Intangible Asset as Part of an Acquisition (PBE ~~Business~~ Combination)

39A.~~1~~ In accordance with PBE IPSAS 40 ~~IFRS 3~~, if an intangible asset is acquired in an acquisition ~~business combination~~, the cost of that intangible asset is its fair value at the acquisition date. The fair value of an intangible asset will reflect expectations about the probability that the future economic benefits or service potential embodied in the asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits or service potential, even if there is uncertainty about the timing or the amount of the inflow. Therefore, the probability recognition criterion in paragraph 28(a) is always considered to be satisfied for intangible assets acquired in acquisitions ~~business combinations~~. If an asset acquired in an acquisition ~~business combination~~ is separable or arises from binding arrangements (including rights from contracts~~ual~~ or other legal rights), sufficient information exists to measure reliably the fair value of the asset. Thus, the reliable measurement criterion in paragraph 28(b) is always considered to be satisfied for intangible assets acquired in acquisitions ~~business combinations~~.

39B.~~2~~ In accordance with this Standard and PBE IPSAS 40 ~~IFRS 3~~, an acquirer recognises at the acquisition date, separately from goodwill, an intangible asset of the acquired operation ~~acquiree~~, irrespective of whether the asset had been recognised by the acquired operation ~~acquiree~~ before the acquisition ~~business combination~~. This means that the acquirer recognises as an asset separately from goodwill an in-process research and development project of the acquired operation ~~acquiree~~ if the project meets the definition of an intangible asset. An acquired operation's ~~acquiree's~~ in-process research and development project meets the definition of an intangible asset when it:

(a) Meets the definition of an asset; and

(b) Is identifiable, i.e., is separable or arises from binding arrangements (including rights from contracts~~ual~~ or other legal rights).

Measuring the Fair Value of an Intangible Asset Acquired in an Acquisition (PBE ~~Business~~ Combination)

39C.~~3~~ If an intangible asset acquired in an acquisition ~~business combination~~ is separable or arises from binding arrangements (including rights from contracts~~ual~~ or other legal rights), sufficient information exists to measure reliably the fair value of the asset. When, for the estimates used to measure an intangible asset's fair value, there is a range of possible outcomes with different probabilities, that uncertainty enters into the measurement of the asset's fair value.

39D.~~4~~ An intangible asset acquired in an acquisition ~~business combination~~ might be separable, but only together with a binding arrangement ~~related contract~~, identifiable asset or liability. In such cases, the acquirer recognises the intangible assets separately from goodwill but together with the related item.

39E.~~5~~ …

39.1~~6~~ …

39.2~~7~~ …

39.3~~8~~ Entities that are involved in the purchase and sale of intangible assets may have developed techniques for estimating their fair values indirectly. These techniques may be used for initial measurement of an intangible asset acquired in an acquisition ~~business combination~~ if their objective is to estimate fair value and if they reflect current transactions and practices in the industry to which the asset belongs. These techniques include, for example:

…

40. **Research or development expenditure that:**

    (a) **Relates to an in-process research or development project acquired separately or in an acquisition and recognised as an intangible asset; and**

    …

41. Applying the requirements in paragraphs 52–60 means that subsequent expenditure on an in-process research or development project acquired separately or in an acquisition and recognised as an intangible asset is:

    …

66. **Expenditure on an intangible item shall be recognised as an expense when it is incurred unless:**

    (a) **It forms part of the cost of an intangible asset that meets the recognition criteria (see paragraphs 26–65); or**

    (b) **The item is acquired in an acquisition ~~business combination~~ and cannot be recognised as an intangible asset. If this is the case, it forms part of the amount recognised as goodwill at the acquisition date (see PBE IPSAS 40 ~~IFRS 3~~).**

67. In some cases, expenditure is incurred to provide future economic benefits or service potential to an entity, but no intangible asset or other asset is acquired or created that can be recognised. In the case of the supply of goods, the entity recognises such expenditure as an expense when it has a right to access those goods. In the case of the supply of services, the entity recognises the expenditure as an expense when it receives the services. For example, expenditure on research is recognised as an expense when it is incurred (see paragraph 52), except when it is acquired as part of an acquisition ~~business combination~~. Other examples of expenditure that is recognised as an expense when it is incurred include:

    …

93. **The useful life of an intangible asset that arises from binding arrangements (including rights from contracts or other legal rights) shall not exceed the period of the binding arrangement (including rights from contracts or other legal rights), but may be shorter depending on the period over which the entity expects to use the asset. If the binding arrangements (including rights from contracts or other legal rights) are conveyed for a limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost. ~~The useful life of a reacquired right recognised as an intangible asset in a business combination is the remaining contractual period of the contract in which the right was granted and shall not include renewal periods.~~**

93A. **The useful life of:**

    (a) **A license or similar right previously granted by one combining operation to another combining operation that is recognised by the resulting entity in an amalgamation; or**

(b) **A reacquired right recognised as an intangible asset in an acquisition**

is the remaining period of the binding arrangement (including rights from contracts or other legal rights) in which the right was granted and shall not include renewal periods.

…

114A. In the case of:

(a) A license or similar right previously granted by one combining operation to another combining operation that is recognised by the resulting entity in an amalgamation; or

(b) A reacquired right recognised as an intangible asset in an acquisition,

if the right is subsequently reissued (sold) to a third party, the related carrying amount, if any, shall be used in determining the gain or loss on reissue.

114.1 [Deleted by NZASB] ~~In the case of a reacquired right in a business combination, if the right is subsequently reissued (sold) to a third party, the related carrying amount, if any, shall be used in determining the gain or loss on reissue.~~

…

117. An entity shall disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:

…

(e) A reconciliation of the carrying amount at the beginning and end of the period showing:

(i) Additions, indicating separately those from internal development, ~~and~~ those acquired separately, and those acquired through acquisitions;

…

133.8 **PBE IPSAS 40, issued in [date], renumbered paragraphs 39.1–39.5 as paragraphs 39A–39E and paragraphs 39.6–39.8 as paragraphs 39.1–39.3, amended paragraphs 6, 18, 24, 39A–39D and the related headings, 40, 41, 66, 67, 93 and 117, added paragraphs 18A 26A, 93A and 114A and a heading above paragraph 18, and deleted paragraphs 3(e), 3(f) and 114.1. An entity shall apply those amendments when it applies PBE IPSAS 40.**

In the Basis for Conclusions, paragraph BC6.1 is added. New text is underlined. Paragraph BC6 has not been amended but has been included for context when reading paragraph BC6.1.

Goodwill and Intangible Assets Acquired in a Business Combination

BC6. NZ IAS 38 *Intangible Assets* contains requirements and guidance on intangible assets acquired in a business combination. When the IPSASB first issued IPSAS 31, which is based on IAS 38, it had not developed an IPSAS on business combinations. The IPSASB therefore excluded intangible assets acquired in a business combination from the scope of IPSAS 31. As a consequence of deciding that PBE IFRS 3 *Business Combinations* should form part of the suite of PBE Standards the NZASB agreed that PBE IPSAS 31 should include guidance on intangible assets acquired in a business combination.

BC6.1 In January 2017 the IPSASB issued IPSAS 40 *Public Sector Combinations* and incorporated guidance in IPSAS 31 on intangible assets acquired in a public sector combination. In [date] the NZASB issued PBE IPSAS 40 *PBE Combinations* and incorporated guidance in PBE IPSAS 31 on intangible assets acquired in a PBE combination. PBE IPSAS 31 and IPSAS 31 are now broadly aligned in relation to this matter.

Comparison with IPSAS 31

Deleted text is struck through.

PBE IPSAS 31 *Intangible Assets* is drawn from IPSAS 31 *Intangible Assets*.

The significant differences between PBE IPSAS 31 and IPSAS 31 are:

(a) PBE IPSAS 31 requires that where intangible heritage assets are able to be reliably measured they shall be recognised.

~~(b) PBE IPSAS 31 includes guidance on goodwill and intangible assets acquired in a business combination~~.

(b)~~(c)~~ PBE IPSAS 31 does not require disclosure of the carrying amount that would have been recognised had a revalued class of intangible assets been measured after initial recognition using the cost model.

(c)~~(d)~~ PBE Standards require the presentation of a statement of comprehensive revenue and expense. IPSASs require the presentation of a statement of financial performance.

PBE IPSAS 35 *Consolidated Financial Statements*

Paragraph 4 and its related heading, paragraphs 40, 56, 57, 63 and 74 are amended and paragraphs 55A and 79.4 are added. New text is underlined and deleted text is struck through.

PBE ~~Business~~ Combinations

4. This Standard does not deal with the accounting requirements for entity combinations and their effect on consolidation, including goodwill arising on an entity combination (guidance on accounting for entity combinations can be found in PBE IPSAS 40 ~~IFRS 3~~ PBE ~~*Business*~~ *Combinations*).

…

40. Consolidated financial statements:

(a) …

(b) Offset (eliminate) the carrying amount of the controlling entity's investment in each controlled entity and the controlling entity's portion of net assets/equity of each controlled entity (PBE IPSAS 40 ~~IFRS 3~~ explains how to account for any related goodwill).

…

55A. [Not used]

56. **Except as described in paragraph 57, an investment entity shall not consolidate its controlled entities or apply PBE IPSAS 40 ~~IFRS 3~~ when it obtains control of another entity. Instead, an investment entity shall measure an investment in a controlled entity at fair value through surplus or deficit in accordance with PBE IPSAS 29.**

57. **Notwithstanding the requirement in paragraph 56, if an investment entity has a controlled entity that is not itself an investment entity and whose main purpose and activities are providing services that relate to the investment entity's investment activities (see paragraphs AG98–AG100), it shall consolidate that controlled entity in accordance with paragraphs 38–55 of this Standard and apply the requirements of PBE IPSAS 40 ~~IFRS 3~~ to the acquisition of any such controlled entity.**

…

63. **When an entity ceases to be an investment entity, it shall apply PBE IPSAS 40 ~~IFRS 3~~ to any controlled entity that was previously measured at fair value through surplus or deficit in accordance with paragraph 56. The date of the change of status shall be the deemed acquisition date. The fair value of the controlled entity at the deemed acquisition date shall represent the transferred deemed consideration when measuring any goodwill or gain from a bargain purchase that arises from the deemed acquisition. All controlled entities shall be consolidated in accordance with paragraphs 38–51 of this Standard from the date of change of status.**

…

74. **If, at the date of initial application, an entity concludes that it shall consolidate another entity that was not consolidated in accordance with PBE IPSAS 6 (PS) or PBE IPSAS 6 (NFP), the entity shall:**

(a) **If the other entity is a business (as defined in PBE IFRS 3),[2] measure the assets, liabilities and non-controlling interests in that previously unconsolidated entity as if that entity had been consolidated (and thus had applied acquisition accounting in accordance with PBE IFRS 3) from the date when the entity obtained control of that other entity on the basis of the requirements of this Standard. The entity shall adjust retrospectively the annual period immediately preceding the date of initial application. When the date that control was obtained is earlier than the beginning of the immediately preceding period, the entity shall recognise,**

as an adjustment to net assets/equity at the beginning of the immediately preceding period, any difference between:

…

[2] PBE IFRS 3 remains applicable until PBE IPSAS 40 is applied or becomes effective, whichever is earlier.

79.4 **PBE IPSAS 40, issued in [date], amended paragraphs 4 and its related heading, 40, 56, 57, 63, and 74, and added paragraph 55A. An entity shall apply those amendments when it applies PBE IPSAS 40.**

In the Basis for Conclusions, paragraph BC3 is amended and paragraph BC3.1 is added. New text is underlined and deleted text is struck through.

Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

BC3. PBE IPSAS 35 does not incorporate the IASB®~~’s~~ narrow scope amendments in *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (Amendments to IFRS 10 and IAS 28), which the IASB issued in September 2014 and the NZASB issued for application by for-profit entities shortly thereafter. These narrow scope amendments established requirements for the recognition of a partial gain or loss for transactions between an investor and its associate or joint venture dependent on whether the sale or contribution of assets constitutes a business as defined in IFRS 3 *Business Combinations*. The IPSASB did not incorporate these requirements in IPSAS 35 because the IPSASB, at that stage, had not developed a standard dealing with combinations of entities. Given the existence of PBE IFRS 3 *Business Combinations* within PBE Standards, the NZASB considered incorporating these amendments in PBE IPSAS 35. However, following the IASB’s decision to defer the effective date of these amendments (pending further work on its equity method project) the NZASB decided not to incorporate these amendments in PBE IPSAS 35.

BC3.1 In January 2017 the IPSASB issued IPSAS 40 *Public Sector Combinations*. IPSAS 40 incorporated *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (Amendments to IFRS 10 and IAS 28) and *Effective Date of Amendments to IFRS 10 and IAS 28* (issued by the IASB in December 2015) in IPSAS 35. In developing PBE IPSAS 40 *PBE Combinations* the NZASB reconsidered incorporating these amendments in PBE IPSAS 35 but, given the IASB’s decision in May 2016 to defer work on its Equity Method research project until it has undertaken post-implementation reviews of certain standards, decided not to incorporate these amendments in PBE IPSAS 35.

In the Illustrative Examples, paragraph IE 13A is added. New text is underlined.

IE13A. [Not used]

PBE IPSAS 36 *Investments in Associates and Joint Ventures*

Paragraph 26 is amended and paragraphs 34A–34B and 51.4 are added. New text is underlined and deleted text is struck through.

26. **An entity shall discontinue the use of the equity method from the date when its investment ceases to be an associate or a joint venture as follows:**

(a) **If the investment becomes a controlled entity, the entity shall account for its investment in accordance with PBE IPSAS 40 ~~IFRS 3~~ *PBE* ~~*Business*~~ *Combinations* and PBE IPSAS 35.**

…

34A–34B. [Not used]

…

51.4 **PBE IPSAS 40, issued in [date], amended paragraph 26 and added paragraphs 34A–34B. An entity shall apply that amendment when it applies PBE IPSAS 40.**

In the Basis for Conclusion, paragraph BC3 is amended and paragraph BC3.1 is added. New text is underlined and deleted text is struck through.

Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

BC3. PBE IPSAS 36 does not incorporate the IASB®~~’s~~ narrow scope amendments in *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (Amendments to IFRS 10 and IAS 28), issued in September 2014. These narrow scope amendments established requirements for the recognition of a partial gain or loss for transactions between an investor and its associate or joint venture dependent on whether the sale or contribution of assets constitutes a business as defined in IFRS 3 *Business Combinations*. The IPSASB did not incorporate these requirements in IPSAS 36 because the IPSASB, at that stage, had not developed a standard dealing with combinations of entities. Given the existence of PBE IFRS 3 *Business Combinations* within PBE Standards, the NZASB considered incorporating these amendments in PBE IPSAS 36. However, following the IASB’s decision to defer the effective date of these amendments (pending further work on its equity method project) the NZASB decided not to incorporate these amendments in PBE IPSAS 36.

BC3.1 In January 2017 the IPSASB issued IPSAS 40 *Public Sector Combinations*. IPSAS 40 incorporated *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (Amendments to IFRS 10 and IAS 28) and the IASB *Effective Date of Amendments to IFRS 10 and IAS 28* (issued by the IASB in December 2015) in IPSAS 35. In developing PBE IPSAS 40 *PBE Combinations* the NZASB reconsidered incorporating these amendments in PBE IPSAS 36 but, given the IASB’s decision in May 2016 to defer work on its Equity Method research project until it has undertaken post-implementation reviews of certain standards, decided not to incorporate these amendments in PBE IPSAS 36.

PBE IPSAS 37 *Joint Arrangements*

Paragraph 24.1 is amended and paragraphs 41A and 42.4 are added. New text is underlined and deleted text is struck through.

24.1 When an entity acquires an interest in a joint operation in which the activity of the joint operation constitutes an operation ~~business~~, as defined in PBE IPSAS 40 ~~IFRS 3~~ *PBE* ~~*Business*~~ *Combinations*, it shall apply, to the extent of its share in accordance with paragraph 23, all of the principles on acquisition ~~business combinations~~ accounting in PBE IPSAS 40 ~~IFRS 3~~, and other PBE Standards, that do not conflict with the guidance in this Standard and disclose the information that is required in those PBE Standards in relation to acquisitions ~~business combinations~~. This applies to the acquisition of both the initial interest and additional interests in a joint operation in which the activity of the joint operation constitutes an operation ~~business~~. The accounting for the acquisition of an interest in such a joint operation is specified in paragraphs AG33.1–AG33.4.

41A. [Not used]

42.4 **PBE IPSAS 40, issued in [date], amended paragraphs 24.1 and AG33.1–AG33.3A and added paragraph 41A. An entity shall apply those amendments when it applies PBE IPSAS 40.**

In Appendix A, paragraphs AG33.1–AG33.3A are amended.[19] New text is underlined and deleted text is struck through.

AG33.1 When an entity acquires an interest in a joint operation in which the activity of the joint operation constitutes an operation ~~business~~, as defined in PBE IPSAS 40 ~~IFRS 3~~, it shall apply, to the extent of its share in accordance with paragraph 23, all of the principles on acquisition ~~business combinations~~ accounting in PBE IPSAS 40 ~~IFRS 3~~, and other PBE Standards, that do not conflict with the guidance in this Standard and disclose the information required by those PBE Standards in relation to acquisitions ~~business combinations~~. The principles on acquisition ~~business combinations~~ accounting that do not conflict with the guidance in this Standard include but are not limited to:

[19] NZASB ED 2018-3 *2018 Omnibus Amendments to PBE Standards* proposes to add paragraph AG33.3A.

(a) Measuring identifiable assets and liabilities at fair value, other than items for which exceptions are given in PBE IPSAS 40 ~~IFRS 3~~ and other PBE Standards;

(b) Recognising acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with the exception that the costs to issue debt or equity securities are recognised in accordance with PBE IPSAS 28 and PBE IPSAS 29;

(c) Recognising deferred tax assets and deferred tax liabilities that arise from the initial recognition of assets or liabilities, except for deferred tax liabilities that arise from the initial recognition of goodwill, as required by PBE IPSAS 40 ~~IFRS 3~~ and PBE IAS 12 for acquisitions ~~business combinations~~;

(d) Recognising the excess of the consideration transferred over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed, if any, as goodwill; and

(e) Testing for impairment a cash-generating unit to which goodwill has been allocated at least annually, and whenever there is an indication that the unit may be impaired, as required by PBE IPSAS 26 *Impairment of Cash-Generating Assets* for goodwill acquired in an acquisition ~~business combination~~.

AG33.2 Paragraphs 24.1 and AG33.1 also apply to the formation of a joint operation if, and only if, an existing operation ~~business~~, as defined in PBE IPSAS 40 ~~IFRS 3~~, is contributed to the joint operation on its formation by one of the parties that participate in the joint operation. However, those paragraphs do not apply to the formation of a joint operation if all of the parties that participate in the joint operation only contribute assets or groups of assets that do not constitute operations ~~businesses~~ to the joint operation on its formation.

AG33.3 A joint operator might increase its interest in a joint operation in which the activity of the joint operation constitutes an operation ~~business~~, as defined in PBE IPSAS 40 ~~IFRS 3~~, by acquiring an additional interest in the joint operation. In such cases, previously held interests in the joint operation are not remeasured if the joint operator retains joint control.

AG33.3A A party that participates in, but does not have joint control of, a joint operation might obtain joint control of the joint operation in which the activity of the joint operation constitutes an operation as defined in PBE IPSAS 40~~IFRS 3~~. In such cases, previously held interests in the joint operation are not remeasured.

In the Illustrative Examples, Illustrative examples 8 and 9 are added.

Example 8–Accounting for Acquisitions of Interests in Joint Operations in which the Activity Constitutes an Operation

IE60. Municipalities A, B and C have joint control of Joint Operation D whose activity constitutes an operation, as defined in PBE IPSAS 40 *PBE Combinations*.

IE61. Municipality E acquires municipality A's 40 percent ownership interest in Joint Operation D at a cost of CU300 and incurs acquisition-related costs of CU50.

IE62. The binding arrangement between the parties that Municipality E joined as part of the acquisition establishes that Municipality E's shares in several assets and liabilities differ from its ownership interest in Joint Operation D. The following table sets out Municipality E's share in the assets and liabilities related to Joint Operation D as established in the binding arrangement between the parties:

	Municipality E's share in the assets and liabilities related to Joint Operation D
Property, plant and equipment	48%
Intangible assets (excluding goodwill)	90%
Accounts receivable	40%
Inventory	40%
Retirement benefit obligations	15%
Accounts payable	40%
Contingent liabilities	56%

Analysis

IE63. Municipality E recognises in its financial statements its share of the assets and liabilities resulting from the contractual arrangement (see paragraph 23).

IE64. It applies the principles on acquisition accounting in PBE IPSAS 40 and other PBE Standards for identifying, recognising, measuring and classifying the assets acquired, and the liabilities assumed, on the acquisition of the interest in Joint Operation D. This is because Municipality E acquired an interest in a joint operation in which the activity constitutes an operation (see paragraph 24.1).

IE65. However, Municipality E does not apply the principles on acquisition accounting in PBE IPSAS 40 and other PBE Standards that conflict with the guidance in this Standard. Consequently, in accordance with paragraph 23, Municipality E recognises, and therefore measures, in relation to its interest in Joint Operation D, only its share in each of the assets that are jointly held and in each of the liabilities that are incurred jointly, as stated in the binding arrangement. Municipality E does not include in its assets and liabilities the shares of the other parties in Joint Operation D.

IE66. PBE IPSAS 40 requires the acquirer to measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values with limited exceptions; for example, a reacquired right recognised as an intangible asset is measured on the basis of the remaining term of the related binding arrangement regardless of whether market participants would consider potential renewals of binding arrangements when measuring its fair value. Such measurement does not conflict with this Standard and thus those requirements apply.

IE67. Consequently, Municipality E determines the fair value, or other measure specified in PBE IPSAS 40, of its share in the identifiable assets and liabilities related to Joint Operation D. The following table sets out the fair value or other measure specified by PBE IPSAS 40 of Municipality E's shares in the identifiable assets and liabilities related to Joint Operation D:

	Fair value or other measure specified by PBE IPSAS 40 for Municipality E's shares in the identifiable assets and liabilities of Joint Operation D **(CU)**
Property, plant and equipment	138
Intangible assets (excluding goodwill)	72
Accounts receivable	84
Inventory	70
Retirement benefit obligations	(12)
Accounts payable	(48)
Contingent liabilities	(52)
Deferred tax liability (see PBE IAS 12 dealing with income taxes)	(24)
Net assets	**228**

IE68. In accordance with PBE IPSAS 40, the excess of the consideration transferred over the amount allocated to Municipality E's shares in the net identifiable assets is recognised as goodwill:

Consideration transferred	CU300
Municipality E's shares in the identifiable assets and liabilities relating to its interest in the joint operation	CU228
Goodwill	**CU72**

IE69. Acquisition-related costs of CU50 are not considered to be part of the consideration transferred for the interest in the joint operation. They are recognised as expenses in surplus or deficit in the period that the costs are incurred and the services are received (see paragraph 111 of PBE IPSAS 40).

Example 9–Contributing the Right to Use Know-how to a Joint Operation in which the Activity Constitutes an Operation

IE70. Entities A and B are two entities whose activities are the construction of high performance batteries for diverse applications.

IE71. In order to develop batteries for electric vehicles they set up a binding arrangement (Joint Operation Z) to work together. Entities A and B share joint control of Joint Operation Z. This arrangement is a joint operation in which the activity constitutes an operation, as defined in PBE IPSAS 40.

IE72. After several years, the joint operators (Entities A and B) concluded that it is feasible to develop a battery for electric vehicles using Material M. However, processing Material M requires specialist know-how and thus far, Material M has only been used in electricity generation.

IE73. In order to get access to existing know-how in processing Material M, Entities A and B arrange for Entity C to join as another joint operator by acquiring an interest in Joint Operation Z from Entities A and B and becoming a party to the binding arrangements.

IE74. Entity C's activity so far has been solely the generation of electricity. It has long-standing and extensive knowledge in processing Material M.

IE75. In exchange for its share in Joint Operation Z, Entity C pays cash to Entities A and B and grants the right to use its know-how in processing Material M for the purposes of Joint Operation Z. In addition, Entity C seconds some of its employees who are experienced in processing Material M to Joint Operation Z. However, Entity C does not transfer control of the know-how to Entities A and B or Joint Operation Z because it retains all the rights to it. In particular, Entity C is entitled to withdraw the right to use its know-how in processing Material M and to withdraw its seconded employees without any restrictions or compensation to Entity A and B or Joint Operation Z if it ceases its participation in Joint Operation Z.

IE76. The fair value of Entity C's know-how on the date of the acquisition of the interest in the joint operation is CU1,000. Immediately before the acquisition, the carrying amount of the know-how in the financial statements of Entity C was CU300.

Analysis

IE77. Entity C has acquired an interest in Joint Operation Z in which the activity of the joint operation constitutes an operation, as defined in PBE IPSAS 40.

IE78 In accounting for the acquisition of its interest in the joint operation, Entity C applies all the principles on acquisition accounting in PBE IPSAS 40 and other PBE Standards that do not conflict with the guidance in this Standard (see paragraph 24.1). Entity C therefore recognises in its financial statements its share of the assets and liabilities resulting from the binding arrangement (see paragraph 23).

IE79. Entity C granted the right to use its know-how in processing Material M to Joint Operation Z as part of joining Joint Operation Z as a joint operator. However, Entity C retains control of this right because it is entitled to withdraw the right to use its know-how in processing Material M and to withdraw its seconded employees without any restrictions or any compensation to Entities A and B or Joint Operation Z if it ceases its participation in Joint Operation Z.

IE80. Consequently, Entity C continues to recognise the know-how in processing Material M after the acquisition of the interest in Joint Operation Z because it retains all the rights to it. This means that Entity C will continue to recognise the know-how based on its carrying amount of CU300. As a consequence of retaining control of the right to use the know-how that it granted to the joint operation, Entity C has granted the right to use the know-how to itself. Consequently, Entity C does not remeasure the know-how, and it does not recognise a gain or loss on the grant of the right to use it.

Comparison with IPSAS 37

Deleted text is struck through.

PBE IPSAS 37 *Joint Arrangements*, is drawn from IPSAS 37 *Joint Arrangements*. ~~PBE IPSAS 37 includes the IASB's *Accounting for Acquisitions of Interests in Joint Operations* (Amendments to IFRS 11) issued in May 2014 whereas IPSAS 37 does not.~~ There are no ~~other~~ significant differences between PBE IPSAS 37 and IPSAS 37.

PBE IFRS 4 *Insurance Contracts*

Paragraphs 4, 17, 31 and its related heading, 33 and 34 are amended. Paragraph is 45.7 is added. New text is underlined and deleted text is struck through.

4. An entity shall not apply this Standard to:

…

(e) Contingent consideration payable or receivable in a <u>PBE</u> ~~business~~ combination (see PBE <u>IPSAS 40</u> ~~IFRS 3~~ *<u>PBE</u> ~~Business~~ Combinations*).

…

17. If an insurer's accounting policies do not require a liability adequacy test that meets the minimum requirements of paragraph 16, the insurer shall:

(a) Determine the carrying amount of the relevant insurance liabilities[6] less the carrying amount of:

(i) Any related deferred acquisition costs; and

(ii) Any related intangible assets, such as those acquired in a <u>PBE</u> ~~business~~ combination or portfolio transfer (see paragraphs 31 and 32). However, related reinsurance assets are not considered because an insurer accounts for them separately (see paragraph 20).

[6] Footnote 6 is not shown.

…

Insurance Contracts Acquired in a <u>PBE</u> ~~Business~~ Combination or Portfolio Transfer

31. To comply with PBE <u>IPSAS 40</u> ~~IFRS 3~~, an insurer shall, at the acquisition date, measure at fair value the insurance liabilities assumed and insurance assets acquired in a <u>PBE</u> ~~business~~ combination. However, an insurer is permitted, but not required, to use an expanded presentation that splits the fair value of acquired insurance contracts into two components:

…

33. The intangible assets described in paragraphs 31 and 32 are excluded from the scope of PBE IPSAS 26 *Impairment of Cash-Generating Assets* and PBE IPSAS 31. However, PBE IPSAS 26 and PBE IPSAS 31 apply to customer lists and customer relationships reflecting the expectation of future contracts that are not part of the contractual insurance rights and contractual insurance obligations that existed at the date of a <u>PBE</u> ~~business~~ combination or portfolio transfer.

34. Some insurance contracts contain a discretionary participation feature as well as a guaranteed element. The issuer of such a contract:

…

(c) May recognise all premiums received as revenue without separating any portion that relates to the net assets/equity component. The resulting changes in the guaranteed element and in the portion of the discretionary participation feature classified as a liability shall be recognised in surplus or deficit. If part or all of the discretionary participation feature is classified in net assets/equity, a portion of surplus or deficit may be attributable to that feature (in the same way that a portion may be attributable to <u>non-controlling</u> ~~minority~~ interests). The issuer shall recognise the portion of surplus or deficit attributable to any net assets/equity component of a discretionary participation feature as an allocation of surplus or deficit, not as expense or revenue (see PBE IPSAS 1 *Presentation of Financial Reports*).

…

45.7 PBE IPSAS 40, issued in [date], amended paragraphs 4, 17, 31 and its related heading, 33, 34, C13.1.1 and its related heading, C13.1.3, C17.5.4, D2.2, D13.3.1 and its related heading and D13.3.3. An entity shall apply those amendments when it applies PBE IPSAS 40.

In Appendix C, paragraphs C13.1.1 and its related heading, C13.1.3 and C17.5.4 are amended. New text is underlined and deleted text is struck through.

Life Insurance Contracts Acquired in a PBE ~~Business~~ Combination or Portfolio Transfer

C13.1.1 To comply with PBE IPSAS 40 ~~IFRS 3~~ *PBE* ~~*Business*~~ *Combinations*, an insurer shall, at the acquisition date, measure at fair value the insurance liabilities assumed and insurance assets acquired in a business combination. However, an insurer is permitted, but not required, to use an expanded presentation that splits the fair value of acquired insurance contracts into two components:

…

C13.1.3 The intangible assets described in paragraphs C13.1.1 and C13.1.2 are excluded from the scope of PBE IPSAS 26 *Impairment of Cash-Generating Assets* and from the scope of PBE IPSAS 31 *Intangible Assets* in respect of recognition and measurement. PBE IPSAS 26 and PBE IPSAS 31 apply to customer lists and customer relationships reflecting the expectation of future contracts that are not part of the contractual insurance rights and contractual insurance obligations that existed at the date of a PBE ~~business~~ combination or portfolio transfer.

C17.5.4 Where a life insurance contract with a discretionary participation feature is issued by a foreign life operation, the issuer of such a contract:

…

(c) May recognise all premiums received as revenue without separating any portion that relates to the net assets/equity component. The resulting changes in the guaranteed element and in the portion of the discretionary participation feature classified as a liability shall be recognised in surplus or deficit. If part of the entire discretionary participation feature is classified directly in net assets/equity, a portion of surplus or deficit may be attributable to that feature (in the same way that a portion may be attributable to non-controlling ~~minority~~ interests). The issuer shall recognise the portion of surplus or deficit attributable to any net assets/equity component of a discretionary participation feature as an allocation of surplus or deficit, not as expense or revenue (see PBE IPSAS 1 *Presentation of Financial Reports*);

…

In Appendix D, paragraphs D2.2, D13.3.1 and its related heading and D13.3.3 are amended. New text is underlined and deleted text is struck through.

D2.2 **This Appendix does not apply to:**

…

(d) **Contingent consideration payable or receivable in a PBE ~~business~~ combination (see PBE IPSAS 40 ~~IFRS 3~~ *PBE* ~~*Business*~~ *Combinations*);**

…

Portfolio Transfers and PBE ~~Business~~ Combinations

…

D13.3.1 To comply with PBE IPSAS 40 ~~IFRS 3~~, an insurer shall, at the acquisition date, measure at fair value the insurance liabilities assumed and insurance assets acquired in a PBE ~~business~~ combination. However, an insurer is permitted, but not required, to use an expanded presentation that splits the fair value of acquired insurance contracts into two components:

…

D13.3.3 The intangible assets described in paragraphs D13.3.1 and D13.3.2 are excluded from the scope of PBE IPSAS 26 and PBE IPSAS 31 in respect of recognition and measurement. PBE IPSAS 26 and PBE IPSAS 31 apply to customer lists and customer relationships reflecting the expectation of future contracts that are not part of the contractual insurance rights and contractual insurance obligations that existed at the date of a PBE ~~business~~ combination or portfolio transfer.

PBE IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

Paragraphs 5B.1 and 16 are amended and paragraph 44.8 is added. New text is underlined and deleted text is struck through.

5B.1 **The following terms are used in this Standard with the meanings specified:**

…

A disposal group is a group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction. The group includes goodwill acquired in a PBE ~~business~~ combination if the group is a cash-generating unit to which goodwill has been allocated or if it is an operation within such a cash-generating unit.

16. If a newly acquired asset (or disposal group) meets the criteria to be classified as held for sale (see paragraph 11), applying paragraph 15 will result in the asset (or disposal group) being measured on initial recognition at the lower of its carrying amount had it not been so classified (for example, cost) and fair value less costs to sell. Hence, if the asset (or disposal group) is acquired as part of a PBE ~~business~~ combination, it shall be measured at fair value less costs to sell.

Note for the Board

We do not propose any amendments to paragraph 16, other than the change in reference. We also propose no amendments to paragraph 11 (shown below).

11. When an entity acquires a non-current asset (or disposal group) exclusively with a view to its subsequent disposal, it shall classify the non-current asset (or disposal group) as held for sale at the acquisition date only if the one-year requirement in paragraph 8 is met (except as permitted by paragraph 9) and it is highly probable that any other criteria in paragraphs 7 and 8 that are not met at that date will be met within a short period following the acquisition (usually within three months).

44.8 **PBE IPSAS 40 *PBE Combinations.* issued in [date], amended paragraphs 5B.1 and 16. An entity shall apply those amendments when it applies PBE IPSAS 40.**

PBE IFRS 9 *Financial Instruments* (if an entity has early adopted PBE IFRS 9)

Paragraphs 2.1, 4.2.1 and 5.7.5 are amended and paragraph 7.1.6 is added. New text is underlined and deleted text is struck through.

2.1 This Standard shall be applied by all entities to all types of financial instruments except:

…

(f) any forward contract between an acquirer and a seller to buy or sell an acquired operation ~~acquiree~~ that will result in ~~an~~ PBE ~~entity~~ combination within the scope of PBE IPSAS 40 ~~IFRS 3~~ *PBE ~~Business~~ Combinations* at a future acquisition date. The term of the forward contract should not exceed a reasonable period normally necessary to obtain any required approvals and to complete the transaction.

…

4.2.1 **An entity shall classify all financial liabilities as subsequently measured at amortised cost, except for:**

…

(e) **contingent consideration recognised by an acquirer in a PBE ~~business~~ combination to which PBE IPSAS 40 ~~IFRS 3~~ applies. Such contingent consideration shall subsequently be measured at fair value with changes recognised in surplus or deficit.**

…

5.7.5 **At initial recognition, an entity may make an irrevocable election to present in other comprehensive revenue and expense subsequent changes in the fair value of an investment in an equity instrument within the scope of this Standard that is neither *held for trading* nor contingent consideration recognised by an acquirer in a PBE ~~business~~ combination to which PBE IPSAS 40 ~~IFRS 3~~ applies. (See paragraph B5.7.3 for guidance on foreign exchange gains or losses.)**

…

7.1.6 PBE IPSAS 40 *PBE Combinations*, issued in [date], amended paragraphs 2.1, 4.2.1, 5.7.5, B4.3.12 and B6.3.1. An entity shall apply those amendments when it applies PBE IPSAS 40.

In Appendix B, paragraphs B4.3.12 and B6.3.1 are amended. New text is underlined and deleted text is struck through.

B4.3.12 Paragraph B4.3.11 does not apply to embedded derivatives in contracts acquired in:

(a) a PBE ~~business~~ combination (as defined in PBE IPSAS 40 ~~IFRS 3~~ *PBE* ~~*Business*~~ *Combinations*); or

(b) [Deleted by NZASB] ~~a combination of entities or businesses under common control as described in paragraphs B1–B4 of PBE IFRS 3; or~~

(c) the formation of a joint venture as defined in PBE IPSAS 37 *Joint Arrangements*[8]

or their possible reassessment at the date of acquisition.[9]

[8] Footnote 8 is not shown.

[9] PBE IPSAS 40 ~~IFRS 3~~ addresses the acquisition of contracts with embedded derivatives in a PBE ~~business~~ combination.

…

B6.3.1 A firm commitment to acquire a business in a PBE ~~business~~ combination cannot be a hedged item, except for foreign currency risk, because the other risks being hedged cannot be specifically identified and measured. Those other risks are general business risks.

PBE IAS 12 *Income Taxes*

The objective, paragraphs 15, 18, 19 and its related heading, 21, 21A, 21B, 22, 24, 26, 32A, 37, 51D, 58, 66 and its related heading, 67, 68, 68C and 81 are amended. Paragraph 98.8 is added. New text is underlined and deleted text is struck through.

Objective

…

This Standard requires an entity to account for the tax consequences of transactions and other events in the same way that it accounts for the transactions and other events themselves. Thus, for transactions and other events recognised in surplus or deficit, any related tax effects are also recognised in surplus or deficit. For transactions and other events recognised outside surplus or deficit (either in other comprehensive revenue and expense or directly in net assets/equity), any related tax effects are also recognised outside surplus or deficit (either in other comprehensive revenue and expense or directly in net assets/equity, respectively). Similarly, the recognition of deferred tax assets and liabilities in a PBE ~~business~~ combination affects the amount of goodwill arising in that PBE ~~business~~ combination or the amount of the bargain purchase gain recognised.

…

15. **A deferred tax liability shall be recognised for all taxable temporary differences, except to the extent that the deferred tax liability arises from:**

    (a) **The initial recognition of goodwill; or**

    (b) **The initial recognition of an asset or liability in a transaction which:**

        (i) **Is not a PBE ~~business~~ combination; and**

    …

18. Temporary differences also arise when:

    (a) The identifiable assets acquired and liabilities assumed in a PBE ~~business~~ combination are recognised at their fair values in accordance with PBE IPSAS 40 ~~IFRS 3~~ *PBE* ~~*Business*~~ *Combinations*, but no equivalent adjustment is made for tax purposes (see paragraph 19);

    (b) Assets are revalued and no equivalent adjustment is made for tax purposes (see paragraph 20);

    (c) Goodwill arises in a PBE ~~business~~ combination (see paragraph 21);

    ...

PBE ~~*Business*~~ *Combinations*

19. With limited exceptions, the identifiable assets acquired and liabilities assumed in a PBE ~~business~~ combination are recognised at their fair values at the acquisition date. Temporary differences arise when the tax bases of the identifiable assets acquired and liabilities assumed are not affected by the PBE ~~business~~ combination or are affected differently. For example, when the carrying amount of an asset is increased to fair value but the tax base of the asset remains at cost to the previous owner, a taxable temporary difference arises which results in a deferred tax liability. The resulting deferred tax liability affects goodwill (see paragraph 66).

…

21. Goodwill arising in a PBE ~~business~~ combination is measured as the excess of (a) over (b) below:

    (a) The aggregate of:

        (i) The consideration transferred measured in accordance with PBE IPSAS 40 ~~IFRS 3~~, which generally requires acquisition-date fair value;

        (ii) The amount of any non-controlling ~~minority~~ interest in the acquired operation ~~acquiree~~ recognised in accordance with PBE IPSAS 40 ~~IFRS 3~~; and

        (iii) In a PBE ~~business~~ combination achieved in stages, the acquisition-date fair value of the acquirer's previously held equity interest in the acquired operation ~~acquiree~~.

    (b) The net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed measured in accordance with PBE IPSAS 40 ~~IFRS 3~~.

    …

21A. Subsequent reductions in a deferred tax liability that is unrecognised because it arises from the initial recognition of goodwill are also regarded as arising from the initial recognition of goodwill and are therefore not recognised under paragraph 15(a). For example, if in a PBE ~~business~~ combination an entity recognises goodwill of CU100 that has a tax base of nil, paragraph 15(a) prohibits the entity from recognising the resulting deferred tax liability. If the entity subsequently recognises an impairment loss of CU20 for that goodwill, the amount of the taxable temporary difference relating to the goodwill is reduced from CU100 to CU80, with a resulting decrease in the value of the unrecognised deferred tax liability. That decrease in the value of the unrecognised deferred tax liability is also regarded as relating to the initial recognition of the goodwill and is therefore prohibited from being recognised under paragraph 15(a).

21B. Deferred tax liabilities for taxable temporary differences relating to goodwill are, however, recognised to the extent they do not arise from the initial recognition of goodwill. For example, if in a PBE ~~business~~ combination an entity recognises goodwill of CU100 that is deductible for tax purposes at a rate of

20 per cent per year starting in the year of acquisition, the tax base of the goodwill is CU100 on initial recognition and CU80 at the end of the year of acquisition. If the carrying amount of goodwill at the end of the year of acquisition remains unchanged at CU100, a taxable temporary difference of CU20 arises at the end of that year. Because that taxable temporary difference does not relate to the initial recognition of the goodwill, the resulting deferred tax liability is recognised.

22. A temporary difference may arise on initial recognition of an asset or liability, for example if part or all of the cost of an asset will not be deductible for tax purposes. The method of accounting for such a temporary difference depends on the nature of the transaction that led to the initial recognition of the asset or liability:

(a) In a PBE ~~business~~ combination, an entity recognises any deferred tax liability or asset and this affects the amount of goodwill or bargain purchase gain it recognises (see paragraph 19);

(b) If the transaction affects either accounting profit or taxable profit, an entity recognises any deferred tax liability or asset and recognises the resulting deferred tax expense or income in surplus or deficit (see paragraph 59);

(c) If the transaction is not a PBE ~~business~~ combination, and affects neither accounting profit nor taxable profit, an entity would, in the absence of the exemption provided by paragraphs 15 and 24, recognise the resulting deferred tax liability or asset and adjust the carrying amount of the asset or liability by the same amount. Such adjustments would make the financial statements less transparent. Therefore, this Standard does not permit an entity to recognise the resulting deferred tax liability or asset, either on initial recognition or subsequently. Furthermore, an entity does not recognise subsequent changes in the unrecognised deferred tax liability or asset as the asset is depreciated.

…

24. **A deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that:**

(a) **Is not a PBE ~~business~~ combination; and**

…

26. The following are examples of deductible temporary differences that result in deferred tax assets:

…

(c) With limited exceptions, an entity recognises the identifiable assets acquired and liabilities assumed in a PBE ~~business~~ combination at their fair values at the acquisition date. When a liability assumed is recognised at the acquisition date but the related costs are not deducted in determining taxable profits until a later period, a deductible temporary difference arises which results in a deferred tax asset. A deferred tax asset also arises when the fair value of an identifiable asset acquired is less than its tax base. In both cases, the resulting deferred tax asset affects goodwill (see paragraph 66); and

…

32A. If the carrying amount of goodwill arising in a PBE ~~business~~ combination is less than its tax base, the difference gives rise to a deferred tax asset. The deferred tax asset arising from the initial recognition of goodwill shall be recognised as part of the accounting for a PBE ~~business~~ combination to the extent that it is probable that taxable profit will be available against which the deductible temporary difference could be utilised.

…

37. At the end of each reporting period, an entity reassesses unrecognised deferred tax assets. The entity recognises a previously unrecognised deferred tax asset to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered. For example, an improvement in trading conditions may make it more probable that the entity will be able to generate sufficient taxable profit in the future for the deferred tax asset to meet the recognition criteria set out in paragraphs 24 or 34. Another

example is when an entity reassesses deferred tax assets at the date of a PBE ~~business~~ combination or subsequently (see paragraphs 67 and 68).

…

51D. The rebuttable presumption in paragraph 51C also applies when a deferred tax liability or a deferred tax asset arises from measuring investment property in a PBE ~~business~~ combination if the entity will use the fair value model when subsequently measuring that investment property.

…

58. **Current and deferred tax shall be recognised as revenue or an expense and included in the surplus or deficit for the period, except to the extent that the tax arises from:**

…

(b) **A PBE ~~business~~ combination (other than the acquisition by an investment entity, as defined in PBE IPSAS 35 *Consolidated Financial Statements*, of a controlled entity that is required to be measured at fair value through surplus or deficit) (see paragraphs 66 to 68).**

…

Deferred Tax Arising from a PBE ~~Business~~ Combination

66. As explained in paragraphs 19 and 26(c), temporary differences may arise in a PBE ~~business~~ combination. In accordance with PBE IPSAS 40 ~~IFRS 3~~, an entity recognises any resulting deferred tax assets (to the extent that they meet the recognition criteria in paragraph 24) or deferred tax liabilities as identifiable assets and liabilities at the acquisition date. Consequently, those deferred tax assets and deferred tax liabilities affect the amount of goodwill or the bargain purchase gain the entity recognises. However, in accordance with paragraph 15(a), an entity does not recognise deferred tax liabilities arising from the initial recognition of goodwill.

67. As a result of a PBE ~~business~~ combination, the probability of realising a pre-acquisition deferred tax asset of the acquirer could change. An acquirer may consider it probable that it will recover its own deferred tax asset that was not recognised before the PBE ~~business~~ combination. For example, the acquirer may be able to utilise the benefit of its unused tax losses against the future taxable profit of the acquired operation ~~acquiree~~. Alternatively, as a result of the PBE ~~business~~ combination it might no longer be probable that future taxable profit will allow the deferred tax asset to be recovered. In such cases, the acquirer recognises a change in the deferred tax asset in the period of the PBE ~~business~~ combination, but does not include it as part of the accounting for the PBE ~~business~~ combination. Therefore, the acquirer does not take it into account in measuring the goodwill or bargain purchase gain it recognises in the PBE ~~business~~ combination.

68. The potential benefit of the acquired operation's ~~acquiree's~~ income tax loss carryforwards or other deferred tax assets might not satisfy the criteria for separate recognition when a PBE ~~business~~ combination is initially accounted for but might be realised subsequently. An entity shall recognise acquired deferred tax benefits that it realises after the PBE ~~business~~ combination as follows:

…

68C. As noted in paragraph 68A, the amount of the tax deduction (or estimated future tax deduction, measured in accordance with paragraph 68B) may differ from the related cumulative remuneration expense. Paragraph 58 of the Standard requires that current and deferred tax should be recognised as income or an expense and included in surplus or deficit for the period, except to the extent that the tax arises from (a) a transaction or event that is recognised, in the same or a different period, outside surplus or deficit, or (b) a PBE ~~business~~ combination (other than the acquisition by an investment entity of a controlled entity that is required to be measured at fair value through surplus or deficit). If the amount of the tax deduction (or estimated future tax deduction) exceeds the amount of the related cumulative remuneration expense, this indicates that the tax deduction relates not only to remuneration expense but also to an equity item. In this situation, the excess of the associated current or deferred tax should be recognised directly in net assets/equity.

…

81. **The following shall also be disclosed separately:**

…

*(j) **If a PBE ~~business~~ combination in which the entity is the acquirer causes a change in the amount recognised for its pre-acquisition deferred tax asset (see paragraph 67), the amount of that change; and**

*(k) **If the deferred tax benefits acquired in a PBE ~~business~~ combination are not recognised at the acquisition date but are recognised after the acquisition date (see paragraph 68), a description of the event or change in circumstances that caused the deferred tax benefits to be recognised.**

…

98.8 **PBE IPSAS 40, issued in [date], amended paragraphs 15, 18, 19 and its related heading, 21, 21A, 21B, 22, 24, 26, 32A, 37, 51D, 58, 66 and its related heading, 67, 68, 68C and 81. An entity shall apply those amendments when it applies PBE IPSAS 40.**

PBE IAS 34 *Interim Financial Reporting*

Paragraph 16A is amended and paragraph 49.11 is added. New text is underlined and deleted text is struck through.

16A. **In addition to disclosing significant events and transactions in accordance with paragraphs 15–15C, an entity shall include the following information, in the notes to its interim financial statements or elsewhere in the interim financial report. The following disclosures shall be given either in the interim financial statements or incorporated by cross-reference from the interim financial statements to some other statement (such as management commentary or risk report) that is available to users of the financial statements on the same terms as the interim financial statements and at the same time. If users of the financial statements do not have access to the information incorporated by cross-reference on the same terms and at the same time, the interim financial report is incomplete. The information shall normally be reported on a financial year-to-date basis.**

…

(i) **The effect of changes in the composition of the entity during the interim period, including PBE ~~business~~ combinations, obtaining or losing control of controlled entities and long-term investments, restructurings, and discontinued operations. In the case of PBE ~~business~~ combinations, the entity shall disclose the information required by PBE IPSAS 40 ~~IFRS 3~~ PBE *~~Business~~ Combinations.***

…

49.11 **PBE IPSAS 40, issued in [date], amended paragraph 16A. An entity shall apply that amendment when it applies PBE IPSAS 40.**

PBE FRS 46 *First-time Adoption of PBE Standards by Entities Previously Applying NZ IFRS*

Paragraph 10 is amended. Paragraph 29.1 and its related heading and paragraph 43.3 are added. New text is underlined.

10. **Except where otherwise required by PBE Standards, and subject to the provisions in paragraph 13, paragraph 17 and paragraphs 22–29.1 of this Standard, an entity that previously presented general purpose financial statements in accordance with NZ IFRS shall apply the same recognition and measurement policies for those transactions and events in its first set of financial statements under PBE Standards.**

PBE IPSAS 40 *PBE Combinations*

29.1 **An entity shall not apply PBE IPSAS 40 to any PBE combinations for which the amalgamation date or acquisition date is before the date of transition to PBE Standards. An entity is not required to restate PBE combinations that occurred before the date of transition to PBE Standards.**

…

43.3 **PBE IPSAS 40, issued in [date], amended paragraph 10 and added paragraph 29.1 and its related heading. An entity shall apply those amendments when it applies PBE IPSAS 40.**

In the Basis for Conclusions, paragraph BC7.1 is added. New text is underlined

BC7.1 In [date] the NZASB issued PBE IPSAS 40 *PBE Combinations* which superseded PBE IFRS 3 *Business Combinations*). The NZASB decided to amend PBE FRS 46 to make it clear that first-time adopters are not permitted to apply PBE IPSAS 40 to any previous PBE combinations that occurred before the date of transition to PBE Standards and to not to restate PBE combinations that occurred before the date of transition to PBE Standards.

PBE FRS 47 *First-time Adoption of PBE Standards by Entities Other Than Those Previously Applying NZ IFRS*

Paragraph 42.8 is added. New text is underlined.

42.8 **PBE IPSAS 40, issued in [date], amended paragraphs A1, the title of Appendix B and the sentence following the title, B1, B2–B5, C13, C14, and added paragraph A7 and its related heading, the heading before paragraph B2, and paragraphs B6–B9 and their related heading. An entity shall apply those amendments when it applies PBE IPSAS 40.**

In Appendix A, paragraph A1 is amended. Paragraph A7 and its related heading are added. New text is underlined and deleted text is struck through.

A1. An entity shall apply the following exceptions:

(a) Derecognition of financial assets and financial liabilities (paragraphs A2 and A3); ~~and~~

(b) Hedge accounting (paragraphs A4–A6); and~~.~~

(c) Non-controlling interests (paragraph A7).

...

Non-controlling Interests

A7. A first-time adopter shall apply the following requirements of PBE IPSAS 35 prospectively from the date of transition to PBE Standards:

(a) The requirement in paragraph 49 that total comprehensive revenue and expense is attributed to the owners of the controlling entity and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance;

(b) The requirements in paragraphs 48 and 51 for accounting for changes in the controlling entity's ownership interest in a controlled entity that do not result in a loss of control; and

(c) The requirements in paragraphs 53–55 for accounting for a loss of control over a controlled entity, and the related requirements of paragraph 8A of PBE IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

However, if a first-time adopter elects to apply PBE IPSAS 40 *PBE Combinations* retrospectively to past PBE combinations, it also shall apply PBE IPSAS 35 in accordance with paragraph B1 of this Standard.

In Appendix B, the title of the appendix and the sentence following the title, paragraph B1, and paragraphs B2–B5 are amended. The heading before paragraph B2 and paragraphs B6–B9 and their related heading are added. New text is underlined and deleted text is struck through.

Exemptions for PBE ~~Business~~ Combinations

This Appendix is an integral part of PBE FRS 47. An entity shall apply the following requirements to PBE ~~business~~ combinations that the entity recognised before the date of transition to PBE Standards.

B1. A first-time adopter may elect not to apply PBE IPSAS 40 ~~IFRS 3~~ *PBE ~~Business~~ Combinations* retrospectively to past PBE ~~business~~ combinations (PBE ~~business~~ combinations that occurred before the date of transition to PBE Standards). However, if a first-time adopter restates any PBE ~~business~~ combination to comply with PBE IPSAS 40 ~~IFRS 3~~, it shall restate all later PBE ~~business~~ combinations and shall also apply PBE IPSAS 35 *Consolidated Financial Statements* from that same date. For example, if a first-time adopter elects to restate a PBE ~~business~~ combination that occurred on 30 June 20X6, it shall restate all PBE ~~business~~ combinations that occurred between 30 June 20X6 and the date of transition to PBE Standards, and it shall also apply PBE IPSAS 35 from 30 June 20X6.

Acquisitions

B2. An entity need not apply PBE IPSAS 4 *The Effects of Changes in Foreign Exchange Rates* retrospectively to fair value adjustments and goodwill arising in PBE ~~business~~ combinations that occurred before the date of transition to PBE Standards. If the entity does not apply PBE IPSAS 4 retrospectively to those fair value adjustments and goodwill, it shall treat them as assets and liabilities of the entity rather than as assets and liabilities of the acquired operation ~~acquiree~~. Therefore, those goodwill and fair value adjustments either are already expressed in the entity's functional currency or are non-monetary foreign currency items, which are reported using the exchange rate applied in accordance with previous GAAP.

B3. An entity may apply PBE IPSAS 4 retrospectively to fair value adjustments and goodwill arising in either:

(a) All PBE ~~business~~ combinations that occurred before the date of transition to PBE Standards; or

(b) All PBE ~~business~~ combinations that the entity elects to restate to comply with PBE IPSAS 40 ~~IFRS 3~~, as permitted by paragraph B1 above.

B4. If a first-time adopter does not apply PBE IPSAS 40 ~~IFRS 3~~ retrospectively to a past acquisition ~~business combination~~, this has the following consequences for that PBE ~~business~~ combination:

(a) The first-time adopter shall retain ~~keep~~ the ~~same~~ classification (as an acquisition by the legal acquirer, or ~~a~~ reverse acquisition by the legal acquired operation ~~acquiree, or a uniting of interests~~) as in its previous GAAP financial statements.

(b) At the date of transition to PBE Standards t~~T~~he first-time adopter shall recognise all ~~its~~ assets and liabilities ~~at the date of transition to PBE Standards~~ that it ~~were~~ acquired or assumed in a past PBE ~~business~~ combination, other than:

(i) Some financial assets and financial liabilities derecognised in accordance with previous GAAP (see paragraph A2); and

(ii) Assets, including goodwill, and liabilities that were not recognised in the acquirer's consolidated statement of financial position in accordance with previous GAAP and which ~~also~~ would not qualify for recognition in accordance with PBE Standards in the separate statement of financial position of the acquired operation ~~acquiree~~ (see (f)–(i) below).

The first-time adopter shall recognise any resulting change by adjusting accumulated comprehensive revenue and expense (or, if appropriate, another category of net assets/equity), unless the change results from the recognition of an intangible asset that was previously subsumed within goodwill (see (g)(i) below).

(c) The first-time adopter shall exclude from its opening statement of financial position under PBE Standards any item recognised in accordance with previous GAAP that does not qualify for recognition as an asset or liability under PBE Standards. The first-time adopter shall account for the resulting change as follows:

(i) The first-time adopter may have classified a past PBE ~~business~~ combination as an acquisition and recognised as an intangible asset an item that does not qualify for recognition as an asset in accordance with PBE IPSAS 31 *Intangible Assets*. It shall reclassify that item (and, if any, the related deferred tax and non-controlling interests) as part of goodwill (unless it deducted goodwill directly from net assets/equity in accordance with previous GAAP, see (g)(i) and (ii) below).

(ii) The first-time adopter shall recognise all other resulting changes in accumulated comprehensive revenue and expense.*

* Such changes include reclassifications from or to intangible assets if goodwill was not recognised in accordance with previous GAAP as an asset. This arises if, in accordance with previous GAAP, the entity (a) deducted goodwill directly from net assets/equity or (b) did not treat the PBE ~~business~~ combination as an acquisition.

(d) PBE Standards require subsequent measurement of some assets and liabilities on a basis that is not based on original cost, such as fair value. The first-time adopter shall measure ~~these~~ such assets and liabilities ~~on that basis~~ in its opening statement of financial position on the basis required by ~~under~~ PBE Standards, even if they were acquired or assumed in a past PBE ~~business~~ combination. It shall recognise any resulting change in the carrying amount by adjusting accumulated comprehensive revenue and expense (or, if appropriate, another category of net assets/equity), rather than goodwill.

(e) Immediately after the PBE ~~business~~ combination, the carrying amount in accordance with previous GAAP of assets acquired and liabilities assumed in that PBE ~~business~~ combination shall be their deemed cost in accordance with PBE Standards at that date. If PBE Standards require a cost-based measurement of those assets and liabilities at a later date, that deemed cost shall be the basis for cost-based depreciation or amortisation from the date of the PBE ~~business~~ combination.

(f) If an asset acquired, or liability assumed, in a past PBE ~~business~~ combination was not recognised in accordance with previous GAAP, it does not have a deemed cost of zero in the opening statement of financial position under PBE Standards. Instead, the acquirer shall recognise and measure it in its consolidated statement of financial position on the basis that PBE Standards would require in the statement of financial position of the acquired operation ~~acquiree~~. To illustrate: if the acquirer had not, in accordance with its previous GAAP, capitalised finance leases acquired in a past PBE ~~business~~ combination, it shall capitalise those leases in its consolidated financial statements, as PBE IPSAS 13 *Leases* would require the acquiree to do in its statement of financial position under PBE Standards. Similarly, if the acquirer had not, in accordance with its previous GAAP, recognised a contingent liability that still exists at the date of transition to PBE Standards, the acquirer shall recognise that contingent liability at that date unless PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* would prohibit its recognition in the financial statements of the acquired operation ~~acquiree~~. Conversely, if an asset or liability was subsumed in goodwill in accordance with previous GAAP but would have been recognised separately under PBE IPSAS 40 ~~IFRS 3~~, that asset or liability remains in goodwill unless PBE Standards would require its recognition in the financial statements of the acquired operation ~~acquiree~~.

…

(h) No other adjustments shall be made to the carrying amount of goodwill at the date of transition to PBE Standards. For example, the first-time adopter shall not restate the carrying amount of goodwill:

(i) To exclude in-process research and development acquired in that PBE ~~business~~ combination (unless the related intangible asset would qualify for recognition in accordance with PBE IPSAS 31 in the statement of financial position of the acquired operation ~~acquiree~~);

(ii) To adjust previous amortisation of goodwill; or

(iii) To reverse adjustments to goodwill that PBE IPSAS 40 ~~IFRS 3~~ would not permit, but were made in accordance with previous GAAP because of adjustments to assets and liabilities between the date of the PBE ~~business~~ combination and the date of transition to PBE Standards.

…

(j) In accordance with its previous GAAP, the first-time adopter may not have consolidated a controlled entity acquired in a past PBE ~~business~~ combination (for example, because the controlling entity did not regard it as a controlled entity in accordance with previous GAAP or did not prepare consolidated financial statements). The first-time adopter shall adjust the carrying amounts of the controlled entity's assets and liabilities to the amounts that PBE Standards would require in the controlled entity's statement of financial position. The deemed cost of goodwill equals the difference at the date of transition to PBE Standards between:

…

B5. The exemption for past PBE ~~business~~ combinations also applies to past acquisitions of investments in associates and of interests in joint ventures and interests in joint operations in which the activity of the joint operation constitutes an operation as defined in PBE IPSAS 40. Furthermore, the date selected for paragraph B1 applies equally for all such acquisitions.

Amalgamations

B6. An entity need not apply PBE IPSAS 4 retrospectively to fair value adjustments and goodwill arising in PBE combinations that occurred before the date of transition to PBE Standards. If the entity does not apply PBE IPSAS 4 retrospectively to those fair value adjustments and goodwill, it shall treat them as assets and liabilities of the entity rather than as assets and liabilities of the combining operations. Therefore, those goodwill and fair value adjustments either are already expressed in the entity's functional currency or are non-monetary foreign currency items, which are reported using the exchange rate applied in accordance with previous GAAP.

B7. An entity may apply PBE IPSAS 4 retrospectively to fair value adjustments and goodwill arising in either:

(a) All PBE combinations that occurred before the date of transition to PBE Standards; or

(b) All PBE combinations that the entity elects to restate to comply with PBE IPSAS 40, as permitted by paragraph B1 above.

B8. If a first-time adopter does not apply PBE IPSAS 40 retrospectively to a past amalgamation, this has the following consequences for that PBE combination:

(a) The first-time adopter shall retain the classification of the combination (that is, as an amalgamation or an acquisition) in its previous GAAP financial statements.

(b) At the date of transition to PBE Standards the first-time adopter shall recognise all the assets and liabilities that it received and assumed in a past amalgamation, other than:

(i) Some financial assets and financial liabilities derecognised in accordance with previous GAAP (see paragraph A2); and

(ii) Assets, including goodwill, and liabilities that were not recognised in the resulting entity's statement of financial position in accordance with previous GAAP and which would not qualify for recognition in accordance with PBE Standards in the separate statement of financial position of the combining operations (see (f)–(i) below).

The first-time adopter shall recognise any resulting change by adjusting accumulated comprehensive revenue and expense (or, if appropriate, another category of net assets/equity), unless the change results from the recognition of an intangible asset that was previously subsumed within goodwill (see (g)(i) below).

(c) The first-time adopter shall exclude from its opening statement of financial position under PBE Standards any item recognised in accordance with previous GAAP that does not qualify for recognition as an asset or liability under PBE Standards. The first-time adopter shall account for the resulting change as follows:

(i) The first-time adopter may have classified a past PBE combination as an acquisition and recognised as an intangible asset an item that does not qualify for recognition as an asset in accordance with PBE IPSAS 31. It shall reclassify that item (and, if any, the related deferred tax and non-controlling interests) as part of goodwill (unless it deducted goodwill directly from net assets/equity in accordance with previous GAAP, see (g)(i) and (g)(ii) below).

(ii) The first-time adopter shall recognise all other resulting changes in accumulated comprehensive revenue and expense.*

* Such changes include reclassifications from or to intangible assets if goodwill was not recognised in accordance with previous GAAP as an asset. This arises if, in accordance with previous GAAP, the entity deducted goodwill directly from net assets/equity.

(d) PBE Standards require subsequent measurement of some assets and liabilities on a basis that is not based on original cost, such as fair value. The first-time adopter shall measure such assets and liabilities in its opening statement of financial position on the basis required by PBE Standards, even if they were received or assumed in a past amalgamation. It shall recognise any resulting change in the carrying amount by adjusting accumulated comprehensive revenue and expense (or, if appropriate, another category of net assets/equity).

(e) Immediately after the amalgamation, the carrying amount in accordance with previous GAAP of assets received and liabilities assumed in that PBE combination shall be their deemed cost in accordance with PBE Standards at that date. If PBE Standards require a cost-based measurement of those assets and liabilities at a later date, that deemed cost shall be the basis for cost-based depreciation or amortisation from the date of the PBE combination.

(f) If an asset received, or liability assumed, in a past amalgamation was not recognised in accordance with previous GAAP, it does not have a deemed cost of zero in the opening statement of financial position under PBE Standards. Instead, the resulting entity shall recognise and measure it in its statement of financial position on the basis that PBE Standards would require in the statement of financial position of the combining operation. To illustrate: if the resulting entity had not, in accordance with its previous GAAP, capitalised finance leases assumed in a past amalgamation, it shall capitalise those leases in its first set of financial statements under PBE Standards, as PBE IPSAS 13 would require the combining operation to do in its statement of financial position under PBE Standards. Similarly, if the resulting entity had not, in accordance with its previous GAAP, recognised a contingent liability that still exists at the date of transition to PBE Standards, the resulting entity shall recognise that contingent liability at that date unless PBE IPSAS 19 would prohibit its recognition in the financial statements of the combining operations. Conversely, if an asset or liability was subsumed in goodwill in accordance with previous GAAP but would have been recognised separately under PBE IPSAS 40, that asset or liability remains in goodwill unless PBE Standards would require its recognition in the financial statements of the resulting entity.

(g) The carrying amount of goodwill in the opening statement of financial position under PBE Standards shall be its carrying amount in accordance with previous GAAP at the date of transition to PBE Standards, after the following two adjustments:

(i) If required by (c)(i) above, the first-time adopter shall increase the carrying amount of goodwill when it reclassifies an item that it recognised as an intangible asset in accordance with previous GAAP. Similarly, if (f) above requires the first-time adopter to recognise an intangible asset that was subsumed in recognised goodwill in accordance with previous GAAP, the first-time adopter shall decrease the carrying amount of goodwill accordingly (and, if applicable, adjust deferred tax and non-controlling interests).

(ii) Regardless of whether there is any indication that the goodwill may be impaired, the first-time adopter shall apply PBE IPSAS 26 in testing the goodwill for impairment at the date of transition to PBE Standards and in recognising any resulting impairment loss in accumulated comprehensive revenue and expense. The impairment test shall be based on conditions at the date of transition to PBE Standards.

(h) No other adjustments shall be made to the carrying amount of goodwill at the date of transition to PBE Standards. For example, the first-time adopter shall not restate the carrying amount of goodwill:

(i) To exclude in-process research and development assumed in that PBE combination (unless the related intangible asset would qualify for recognition in accordance with PBE IPSAS 31 in the statement of financial position of the resulting entity);

(ii) To adjust previous amortisation of goodwill; or

(iii) To reverse adjustments to goodwill that PBE IPSAS 40 would not permit, but were made in accordance with previous GAAP because of adjustments to assets and liabilities between the date of the amalgamation and the date of transition to PBE Standards.

(i) If the first-time adopter recognised goodwill in accordance with previous GAAP as a deduction from net assets/equity it shall not recognise that goodwill in its opening statement of financial position under PBE Standards.

(j) In accordance with its previous GAAP, the first-time adopter may not have recognised the assets received and liabilities assumed in a previous amalgamation. The first-time adopter shall adjust the carrying amounts of the resulting entity's assets and liabilities to the amounts that PBE Standards would require in the resulting entity's statement of financial position. The adjustments shall be recognised by adjusting the accumulated comprehensive revenue or expense (or, if appropriate, another category of net assets/equity).

(k) The measurement of non-controlling interests and deferred tax follows from the measurement of other assets and liabilities. Therefore, the above adjustments to recognised assets and liabilities affect non-controlling interests and deferred tax.

B9. The exemption for past PBE combinations also applies to past amalgamations of investments in associates and of interests in joint ventures and interests in joint operations in which the activity of the joint operation constitutes an operation as defined in PBE IPSAS 40. Furthermore, the date selected for paragraph B1 applies equally for all such amalgamations.

In Appendix C, paragraphs C13–C14 are amended. New text is underlined and deleted text is struck through.

…

C13. If a controlled entity becomes a first-time adopter later than its controlling entity, the controlled entity shall, in its financial statements, measure its assets and liabilities at either:

(a) The carrying amounts that would be included in the controlling entity's consolidated financial statements, based on the controlling entity's date of transition to PBE Standards, if no adjustments were made for consolidation procedures and for the effects of the PBE ~~business~~ combination in which the controlling entity acquired the controlled entity (this election is not available to a controlled entity of an investment entity, as defined in PBE IPSAS 35, that is required to be measured at fair value through surplus or deficit); or

…

C14. However, if an entity becomes a first-time adopter later than its controlled entity (or associate or joint venture) the entity shall, in its consolidated financial statements, measure the assets and liabilities of the controlled entity (or associate or joint venture) at the same carrying amounts as in the financial statements of the controlled entity (or associate or joint venture), after adjusting for consolidation and equity accounting adjustments and for the effects of the PBE ~~business~~ combination in which the entity acquired the controlled entity. Similarly, if a controlling entity becomes a first-time adopter for its separate financial statements earlier or later than for its consolidated financial statements, it shall measure its assets and liabilities at the same amounts in both financial statements, except for consolidation adjustments.

XRB A1 *Application of the Accounting Standards Framework*

Appendix C is amended. New text is underlined.

APPENDIX C

TIER 1 PBE ACCOUNTING REQUIREMENTS AND TIER 2 PBE ACCOUNTING REQUIREMENTS TO BE APPLIED BY PUBLIC BENEFIT ENTITIES

This appendix forms an integral part of XRB A1 Application of the Accounting Standards Framework.

…

Accounting Standards

…

PBE IPSAS 39	*Employee Benefits*
<u>PBE IPSAS 40</u>	<u>*PBE Combinations*</u>
PBE IFRS 3	*Business Combinations* <u>(superseded on adoption of PBE IPSAS 40)</u>

…

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, PBE IPSAS 40.

Introduction

BC1. The New Zealand Accounting Standards Board (NZASB) has modified IPSAS 40 *Public Sector Combinations* for application by Tier 1 and Tier 2 public benefit entities (PBEs). Where applicable, disclosure concessions have been identified for Tier 2 entities and the language generalised for use by PBEs. The NZASB considers that the requirements of IPSAS 40 are generally appropriate for application by PBEs except for the matters discussed below.

BC2. In developing the Standard the NZASB considered:

(a) The differences between IPSAS 40 and IFRS 3 *Business Combinations* in respect of accounting for acquisitions – why the IPSASB had diverged from IFRS 3 and whether those divergences would cause any problems for New Zealand PBEs;

(b) The distinction between amalgamations and acquisitions – whether this distinction is clear enough and whether the proposed approach to classification would lead to sensible answers in New Zealand; and

(c) Whether there were any requirements which might be open to interpretation or could be clarified.

BC3. As a result of considering these matters the NZASB modified a number of the requirements in IPSAS 40. The significant changes to the requirements of IPSAS 40 are discussed in this Basis for Conclusions. The types of changes made by the NZASB included:

(a) Changes to the requirements in IPSAS 40;

(b) Clarifications to the guidance in IPSAS 40;

(c) Not-for-profit (NFP) enhancements to ensure that the Standard is appropriate for application by NFP PBEs as well as public sector PBEs; and

(d) Changes to ensure coherence within the suite of PBE Standards by acknowledging the existence of certain PBE Standards (for example, PBE IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*) for which there is no corresponding IPSAS.

Indicators Relating to Consideration

BC4. The NZASB reflected on the types of PBE combinations that it has observed in New Zealand and the role of consideration in those combinations. The NZASB noted that the absence of consideration is a common feature of PBE combinations, and was of the view that the absence of consideration, in itself, does not provide evidence that the combination is an amalgamation. The NZASB was concerned that application of the guidance in IPSAS 40 about consideration, without any changes, could lead to some PBE combinations, particularly some involving NFP entities, being inappropriately classified as amalgamations. For example, the NZASB considered that a transaction involving a donated operation could be an acquisition. This led the NZASB to modify the sections of IPSAS 40 dealing with consideration and the classification of combinations.

BC5. Paragraph 12 of IPSAS 40 sets out indictors supporting the classification of a combination as an amalgamation. That paragraph read as follows:

12. The following indicators may provide evidence that the combination is an amalgamation:

(a) Consideration is paid for reasons other than to compensate those with an entitlement to the net assets of a transferred operation for giving up that entitlement (paragraphs AG27–AG28 provide additional guidance);

(b) Consideration is not paid to those with an entitlement to the net assets of a transferred operation (paragraphs AG29–AG30 provide additional guidance); or

(c) Consideration is not paid because there is no-one (whether an individual or an entity) with an entitlement to the net assets of a transferred entity (paragraph AG31 provides additional guidance).

BC6. The NZASB combined the indicators in paragraphs 12(a) and 12(b) and removed the indicator in paragraph 12(c). The NZASB combined paragraphs 12(a) and 12(b) because of its view that, on its own, the indicator in paragraph 12(a) is not a helpful indicator of an amalgamation. The NZASB was of the view that, when classifying combinations, it is necessary to consider the reasons why no consideration has been paid to compensate those with an entitlement to the net assets of a transferred operation.

BC7. Consistent with its view that the absence of consideration does not in itself provide evidence that a PBE combination is an amalgamation, and the broader view of equity interests and owners by PBEs in New Zealand, the NZASB removed paragraph 12(c). In the New Zealand public sector and NFP sector the concept of equity interests is not limited to equity participants with an equity instrument, and the use of the term owners is not limited to owners with a quantifiable ownership interest.

BC8. The changes to the indicators in paragraph 12 led to a number of other changes throughout the Standard including:

(a) The reordering of the guidance in paragraphs AG27–AG30;

(b) The replacement of the examples in paragraph AG30;

(c) The removal of paragraph AG31 which contained guidance on paragraph 12(c);

(d) The removal of the reference to the indicator in paragraph 12(c) in the illustrative examples (scenario 2 variation, scenario 3 and scenario 14);

(e) The updating of the analysis in the illustrative examples; and

(f) The reclassification of scenario 6 in the illustrative examples from an amalgamation to an acquisition.

Definitions of Equity Interests and Owners

BC9. The NZASB modified the definitions of equity interests and owners in IPSAS 40 to broadly align the definitions with those used in PBE IFRS 3 *Business Combinations*. The NZASB was of the view that these definitions should be broad enough to capture the different types of PBEs and different types of residual interests in PBEs in New Zealand.

BC10. As a result of changing these definitions the NZASB also replaced the phrase "quantifiable ownership interests" with "equity interests" where appropriate.

Use of the Term New Entity

BC11. The meaning of the term "new entity" in IPSAS 40 is unclear because IPSAS 40 uses the same term to refer to both new legal entities and new economic entities (paragraphs AG17 and AG22 of IPSAS 40 as shown below).

BC12. IPSAS 40 also uses the term "new entity" inconsistently. For example, paragraphs AG1 (as shown below) and AG22 take the view that an amalgamation creates a new entity but there are different presentation requirements for amalgamations in IPSAS 40 depending upon whether the amalgamation results in a new entity or a continuing entity (paragraphs 50 and 51 of IPSAS 40 as shown below).

> 50. Except where a resulting entity is not a new entity following a public sector combination, the resulting entity's first set of financial statements following the amalgamation shall comprise: …
>
> 51. Where a resulting entity is not a new entity following a public sector combination, the resulting entity shall disclose: …
>
> AG1. Paragraph 5 of this Standard defines a resulting entity as "the entity that is the result of two or more operations combining in an amalgamation." A resulting entity is not initially a party to the public sector combination. A resulting entity may have the legal form of a new entity, or may retain the legal identity of one of the combining operations. However, a resulting entity usually has the economic substance of a new entity. In a combination in which one party to the combination gains control of one or more operations, and in which the economic substance is that of an amalgamation, the nature of the combination is usually that the resulting entity has the substance of a new entity.
>
> AG17. In a public sector combination in which a new entity is formed to effect the combination, that entity may gain control of operations only where the entity exists prior to the combination taking place. Where this new entity does not exist prior to the combination taking place, an entity considers

whether one of the parties to the combination that existed prior to the combination taking place gains control of operations.

AG22. The economic substance of an amalgamation is usually that a new entity is formed, irrespective of the legal form of the resulting entity. This applies equally to a combination in which one party to the combination gains control of one or more operations. If the economic substance of a public sector combination is that one of the parties to the combination continues to exist, this may provide evidence that the economic substance of the combination is that of an acquisition. In combinations of operations under common control, the fact that the ultimate controlling entity controls the operations both before and after the combination reduces the significance of this factor.

BC13. These inconsistencies and lack of clarity caused the NZASB to review the use of the term "new entity" and "continuing entity". Providing clarity is important because it affects presentation, disclosure and how to apply the modified pooling of interests method. The NZASB thought the best way to clarify these terms was to specify when a *new reporting entity* and *continuing reporting entity* can arise from an amalgamation.

BC14. When considering how best to provide that clarity, the NZASB noted that IPSAS 40 contains requirements for two types of amalgamations, which could be used to differentiate between a new reporting entity and a continuing reporting entity. These two types of amalgamations are as follows.

(a) Amalgamations in which no party to an amalgamation gains control of one or more operations as a result of an amalgamation (see paragraph 7 of the Standard).

(b) Amalgamations in which one party to the combination gains control of one or more operations but the entity determines that the combination has the substance of an amalgamation rather than an acquisition (see paragraphs 8 to 14 of the Standard).

BC15. The NZASB added guidance in paragraph 18 of the Standard to specify that in the first type of amalgamation, the resulting entity is a new reporting entity, and in the second type of amalgamation, the resulting entity is a continuing reporting entity.

BC16. The NZASB decided not to base the requirements in the Standard on whether or not an entity is a new legal entity, because any new entities established as part of a PBE combination would not necessarily be separate legal entities.

BC17. The clarification of these terms led to a number of other changes throughout the Standard including:

(a) Clarifying that the resulting entity is a new reporting entity in paragraph 50;

(b) Clarifying that the resulting entity is a continuing reporting entity in paragraph 51; and

(c) The removal of paragraphs AG1 and AG22.

Applying the Modified Pooling of Interests Method

BC18. The NZASB thought about application of the Standard to PBE combinations (in which the resulting entity could be either a continuing reporting entity or new reporting entity) where the combining operations have reported in accordance with different suites of standards. The NZASB thought that it was important for the Standard to be clear about was is required if (i) one of the combining entities had previously recognised assets and liabilities that did not meet the recognition and measurement requirements in PBE Standards; and/or (ii) one of the combining entities had failed to recognise assets and liabilities that should be recognised in accordance with PBE Standards. The NZASB also thought that the Standard needed to be clear about the circumstances in which the resulting entity would be expected to go through a first-time adoption process.

BC19. The NZASB was of the view that IPSAS 40 does not contain sufficient guidance about these issues for New Zealand PBEs. For example, IPSAS 40 does not establish requirements about when the first-time adoption standard would be applied; this has been left to the judgement of the reporting entity. This guidance is particularly important in New Zealand because of our tiered Accounting Standards Framework. The NZASB considered scenarios where the amalgamation involves combining operations that have been reporting under the Tier 3 or Tier 4 PBE Accounting Requirements. The NZASB therefore added guidance to address these situations (see paragraphs 20.1, AG50.1, AG50.2 of the Standard and paragraphs B6 to B9 of PBE FRS 47 *First-time Adoption of PBE Standards by Entities Other Than Those Previously Applying NZ IFRS*).

BC20. The IPSASB did not permit the recognition of previously unrecognised assets/liabilities of the combining operations on the grounds that the IPSASB considered it would be costly for entities to identify, measure and recognise these assets/liabilities. The NZASB has previously established requirements for first-time adoption of PBE Standards and, as a consequence, the prohibition in IPSAS 40 on the recognition of previously unrecognised assets and liabilities had to be modified. This was necessary because application of PBE FRS 47 may result in the recognition of assets and liabilities as at the date of amalgamation that were not previously recognised by the first-time adopter. Hence, retaining the prohibition in IPSAS 40 would have created an inconsistency between PBE IPSAS 40 and PBE FRS 47. The NZASB therefore changed paragraph 21, omitted paragraph 23 and added paragraphs B6 to B9 of PBE FRS 47.

Presentation of Financial Statements and Disclosures

BC21. IPSAS 40 permits but does not require the resulting entity to present the combining operations' comparatives in the first set of financial statements following an amalgamation.

BC22. The NZASB is of the view that the continuing reporting entity's comparatives are useful to readers and that a requirement to present such comparatives would not be onerous because the information would have already been prepared. The NZASB has therefore required that the continuing reporting entity present comparative information (see paragraph 51). The comparative information is not restated for the combining operations. This requirement has been clarified in paragraphs 51 and 52.

BC23. The NZASB also clarified that a new reporting entity shall not present comparatives because it has not been in existence prior to the amalgamation (see paragraph 50).

BC24. The NZASB considered what information should be presented in respect of amalgamations that occur part way through a reporting period. Generally, disestablished or newly established public sector entities are required to prepare financial statements following an amalgamation in accordance with legislative requirements (which are intended to ensure that users receive appropriate financial information up to, and following, the amalgamation). Other PBEs such as registered charities do not have equivalent legislative requirements. To address the potential information gap that could occur, the NZASB clarified that PBEs are required to provide historical information up to the date of the amalgamation (see paragraphs 52, 54(g) and 54(h)).

Identifying an Acquirer

BC25. The NZASB noted that guidance from IFRS 3 (and PBE IFRS 3) on identifying an acquirer in a reverse acquisition was omitted from IPSAS 40 (see paragraphs B14–B18 of PBE IFRS 3). The IPSASB may have omitted this guidance from IPSAS 40 on the grounds that the exchange of equity instruments in the public sector is uncommon and is likely to occur only if there is a corporation involved. The NZASB acknowledged that PBE combinations are unlikely to involve reverse acquisitions and that guidance on identifying the acquirer in this situation is not required. However, the NZASB was of the view that it would be helpful to add guidance on whether one entity (and, if so, which entity) has gained control of another entity. The NZASB therefore added guidance from PBE IFRS 3 paragraph B15(c) and (d) in paragraphs AG14 and AG17.

Transition

BC26. IPSAS 40 requires prospective application. However, when providing guidance for first-time adopters of PBE Standards, the NZASB decided to permit retrospective application for prior amalgamations, consistent with the existing requirements in PBE FRS 47 for prior acquisitions, where retrospective application is permitted. Hence, the NZASB modified the transitional provisions to provide an exception for first-time adopters of PBE Standards — these are entities not previously applying New Zealand equivalents to International Financial Reporting Standards (NZ IFRS).

BC27. The NZASB has therefore:

(a) Retained the approach in IPSAS 40 of mandating prospective application, except for first-time adopters of PBE Standards to which PBE FRS 47 applies (see paragraph 125.1 of the Standard);

(b) Provided additional requirements in paragraph 125.2 to clarify that, as a consequence of mandating prospective application (except for first-time adopters of PBE Standards to which PBE FRS 47 applies), restatement of combinations that occurred before the effective date of the Standard is prohibited;

(c) Provided an exception for first-time adopters of PBE Standards to which PBE FRS 47 applies in paragraph 125.3 and guidance for first-time adopters of PBE Standards in PBE FRS 47;

(d) Prohibited retrospective application for first-time adopters of PBE Standards to which PBE FRS 46 *First-time Adoption of PBE Standards by Entities Previously Applying NZ IFRS* applies. This is consistent with the general principle in PBE FRS 46 which restricts an entity changing its accounting policies previously used under NZ IFRS on first-time adoption of PBE Standards (see paragraph 29.1 of PBE FRS 46); and

(e) Retained the approach in IPSAS 40 of permitting early application.

Voluntary Combination not under Common Control

BC28. IPSAS 40 does not provide guidance for voluntary combinations not under common control. These combinations are more common in the NFP sector than the public sector. The NZASB thought it would be helpful to add guidance and a related illustrative example for such combinations (see paragraph AG17.1 and scenario 15 in the illustrative examples).

Selection of Accounting Policies by the Resulting Entity

BC29. The NZASB was of the view that New Zealand PBEs required clear guidance on the selection of accounting policies by the resulting entity and the interaction between the Standard and PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors*. The NZASB clarified the requirements in IPSAS 40, including making it clear that a continuing reporting entity would retain its prior accounting policies. The NZASB therefore added paragraphs AG54.1 and AG54.2 to provide guidance on the section of accounting policies by a new reporting entity and a continuing reporting entity.

Income Taxes

BC30. The NZASB noted that the IPSASB had included some requirements on the recognition and measurement of income taxes following acquisitions and amalgamations and how to account for taxes forgiven as a result of a combination. Paragraphs 34, 79, AG58 and AG86 of IPSAS 40 read as follows.

34. The resulting entity shall recognize and measure any remaining taxation items included in or arising from an amalgamation in accordance with the relevant international or national accounting standard dealing with income taxes. The resulting entity shall recognize and measure any remaining revenue from taxation included in or arising from an amalgamation in accordance with IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers).*

79. The acquirer shall recognize and measure any remaining taxation items included in or arising from an acquisition in accordance with the relevant international or national accounting standard dealing with income taxes. The acquirer entity shall recognize and measure any remaining revenue from taxation included in or arising from an acquisition in accordance with IPSAS 23.

AG58. Where, as a result of the amalgamation, the resulting entity becomes the tax authority, it shall derecognize any tax receivable relating to the combining operation's tax due that has been forgiven in accordance with IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*.

AG86. If the acquirer is itself the tax authority, it shall derecognize any tax receivable relating to the acquired operation's tax due that has been forgiven in accordance with IPSAS 23.

BC31. The NZASB was of the view that some of these requirements were not necessary and could create confusion. The NZASB therefore omitted paragraphs 34 and 79 and the related paragraphs AG58 and AG86.

IPSASB Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 40

Objective (paragraph 1)

BC1. In the absence of an International Public Sector Accounting Standard (IPSAS) dealing with public sector combinations, public sector entities are directed, in IPSAS 1, *Presentation of Financial Statements,* to look to other international or national accounting standards. In the case of public sector combinations, they may look to International Financial Reporting Standard (IFRS®) 3, *Business Combinations*. However, IFRS 3 requires all business combinations to be accounted for using acquisition accounting. In developing IFRS 3, the International Accounting Standards Board (IASB®) came to the conclusion that 'true mergers' or 'mergers of equals' in which none of the combining entities obtains control of the others are so rare as to be virtually non-existent. The IASB also observed that respondents and other constituents were unable to suggest an unambiguous and non-arbitrary boundary for distinguishing true mergers or mergers of equals from other business combinations and concluded that developing such an operational boundary would not be feasible (see IFRS 3, BC35). Consequently, the IASB decided that separate accounting requirements for such combinations was not necessary.

BC2. Many consider that in the public sector, mergers or amalgamations are the most common form of combination. As a result, public sector entities may not apply IFRS Standards when accounting for public sector combinations. This means that there may not be consistent or appropriate reporting of such combinations in general purpose financial statements (GPFSs). Consequently, users may not be able to obtain the information needed to identify the type of public sector combination and evaluate its nature and financial effect. The IPSASB believes this Standard will promote consistency and comparability in how public sector combinations are reported by public sector entities.

Process

BC3. In developing this Standard the IPSASB had regard to the discussion of control in IPSAS 35, *Consolidated Financial Statements*. The IPSASB considered how control, as defined in IPSAS 35, should influence the classification of public sector combinations in this Standard. The IPSASB also had regard to the guidance on combinations in the *Government Finance Statistics Manual* 2014 (GFSM 2014) with the aim of avoiding unnecessary differences. The IPSASB also considered IFRS 3 and guidance on combinations developed by national standard setters.

Alignment with Government Finance Statistics (GFS)

BC4. In developing this Standard, the IPSASB had regard to the treatment of public sector combinations in Government Finance Statistics (GFS):

GFS guidelines make a distinction between an acquisition and an amalgamation based on the principle that with an acquisition a transaction occurs, while with an amalgamation just a reclassification of units may occur.

A transaction will occur where a "market unit" is nationalized or privatized (that is, entering government control or leaving it), and the amounts are recorded in GFS as transactions in equity that correspond to the observed transaction price. Any changes in valuation–for example, between the opening balance of a government equity stake and the eventual transaction price–are recorded as revaluation effects, with no impact on government net lending/net borrowing. For amalgamations, the main impact is on the sectorization of the "institutional units".

Where the units before amalgamation belonged to the same sector or subsector of general government, the amalgamation will have no impact on the data for that sector or subsector. For example, an amalgamation of two local governments, where both are already classified to the local government sector, would not change results for the local government sector.

However, in cases where a unit in one subsector is being amalgamated with a unit in another subsector, the amalgamated units will be removed from the sector they belonged to and be added to the sector of the new amalgamated unit, through a reclassification of the unit (recorded in GFS as an "other volume change in assets and liabilities"). For example, if a local government unit is amalgamated with a state government, the unit will be reclassified from the local government subsector to the state government subsector.

BC5. The IPSASB agreed the approach in GFS was not an appropriate basis for classifying public sector combinations in this Standard, for the following reasons:

(a) The approach in GFS is based on a number of concepts that have no equivalent in IPSASs, for example:

(i) The classification of institutional units into sectors based on their economic nature; and

(ii) The distinction between market producers and nonmarket producers.

(b) Amalgamations in GFS can arise from a reclassification of units without a transaction being recorded, which is inconsistent with the approach in IPSASs; and

(c) Public sector combinations within the same sector or subsector of general government have no impact on the data in GFS, whereas IPSASs would require the changes to individual entities to be accounted for.

BC6. In coming to this conclusion the IPSASB noted that the different approaches in GFS and IPSASs may lead to similar accounting, for example:

(a) Nationalizations are likely to be recorded as acquisitions under both approaches; and

(b) The modified pooling of interests method of accounting will produce similar accounting to the GFS reclassification approach where the combining operations had previously adopted the same accounting policies.

Scope (paragraphs 2–4)

BC7. The IPSASB initially considered developing two Standards on public sector combinations, covering:

(a) Entity combinations arising from exchange transactions—a limited convergence project with IFRS 3; and

(b) Entity combinations arising from non-exchange transactions—a public sector-specific project.

BC8. In May 2009, the IPSASB issued Exposure Draft (ED) 41, *Entity Combinations from Exchange Transactions*, which was the limited convergence project with IFRS 3. Following the consultation process on ED 41, the IPSASB decided not to continue with this approach for the following reasons:

(a) IFRS 3 includes bargain purchases within its scope. It could be argued, therefore, that IFRS 3 also applies to at least some non-exchange entity combinations. The IPSASB acknowledged that it may be difficult to establish a clear demarcation between all exchange and non-exchange entity combinations.

(b) It was not clear whether combinations where no party gains control of the other parties to the combination would be classified as entity combinations arising from exchange transactions, and therefore required to be accounted for as an acquisition in accordance with ED 41.

BC9. Subsequently, the IPSASB decided to develop a single standard dealing with all public sector combinations. This wider scope was included in the Consultation Paper (CP), *Public Sector Combinations*, issued in June 2012. Respondents to the CP supported this wider scope.

BC10. The IPSASB, therefore, decided that this Standard should apply to all public sector combinations, with only limited exceptions. This Standard defines a public sector combination as the bringing together of separate operations into one public sector entity. This definition refers to the bringing together of operations rather than entities, as public sector combinations, in common with business combinations, may involve part of an entity that can be managed separately from the rest of the entity.

BC11. In coming to a decision on the scope of this Standard, the IPSASB agreed to include public sector combinations under common control. While these are excluded from the scope of IFRS 3, the IPSASB considered it important that this Standard included all public sector combinations within its scope.

Scope exclusions

BC12. The IPSASB agreed that this Standard should not apply to the formation of joint arrangements or joint ventures. The IPSASB stated in the CP that:

"The concept underlying the formation of a joint venture differs from other combinations, in that the formation arises from separate entities deciding to share control, i.e., they have joint control of the operations that form the joint venture. The concept of joint control may give rise to issues that affect how the joint venture itself should account for its formation."

BC13. In developing this Standard, the IPSASB discussed whether this rationale was still valid given that this Standard takes a different approach to classifying public sector combinations. The IPSASB concluded that the concept of joint control does not reflect the issues addressed in this Standard, and agreed to exclude the formation of joint arrangements or joint ventures from its scope.

BC14. The IPSASB noted that combinations of two or more joint arrangements may occur. The IPSASB considered that, where such a combination results in the formation of a new joint arrangement, this would be outside the scope of IPSAS 40. The IPSASB noted that a combination may result in the acquisition of one or more joint arrangements by another joint arrangement. In such circumstances, the entities that previously had control over the acquired joint arrangements give up that joint control. Such a combination would be an acquisition within the scope of IPSAS 40.

BC15. The IPSASB also agreed to exclude from the scope of this Standard the acquisition by an investment entity of an investment in a controlled entity that is required to be measured at fair value through surplus or deficit. Such transactions are considered to be investments rather than public sector combinations. IPSAS 35 prescribes the accounting requirements for such transactions.

Responses to ED 60, Public Sector Combinations

BC16. The IPSASB issued its proposals in ED 60, *Public Sector Combinations*, in January 2016. Respondents to ED 60 generally supported the proposed scope and the exclusions. The IPSASB considered the responses, and agreed that no changes to the scope were required. In doing so, the IPSASB noted that the scope of the standard included combinations undertaken on a temporary basis, for example the bailout of a private sector company with the intention of selling that company as soon as it was returned to a sound financial position. The IPSASB noted that including such combinations within the scope of this Standard was consistent with the decision taken in developing IPSAS 35 not to require a different accounting treatment for temporarily controlled entities.

Classification of Public Sector Combinations (paragraphs 7–14)

BC17. As a result of the responses it received to ED 41, the IPSASB concluded that distinguishing between entity combinations arising from exchange transactions and entity combinations arising from non-exchange transactions did not provide a suitable basis for a future IPSAS. Relying on the definition of "exchange transactions" in the IPSASB's literature would mean that most government interventions during times of economic crisis, such as the global financial crisis in 2008, would not meet the definition of an acquisition. The IPSASB considered it inappropriate to define such "bailouts" as amalgamations.

BC18. The IPSASB also noted that IFRS 3 applied to a "business", not to an entity. As well as applying to an entity, the definition of a business could also apply to part of an entity that could be managed separately from the rest of the entity. The IPSASB had regard to these issues in developing its approach in the CP.

Classification approach in the Consultation Paper, Public Sector Combinations

BC19. The approach taken in the CP was to distinguish between combinations where the parties to the combination are under common control, and combinations where the parties to the combination are not controlled by the same ultimate controlling party, i.e., not under common control. A further distinction was made between combinations where one party gains control of another party (considered by the CP to be acquisitions), and combinations where no party gains control of the other parties to the combination (considered by the CP to be amalgamations).

BC20. The IPSASB considered that the concept of control was important in determining the classification of a public sector combination. Control underpins much of financial reporting. IPSAS 35 requires an entity to consolidate those other entities that it controls, as does the predecessor standard, IPSAS 6, *Consolidated and Separate Financial Statements*. The IPSASB also noted that Government Finance Statistics adopts a similar approach to control as that adopted in both IPSAS 35 and IPSAS 6.

BC21. Similarly, control is an important factor when recognizing assets. Paragraph 5.6 of the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the Conceptual Framework) defines an asset as "A resource presently controlled by the entity as a result of a past event."

BC22. The IPSASB determined, therefore, that control was an appropriate starting point for the classification of public sector combinations. As a result, the CP included the IPSASB's preliminary view as to the role of control in classifying public sector combinations:

"The sole definitive criterion for distinguishing an amalgamation from an acquisition is that, in an amalgamation, none of the combining operations gains control of the other operations."

BC23. In developing the CP, the IPSASB explained that the parties to a public sector combination under common control are ultimately controlled by the same entity both before and after the combination. This leads to economic differences between combinations that take place under common control and those that take place not under common control, as follows:

(a) Public sector combinations between entities within an economic entity (i.e., under common control) do not change the economic resources of that economic entity;

(b) Any surpluses and deficits resulting from a public sector combination under common control are eliminated in full in the ultimate controlling entity's consolidated GPFSs; and

(c) The ultimate controlling entity can specify whether any consideration is transferred (and if consideration is transferred, the amount of that consideration) in a public sector combination under common control.

These differences may have implications for the accounting treatment of a public sector combination under common control.

BC24. The approach in the CP reflected the IPSASB's views that:

(a) The economic differences between combinations that take place under common control and those that take place not under common control may have implications for their accounting treatment; and

(b) Acquisitions should be distinguished from amalgamations on the basis of control.

BC25. Similar numbers of respondents to the CP supported and disagreed with the proposals. Respondents who disagreed with the proposals suggested that distinguishing acquisitions from amalgamations based solely on control did not reflect public sector circumstances. In particular, these respondents noted that

(a) Public sector combinations may occur where it is not possible to identify an acquirer even if it is possible to identify an entity that has gained control of operations as a result of the public sector combination. Under IFRS 3, the acquirer can be identified by analyzing the ownership interests in the respective parties. However, in the public sector there may be no quantifiable ownership interests in the entities, making such an analysis impossible. The entity gaining control of the operations may not have existed prior to the combination, and if there are no quantifiable ownership interests in that entity, it will not be possible to identify an acquirer.

(b) Public sector combinations may be imposed on all parties to the combination by a higher level of government, for example when a central government reorganizes local government by legislating the combination of municipalities irrespective of the wishes of those municipalities.

BC26. Respondents who disagreed with the proposals in the CP suggested a number of alternative bases for classifying public sector combinations, including:

(a) Variations of whether consideration was transferred:

(i) Consideration was transferred as part of the combination;

(ii) Significant consideration was transferred as part of the combination;

(iii) The combination was effected at market value;

(iv) Distinguishing acquisitions (which include the transfer of consideration) not under common control from all other combinations; and

(v) Distinguishing between combinations under common control on the basis of whether the combination has "commercial substance" (which includes the transfer of consideration).

(b) Whether the public sector combination was effected voluntarily or involuntarily.

Development of the classification approach in ED 60, Public Sector Combinations

BC27. The IPSASB considered the responses to the CP. The IPSASB accepted that the classification approach adopted in the CP would not always reflect public sector circumstances. Consequently, the IPSASB agreed to revisit the classification of public sector combinations.

BC28. As part of this process, the IPSASB considered whether any of the approaches suggested by respondents might provide an alternative basis for classification. The IPSASB concluded that these approaches were not suitable, for the following reasons:

(a) The IPSASB came to the view that the transfer of consideration, on its own, was insufficient to distinguish an acquisition from an amalgamation. As noted in paragraph BC17 above, defining an acquisition as an exchange transaction would lead to bailouts being classified as amalgamations. Similarly, if an acquisition was defined as requiring consideration to be transferred by the acquirer, this could lead to bailouts being classified as amalgamations. Definitions of an acquisition that required the transfer of significant consideration, or for the public sector combination to take place at market value, would not address issues such as bargain purchases (discussed above in paragraph BC8(a)).

(b) The IPSASB came to the view that whether a public sector combination was effected voluntarily or involuntarily did not provide, on its own, sufficient information to classify a public sector combination. The voluntary or involuntary nature of a public sector combination provides information as to the process of the combination but not its outcome. Public sector combinations may have different economic outcomes irrespective of their voluntary or involuntary nature. The IPSASB did not consider that it was possible to classify a public sector combination without considering the outcome of that combination. Consequently, the IPSASB did not consider a classification based solely on the voluntary or involuntary nature of the public sector combination would meet the objectives of financial reporting.

BC29. The IPSASB reviewed the role of control in classifying public sector combinations, and concluded that control remained an important factor in determining whether a combination was an acquisition or an amalgamation. In coming to this conclusion, the IPSASB noted that an acquisition could only occur when a party to the combination gained control of one or more operations (this is discussed in more detail in paragraph BC25(a) above). Consequently, the IPSASB reviewed the factors suggested by respondents to the CP to determine which factors might usefully supplement the concept of control.

BC30. The IPSASB discussed the following factors, and agreed that they could be helpful in supplementing the concept of control in classifying public sector combinations:

(a) **Consideration**. The IPSASB agreed that whether a public sector combination includes the transfer of consideration is relevant to classifying the combination. Acquisitions generally include consideration, whereas consideration will be absent from amalgamations. For the reasons given in paragraph BC28(a) above, the IPSASB agreed that the transfer of consideration in itself was not conclusive, and that more information about the nature of a combination would be obtained by having regard to the reasons why consideration was or was not transferred.

(b) **Exchange transactions**. The IPSASB agreed that an acquisition was more likely to occur in an exchange transaction than in a non-exchange transaction. However, the IPSASB had already acknowledged that it may be difficult to establish a clear demarcation between all exchange and non-exchange entity combinations (see paragraph BC8(a) above). The IPSASB came to the conclusion that information about whether a public sector combination was an exchange transaction or a non-exchange transaction could be determined by having regard to the reasons why consideration was or was not transferred. Consequently, the IPSASB concluded that it is not necessary to assess this factor independently of consideration.

(c) **Quantifiable ownership interests**. The IPSASB noted that whether there are quantifiable ownership interests in an operation can influence the economic substance of a public sector combination. If there are no quantifiable ownership interests in an operation, no consideration can be transferred as there is no party with an entitlement to receive the consideration. This can distinguish the combination from an acquisition, where there is always an owner to receive the consideration. The IPSASB noted that that lack of quantifiable ownership interests could be a reason why consideration was not transferred. Consequently, the IPSASB concluded that it is not necessary to assess this factor independently of consideration.

(d) **Decision-making process**. The IPSASB agreed that having regard to which parties were able to make decisions regarding a public sector combination could provide useful information about the classification of that combination. In the private sector, combinations are usually entered into voluntarily, at least from the acquirer's perspective. In the public sector, other parties may be involved in the decision-making process. The freedom that the parties to the combination are able to exercise may influence the economic substance of the combination and hence its classification.

(e) **Compulsion**. In the public sector, a public sector combination may be imposed by a higher level of government, whether or not that higher level of government controls the parties to the combination for financial reporting purposes. For example, a central government may restructure local government by directing certain municipalities to combine. The IPSASB agreed that compulsion was relevant to the classification of a public sector combination, but considered that information about compulsion would be obtained by having regard to decision-making. Consequently, the IPSASB concluded that it is not necessary to assess this factor independently of the decision-making process.

(f) **Common control**. In developing the CP, the IPSASB identified the economic differences between public sector combinations that take place under common control and those that take place not under common control (see paragraph BC23 above). The IPSASB agreed that the ability of the controlling entity to specify whether any consideration is transferred is relevant to the classification of the combination, but considered this to be an element of the decision-making process. The fact that the economic resources of the economic entity do not change in a combination under common control, and that any surpluses or deficits would be eliminated on consolidation were seen as relevant to the controlling entity, but not the controlled entity. As the controlled entity will be the reporting entity for the combination, the IPSASB concluded that it is not necessary to assess this factor independently of the decision-making process.

(g) **Citizens' rights**. In some jurisdictions, citizens may be part of the decision-making process, for example where public sector combinations are subject to the approval of citizens through a referendum. The IPSASB agreed that citizens' rights to accept or reject the combination was relevant to the classification of the combination. However, the IPSASB considered these rights to be rights to participate in the decision-making process. Consequently, the IPSASB concluded that it is not necessary to assess this factor independently of the decision-making process.

BC31. The IPSASB did not consider that the following factors would be helpful in supplementing the concept of control in classifying public sector combinations:

(a) **Change of sector**. The IPSASB acknowledged that a change of sector would be an indicator of a public sector entity acquiring an operation. However, the IPSASB considered that this change of sector would be a consequence of a change in control rather than a separate factor to be considered. The IPSASB also noted that the classification of institutional units into sectors based on their economic nature of being government units was a feature of GFS that had no equivalent in the IPSASB's literature. This will continue to be a significant difference between macroeconomic statistical reporting and accounting and financial reporting. Consequently, the IPSASB did not consider a change of sector to be a useful factor in classifying public sector combinations.

(b) **Nature of the jurisdiction**. Some responses to the CP suggested that, in jurisdictions where there is significant interaction or redistribution between the different levels of government, the public sector can be seen as operating as part of a single quasi "group" entity. Such a view could have implications for the classification of public sector combinations. The IPSASB did not consider that from the reporting entity's perspective, the nature of the jurisdiction was relevant to the classification of public sector combinations. A reporting entity could make an assessment of control, consideration and decision-making without reference to a quasi-group entity. The

IPSASB noted that the nature of the jurisdiction may form part of the assessment of the nature of the public sector combination, which an entity may need to consider when the analysis of all other factors has produced inconclusive results or does not provide sufficient evidence to determine the appropriate classification of a public sector combination.

(c) **Operation of government**. Some respondents to the CP suggested that the operation of government would be relevant to the classification of public sector combinations. Examples given included:

(i) The existence of a ministerial or other government power enabling the government to direct the entity's governing body to achieve the government's policy objectives;

(ii) Ministerial approval is required for operating budgets; and

(iii) The government has broad discretion, under existing legislation, to appoint or remove a majority of the members of the governing body of the entity.

The IPSASB concluded that the examples were indicators of control or common control rather than suggesting an independent factor. As such, the IPSASB did not consider that the operation of government was relevant to the classification of public sector combinations.

(d) **The entity directs public policy and/or engages in non-market activity mainly financed by public resources**. Some respondents to the CP suggested that control should be supplemented by having regard to whether the entity directs public policy and/or engages in non-market activity mainly financed by public resources. Where this was the case, this would suggest an amalgamation. The IPSASB noted that this approach would require the introduction of new concepts into the IPSASB's literature. For example, non-market activity is a GFS concept that the IPSASB has not adopted. The IPSASB did not consider it appropriate to introduce these concepts in ED 60. Consequently, the IPSASB did not consider that this factor was relevant to the classification of public sector combinations.

(e) **Accountability**. Some respondents suggested that accounting for a public sector combination at fair value provides more information about the effect of that combination, but that this is only useful for accountability purposes where the entity was responsible for the decision to combine. The IPSASB did not consider accountability to be a primary factor in its own right, but acknowledged that the information resulting from the classification of a public sector combination should meet the objectives of financial reporting. In exceptional circumstances, when an analysis of consideration and the decision-making process produces an inconclusive result or does not provide sufficient evidence as to the appropriate classification of a public sector combination, an entity may need to consider other matters, including what information would meet the objectives of financial reporting and satisfy the qualitative characteristics (QCs).

BC32. The IPSASB concluded, therefore, that control should be supplemented by two additional factors– whether consideration was transferred, and the reasons for the presence or absence of consideration; and the decision-making process. These factors are wide ranging, and encompass elements of other factors, as discussed above.

BC33. The IPSASB noted that these factors could be used either to supplement the indicators of control in IPSAS 35, or could be used to supplement the control concept in classifying public sector combinations. The IPSASB debated the merits of these two approaches. The IPSASB noted that using the factors to supplement the indicators of control was likely to result in a classification approach that better satisfied the QC of comparability. However, the IPSASB considered that using the factors to supplement the control concept was likely to produce a classification approach that provided more relevant and faithfully representative information. Using the factors to supplement the control concept was also more likely to address the concerns raised by respondents.

BC34. Respondents to the CP had identified difficulties with distinguishing between acquisitions and amalgamations based solely on control that were unlikely to be fully addressed by further development of the indicators of control. The IPSASB agreed, and concluded that the gaining of control of operations by a party to the combination is an essential element of an acquisition, but is not sufficient in itself to determine whether a combination is an acquisition. Consequently, the IPSASB agreed to develop an approach to classifying public sector combinations that:

(a) Uses the factors to supplement the concept of control; and

(b) Considers control in the context of whether a party to the combination gains control of one or more operations as a result of the combination.

BC35. Having agreed to develop an approach that uses the factors to supplement control, the IPSASB discussed the relative importance to be attached to control and to the other factors in classifying public sector combinations. As part of this discussion, the IPSASB identified the following two approaches:

(a) **Rebuttable presumption approach**. Under this approach, when one party to the combination gains control of an operation, this creates a rebuttable presumption that the combination is an acquisition. This approach gives a strong weighting to the gaining of control, and the analysis of the other factors is focused on whether there is sufficient evidence to rebut this presumption.

(b) **Individual weighting approach.** Under this approach, the weightings given to the gaining of control, consideration and decision-making are a matter for professional judgment based on the individual circumstances of the combination. Preparers would identify which (if any) factors indicate an acquisition and which (if any) factors indicate an amalgamation. Where indicators of both an acquisition and an amalgamation are present, the weighting given to the respective factors by preparers using professional judgment would determine the classification.

BC36. The IPSASB noted that the rebuttable presumption approach provided greater clarity, and better satisfied the QC of comparability. The individual weighting approach was likely to be more subjective in practice. However, the IPSASB acknowledged that the individual weighting approach would enable practitioners to better reflect the economic substance of the combination, and might better meet the QCs of relevance and faithful representation.

BC37. Control was seen by most members as more important in determining the classification than the other factors, and the rebuttable presumption approach reflected this. Consequently, the IPSASB agreed to develop the rebuttable presumption approach.

BC38. In coming to this decision the IPSASB noted that an approach that considered other factors as supplementing control (which better satisfies the QCs of relevance and faithful representation at the expense of comparability) while at the same time incorporating a rebuttable presumption that one party to a combination gaining control of operations gives rise to an acquisition (which better satisfies the QC of comparability at the expense of relevance and faithful representation) is likely to produce an appropriate balance between the QCs.

BC39. The IPSASB also considered the possibility that, in rare circumstances, neither the consideration nor the decision-making indicators would be sufficient to rebut the presumption that a public sector combination was an acquisition even though this classification did not reflect the economic substance of the combination. The IPSASB agreed to require consideration of the economic substance of the combination when determining whether the presumption should be rebutted. To assist preparers in this determination, ED 60 also required, in these rare circumstances, an assessment as to which classification produces information that best satisfies the objectives of financial reporting and the QCs.

BC40. The IPSASB considered that the most common circumstances in which a public sector combination would be considered an acquisition are:

(a) One party to the combination gains control of an operation and pays consideration that is intended to compensate those with an entitlement to the net assets of the transferred operation for giving up that entitlement.

(b) One party to the combination gains control of an operation from outside the public sector without paying consideration to compensate those with an entitlement to the net assets of the transferred operations.

(c) One party to the combination gains control of an operation from outside the public sector by imposing the combination on the other party.

(d) One party to the combination gains control of an operation from a separate government.

The IPSASB noted that, except in exceptional cases, the classification approach adopted in ED 60 would result in such combinations being classified as acquisitions. This provided reassurance to the IPSASB that the approach adopted was appropriate.

Responses to ED 60

BC41. The IPSASB considered the responses to ED 60. The IPSASB noted that there was substantial support for the overall approach to classifying public sector combinations in the ED.

BC42. Respondents did, however, identify areas where they considered the approach could be improved. The main issues identified were:

(a) Having a rebuttable presumption that was expected to be rebutted significantly more frequently than not was confusing;

(b) The approach was seen as giving too much emphasis to control, with some stakeholders interpreting the ED as requiring the use of the acquisition method in most cases where one party to the combination gained control of operations; and

(c) In many jurisdictions, it will be easier to determine the economic substance of a public sector combination by reference to the indicators (consideration and decision making) than by reference to whether one party to the combination gained control of operations.

BC43. The IPSASB acknowledged these concerns. The IPSASB accepted that rebuttable presumptions are generally expected to be rebutted infrequently, and that the use of this term with an expectation that it would be frequently rebutted may be confusing for preparers. This confusion could result in a preparer classifying a public sector combination as an acquisition when this was not the IPSASB's intention.

BC44. The IPSASB considered that the potential confusion as to how the rebuttable presumption was to be interpreted might explain the concerns of some stakeholders that the acquisition method would be used inappropriately. The IPSASB did not intend that the approach in the ED would require the use of the acquisition method in most cases where one party to the combination gained control of operations. The IPSASB considered that acquisitions would arise in limited circumstances, as can be seen from the list in paragraph BC40 above.

BC45. The IPSASB accepted that, in many jurisdictions, the economic substance of a public sector combination could be more readily determined by reference to the indicators, in particular whether a combination occurred under common control. However, the IPSASB noted that this was not the case for all jurisdictions. The IPSASB noted that control remained a significant factor; in particular, an acquisition can only occur when a party to the combination gains control of one or more operations. The IPSASB also noted that the approach in ED 60 provided a suitable decision framework for ensuring all relevant factors were considered.

BC46. Consequently, the IPSASB agreed to reconsider the way the classification approach is expressed to address these concerns, without changing the substance of the approach. The rebuttable presumption and reference to control was intended to be the first step in the process of determining a classification based on the economic substance of the combination. In creating this first step, the IPSASB did not intend that, once it has been established that one party has gained control, control should be given greater weight than consideration and decision making in determining the economic substance of the combination. The IPSASB accepted that the reference in BC35(a) to the approach giving a strong weighting to the gaining of control could be misleading. Control remains important, as its absence eliminates the possibility of an acquisition, but its significance in determining the economic substance of a particular combination where one party has gained control is a matter of professional judgment. The IPSASB remains of the view that the classification approach in ED 60 was appropriate, and the changes introduced in this Standard are intended to provide greater clarity as to how the approach should be applied. These changes are not intended to produce different classifications from ED 60.

Comparison with IFRS 3

BC47. This Standard is not converged with IFRS 3. IFRS 3 considers all business combinations to be acquisitions, whereas this Standard provides for both amalgamations and acquisitions. The IPSASB considers this difference to be appropriate, for the following reasons:

(a) In developing IFRS 3, the IASB concluded that 'true mergers' or 'mergers of equals' in which none of the combining entities obtains control of the others are so rare as to be virtually non-existent. However, in the public sector, such combinations are common. Developing a Standard that did not address amalgamations would not meet the needs of the users of public sector GPFSs.

(b) IFRS 3 assumes that it is always possible to identify the acquirer, as the businesses to which IFRS 3 applies will always have owners. In the public sector, there may be no quantifiable ownership interests in a public sector entity, which can make it impossible to identify an acquirer. Developing a Standard that does not recognize this situation would not meet the needs of the users of public sector GPFSs.

Accounting for Amalgamations (paragraphs 15–57)

Reasons for adopting the modified pooling of interests method of accounting for amalgamations

BC48. In developing the CP, the IPSASB identified three methods of accounting for public sector combinations that have either been applied in practice, or discussed. These are:

(a) The acquisition method;

(b) The pooling of interests method, including a possible modification to this method; and

(c) The fresh start method.

BC49. The acquisition method (which is applied by IFRS 3) requires that an acquirer is identified for all combinations. The IPSASB had already concluded that it may not be possible to identify an acquirer for all public sector combinations, and that any combination in which an acquirer could not be identified would be classified as an amalgamation. The IPSASB therefore concluded that the acquisition method of accounting would not be appropriate for amalgamations.

BC50. The pooling of interests method of accounting was previously used in IAS 22, *Business Combinations* (the predecessor standard to IFRS 3). It was intended for application to a combination in which an acquirer cannot be identified. The pooling of interests method of accounting was previously used by many jurisdictions as the basis for merger accounting or amalgamation accounting. It continues to be used by many entities when accounting for combinations under common control (which are outside the scope of IFRS 3).

BC51. The pooling of interests method accounts for the combining operations as though they were continuing as before, although now jointly owned and managed. The financial statement items of the combining operations for the period in which the combination occurs, and for any comparative periods disclosed, are included in the financial statements of the resulting entity as if they had been combined from the beginning of the earliest period presented. In other words, the recognition point is the beginning of the earliest period presented, and, consequently, comparative information is restated.

BC52. The IPSASB noted that some are of the view that the requirement to restate comparative information might be onerous and unnecessary. In the CP, the IPSASB consulted on a variation of the pooling of interests method of accounting, described as the modified pooling of interests method of accounting. Under the modified pooling of interests method, the resulting entity combines the items in the statement of financial position as at the date of the amalgamation.

BC53. The third method the IPSASB discussed in the CP was the fresh start method of accounting. In contrast to the pooling of interests method of accounting, the premise of the fresh start method is that the resulting entity is a new entity (irrespective of whether a new entity is formed) and therefore its history commences on that date. The modified pooling of interests method has a similar effect in practice.

BC54. The fresh start method requires recognition of all of the identifiable assets and liabilities of all the combining operations at fair value as at the date of the combination in the financial statements of the resulting entity. This includes recognizing identifiable assets and liabilities that were not previously recognized by the combining operations. In other words, the fresh start method uses the same recognition and measurement basis as the acquisition method, but applies it to all of the combining operations rather than just acquired operations.

BC55. In developing the CP, the IPSASB came to the conclusion that the pooling of interests method of accounting, the modified pooling of interests method of accounting and the fresh start method of accounting all provided a possible basis for accounting for amalgamations.

BC56. The IPSASB noted that the future cash flows and service potential of the resulting entity will generally be the same regardless of which method is used to account for the amalgamation. However, the presentation of the financial performance and financial position of the resulting entity differs significantly depending on the method applied. If preparers are given a free choice of method, this would reduce comparability between entities and over time.

BC57. Supporters of the pooling or modified pooling of interests method of accounting for amalgamations considered that these methods satisfy users' needs:

(a) For information for decision-making purposes; and

(b) To assess the accountability of the resulting entity for its use of resources.

This is because users of public sector entities' GPFSs use the information to assess how financial resources have been allocated and the financial condition of an entity. This information can be obtained by applying the pooling or modified pooling of interests methods of accounting.

BC58. These methods are seen as satisfying the QCs of relevance and faithful representation, because they reflect the amounts recognized in the financial statements of the combining operations before the amalgamation. The subsequent performance of the resulting entity, and its accountability for the management of those resources, can be assessed on the same basis as was used to assess accountability before the amalgamation.

BC59. The pooling or modified pooling of interests methods of accounting are seen as generally the least costly to apply, because they:

(a) Use the existing carrying amounts of the assets, liabilities, and net assets/equity of the combining operations; and

(b) Do not require identifying, measuring, and recognizing assets or liabilities not previously recognized before the amalgamation.

BC60. Supporters of the modified pooling of interests method of accounting consider it to be superior to the pooling of interests method because it portrays the amalgamation as it actually is. This is because it recognizes the assets and liabilities of the combining operations at the date of the amalgamation. Supporters consider this to be a faithful representation of the amalgamation.

BC61. Those who support the use of the modified pooling of interests method acknowledge that the history of the combining operations may help in assessing the performance of the resulting entity. In debating the merits of the different methods, the IPSASB acknowledged that adopting the modified pooling of interests method of accounting without addressing users' needs for historical information may not satisfy the objectives of financial reporting.

BC62. Others consider that the fresh start method of accounting is conceptually superior to both the pooling of interests method of accounting and its modified version, because the resulting entity is held accountable for the current value of the resources of the combining operations. It also provides more complete information of an amalgamation, because it recognizes the identifiable assets and liabilities of the combining operations, regardless of whether they were recognized prior to the amalgamation.

BC63. Supporters of the fresh start method of accounting consider that it satisfies users' needs:

(a) For information for decision-making purposes; and

(b) To assess the accountability of the resulting entity for its use of resources.

This is because it enables users to better assess the financial condition of the entity and how the financial resources have been allocated.

BC64. Supporters of the fresh start method of accounting consider that this method is, to a large extent, an extension of the use of fair value in the acquisition method of accounting. Consequently, they argue that if the acquisition method is adopted for acquisitions, there is no reason not to adopt similar accounting for amalgamations.

BC65. In developing the CP, the IPSASB came to the view that the modified pooling of interests method of accounting is the appropriate method to apply, because users' are able to assess the performance and accountability of the resulting entity without the entity having to remeasure its assets and liabilities. Furthermore, it recognizes the amalgamation on the date it takes place. The IPSASB noted that IPSASs permit revaluation to fair value subsequent to initial recognition if a resulting entity considers that this approach would provide more relevant information to users.

BC66. Respondents to the CP generally supported the IPSASB's view that the modified pooling of interests method of accounting is the appropriate method to apply to amalgamations. The IPSASB reconsidered the methods in developing ED 60, and identified no reason to change its previously stated view. The IPSASB therefore agreed that the modified pooling of interests method of accounting should be adopted for amalgamations in ED 60. In coming to this decision, the IPSASB agreed that the modified pooling of interests method of accounting should include appropriate disclosures to ensure that the users of public sector entities' GPFSs had access to the historical information they need.

BC67. Respondents to ED 60 generally agreed that the modified pooling of interests method of accounting is the appropriate method to apply to amalgamations. However, some respondents considered that the pooling of interests method of accounting provided better information, and only supported the modified pooling of interests method for cost/benefit reasons. These respondents considered that, in some circumstances, the benefits of providing prior period information would outweigh the cost of so doing. The IPSASB accepted this view, and agreed that resulting entities should be permitted, but not required, to present prior period information. The IPSASB decided that prior period information should not be restated, as doing so would require the use of a different recognition point, which would reduce comparability.

Exceptions to the principle that assets and liabilities are recognized and measured at their previous carrying amount

BC68. The modified pooling of interests method of accounting requires the resulting entity to recognize and measure the assets and liabilities of the combining operations at their previous carrying amounts, subject to the requirement to adjust the carrying amounts to conform to the resulting entity's accounting policies. The effects of all transactions between the combining operations, whether occurring before or after the amalgamation date, are eliminated in preparing the financial statements of the resulting entity.

BC69. The IPSASB considered the circumstances in which the application of these principles would not be appropriate. The IPSASB identified three circumstances in which an exception to the recognition and/or measurement principles would be appropriate:

(a) **Licenses and similar rights previously granted by one combining operation to another combining operation**. A license or similar right may have been granted by one combining operation to another combining operation and recognized as an intangible asset by the recipient. Applying the general principles would require this transaction to be eliminated. However, the IPSASB considered that, in granting the license or similar right, the recognition criteria for an intangible asset are met. Where internally generated intangible assets are not recognized, this is because of the problems in Identifying whether and when there is an identifiable asset that will generate expected future economic benefits or service potential; and in determining the cost of the asset reliably. Once a license or similar right has been granted to a recipient, this demonstrates that there is an identifiable asset that will generate future economic benefits or service potential. Similarly, the transaction will establish a cost for the asset. Consequently, the recognition criteria for an intangible asset are met. Because of this, the asset is not eliminated when combining operations that have granted and received the license or similar right are part of an amalgamation. The situation is similar to that where a tangible asset is sold by one combining operation to another combining operation. Eliminating the effect of the sale does not eliminate the tangible asset itself, as the asset was previously recognized by the seller. In the case of a license or similar right, eliminating the transaction does not eliminate the intangible asset, as the transaction provides sufficient evidence of the existence of the intangible asset, such that the grantor would itself recognize that intangible asset. The IPSASB noted that in some cases where a combining operation gains control of other operations, the right might be considered as a reacquired right. The IPSASB did not consider that this would warrant a different accounting treatment, and noted that reacquired rights are recognized as intangible assets under the acquisition method. For these reasons, the IPSASB concluded that the asset recognized in respect of a license or similar right previously granted by one combining operation to another should not be eliminated.

(b) **Income taxes**. In the public sector, amalgamations, especially those imposed by a higher level of government, may include tax forgiveness as part of the terms and conditions of the amalgamation. The IPSASB agreed that the resulting entity should recognize any tax items that exist following the amalgamation rather than those that existed prior to the amalgamation. Having considered comments by respondents to ED 60, the IPSASB agreed that there may be cases where any tax forgiveness arises subsequent to the amalgamation, rather than as part of the terms and conditions of the amalgamation. The IPSASB agreed to include provisions dealing with both cases in IPSAS 40.

(c) **Employee benefits**. The IPSASB noted that the assets and liabilities required to be recognized by IPSAS 39, *Employee Benefits*, in respect of a post-employment benefit plan following an amalgamation might differ from the combined carrying amounts of the combining operations' equivalent amounts. As an example, an amalgamation involves five combining operations who are the only participants in a multi-employer defined benefit plan. Prior to the amalgamation, the combining operations have insufficient information to determine each combining operation's proportionate share of the defined benefit obligation, plan assets, and cost associated with the plan. As a result, the combining operations account for the plan as if it is a defined contribution plan. Following the amalgamation, the resulting entity is the only participant in the plan, and is able to determine its defined benefit obligation, plan assets, and cost associated with the plan. It therefore accounts for the plan as a defined benefit plan from the date of the amalgamation. The IPSASB agreed that the resulting entity's opening statement of financial position should include the assets and liabilities measured in accordance with IPSAS 39.

Recognizing and measuring components of net assets/equity arising as a result of an amalgamation

BC70. In developing ED 60, the IPSASB noted that a residual amount might arise as a result of an amalgamation. The IPSASB considered how this should be recognized and measured. The IPSASB agreed that the residual amount does not reflect the financial performance of the resulting entity, and concluded that the residual amount should be recognized in the resulting entity's opening statement of financial position.

BC71. The IPSASB considered the nature of the residual amount. The IPSASB considered that, for amalgamations not under common control, the residual amount represents the past financial performance of the combining operations not included in their transferred net assets/equity. The IPSASB agreed that the residual amount should be included in the resulting entity's opening net assets/equity where the amalgamation takes place not under common control.

BC72. The IPSASB considered that, for amalgamations under common control, the residual amount represents the financial consequences of decisions made by the controlling entity in setting or accepting the terms of the amalgamation. Consequently, the IPSASB agreed that the residual amount should be treated as an ownership contribution or ownership distribution where the amalgamation takes place under common control.

BC73. The IPSASB considered the items that should be included in the residual amount. The IPSASB noted that the modified pooling of interests method of accounting usually recognizes an amalgamation as giving rise to, in substance, a new entity on the date the amalgamation takes place. As the new entity would not have generated other components of net assets/equity such as accumulated surplus or deficit, or revaluation surplus, all items within net assets/equity would be included as part of the residual amount.

BC74. The IPSASB considered that this approach best reflects the conceptual basis of an amalgamation and agreed that all items within net assets/equity at the amalgamation date should be considered to be part of the residual amount. In coming to this view, the IPSASB accepted that this approach may have consequences for some entities. For example, because the residual amount would include any previously recognized revaluation surplus, any future revaluation decreases are more likely to be recognized in surplus or deficit. This is because the previously recognized revaluation surplus would no longer be available to absorb future revaluation decreases.

BC75. Another consequence relates to amalgamations that take place under common control. The resulting entity would recognize a residual amount but the controlling entity would continue to recognize the previous components of net assets/equity in its consolidated financial statements, giving rise to ongoing consolidation adjustments. The IPSASB did not consider that these consequences outweighed the benefits of adopting the conceptual approach.

Responses to ED 60

BC76. Although the majority of respondents to ED 60 supported the IPSASB's approach to the residual amount, a significant minority did not. The main reasons respondents gave for not supporting the proposed treatment of the residual amount were as follows:

(a) Retaining existing reserves better represents the combination, is more transparent and better meets users' needs;

(b) The proposals will result in reliable information on the revaluation reserve being discarded;

(c) For amalgamations under common control, the combining entities may effectively be continuing as one entity rather than as two or more separate entities, as opposed to being a new entity;

(d) Reporting subsequent revaluation losses as an expense risks misrepresenting financial performance in future years;

(e) The proposals will produce ongoing consolidation adjustments where the amalgamation takes place under common control, and the need to prepare these adjustments outweighed the benefits of recognizing a single residual amount; and

(f) The proposals will impact on a wide range of reserves, including those relating to employee benefits, hedging and reserves restricted by legislation, which would be inconsistent with ED 60's requirement that the existing classifications and designations are maintained.

BC77. The IPSASB was persuaded by some of the reasons provided by respondents. In particular the IPSASB acknowledged that the proposals in ED 60 might be internally inconsistent.

BC78. The IPSASB therefore reconsidered the proposal to require all amounts recognized in net assets/equity to be recognized in the residual amount.

BC79. The IPSASB concluded that the most appropriate presentation of net assets/equity would depend on the circumstances of the amalgamation. In an amalgamation not under common control, and where there were no reserves such as those referred to in paragraph BC76(f) above, presenting a single opening balance in net assets/equity could provide faithfully representative information. In an amalgamation under common control, and with reserves such as those referred to in paragraph BC76(f) above, presenting a single opening balance in net assets/equity is unlikely to provide faithfully representative information. In these circumstances, presenting separate components of net assets/equity will provide more relevant and useful information.

BC80. Consequently, the IPSASB decided not to specify which components of net assets/equity should be presented, as preparers will be in the best position to judge the most appropriate treatment. The IPSASB agreed to amend the requirements accordingly.

Measurement period

BC81. IFRS 3 permits acquirers a period of one year after the acquisition date to complete the accounting for the acquisition. This is to allow the acquirer sufficient time to obtain information to determine the fair value of an acquired operation's assets and liabilities.

BC82. The IPSASB considered whether such a period was required when accounting for an amalgamation. The modified pooling of interests method does not require assets and liabilities to be restated to fair value at the amalgamation date. However, the IPSASB noted that the combining operations may have different accounting policies, which could result in some assets and liabilities being required to be restated to conform to the resulting entity's accounting policies. For example, the resulting entity may adopt an accounting policy of revaluing certain assets such as property, plant and equipment. If one or more combining operations had previously adopted an accounting policy of measuring such assets at cost, the practical effect of determining the carrying amount of those assets under the revaluation model would be similar to that of determining their fair value. For this reason, the IPSASB agreed that it was appropriate to permit a resulting entity time to obtain the information needed to restate assets and liabilities to conform to its accounting policies. The IPSASB agreed that a period of one year was appropriate.

Combining operations that have not previously adopted accrual basis IPSASs

BC83. In developing this Standard, the IPSASB considered whether it was necessary to include specific provisions to address the situation where one or more combining operations had not previously adopted accrual basis IPSASs. For example, one public sector entity that has previously applied accrual basis IPSASs may be amalgamated with a second public sector entity that has previously applied an alternative accrual basis of accounting. In such circumstances, recognizing and measuring the second public sector entity's assets and liabilities at their carrying amount may not be consistent with the requirements of accrual basis IPSASs.

BC84. The IPSASB concluded that no separate provisions were required in this Standard. Paragraph 27 of IPSAS 40 requires the resulting entity to adjust the carrying amounts of the identifiable assets and liabilities of the combining operations where required to conform to the resulting entity's accounting policies. The IPSASB considered this requirement to be sufficient to address most circumstances where one or more combining operations had not previously adopted accrual basis IPSASs.

BC85. The IPSASB came to the view that where adjusting the carrying amounts to conform to the resulting entity's accounting policies was insufficient to achieve compliance with accrual basis IPSASs, the resulting entity would be a first-time adopter of accrual basis IPSASs. This could occur where one or more combining operations had previously adopted the cash basis of accounting and had, therefore, not previously recognized certain assets and liabilities. In these circumstances, the resulting entity would apply IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* in preparing its first post-combination financial statements.

Accounting for acquisitions (paragraphs 58–125)

Reasons for adopting the acquisition method of accounting for acquisitions

BC86. In developing the CP, the IPSASB did not reach a conclusion as to "whether the use of fair value as the measurement basis, is appropriate for some or all acquisitions in the public sector. This is because the most prevalent types of acquisition occur where operations are acquired for the achievement of objectives relating to the delivery of goods and/or services, instead of generating economic benefits to return to equity holders. Moreover, many acquisitions do not include the transfer of consideration. Some consider that these types of acquisitions are different in nature from business combinations as identified in IFRS 3, because the concept of acquiring an operation directly in exchange for the transfer of consideration is missing." Respondents to the CP generally supported the use of fair value for acquisitions in which consideration was transferred. For acquisitions in which no consideration was transferred, there was broadly equal support for fair value measurement and measurement at carrying amount.

BC87. The arguments developed in the CP reflected the classification approach in the CP. In the CP, the IPSASB proposed that the gaining of control was the sole definitive criterion for distinguishing an amalgamation from an acquisition. The IPSASB has subsequently decided to supplement the gaining of control with two other factors, consideration and decision-making. The IPSASB considers that this will result in fewer public sector combinations being classified as acquisitions than under the approach in the CP. Those public sector combinations that are classified as acquisitions will be similar in nature to the business combinations addressed by IFRS 3.

BC88. Having regard to the revised classification approach that it had agreed to adopt, the IPSASB reconsidered which accounting method would be appropriate for acquisitions. The IPSASB concluded that the acquisition method was appropriate, and agreed to adopt the acquisition method as set out in IFRS 3 as the accounting method for acquisitions in this Standard. This approach was supported by respondents to ED 60.

Differences to the accounting treatments in IFRS 3

BC89. IFRS 3 includes accounting treatments that are based on other IFRS Standards for which there is no equivalent IPSAS, for example income taxes and share-based payment. The IPSASB agreed not to include the detailed requirements specified in IFRS 3, but to include references to the relevant international or national accounting standard dealing with the issue.

BC90. The IPSASB considered whether any additional guidance to that provided by IFRS 3 was required. The IPSASB noted that acquisitions in the public sector may include assets and liabilities arising from non-exchange transactions that are not addressed in IFRS 3. Consequently, the IPSASB agreed to include additional guidance on the following non-exchange items:

(a) Tax forgiveness; and

(b) The subsequent measurement of transfers, concessionary loans and similar benefits received by a combining operation on the basis of criteria that may change as a result of an acquisition.

BC91. The IPSASB considered comments from respondents to ED 60 regarding the acquisition method. As a result, the IPSASB agreed to make minor changes to the requirements:

The tax forgiveness requirements have been amended to allow for those cases where tax forgiveness occurs subsequent to the acquisition as well as where it forms part of the terms of the acquisition.

The IPSASB considered whether any additional exemptions to the recognition and measurement principles or any additional guidance on the acquisition method were required. The IPSASB concluded that no further provisions were necessary, as the Board considered that the provisions in this Standard or in other IPSASs were already sufficiently clear.

Acquired operations that have not previously adopted accrual basis IPSASs

BC92. In developing this Standard, the IPSASB considered whether it was necessary to include specific provisions to address the situation where one or more acquired operations had not previously adopted accrual basis IPSASs. The IPSASB concluded that no separate provisions were required in this Standard. Paragraph 64 of IPSAS 40 requires an acquirer to recognize the identifiable assets acquired, the liabilities assumed and any non-controlling interest in an acquired operation. Paragraph 72 of the Standard requires the acquirer to measure the assets and liabilities acquired at their acquisition-date fair values. Consequently, the acquirer will measure all assets and liabilities in accordance with accrual basis IPSASs, irrespective of the accounting basis previously adopted by an acquired operation.

Fair value cannot be determined

BC93. Respondents to ED 60 commented that, in exceptional circumstances, it may be impracticable for an acquirer to determine the fair value of an item and suggested that the use of the item's previous carrying amount may be an appropriate alternative. The IPSASB considered this suggestion but concluded that using carrying amount may not be appropriate in all instances, particularly if the acquired operation does not apply accrual based IPSASs. The IPSASB agreed that entities should apply the existing requirements in IPSASs. In particular, the IPSASB noted that, in accordance with IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so. IPSAS 3 provides additional guidance. In such cases, the acquirer would measure the item as of the acquisition date in a manner that is consistent with other IPSASs and the acquirer's accounting policies, and make the disclosures required by other IPSASs. The IPSASB considered that it would be appropriate to measure the item at its previous carrying amount only where that carrying amount is consistent with other IPSASs and the acquirer's accounting policies.

Revision of IPSAS 40 as a result of [draft] *Improvements to IPSAS*, 2018[20]

BC94. The IPSASB reviewed the revisions to IFRS 3, *Business Combinations*, included in Annual Improvements to *IFRS® Standards 2015–2017 Cycle* issued by the IASB in December 2017, and the IASB's rationale for making these amendments as set out in its Basis for Conclusions. The IPSASB concurred that, as the accounting for an acquisition achieved in stages was the same in IPSAS 40 as in IFRS 3, there was no public sector specific reason for not adopting the amendments.

[20] In May 2018 the IPSASB issued *Improvements to IPSAS, 2018* which includes proposals to amend IPSAS 40 by adding paragraph 100A and to add paragraph BC94 to the IPSASB's Basis for Conclusions.

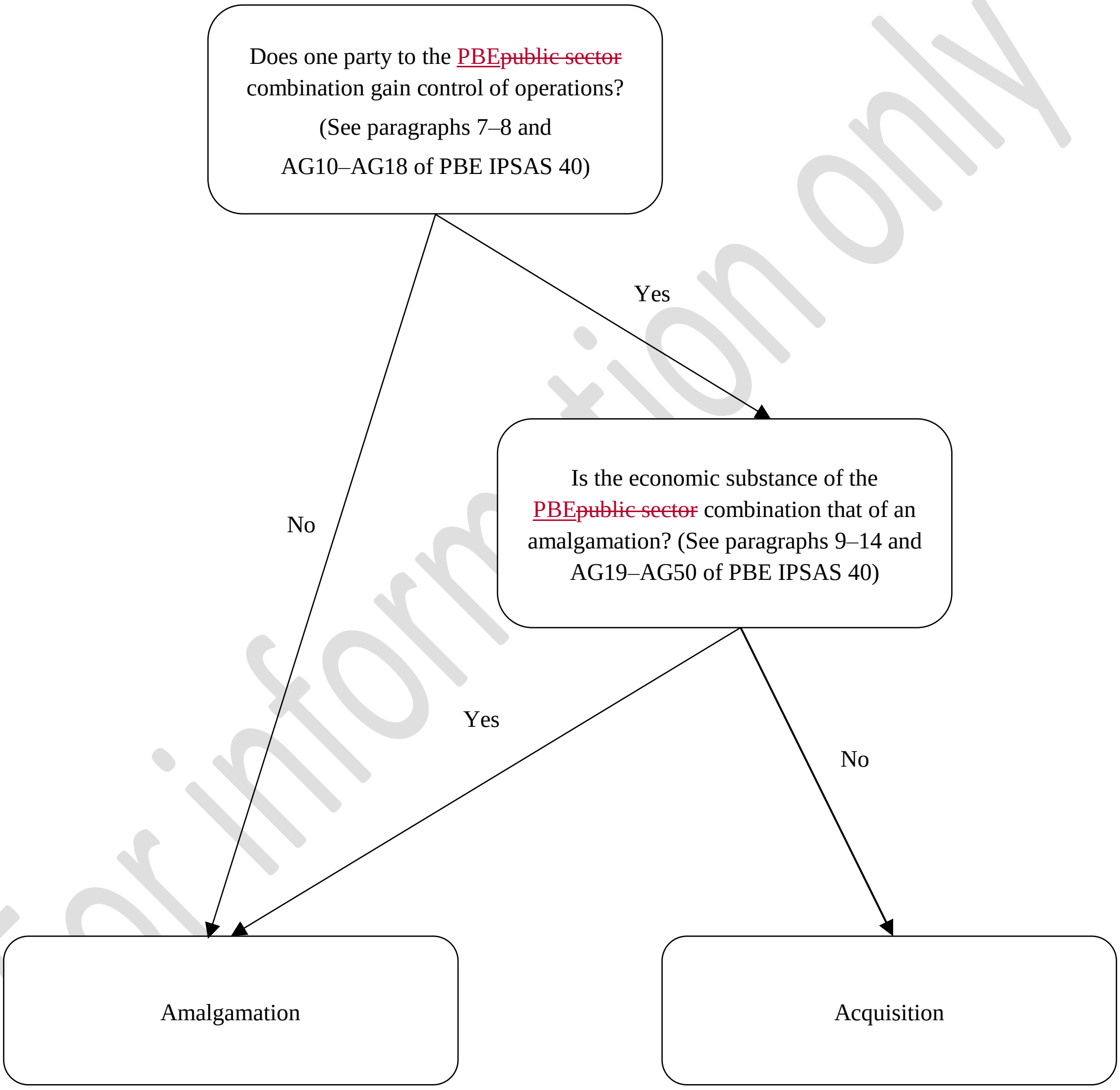
Implementation Guidance

This guidance accompanies, but is not part of, PBE IPSAS 40

IG1. The purpose of this Implementation Guidance is to illustrate certain aspects of the requirements of PBE IPSAS 40.

Classification of PBE Combinations

IG2. The diagram below summarises the process established by PBE IPSAS 40 for classifying PBE combinations.



Illustrative Examples

These examples accompany, but are not part of, PBE IPSAS 40

Classification of PBE~~public Sector~~ Combinations

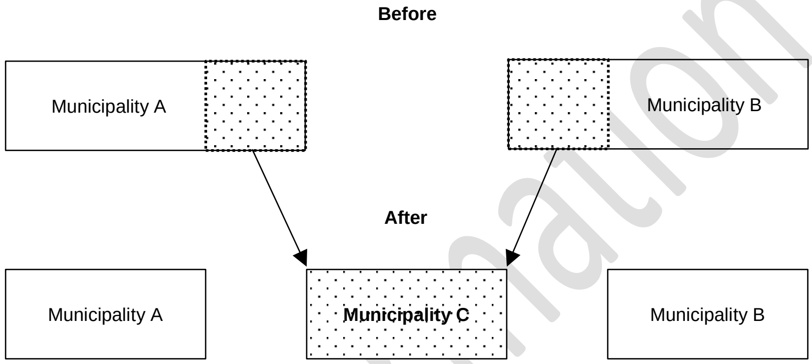
Illustrating the Consequences of Applying Paragraphs 7–14 and AG10–AG50 of PBE IPSAS 40

IE1. The following scenarios illustrate the process for classifying PBE~~public sector~~ combinations. These scenarios portray hypothetical situations. Although some aspects of the scenarios may be present in actual fact patterns, all facts and circumstances of a particular fact pattern would need to be evaluated when applying PBE IPSAS 40.

IE2. Each scenario is illustrated by a diagram. Where a PBE ~~public sector~~ combination involves operations which form part of an economic entity, but not the whole economic entity, the operations that are involved in the combination, and the entity that is formed by the combination, are shaded in the diagram. Where more than one reporting entity is included in an economic entity, the boundary of the economic entity is shown by a dotted line.

Scenario 1: Reorganisation of Local Government by Rearranging Territorial Boundaries

IE3. The following diagram illustrates the creation of a new municipality by combining some operations from two existing municipalities.



IE4. In this scenario, the territorial boundaries of two existing municipalities, Municipality A and Municipality B, are redrawn by Parliament through legislation; neither Parliament nor Central Government controls Municipality A or Municipality B. Responsibility for part of each municipality's former territory is transferred to a new municipality, Municipality C. Operations in respect of the transferred territory are combined to form Municipality C. A PBE ~~public sector~~ combination occurs.

IE5. Municipality A and Municipality B remain otherwise unchanged and retain their governing bodies. A new governing body (unrelated to the governing bodies of Municipality A and Municipality B) is elected for Municipality C to manage the operations that are transferred from the other municipalities.

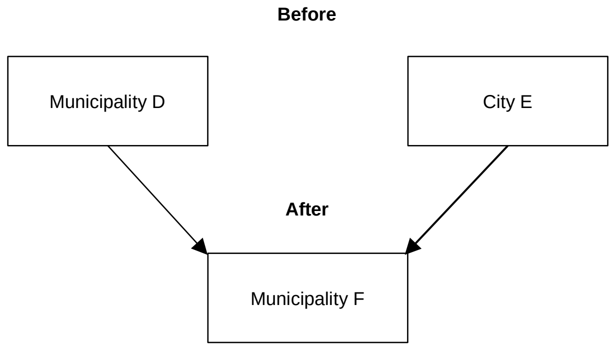
IE6. The creation of Municipality C is a PBE ~~public sector~~ combination. In determining whether this should be classified as an amalgamation or an acquisition, the first question to consider is whether one of the parties to the combination has gained control of operations as a result of the combination.

IE7. Municipality C has a newly elected governing body, unrelated to the governing bodies of Municipality A and Municipality B. Neither Municipality A nor Municipality B has power over the Municipality C. Neither do they have exposure, or rights, to variable benefits from any involvement with Municipality C.

IE8. Neither Municipality A nor Municipality B have gained control over Municipality C as a result of the PBE~~public sector~~ combination. Consequently the combination is classified as an amalgamation.

Scenario 2: Reorganisation of Local Government by Combining Municipalities into a New Legal Entity

IE9. The following diagram illustrates the creation of a new municipality by combining all of the operations of two existing municipalities into a new legal entity.



IE10. In this scenario, a PBE ~~public sector~~ combination occurs in which Municipality F is formed to combine the operations (and the related assets, liabilities and components of net assets/equity) of Municipality D and City E. Prior to the combination, Municipality D and City E are not under common control. The combination is imposed by the provincial government (a third party) through legislation. The provincial government has the legal power to direct the two entities to combine, through legislation, even though it does not control them.

IE11. The legislation that creates Municipality F provides for the formation of a new governing body with no links to Municipality D or City E. Municipality D and City E have no role in determining the terms of the combination. After the combination, Municipality D and City E cease to exist.

IE12. The creation of Municipality F is a PBE ~~public sector~~ combination. In determining whether this should be classified as an amalgamation or an acquisition, the first question to consider is whether one of the parties to the combination has gained control of operations as a result of the combination.

IE13. Municipality F has a newly formed governing body, unrelated to the governing bodies of Municipality D and City E. Neither Municipality D nor City E has power over Municipality F. Neither do they have exposure, or rights, to variable benefits from any involvement with Municipality F.

IE14. Neither Municipality D nor City E have gained control over Municipality F as a result of the PBE ~~public sector~~ combination. Consequently the combination is classified as an amalgamation.

Scenario 2: Variation

IE15. In scenario 2, the legislation that creates Municipality F provides for the formation of a new governing body with no links to Municipality D or City E. In this variation, the legislation that creates Municipality F provides for the governing body of Municipality D to become the governing body of Municipality F.

IE16. This suggests that as part of the PBE ~~public sector~~ combination that creates Municipality F, Municipality D is gaining control of the operations of City E. However, the assessment as to whether Municipality D is gaining control is based on the substance of the combination, not its legal form. In preparing its first financial statements, Municipality F considers the guidance in paragraphs 7–8 and AG10–AG18 of PBE IPSAS 40.

IE17. In this variation, it is assumed that the legislation that provides for the governing body of Municipality D to become the governing body of Municipality F results in Municipality D gaining:

(a) Power over the operations of City E;

(b) Exposure, or rights, to variable benefits from its involvement with those operations; and

(c) The ability to use its power over those operations to affect the nature or amount of the benefits from its involvement with those operations.

IE18. Municipality F concludes that, as a result of the PBE ~~public sector~~ combination, Municipality D has gained control of City E. Municipality F considers the guidance in paragraphs 9–14 and AG19–AG50 of PBE IPSAS 40 in determining whether the economic substance of the combination is that of an amalgamation.

IE19. [Not used] ~~In considering the economic substance of the public sector combination, Municipality F notes that the combination does not result in a controlling entity/controlled entity relationship between Municipality D and City E. This is consistent with both an amalgamation and an acquisition. Municipality F also notes that Municipality D obtains access to economic benefits or service potential that are similar to those that could have been obtained by mutual agreement; this may suggest that the economic substance of the combination is that of an acquisition, but is not conclusive.~~

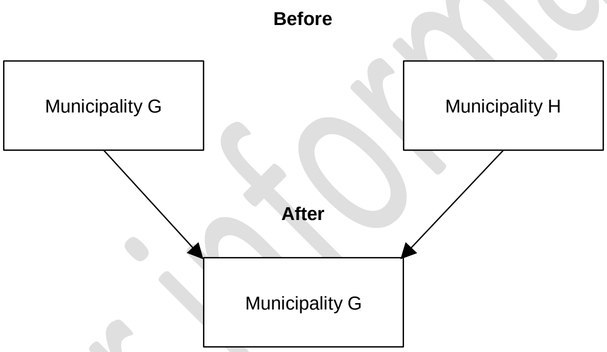
IE20. In considering the indicator~~s~~ relating to consideration, Municipality F notes that the ~~public sector~~PBE combination does not include the payment of consideration and the reasons for the absence of consideration do not provide evidence of an acquisition~~because there is no party with an entitlement to the net assets of City E (i.e., there are no former owners of City E with quantifiable ownership interests)~~. This suggests that the economic substance of the combination is that of an amalgamation.

IE21. In considering the indicators relating to the decision-making process, Municipality F notes that the ~~public sector~~PBE combination was imposed by the provincial government (a third party) and that Municipality D and City E had no role in determining the terms of the combination. This may suggest that the economic substance of the combination is that of an amalgamation.

IE22. ~~Taking these factors together,~~On balance these factors suggest ~~Municipality F considers~~ that the ~~public sector~~PBE ~~–~~combination should be classified as an amalgamation. ~~In coming to this decision, Municipality F considers the absence of consideration because there is no party with an entitlement to the net assets of an operation to be the most significant factor in determining the economic substance of the combination.~~

Scenario 3: Reorganisation of Local Government by Combining Municipalities into an Existing Legal Entity

IE23. The following diagram illustrates the combining of all of the operations of two existing municipalities into an existing legal entity.



IE24. In this scenario, a PBE ~~public sector~~ combination occurs in which the operations of Municipality G and Municipality H (and their related assets, liabilities and components of net assets/equity) are combined into the legal entity of Municipality G. Prior to the combination, Municipality G and Municipality H are not under common control. The combination is imposed by Central Government (a third party) through legislation. Central Government has the legal power to direct the two entities to combine, through legislation, even though it does not control them.

IE25. The legislation that effects the combination provides for the governing body of Municipality G to continue as the governing body of the combined entity. Municipality G and Municipality H have no role in determining the terms of the combination. After the PBE ~~public sector~~ combination, Municipality H ceases to exist.

IE26. These facts suggest that as part of the PBE~~public sector~~ combination, Municipality G is gaining control of the operations of Municipality H. However, the assessment as to whether Municipality G is gaining control is based on the substance of the combination, not its legal form. Municipality G considers the guidance in paragraphs 7–8 and AG10–AG18 of PBE IPSAS 40 in determining whether to classify the combination as an amalgamation or an acquisition.

IE27. In this scenario, it is assumed that the legislation that provides for the governing body of Municipality G to continue as the governing body of combined entity results in Municipality G gaining:

(a) Power over the operations of Municipality H;

(b) Exposure, or rights, to variable benefits from its involvement with those operations; and

(c) The ability to use its power over those operations to affect the nature or amount of the benefits from its involvement with those operations.

IE28. Municipality G concludes that, as a result of the PBE ~~public sector~~ combination, it has gained control of Municipality H. Municipality G considers the guidance in paragraphs 9–14 and AG19–AG50 of PBE IPSAS 40 in determining whether the economic substance of the combination is that of an amalgamation.

IE29. [Not used] ~~In considering the economic substance of the public sector combination, Municipality G notes that the combination does not result in a controlling entity/controlled entity relationship between Municipality G and Municipality H. This is consistent with both an amalgamation and an acquisition. Municipality G also notes that it obtains access to economic benefits or service potential that are similar to those that could have been obtained by mutual agreement; this may suggest that the economic substance of the combination is that of an acquisition, but is not conclusive.~~

IE30. In considering the indicator~~s~~ relating to consideration, Municipality G notes that the PBE~~public sector~~ combination does not include the payment of consideration and the reasons for the absence of consideration do not provide evidence of an acquisition ~~because there is no party with an entitlement to the net assets of Municipality H (i.e., there are no former owners of Municipality H with quantifiable ownership interests)~~. This suggests that the economic substance of the combination is that of an amalgamation.

IE31. In considering the indicators relating to the decision-making process, Municipality G notes that the~~public sector~~entity combination was imposed by Central Government (a third party) and that Municipality G and Municipality H had no role in determining the terms of the combination. This may suggest that the economic substance of the combination is that of an amalgamation.

IE32. ~~Taking these factors together,~~On balance these factors suggest ~~Municipality G considers~~ that the ~~public sector~~PBE combination should be classified as an amalgamation~~. In coming to this decision, Municipality G considers the absence of consideration because there is no party with an entitlement to the net assets of an operation to be the most significant factor in determining the economic substance of the combination~~.

Scenario 3: Variation

IE33. In scenario 3, the legislation provides for the governing body of Municipality G to become the governing body of the combined entity. In this variation, the legislation provides for a new governing body to be formed that has no links to Municipality G or Municipality H.

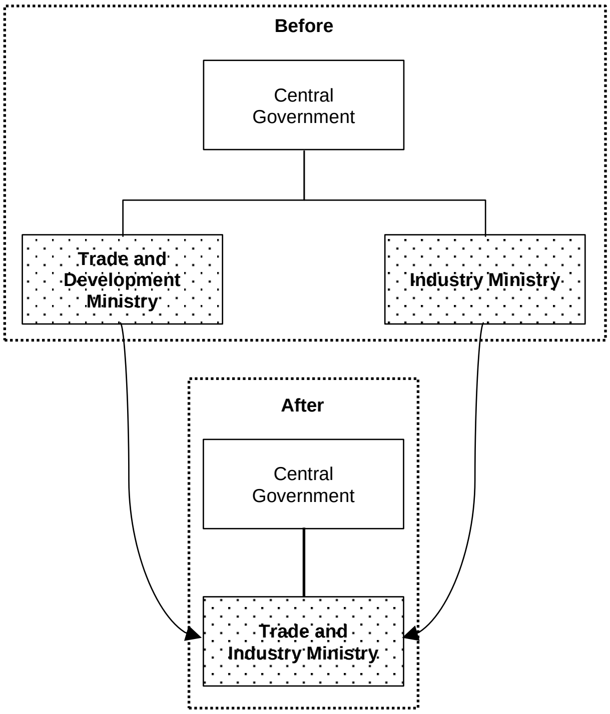
IE34. In determining whether this PBE ~~public sector~~ combination should be classified as an amalgamation or an acquisition, the first question to consider is whether one of the parties to the combination has gained control of operations as a result of the combination.

IE35. Despite its legal form continuing, Municipality G has a newly formed governing body, unrelated to its previous governing body or that of Municipality H. Consequently, the previous Municipality G does not gain power over Municipality H. Neither does it have exposure, or rights, to variable benefits from any involvement with Municipality H.

IE36. Municipality G has not gained control over Municipality H as a result of the PBE ~~public sector~~ combination. Consequently the combination is classified as an amalgamation.

Scenario 4: Restructuring of Central Government Ministries

IE37. The following diagram illustrates the reorganisation of Central Government ministries by combining the Trade and Development Ministry and the Industry Ministry into the newly formed Trade and Industry Ministry.



IE38. In this scenario, a PBE ~~public sector~~ combination occurs in which the Trade and Industry Ministry is formed to combine the operations (and the related assets, liabilities and components of net assets/equity) of the Trade and Development Ministry and the Industry Ministry. All the ministries, both prior to and after the combination, are controlled by Central Government. The combination is imposed by Central Government using this control. The Trade and Development Ministry and the Industry Ministry have no role in determining the terms of the combination.

IE39. In effecting the combination, Central Government gives responsibility for the new Trade and Industry Ministry to the Minister of Industry and the governing body of the Industry Ministry. After the combination, the Trade and Development Ministry and the Industry Ministry cease to exist.

IE40. As Central Government controls the same operations both before and after the PBE ~~public sector~~ combination, Central Government does not report a combination in its consolidated financial statements. The combination is reported by the Trade and Industry Ministry.

IE41. The creation of the Trade and Industry Ministry is a PBE ~~public sector~~ combination. In determining whether this should be classified as an amalgamation or an acquisition, the first question to consider is whether one of the parties to the combination has gained control of operations as a result of the combination.

IE42. Central Government gives responsibility for the new Trade and Industry Ministry to the Minister of Industry and the governing body of the Industry Ministry. This suggests that as part of the PBE ~~public sector~~ combination that creates the new Trade and Industry Ministry, the Industry Ministry is gaining control of the operations of the Trade and Development Ministry. However, the assessment as to whether the Industry Ministry is gaining control is based on the substance of the combination, not its form. In determining whether the combination should be classified as an amalgamation or an acquisition, the Trade and Industry Ministry considers the guidance in paragraphs 7–8 and AG10–AG18 of PBE IPSAS 40.

IE43. In this scenario, it is assumed that the decision of Central Government to give responsibility for the new Trade and Industry Ministry to the Minister of Industry and the governing body of the Industry Ministry results in the Industry Ministry gaining:

(a) Power over the operations of the Trade and Development Ministry;

(b) Exposure, or rights, to variable benefits from its involvement with those operations; and

(c) The ability to use its power over those operations to affect the nature or amount of the benefits from its involvement with those operations.

IE44. The Trade and Industry Ministry concludes that, as a result of the PBE ~~public sector~~ combination, the Industry Ministry has gained control of the Trade and Development Ministry. The Trade and Industry Ministry considers the guidance in paragraphs 9–14 and AG19–AG50 of PBE IPSAS 40 in determining whether the economic substance of the combination is that of an amalgamation.

IE45. [Not used] ~~In considering the economic substance of the public sector combination, the Trade and Industry Ministry notes that the combination does not result in a controlling entity/controlled entity relationship between the Trade and Development Ministry and the Industry Ministry. This is consistent with both an amalgamation and an acquisition. The Trade and Development Ministry also notes that the Industry Ministry obtains access to economic benefits or service potential that are similar to those that could have been obtained by mutual agreement; this may suggest that the economic substance of the combination is that of an acquisition.~~

IE46. In considering the indicator~~s~~ relating to consideration, the Trade and Industry Ministry notes that the PBE ~~public sector~~ combination does not include the payment of consideration because the combination took place under common control, and Central Government, the controlling entity, did not specify any consideration in the terms of the combination. ~~Consequently,~~ A~~a~~lthough the absence of consideration (and the reasons for the absence of consideration) may suggest that the economic substance of the combination is that of an amalgamation, this is not of itself conclusive and other factors also need to be taken into account.

IE47. In considering the indicators relating to the decision-making process, the Trade and Industry Ministry notes that the PBE ~~public sector~~ combination takes place under common control. The combination was directed by Central Government and the Trade and Development Ministry and the Industry Ministry had no role in determining the terms of the combination. This provides evidence that the ultimate decision as to whether the combination took place, and the terms of the combination, are determined by the Central Government, the controlling entity. This provides evidence that the economic substance of the combination is that of an amalgamation.

IE48. On balance ~~Taking~~ these factors suggest ~~together, the Trade and Industry Ministry considers~~ that the PBE ~~public sector~~ combination should be classified as an amalgamation. In coming to this decision, the fact that the PBE ~~public sector~~ combination takes place under common control is considered to be the most significant factor in determining the economic substance of the combination.

Scenario 4: Variation

IE49. In scenario 4, Central Government gives responsibility for the new Trade and Industry Ministry to the Minister of Industry and the governing body of the Industry Ministry. In this variation, Central Government appoints a new Minister and governing body.

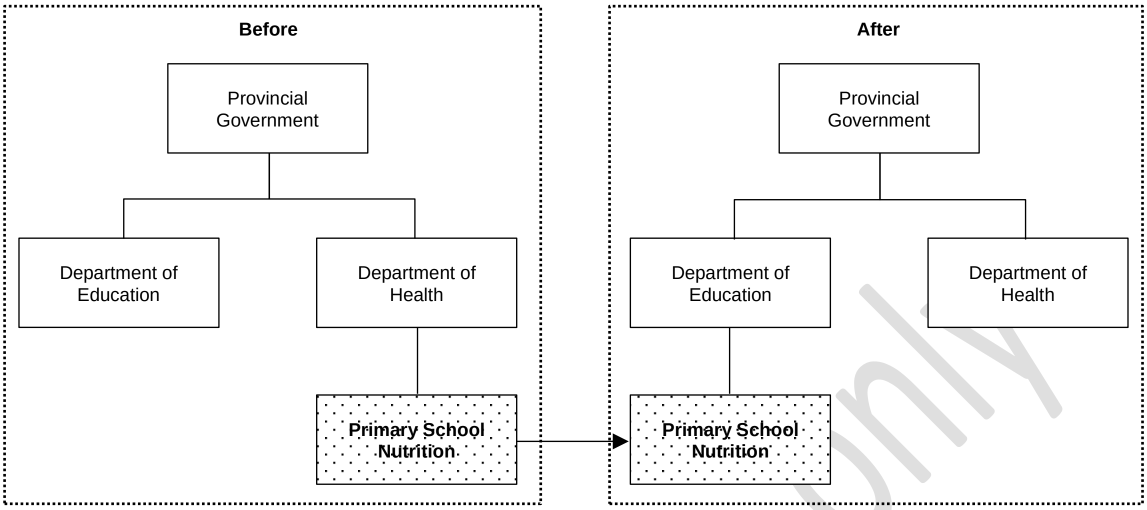
IE50. The creation of the Trade and Industry Ministry is a PBE ~~public sector~~ combination under common control. In determining whether this should be classified as an amalgamation or an acquisition, the first question to consider is whether one of the parties to the combination has gained control of operations as a result of the combination.

IE51. The Trade and Industry Ministry has a new Minister and a newly formed governing body, unrelated to the governing bodies of the Trade and Development Ministry and the Industry Ministry. Neither the Trade and Development Ministry or the Industry Ministry has gained power over the operations of the other ministry. Neither do they have exposure, or rights, to variable benefits from any involvement with the operations of the other ministry.

IE52. Neither of the Trade and Development Ministry nor the Industry Ministry has gained control over the Trade and Industry Ministry as a result of the PBE ~~public sector~~ combination. Consequently the combination is classified as an amalgamation.

Scenario 5: Transfer of Operations under Common Control

IE53. The following diagram illustrates the transfer of operations between two public sector entities that are under common control.



IE54. In this scenario, a PBE ~~public sector~~ combination occurs in which the Primary School Nutrition operation is transferred from the Provincial Government's Department of Health to its Department of Education. Both departments are controlled by the Provincial Government prior to and after the combination.

IE55. As the Provincial Government controls the same operations both before and after the PBE ~~public sector~~ combination, the Provincial Government does not report a combination in its consolidated financial statements. The combination is reported by the Department of Education.

IE56. The transfer of the Primary School Nutrition operation is a PBE ~~public sector~~ combination. In determining whether this should be classified as an amalgamation or an acquisition, the first question the Department of Education considers is whether one of the parties to the combination has gained control of operations as a result of the combination.

IE57. In this scenario, the Department of Education gains:

(a) Power over the Primary School Nutrition operation;

(b) Exposure, or rights, to variable benefits from its involvement with that operation; and

(c) The ability to use its power over that operation to affect the nature or amount of the benefits from its involvement with that operation.

IE58. The Department of Education concludes that, as a result of the PBE ~~public sector~~ combination, it has gained control of the Primary School Nutrition operation. The Department of Education considers the guidance in paragraphs 9–14 and AG19–AG50 of PBE IPSAS 40 in determining whether the economic substance of the combination is that of an amalgamation.

IE59. [Not used] ~~In considering the economic substance of the public sector combination, the Department of Education notes that it obtains access to economic benefits or service potential that are similar to those that could have been obtained in a voluntary transaction; this may suggest that the economic substance of the combination is that of an acquisition~~.

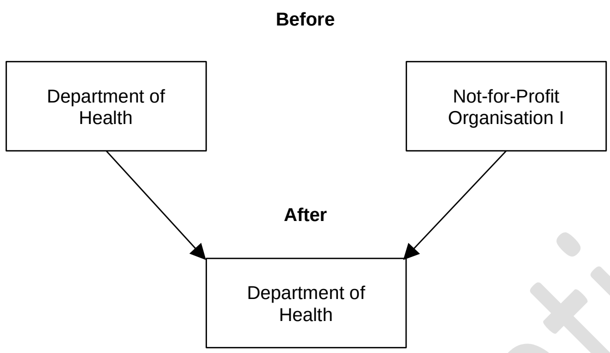
IE60. In considering the indicator~~s~~ relating to consideration, the Department of Education notes that the PBE ~~public sector~~ combination does not include the payment of consideration because the combination took place under common control, and the Provincial Government, the controlling entity, did not specify any consideration in the terms of the combination. ~~Consequently,~~ ~~A~~although the absence of consideration (and the reasons for the absence of consideration) may suggest that the economic substance of the combination is that of an amalgamation, this is not of itself conclusive and other factors also need to be taken into account.

IE61. In considering the indicators relating to the decision-making process, the Department of Education notes that the PBE~~public sector~~ combination takes place under common control. The combination was directed by the Provincial Government. This provides evidence that the ultimate decision as to whether the combination took place, and the terms of the combination, are determined by the Provincial Government, the controlling entity. This provides evidence that the economic substance of the combination is that of an amalgamation.

IE62. On balance ~~Taking~~ these factors suggest ~~together, the Department of Education considers~~ that the PBE ~~public sector~~ combination should be classified as an amalgamation. In coming to this decision, the fact that the PBE~~public sector~~ combination takes place under common control is considered to be the most significant factor in determining the economic substance of the combination.

Scenario 6: Combination of a Public Sector Entity with a Not-For-Profit Organisation

IE63. The following diagram illustrates the combination of a public sector entity with a not-for-profit organisation providing similar services.



IE64. In this scenario, a PBE ~~public sector~~ combination occurs in which Not-for-Profit Organisation I, a charity which provides paramedic services, voluntarily agrees to combine with the Department of Health in order to improve the delivery of services to the public. The operations of Not-for-Profit Organisation I are integrated with similar operations provided by the Department of Health. Prior to the combination, the Department of Health has provided funding for Not-for-Profit Organisation I. The Department of Health meets the cost of transferring the title to the assets and liabilities of Not-for-Profit Organisation I incurred by the trustees of the charity.

IE65. The combination of the Department of Health and Not-for-Profit Organisation I is a PBE ~~public sector~~ combination. In determining whether this should be classified as an amalgamation or an acquisition, the first question the Department of Health considers is whether it has gained control of operations as a result of the combination.

IE66. In this scenario, the Department of Health gains:

(a) Power over Not-for-Profit Organisation I and its operations;

(b) Exposure, or rights, to variable benefits from its involvement with those operations; and

(c) The ability to use its power over those operations to affect the nature or amount of the benefits from its involvement with those operations.

IE67. The Department of Health concludes that, as a result of the PBE ~~public sector~~ combination, it has gained control of Not-for-Profit Organisation I. The Department of Health considers the guidance in paragraphs 9–14 and AG19–AG50 of PBE IPSAS 40 in determining whether the economic substance of the combination is that of an amalgamation.

IE68. [Not used] ~~In considering the economic substance of the public sector combination, the Department of Health notes that the combination does not result in a controlling entity/controlled entity relationship between the Department and Not-for-Profit Organisation I. This is consistent with both an amalgamation and an acquisition.~~

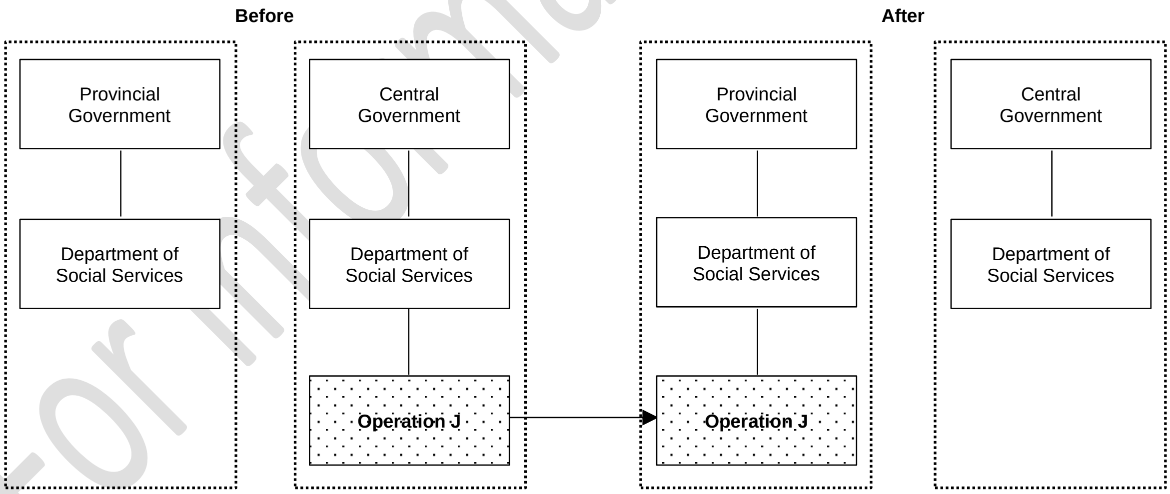
IE69. In considering the indicator~~s~~ relating to consideration, the Department of Health notes that the PBE~~public sector~~ combination does not include the payment of consideration that is intended to compensate ~~the~~ Not-for-Profit Organisation I~~seller~~ for giving up its~~their~~ entitlement to ~~the~~ its net assets ~~of an operation~~. Although the Department of Health makes a payment to Not-for-Profit Organisation I~~the trustees~~, the payment ~~this~~ is to compensate Not-for-Profit Organisation I~~them~~ for costs incurred in effecting the combination.~~, not to compensate them for giving up their entitlement to the net assets of Not-for-Profit Organisation I. Although Not-for-Profit Organisation I has a Board of Trustees, these individuals are not entitled to the net assets of the operation. This means there is no party with an entitlement to the net assets of Not-for-Profit Organisation I (i.e., there are no former owners of Not-for-Profit Organisation I with quantifiable ownership interests).~~ Not-for-Profit Organisation I has voluntarily given up the rights to its net assets and donated them to the Department of Health because the Department of Health will provide an improved delivery of services to the public. This suggests that the economic substance of the combination is that of an acquisition~~amalgamation~~. ~~In this scenario, this is confirmed by the fact that the purpose of the combination is to improve the delivery of services to the public.~~

IE70. In considering the indicators relating to the decision-making process, the Department of Health notes that the PBE ~~public sector~~ combination was a voluntary combination. Consequently, these indicators do not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE71. ~~Taking these factors together,~~ On balance these factors suggest ~~the Department of Health considers~~ that the ~~public sector~~PBE combination should be classified as an acquisition~~amalgamation~~.~~In coming to this decision, the Department of Health considers the absence of consideration because there is no party with an entitlement to the net assets of an operation to be the most significant factor in determining the economic substance of the combination. In this scenario, this view is reinforced by the fact that that Board of Trustees is voluntarily giving up control over the operations to improve the delivery of services to the public.~~

Scenario 7: Transfer of an Operation between Levels of Government

IE72. The following diagram illustrates the transfer of an operation between levels of government.



IE73. In this scenario, Central Government adopts a policy of devolving responsibility for some social services to the Provincial Government. Consequently, it proposes transferring Operation J, which provides residential care services, from Central Government's Department of Social Services to the Provincial Government's Department of Social Services. The Provincial Government supports the policy and agrees to accept Operation J. Operation J has net assets of CU1,000.[21] There is no transfer of consideration by the Provincial Government to the Central Government. However, the transfer agreement imposes an obligation on the Provincial Government to continue to provide the residential care services for a minimum of 10 years. Operation J does not recover all its costs from charges; the Provincial Government therefore assumes the responsibility for providing resources to meet the

[21] In these examples monetary amounts are denominated in 'currency units (CU)'.

shortfall. Following the transfer, the Provincial Government operates Operation J as a stand-alone entity (i.e., there is a controlling entity/controlled entity relationship between the Provincial Government and Operation J), although it plans to integrate the operation with its other operations at a later date, which would remove the controlling entity/controlled entity relationship.

IE74. The transfer of Operation J is a PBE ~~public sector~~ combination that will need to be reported in both the Provincial Government's financial statements and those of the Provincial Government's Department of Social Services. As the analysis required will be the same for both entities, this example uses the term Provincial Government to refer to both entities.

IE75. In determining whether this should be classified as an amalgamation or an acquisition, the first question the Provincial Government considers is whether it has gained control of operations as a result of the combination.

IE76. In this scenario, the Provincial Government gains:

(a) Power over Operation J;

(b) Exposure, or rights, to variable benefits from its involvement with Operation J; and

(c) The ability to use its power over Operation J to affect the nature or amount of the benefits from its involvement with the operation.

IE77. The Provincial Government concludes that, as a result of the PBE ~~public sector~~ combination, it has gained control of Operation J. The Provincial Government considers the guidance in paragraphs 9–14 and AG19–AG50 of PBE IPSAS 40 in determining whether the economic substance of the combination is that of an amalgamation.

IE78. In considering the economic substance of the PBE ~~public sector~~ combination, the Provincial Government notes that the combination results in a controlling entity/controlled entity relationship between the Provincial Government and Operation J. This is inconsistent with the economic substance of an amalgamation.

IE79. In considering the indicator~~s~~ relating to consideration, the Provincial Government notes that the PBE~~public sector~~ combination does not include the payment of consideration that is intended to compensate Central Government~~the seller~~ for giving up its~~their~~ entitlement to the net assets of an operation. However, the transfer agreement requires the Provincial Government to continue to provide the services. As Operation J does not recover all its costs from charges, the Provincial Government will need to provide the necessary resources to cover the shortfall. The Provincial Government considers that the cost of providing services for the agreed 10 year period is likely to be approximately equal to the value of the net assets received. It therefore considers that a market participant would estimate the fair value of Operation J (with the obligation to provide services for 10 years) to be zero. Although no consideration is transferred, this reflects the fair value of the combination. The Provincial Government concludes that, in this case the absence ~~indicators relating t~~of consideration does not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE80. In considering the indicators relating to the decision-making process, the Provincial Government notes that the PBE~~public sector~~ combination is a voluntary combination. Consequently, these indicators do not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE81. Taking these factors together, the Provincial Government concludes that there is no evidence that economic substance of the combination is that of an amalgamation, and that the PBE~~public sector~~ combination should, therefore, be classified as an acquisition.

Scenario 7: Variation

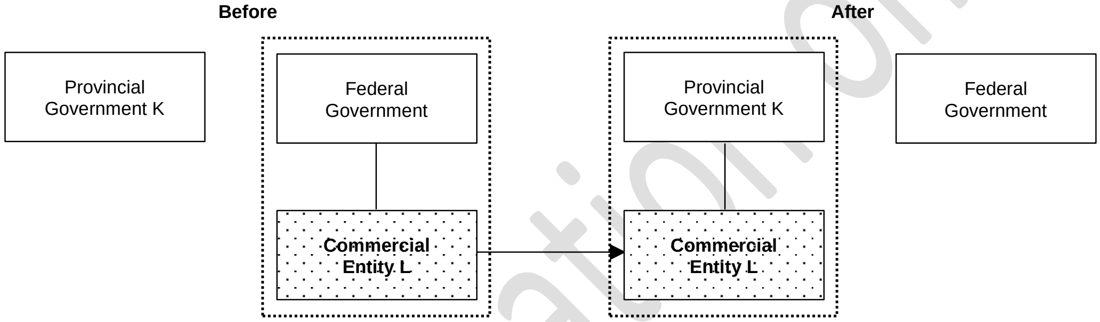
IE82. In scenario 7, the Provincial Government considers that a market participant would estimate the fair value of Operation J (with the obligation to provide services for 10 years) to be zero. This is the reason that no consideration is paid. In this variation, Operation J is assumed to cover its costs from charges. Consequently, a market participant would estimate the fair value of Operation J (with the obligation to provide services for 10 years) to be greater than zero.

IE83. In these circumstances, the fact that the combination does not include the payment of consideration that is intended to compensate Central Government~~the seller~~ for giving up its~~their~~ entitlement to the net assets of an operation may provide evidence that the economic substance of the combination is that of an amalgamation. However, the reasons for the absence of consideration need to be considered. There is nothing specific in the fact pattern about the reasons for the absence of consideration to support the classification as an amalgamation or an acquisition.

IE84. In determining the classification of the PBE~~public sector~~ combination, the Provincial Government considers which factor or factors are the most significant. The Provincial Government considers the fact that it has gained control of Operation J and the fact that the combination does not involve the integration of its operations and those of Operation J to be the most significant factors in determining the economic substance of the combination. This suggests that the combination should be classified as an acquisition. The indicators relating to the decision-making process also support the~~is~~ classification as an acquisition.~~; only the indicators relating to consideration suggest that the economic substance of the combination may be an amalgamation~~. The Provincial Government therefore classifies the combination as an acquisition.

Scenario 8: Transfer of a Commercial Entity between Levels of Government

IE85. The following diagram illustrates the transfer of a commercial entity between levels of government.



IE86. In this scenario, the Federal Government agrees to transfer Commercial Entity L to Provincial Government K. Provincial Government K pays consideration to the Federal Government in respect of the transfer. Following the combination, Provincial Government K operates Commercial Entity L as an arms-length, stand-alone entity.

IE87. The transfer of Commercial Entity L is a PBE~~ public sector~~ combination. In determining whether this should be classified as an amalgamation or an acquisition, the first question Provincial Government K considers is whether it has gained control of operations as a result of the combination.

IE88. In this scenario, Provincial Government K gains:

(a) Power over Commercial Entity L and its operations;

(b) Exposure, or rights, to variable benefits from its involvement with those operations; and

(c) The ability to use its power over those operations to affect the nature or amount of the benefits from its involvement with those operations.

IE89. Provincial Government K concludes that, as a result of the PBE~~public sector~~ combination, it has gained control of Commercial Entity L. Provincial Government K considers the guidance in paragraphs 9–14 and AG19–AG50 of PBE IPSAS 40 in determining whether the economic substance of the combination is that of an amalgamation.

IE90. In considering the economic substance of the PBE~~public sector~~ combination, Provincial Government K notes that the combination results in a controlling entity/controlled entity relationship between the Provincial Government and Commercial Entity L. This is inconsistent with the economic substance of an amalgamation. Provincial Government K also notes that the combination has commercial substance, which is suggestive of an acquisition.

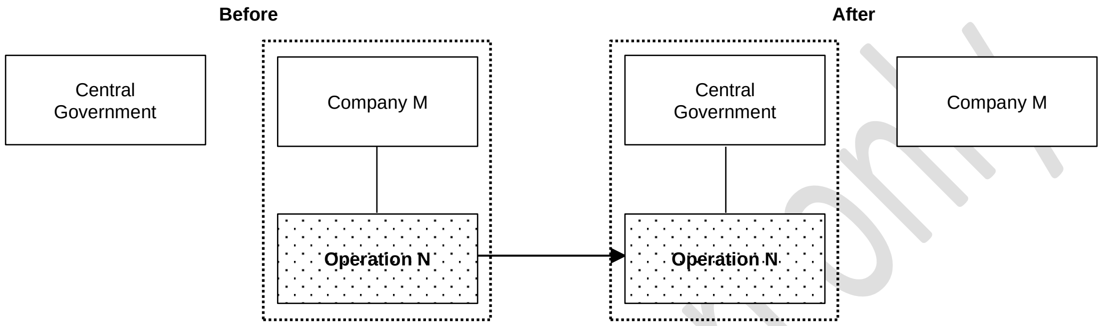
IE91. In considering the indicator~~s~~ relating to consideration, Provincial Government K notes that the PBE~~public sector~~ combination includes the payment of consideration that is intended to compensate the seller for giving up its~~their~~ entitlement to the net assets of an operation. Provincial Government K concludes that the indicator~~s~~ relating to consideration does not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE92. In considering the indicators relating to the decision-making process, Provincial Government K notes that the PBE~~public sector~~ combination is a voluntary combination. Consequently, these indicators do not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE93. Taking these factors together, Provincial Government K concludes that there is no evidence that the economic substance of the combination is that of an amalgamation, and that the PBE~~public sector~~ combination should, therefore, be classified as an acquisition.

Scenario 9: Purchase of a Private Sector Operation

IE94. The following diagram illustrates the purchase of a private sector operation by a public sector entity.



IE95. In this scenario, Central Government purchases Operation N from Company M. Central Government pays the market value of Operation N, and Company M acts voluntarily. Following the purchase, Operation N is managed as an arms-length, stand-alone entity.

IE96. The purchase of Operation N is a PBE ~~public sector~~ combination. In determining whether this should be classified as an amalgamation or an acquisition, the first question Central Government considers is whether it has gained control of operations as a result of the combination.

IE97. In this scenario, Central Government gains:

(a) Power over Operation N;

(b) Exposure, or rights, to variable benefits from its involvement with Operation N; and

(c) The ability to use its power over Operation N to affect the nature or amount of the benefits from its involvement with that operation.

IE98. Central Government concludes that, as a result of the PBE~~public sector~~ combination, it has gained control of Operation N. Central Government considers the guidance in paragraphs 9–14 and AG19–AG50 of PBE IPSAS 40 in determining whether the economic substance of the combination is that of an amalgamation.

IE99. In considering the economic substance of the PBE ~~public sector~~ combination, Central Government notes that the combination results in a controlling entity/controlled entity relationship between Central Government and Operation N. This is inconsistent with the economic substance of an amalgamation. Central Government also notes that the combination has commercial substance, which is suggestive of an acquisition.

IE100. In considering the indicator~~s~~ relating to consideration, Central Government notes that the PBE ~~public sector~~ combination includes the payment of consideration that is intended to compensate the seller for giving up its~~their~~ entitlement to the net assets of an operation. Central Government concludes that the indicator~~s~~ relating to consideration does not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE101. In considering the indicators relating to the decision-making process, Central Government notes that the PBE ~~public sector~~ combination is a voluntary combination. Consequently, these indicators do not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE102. Taking these factors together, Central Government concludes that there is no evidence that the economic substance of the combination is that of an amalgamation, and that the PBE ~~public sector~~ combination should, therefore, be classified as an acquisition.

Scenario 9: Variation

IE103. In scenario 9, Company M enters into the transaction voluntarily. In this variation, Central Government nationalises Operation N through a compulsory purchase. The purchase is still effected at the market value of Operation N.

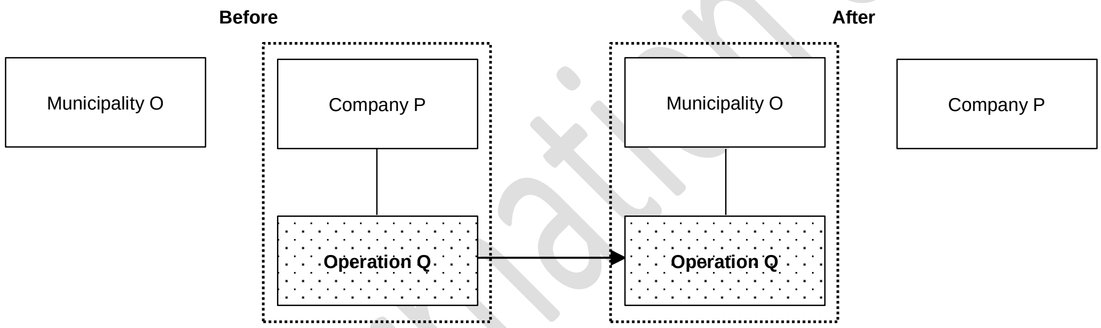
IE104. The change from a voluntary transaction to a compulsory purchase does not affect the assessments of control or the indicator~~s~~ related to consideration.

IE105. In considering the indicators relating to the decision-making process, Central Government notes that Company M does not act voluntarily. The fact that Central Government (a party to the combination) is able to impose the PBE ~~public sector~~ combination on Company M provides evidence that the economic substance of the combination is that of an acquisition.

IE106. Consequently, Central Government classifies the PBE ~~public sector~~ combination as an acquisition.

Scenario 10: Bargain Purchase

IE107. The following diagram illustrates a bargain purchase by a public sector entity.



IE108. In this scenario, Municipality O purchases Operation Q from Company P in a bargain purchase. Company P is seeking to sell Operation Q quickly to release cash for its other operations, and is willing to accept a price below the market value of Operation Q for an early sale. In entering into the bargain purchase, Company P acts voluntarily. Following the purchase, Operation Q is managed as an arms-length, stand-alone entity by Municipality O.

IE109. The bargain purchase of Operation Q is a PBE ~~public sector~~ combination. In determining whether this should be classified as an amalgamation or an acquisition, the first question Municipality O considers is whether it has gained control of operations as a result of the combination.

IE110. In this scenario, Municipality O gains:

(a) Power over Operation Q;

(b) Exposure, or rights, to variable benefits from its involvement with Operation Q; and

(c) The ability to use its power over Operation Q to affect the nature or amount of the benefits from its involvement with that operation.

IE111. Municipality O concludes that, as a result of the PBE~~public sector~~ combination, it has gained control of Operation Q. Municipality O considers the guidance in paragraphs 9–14 and AG19–AG50 of PBE IPSAS 40 in determining whether the economic substance of the combination is that of an amalgamation.

IE112. In considering the economic substance of the PBE~~public sector~~ combination, Municipality O notes that the combination results in a controlling entity/controlled entity relationship between Municipality O and Operation Q. This is inconsistent with the economic substance of an amalgamation. Municipality O also notes that the combination has commercial substance (even though the price paid was below the market price of Operation Q), which is suggestive of an acquisition.

IE113. In considering the indicator~~s~~ relating to consideration, Municipality O notes that the PBE~~public sector~~ combination includes the payment of consideration that is intended to compensate the seller for giving up its~~their~~ entitlement to the net assets of an operation, even though that price was below market value. Company P voluntarily accepted a lower price for a quick sale, and the purpose of the consideration paid was to provide Company P with the level of compensation for giving up its entitlement to the net assets of Operation Q that it was willing to accept. Municipality O concludes that the indicator~~s~~ relating to consideration does not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE114. In considering the indicators relating to the decision-making process, Municipality O notes that the PBE~~public sector~~ combination is a voluntary combination. Consequently, these indicators do not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE115. Taking these factors together, Municipality O concludes that there is no evidence that the economic substance of the combination is that of an amalgamation, and that the PBE ~~public sector~~ combination should, therefore, be classified as an acquisition.

Scenario 10: Variation

IE116. In scenario 10, Company P enters into the transaction voluntarily. In this variation, Municipality O seizes Operation Q through a compulsory purchase. The purchase is still effected at a price below the market value of Operation Q. Company P would not have sold Operation Q for a price below market value voluntarily.

IE117. The change from a voluntary transaction to a compulsory purchase does not affect the assessment of control.

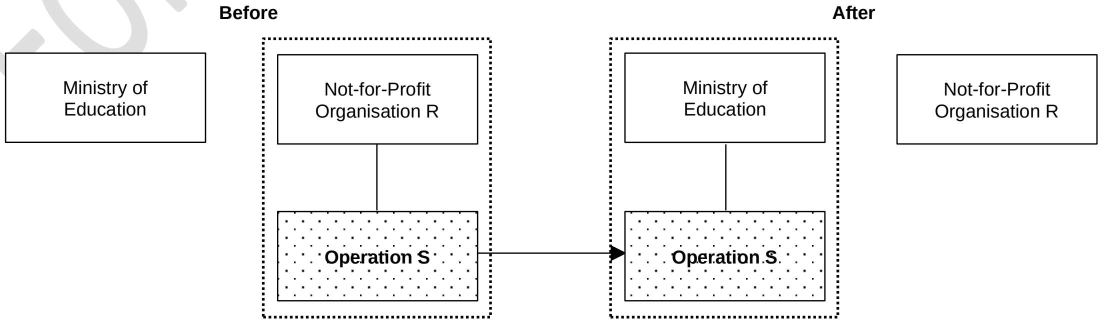
IE118. In considering the indicator~~s~~ relating to consideration, Municipality O notes that the PBE~~public sector~~ combination includes consideration that is intended to compensate the seller for giving up its~~their~~ entitlement to the net assets of an operation. However, the level of compensation is less than Company P would have accepted voluntarily. Consequently, thi~~ese~~ indicator~~s~~ provides only weak evidence that the economic substance of the combination is that of an acquisition, and greater reliance is placed on other factors.

IE119. In considering the indicators relating to the decision-making process, Municipality O notes that Company P does not act voluntarily. The fact that Municipality O (a party to the combination) is able to impose the PBE~~public sector~~ combination on Company P provides evidence that the economic substance of the combination is that of an acquisition.

IE120. Taking all the factors into account, Municipality O classifies the PBE ~~public sector~~ combination as an acquisition.

Scenario 11: Donated Operations

IE121. The following diagram illustrates the receipt of a donated operation by a public sector entity.



IE122. In this scenario, Not-for-Profit Organisation R, a charity providing education services, voluntarily transfers Operation S, a school, to the Ministry of Education at no cost. Not-for-Profit Organisation R does this because it considers that this will result in improved services to the public, and enable it to meet its objectives.

IE123. The donation of Operation S is a PBE ~~public sector~~ combination. In determining whether this should be classified as an amalgamation or an acquisition, the first question the Ministry of Education considers is whether it has gained control of operations as a result of the combination.

IE124. In this scenario, the Ministry of Education gains:

(a) Power over Operation S;

(b) Exposure, or rights, to variable benefits from its involvement with Operation S; and

(c) The ability to use its power over Operation S to affect the nature or amount of the benefits from its involvement with that operation.

IE125. The Ministry of Education concludes that, as a result of the PBE ~~public sector~~ combination, it has gained control of Operation S. The Ministry of Education considers the guidance in paragraphs 9–14 and AG19–AG50 of PBE IPSAS 40 in determining whether the economic substance of the combination is that of an amalgamation.

IE126. In considering the economic substance of the PBE ~~public sector~~ combination, the Ministry of Education notes that the combination has commercial substance (even though no price was paid for Operation S), which is suggestive of an acquisition.

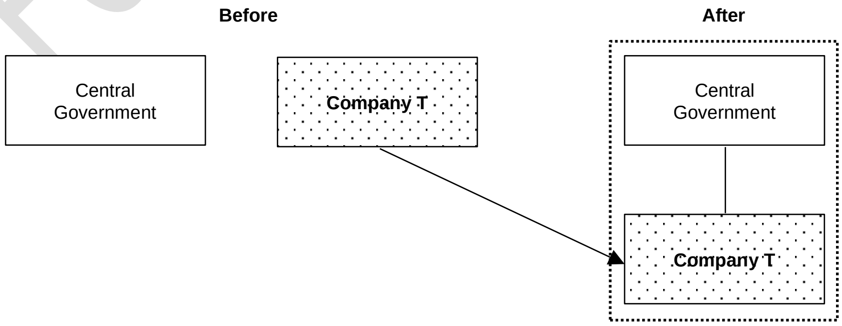
IE127. In considering the indicator~~s~~ relating to consideration, the Ministry of Education notes that the PBE~~public sector~~ combination does not include the payment of consideration that is intended to compensate Not-for-Profit Organisation R ~~the seller~~ for giving up its~~their~~ entitlement to its~~the~~ net assets ~~of an operation~~. However, the reason for this is that Not-for-Profit Organisation R voluntarily surrendered those rights. The situation is similar to that of a bargain purchase. In a bargain purchase, a seller may be willing to accept a price below market value where this meets its ~~their~~ needs, for example in enabling a quick sale. With a donated operation, the former owner is willing to transfer the operation for no consideration to its~~their~~ preferred counterparty. In this scenario, Not-for-Profit Organisation R is willing to transfer Operation S to the Ministry of Education because this will provide improved services to the public. Consequently, the Ministry of Education concludes that the indicator~~s~~ of consideration does not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE128. In considering the indicators relating to the decision-making process, the Ministry of Education notes that the PBE~~public sector~~ combination is a voluntary combination. Consequently, these indicators do not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE129. Taking these factors together, the Ministry of Education concludes that there is no evidence that the economic substance of the combination is that of an amalgamation, and that the PBE ~~public sector~~ combination should, therefore, be classified as an acquisition.

Scenario 12: Nationalisation of a Private Sector Entity–Forced Seizure

IE130. The following diagram illustrates the nationalisation of a private sector entity by a public sector entity by means of a forced seizure.



IE131. In this scenario, Central Government nationalises Company T through legislation. Central Government does not pay any consideration to the shareholders of Company T. Following the purchase, Company T is managed as an arms-length, stand-alone entity.

IE132. The nationalisation of Company T is a PBE ~~public sector~~ combination. In determining whether this should be classified as an amalgamation or an acquisition, the first question Central Government considers is whether it has gained control of operations as a result of the combination.

IE133. In this scenario, Central Government gains:

(a) Power over Company T;

(b) Exposure, or rights, to variable benefits from its involvement with Company T; and

(c) The ability to use its power over Company T to affect the nature or amount of the benefits from its involvement with Company T.

IE134. Central Government concludes that, as a result of the PBE ~~public sector~~ combination, it has gained control of Company T. Central Government considers the guidance in paragraphs 9–14 and AG19–AG50 of PBE IPSAS 40 in determining whether the economic substance of the combination is that of an amalgamation.

IE135. In considering the economic substance of the PBE ~~public sector~~ combination, Central Government notes that the combination results in a controlling entity/controlled entity relationship between Central Government and Company T. This is inconsistent with the economic substance of an amalgamation. Central Government also notes that, by depriving the former shareholders of their rights to Company T, the combination has commercial substance, which is suggestive of an acquisition.

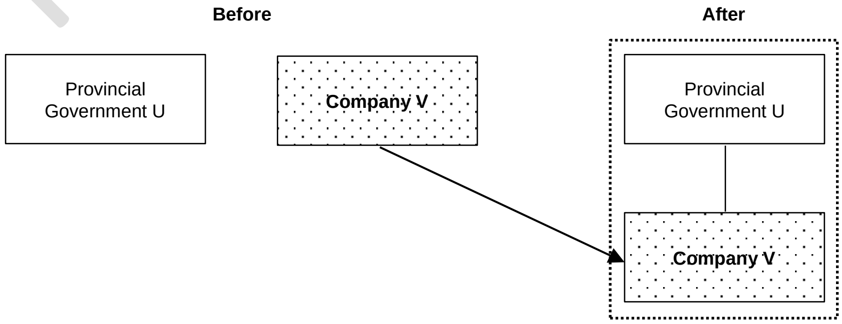
IE136. In considering the indicator~~s~~ relating to consideration, Central Government notes that the PBE ~~public sector~~ combination does not include the payment of consideration that is intended to compensate the former shareholders of Company T ~~seller~~ for giving up their entitlements to the net assets of an operation. However, the former shareholders of Company T have had their entitlements extinguished through compulsion, which provides evidence that the economic substance of the combination is that of an acquisition. Central Government concludes that the indicator~~s~~ relating to consideration does not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE137. In considering the indicators relating to the decision-making process, Central Government notes that Company T does not act voluntarily. The fact that Central Government (a party to the combination) is able to impose the ~~public sector~~ combination on Company T provides evidence that the economic substance of the combination is that of an acquisition.

IE138. Taking these factors together, Central Government concludes that there is no evidence that the economic substance of the combination is that of an amalgamation, and that the PBE ~~public sector~~ combination should, therefore, be classified as an acquisition.

Scenario 13: Nationalisation of a Private Sector Entity–Bailout

IE139. The following diagram illustrates the nationalisation of a private sector entity by a public sector entity by means of a bailout.



IE140. In this scenario, Provincial Government U nationalises Company V through legislation as a result of a bailout. Prior to the nationalisation, Company V was in financial distress. Provincial Government U does not pay any consideration to the shareholders of Company V but does assume Company V's net liabilities. Following the purchase, Company V is managed as an arms-length, stand-alone entity.

IE141. The nationalisation of Company V is a PBE ~~public sector~~ combination. In determining whether this should be classified as an amalgamation or an acquisition, the first question Provincial Government U considers is whether it has gained control of operations as a result of the combination.

IE142. In this scenario, Provincial Government U gains:

(a) Power over Company V;

(b) Exposure, or rights, to variable benefits from its involvement with Company V; and

(c) The ability to use its power over Company V to affect the nature or amount of the benefits from its involvement with Company V.

IE143. Provincial Government U concludes that, as a result of the PBE~~public sector~~ combination, it has gained control of Company V. Provincial Government U considers the guidance in paragraphs 9–14 and AG19–AG50 of PBE IPSAS 40 in determining whether the economic substance of the combination is that of an amalgamation.

IE144. In considering the economic substance of the PBE~~public sector~~ combination, Provincial Government U notes that the combination results in a controlling entity/controlled entity relationship between Provincial Government U and Company V. This is inconsistent with the economic substance of an amalgamation. Provincial Government U also notes that, by assuming the net liabilities of Company V, the combination has commercial substance, which is suggestive of an acquisition.

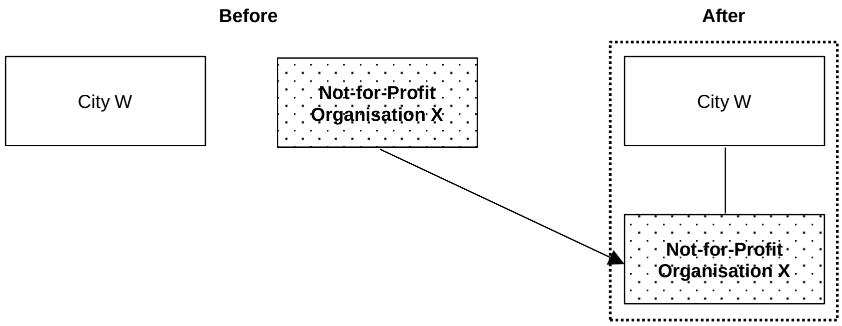
IE145. In considering the indicator~~s~~ relating to consideration, Provincial Government U notes that the PBE~~public sector~~ combination does not include the payment of consideration ~~that is intended to compensate the seller for giving up their entitlement to the net assets of an operation~~. However, Company V has net liabilities that are assumed by Provincial Government U as part of the combination. The lack of consideration reflects the fair value of Company V rather than suggesting that the economic substance of the combination is that of an amalgamation. Provincial Government U concludes that the indicator~~s~~ relating to consideration does not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE146. In considering the indicators relating to the decision-making process, Provincial Government U notes that Company V does not act voluntarily. The fact that Provincial Government U (a party to the combination) is able to impose the PBE ~~public sector~~ combination on Company V provides evidence that the economic substance of the combination is that of an acquisition.

IE147. Taking these factors together, Provincial Government U concludes that there is no evidence that the economic substance of the combination is that of an amalgamation, and that the PBE~~public sector~~ combination should, therefore, be classified as an acquisition.

Scenario 14: Nationalisation of a Not-For-Profit Organisation–Bailout

IE148. The following diagram illustrates the nationalisation of a not-for-profit organisation by a public sector entity by means of a bailout.



IE149. In this scenario, City W nationalises Not-for-Profit Organisation X (a charity) as a result of a voluntary bailout. Prior to the nationalisation, Not-for-Profit Organisation X was in financial distress and approached City W for support. City W assumes Not-for-Profit Organisation X's net liabilities. Following the purchase, Not-for-Profit Organisation X is managed as an arms-length, stand-alone entity.

IE150. The nationalisation of Not-for-Profit Organisation X is a PBE ~~public sector~~ combination. In determining whether this should be classified as an amalgamation or an acquisition, the first question City W considers is whether it has gained control of operations as a result of the combination.

IE151. In this scenario, City W gains:

(a) Power over Not-for-Profit Organisation X;

(b) Exposure, or rights, to variable benefits from its involvement with Not-for-Profit Organisation X; and

(c) The ability to use its power over Not-for-Profit Organisation X to affect the nature or amount of the benefits from its involvement with Not-for-Profit Organisation X.

IE152. City W concludes that, as a result of the PBE ~~public sector~~ combination, it has gained control of Not-for-Profit Organisation X. City W considers the guidance in paragraphs 9–14 and AG19–AG50 of PBE IPSAS 40 in determining whether the economic substance of the combination is that of an amalgamation.

IE153. In considering the economic substance of the PBE~~public sector~~ combination, City W notes that the combination results in a controlling entity/controlled entity relationship between City W and Not-for-Profit Organisation X. This is inconsistent with the economic substance of an amalgamation. City W also notes that, by assuming the net liabilities of Not-for-Profit Organisation X, the combination has commercial substance, which is suggestive of an acquisition.

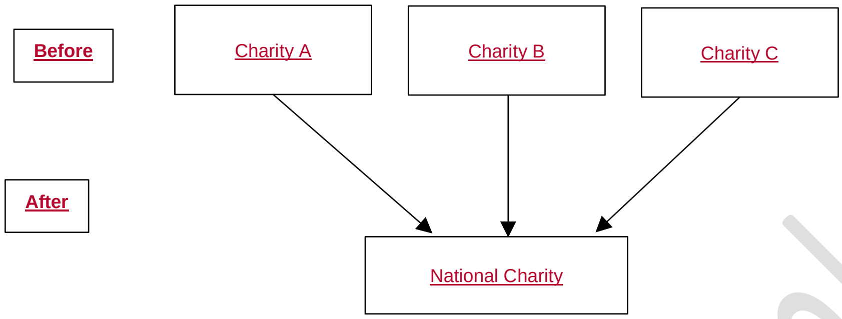
IE154. In considering the indicator~~s~~ relating to consideration, City W notes that the PBE~~public sector~~ combination does not include the payment of consideration ~~that is intended to compensate the seller for giving up their entitlement to the net assets of an operation~~. ~~This is because there is no party with an entitlement to the net assets of Not-for-Profit Organisation X (i.e., there is no former owner) as the trustees have no entitlement to the net assets.~~ This would usually provide evidence that the economic substance of the combination is that of an amalgamation. However, in this scenario Not-for-Profit Organisation X has net liabilities that are assumed by City W as part of the combination. By assuming the net liabilities, City W relieves the trustees of Not-for-Profit Organisation X of the responsibility for settling the liabilities, therefore no payment of consideration by City W is necessary ~~which is analogous to paying consideration~~. City W concludes, therefore, that the indicator~~s~~ relating to consideration does not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE155. In considering the indicators relating to the decision-making process, City W notes that Not-for-Profit Organisation X voluntarily initiated the combination. City W concludes that the indicators relating to decision-making do not provide any evidence to suggest that the economic substance of the combination is that of an amalgamation.

IE156. Taking these factors together, City W concludes that there is no evidence that the economic substance of the combination is that of an amalgamation, and that the ~~public sector~~PBE combination should, therefore, be classified as an acquisition.

Scenario 15: Combination of Three Charities

IE156.1 The following diagram illustrates the combination of three charities providing similar services in different parts of the country.



IE156.2 Charity A covers the South Island, Charity B covers the lower North Island and Charity C covers the upper North Island. To gain operational efficiencies and make it easier to obtain grants, donations and other funding, the three charities decide to unite their resources and activities by forming a new national registered charity, National Charity. They establish National Charity at the time of the combination.

IE156.3 The governing body of National Charity is formed through the appointment of trustees from the governing bodies of charities A, B and C. The former trustees of any one of the three charities do not constitute a majority of the governing body of the National Charity.

IE156.4 All of the resources and activities of charities A, B and C are transferred to National Charity for nil consideration, whereupon charities A, B and C are wound up.

IE156.5 In determining whether the combination of charities A, B and C should be classified as an amalgamation or an acquisition, the first question to consider is whether one of the parties has gained control of operations as a result of the combination. National Charity is a newly formed entity that did not exist prior to the combination taking place. None of the existing charities (A, B and C) gained control of the other charities, nor do they have exposure, or rights, to variable benefits from their involvement with National Charity.

IE156.6 Taking these factors together, National Charity concludes that the PBE combination should be classified as an amalgamation because no party to the combination has gained control of the other parties.

Accounting for Amalgamations

Eliminating Transactions between the Combining Operations – Loans

Illustrating the Consequences of Applying Paragraphs 22 and AG51–AG52 of PBE IPSAS 40

IE157. The following example illustrates the process for eliminating a loan between two combining operations not under common control.

IE158. On 30 June 20X5 Resulting Entity (RE) is formed by an amalgamation of two municipalities, Combining Operation A (COA) and Combining Operation B (COB). Four years previously, COA had provided COB with a ten year, fixed interest rate loan of CU250. Interest on the loan is payable annually, with the principal repayable on maturity.

IE159. COB has recently experienced financial difficulties, and at the amalgamation date was in arrears on making the interest payments. The carrying amount of the financial liability (the amortised cost of the loan) in its financial statements at the amalgamation date is CU260.

IE160. Because of the arrears and the fact that COB was experiencing financial difficulties, COA had impaired the loan. The carrying amount of the financial asset (the loan) in its financial statements at the amalgamation date is CU200.

IE161. At the amalgamation date, RE eliminates the financial asset received from COA and the financial liability assumed from COB and credits components of net assets/equity with CU60, the difference between the carrying amounts of the financial asset and the financial liability associated with the loan.

Eliminating Transactions between the Combining Operations – Transfers

Illustrating the Consequences of Applying Paragraphs 22 and AG51–AG52 of PBE IPSAS 40

IE162. The following example illustrates the process for eliminating a transfer between two combining operations not under common control.

IE163. On 30 June 20X9, Resulting Entity (RE) is formed by an amalgamation of two government agencies, Combining Operation A (COA) and Combining Operation B (COB). On 1 January 20X9, COA had provided COB with a grant of CU700 to be used in the provision of an agreed number of training courses.

IE164. The grant was subject to a condition that the grant would be returned proportionately to the number of training courses not delivered. At the amalgamation date, COB had delivered half of the agreed number of courses, and recognised a liability of CU350 in respect of its performance obligation, in accordance with PBE IPSAS 23 *Revenue from Non-Exchange Transactions*. Based on past experience, COA considered that COB was more likely than not to deliver the training courses. It was therefore not probable that there would be a flow of resources to COA, and COA did not recognise an asset in respect of the grant, but accounted for the full CU700 as an expense.

IE165. At the amalgamation date, the transaction is eliminated. There is no longer an obligation to an external party. The resulting entity does not recognise a liability for the CU350, but instead recognises this amount in net assets/equity.

Adjusting the Carrying Amounts of the ~~Identifiable~~ Assets and Liabilities of the Combining Operations to Conform to the Resulting Entity's Accounting Policies in an Amalgamation

Illustrating the Consequences of Applying Paragraphs 26–27 and 36 of PBE IPSAS 40

IE166. The following example illustrates the process for adjusting the carrying amounts of the ~~identifiable~~ assets and liabilities of the combining operations to conform to the resulting entity's accounting policies in an amalgamation under common control.

IE167. On 1 October 20X5 RE is formed by an amalgamation of two government departments, COA and COB. COA has previously adopted an accounting policy of measuring property, plant and equipment using the cost model in PBE IPSAS 17 *Property, Plant and Equipment*. COB has previously adopted an accounting policy of measuring property, plant and equipment using the revaluation model in PBE IPSAS 17.

IE168. RE adopts an accounting policy of measuring property, plant and equipment using the revaluation model. RE seeks an independent valuation for the items of property, plant and equipment previously controlled by COA.

IE169. On receiving the independent valuation for the items of property, plant and equipment previously controlled by COA, RE adjusts the carrying amounts of the items of property, plant and equipment as follows, with the corresponding entry being made to components of net assets/equity:

Class of Asset	Carrying Amount (CU)	Valuation (CU)	Adjustment (CU)
Land	17,623	18,410	787
Buildings	35,662	37,140	1,478
Vehicles	1,723	1,605	(118)

IE170. RE also reviews the carrying amounts of the items of property, plant and equipment previously controlled by COB to ensure the amounts are up to date as at 1 October 20X5. The review confirms the carrying amounts of the items of property, plant and equipment previously controlled by COB are up to date and that no adjustment is required.

IE171. RE recognises the items of property, plant and equipment previously controlled by COB at their carrying amounts. In accordance with paragraph 67 of PBE IPSAS 17, RE will review the residual values and useful lives of the plant and equipment previously controlled by both COA and COB at least at each annual reporting date. If expectations differ from previous estimates, RE will account for these changes as changes in accounting estimates, in accordance with PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Forgiveness of Amounts of Tax Due in an Amalgamation

Illustrating the Consequences of Accounting for Tax Forgiveness in an Amalgamation by Applying Paragraphs 33 ~~34~~ and AG57 ~~AG58~~ of PBE IPSAS 40

IE172. The following example illustrates the accounting for an amalgamation not under common control in which the resulting entity's tax liability is forgiven as part of the terms of the amalgamation.

IE173. On 1 January 20X6 RE is formed by an amalgamation of two public sector entities, COA and COB. The amalgamation is directed by the national government. RE, COA and COB have the same accounting policies; no adjustment to the carrying amounts of the ~~identifiable~~ assets and liabilities of the COA and COB to conform to the resulting entity's accounting policies is required. At the date of the amalgamation, there are no amounts outstanding between COA and COB.

IE174. In its statement of financial position as at 1 January 20X6, RE recognises and measures the assets and liabilities of COA and COB at their carrying amounts in their respective financial statements as of the amalgamation date:

Statement of Financial Position:	**COA (CU)**	**COB (CU)**	**RE (CU)**
Financial assets	1,205	997	2,202
Inventory	25	42	67
Property, plant and equipment	21,944	18,061	40,005
~~Identifiable~~ Intangible assets	0	3,041	3,041
Financial liabilities	(22,916)	(22,020)	(44,936)
Tax liabilities	(76)	(119)	(195)
Total net assets	182	2	184
Net Assets/Equity	182	2	184

IE175. Suppose that the terms of the amalgamation include the Ministry of Finance (MF) (the tax authority) forgiving RE's tax liability. RE would derecognise the tax liability and make the adjustment to net assets/equity. The statement of financial position as at 1 January 20X6 for RE would be as follows:

Statement of Financial Position:	**RE (CU)**
Financial assets	2,202
Inventory	67
Property, plant and equipment	40,005
Intangible assets	3,041
Financial liabilities	(44,936)
Tax liabilities	0
Total net assets	379
Net Assets/Equity	379

IE176. MF would recognise an adjustment for the tax forgiven, and accounts~~s~~ for the remaining tax receivable in accordance with PBE IPSAS 23~~, and would recognise an adjustment for the tax forgiven~~.

Recognising and Measuring Components of Net Assets/Equity Arising as a Result of an Amalgamation

Illustrating the Consequences of Applying Paragraphs 37–39 of PBE IPSAS 40

IE177. The following example illustrates the accounting for recognising and measuring components of net assets/equity in an amalgamation.

IE178. On 1 June 20X4, a new municipality RE is formed by the amalgamation of operations COA and COB relating to two geographical areas of other municipalities, not previously under common control.

IE179. COB has previously performed services for COA for which it was to be paid CU750. Payment was outstanding at the amalgamation date. This transaction formed part of the carrying amount of financial liabilities for COA and part of the carrying amount of financial assets for COB.

IE180. COA has previously adopted an accounting policy of measuring property, plant and equipment using the cost model. COB has previously adopted an accounting policy of measuring property, plant and equipment using the revaluation model. RE has adopted an accounting policy of measuring property, plant and equipment using the revaluation model. RE obtains an independent valuation for the items of property, plant and equipment previously controlled by COA. As a result, it increases its carrying amount for those items of the property, plant and equipment by CU5,750 and makes the corresponding adjustment to components of net assets/equity.

IE181. The carrying amounts of the assets, liabilities and components of net assets/equity transferred are summarised below. Adjustments to eliminate transactions between COA and COB (see paragraph 22), and to conform the carrying amounts to the resulting entity's accounting policies are also shown.

	COA (CU)	**COB (CU)**	**Elimination Adjustments (CU)**	**Accounting Policy Adjustments (CU)**	**RE Opening Balance (CU)**
Financial Assets	11,248	17,311	(750)	0	27,809
Inventory	1,072	532	0	0	1,604
Property, plant and equipment	5,663	12,171	0	5,750	23,584
Intangible assets	0	137	0	0	137
Financial liabilities	(18,798)	(20,553)	750	0	(38,601)
Total net assets/(liabilities)	(815)	9,598	0	5,750	14,533
Revaluation surplus	0	6,939	0	5,750	12,689
Accumulated ~~surpluses or deficits~~ comprehensive revenue and expense	(815)	2,659	0	0	1,844
Total net assets/equity	(815)	9,598	0	5,750	14,533

IE182. In accordance with paragraphs 37–39 of PBE IPSAS 40, RE may present net assets/equity as either a single opening balance of CU14,533 or as the separate components shown above.

IE183. The other municipalities that, prior to the amalgamation, controlled COA and COB would derecognise the assets, liabilities and components of net assets/equity transferred to RE in accordance with other PBE Standards.

Measurement Period in an Amalgamation

Illustrating the Consequences of Applying Paragraphs 40–44 of PBE IPSAS 40.

IE184. If the initial accounting for an amalgamation is not complete at the end of the financial reporting period in which the amalgamation occurs, paragraph 40 of PBE IPSAS 40 requires the resulting entity to recognise in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the resulting entity recognises adjustments to the provisional amounts needed to reflect new information obtained about facts and circumstances that existed as of the amalgamation date and, if known, would have affected the measurement of the amounts recognised as of that date. Paragraph 43 of PBE IPSAS 40 requires the resulting entity to recognise such adjustments as if the accounting for the amalgamation had been completed at the amalgamation date. Measurement period adjustments are not included in surplus or deficit.

IE185. Suppose that RE is formed by the amalgamation of COA and COB (two municipalities that were not under common control prior to the amalgamation) on 30 November 20X3. Prior to the amalgamation, COA had an accounting policy of using the revaluation model for measuring land and buildings, whereas COB's accounting policy was to measure land and buildings using the cost model. RE adopts an accounting policy of measuring land and buildings using the revaluation model, and seeks an independent valuation for the land and buildings previously controlled by COB. This valuation was not complete by the time RE authorised for issue its financial statements for the year ended 31 December 20X3. In its 20X3 annual financial statements, RE recognised provisional values for the land and buildings of CU150,000 and CU275,000 respectively. At the amalgamation date, the buildings had a remaining useful life of fifteen years. The land had an indefinite life. Four months after the amalgamation date, RE received the independent valuation, which estimated the amalgamation-date value of the land as CU160,000 and the amalgamation-date value of the buildings as CU365,000.

IE186. In its financial statements for the year ended 31 December 20X4, RE retrospectively adjusts the 20X3 prior year information as follows:

(a) The carrying amount of the land as of 31 December 20X3 is increased by CU10,000. As the land has an indefinite life, no depreciation is charged.

(b) The carrying amount of the buildings as of 31 December 20X3 is increased by CU89,500. That adjustment is measured as the valuation adjustment at the amalgamation date of CU90,000 less the additional depreciation that would have been recognised if the asset's value at the amalgamation date had been recognised from that date (CU500 for one months' depreciation).

(c) An adjustment of CU100,000 is recognised in net assets/equity as of 31 December 20X3.

(d) Depreciation expense for 20X3 is increased by CU500.

IE187. In accordance with paragraph 56 of PBE IPSAS 40, RE discloses:

(a) In its 20X3 financial statements, that the initial accounting for the amalgamation has not been completed because the valuation of land and buildings previously controlled by COB has not yet been received.

(b) In its 20X4 financial statements, the amounts and explanations of the adjustments to the provisional values recognised during the current reporting period. Therefore, RE discloses that the 20X3 comparative information is adjusted retrospectively to increase the value of the land and buildings by CU99,500 (CU100,000 at the amalgamation date), an increase in depreciation expense of CU500 and an increase in net assets/equity of CU100,000.

Subsequent Measurement of a Transfer Received by a Combining Operation on the Basis of Criteria that may Change as a Result of an Amalgamation

Illustrating the Consequences of Applying the Requirements in Paragraphs 48 and AG61–AG63 of PBE IPSAS 40.

IE188. The following example illustrates the subsequent accounting for a transfer received by a combining operation on the basis of criteria that may change as a result of an amalgamation.

IE189. On 1 January 20X3, a national government provides an annual grant to those municipalities where the average household income is below a threshold. On 1 June 20X3, RE, a new municipality, is formed by the amalgamation of two existing municipalities, COA and COB. COA had previously received a grant of CU1,000, based on its average household income. COB has received no grant as its average household income was above the threshold.

IE190. Following the amalgamation on 1 June 20X3, the average household income of RE is above the threshold that the government had set when allocating grants.

IE191. On 1 July 20X3, the national government requires RE to repay a portion (CU200) of the grant previously paid to COA. RE recognises a liability and an expense of CU200 on 1 July 20X3.

Disclosure Requirements Relating to Amalgamations

Illustrating the Consequences of Applying the Disclosure Requirements in Paragraphs 53–57 of PBE IPSAS 40.

IE192. The following example illustrates some of the disclosure requirements relating to amalgamations of PBE IPSAS 40; it is not based on an actual transaction. The example assumes that RE is a newly created municipality formed by amalgamating the former municipalities COA and COB. The illustration presents the disclosures in a tabular format that refers to the specific disclosure requirements illustrated. ~~An actual footnote might present many of the disclosures illustrated in a simple narrative format.~~

Paragraph reference

54(a)–(c) On 30 June 20X2 RE was formed by an amalgamation of the former municipalities COA and COB. Neither COA nor COB gained control of RE in the amalgamation. The amalgamation was mutually agreed by COA and COB, and enacted by the Government through legislation. The amalgamation aims to reduce costs through economies of scale, and to provide improved services to residents.

54(d)

Amounts recognised for each major class of assets and liabilities transferred as at 30 June 20X2	CU
Financial assets	1,701
Inventory	5
Property, plant and equipment	74,656
Intangible assets	42
Financial liabilities	(2,001)
Total net assets	74,403

54(e) The following adjustments have been made to the carrying amounts of assets and liabilities recorded by COA and COB as at 30 June 20X2 prior to the amalgamation:

Paragraph reference		Original Amount (CU)	Adjustment (CU)	Revised Amount (CU)
54(e)(i)	Restatement of financial assets recorded by COA to eliminate transactions with COB	822	(25)	797
54(e)(i)	Restatement of financial liabilities recorded by COB to eliminate transactions with COA	(1,093)	25	(1,068)
54(e)(ii)	Restatement of property plant and equipment recorded by COA to measure the items using the revaluation model	12,116	17,954	30,070

Paragraph reference

54(f)

Amounts recognised in Net Assets/Equity as at 30 June 20X2	**COA (CU)**	**COB (CU)**	**Adjustment (CU)**	**RE (CU)**
Revaluation surplus	0	18,332	17,954	36,286
Accumulated ~~surpluses or deficits~~ comprehensive revenue and expense	12,047	26,070	0	38,117
Total net assets/equity	12,047	44,402	17,954	74,403

54(h) At the time these financial statements were authorised for issue, the last reporting date for COA and COB was 31 December 20X1. The revenue and expense, and surplus or deficit for COA and COB from 1 January 20X2 to the amalgamation date (30 June 20X2), and the amounts reported by COA and COB for each major class of assets and liabilities, and for components of net assets/equity, is shown below:

Paragraph reference		**COA (CU)**	**COB (CU)**
54(h)(i)	**Revenue**		
	Property taxes	45,213	70,369
	Revenue from exchange transactions	2,681	25,377
	Transfers from other government entities	32,615	19,345
	Total revenue	80,509	115,091
54(h)(i)	**Expenses**		
	Wages, salaries and employee benefits	(51,263)	(68,549)
	Grants and other transfer payments	(18,611)	(26,445)
	Supplies and consumables used	(7,545)	(13,391)
	Depreciation expense	(677)	(2,598)
	Impairment of property, plant and equipment	(17)	(33)
	Finance costs	(2)	(3)
	Total expenses	(78,115)	(111,019)
54(h)(i)	**Surplus or (deficit) for the period 1 January 20X2 to 30 June 20X2**	2,394	4,072

54(h)(ii)	**Assets as at 30 June 20X2**		
	Financial assets	822	904
	Inventory	0	5
	Property, plant and equipment	12,116	44,586
	Intangible assets	42	0
	Total Assets	12,980	45,495
54(h)(ii)	**Liabilities as at 30 June 20X2**		
	Financial liabilities	(933)	(1,093)
	Total liabilities	(933)	(1,093)
54(h)(iii)	**Net assets as at 30 June 20X2**	12,047	44,402
	Net assets/equity as at 30 June 20X2		
	Revaluation surplus	0	18,332
	Accumulated ~~surpluses or deficits~~ comprehensive revenue and expense	12,047	26,070
	Total net assets/equity as at 30 June 20X2	12,047	44,402

In considering the disclosures related to an amalgamation, an entity may find it helpful to refer to the discussion of materiality in PBE IPSAS 1 *Presentation of Financial Reports*.

Accounting for Acquisitions

Reverse Acquisitions

Illustrating the Consequences of Recognising a Reverse Acquisition by Applying Paragraphs AG66–AG71 of PBE IPSAS 40

IE193. This example illustrates the accounting for a reverse acquisition in which Entity B, the legal controlled entity, acquires Entity A, the entity issuing equity instruments and therefore the legal controlling entity, in a reverse acquisition on 30 September 20X6. This example ignores the accounting for any income tax effects.

IE194. The statements of financial position of Entity A and Entity B immediately before the acquisition are:

	Entity A (legal controlling entity, accounting acquired operation) CU	**Entity B (legal controlled entity, accounting acquirer) CU**
Current assets	500	700
Non-current assets	1,300	3,000
Total assets	1,800	3,700
Current liabilities	300	600
Non-current liabilities	400	1,100
Total liabilities	700	1,700
Shareholders' equity		
Accumulated ~~surplus or deficit~~ comprehensive revenue and expense	800	1,400
Issued equity		
100 ordinary shares	300	0
60 ordinary shares	0	600
Total shareholders' equity	1,100	2,000
Total liabilities and shareholders' equity	1,800	3,700

IE195. This example also uses the following information:

(a) On 30 September 20X6 Entity A issues 2.5 shares in exchange for each ordinary share of Entity B. Entity B's sole shareholder, a government, exchanges its shares in Entity B. Therefore, Entity A issues 150 ordinary shares in exchange for all 60 ordinary shares of Entity B.

(b) The fair value of each ordinary share of Entity B at 30 September 20X6 is CU40. The quoted market price of Entity A's ordinary shares at that date is CU16.

(c) The fair values of Entity A's identifiable assets and liabilities at 30 September 20X6 are the same as their carrying amounts, except that the fair value of Entity A's non-current assets at 30 September 20X6 is CU1,500.

Calculating the Fair Value of the Consideration Transferred

IE196. As a result of Entity A (legal controlling entity, accounting acquired operation) issuing 150 ordinary shares, Entity B's shareholder (the government) owns 60 percent of the issued shares of the combined entity (i.e., 150 of 250 issued shares). The remaining 40 percent is owned by Entity A's shareholders. If the acquisition had taken the form of Entity B issuing additional ordinary shares to Entity A's shareholders in exchange for their ordinary shares in Entity A, Entity B would have had to issue 40 shares for the ratio of ownership interest in the combined entity to be the same. Entity B's shareholder (the government) would then own 60 of the 100 issued shares of Entity B—60 percent of the combined entity. As a result, the fair value of the consideration effectively transferred by Entity B and the group's interest in Entity A is CU1,600 (40 shares with a fair value per share of CU40).

IE197. The fair value of the consideration effectively transferred should be based on the most reliable measure. In this example, the quoted price of Entity A's shares in the principal (or most advantageous) market for the shares provides a more reliable basis for measuring the consideration effectively transferred than the fair value of the shares in Entity B, and the consideration is measured using the market price of Entity A's shares—100 shares with a fair value per share of CU16.

Measuring Goodwill

IE198. Goodwill is measured as the excess of the fair value of the consideration effectively transferred (the group's interest in Entity A) over the net amount of Entity A's recognised identifiable assets and liabilities, as follows:

	CU	CU
Consideration effectively transferred		1,600
Net recognised values of Entity A's identifiable assets and liabilities		
Current assets	500	
Non-current assets	1,500	
Current liabilities	(300)	
Non-current liabilities	(400)	(1,300)
Goodwill		300

Consolidated Statement of Financial Position as at 30 September 20X6

IE199. The consolidated statement of financial position immediately after the acquisition is:

	CU
Current assets [CU700 + CU500]	1,200
Non-current assets [CU3,000 + CU1,500]	4,500
Goodwill	300
Total assets	6,000
Current liabilities [CU600 + CU300]	900
Non-current liabilities [CU1,100 + CU400]	1,500
Total liabilities	2,400
Shareholders' equity	
Accumulated ~~surplus or deficit~~ comprehensive revenue and expense	1,400
Issued equity	
250 ordinary shares [CU600 + CU1,600]	2,200
Total shareholders' equity	3,600
Total liabilities and shareholders' equity	6,000

IE200. The amount recognised as issued equity interests in the consolidated financial statements (CU2,200) is determined by adding the issued equity of the legal controlled entity immediately before the acquisition (CU600) and the fair value of the consideration effectively transferred (CU1,600). However, the equity

structure appearing in the consolidated financial statements (i.e., the number and type of equity interests issued) must reflect the equity structure of the legal controlling entity, including the equity interests issued by the legal controlling entity to effect the combination.

Non-Controlling Interest

IE201. Assume the same facts as above, except that Entity B has more than one shareholder, and that only 56 of Entity B's 60 ordinary shares are exchanged. Because Entity A issues 2.5 shares in exchange for each ordinary share of Entity B, Entity A issues only 140 (rather than 150) shares. As a result, Entity B's shareholders own 58.3 percent of the issued shares of the combined entity (140 of 240 issued shares). The fair value of the consideration transferred for Entity A, the accounting acquired operation, is calculated by assuming that the combination had been effected by Entity B issuing additional ordinary shares to the shareholders of Entity A in exchange for their ordinary shares in Entity A. That is because Entity B is the accounting acquirer, and paragraph AG67 of PBE IPSAS 40 requires the acquirer to measure the consideration exchanged for the accounting acquired operation.

IE202. In calculating the number of shares that Entity B would have had to issue, the non-controlling interest is excluded from the calculation. The majority shareholder (the government) owns 56 shares of Entity B. For that to represent a 58.3 percent equity interest, Entity B would have had to issue an additional 40 shares. The majority shareholder (the government) would then own 56 of the 96 issued shares of Entity B and, therefore, 58.3 percent of the combined entity. As a result, the fair value of the consideration transferred for Entity A, the accounting acquired operation, is CU1,600 (i.e., 40 shares, each with a fair value of CU40). That is the same amount as when Entity B's sole shareholder tenders all 60 of its ordinary shares for exchange. The recognised amount of the group's interest in Entity A, the accounting acquired operation, does not change if some of Entity B's shareholders do not participate in the exchange.

IE203. The non-controlling interest is represented by the four shares of the total 60 shares of Entity B that are not exchanged for shares of Entity A. Therefore, the non-controlling interest is 6.7 percent. The non-controlling interest reflects the proportionate interest of the non-controlling shareholders in the pre-combination carrying amounts of the net assets of Entity B, the legal controlled entity. Therefore, the consolidated statement of financial position is adjusted to show a non-controlling interest of 6.7 percent of the pre-combination carrying amounts of Entity B's net assets (i.e., CU134 or 6.7 percent of CU2,000).

IE204. The consolidated statement of financial position as at 30 September 20X6, reflecting the non-controlling interest, is as follows:

	CU
Current assets [CU700 + CU500]	1,200
Non-current assets [CU3,000 + CU1,500]	4,500
Goodwill	300
Total assets	6,000
Current liabilities [CU600 + CU300]	900
Non-current liabilities [CU1,100 + CU400]	1,500
Total liabilities	2,400
Shareholders' equity	
Accumulated ~~surplus or deficit~~ comprehensive revenue and expense [CU1,400 × 93.3 percent]	1,306
Issued equity	
240 ordinary shares [CU560 + CU1,600]	2,160
Non-controlling interest	134
Total shareholders' equity	3,600
Total liabilities and shareholders' equity	6,000

IE205. The non-controlling interest of CU134 has two components. The first component is the reclassification of the non-controlling interest's share of the accounting acquirer's accumulated revenue and expense~~retained earnings~~ immediately before the acquisition (CU1,400 × 6.7 percent or CU93.80). The second component represents the reclassification of the non-controlling interest's share of the accounting acquirer's issued equity (CU600 × 6.7 percent or CU40.20).

Identifiable Intangible Assets in an Acquisition

Illustrating the Consequences of Applying Paragraphs 64–68 and AG75–AG84 of PBE IPSAS 40

IE206. The following are examples of identifiable intangible assets acquired in an acquisition. Some of the examples may have characteristics of assets other than intangible assets. The acquirer should account for those assets in accordance with their substance. The examples are not intended to be all-inclusive.

IE207. Intangible assets identified as having a 'binding arrangement' basis are those that arise from binding arrangements (including rights from contracts or other legal rights). Those designated as having a 'no binding arrangement' basis do not arise from binding arrangements but are separable. Intangible assets identified as having a binding arrangement basis might also be separable but separability is not a necessary condition for an asset to meet the binding arrangement criterion.

Marketing-Related Intangible Assets

IE208. Marketing-related intangible assets are used primarily in the marketing or promotion of products or services. Examples of marketing-related intangible assets are:

Class	**Basis**
Trademarks, trade names, service marks, collective marks and certification marks	Binding arrangement
Trade dress (unique colour, shape or package design)	Binding arrangement
Newspaper mastheads	Binding arrangement
Internet domain names	Binding arrangement
Non-competition agreements	Binding arrangement

Trademarks, Trade Names, Service Marks, Collective Marks and Certification Marks

IE209. Trademarks are words, names, symbols or other devices used in trade to indicate the source of a product and to distinguish it from the products of others. A service mark identifies and distinguishes the source of a service rather than a product. Collective marks identify the goods or services of members of a group. Certification marks certify the geographical origin or other characteristics of a good or service.

IE210. Trademarks, trade names, service marks, collective marks and certification marks may be protected legally through registration with governmental agencies, continuous use in commerce or by other means. If it is protected legally through registration or other means, a trademark or other mark acquired in an acquisition is an intangible asset that meets the binding arrangement criterion. Otherwise, a trademark or other mark acquired in an acquisition can be recognised separately from goodwill if the separability criterion is met, which normally it would be.

IE211. The terms *brand* and *brand name*, often used as synonyms for trademarks and other marks, are general marketing terms that typically refer to a group of complementary assets such as a trademark (or service mark) and its related trade name, formulas, recipes and technological expertise. PBE IPSAS 40 does not preclude an entity from recognising, as a single asset separately from goodwill, a group of complementary intangible assets commonly referred to as a brand if the assets that make up that group have similar useful lives.

Internet Domain Names

IE212. An Internet domain name is a unique alphanumeric name that is used to identify a particular numeric Internet address. Registration of a domain name creates an association between that name and a designated computer on the Internet for the period of the registration. Those registrations are renewable. A registered domain name acquired in an acquisition meets the binding arrangement criterion.

Service User or Customer-Related Intangible Assets

IE213. Examples of service user or customer-related intangible assets are:

Class	**Basis**
Lists of users of a service	No binding arrangement
Order or production backlog	Binding arrangement
Customer binding arrangements and the related customer relationships	Binding arrangement
Customer relationships arising through means other than binding arrangements	No binding arrangement

Lists of Users of a Service

IE214. A list of users of a service consists of information about service users, such as their names and contact information. A list of users of a service also may be in the form of a database that includes other information about the users, such as their service use histories and demographic information. A list of users of a service does not usually arise from a binding arrangement (including rights from contracts or other legal rights). However, lists of users of a service are often leased or exchanged. Therefore, a list of users of a service acquired in an acquisition normally meets the separability criterion.

Order or Production Backlog

IE215. An order or production backlog arises from binding arrangements such as purchase or sales orders. An order or production backlog acquired in an acquisition meets the binding arrangement criterion even if the purchase or sales orders can be cancelled.

Customer Binding Arrangements and the Related Customer Relationships

IE216. If an entity establishes relationships with its customers through binding arrangements, those customer relationships arise from binding arrangement rights. Therefore, customer binding arrangements and the related customer relationships acquired in an acquisition meet the binding arrangement criterion, even if confidentiality or other terms of the binding arrangement prohibit the sale or transfer of a binding arrangement separately from the acquired operation.

IE217. A customer binding arrangement and the related customer relationship may represent two distinct intangible assets. Both the useful lives and the pattern in which the economic benefits of the two assets are consumed may differ.

IE218. A customer relationship exists between an entity and its customer if (a) the entity has information about the customer and has regular contact with the customer and (b) the customer has the ability to make direct contact with the entity. Customer relationships meet the binding arrangement criterion if an entity has a practice of establishing binding arrangements with its customers, regardless of whether a binding arrangement exists at the acquisition date. Customer relationships may also arise through means other than binding arrangements, such as through regular contact by sales or service representatives.

IE219. As noted in paragraph IE215, an order or a production backlog arises from binding arrangements such as purchase or sales orders and is therefore considered a binding arrangement right. Consequently, if an entity has relationships with its customers through these types of binding arrangements, the customer relationships also arise from binding arrangement rights and therefore meet the binding arrangement criterion.

Examples

IE220. The following examples illustrate the recognition of customer binding arrangement and customer relationship intangible assets acquired in an acquisition.

(a) Acquirer Entity (AE) acquires Target Entity (TE) in an acquisition on 31 December 20X5. TE has a five-year agreement to supply goods to Customer. Both TE and AE believe that Customer will renew the agreement at the end of the current binding arrangement. The agreement is not separable.

The agreement, whether cancellable or not, meets the binding arrangement criterion. Additionally, because TE establishes its relationship with Customer through a binding arrangement, not only the agreement itself but also TE's customer relationship with Customer meet the binding arrangement criterion.

(b) AE acquires TE in an acquisition on 31 December 20X5. TE manufactures goods in two distinct lines of business: sporting goods and electronics. Customer purchases both sporting goods and electronics from TE. TE has a binding arrangement with Customer to be its exclusive provider of sporting goods but has no binding arrangement for the supply of electronics to Customer. Both TE and AE believe that only one overall customer relationship exists between TE and Customer.

The binding arrangement to be Customer's exclusive supplier of sporting goods, whether cancellable or not, meets the binding arrangement criterion. Additionally, because TE establishes its relationship with Customer through a binding arrangement, the customer relationship with Customer meets the binding arrangement criterion. Because TE has only one customer relationship with Customer, the fair value of that relationship incorporates assumptions about TE's relationship with Customer related to both sporting goods and electronics. However, if AE determines that the customer relationships with Customer for sporting goods and for electronics are separate from each other, AE would assess whether the customer relationship for electronics meets the separability criterion for identification as an intangible asset.

(c) AE acquires TE in an acquisition on 31 December 20X5. TE does business with its customers solely through purchase and sales orders. At 31 December 20X5, TE has a backlog of customer purchase orders from 60 percent of its customers, all of whom are recurring customers. The other 40 percent of TE's customers are also recurring customers. However, as of 31 December 20X5, TE has no open purchase orders or other binding arrangements with those customers.

Regardless of whether they are cancellable or not, the purchase orders from 60 percent of TE's customers meet the binding arrangement criterion. Additionally, because TE has established its relationship with 60 percent of its customers through binding arrangements, not only the purchase orders but also TE's customer relationships meet the binding arrangement criterion. Because TE has a practice of establishing binding arrangements with the remaining 40 percent of its customers, its relationship with those customers also arises through binding arrangement rights and therefore meets the binding arrangement criterion even though TE does not have binding arrangements with those customers at 31 December 20X5.

(d) AE acquires TE, an insurer, in an acquisition on 31 December 20X5. TE has a portfolio of one-year motor insurance contracts that are cancellable by policyholders.

Because TE establishes its relationships with policyholders through insurance contracts, the customer relationship with policyholders meets the binding arrangement criterion. PBE IPSAS 26 *Impairment of Cash-Generating Assets* and PBE IPSAS 31 *Intangible Assets* apply to the customer relationship intangible asset.

Customer Relationships Arising through Means Other than Binding Arrangements

IE221. A customer relationship acquired in an acquisition that does not arise from a binding arrangement may nevertheless be identifiable because the relationship is separable. Exchange transactions for the same asset or a similar asset that indicate that other entities have sold or otherwise transferred a particular type of customer relationship arising through means other than binding arrangements would provide evidence that the relationship is separable.

Artistic-Related Intangible Assets

IE222. Examples of artistic-related intangible assets are:

Class	**Basis**
Plays, operas and ballets	Binding arrangement
Books, magazines, newspapers and other literary works	Binding arrangement
Musical works such as compositions, song lyrics and advertising jingles	Binding arrangement
Pictures and photographs	Binding arrangement
Video and audio-visual material, including motion pictures or films, music videos and television programmes	Binding arrangement

IE223. Artistic-related assets acquired in an acquisition are identifiable if they arise from binding arrangements (including rights from contracts) or legal rights such as those provided by copyright. The holder can transfer a copyright, either in whole through an assignment or in part through a licensing agreement. An acquirer is not precluded from recognising a copyright intangible asset and any related assignments or licence agreements as a single asset, provided they have similar useful lives.

Binding Arrangement-Based Intangible Assets

IE224. Binding arrangement-based intangible assets represent the value of rights that arise from binding arrangements. Binding arrangements with customers are one type of binding arrangement-based intangible asset. If the terms of a binding arrangement give rise to a liability (for example, if the terms of an operating lease or binding arrangement with a customer are unfavourable relative to market terms), the acquirer recognises it as a liability assumed in the acquisition. Examples of binding arrangement-based intangible assets are:

Class	**Basis**
Licensing, royalty and standstill agreements	Binding arrangement
Advertising, construction, management, service or supply binding arrangements	Binding arrangement
Lease agreements (whether the acquired operation is the lessee or the lessor)	Binding arrangement
Construction permits	Binding arrangement
Franchise agreements	Binding arrangement
Operating and broadcast rights	Binding arrangement
Servicing binding arrangements, such as mortgage servicing binding arrangements	Binding arrangement
Binding arrangements for employment	Binding arrangement
Use rights, such as drilling, water, air, timber cutting and route authorities	Binding arrangement

Servicing Binding Arrangements, such as Mortgage Servicing Binding Arrangements

IE225. Binding arrangements to service financial assets are one type of binding arrangement-based intangible asset. Although servicing is inherent in all financial assets, it becomes a distinct asset (or liability) by one of the following:

(a) When separated in the binding arrangement from the underlying financial asset by sale or securitisation of the assets with servicing retained;

(b) Through the separate purchase and assumption of the servicing.

IE226. If mortgage loans, credit card receivables or other financial assets are acquired in an acquisition with servicing retained, the inherent servicing rights are not a separate intangible asset because the fair value of those servicing rights is included in the measurement of the fair value of the acquired financial asset.

Binding Arrangements for Employment

IE227. Binding arrangements for employment that are beneficial binding arrangements from the perspective of the employer because the pricing of those binding arrangements is favourable relative to market terms are one type of binding arrangement-based intangible asset.

Use Rights

IE228. Use rights include rights for drilling, water, air, timber cutting and route authorities. Some use rights are binding arrangement-based intangible assets to be accounted for separately from goodwill. Other use rights may have characteristics of tangible assets rather than of intangible assets. An acquirer should account for use rights on the basis of their nature.

Technology-Based Intangible Assets

IE229. Examples of technology-based intangible assets are:

Class	**Basis**
Patented technology	Binding arrangement
Computer software and mask works	Binding arrangement
Unpatented technology	No binding arrangement
Databases, including title plants	No binding arrangement
Trade secrets, such as secret formulas, processes and recipes	Binding arrangement

Computer Software and Mask Works

IE230. Computer software and programme formats acquired in an acquisition that are protected legally, such as by patent or copyright, meet the binding arrangement criterion for identification as intangible assets.

IE231. Mask works are software permanently stored on a read-only memory chip as a series of stencils or integrated circuitry. Mask works may have legal protection. Mask works with legal protection that are acquired in an acquisition meet the binding arrangement criterion for identification as intangible assets.

Databases, Including Title Plants

IE232. Databases are collections of information, often stored in electronic form (such as on computer disks or files). A database that includes original works of authorship may be entitled to copyright protection. A database acquired in an acquisition and protected by copyright meets the binding arrangement criterion. However, a database typically includes information created as a consequence of an entity's normal operations, such as lists of service users, or specialised information, such as scientific data or credit information. Databases that are not protected by copyright can be, and often are, exchanged, licensed or leased to others in their entirety or in part. Therefore, even if the future economic benefits from a database do not arise from legal rights, a database acquired in an acquisition meets the separability criterion.

IE233. Title plants constitute a historical record of all matters affecting title to parcels of land in a particular geographical area. Title plant assets are bought and sold, either in whole or in part, in exchange transactions or are licensed. Therefore, title plant assets acquired in an acquisition meet the separability criterion.

Trade Secrets, such as Secret Formulas, Processes and Recipes

IE234. A trade secret is 'information, including a formula, pattern, recipe, compilation, programme, device, method, technique, or process that (a) derives independent economic value, actual or potential, from not being generally known and (b) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.'[22] If the future economic benefits from a trade secret acquired in an acquisition are legally protected, that asset meets the binding arrangement criterion. Otherwise, trade secrets acquired in an acquisition are identifiable only if the separability criterion is met, which is likely to be the case.

Measurement of Non-Controlling Interest (NCI) in an Acquisition

Illustrating the Consequences of Applying Paragraph 73 of PBE IPSAS 40.

IE235. The following examples illustrate the measurement of components of NCI at the acquisition date in an acquisition.

Measurement of NCI Including Preference Shares

IE236. TE has issued 100 preference shares, which are classified as equity. The preference shares have a nominal value of CU1 each. The preference shares give their holders a right to a preferential dividend in priority to the payment of any dividend to the holders of ordinary shares. Upon liquidation of TE, the holders of the preference shares are entitled to receive out of the assets available for distribution the amount of CU1 per share in priority to the holders of ordinary shares. The holders of the preference shares do not have any further rights on liquidation.

IE237. AE acquires all ordinary shares of TE. The transaction gives AE control of TE, and an analysis of the economic substance of the combination using the guidance in paragraphs 9–14 and AG19–AG50 of PBE IPSAS 40 confirms the transaction is an acquisition. The acquisition-date fair value of the preference shares is CU120.

IE238. Paragraph 73 of PBE IPSAS 40 states that for each acquisition, the acquirer shall measure at the acquisition date components of non-controlling interest in the acquired operation that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation at either fair value or the present ownership instruments' proportionate share in the

[22] Melvin Simensky and Lanning Bryer, The New Role of Intellectual Property in Commercial Transactions (New York: John Wiley & Sons, 1998), page 293.

acquired operation's recognised amounts of the identifiable net assets. All other components of non-controlling interest must be measured at their acquisition-date fair value, unless another measurement basis is required by PBE Standards.

IE239. The non-controlling interests that relate to TE's preference shares do not qualify for the measurement choice in paragraph 73 of PBE IPSAS 40 because they do not entitle their holders to a proportionate share of the entity's net assets in the event of liquidation. The acquirer measures the preference shares at their acquisition-date fair value of CU120.

First Variation

IE240. Suppose that upon liquidation of TE, the preference shares entitle their holders to receive a proportionate share of the assets available for distribution. The holders of the preference shares have equal right and ranking to the holders of ordinary shares in the event of liquidation. Assume that the acquisition-date fair value of the preference shares is now CU160 and that the proportionate share of TE's recognised amounts of the identifiable net assets that is attributable to the preference shares is CU140.

IE241. The preference shares qualify for the measurement choice in paragraph 73 of PBE IPSAS 40. AE can choose to measure the preference shares either at their acquisition-date fair value of CU160 or at their proportionate share in the acquired operation's recognised amounts of the identifiable net assets of CU140.

Second Variation

IE242. Suppose also that TE has issued share options as remuneration to its employees. The share options are classified as equity and are vested at the acquisition date. They do not represent present ownership interest and do not entitle their holders to a proportionate share of TE's net assets in the event of liquidation. The fair value of the share options in accordance with the relevant international or national accounting standard dealing with share-based payments at the acquisition date is CU200. The share options do not expire on the acquisition date and AE does not replace them.

IE243. Paragraph 73 of PBE IPSAS 40 requires such share options to be measured at their acquisition-date fair value, unless another measurement basis is required by PBE Standards. Paragraph 84 of PBE IPSAS 40 states that the acquirer shall measure an equity instrument related to share-based payment transactions of the acquired operation in accordance with the relevant international or national accounting standard dealing with share-based payments.

IE244. The acquirer measures the non-controlling interests that are related to the share options at their fair value of CU200.

Forgiveness of Amounts of Tax Due in an Acquisition

Illustrating the Consequences of Accounting for Tax Forgiveness in an Acquisition by Applying Paragraphs 78,~~ 79~~ ~~and~~ AG85 and ~~–~~AG87 of PBE IPSAS 40

IE245. The following example illustrates the accounting for an acquisition in which part of the acquired operation's tax liability is forgiven as part of the terms of the acquisition.

IE246. On 1 January 20X4 AE, a government ministry acting on behalf of the government, acquires TE, a private entity in exchange for cash of CU575. As a result of the acquisition, AE expects to reduce costs through economies of scale. The fair value of the assets acquired and liabilities assumed are as follows:

Assets acquired and liabilities assumed:	**CU**
Financial assets	265
Inventory	5
Property, plant and equipment	640
Identifiable intangible assets	12
Financial liabilities	(320)
Tax liabilities	(40)
Total net assets	562

IE247. AE recognises goodwill of CU13, the difference between the price paid to acquire TE (CU575) and the net assets of TE (CU562).

IE248. Suppose that as part of the terms of the acquisition, the government requires MF (the tax authority) to forgive 50 percent of TE's tax liability. The fair value of the assets acquired and liabilities assumed would now be as follows:

Assets acquired and liabilities assumed:	**CU**
Financial assets	265
Inventory	5
Property, plant and equipment	640
Identifiable intangible assets	12
Financial liabilities	(320)
Tax liabilities	(20)
Total net assets	582

IE249. AE recognises a gain of CU7, the difference between the price paid to acquire TE (CU575) and the net assets of TE (CU582). AE would account for the remaining tax liability in accordance with PBE IAS 12~~the relevant international or national accounting standard~~ dealing with income taxes.

IE250. MF would recognise an adjustment for the tax forgiven, and account~~s~~ for the remaining tax receivable in accordance with PBE IPSAS 23~~, and would recognise an adjustment for the tax forgiven~~.

Gain on a Bargain Purchase in an Acquisition

Illustrating the Consequences of Recognising and Measuring a Gain from a Bargain Purchase in an Acquisition by Applying Paragraphs 85–90 of PBE IPSAS 40

IE251. The following example illustrates the accounting for an acquisition in which a gain on a bargain purchase is recognised.

IE252. On 1 January 20X5 AE acquires 80 percent of the equity interests of TE, a private entity, in exchange for cash of CU150. Because the former owners of TE needed to dispose of their investments in TE by a specified date, they did not have sufficient time to market TE to multiple potential buyers. The management of AE initially measures the separately recognisable identifiable assets acquired and the liabilities assumed as of the acquisition date in accordance with the requirements of PBE IPSAS 40. The identifiable assets are measured at CU250 and the liabilities assumed are measured at CU50. AE engages an independent consultant, who determines that the fair value of the 20 percent non-controlling interest in TE is CU42.

IE253. The amount of TE's identifiable net assets (CU200, calculated as CU250 – CU50) exceeds the fair value of the consideration transferred plus the fair value of the non-controlling interest in TE. Therefore, AE reviews the procedures it used to identify and measure the assets acquired and liabilities assumed and to measure the fair value of both the non-controlling interest in TE and the consideration transferred. After that review, AE decides that the procedures and resulting measures were appropriate. AE measures the gain on its purchase of the 80 percent interest as follows:

		CU	CU
Amount of the identifiable net assets acquired (CU250 – CU50)			200
Less:	Fair value of the consideration transferred for AE's 80 percent interest in TE; plus	150	
	Fair value of non-controlling interest in TE	42	
			192
Gain on bargain purchase of 80 percent interest			8

IE254. AE would record its acquisition of TE in its consolidated financial statements as follows:

	CU	CU
Dr Identifiable assets acquired	250	
Cr Cash		150
Cr Liabilities assumed		50
Cr Gain on the bargain purchase		8
Cr Equity—non-controlling interest in TE		42

IE255. If the acquirer chose to measure the non-controlling interest in TE on the basis of its proportionate interest in the identifiable net assets of the acquired operation, the recognised amount of the non-controlling interest would be CU40 (CU200 × 0.20). The gain on the bargain purchase then would be CU10 (CU200 – (CU150 + CU40)).

Measurement Period in an Acquisition

Illustrating the Consequences of Applying Paragraphs 103–108 of PBE IPSAS 40.

IE256. If the initial accounting for an acquisition is not complete at the end of the financial reporting period in which the combination occurs, paragraph 103 of PBE IPSAS 40 requires the acquirer to recognise in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the acquirer recognises adjustments to the provisional amounts needed to reflect new information obtained about facts and circumstances that existed as of the acquisition date and, if known, would have affected the measurement of the amounts recognised as of that date. Paragraph 107 of PBE IPSAS 40 requires the acquirer to recognise such adjustments as if the accounting for the acquisition had been completed at the acquisition date. Measurement period adjustments are not included in surplus or deficit.

IE257. Suppose that AE acquires TE on 30 September 20X7. AE seeks an independent valuation for an item of property, plant and equipment acquired in the combination, and the valuation was not complete by the time AE authorised for issue its financial statements for the year ended 31 December 20X7. In its 20X7 annual financial statements, AE recognised a provisional fair value for the asset of CU30,000. At the acquisition date, the item of property, plant and equipment had a remaining useful life of five years. Five months after the acquisition date, AE received the independent valuation, which estimated the asset's acquisition-date fair value as CU40,000.

IE258. In its financial statements for the year ended 31 December 20X8, AE retrospectively adjusts the 20X7 prior year information as follows:

(a) The carrying amount of property, plant and equipment as of 31 December 20X7 is increased by CU9,500. That adjustment is measured as the fair value adjustment at the acquisition date of CU10,000 less the additional depreciation that would have been recognised if the asset's fair value at the acquisition date had been recognised from that date (CU500 for three months' depreciation).

(b) The carrying amount of goodwill as of 31 December 20X7 is decreased by CU10,000.

(c) Depreciation expense for 20X7 is increased by CU500.

IE259. In accordance with paragraph 124 of PBE IPSAS 40, AE discloses:

(a) In its 20X7 financial statements, that the initial accounting for the acquisition has not been completed because the valuation of property, plant and equipment has not yet been received.

(b) In its 20X8 financial statements, the amounts and explanations of the adjustments to the provisional values recognised during the current reporting period. Therefore, AE discloses that the 20X7 comparative information is adjusted retrospectively to increase the fair value of the item of property, plant and equipment at the acquisition date by CU9,500, offset by a decrease to goodwill of CU10,000 and an increase in depreciation expense of CU500.

Determining what is Part of the Acquisition Transaction

Settlement of a Pre-Existing Relationship –Loan

Illustrating the Consequences of Applying Paragraphs 109–110 and AG98–AG101 of PBE IPSAS 40.

IE260. AE provides TE with a five year, fixed rate loan of CU100. Interest is payable quarterly, with the principal repaid on maturity. With two years remaining under the loan agreement, AE acquires TE.

IE261. Included in the total fair value of TE is a CU90 financial liability for the fair value of the loan arrangement with AE. At the acquisition date, the carrying amount of the corresponding financial asset in AE's financial statements (the amortised cost of the loan) is CU100.

IE262. In this example, AE calculates a loss of CU10. The loss is calculated as the difference between the fair value of the financial liability assumed and carrying amount of the corresponding financial asset previously recognised by AE. In its consolidated financial statements, AE will eliminate its financial asset (CU100) against the fair value of TE's financial liability (CU90), the difference representing the loss to AE.

Settlement of a Pre-Existing Relationship –Transfers

Illustrating the Consequences of Applying Paragraphs 109–110 and AG98–AG101 of PBE IPSAS 40.

IE263. On 1 January 20X7, AE acquires TE. Previously, on 1 October 20X6, AE provided TE with a grant of CU800 to be used in the provision of an agreed number of training courses.

IE264. The grant was subject to a condition that the grant would be returned proportionately to the number of training courses not delivered. At the acquisition date, TE had delivered a quarter of the agreed number of courses, and recognised a liability of CU600 in respect of its performance obligation, in accordance with PBE IPSAS 23. Based on past experience, AE considered that TE was more likely than not to deliver the training courses. It was therefore not probable that there would be a flow of resources to AE, and AE did not recognise an asset in respect of the grant, but accounted for the full CU800 as an expense.

IE265. In this example, AE calculates a gain of CU600. The gain is calculated as the liability assumed that is derecognised because, as a result of the acquisition, there is no longer an obligation owed to a third party.

IE266. In this example, no corresponding asset had been recognised by AE; if AE had previously recognised a corresponding asset, this would be derecognised at the acquisition date, and the derecognised amount would be included in the calculation of the gain or loss.

Settlement of a Pre-Existing Relationship –Supply Contract

Illustrating the Consequences of Applying Paragraphs 109–110 and AG98–AG101 of PBE IPSAS 40.

IE267. AE purchases electronic components from TE under a five-year supply contract at fixed rates. Currently, the fixed rates are higher than the rates at which AE could purchase similar electronic components from another supplier. The supply contract allows AE to terminate the contract before the end of the initial five-year term but only by paying a CU6 million penalty. With three years remaining under the supply contract, AE pays CU50 million to acquire TE, which is the fair value of TE based on what other market participants would be willing to pay.

IE268. Included in the total fair value of TE is CU8 million related to the fair value of the supply contract with AE. The CU8 million represents a CU3 million component that is 'at market' because the pricing is comparable to pricing for current market transactions for the same or similar items (selling effort, customer relationships and so on) and a CU5 million component for pricing that is unfavourable to AE because it exceeds the price of current market transactions for similar items. TE has no other identifiable assets or liabilities related to the supply contract, and AE has not recognised any assets or liabilities related to the supply contract before the acquisition.

IE269. In this example, AE calculates a loss of CU5 million (the lesser of the CU6 million stated settlement amount and the amount by which the contract is unfavourable to the acquirer) separately from the acquisition. The CU3 million 'at-market' component of the contract is part of goodwill.

IE270. Whether AE had recognised previously an amount in its financial statements related to a pre-existing relationship will affect the amount recognised as a gain or loss for the effective settlement of the relationship. Suppose that PBE Standards had required AE to recognise a CU6 million liability for the supply contract before the acquisition. In that situation, AE recognises a CU1 million settlement gain on the contract in surplus or deficit at the acquisition date (the CU5 million measured loss on the contract less the CU6 million loss previously recognised). In other words, AE has in effect settled a recognised liability of CU6 million for CU5 million, resulting in a gain of CU1 million.

Contingent Payments to Employees in an Acquisition

Illustrating the Consequences of Applying Paragraphs 109–110, AG98 and AG102–AG103 of PBE IPSAS 40.

IE271. TE appointed a candidate as its new CEO under a ten-year contract. The contract required TE to pay the candidate CU5 million if TE is acquired before the contract expires. AE acquires TE eight years later. The CEO was still employed at the acquisition date and will receive the additional payment under the existing contract.

IE272. In this example, TE entered into the employment agreement before the negotiations of the combination began, and the purpose of the agreement was to obtain the services of CEO. Thus, there is no evidence that the agreement was arranged primarily to provide benefits to AE or the combined entity. Therefore, the liability to pay CU5 million is included in the application of the acquisition method.

IE273. In other circumstances, TE might enter into a similar agreement with CEO at the suggestion of AE during the negotiations for the acquisition. If so, the primary purpose of the agreement might be to provide severance pay to CEO, and the agreement may primarily benefit AE or the combined entity rather than TE or its former owners. In that situation, AE accounts for the liability to pay CEO in its post-combination financial statements separately from application of the acquisition method.

Subsequent Measurement of Transfers, Concessionary Loans and Similar Benefits Received by an Acquirer or an Acquired Operation on the Basis of Criteria that may Change as a Result of an Acquisition

Illustrating the Consequences of Applying Paragraphs 114 and AG109–AG111 of PBE IPSAS 40.

IE274. The following example illustrates the subsequent accounting for a transfer received by an acquirer on the basis of criteria that may change as a result of an acquisition.

IE275. On 1 January 20X6, a national government provides an annual grant to those municipalities where their revenue per head of population is below a threshold. On 1 June 20X3 AE, a municipality, acquires TE, a shopping complex that will generate revenue for AE. AE had previously received a grant of CU500, based on its revenue per head of population.

IE276. As a result of its acquisition of TE on 1 June 20X3, the revenue per head of population of AE increases above the threshold that the government had set when allocating grants.

IE277. On 1 July 20X3, the national government requires AE to repay a portion (CU100) of the grant previously received by AE. AE recognises a liability and an expense of CU100 on 1 July 20X3.

Disclosure Requirements Relating to Acquisitions

Illustrating the Consequences of Applying the Disclosure Requirements in Paragraphs 119–125 of PBE IPSAS 40.

IE278. The following example illustrates some of the disclosure requirements relating to acquisitions; it is not based on an actual transaction. The example assumes that AE is a public sector entity with responsibility for healthcare in its region and that TE is a listed entity. The illustration presents the disclosures in a tabular format that refers to the specific disclosure requirements illustrated. ~~An actual footnote might present many of the disclosures illustrated in a simple narrative format.~~

Paragraph reference	
120(a)–(d)	On 30 June 20X2 AE acquired 75 percent of the ordinary shares of TE and obtained control of TE. An analysis of the economic substance of the combination confirms the transaction is an acquisition. TE is a provider of medical supplies. As a result of the acquisition, AE is expected to deliver improved healthcare to its residents. It also expects to reduce costs through economies of scale.
120(e)	The goodwill of CU2,500 arising from the acquisition consists largely of the synergies and economies of scale expected from combining the operations of AE and TE.

Paragraph reference

120(k) None of the goodwill recognised is expected to be deductible for income tax purposes. The following table summarises the consideration paid for TE and the amounts of the assets acquired and liabilities assumed recognised at the acquisition date, as well as the fair value at the acquisition date of the non-controlling interest in TE.

	As at 30 June 20X2	
	Consideration	**CU**
120(f)(i)	Cash	11,000
120(f)(iii); 120(g)(i)	Contingent consideration arrangement	1,000
120(f)	**Total consideration transferred**	12,000
120(m)	**Acquisition-related costs** (included in selling, general and administrative expenses in AE's statement of comprehensive revenue and expense~~income~~ for the year ended 31 December 20X2)	1,250
120(i)	**Recognised amounts of identifiable assets acquired and liabilities assumed**	
	Financial assets	3,500
	Inventory	1,000
	Property, plant and equipment	10,000
	Identifiable intangible assets	3,300
	Financial liabilities	(4,000)
	Contingent liability	(1,000)
	Total identifiable net assets	12,800
120(p)(i)	**Non-controlling interest in TE**	(3,300)
	Goodwill	2,500
		12,000

120(f)(iii)
120(g)
124(b) The contingent consideration arrangement requires AE to pay the former owners of TE 5 percent of the revenues of XE, an unconsolidated equity investment owned by TE, in excess of CU7,500 for 20X3, up to a maximum amount of CU2,500 (undiscounted).

The potential undiscounted amount of all future payments that AE could be required to make under the contingent consideration arrangement is between CU0 and CU2,500.

The fair value of the contingent consideration arrangement of CU1,000 was estimated by applying an income approach. Key assumptions include a discount rate range of 20–25 percent and assumed probability-adjusted revenues in XE of CU10,000–20,000.

As of 31 December 20X2, neither the amount recognised for the contingent consideration arrangement, nor the range of outcomes or the assumptions used to develop the estimates had changed.

120(h) The fair value of the financial assets acquired includes receivables with a fair value of CU2,375. The gross amount due under the contracts is CU3,100, of which CU450 is expected to be uncollectible.

Paragraph reference	
124(a)	The fair value of the acquired identifiable intangible assets of CU3,300 is provisional pending receipt of the final valuations for those assets.
120(j) 124(c) PBE IPSAS 19 paras 97–98	A contingent liability of CU1,000 has been recognised for expected warranty claims on products sold by TE during the last three years. We expect that the majority of this expenditure will be incurred in 20X3 and that all will be incurred by the end of 20X4. The potential undiscounted amount of all future payments that AE could be required to make under the warranty arrangements is estimated to be between CU500 and CU1,500. As of 31 December 20X2, there has been no change since 30 June 20X2 in the amount recognised for the liability or any change in the range of outcomes or assumptions used to develop the estimates.
120(p)	The fair value of the non-controlling interest in TE, a listed entity, was measured using the closing market price of TE's ordinary shares on the acquisition date.
120(r)(i)	The revenue included in the consolidated statement of comprehensive revenue and expense ~~income~~ since 30 June 20X2 contributed by TE was CU4,090. TE also contributed profit of CU1,710 over the same period.
120(r)(ii)	Had TE been consolidated from 1 January 20X2 the consolidated statement of comprehensive revenue and expense ~~income~~ would have included revenue of CU27,670 and profit of CU12,870.

In considering the disclosures related to an acquisition, an entity may find it helpful to refer to the discussion of materiality in PBE IPSAS 1.

Comparison with IPSAS 40

PBE IPSAS 40 *PBE Combinations* is drawn from IPSAS 40 *Public Sector Combinations.*

The significant differences between PBE IPSAS 40 and IPSAS 40 are:

(a) PBE Standards require the presentation of a statement of comprehensive revenue and expense. IPSAS require the presentation of a statement of financial performance.

(b) PBE IPSAS 40 treats the existence or absence of consideration as a single indicator of whether a combination is an amalgamation or an acquisition. IPSAS 40 identifies three indicators relating to consideration. PBE IPSAS 40 reclassifies scenario 6 in the illustrative examples from an amalgamation to an acquisition.

(c) PBE IPSAS 40 modifies the definitions of equity interests and owners to broadly align with PBE IFRS 3 *Business Combinations*. The revised definitions reflect the New Zealand public benefit entities' broader view of equity interests and owners.

(d) PBE IPSAS 40 uses the terms new reporting entity and continuing reporting entity to identify the requirements that apply in various circumstances. IPSAS 40 uses the terms "new entity" and "continuing entity".

(e) PBE IPSAS 40 contains additional guidance on how to apply the modified pooling interests method if one of the combining operations had not applied PBE Standards prior to the amalgamation. PBE IPSAS 40 also requires the resulting entity to recognise all assets and liabilities of the combining operations in accordance with PBE Standards, irrespective of whether or not the combining operations had recognised the assets and liabilities prior to the amalgamation. IPSAS 40 does not permit the recognition of previously unrecognised assets and liabilities of the combining operations.

(f) PBE IPSAS 40 requires the continuing reporting entity to provide comparatives in the first set of financial statements following an amalgamation and clarifies that a new reporting entity shall not present comparatives. PBE IPSAS 40 also clarifies that combining operations provide historical information up to the amalgamation date. IPSAS 40 permits but does not require that a resulting entity present comparative information.

(g) PBE IPSAS 40 contains guidance on assessing whether one entity has obtained control of another operation. IPSAS 40 does not have such guidance.

(h) PBE IPSAS 40 permits retrospective application of the Standard for some first-time adopters of PBE Standards. PBE IPSAS 40 also clarifies that restatement of combinations that occurred before the date the Standard is applied is prohibited. IPSAS 40 does not permit retrospective application.

(i) PBE IPSAS 40 contains additional guidance and an additional illustrative example on voluntary combinations not under common control.

(j) PBE IPSAS 40 omits some requirements in IPSAS 40 on the recognition and measurement of income taxes following acquisitions and amalgamations and how to account for taxes forgiven as a result of a combination.

(k) PBE IPSAS 40 does not permit the recognition of goodwill related to the acquisition of a non-cash generating operation. IPSAS 40 permits the recognition of goodwill related to the acquisition of a non-cash generating operation.

History of Amendments

PBE IPSAS 40 *PBE Combinations* was issued in [date].

This table lists the pronouncements establishing and substantially amending PBE IPSAS 40.

Pronouncements	**Date approved**	**Early operative date**	**Effective date (annual reporting periods… on or after …)**
PBE IPSAS 40 *PBE Combinations*	[date]	Early application is permitted	[date]

NZ ACCOUNTING STANDARDS BOARD

WORK IN PROGRESS
EXPOSURE DRAFT

PUBLIC BENEFIT ENTITY INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD 41 FINANCIAL INSTRUMENTS (PBE IPSAS 41)

Issued [Date]

This [draft][1] Standard was issued on [Date] by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 12(a) of the Financial Reporting Act 2013.

This [draft] Standard is a disallowable instrument for the purposes of the Legislation Act 2012, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on [Date].

Reporting entities that are subject to this [draft] Standard are required to apply it in accordance with the effective date, which is set out in paragraphs [156 to xx] [expected to be reporting periods beginning on or after 1 January 2022, with earlier application permitted].

In finalising this [draft] Standard, the New Zealand Accounting Standards Board has carried out appropriate consultation in accordance with section 22(1) of the Financial Reporting Act 2013.

This [draft] New Zealand Tier 1 and Tier 2 Public Benefit Entity Accounting Standard has been issued as a result of a new International Public Sector Accounting Standard – IPSAS 41 *Financial Instruments*.

This [draft] Standard, when applied, supersedes parts of PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*. These parts are identified in Appendix D of the [draft] Standard.

This [draft] Standard, supersedes PBE IFRS 9 *Financial Instruments* and precludes entities from adopting PBE IFRS 9 for reporting periods beginning on or after 1 January 2021.

[1] References to "this Standard" throughout this Exposure Draft should be read as referring to "this draft Standard".

PBE IPSAS 41 FINANCIAL INSTRUMENTS

ISBN

PBE IPSAS 41 FINANCIAL INSTRUMENTS

CONTENTS

from paragraph

The following is available on the XRB website as additional material:

Public Benefit Entity International Public Sector Accounting Standard 41 *Financial Instruments* is set out in paragraphs 1–184.X and Appendices A to D. All the paragraphs have equal authority. PBE IPSAS 41 should be read in the context of its objective, the NZASB's Basis for Conclusions on PBE IPSAS 41, the IPSASB's Basis for Conclusions on IPSAS 41, the *Public Benefit Entities' Conceptual Framework* and Standard XRB A1 *Application of the Accounting Standards Framework*. PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

~~Chapter 1~~ Objective

1.~~1.1~~ The objective of this Standard is to establish principles for the financial reporting of *financial assets* and *financial liabilities* that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows.

~~Chapter 2~~ Scope

2.~~2.1~~ **This Standard shall be applied by all entities to all types of financial instruments except:**

(a) **Those interests in controlled entities~~subsidiaries~~, associates and joint ventures that are accounted for in accordance with PBE IPSAS 34 *Separate Financial Statements*, PBE IPSAS 35~~IFRS 10~~ *Consolidated Financial Statements*~~, IAS 27 *Separate Financial Statements*~~ or PBE IPSAS 36~~IAS 28~~ *Investments in Associates and Joint Ventures*. However, in some cases, PBE IPSAS 34, PBE IPSAS 35 or PBE IPSAS 36 ~~IFRS 10, IAS 27 or IAS 28~~ require or permit an entity to account for an interest in a controlled entity~~subsidiary~~, associate or joint venture in accordance with some or all of the requirements of this Standard. Entities shall also apply this Standard to derivatives on an interest in a controlled entity~~subsidiary~~, associate or joint venture unless the derivative meets the definition of an equity instrument of the entity in PBE IPSAS 28~~IAS 32~~ *Financial Instruments: Presentation*.**

(b) **Rights and obligations under leases to which PBE IPSAS 13~~IFRS 16~~ *Leases* applies. However:**

(i) **Finance lease receivables (i.e., net investments in finance leases) and operating lease receivables recognised by a lessor are subject to the derecognition and impairment requirements of this Standard;**

(ii) **Lease liabilities recognised by a lessee are subject to the derecognition requirements in paragraph 35~~3.3.1~~ of this Standard; and**

(iii) **Derivatives that are embedded in leases are subject to the embedded derivatives requirements of this Standard.**

(c) **Employers' rights and obligations under employee benefit plans, to which PBE IPSAS 39~~IAS 19~~ *Employee Benefits* applies.**

(d) **Financial instruments issued by the entity that meet the definition of an equity instrument in PBE IPSAS 28~~IAS 32~~ (including options and warrants) or that are required to be classified as an equity instrument in accordance with paragraphs 15~~16A~~ and 16~~B~~ or paragraphs 17~~16C~~ and 18~~16D~~ of PBE IPSAS 28~~IAS 32~~. However, the holder of such equity instruments shall apply this Standard to those instruments, unless they meet the exception in (a).**

(e) **Rights and obligations arising under a contract within the scope of PBE IFRS 17 *Insurance Contracts*, other than an issuer's rights and obligations arising under an insurance contract that meets the definition of a financial guarantee contract. However, this Standard applies to (i) a derivative that is embedded in a contract within the scope of PBE IFRS 17, if the derivative is not itself a contract within the scope of PBE IFRS 17; and (ii) an investment component that is separated from a contract within the scope of PBE IFRS 17, if PBE IFRS 17 requires such separation.**
An entity applies this Standard to financial guarantee contracts, but shall apply PBE IFRS 17 if the issuer elects to apply that standard in recognising and measuring them. Notwithstanding (i) above, an entity may apply this Standard to other insurance contracts which involve the transfer of financial risk. ~~Moreover, if an issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting that is applicable to insurance contracts, the issuer may elect to apply either this Standard or IFRS 17 to such financial guarantee contracts (see paragraphs B2.5–B2.6). The issuer may make that election contract by contract, but the election for each contract is irrevocable.~~

> Note:
>
> The intention of the modification in paragraph 2(e) is to carry forward the modifications in PBE IPSAS 29 and PBE IFRS 9, taking account of IFRS 9 as amended by IFRS 17.
> PBE IFRS 9 says "This Standard applies to a derivative that is embedded in an insurance contract if the derivative is not itself an insurance contract (see paragraphs 4.3.1–4.3.7 and paragraphs B4.3.1–B4.3.8 of this Standard). An entity applies this Standard to financial guarantee contracts, but shall apply PBE IFRS 4 if the issuer elects to apply that standard in recognising and measuring them. Notwithstanding (i) above, an entity may apply this Standard to other insurance contracts which involve the transfer of financial risk."

(f) **Any forward contract between an acquirer and a selling shareholder to buy or sell an acquiree that will result in a business combination within the scope of PBE IFRS 3 *Business Combinations*[2] at a future acquisition date. The term of the forward contract should not exceed a reasonable period normally necessary to obtain any required approvals and to complete the transaction.**

(g) **Loan commitments other than those loan commitments described in paragraph 4 ~~2.3~~. However, an issuer of loan commitments shall apply the impairment requirements of this Standard to loan commitments that are not otherwise within the scope of this Standard. Also, all loan commitments are subject to the derecognition requirements of this Standard.**

(h) **Financial instruments, contracts and obligations under share-based payment transactions to which the relevant international or national accounting standard dealing with share-based payment ~~IFRS 2 *Share-based Payment*~~ applies, except for contracts within the scope of paragraphs 5–8~~2.4–2.7~~ of this Standard to which this Standard applies.**

(i) **Rights to payments to reimburse the entity for expenditure that it is required to make to settle a liability that it recognises as a provision in accordance with PBE IPSAS 19~~IAS 37~~ *Provisions, Contingent Liabilities and Contingent Assets*, or for which, in an earlier period, it recognised a provision in accordance with PBE IPSAS 19~~IAS 37~~.**

(j) **~~Rights and obligations within the scope of IFRS 15 *Revenue from Contracts with Customers* that are financial instruments, except for those that IFRS 15 specifies are accounted for in accordance with this Standard.~~The initial recognition and initial measurement of rights and obligations arising from non-exchange revenue transactions, to which PBE IPSAS 23 *Revenue from Non-Exchange Transactions* applies, except as described in paragraph AG6.**

(k) **Rights and obligations under service concession arrangements to which PBE IPSAS 32 *Service Concession Arrangements: Grantor* applies. However, financial liabilities recognised by a grantor under the financial liability model are subject to the derecognition provisions of this Standard (see paragraphs 35–38 and Appendix A paragraphs AG39–AG47).**

3.~~2.2~~ **The impairment requirements of this Standard shall be applied to those rights arising from PBE IPSAS 9 *Revenue from Exchange Transactions* and PBE IPSAS 23 *Revenue from Exchange Transactions* which give rise to financial instruments ~~that IFRS 15 specifies are accounted for in accordance with this Standard~~ for the purposes of recognising impairment gains or losses.**

4.~~2.3~~ **The following loan commitments are within the scope of this Standard:**

(a) **Loan commitments that the entity designates as financial liabilities at fair value through surplus or deficit~~profit or loss~~ (see paragraph 46~~4.2.2~~). An entity that has a past practice of selling the assets resulting from its loan commitments shortly after origination shall apply this Standard to all its loan commitments in the same class.**

(b) **Loan commitments that can be settled net in cash or by delivering or issuing another financial instrument. These loan commitments are derivatives. A loan commitment is not regarded as settled net merely because the loan is paid out in instalments (for example, a mortgage construction loan that is paid out in instalments in line with the progress of construction).**

(c) **Commitments to provide a loan at a below-market interest rate (see paragraph 45~~4.2.1~~(d)).**

[2] NZASB ED 2018-X PBE IPSAS 40 *PBE Combinations* sets out proposals for a PBE Standard which would supersede PBE IFRS 3. If that standard is finalised before this standard, paragraph 2(f) would refer to "Any forward contract between an acquirer and a selling shareholder to buy or sell an acquired operation that will result in a PBE combination to which PBE IPSAS 40 *PBE Combinations* applies at a future acquisition date. …"

5.~~2.4~~ **This Standard shall be applied to those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements. However, this Standard shall be applied to those contracts that an entity designates as measured at fair value through surplus or deficit~~profit or loss~~ in accordance with paragraph 6 ~~2.5~~.**

6.~~2.5~~ **A contract to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contract was a financial instrument, may be irrevocably designated as measured at fair value through surplus or deficit~~profit or loss~~ even if it was entered into for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements. This designation is available only at inception of the contract and only if it eliminates or significantly reduces a recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise from not recognising that contract because it is excluded from the scope of this Standard (see paragraph 5 ~~2.4~~).**

7.~~2.6~~ There are various ways in which a contract to buy or sell a non-financial item can be settled net in cash or another financial instrument or by exchanging financial instruments. These include:

(a) When the terms of the contract permit either party to settle it net in cash or another financial instrument or by exchanging financial instruments;

(b) When the ability to settle net in cash or another financial instrument, or by exchanging financial instruments, is not explicit in the terms of the contract, but the entity has a practice of settling similar contracts net in cash or another financial instrument or by exchanging financial instruments (whether with the counterparty, by entering into offsetting contracts or by selling the contract before its exercise or lapse);

(c) When, for similar contracts, the entity has a practice of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin; and

(d) When the non-financial item that is the subject of the contract is readily convertible to cash.

A contract to which (b) or (c) applies is not entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements and, accordingly, is within the scope of this Standard. Other contracts to which paragraph 5 ~~2.4~~ applies are evaluated to determine whether they were entered into and continue to be held for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements and, accordingly, whether they are within the scope of this Standard.

8.~~2.7~~ A written option to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, in accordance with paragraph 7~~2.6~~(a) or 7~~2.6~~(d) is within the scope of this Standard. Such a contract cannot be entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements.

Definitions

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

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

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

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

(a) **Significant financial difficulty of the issuer or the borrower;**

(b) **A breach of contract, such as a default or past due event;**

(c) **The lender(s) of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession(s) that the lender(s) would not otherwise consider;**

(d) **It is becoming probable that the borrower will enter bankruptcy or other financial reorganisation;**

(e) **The disappearance of an active market for that financial asset because of financial difficulties; or**

(f) **The purchase or origination of a financial asset at a deep discount that reflects the incurred credit losses.**

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

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

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

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

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

(a) **Its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying').**

(b) **It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.**

(c) **It is settled at a future date.**

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

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

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset or to the amortised cost of a financial liability. When calculating the effective interest rate, an entity shall estimate the expected cash flows by considering all the contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) but shall not consider the expected credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate (see paragraphs AG156–AG158~~PBE IPSAS 9~~), transaction costs, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the cash flows or the expected life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments).

An ~~E~~expected credit loss~~es~~ is~~are~~ the weighted average of credit losses with the respective risks of a default occurring as the weights.

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

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

(a) **It meets the definition of held for trading.**

(b) **Upon initial recognition it is designated by the entity as at fair value through surplus or deficit in accordance with paragraph 46 or 51~~4.2.2 or 4.3.5~~.**

(c) **It is designated either upon initial recognition or subsequently as at fair value through surplus or deficit in accordance with paragraph 152~~6.7.1~~.**

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

A forecast transaction is an uncommitted but anticipated future transaction.

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

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

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

(a) **Is acquired or incurred principally for the purpose of selling or repurchasing it in the near term;**

(b) **On initial recognition is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or**

(c) **Is a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).**

An impairment gains or loss~~es~~ is~~are gains or losses that are~~ recognised in surplus or deficit in accordance with paragraph 80~~5.5.8~~ and ~~that~~ arises from applying the impairment requirements in paragraphs 73–93~~Section 5.5~~. [This has been aligned with IPSAS 41. Needs further review to look at the omission of the word "that"]

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

A loss allowance is the allowance for expected credit losses on financial assets measured in accordance with paragraph 40~~4.1.2~~ and lease receivables, the accumulated impairment amount for financial assets measured in accordance with paragraph 41~~4.1.2A~~ and the provision for expected credit losses on loan commitments and financial guarantee contracts.

A modification gain or loss is the amount arising from adjusting the gross carrying amount of a financial asset to reflect the renegotiated or modified contractual cash flows. The entity recalculates the gross carrying amount of a financial asset as the present value of the estimated future cash payments or receipts through the expected life of the renegotiated or modified financial asset that are discounted at the financial asset's original effective interest rate (or the original credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets) or, when applicable, the revised effective interest rate calculated in accordance with paragraph 139~~6.5.10~~. When estimating the expected cash flows of a financial asset, an entity shall consider all contractual terms of the financial asset (for example, prepayment, call and similar options) but shall not consider the expected credit losses, unless the financial asset is a purchased or originated credit-impaired financial asset, in which case an entity shall also consider the initial expected credit losses that were considered when calculating the original credit-adjusted effective interest rate.

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

A purchased or originated credit-impaired financial asset is ~~a purchased or originated financial asset that is~~ credit-impaired on initial recognition.

The r~~R~~eclassification date is the first day of the first reporting period following the change in management ~~business~~ model that results in an entity reclassifying financial assets.

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

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability (see paragraph AG163~~B5.4.8~~). An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.

~~2A.2~~ Terms defined in other PBE Standards are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately. The following terms are defined in ~~PBE IPSAS 9,~~ PBE IPSAS 28 or PBE IPSAS 30 *Financial Instruments: Disclosures*~~and are used in this Standard with the meanings specified in PBE IPSAS 9, PBE IPSAS 28 or PBE IPSAS 30~~: credit risk,[3] currency risk, liquidity risk, market risk, equity instrument, financial asset, financial instrument, financial liability and puttable instrument.

~~(a) credit risk;~~[4]

~~(b) equity instrument;~~

~~(c) fair value;~~

~~(d) financial asset;~~

~~(e) financial instrument;~~

~~(f) financial liability.~~

[3] This term (as defined in PBE IPSAS 30) is used in the requirements for presenting the effects of changes in credit risk on liabilities designated as at fair value through surplus or deficit (see paragraph 107).

~~[4] This term (as defined in PBE IPSAS 30) is used in the requirements for presenting the effects of changes in credit risk on liabilities designated as at fair value through surplus or deficit (see paragraph 5.7.7).~~

~~Chapter 3~~ Recognition and Derecognition

~~3.1~~ Initial Recognition

10.~~3.1.1~~ **An entity shall recognise a financial asset or a financial liability in its statement of financial position when, and only when, the entity becomes party to the contractual provisions of the instrument (see paragraphs AG15~~B3.1.1~~ and AG16~~B3.1.2~~). When an entity first recognises a financial asset, it shall classify it in accordance with paragraphs 39–44~~4.1.1–4.1.5~~ and measure it in accordance with paragraphs 57 and 59~~5.1.1–5.1.3~~. When an entity first recognises a financial liability, it shall classify it in accordance with paragraphs 45 ~~4.2.1~~ and 46~~4.2.2~~ and measure it in accordance with paragraph 57~~5.1.1~~.**

Regular Way Purchase or Sale of Financial Assets

11.~~3.1.2~~ **A regular way purchase or sale of financial assets shall be recognised and derecognised, as applicable, using trade date accounting or settlement date accounting (see paragraphs AG17–AG20~~B3.1.3–B3.1.6~~).**

~~3.2~~ Derecognition of Financial Assets

12.~~3.2.1~~ In consolidated financial statements, paragraphs13–20~~3.2.2–3.2.9~~, AG15~~B3.1.1~~, AG15~~B3.1.2~~ and AG21–AG38~~B3.2.1–B3.2.17~~ are applied at a consolidated level. Hence, an entity first consolidates all controlled entities~~subsidiaries~~ in accordance with PBE IPSAS 35~~IFRS 10~~ and then applies those paragraphs to the resulting economic entity~~group~~.

13.~~3.2.2~~ **Before evaluating whether, and to what extent, derecognition is appropriate under paragraphs 14–20 ~~3.2.3–3.2.9~~, an entity determines whether those paragraphs should be applied to a part of a financial asset (or a part of a group of similar financial assets) or a financial asset (or a group of similar financial assets) in its entirety, as follows.**

(a) **Paragraphs 14–20 ~~3.2.3–3.2.9~~ are applied to a part of a financial asset (or a part of a group of similar financial assets) if, and only if, the part being considered for derecognition meets one of the following three conditions.**

(i) **The part comprises only specifically identified cash flows from a financial asset (or a group of similar financial assets). For example, when an entity enters into an interest rate strip whereby the counterparty obtains the right to the interest cash flows, but not the principal cash flows from a debt instrument, paragraphs 14–20 ~~3.2.3–3.2.9~~ are applied to the interest cash flows.**

(ii) **The part comprises only a fully proportionate (pro rata) share of the cash flows from a financial asset (or a group of similar financial assets). For example, when an entity enters into an arrangement whereby the counterparty obtains the rights to a 90 per cent share of all cash flows of a debt instrument, paragraphs 14–20 ~~3.2.3–3.2.9~~ are applied to 90 per cent of those cash flows. If there is more than one counterparty, each counterparty is not required to have a proportionate share of the cash flows provided that the transferring entity has a fully proportionate share.**

(iii) **The part comprises only a fully proportionate (pro rata) share of specifically identified cash flows from a financial asset (or a group of similar financial assets). For example, when an entity enters into an arrangement whereby the counterparty obtains the rights to a 90 per cent share of interest cash flows from a financial asset, paragraphs 14–20~~3.2.3–3.2.9~~ are applied to 90 per cent of those interest cash flows. If there is more than one counterparty, each counterparty is not required to have a proportionate share of the specifically identified cash flows provided that the transferring entity has a fully proportionate share.**

(b) **In all other cases, paragraphs 14–20~~3.2.3–3.2.9~~ are applied to the financial asset in its entirety (or to the group of similar financial assets in their entirety). For example, when an entity transfers (i) the rights to the first or the last 90 per cent of cash collections from a**

financial asset (or a group of financial assets), or (ii) the rights to 90 per cent of the cash flows from a group of receivables, but provides a guarantee to compensate the buyer for any credit losses up to 8 per cent of the principal amount of the receivables, paragraphs 14–20~~3.2.3–3.2.9~~ are applied to the financial asset (or a group of similar financial assets) in its entirety.

In paragraphs 14–23 ~~3.2.3–3.2.12~~, the term 'financial asset' refers to either a part of a financial asset (or a part of a group of similar financial assets) as identified in (a) above or, otherwise, a financial asset (or a group of similar financial assets) in its entirety.

14.~~3.2.3~~ **An entity shall derecognise a financial asset when, and only when:**

(a) **The contractual rights to the cash flows from the financial asset expire or are waived, or**

(b) **It transfers the financial asset as set out in paragraphs 15 ~~3.2.4~~ and 16~~3.2.5~~ and the transfer qualifies for derecognition in accordance with paragraph 17 ~~3.2.6~~.**

(See paragraph 11~~3.1.2~~ for regular way sales of financial assets.)

15.~~3.2.4~~ **An entity transfers a financial asset if, and only if, it either:**

(a) **Transfers the contractual rights to receive the cash flows of the financial asset, or**

(b) **Retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients in an arrangement that meets the conditions in paragraph 16 ~~3.2.5~~.**

16.~~3.2.5~~ **When an entity retains the contractual rights to receive the cash flows of a financial asset (the 'original asset'), but assumes a contractual obligation to pay those cash flows to one or more entities (the 'eventual recipients'), the entity treats the transaction as a transfer of a financial asset if, and only if, all of the following three conditions are met.**

(a) **The entity has no obligation to pay amounts to the eventual recipients unless it collects equivalent amounts from the original asset. Short-term advances by the entity with the right of full recovery of the amount lent plus accrued interest at market rates do not violate this condition.**

(b) **The entity is prohibited by the terms of the transfer contract from selling or pledging the original asset other than as security to the eventual recipients for the obligation to pay them cash flows.**

(c) **The entity has an obligation to remit any cash flows it collects on behalf of the eventual recipients without material delay. In addition, the entity is not entitled to reinvest such cash flows, except for investments in cash or cash equivalents (as defined in PBE IPSAS 2 ~~IAS 7~~ *Cash Flow Statements ~~of Cash Flows~~*) during the short settlement period from the collection date to the date of required remittance to the eventual recipients, and interest earned on such investments is passed to the eventual recipients.**

17.~~3.2.6~~ **When an entity transfers a financial asset (see paragraph 15 ~~3.2.4~~), it shall evaluate the extent to which it retains the risks and rewards of ownership of the financial asset. In this case:**

(a) **If the entity transfers substantially all the risks and rewards of ownership of the financial asset, the entity shall derecognise the financial asset and recognise separately as assets or liabilities any rights and obligations created or retained in the transfer.**

(b) **If the entity retains substantially all the risks and rewards of ownership of the financial asset, the entity shall continue to recognise the financial asset.**

(c) **If the entity neither transfers nor retains substantially all the risks and rewards of ownership of the financial asset, the entity shall determine whether it has retained control of the financial asset. In this case:**

(i) **If the entity has not retained control, it shall derecognise the financial asset and recognise separately as assets or liabilities any rights and obligations created or retained in the transfer.**

(ii) **If the entity has retained control, it shall continue to recognise the financial asset to the extent of its continuing involvement in the financial asset (see paragraph 27 ~~3.2.16~~).**

18.~~3.2.7~~ The transfer of risks and rewards (see paragraph 17 ~~3.2.6~~) is evaluated by comparing the entity's exposure, before and after the transfer, with the variability in the amounts and timing of the net cash flows of the transferred asset. An entity has retained substantially all the risks and rewards of ownership of a financial asset if its exposure to the variability in the present value of the future net cash flows from the financial asset does not change significantly as a result of the transfer (e.g., because the entity has sold a financial asset subject to an agreement to buy it back at a fixed price or the sale price plus a lender's return). An entity has transferred substantially all the risks and rewards of ownership of a financial asset if its exposure to such variability is no longer significant in relation to the total variability in the present value of the future net cash flows associated with the financial asset (e.g., because the entity has sold a financial asset subject only to an option to buy it back at its *fair value* at the time of repurchase or has transferred a fully proportionate share of the cash flows from a larger financial asset in an arrangement, such as a loan sub-participation, that meets the conditions in paragraph 16 ~~3.2.5~~).

19.~~3.2.8~~ Often it will be obvious whether the entity has transferred or retained substantially all risks and rewards of ownership and there will be no need to perform any computations. In other cases, it will be necessary to compute and compare the entity's exposure to the variability in the present value of the future net cash flows before and after the transfer. The computation and comparison are made using as the discount rate an appropriate current market interest rate. All reasonably possible variability in net cash flows is considered, with greater weight being given to those outcomes that are more likely to occur.

20.~~3.2.9~~ Whether the entity has retained control (see paragraph 17~~3.2.6~~(c)) of the transferred asset depends on the transferee's ability to sell the asset. If the transferee has the practical ability to sell the asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without needing to impose additional restrictions on the transfer, the entity has not retained control. In all other cases, the entity has retained control.

Transfers that Qualify for Derecognition

21.~~3.2.10~~ **If an entity transfers a financial asset in a transfer that qualifies for derecognition in its entirety and retains the right to service the financial asset for a fee, it shall recognise either a servicing asset or a servicing liability for that servicing contract. If the fee to be received is not expected to compensate the entity adequately for performing the servicing, a servicing liability for the servicing obligation shall be recognised at its fair value. If the fee to be received is expected to be more than adequate compensation for the servicing, a servicing asset shall be recognised for the servicing right at an amount determined on the basis of an allocation of the carrying amount of the larger financial asset in accordance with paragraph 24~~3.2.13~~.**

22.~~3.2.11~~ **If, as a result of a transfer, a financial asset is derecognised in its entirety but the transfer results in the entity obtaining a new financial asset or assuming a new financial liability, or a servicing liability, the entity shall recognise the new financial asset, financial liability or servicing liability at fair value.**

23.~~3.2.12~~ **On derecognition of a financial asset in its entirety, the difference between:**

(a) **The carrying amount (measured at the date of derecognition); and**

(b) **The consideration received (including any new asset obtained less any new liability assumed)**

shall be recognised in surplus or deficit~~profit or loss~~.

24.~~3.2.13~~ **If the transferred asset is part of a larger financial asset (e.g., when an entity transfers interest cash flows that are part of a debt instrument, see paragraph 13~~3.2.2~~(a)) and the part transferred qualifies for derecognition in its entirety, the previous carrying amount of the larger financial asset shall be allocated between the part that continues to be recognised and the part that is derecognised, on the basis of the relative fair values of those parts on the date of the transfer. For this purpose, a retained servicing asset shall be treated as a part that continues to be recognised. The difference between:**

(a) **The carrying amount (measured at the date of derecognition) allocated to the part derecognised; and**

(b) **The consideration received for the part derecognised (including any new asset obtained less any new liability assumed)**

shall be recognised in surplus or deficit~~profit or loss~~.

25.~~3.2.14~~ When an entity allocates the previous carrying amount of a larger financial asset between the part that continues to be recognised and the part that is derecognised, the fair value of the part that continues to be recognised needs to be measured. When the entity has a history of selling parts similar to the part that continues to be recognised or other market transactions exist for such parts, recent prices of actual transactions provide the best estimate of its fair value. When there are no price quotes or recent market transactions to support the fair value of the part that continues to be recognised, the best estimate of the fair value is the difference between the fair value of the larger financial asset as a whole and the consideration received from the transferee for the part that is derecognised.

Transfers that do not Qualify for Derecognition

26.~~3.2.15~~ **If a transfer does not result in derecognition because the entity has retained substantially all the risks and rewards of ownership of the transferred asset, the entity shall continue to recognise the transferred asset in its entirety and shall recognise a financial liability for the consideration received. In subsequent periods, the entity shall recognise any revenue~~income~~ on the transferred asset and any expense incurred on the financial liability.**

Continuing Involvement in Transferred Assets

27.~~3.2.16~~ **If an entity neither transfers nor retains substantially all the risks and rewards of ownership of a transferred asset, and retains control of the transferred asset, the entity continues to recognise the transferred asset to the extent of its continuing involvement. The extent of the entity's continuing involvement in the transferred asset is the extent to which it is exposed to changes in the value of the transferred asset. For example:**

(a) **When the entity's continuing involvement takes the form of guaranteeing the transferred asset, the extent of the entity's continuing involvement is the lower of (i) the amount of the asset and (ii) the maximum amount of the consideration received that the entity could be required to repay ('the guarantee amount').**

(b) **When the entity's continuing involvement takes the form of a written or purchased option (or both) on the transferred asset, the extent of the entity's continuing involvement is the amount of the transferred asset that the entity may repurchase. However, in the case of a written put option on an asset that is measured at fair value, the extent of the entity's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price (see paragraph AG34~~B3.2.13~~).**

(c) **When the entity's continuing involvement takes the form of a cash-settled option or similar provision on the transferred asset, the extent of the entity's continuing involvement is measured in the same way as that which results from non-cash settled options as set out in (b) above.**

28.~~3.2.17~~ **When an entity continues to recognise an asset to the extent of its continuing involvement, the entity also recognises an associated liability. Despite the other measurement requirements in this Standard, the transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the entity has retained. The associated liability is measured in such a way that the net carrying amount of the transferred asset and the associated liability is:**

(a) **The amortised cost of the rights and obligations retained by the entity, if the transferred asset is measured at amortised cost, or**

(b) **Equal to the fair value of the rights and obligations retained by the entity when measured on a stand-alone basis, if the transferred asset is measured at fair value.**

29.~~3.2.18~~ **The entity shall continue to recognise any revenue~~income~~ arising on the transferred asset to the extent of its continuing involvement and shall recognise any expense incurred on the associated liability.**

30.~~3.2.19~~ **For the purpose of subsequent measurement, recognised changes in the fair value of the transferred asset and the associated liability are accounted for consistently with each other in accordance with paragraph 101~~5.7.1~~, and shall not be offset.**

31.~~3.2.20~~ **If an entity's continuing involvement is in only a part of a financial asset (e.g., when an entity retains an option to repurchase part of a transferred asset, or retains a residual interest that does not result in the retention of substantially all the risks and rewards of ownership and the entity retains control), the entity allocates the previous carrying amount of the financial asset between the part it continues to recognise under continuing involvement, and the part it no longer recognises on the basis of the relative fair values of those parts on the date of the transfer. For this purpose, the requirements of paragraph 25~~3.2.14~~ apply. The difference between:**

(a) **The carrying amount (measured at the date of derecognition) allocated to the part that is no longer recognised; and**

(b) **The consideration received for the part no longer recognised**

shall be recognised in ~~profit or loss~~surplus or deficit.

32.~~3.2.21~~ If the transferred asset is measured at amortised cost, the option in this Standard to designate a financial liability as at fair value through surplus or deficit~~profit or loss~~ is not applicable to the associated liability.

All transfers

33.~~3.2.22~~ **If a transferred asset continues to be recognised, the asset and the associated liability shall not be offset. Similarly, the entity shall not offset any revenue~~income~~ arising from the transferred asset with any expense incurred on the associated liability (see paragraph 47~~42~~ of PBE IPSAS 28~~IAS 32~~).**

34.~~3.2.23~~ **If a transferor provides non-cash collateral (such as debt or equity instruments) to the transferee, the accounting for the collateral by the transferor and the transferee depends on whether the transferee has the right to sell or repledge the collateral and on whether the transferor has defaulted. The transferor and transferee shall account for the collateral as follows:**

(a) **If the transferee has the right by contract or custom to sell or repledge the collateral, then the transferor shall reclassify that asset in its statement of financial position (e.g., as a loaned asset, pledged equity instruments or repurchase receivable) separately from other assets.**

(b) **If the transferee sells collateral pledged to it, it shall recognise the proceeds from the sale and a liability measured at fair value for its obligation to return the collateral.**

(c) **If the transferor defaults under the terms of the contract and is no longer entitled to redeem the collateral, it shall derecognise the collateral, and the transferee shall recognise the collateral as its asset initially measured at fair value or, if it has already sold the collateral, derecognise its obligation to return the collateral.**

(d) **Except as provided in (c), the transferor shall continue to carry the collateral as its asset, and the transferee shall not recognise the collateral as an asset.**

~~3.3~~ Derecognition of financial liabilities

35.~~3.3.1~~ **An entity shall remove a financial liability (or a part of a financial liability) from its statement of financial position when, and only when, it is extinguished—i.e., when the obligation specified in the contract is discharged, waived, ~~or~~ cancelled or expires.**

36.~~3.3.2~~ **An exchange between an existing borrower and lender of debt instruments with substantially different terms shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. Similarly, a substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.**

37.~~**3.3.3**~~ **The difference between the carrying amount of a financial liability (or part of a financial liability) extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, shall be recognised in ~~profit or loss~~surplus or deficit. Where an obligation is waived by the lender or assumed by a third party as part of a non-exchange transaction, an entity applies PBE IPSAS 23.**

38.~~3.3.4~~ If an entity repurchases a part of a financial liability, the entity shall allocate the previous carrying amount of the financial liability between the part that continues to be recognised and the part that is derecognised based on the relative fair values of those parts on the date of the repurchase. The difference between (a) the carrying amount allocated to the part derecognised and (b) the consideration paid, including any non-cash assets transferred or liabilities assumed, for the part derecognised shall be recognised in ~~profit or loss~~surplus or deficit.

Note for Board

IFRS 17 added paragraph 3.35 to IFRS 9. Shown as paragraph 38.1 in this ED.

38.1~~3.3.5~~ Some entities operate, either internally or externally, an investment fund that provides investors with benefits determined by units in the fund and recognise financial liabilities for the amounts to be paid to those investors. Similarly, some entities issue groups of insurance contracts with direct participation features and those entities hold the underlying items. Some such funds or underlying items include the entity's financial liability (for example, a corporate bond issued). Despite the other requirements in this

Standard for the derecognition of financial liabilities, an entity may elect not to derecognise its financial liability that is included in such a fund or is an underlying item when, and only when, the entity repurchases its financial liability for such purposes. Instead, the entity may elect to continue to account for that instrument as a financial liability and to account for the repurchased instrument as if the instrument were a financial asset, and measure it at fair value through surplus or deficit~~profit or loss~~ in accordance with this Standard. That election is irrevocable and made on an instrument-by-instrument basis. For the purposes of this election, insurance contracts include investment contracts with discretionary participation features. (See PBE IFRS 17 for terms used in this paragraph that are defined in that Standard.)

~~Chapter 4~~ Classification

~~4.1~~ Classification of Financial Assets

39.~~4.1.1~~ **Unless paragraph 44 ~~4.1.5~~ applies, an entity shall classify financial assets as subsequently measured at amortised cost, fair value through other comprehensive ~~income~~ revenue and expense or fair value through ~~profit or loss~~surplus or deficit on the basis of both:**

(a) **The entity's ~~business~~ management model for managing the financial assets and**

(b) **The contractual cash flow characteristics of the financial asset.**

40.~~4.1.2~~ **A financial asset shall be measured at amortised cost if both of the following conditions are met:**

(a) **The financial asset is held within a management~~business~~ model whose objective is to hold financial assets in order to collect contractual cash flows and**

(b) **The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.**

Paragraphs AG48–AG88~~B4.1.1–B4.1.26~~ provide guidance on how to apply these conditions.

41.~~4.1.2A~~ **A financial asset shall be measured at fair value through other comprehensive ~~income~~ revenue and expense if both of the following conditions are met:**

(a) **The financial asset is held within a management~~business~~ model whose objective is achieved by both collecting contractual cash flows and selling financial assets and**

(b) **The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.**

Paragraphs AG48–AG88~~B4.1.1–B4.1.26~~ provide guidance on how to apply these conditions.

42.~~4.1.3~~ **For the purpose of applying paragraphs 40~~4.1.2~~(b) and 41~~4.1.2A~~(b):**

(a) **Principal is the fair value of the financial asset at initial recognition. Paragraph AG64~~B4.1.7B~~ provides additional guidance on the meaning of principal.**

(b) **Interest consists of consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs, as well as a profit margin. Paragraphs AG63~~B4.1.7A~~ and AG67–AG71~~B4.1.9A–B4.1.9E~~ provide additional guidance on the meaning of interest, including the meaning of the time value of money.**

43.~~4.1.4~~ **A financial asset shall be measured at fair value through ~~profit or loss~~surplus or deficit unless it is measured at amortised cost in accordance with paragraph 40~~4.1.2~~ or at fair value through other comprehensive ~~income~~ revenue and expense in accordance with paragraph 41~~4.1.2A~~. However an entity may make an irrevocable election at initial recognition for particular investments in *equity instruments* that would otherwise be measured at fair value through ~~profit or loss~~surplus or deficit to present subsequent changes in fair value in other comprehensive ~~income~~ revenue and expense (see paragraphs 106–107~~5.7.5–5.7.6~~).**

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

44.~~4.1.5~~ **Despite paragraphs 39–43~~4.1.1–4.1.4~~, an entity may, at initial recognition, irrevocably designate a financial asset as measured at fair value through ~~profit or loss~~surplus or deficit if doing so eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases (see paragraphs AG91–AG94~~B4.1.29–B4.1.32~~).**

~~4.2~~ Classification of Financial Liabilities

45.~~4.2.1~~ **An entity shall classify all financial liabilities as subsequently measured at amortised cost, except for:**

(a) **Financial liabilities at fair value through ~~profit or loss~~surplus or deficit. Such liabilities, including derivatives that are liabilities, shall be subsequently measured at fair value.**

(b) **Financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies. Paragraphs 26~~3.2.15~~ and 28~~3.2.17~~ apply to the measurement of such financial liabilities.**

(c) **Financial guarantee contracts. After initial recognition, an issuer of such a contract shall (unless paragraph 45~~4.2.1~~(a) or (b) applies) subsequently measure it at the higher of:**

(i) **The amount of the loss allowance determined in accordance with paragraphs 73–93~~Section 5.5~~; and**

(ii) **The amount initially recognised (see paragraph 57~~5.1.1~~) less, when appropriate, the cumulative amount of amortisation~~income~~ recognised in accordance with the principles of PBE IPSAS 9~~IFRS 15~~.**

(d) **Commitments to provide a loan at a below-market interest rate. An issuer of such a commitment shall (unless paragraph 45~~4.2.1~~(a) applies) subsequently measure it at the higher of:**

(i) **The amount of the loss allowance determined in accordance with paragraphs 73–93~~Section 5.5~~; and**

(ii) **The amount initially recognised (see paragraph 57~~5.1.1~~) less, when appropriate, the cumulative amount of amortisation~~income~~ recognised in accordance with the principles of PBE IPSAS 9~~IFRS 15~~.**

(e) **Contingent consideration recognised by an acquirer in a business combination to which PBE IFRS 3 applies.[5] Such contingent consideration shall subsequently be measured at fair value with changes recognised in ~~profit or loss~~surplus or deficit.**

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

46.~~4.2.2~~ **An entity may, at initial recognition, irrevocably designate a financial liability as measured at fair value through ~~profit or loss~~surplus or deficit when permitted by paragraph 51~~4.3.5~~, or when doing so results in more relevant information, because either:**

(a) **It eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as 'an accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases (see paragraphs AG91–AG94~~B4.1.29–B4.1.32~~); or**

(b) **A group of financial liabilities or financial assets and financial liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel (as defined in PBE IPSAS ~~IAS~~ 24**

[5] NZASB ED 2018-X PBE IPSAS 40 *PBE Combinations* sets out proposals for a PBE Standard which would supersede PBE IFRS 3. If that standard is finalised before this standard, paragraph 45 would refer to "Contingent consideration recognised by an acquirer in a PBE combination to which PBE IPSAS 40 applies."

***Related Party Disclosures*), for example, the entity's board of directors and chief executive officer (see paragraphs AG95–AG98~~B4.1.33–B4.1.36~~).**

~~4.3~~ Embedded Derivatives

47.~~4.3.1~~ An embedded derivative is a component of a hybrid contract that also includes a non-derivative host—with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract. A derivative that is attached to a *financial instrument* but is contractually transferable independently of that instrument, or has a different counterparty, is not an embedded derivative, but a separate financial instrument.

Hybrid Contracts with Financial Asset Hosts

48.~~4.3.2~~ **If a hybrid contract contains a host that is an asset within the scope of this Standard, an entity shall apply the requirements in paragraphs 39–44~~4.1.1–4.1.5~~ to the entire hybrid contract.**

Other Hybrid Contracts

49.~~4.3.3~~ **If a hybrid contract contains a host that is not an asset within the scope of this Standard, an embedded derivative shall be separated from the host and accounted for as a derivative under this Standard if, and only if:**

(a) **The economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host (see paragraphs AG103~~B4.3.5~~ and AG106~~B4.3.8~~);**

(b) **A separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and**

(c) **The hybrid contract is not measured at fair value with changes in fair value recognised in ~~profit or loss~~surplus or deficit (i.e., a derivative that is embedded in a financial liability at fair value through ~~profit or loss~~surplus or deficit is not separated).**

50.~~4.3.4~~ **If an embedded derivative is separated, the host contract shall be accounted for in accordance with the appropriate Standards. This Standard does not address whether an embedded derivative shall be presented separately in the statement of financial position.**

51.~~4.3.5~~ **Despite paragraphs 49~~4.3.3~~ and 50~~4.3.4~~, if a contract contains one or more embedded derivatives and the host is not an asset within the scope of this Standard, an entity may designate the entire hybrid contract as at fair value through ~~profit or loss~~surplus or deficit unless:**

(a) **The embedded derivative(s) do(es) not significantly modify the cash flows that otherwise would be required by the contract; or**

(b) **It is clear with little or no analysis when a similar hybrid instrument is first considered that separation of the embedded derivative(s) is prohibited, such as a prepayment option embedded in a loan that permits the holder to prepay the loan for approximately its amortised cost.**

52.~~4.3.6~~ **If an entity is required by this Standard to separate an embedded derivative from its host, but is unable to measure the embedded derivative separately either at acquisition or at the end of a subsequent financial reporting period, it shall designate the entire hybrid contract as at fair value through ~~profit or loss~~surplus or deficit.**

53.~~4.3.7~~ If an entity is unable to measure reliably the fair value of an embedded derivative on the basis of its terms and conditions, the fair value of the embedded derivative is the difference between the fair value of the hybrid contract and the fair value of the host. If the entity is unable to measure the fair value of the embedded derivative using this method, paragraph 52~~4.3.6~~ applies and the hybrid contract is designated as at fair value through ~~profit or loss~~surplus or deficit.

~~4.4~~ Reclassification

54.~~4.4.1~~ **When, and only when, an entity changes its management~~business~~ model for managing financial assets it shall reclassify all affected financial assets in accordance with paragraphs 39–43~~4.1.1–4.1.4~~. See paragraphs 94–100~~5.6.1–5.6.7~~, AG111–AG113~~B4.4.1–B4.4.3~~ and AG220–AG221~~B5.6.1–B5.6.2~~ for additional guidance on reclassifying financial assets.**

4.4.2 **An entity shall not reclassify any financial liability.**

4.4.3 The following changes in circumstances are not reclassifications for the purposes of paragraphs 54–55~~4.4.1–4.4.2~~:

(a) An item that was previously a designated and effective hedging instrument in a cash flow hedge or net investment hedge no longer qualifies as such;

(b) An item becomes a designated and effective hedging instrument in a cash flow hedge or net investment hedge; and

(c) Changes in measurement in accordance with paragraphs 152–155~~Section 6.7~~.

~~Chapter 5~~ Measurement

~~5.1~~ Initial Measurement

57.~~5.1.1~~ **Except for short-term~~trade~~ receivables and payables within the scope of paragraph 60~~5.1.3~~, at initial recognition, an entity shall measure a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through ~~profit or loss~~surplus or deficit, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.**

58.~~5.1.1A~~ **However, if the fair value of the financial asset or financial liability at initial recognition differs from the transaction price, an entity shall apply paragraph AG117~~B5.1.2A~~.**

59.~~5.1.2~~ When an entity uses settlement date accounting for an asset that is subsequently measured at amortised cost, the asset is recognised initially at its fair value on the trade date (see paragraphs AG17–AG20~~B3.1.3–B3.1.6~~).

60.~~5.1.3~~ Despite the requirement in paragraph 57~~5.1.1~~, at initial recognition, an entity may~~shall~~ measure short-term~~trade~~ receivables and payables at the original invoice amount if the effect of discounting is immaterial~~their transaction price (as defined in IFRS 15) if the trade receivables do not contain a significant financing component in accordance with IFRS 15 (or when the entity applies the practical expedient in accordance with paragraph 63 of IFRS 15)~~.

~~5.2~~ Subsequent Measurement of Financial Assets

61.~~5.2.1~~ **After initial recognition, an entity shall measure a financial asset in accordance with paragraphs 39–44~~4.1.1–4.1.5~~ at:**

(a) **Amortised cost;**

(b) **Fair value through other comprehensive revenue and expense~~income~~; or**

(c) **Fair value through ~~profit or loss~~surplus or deficit.**

62.~~5.2.2~~ **An entity shall apply the impairment requirements in 73–93~~Section 5.5~~ to financial assets that are measured at amortised cost in accordance with paragraph 40~~4.1.2~~ and to financial assets that are measured at fair value through other comprehensive revenue and expense~~income~~ in accordance with paragraph 41~~4.1.2A~~.**

63.~~5.2.3~~ **An entity shall apply the hedge accounting requirements in paragraphs 137–143~~6.5.8–6.5.14~~ (and, if applicable, paragraphs 99–105~~89–94~~ of PBE IPSAS 29~~IAS 39~~ *Financial Instruments: Recognition and***

Measurement **for the fair value hedge accounting for a portfolio hedge of interest rate risk) to a financial asset that is designated as a hedged item.**[6]

~~5.3~~ Subsequent Measurement of Financial Liabilities

64.~~5.3.1~~ **After initial recognition, an entity shall measure a financial liability in accordance with paragraphs 45–46~~4.2.1–4.2.2~~.**

65.~~5.3.2~~ **An entity shall apply the hedge accounting requirements in paragraphs 137–143~~6.5.8–6.5.14~~ (and, if applicable, paragraphs 99–105~~89–94~~ of PBE IPSAS 29~~IAS 39~~ for the fair value hedge accounting for a portfolio hedge of interest rate risk) to a financial liability that is designated as a hedged item.**

Fair Value Measurement Considerations

66. In determining the fair value of a financial asset or a financial liability for the purpose of applying this Standard, PBE IPSAS 28 or PBE IPSAS 30, an entity shall apply paragraphs AG144–AG155 of Appendix A.

67. The best evidence of fair value is quoted prices in an active market. If the market for a financial instrument is not active, an entity establishes fair value by using a valuation technique. The objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal operating business considerations. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, if available, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the entity uses that technique. The chosen valuation technique makes maximum use of market inputs and relies as little as possible on entity-specific inputs. It incorporates all factors that market participants would consider in setting a price and is consistent with accepted economic methodologies for pricing financial instruments. Periodically, an entity calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on any available observable market data.

68. The fair value of a financial liability with a demand feature (e.g., a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

~~5.4~~ Amortised Cost Measurement

Financial Assets

Effective Interest Method

69.~~5.4.1~~ **Interest revenue shall be calculated by using the effective interest method (see ~~Appendix A and~~ paragraphs 9 and AG156–AG162~~B5.4.1–B5.4.7~~). This shall be calculated by applying the effective interest rate to the gross carrying amount of a financial asset except for:**

(a) **Purchased or originated credit-impaired financial assets. For those financial assets, the entity shall apply the credit-adjusted effective interest rate to the amortised cost of the financial asset from initial recognition.**

(b) **Financial assets that are not purchased or originated credit-impaired financial assets but subsequently have become credit-impaired financial assets. For those financial assets, the**

---

[6] In accordance with paragraph 178~~7.2.21~~, an entity may choose as its accounting policy to continue to apply the hedge accounting requirements in PBE IPSAS 29~~IAS 39~~ instead of the requirements in paragraphs 113–155~~Chapter 6~~ of this Standard. If an entity has made this election, the references in this Standard to particular hedge accounting requirements in paragraphs 113–155~~Chapter 6~~ are not relevant. Instead the entity applies the relevant hedge accounting requirements in PBE IPSAS 29~~IAS 39~~.

entity shall apply the effective interest rate to the amortised cost of the financial asset in subsequent reporting periods.

70.~~5.4.2~~ An entity that, in a reporting period, calculates interest revenue by applying the effective interest method to the amortised cost of a financial asset in accordance with paragraph 69~~5.4.1~~(b), shall, in subsequent reporting periods, calculate the interest revenue by applying the effective interest rate to the gross carrying amount if the credit risk on the financial instrument improves so that the financial asset is no longer credit-impaired and the improvement can be related objectively to an event occurring after the requirements in paragraph 69~~5.4.1~~(b) were applied (such as an improvement in the borrower's credit rating).

Modification of Contractual Cash Flows

71.~~5.4.3~~ When the contractual cash flows of a financial asset are renegotiated or otherwise modified and the renegotiation or modification does not result in the derecognition of that financial asset in accordance with this Standard, an entity shall recalculate the gross carrying amount of the financial asset and shall recognise a modification gain or loss in ~~profit or loss~~surplus or deficit. The gross carrying amount of the financial asset shall be recalculated as the present value of the renegotiated or modified contractual cash flows that are discounted at the financial asset's original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets) or, when applicable, the revised effective interest rate calculated in accordance with paragraph 139~~6.5.10~~. Any costs or fees incurred adjust the carrying amount of the modified financial asset and are amortised over the remaining term of the modified financial asset.

Write-off

72.~~5.4.4~~ **An entity shall directly reduce the gross carrying amount of a financial asset when the entity has no reasonable expectations of recovering a financial asset in its entirety or a portion thereof. A write-off constitutes a derecognition event (see paragraph AG37~~B3.2.16~~(r)).**

~~5.5~~ Impairment

Recognition of Expected Credit Losses

General Approach

73.~~5.5.1~~ **An entity shall recognise a loss allowance for expected credit losses on a financial asset that is measured in accordance with paragraphs 40 or 41 ~~4.1.2 or 4.1.2A~~, a lease receivable, ~~a contract asset~~ or a loan commitment and a financial guarantee contract to which the impairment requirements apply in accordance with paragraphs 2~~2.1~~(g), 45~~4.2.1~~(c) or 45~~4.2.1~~(d).**

74.~~5.5.2~~ An entity shall apply the impairment requirements for the recognition and measurement of a loss allowance for financial assets that are measured at fair value through other comprehensive revenue and expense~~income~~ in accordance with paragraph 41~~4.1.2A~~. However, the loss allowance shall be recognised in other comprehensive revenue and expense~~income~~ and shall not reduce the carrying amount of the financial asset in the statement of financial position.

75.~~5.5.3~~ **Subject to paragraphs 85–88~~5.5.13–5.5.16~~, at each reporting date, an entity shall measure the loss allowance for a financial instrument at an amount equal to the lifetime expected credit losses if the credit risk on that financial instrument has increased significantly since initial recognition.**

76.~~5.5.4~~ The objective of the impairment requirements is to recognise lifetime expected credit losses for all financial instruments for which there have been significant increases in credit risk since initial recognition — whether assessed on an individual or collective basis — considering all reasonable and supportable information, including that which is forward-looking.

77.~~5.5.5~~ **Subject to paragraphs 85–88~~5.5.13–5.5.16~~, if, at the reporting date, the credit risk on a financial instrument has not increased significantly since initial recognition, an entity shall measure the loss allowance for that financial instrument at an amount equal to 12-month expected credit losses.**

78.~~5.5.6~~ For loan commitments and financial guarantee contracts, the date that the entity becomes a party to the irrevocable commitment shall be considered to be the date of initial recognition for the purposes of applying the impairment requirements.

79.~~5.5.7~~ If an entity has measured the loss allowance for a financial instrument at an amount equal to lifetime expected credit losses in the previous reporting period, but determines at the current reporting date that paragraph 75~~5.5.3~~ is no longer met, the entity shall measure the loss allowance at an amount equal to 12-month expected credit losses at the current reporting date.

80.~~5.5.8~~ An entity shall recognise in ~~profit or loss~~surplus or deficit, as an impairment gain or loss, the amount of expected credit losses (or reversal) that is required to adjust the loss allowance at the reporting date to the amount that is required to be recognised in accordance with this Standard.

Determining Significant Increases in Credit Risk

81.~~5.5.9~~ At each reporting date, an entity shall assess whether the credit risk on a financial instrument has increased significantly since initial recognition. When making the assessment, an entity shall use the change in the risk of a default occurring over the expected life of the financial instrument instead of the change in the amount of expected credit losses. To make that assessment, an entity shall compare the risk of a default occurring on the financial instrument as at the reporting date with the risk of a default occurring on the financial instrument as at the date of initial recognition and consider reasonable and supportable information, that is available without undue cost or effort, that is indicative of significant increases in credit risk since initial recognition.

82.~~5.5.10~~ An entity may assume that the credit risk on a financial instrument has not increased significantly since initial recognition if the financial instrument is determined to have low credit risk at the reporting date (see paragraphs AG186–AG188~~B5.5.22–B5.5.24~~).

83.~~5.5.11~~ If reasonable and supportable forward-looking information is available without undue cost or effort, an entity cannot rely solely on past due information when determining whether credit risk has increased significantly since initial recognition. However, when information that is more forward-looking than past due status (either on an individual or a collective basis) is not available without undue cost or effort, an entity may use past due information to determine whether there have been significant increases in credit risk since initial recognition. Regardless of the way in which an entity assesses significant increases in credit risk, there is a rebuttable presumption that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due. An entity can rebut this presumption if the entity has reasonable and supportable information that is available without undue cost or effort, that demonstrates that the credit risk has not increased significantly since initial recognition even though the contractual payments are more than 30 days past due. When an entity determines that there have been significant increases in credit risk before contractual payments are more than 30 days past due, the rebuttable presumption does not apply.

Modified Financial Assets

84.~~5.5.12~~ If the contractual cash flows on a financial asset have been renegotiated or modified and the financial asset was not derecognised, an entity shall assess whether there has been a significant increase in the credit risk of the financial instrument in accordance with paragraph 75~~5.5.3~~ by comparing:

(a) The risk of a default occurring at the reporting date (based on the modified contractual terms); and

(b) The risk of a default occurring at initial recognition (based on the original, unmodified contractual terms).

Purchased or Originated Credit-Impaired Financial Assets

85.~~5.5.13~~ **Despite paragraphs 75~~5.5.3~~ and 77~~5.5.5~~, at the reporting date, an entity shall only recognise the cumulative changes in lifetime expected credit losses since initial recognition as a loss allowance for purchased or originated credit-impaired financial assets.**

86.~~5.5.14~~ At each reporting date, an entity shall recognise in ~~profit or loss~~surplus or deficit the amount of the change in lifetime expected credit losses as an impairment gain or loss. An entity shall recognise favourable changes in lifetime expected credit losses as an impairment gain, even if the lifetime expected credit losses are less than the amount of expected credit losses that were included in the estimated cash flows on initial recognition.

Simplified Approach for ~~Trade~~ Receivables~~, Contract Assets and Lease Receivables~~

87.~~5.5.15~~ **Despite paragraphs 75~~5.5.3~~ and 77~~5.5.5~~, an entity shall always measure the loss allowance at an amount equal to lifetime expected credit losses for:**

(a) **~~Trade~~ Receivables ~~or contract assets~~ that result from exchange transactions that are within the scope of PBE IPSAS 9 and non-exchange transactions within the scope of PBE IPSAS 23.~~IFRS 15, and that:~~**

~~(i) Do not contain a significant financing component in accordance with IFRS 15 (or when the entity applies the practical expedient in accordance with paragraph 63 of IFRS 15); or~~

(b) **Lease receivables that result from transactions that are within the scope of PBE IPSAS 13~~IFRS 16~~, if the entity chooses as its accounting policy to measure the loss allowance at an amount equal to lifetime expected credit losses. That accounting policy shall be applied to all lease receivables but may be applied separately to finance and operating lease receivables.**

88.~~5.5.16~~ An entity may select its accounting policy for trade receivables~~,~~ and lease receivables ~~and contract assets~~ independently of each other.

89. The requirements for purchased or originated credit-impaired financial assets (see paragraphs 9 and 85 to 86) do not apply to short-term receivables.

Measurement of Expected Credit Losses

90.~~5.5.17~~ **An entity shall measure expected credit losses of a financial instrument in a way that reflects:**

(a) **An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;**

(b) **The time value of money; and**

(c) **Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.**

91.~~5.5.18~~ When measuring expected credit losses, an entity need not necessarily identify every possible scenario. However, it shall consider the risk or probability that a credit loss occurs by reflecting the possibility that a credit loss occurs and the possibility that no credit loss occurs, even if the possibility of a credit loss occurring is very low.

92.~~5.5.19~~ The maximum period to consider when measuring expected credit losses is the maximum contractual period (including extension options) over which the entity is exposed to credit risk and not a longer period, even if that longer period is consistent with business practice.

93.~~5.5.20~~ However, some financial instruments include both a loan and an undrawn commitment component and the entity's contractual ability to demand repayment and cancel the undrawn commitment does not limit the entity's exposure to credit losses to the contractual notice period. For such financial instruments, and only those financial instruments, the entity shall measure expected credit losses over the period that the entity is exposed to credit risk and expected credit losses would not be mitigated by credit risk management actions, even if that period extends beyond the maximum contractual period.

~~5.6~~ Reclassification of Financial Assets

94.~~5.6.1~~ **If an entity reclassifies financial assets in accordance with paragraph 54~~4.4.1~~, it shall apply the reclassification prospectively from the reclassification date. The entity shall not restate any previously recognised gains, losses (including impairment gains or losses) or interest. Paragraphs 95–100~~5.6.2–5.6.7~~ set out the requirements for reclassifications.**

95.~~5.6.2~~ **If an entity reclassifies a financial asset out of the amortised cost measurement category and into the fair value through ~~profit or loss~~surplus or deficit measurement category, its fair value is measured at the reclassification date. Any gain or loss arising from a difference between the previous amortised cost of the financial asset and fair value is recognised in ~~profit or loss~~surplus or deficit.**

96.~~5.6.3~~ **If an entity reclassifies a financial asset out of the fair value through ~~profit or loss~~surplus or deficit measurement category and into the amortised cost measurement category, its fair value at the reclassification date becomes its new gross carrying amount. (See paragraph AG221~~B5.6.2~~ for guidance on determining an effective interest rate and a loss allowance at the reclassification date.)**

97.~~5.6.4~~ **If an entity reclassifies a financial asset out of the amortised cost measurement category and into the fair value through other comprehensive revenue and expense~~income~~ measurement category, its fair value is measured at the reclassification date. Any gain or loss arising from a difference between the previous amortised cost of the financial asset and fair value is recognised in other comprehensive revenue and expense~~income~~. The effective interest rate and the measurement of expected credit losses are not adjusted as a result of the reclassification. (See paragraph AG220~~B5.6.1~~.)**

98.~~5.6.5~~ **If an entity reclassifies a financial asset out of the fair value through other comprehensive revenue and expense~~income~~ measurement category and into the amortised cost measurement category, the financial asset is reclassified at its fair value at the reclassification date. However, the cumulative gain or loss previously recognised in other comprehensive revenue and expense~~income~~ is removed from equity and adjusted against the fair value of the financial asset at the reclassification date. As a result, the financial asset is measured at the reclassification date as if it had always been measured at amortised cost. This adjustment affects other comprehensive revenue and expense~~income~~ but does not affect ~~profit or loss~~surplus or deficit and therefore is not a reclassification adjustment (see PBE IPSAS 1~~IAS 1~~ *Presentation of Financial Reports~~Statements~~*). The effective interest rate and the measurement of expected credit losses are not adjusted as a result of the reclassification. (See paragraph AG220~~B5.6.1~~.)**

99.~~5.6.6~~ **If an entity reclassifies a financial asset out of the fair value through ~~profit or loss~~surplus or deficit measurement category and into the fair value through other comprehensive revenue and expense~~income~~ measurement category, the financial asset continues to be measured at fair value. (See paragraph AG221~~B5.6.2~~ for guidance on determining an effective interest rate and a loss allowance at the reclassification date.)**

100.~~5.6.7~~ **If an entity reclassifies a financial asset out of the fair value through other comprehensive revenue and expense~~income~~ measurement category and into the fair value through ~~profit or loss~~surplus or deficit measurement category, the financial asset continues to be measured at fair value. The cumulative gain or loss previously recognised in other comprehensive revenue and expense~~income~~ is reclassified from net assets/equity to ~~profit or loss~~surplus or deficit as a reclassification adjustment (see PBE IPSAS 1~~IAS 1~~) at the reclassification date.**

~~5.7~~ Gains and Losses

101.~~5.7.1~~ **A gain or loss on a financial asset or financial liability that is measured at fair value shall be recognised in ~~profit or loss~~surplus or deficit unless:**

(a) **It is part of a hedging relationship (see paragraphs 137–143~~6.5.8–6.5.14~~ and, if applicable, paragraphs 99–105~~89–94~~ of PBE IPSAS 29~~IAS 39~~ for the fair value hedge accounting for a portfolio hedge of interest rate risk);**

(b) **It is an investment in an equity instrument and the entity has elected to present gains and losses on that investment in other comprehensive revenue and expense~~income~~ in accordance with paragraph 106~~5.7.5~~;**

(c) **It is a financial liability designated as at fair value through ~~profit or loss~~surplus or deficit and the entity is required to present the effects of changes in the liability's credit risk in other comprehensive revenue and expense~~income~~ in accordance with paragraph 108~~5.7.7~~; or**

(d) **It is a financial asset measured at fair value through other comprehensive revenue and expense~~income~~ in accordance with paragraph 41~~4.1.2A~~ and the entity is required to recognise some changes in fair value in other comprehensive revenue and expense~~income~~ in accordance with paragraph 111~~5.7.10~~.**

102.~~5.7.1A~~ Dividends are recognised in ~~profit or loss~~surplus or deficit only when:

(a) The entity's right to receive payment of the dividend is established;

(b) It is probable that the economic benefits associated with the dividend will flow to the entity; and

(c) The amount of the dividend can be measured reliably.

103.~~5.7.2~~ **A gain or loss on a financial asset that is measured at amortised cost and is not part of a hedging relationship (see paragraphs 137–143~~6.5.8–6.5.14~~ and, if applicable, paragraphs 99–105~~89–94~~ of PBE IPSAS 29~~IAS 39~~ for the fair value hedge accounting for a portfolio hedge of interest rate risk) shall be recognised in ~~profit or loss~~surplus or deficit when the financial asset is derecognised, reclassified in accordance with paragraph 95~~5.6.2~~, through the amortisation process or in order to recognise impairment gains or losses. An entity shall apply paragraphs 95~~5.6.2~~ and 97~~5.6.4~~ if it reclassifies financial assets out of the amortised cost measurement category. A gain or loss on a financial liability that is measured at amortised cost and is not part of a hedging relationship (see paragraphs 137–143~~6.5.8–6.5.14~~ and, if applicable, paragraphs 99–105~~89–94~~ of PBE IPSAS 29~~IAS 39~~ for the fair value hedge accounting for a portfolio hedge of interest rate risk) shall be recognised in ~~profit or loss~~surplus or deficit when the financial liability is derecognised and through the amortisation process. (See paragraph AG224~~B5.7.2~~ for guidance on foreign exchange gains or losses.)**

104.~~5.7.3~~ **A gain or loss on financial assets or financial liabilities that are hedged items in a hedging relationship shall be recognised in accordance with paragraphs 137–143~~6.5.8–6.5.14~~ and, if applicable, paragraphs 99–105~~89–94~~ of PBE IPSAS 29~~IAS 39~~ for the fair value hedge accounting for a portfolio hedge of interest rate risk.**

105.~~5.7.4~~ **If an entity recognises financial assets using settlement date accounting (see paragraphs 11, AG17 and AG20~~3.1.2, B3.1.3 and B3.1.6~~), any change in the fair value of the asset to be received during the period between the trade date and the settlement date is not recognised for assets measured at amortised cost. For assets measured at fair value, however, the change in fair value shall be recognised in ~~profit or loss~~surplus or deficit or in other comprehensive revenue and expense~~income~~, as appropriate in accordance with paragraph 101~~5.7.1~~. The trade date shall be considered the date of initial recognition for the purposes of applying the impairment requirements.**

Investments in Equity Instruments

106.~~5.7.5~~ **At initial recognition, an entity may make an irrevocable election to present in other comprehensive ~~income~~ revenue and expense subsequent changes in the fair value of an investment in an equity instrument within the scope of this Standard that is neither held for trading nor contingent consideration recognised by an acquirer in a business combination to which PBE IFRS 3 applies.[7] (See paragraph AG226~~B5.7.3~~ for guidance on foreign exchange gains or losses.)**

107.~~5.7.6~~ If an entity makes the election in paragraph 106~~5.7.5~~, it shall recognise in ~~profit or loss~~surplus or deficit dividends or similar distributions from that investment in accordance with paragraph 102~~5.7.1A~~.

Liabilities Designated as at Fair Value through ~~profit or loss~~Surplus or Deficit

108.~~5.7.7~~ **An entity shall present a gain or loss on a financial liability that is designated as at fair value through ~~profit or loss~~surplus or deficit in accordance with paragraph 46~~4.2.2~~ or paragraph 51~~4.3.5~~ as follows:**

(a) The amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability shall be presented in other comprehensive revenue and expense~~income~~ (see paragraphs AG236–AG243~~B5.7.13–B5.7.20~~), and

(b) The remaining amount of change in the fair value of the liability shall be presented in ~~profit or loss~~surplus or deficit

unless the treatment of the effects of changes in the liability's credit risk described in (a) would create or enlarge an accounting mismatch in ~~profit or loss~~surplus or deficit (in which case paragraph 109~~5.7.8~~ applies). Paragraphs AG228–AG230~~B5.7.5–B5.7.7~~ and AG233–AG235~~B5.7.10–B5.7.12~~ provide guidance on determining whether an accounting mismatch would be created or enlarged.

109.~~5.7.8~~ **If the requirements in paragraph 108~~5.7.7~~ would create or enlarge an accounting mismatch in ~~profit or loss~~surplus or deficit, an entity shall present all gains or losses on that liability (including the effects of changes in the credit risk of that liability) in ~~profit or loss~~surplus or deficit.**

[7] NZASB ED 2018-X PBE IPSAS 40 *PBE Combinations* sets out proposals for a PBE Standard which would supersede PBE IFRS 3. If that standard is finalised before this standard, paragraph 106 would refer to "…contingent consideration recognised by an acquirer in a PBE combination to which PBE IPSAS 40 applies."

110.~~5.7.9~~ Despite the requirements in paragraphs 108~~5.7.7~~ and 109~~5.7.8~~, an entity shall present in ~~profit or loss~~surplus or deficit all gains and losses on loan commitments and financial guarantee contracts that are designated as at fair value through ~~profit or loss~~surplus or deficit.

Assets Measured at Fair Value through Other Comprehensive ~~Income~~Revenue and Expense

111.~~5.7.10~~ **A gain or loss on a financial asset measured at fair value through other comprehensive revenue and expense~~income~~ in accordance with paragraph 41~~4.1.2A~~ shall be recognised in other comprehensive revenue and expense~~income~~, except for impairment gains or losses (see paragraphs 73–93~~Section 5.5~~) and foreign exchange gains and losses (see paragraphs AG224–AG225~~B5.7.2–B5.7.2A~~), until the financial asset is derecognised or reclassified. When the financial asset is derecognised the cumulative gain or loss previously recognised in other comprehensive revenue and expense~~income~~ is reclassified from net assets/equity to ~~profit or loss~~surplus or deficit as a reclassification adjustment (see PBE IPSAS 1~~IAS 1~~). If the financial asset is reclassified out of the fair value through other comprehensive revenue and expense~~income~~ measurement category, the entity shall account for the cumulative gain or loss that was previously recognised in other comprehensive revenue and expense~~income~~ in accordance with paragraphs 98~~5.6.5~~ and 100~~5.6.7~~. Interest calculated using the effective interest method is recognised in ~~profit or loss~~surplus or deficit.**

112.~~5.7.11~~ **As described in paragraph 111~~5.7.10~~, if a financial asset is measured at fair value through other comprehensive revenue and expense~~income~~ in accordance with paragraph 41~~4.1.2A~~, the amounts that are recognised in ~~profit or loss~~surplus or deficit are the same as the amounts that would have been recognised in ~~profit or loss~~surplus or deficit if the financial asset had been measured at amortised cost.**

~~Chapter 6~~ Hedge Accounting

~~6.1~~ Objective and Scope of Hedge Accounting

113.~~6.1.1~~ The objective of hedge accounting is to represent, in the financial statements, the effect of an entity's risk management activities that use financial instruments to manage exposures arising from particular risks that could affect ~~profit or loss~~surplus or deficit (or other comprehensive revenue and expense~~income~~, in the case of investments in equity instruments for which an entity has elected to present changes in fair value in other comprehensive revenue and expense~~income~~ in accordance with paragraph 106~~5.7.5~~). This approach aims to convey the context of hedging instruments for which hedge accounting is applied in order to allow insight into their purpose and effect.

114.~~6.1.2~~ An entity may choose to designate a hedging relationship between a hedging instrument and a hedged item in accordance with paragraphs 116–128~~6.2.1–6.3.7~~ and AG244–AG274~~B6.2.1–B6.3.25~~. For hedging relationships that meet the qualifying criteria, an entity shall account for the gain or loss on the hedging instrument and the hedged item in accordance with paragraphs 130–143~~6.5.1–6.5.14~~ and AG294–AG321B6.5.1–B6.5.28. When the hedged item is a group of items, an entity shall comply with the additional requirements in paragraphs 146–151~~6.6.1–6.6.6~~ and AG333–AG348~~B6.6.1–B6.6.16~~.

115.~~6.1.3~~ For a fair value hedge of the interest rate exposure of a portfolio of financial assets or financial liabilities (and only for such a hedge), an entity may apply the hedge accounting requirements in PBE IPSAS 29~~IAS 39~~ instead of those in this Standard. In that case, the entity must also apply the specific requirements for the fair value hedge accounting for a portfolio hedge of interest rate risk and designate as the hedged item a portion that is a currency amount (see paragraphs 91~~81A~~, 100~~89A~~ and AG157–AG175~~AG114–AG132~~ of PBE IPSAS 29~~IAS 39~~).

~~6.2~~ Hedging Instruments

Qualifying Instruments

116.~~6.2.1~~ **A derivative measured at fair value through ~~profit or loss~~surplus or deficit may be designated as a hedging instrument, except for some written options (see paragraph AG247~~B6.2.4~~).**

117.~~6.2.2~~ **A non-derivative financial asset or a non-derivative financial liability measured at fair value through ~~profit or loss~~surplus or deficit may be designated as a hedging instrument unless it is a financial liability designated as at fair value through ~~profit or loss~~surplus or deficit for which the amount of its change in fair value that is attributable to changes in the credit risk of that liability is presented in other comprehensive ~~income~~revenue and expense in accordance with paragraph 108~~5.7.7~~. For a hedge of foreign currency risk, the foreign currency risk component of a non-derivative financial asset or a non-derivative financial liability may be designated as a hedging instrument provided that it is not an investment in an equity instrument for which an entity has elected to present changes in fair value in other comprehensive ~~income~~revenue and expense in accordance with paragraph 106~~5.7.5~~.**

118.~~6.2.3~~ **For hedge accounting purposes, only contracts with a party external to the reporting entity (i.e., external to the group or individual entity that is being reported on) can be designated as hedging instruments.**

Designation of Hedging Instruments

119.~~6.2.4~~ A qualifying instrument must be designated in its entirety as a hedging instrument. The only exceptions permitted are:

(a) Separating the intrinsic value and time value of an option contract and designating as the hedging instrument only the change in intrinsic value of an option and not the change in its time value (see paragraphs 144~~6.5.15~~ and AG322~~B6.5.29~~–AG326~~B6.5.33~~);

(b) Separating the forward element and the spot element of a forward contract and designating as the hedging instrument only the change in the value of the spot element of a forward contract and not the forward element; similarly, the foreign currency basis spread may be separated and excluded from the designation of a financial instrument as the hedging instrument (see paragraphs 145~~6.5.16~~ and AG327–AG332~~B6.5.34–B6.5.39~~); and

(c) A proportion of the entire hedging instrument, such as 50 per cent of the nominal amount, may be designated as the hedging instrument in a hedging relationship. However, a hedging instrument may not be designated for a part of its change in fair value that results from only a portion of the time period during which the hedging instrument remains outstanding.

120.~~6.2.5~~ An entity may view in combination, and jointly designate as the hedging instrument, any combination of the following (including those circumstances in which the risk or risks arising from some hedging instruments offset those arising from others):

(a) Derivatives or a proportion of them; and

(b) Non-derivatives or a proportion of them.

121.~~6.2.6~~ However, a derivative instrument that combines a written option and a purchased option (for example, an interest rate collar) does not qualify as a hedging instrument if it is, in effect, a net written option at the date of designation (unless it qualifies in accordance with paragraph AG247~~B6.2.4~~). Similarly, two or more instruments (or proportions of them) may be jointly designated as the hedging instrument only if, in combination, they are not, in effect, a net written option at the date of designation (unless it qualifies in accordance with paragraph AG247~~B6.2.4~~).

~~6.3~~ Hedged Items

Qualifying Items

122.~~6.3.1~~ **A hedged item can be a recognised asset or liability, an unrecognised firm commitment, a forecast transaction or a net investment in a foreign operation. The hedged item can be:**

(a) **A single item; or**

(b) **A group of items (subject to paragraphs 146–151~~6.6.1–6.6.6~~ and AG333–AG348~~B6.6.1–B6.6.16~~).**

A hedged item can also be a component of such an item or group of items (see paragraphs 128~~6.3.7~~ and AG256–AG274~~B6.3.7–B6.3.25~~).

123.~~6.3.2~~ **The hedged item must be reliably measurable.**

124.~~6.3.3~~ **If a hedged item is a forecast transaction (or a component thereof), that transaction must be highly probable.**

125.~~6.3.4~~ **An aggregated exposure that is a combination of an exposure that could qualify as a hedged item in accordance with paragraph 122~~6.3.1~~ and a derivative may be designated as a hedged item (see paragraphs AG252–AG253~~B6.3.3–B6.3.4~~). This includes a forecast transaction of an aggregated exposure (i.e., uncommitted but anticipated future transactions that would give rise to an exposure and a derivative) if that aggregated exposure is highly probable and, once it has occurred and is therefore no longer forecast, is eligible as a hedged item.**

126.~~6.3.5~~ **For hedge accounting purposes, only assets, liabilities, firm commitments or highly probable forecast transactions with a party external to the reporting entity can be designated as hedged items. Hedge accounting can be applied to transactions between entities in the same economic entity~~group~~ only in the individual or separate financial statements of those entities and not in the consolidated financial statements of the economic entity~~group~~, except for:**

(a) **The consolidated financial statements of an investment entity, as defined in PBE IPSAS 35~~IFRS 10~~, where transactions between an investment entity and its controlled entities~~subsidiaries~~ measured at fair value through ~~profit or loss~~surplus or deficit will not be eliminated in the consolidated financial statements~~.~~; or**

(b) **The consolidated financial statements of a controlling entity of an investment entity, as defined in PBE IPSAS 35, that is not itself an investment entity, where transactions between a controlled investment entity and the investments of a controlled investment entity measured at fair value through surplus or deficit will not be eliminated in the consolidated financial statements.**

127.~~6.3.6~~ However, as an exception to paragraph 126~~6.3.5~~, the foreign currency risk of a~~n~~ ~~intragroup~~ monetary item within an economic entity (for example, a payable/receivable between two controlled entities~~subsidiaries~~) may qualify as a hedged item in the consolidated financial statements if it results in an exposure to foreign exchange rate gains or losses that are not fully eliminated on consolidation in accordance with PBE IPSAS 4~~IAS 21~~ *The Effects of Changes in Foreign Exchange Rates*. In accordance with PBE IPSAS 4~~IAS 21~~, foreign exchange rate gains and losses on ~~intragroup~~ monetary items within an economic entity are not fully eliminated on consolidation when the ~~intragroup~~ monetary item is transacted between two ~~group~~ entities within the economic entity that have different functional currencies. In addition, the foreign currency risk of a highly probable forecast ~~intragroup~~ transaction within the economic entity may qualify as a hedged item in consolidated financial statements provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated ~~profit or loss~~surplus or deficit.

Designation of Hedged Items

128.~~6.3.7~~ An entity may designate an item in its entirety or a component of an item as the hedged item in a hedging relationship. An entire item comprises all changes in the cash flows or fair value of an item. A component comprises less than the entire fair value change or cash flow variability of an item. In that case, an entity may designate only the following types of components (including combinations) as hedged items:

(a) Only changes in the cash flows or fair value of an item attributable to a specific risk or risks (risk component), provided that, based on an assessment within the context of the particular market structure, the risk component is separately identifiable and reliably measurable (see paragraphs AG257–AG264~~B6.3.8–B6.3.15~~). Risk components include a designation of only changes in the cash flows or the fair value of a hedged item above or below a specified price or other variable (a one-sided risk).

(b) One or more selected contractual cash flows.

(c) Components of a nominal amount, i.e., a specified part of the amount of an item (see paragraphs AG265–AG269~~B6.3.16–B6.3.20~~).

~~6.4~~ Qualifying Criteria for Hedge Accounting

129.~~6.4.1~~ **A hedging relationship qualifies for hedge accounting only if all of the following criteria are met:**

(a) **The hedging relationship consists only of eligible hedging instruments and eligible hedged items.**

(b) **At the inception of the hedging relationship there is formal designation and documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge. That documentation shall include identification of the hedging instrument, the hedged item, the nature of the risk being hedged and how the entity will assess whether the hedging relationship meets the hedge effectiveness requirements (including its analysis of the sources of hedge ineffectiveness and how it determines the hedge ratio).**

(c) **The hedging relationship meets all of the following hedge effectiveness requirements:**

(i) **There is an economic relationship between the hedged item and the hedging instrument (see paragraphs AG278–AG280~~B6.4.4–B6.4.6~~);**

(ii) **The effect of credit risk does not dominate the value changes that result from that economic relationship (see paragraphs AG281–AG282~~B6.4.7–B6.4.8~~); and**

(iii) **The hedge ratio of the hedging relationship is the same as that resulting from the quantity of the hedged item that the entity actually hedges and the quantity of the hedging instrument that the entity actually uses to hedge that quantity of hedged item. However, that designation shall not reflect an imbalance between the weightings of the hedged item and the hedging instrument that would create hedge ineffectiveness (irrespective of whether recognised or not) that could result in an accounting outcome that would be inconsistent with the purpose of hedge accounting (see paragraphs AG283–AG285~~B6.4.9–B6.4.11~~).**

~~6.5~~ Accounting for Qualifying Hedging Relationships

130.~~6.5.1~~ **An entity applies hedge accounting to hedging relationships that meet the qualifying criteria in paragraph 129~~6.4.1~~ (which include the entity's decision to designate the hedging relationship).**

131.~~6.5.2~~ **There are three types of hedging relationships:**

(a) **Fair value hedge: a hedge of the exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, or a component of any such item, that is attributable to a particular risk and could affect ~~profit or loss~~surplus or deficit.**

(b) **Cash flow hedge: a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with all, or a component of, a recognised asset or liability (such as all or some future interest payments on variable-rate debt) or a highly probable forecast transaction, and could affect ~~profit or loss~~surplus or deficit.**

(c) **Hedge of a net investment in a foreign operation as defined in PBE IPSAS 4~~IAS 21~~.**

132.~~6.5.3~~ If the hedged item is an equity instrument for which an entity has elected to present changes in fair value in other comprehensive ~~income~~revenue and expense in accordance with paragraph 106~~5.7.5~~, the hedged exposure referred to in paragraph 131~~6.5.2~~(a) must be one that could affect other comprehensive ~~income~~revenue and expense. In that case, and only in that case, the recognised hedge ineffectiveness is presented in other comprehensive ~~income~~revenue and expense.

133.~~6.5.4~~ A hedge of the foreign currency risk of a firm commitment may be accounted for as a fair value hedge or a cash flow hedge.

134.~~6.5.5~~ **If a hedging relationship ceases to meet the hedge effectiveness requirement relating to the hedge ratio (see paragraph 129~~6.4.1~~(c)(iii)) but the risk management objective for that designated hedging relationship remains the same, an entity shall adjust the hedge ratio of the hedging relationship so that it meets the qualifying criteria again (this is referred to in this Standard as 'rebalancing'—see paragraphs AG300–AG314~~B6.5.7–B6.5.21~~).**

135.~~6.5.6~~ **An entity shall discontinue hedge accounting prospectively only when the hedging relationship (or a part of a hedging relationship) ceases to meet the qualifying criteria (after taking into account any rebalancing of the hedging relationship, if applicable). This includes instances when the hedging instrument expires or is sold, terminated or exercised. For this purpose, the replacement or rollover of a hedging instrument into another hedging instrument is not an expiration or termination if such a replacement or rollover is part of, and consistent with, the entity's documented risk management objective. Additionally, for this purpose there is not an expiration or termination of the hedging instrument if:**

(a) **As a consequence of laws or regulations or the introduction of laws or regulations, the parties to the hedging instrument agree that one or more clearing counterparties replace their original counterparty to become the new counterparty to each of the parties. For this purpose, a clearing counterparty is a central counterparty (sometimes called a 'clearing organisation' or 'clearing agency') or an entity or entities, for example, a clearing member of a clearing organisation or a client of a clearing member of a clearing organisation, that are acting as a counterparty in order to effect clearing by a central counterparty. However, when the parties to the hedging instrument replace their original counterparties with different counterparties the requirement in this subparagraph is met only if each of those parties effects clearing with the same central counterparty.**

(b) **Other changes, if any, to the hedging instrument are limited to those that are necessary to effect such a replacement of the counterparty. Such changes are limited to those that are consistent with the terms that would be expected if the hedging instrument were originally cleared with the clearing counterparty. These changes include changes in the collateral requirements, rights to offset receivables and payables balances, and charges levied.**

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

136.~~6.5.7~~ An entity shall apply:

(a) Paragraph 139~~6.5.10~~ when it discontinues hedge accounting for a fair value hedge for which the hedged item is (or is a component of) a financial instrument measured at amortised cost; and

(b) Paragraph 141~~6.5.12~~ when it discontinues hedge accounting for cash flow hedges.

Fair Value Hedges

137.~~6.5.8~~ **As long as a fair value hedge meets the qualifying criteria in paragraph 129~~6.4.1~~, the hedging relationship shall be accounted for as follows:**

(a) **The gain or loss on the hedging instrument shall be recognised in ~~profit or loss~~surplus or deficit (or other comprehensive ~~income~~revenue and expense, if the hedging instrument hedges an equity instrument for which an entity has elected to present changes in fair value in other comprehensive ~~income~~revenue and expense in accordance with paragraph 106~~5.7.5~~).**

(b) **The hedging gain or loss on the hedged item shall adjust the carrying amount of the hedged item (if applicable) and be recognised in ~~profit or loss~~surplus or deficit. If the hedged item is a financial asset (or a component thereof) that is measured at fair value through other comprehensive ~~income~~revenue and expense in accordance with paragraph 41~~4.1.2A~~, the hedging gain or loss on the hedged item shall be recognised in ~~profit or loss~~surplus or deficit. However, if the hedged item is an equity instrument for which an entity has elected to present changes in fair value in other comprehensive ~~income~~revenue and expense in accordance with paragraph 106~~5.7.5~~, those amounts shall remain in other comprehensive ~~income~~revenue and expense. When a hedged item is an unrecognised firm commitment (or a component thereof), the cumulative change in the fair value of the hedged item subsequent to its designation is recognised as an asset or a liability with a corresponding gain or loss recognised in ~~profit or loss~~surplus or deficit.**

138.~~6.5.9~~ When a hedged item in a fair value hedge is a firm commitment (or a component thereof) to acquire an asset or assume a liability, the initial carrying amount of the asset or the liability that results from the entity meeting the firm commitment is adjusted to include the cumulative change in the fair value of the hedged item that was recognised in the statement of financial position.

139.~~6.5.10~~ Any adjustment arising from paragraph 137~~6.5.8~~(b) shall be amortised to ~~profit or loss~~surplus or deficit if the hedged item is a financial instrument (or a component thereof) measured at amortised cost. Amortisation may begin as soon as an adjustment exists and shall begin no later than when the hedged item ceases to be adjusted for hedging gains and losses. The amortisation is based on a recalculated effective interest rate at the date that amortisation begins. In the case of a financial asset (or a component thereof) that is a hedged item and that is measured at fair value through other comprehensive ~~income~~revenue and expense in accordance with paragraph 41~~4.1.2A~~, amortisation applies in the same manner but to the amount that represents the cumulative gain or loss previously recognised in accordance with paragraph 137~~6.5.8~~(b) instead of by adjusting the carrying amount.

Cash Flow Hedges

140.~~6.5.11~~ **As long as a cash flow hedge meets the qualifying criteria in paragraph 129~~6.4.1~~, the hedging relationship shall be accounted for as follows:**

(a) **The separate component of net assets/equity associated with the hedged item (cash flow hedge reserve) is adjusted to the lower of the following (in absolute amounts):**

(i) **The cumulative gain or loss on the hedging instrument from inception of the hedge; and**

(ii) **The cumulative change in fair value (present value) of the hedged item (i.e., the present value of the cumulative change in the hedged expected future cash flows) from inception of the hedge.**

(b) **The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge (i.e., the portion that is offset by the change in the cash flow hedge reserve calculated in accordance with (a)) shall be recognised in other comprehensive ~~income~~revenue and expense.**

(c) **Any remaining gain or loss on the hedging instrument (or any gain or loss required to balance the change in the cash flow hedge reserve calculated in accordance with (a)) is hedge ineffectiveness that shall be recognised in ~~profit or loss~~surplus or deficit.**

(d) **The amount that has been accumulated in the cash flow hedge reserve in accordance with (a) shall be accounted for as follows:**

(i) **If a hedged forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, or a hedged forecast transaction for a non-financial asset or a non-financial liability becomes a firm commitment for which fair value hedge accounting is applied, the entity shall remove that amount from the cash flow hedge reserve and include it directly in the initial cost or other carrying amount of the asset or the liability. This is not a reclassification adjustment (see PBE IPSAS 1~~IAS 1~~) and hence it does not affect other comprehensive ~~income~~revenue and expense.**

(ii) **For cash flow hedges other than those covered by (i), that amount shall be reclassified from the cash flow hedge reserve to ~~profit or loss~~surplus or deficit as a reclassification adjustment (see paragraphs 125A–125C of PBE IPSAS 1~~IAS 1~~) in the same period or periods during which the hedged expected future cash flows affect ~~profit or loss~~surplus or deficit (for example, in the periods that interest revenue~~income~~ or interest expense is recognised or when a forecast sale occurs).**

(iii) **However, if that amount is a loss and an entity expects that all or a portion of that loss will not be recovered in one or more future periods, it shall immediately reclassify the amount that is not expected to be recovered into ~~profit or loss~~surplus or deficit as a reclassification adjustment (see paragraphs 125A–125C of PBE IPSAS 1~~IAS 1~~).**

141.~~6.5.12~~ When an entity discontinues hedge accounting for a cash flow hedge (see paragraphs 135~~6.5.6~~ and 136~~6.5.7~~(b)) it shall account for the amount that has been accumulated in the cash flow hedge reserve in accordance with paragraph 140~~6.5.11~~(a) as follows:

(a) If the hedged future cash flows are still expected to occur, that amount shall remain in the cash flow hedge reserve until the future cash flows occur or until paragraph 140~~6.5.11~~(d)(iii) applies. When the future cash flows occur, paragraph 140~~6.5.11~~(d) applies.

(b) If the hedged future cash flows are no longer expected to occur, that amount shall be immediately reclassified from the cash flow hedge reserve to ~~profit or loss~~surplus or deficit as a reclassification adjustment (see PBE IPSAS 1~~IAS 1~~). A hedged future cash flow that is no longer highly probable to occur may still be expected to occur.

Hedges of a Net Investment in a Foreign Operation

142.~~6.5.13~~ **Hedges of a net investment in a foreign operation, including a hedge of a monetary item that is accounted for as part of the net investment (see PBE IPSAS 4~~IAS 21~~), shall be accounted for similarly to cash flow hedges:**

(a) **The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge shall be recognised in other comprehensive ~~income~~revenue and expense (see paragraph 140~~6.5.11~~); and**

(b) **The ineffective portion shall be recognised in ~~profit or loss~~surplus or deficit.**

143.~~6.5.14~~ **The cumulative gain or loss on the hedging instrument relating to the effective portion of the hedge that has been accumulated in the foreign currency translation reserve shall be reclassified from net assets/equity to ~~profit or loss~~surplus or deficit as a reclassification adjustment (see PBE IPSAS 1~~IAS 1~~) in accordance with paragraphs 57–58~~48–49~~ of PBE IPSAS 4~~IAS 21~~ on the disposal or partial disposal of the foreign operation.**

Accounting for the Time Value of Options

144.~~6.5.15~~ When an entity separates the intrinsic value and time value of an option contract and designates as the hedging instrument only the change in intrinsic value of the option (see paragraph 119~~6.2.4~~(a)), it shall account for the time value of the option as follows (see paragraphs AG322–AG326~~B6.5.29–B6.5.33~~):

(a) An entity shall distinguish the time value of options by the type of hedged item that the option hedges (see paragraph AG322~~B6.5.29~~):

(i) A transaction related hedged item; or

(ii) A time-period related hedged item.

(b) The change in fair value of the time value of an option that hedges a transaction related hedged item shall be recognised in other comprehensive ~~income~~revenue and expense to the extent that it relates to the hedged item and shall be accumulated in a separate component of net assets/equity. The cumulative change in fair value arising from the time value of the option that has been accumulated in a separate component of net assets/equity (the 'amount') shall be accounted for as follows:

(i) If the hedged item subsequently results in the recognition of a non-financial asset or a non-financial liability, or a firm commitment for a non-financial asset or a non-financial liability for which fair value hedge accounting is applied, the entity shall remove the amount from the separate component of net assets/equity and include it directly in the initial cost or other carrying amount of the asset or the liability. This is not a reclassification adjustment (see PBE IPSAS 1~~IAS 1~~) and hence does not affect other comprehensive ~~income~~revenue and expense.

(ii) For hedging relationships other than those covered by (i), the amount shall be reclassified from the separate component of net assets/equity to ~~profit or loss~~surplus or deficit as a reclassification adjustment (see PBE IPSAS 1~~IAS 1~~) in the same period or periods during which the hedged expected future cash flows affect ~~profit or loss~~surplus or deficit (for example, when a forecast sale occurs).

(iii) However, if all or a portion of that amount is not expected to be recovered in one or more future periods, the amount that is not expected to be recovered shall be immediately reclassified into ~~profit or loss~~surplus or deficit as a reclassification adjustment (see PBE IPSAS 1~~IAS 1~~).

(c) The change in fair value of the time value of an option that hedges a time-period related hedged item shall be recognised in other comprehensive ~~income~~revenue and expense to the extent that it relates to the hedged item and shall be accumulated in a separate component of net assets/equity. The time value at the date of designation of the option as a hedging instrument, to the extent that it relates to the hedged item, shall be amortised on a systematic and rational basis over the period during which the hedge adjustment for the option's intrinsic value could affect ~~profit or~~

~~loss~~surplus or deficit (or other comprehensive ~~income~~revenue and expense, if the hedged item is an equity instrument for which an entity has elected to present changes in fair value in other comprehensive ~~income~~revenue and expense in accordance with paragraph 106~~5.7.5~~). Hence, in each reporting period, the amortisation amount shall be reclassified from the separate component of net assets/equity to ~~profit or loss~~surplus or deficit as a reclassification adjustment (see PBE IPSAS 1~~IAS 1~~). However, if hedge accounting is discontinued for the hedging relationship that includes the change in intrinsic value of the option as the hedging instrument, the net amount (i.e., including cumulative amortisation) that has been accumulated in the separate component of net assets/equity shall be immediately reclassified into ~~profit or loss~~surplus or deficit as a reclassification adjustment (see PBE IPSAS 1~~IAS 1~~).

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

145.~~6.5.16~~ When an entity separates the forward element and the spot element of a forward contract and designates as the hedging instrument only the change in the value of the spot element of the forward contract, or when an entity separates the foreign currency basis spread from a financial instrument and excludes it from the designation of that financial instrument as the hedging instrument (see paragraph 119~~6.2.4~~(b)), the entity may apply paragraph 144~~6.5.15~~ to the forward element of the forward contract or to the foreign currency basis spread in the same manner as it is applied to the time value of an option. In that case, the entity shall apply the application guidance in paragraphs AG327–AG332~~B6.5.34–B6.5.39~~.

~~6.6~~ Hedges of a Group of Items

Eligibility of a Group of Items as the Hedged Item

146.~~6.6.1~~ **A group of items (including a group of items that constitute a net position; see paragraphs AG333–AG340~~B6.6.1–B6.6.8~~) is an eligible hedged item only if:**

(a) **It consists of items (including components of items) that are, individually, eligible hedged items;**

(b) **The items in the group are managed together on a group basis for risk management purposes; and**

(c) **In the case of a cash flow hedge of a group of items whose variabilities in cash flows are not expected to be approximately proportional to the overall variability in cash flows of the group so that offsetting risk positions arise:**

(i) **It is a hedge of foreign currency risk; and**

(ii) **The designation of that net position specifies the reporting period in which the forecast transactions are expected to affect ~~profit or loss~~surplus or deficit, as well as their nature and volume (see paragraphs AG339–AG340~~B6.6.7–B6.6.8~~).**

Designation of a Component of a Nominal Amount

147.~~6.6.2~~ A component that is a proportion of an eligible group of items is an eligible hedged item provided that designation is consistent with the entity's risk management objective.

148.~~6.6.3~~ A layer component of an overall group of items (for example, a bottom layer) is eligible for hedge accounting only if:

(a) It is separately identifiable and reliably measurable;

(b) The risk management objective is to hedge a layer component;

(c) The items in the overall group from which the layer is identified are exposed to the same hedged risk (so that the measurement of the hedged layer is not significantly affected by which particular items from the overall group form part of the hedged layer);

(d) For a hedge of existing items (for example, an unrecognised firm commitment or a recognised asset) an entity can identify and track the overall group of items from which the hedged layer is defined (so that the entity is able to comply with the requirements for the accounting for qualifying hedging relationships); and

(e) Any items in the group that contain prepayment options meet the requirements for components of a nominal amount (see paragraph AG269~~B6.3.20~~).

Presentation

149.~~6.6.4~~ For a hedge of a group of items with offsetting risk positions (i.e., in a hedge of a net position) whose hedged risk affects different line items in the statement of ~~profit or loss~~surplus or deficit and other comprehensive ~~income~~revenue and expense, any hedging gains or losses in that statement shall be presented in a separate line from those affected by the hedged items. Hence, in that statement the amount in the line item that relates to the hedged item itself (for example, revenue or expenses~~cost of sales~~) remains unaffected.

150.~~6.6.5~~ For assets and liabilities that are hedged together as a group in a fair value hedge, the gain or loss in the statement of financial position on the individual assets and liabilities shall be recognised as an adjustment of the carrying amount of the respective individual items comprising the group in accordance with paragraph 137~~6.5.8~~(b).

Nil Net Positions

151.~~6.6.6~~ When the hedged item is a group that is a nil net position (i.e., the hedged items among themselves fully offset the risk that is managed on a group basis), an entity is permitted to designate it in a hedging relationship that does not include a hedging instrument, provided that:

(a) The hedge is part of a rolling net risk hedging strategy, whereby the entity routinely hedges new positions of the same type as time moves on (for example, when transactions move into the time horizon for which the entity hedges);

(b) The hedged net position changes in size over the life of the rolling net risk hedging strategy and the entity uses eligible hedging instruments to hedge the net risk (i.e., when the net position is not nil);

(c) Hedge accounting is normally applied to such net positions when the net position is not nil and it is hedged with eligible hedging instruments; and

(d) Not applying hedge accounting to the nil net position would give rise to inconsistent accounting outcomes, because the accounting would not recognise the offsetting risk positions that would otherwise be recognised in a hedge of a net position.

~~6.7~~ Option to Designate a Credit Exposure as Measured at Fair Value Through ~~profit or loss~~Surplus or Deficit

Eligibility of Credit Exposures for Designation at Fair Value Through ~~profit or loss~~Surplus or Deficit

152.~~6.7.1~~ **If an entity uses a credit derivative that is measured at fair value through ~~profit or loss~~surplus or deficit to manage the credit risk of all, or a part of, a financial instrument (credit exposure) it may designate that financial instrument to the extent that it is so managed (i.e., all or a proportion of it) as measured at fair value through ~~profit or loss~~surplus or deficit if:**

(a) **The name of the credit exposure (for example, the borrower, or the holder of a loan commitment) matches the reference entity of the credit derivative ('name matching'); and**

(b) **The seniority of the financial instrument matches that of the instruments that can be delivered in accordance with the credit derivative.**

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

Accounting for Credit Exposures Designated at Fair Value Through ~~Profit or Loss~~Surplus or Deficit

153.~~6.7.2~~ If a financial instrument is designated in accordance with paragraph 152~~6.7.1~~ as measured at fair value through ~~profit or loss~~surplus or deficit after its initial recognition, or was previously not recognised, the difference at the time of designation between the carrying amount, if any, and the fair value shall immediately be recognised in ~~profit or loss~~surplus or deficit. For financial assets measured at fair value through other comprehensive ~~income~~revenue and expense in accordance with paragraph 41~~4.1.2A~~, the cumulative gain or loss previously recognised in other comprehensive ~~income~~revenue and expense shall immediately be reclassified from net assets/equity to ~~profit or loss~~surplus or deficit as a reclassification adjustment (see PBE IPSAS 1~~IAS 1~~).

154.~~6.7.3~~ An entity shall discontinue measuring the financial instrument that gave rise to the credit risk, or a proportion of that financial instrument, at fair value through ~~profit or loss~~surplus or deficit if:

(a) The qualifying criteria in paragraph 152~~6.7.1~~ are no longer met, for example:

(i) The credit derivative or the related financial instrument that gives rise to the credit risk expires or is sold, terminated or settled; or

(ii) The credit risk of the financial instrument is no longer managed using credit derivatives. For example, this could occur because of improvements in the credit quality of the borrower or the loan commitment holder or changes to capital requirements imposed on an entity; and

(b) The financial instrument that gives rise to the credit risk is not otherwise required to be measured at fair value through ~~profit or loss~~surplus or deficit (i.e., the entity's management~~business~~ model has not changed in the meantime so that a reclassification in accordance with paragraph 54~~4.4.1~~ was required).

155.~~6.7.4~~ When an entity discontinues measuring the financial instrument that gives rise to the credit risk, or a proportion of that financial instrument, at fair value through ~~profit or loss~~surplus or deficit, that financial instrument's fair value at the date of discontinuation becomes its new carrying amount. Subsequently, the same measurement that was used before designating the financial instrument at fair value through ~~profit or loss~~surplus or deficit shall be applied (including amortisation that results from the new carrying amount). For example, a financial asset that had originally been classified as measured at amortised cost would revert to that measurement and its effective interest rate would be recalculated based on its new gross carrying amount on the date of discontinuing measurement at fair value through ~~profit or loss~~surplus or deficit.

~~Chapter 7~~ Effective Date and Transition

~~7.1~~ Effective Date

156.~~7.1.1~~ An entity shall apply this Standard for annual periods beginning on or after 1 January 2022~~2018~~. Earlier application is permitted. If an entity elects to apply this Standard early, it must disclose that fact and apply all of the requirements in this Standard at the same time (but see also paragraph~~s~~ 179~~7.1.2, 7.2.21~~ and 184.3~~7.3.2~~). It shall also, at the same time, apply the amendments in Appendix ~~C~~D.

157 [Not used.] [Paragraph 157 of IPSAS 41 refers to IPSAS 33 *First-time Adoption* ....]

~~7.1.2 Despite the requirements in paragraph 7.1.1, for annual periods beginning before 1 January 2018, an entity may elect to early apply only the requirements for the presentation of gains and losses on financial liabilities designated as at fair value through profit or loss in paragraphs 5.7.1(c), 5.7.7–5.7.9, 7.2.14 and B5.7.5–B5.7.20 without applying the other requirements in this Standard. If an entity elects to apply only those paragraphs, it shall disclose that fact and provide on an ongoing basis the related disclosures set out in paragraphs 10–11 of IFRS 7~~ ~~*Financial Instruments: Disclosures*~~ ~~(as amended by IFRS 9 (2010)). (See also paragraphs 7.2.2 and 7.2.15.)~~

~~7.1.3~~ ~~*Annual Improvements to IFRSs 2010–2012 Cycle*~~~~, issued in December 2013, amended paragraphs 4.2.1 and 5.7.5 as a consequential amendment derived from the amendment to IFRS 3. An entity shall apply that amendment prospectively to business combinations to which the amendment to IFRS 3 applies.~~

~~7.1.4 IFRS 15, issued in May 2014, amended paragraphs 3.1.1, 4.2.1, 5.1.1, 5.2.1, 5.7.6, B3.2.13, B5.7.1, C5 and C42 and deleted paragraph C16 and its related heading. Paragraphs 5.1.3 and 5.7.1A, and a definition to Appendix A, were added. An entity shall apply those amendments when it applies IFRS 15.~~

~~7.1.5 IFRS 16, issued in January 2016, amended paragraphs 2.1, 5.5.15, B4.3.8, B5.5.34 and B5.5.46. An entity shall apply those amendments when it applies IFRS 16.~~

~~7.1.6 IFRS 17, issued in May 2017, amended paragraphs 2.1, B2.1, B2.4, B2.5 and B4.1.30, and added paragraph 3.3.5. An entity shall apply those amendments when it applies IFRS 17.~~

~~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.~~

The cover memo (agenda item 6.1) seeks feedback on the approach to transition – we will do more work on these sections following direction from the Board.

~~7.2~~ Transition

158.~~7.2.1~~ An entity shall apply this Standard retrospectively, in accordance with PBE IPSAS 3~~IAS 8~~ *Accounting Policies, Changes in Accounting Estimates and Errors*, except as specified in paragraphs 161–184~~7.2.4–7.2.26 and 7.2.28~~. This Standard shall not be applied to items that have already been derecognised at the date of initial application.

159.~~7.2.2~~ For the purposes of the transition provisions in paragraphs 158~~7.2.1,~~ and 160–184~~7.2.3–7.2.28~~ and 184.3~~7.3.2~~, the date of initial application is the date when an entity first applies those requirements of this Standard and must be the beginning of a reporting period after the issue of this Standard. Depending on whether an entity has early adopted PBE IFRS9 *Financial Instruments*~~the entity's chosen approach to applying IFRS 9~~, the transition can involve one or more than one date of initial application for different requirements.

Transition for Classification and Measurement ~~(Chapters 4 and 5)~~

160.~~7.2.3~~ At the date of initial application, an entity shall assess whether a financial asset meets the condition in paragraphs 40~~4.1.2~~(a) or 41~~4.1.2A~~(a) on the basis of the facts and circumstances that exist at that date. The resulting classification shall be applied retrospectively irrespective of the entity's management~~business~~ model in prior reporting periods.

161.~~7.2.4~~ If, at the date of initial application, it is impracticable (as defined in PBE IPSAS 3~~IAS 8~~) for an entity to assess a modified time value of money element in accordance with paragraphs AG68–AG70~~B4.1.9B–B4.1.9D~~ on the basis of the facts and circumstances that existed at the initial recognition of the financial asset, an entity shall assess the contractual cash flow characteristics of that financial asset on the basis of the facts and circumstances that existed at the initial recognition of the financial asset without taking into account the requirements related to the modification of the time value of money element in paragraphs AG68–AG70~~B4.1.9B–B4.1.9D~~. (See also paragraph 49~~42~~R of PBE IPSAS 30~~IFRS 7~~.)

162.~~7.2.5~~ If, at the date of initial application, it is impracticable (as defined in PBE IPSAS 3~~IAS 8~~) for an entity to assess whether the fair value of a prepayment feature was insignificant in accordance with paragraph AG74~~B4.1.12~~(c) on the basis of the facts and circumstances that existed at the initial recognition of the financial asset, an entity shall assess the contractual cash flow characteristics of that financial asset on the basis of the facts and circumstances that existed at the initial recognition of the financial asset without taking into account the exception for prepayment features in paragraph AG74~~B4.1.12~~. (See also paragraph 49~~42~~S of PBE IPSAS 30~~IFRS 7~~.)

163.~~7.2.6~~ If an entity measures a hybrid contract at fair value in accordance with paragraphs 41~~4.1.2A~~, 43~~4.1.4~~ or 44~~4.1.5~~ but the fair value of the hybrid contract had not been measured in comparative reporting periods, the fair value of the hybrid contract in the comparative reporting periods shall be the sum of the fair values of the components (i.e., the non-derivative host and the embedded derivative) at the end of each comparative reporting period if the entity restates prior periods (see paragraph 173~~7.2.15~~).

164.~~7.2.7~~ If an entity has applied paragraph 163~~7.2.6~~ then at the date of initial application the entity shall recognise any difference between the fair value of the entire hybrid contract at the date of initial application and the sum of the fair values of the components of the hybrid contract at the date of initial application in the opening accumulated surplus or deficit ~~retained earnings~~ (or other component of net assets/equity, as appropriate) of the reporting period that includes the date of initial application.

165.~~7.2.8~~ At the date of initial application an entity may designate:

(a) A financial asset as measured at fair value through ~~profit or loss~~surplus or deficit in accordance with paragraph 44~~4.1.5~~; or

(b) An investment in an equity instrument as at fair value through other comprehensive ~~income~~revenue and expense in accordance with paragraph 106~~5.7.5~~.

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

166.~~7.2.9~~ At the date of initial application an entity:

(a) Shall revoke its previous designation of a financial asset as measured at fair value through ~~profit or loss~~surplus or deficit if that financial asset does not meet the condition in paragraph 44~~4.1.5~~.

(b) May revoke its previous designation of a financial asset as measured at fair value through ~~profit or loss~~surplus or deficit if that financial asset meets the condition in paragraph 44~~4.1.5~~.

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

167.~~7.2.10~~ At the date of initial application, an entity:

(a) May designate a financial liability as measured at fair value through ~~profit or loss~~surplus or deficit in accordance with paragraph 46~~4.2.2~~(a).

(b) Shall revoke its previous designation of a financial liability as measured at fair value through ~~profit or loss~~surplus or deficit if such designation was made at initial recognition in accordance with the condition now in paragraph 46~~4.2.2~~(a) and such designation does not satisfy that condition at the date of initial application.

(c) May revoke its previous designation of a financial liability as measured at fair value through ~~profit or loss~~surplus or deficit if such designation was made at initial recognition in accordance with the condition now in paragraph 46~~4.2.2~~(a) and such designation satisfies that condition at the date of initial application.

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

168.~~7.2.11~~ If it is impracticable (as defined in PBE IPSAS 3~~IAS 8~~) for an entity to apply retrospectively the effective interest method, the entity shall treat:

(a) The fair value of the financial asset or the financial liability at the end of each comparative period presented as the gross carrying amount of that financial asset or the amortised cost of that financial liability if the entity restates prior periods; and

(b) The fair value of the financial asset or the financial liability at the date of initial application as the new gross carrying amount of that financial asset or the new amortised cost of that financial liability at the date of initial application of this Standard.

169.~~7.2.12~~ If an entity previously accounted at cost (in accordance with PBE IPSAS 29~~IAS 39~~), for an investment in an equity instrument that does not have a quoted price in an active market for an identical instrument (i.e., a Level 1 input) (or for a derivative asset that is linked to and must be settled by delivery of such an equity instrument) it shall measure that instrument at fair value at the date of initial application. Any difference between the previous carrying amount and the fair value shall be recognised in the opening accumulated surplus or deficit~~retained earnings~~ (or other component of net assets/equity, as appropriate) of the reporting period that includes the date of initial application.

170.~~7.2.13~~ If an entity previously accounted for a derivative liability that is linked to, and must be settled by, delivery of an equity instrument that does not have a quoted price in an active market for an identical instrument (i.e., a Level 1 input) at cost in accordance with PBE IPSAS 29~~IAS 39~~, it shall measure that derivative liability at fair value at the date of initial application. Any difference between the previous carrying amount and the fair value shall be recognised in the opening net assets/equity~~retained earnings~~ of the reporting period that includes the date of initial application.

171.~~7.2.14~~ At the date of initial application, an entity shall determine whether the treatment in paragraph 108~~5.7.7~~ would create or enlarge an accounting mismatch in ~~profit or loss~~surplus or deficit on the basis of the facts and circumstances that exist at the date of initial application. This Standard shall be applied retrospectively on the basis of that determination.

172.~~7.2.14A~~ At the date of initial application, an entity is permitted to make the designation in paragraph 6~~2.5~~ for contracts that already exist on the date but only if it designates all similar contracts. The change in the net assets resulting from such designations shall be recognised in net assets/equity~~retained earnings~~ at the date of initial application.

173.~~7.2.15~~ Despite the requirement in paragraph 158~~7.2.1~~, an entity that adopts the classification and measurement requirements of this Standard (which include the requirements related to amortised cost measurement for financial assets and impairment in paragraphs 69–72 and paragraphs 73–93~~Sections 5.4 and 5.5~~) shall provide the disclosures set out in paragraphs 49~~42~~L–49~~42~~O of PBE IPSAS 30~~IFRS 7~~ but need not restate prior periods. The entity may restate prior periods if, and only if, it is possible without the use of hindsight. If an entity does not restate prior periods, the entity shall 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 in the opening accumulated surplus or deficit ~~retained earnings~~ (or other component of net assets/equity, as appropriate) of the annual reporting period that includes the date of initial application. However, if an entity restates prior periods, the restated financial statements must reflect all of the requirements in this Standard. If an entity's chosen approach to applying IFRS 9 results in more than one date of initial application for different requirements, this paragraph applies at each date of initial application~~ (see paragraph 7.2.2)~~. However, if an entity restates prior periods, the restated financial statements must reflect all of the requirements in this Standard. ~~This would be the case, for example, if an entity elects to early apply only the requirements for the presentation of gains and losses on financial liabilities designated as at fair value through profit or loss in accordance with paragraph 7.1.2 before applying the other requirements in this Standard.~~

174.~~7.2.16~~ If an entity prepares interim financial reports in accordance with PBE IAS 34 *Interim Financial Reporting* the entity need not apply the requirements in this Standard to interim periods prior to the date of initial application if it is impracticable (as defined in PBE IPSAS 3~~IAS 8~~).

Impairment ~~(Section 5.5)~~

175.~~7.2.17~~ An entity shall apply the impairment requirements in paragraphs 73–93~~Section 5.5~~ retrospectively in accordance with PBE IPSAS 3~~IAS 8~~ subject to paragraphs 173~~7.2.15~~ and 176–178~~7.2.18–7.2.20~~.

176.~~7.2.18~~ At the date of initial application, an entity shall use reasonable and supportable information that is available without undue cost or effort to determine the credit risk at the date that a financial instrument was initially recognised (or for loan commitments and financial guarantee contracts at the date that the entity became a party to the irrevocable commitment in accordance with paragraph 78~~5.5.6~~) and compare that to the credit risk at the date of initial application of this Standard.

177.~~7.2.19~~ When determining whether there has been a significant increase in credit risk since initial recognition, an entity may apply:

(a) The requirements in paragraphs 82~~5.5.10~~ and AG186–AG188~~B5.5.22–B5.5.24~~; and

(b) The rebuttable presumption in paragraph 83~~5.5.11~~ for contractual payments that are more than 30 days past due if an entity will apply the impairment requirements by identifying significant increases in credit risk since initial recognition for those financial instruments on the basis of past due information.

178.~~7.2.20~~ If, at the date of initial application, determining whether there has been a significant increase in credit risk since initial recognition would require undue cost or effort, an entity shall recognise a loss allowance at an amount equal to lifetime expected credit losses at each reporting date until that financial instrument is derecognised (unless that financial instrument is low credit risk at a reporting date, in which case paragraph 177~~7.2.19~~(a) applies).

Transition for Hedge Accounting ~~(Chapter 6)~~

Subject to further consideration as to whether there should be additional transitional provisions for entities that have adopted the hedge accounting requirements in PBE IFRS 9.

179.~~7.2.21~~ When an entity first applies this Standard, it may choose as its accounting policy to continue to apply the hedge accounting requirements of PBE IPSAS 29~~IAS 39~~ instead of the requirements in paragraphs 113–155~~Chapter 6~~ of this Standard. An entity shall apply that policy to all of its hedging relationships. An entity that chooses that policy shall also apply Appendix C of PBE IPSAS 29~~IFRIC 16~~ ~~*Hedges of a Net Investment in a Foreign Operation* without the amendments that conform that Interpretation to the requirements in Chapter 6 of this Standard~~.

180.~~7.2.22~~ Except as provided in paragraph 184~~7.2.26~~, an entity shall apply the hedge accounting requirements of this Standard prospectively.

181.~~7.2.23~~ To apply hedge accounting from the date of initial application of the hedge accounting requirements of this Standard, all qualifying criteria must be met as at that date.

182.~~7.2.24~~ Hedging relationships that qualified for hedge accounting in accordance with PBE IPSAS 29~~IAS 39~~ that also qualify for hedge accounting in accordance with the criteria of this Standard (see paragraph 129~~6.4.1~~), after taking into account any rebalancing of the hedging relationship on transition (see paragraph 183~~7.2.25~~(b)), shall be regarded as continuing hedging relationships.

183~~7.2.25~~ On initial application of the hedge accounting requirements of this Standard, an entity:

(a) May start to apply those requirements from the same point in time as it ceases to apply the hedge accounting requirements of PBE IPSAS 29~~IAS 39~~; and

(b) Shall consider the hedge ratio in accordance with PBE IPSAS 29~~IAS 39~~ as the starting point for rebalancing the hedge ratio of a continuing hedging relationship, if applicable. Any gain or loss from such a rebalancing shall be recognised in ~~profit or loss~~surplus or deficit.

184.~~7.2.26~~ As an exception to prospective application of the hedge accounting requirements of this Standard, an entity:

(a) Shall apply the accounting for the time value of options in accordance with paragraph 144~~6.5.15~~ retrospectively if, in accordance with PBE IPSAS 29~~IAS 39~~, only the change in an option's intrinsic value was designated as a hedging instrument in a hedging relationship. This retrospective application applies only to those hedging relationships that existed at the beginning of the earliest comparative period or were designated thereafter.

(b) May apply the accounting for the forward element of forward contracts in accordance with paragraph 145~~6.5.16~~ retrospectively if, in accordance with PBE IPSAS 29~~IAS 39~~, only the change in the spot element of a forward contract was designated as a hedging instrument in a hedging relationship. This retrospective application applies only to those hedging relationships that existed at the beginning of the earliest comparative period or were designated thereafter. In addition, if an entity elects retrospective application of this accounting, it shall be applied to all hedging relationships that qualify for this election (i.e., on transition this election is not available on a hedging-relationship-by-hedging-relationship basis). The accounting for foreign currency basis spreads (see paragraph 145~~6.5.16~~) may be applied retrospectively for those hedging relationships that existed at the beginning of the earliest comparative period or were designated thereafter.

(c) Shall apply retrospectively the requirement of paragraph 135~~6.5.6~~ that there is not an expiration or termination of the hedging instrument if:

(i) As a consequence of laws or regulations, or the introduction of laws or regulations, the parties to the hedging instrument agree that one or more clearing counterparties replace their original counterparty to become the new counterparty to each of the parties; and

(ii) Other changes, if any, to the hedging instrument are limited to those that are necessary to effect such a replacement of the counterparty.

Entities that have Applied PBE IFRS 9 ~~(2009), IFRS 9 (2010) or IFRS 9 (2013)~~ Early

184.1~~7.2.27~~ An entity shall apply the transition requirements in paragraphs 158–184~~7.2.1–7.2.26~~ at the relevant date of initial application. An entity shall apply each of the transition provisions in paragraphs 160–172~~7.2.3–7.2.14A~~ and 175–184~~7.2.17–7.2.26~~ only once (i.e., if an entity chooses an approach of applying PBE IFRS 9 that involves more than one date of initial application, it cannot apply any of those provisions again if they were already applied at an earlier date). (See paragraphs 159~~7.2.2~~ and 184.X~~7.3.2~~.)

184.2~~7.2.28~~ An entity that applied PBE IFRS 9 ~~(2009), IFRS 9 (2010) or IFRS 9 (2013)~~ and subsequently applies this Standard:

(a) Shall revoke its previous designation of a financial asset as measured at fair value through surplus or deficit~~profit or loss~~ if that designation was previously made in accordance with the condition in paragraph 44~~4.1.5~~ but that condition is no longer satisfied as a result of the application of this Standard;

(b) May designate a financial asset as measured at fair value through surplus or deficit~~profit or loss~~ if that designation would not have previously satisfied the condition in paragraph 44~~4.1.5~~ but that condition is now satisfied as a result of the application of this Standard;

(c) Shall revoke its previous designation of a financial liability as measured at fair value through surplus or deficit~~profit or loss~~ if that designation was previously made in accordance with the condition in paragraph 46~~4.2.2~~(a) but that condition is no longer satisfied as a result of the application of this Standard; and

(d) May designate a financial liability as measured at fair value through surplus or deficit~~profit or loss~~ if that designation would not have previously satisfied the condition in paragraph 46~~4.2.2~~(a) but that condition is now satisfied as a result of the application of this Standard.

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 this Standard. That classification shall be applied retrospectively.

~~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.~~

~~7.3~~ Withdrawal of ~~IFRIC 9,~~ PBE IFRS 9 ~~(2009), IFRS 9 (2010) and IFRS 9 (2013)~~

~~7.3.1 This Standard supersedes IFRIC 9 *Reassessment of Embedded Derivatives*. The requirements added to IFRS 9 in October 2010 incorporated the requirements previously set out in paragraphs 5 and 7 of IFRIC 9. As a consequential amendment, IFRS 1 *First-time Adoption of International Financial Reporting Standards* incorporated the requirements previously set out in paragraph 8 of IFRIC 9.~~

184.3~~7.3.2~~ This Standard supersedes PBE IFRS 9 ~~(2009), IFRS 9 (2010) and IFRS 9 (2013)~~. However, for annual periods beginning before 1 January 2022~~2018~~, an entity may elect to apply ~~those earlier versions of~~ PBE IFRS 9 instead of applying this Standard if, and only if, the entity's relevant date of initial application is before [proposed date to be six months after the date of issue of this Standard]~~1 February 2015~~.

~~Appendix A~~
~~Defined terms~~

~~*This appendix is an integral part of the Standard.*~~

[Not used.]

Note: The definitions are now located in paragraph 9.

Appendix ~~B~~A

Application Guidance

This Appendix is an integral part of PBE IPSAS 41~~the Standard~~.

Scope ~~(Chapter 2)~~

AG1.~~B2.1~~Some contracts require a payment based on climatic, geological or other physical variables. (Those based on climatic variables are sometimes referred to as 'weather derivatives'.) If those contracts are not within the scope of PBE IFRS 17 *Insurance Contracts*, they are within the scope of this Standard.

AG2.~~B2.2~~This Standard does not change the requirements relating to employee benefit plans that comply with the relevant international or national accounting standard on accounting and reporting by retirement benefit plans ~~IAS 26 *Accounting and Reporting by Retirement Benefit Plans*~~ and royalty agreements based on the volume of sales or service revenues that are accounted for under PBE IPSAS 9 *Revenue from Exchange Transactions* ~~IFRS 15 *Revenue from Contracts with Customers*~~.

AG3.~~B2.3~~Sometimes, an entity makes what it views as a 'strategic investment' in equity instruments issued by another entity, with the management model ~~intention~~ of establishing or maintaining a long-term operating relationship with the entity in which the investment is made. The investor or joint venturer entity uses PBE IPSAS 36~~IAS 28~~ *Investments in Associates and Joint Ventures* to determine whether the equity method of accounting shall be applied to such an investment.

AG4.~~B2.4~~This Standard applies to the financial assets and financial liabilities of insurers, other than rights and obligations that paragraph 2~~2.1~~(e) excludes because they arise under contracts within the scope of PBE IFRS 17. An entity does however apply this Standard to

(a) Financial guarantee contracts, except those where the issuer elects to treat such contracts as insurance contracts in accordance with PBE IPSAS 28; and

(b) Embedded derivatives included in insurance contracts.

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

AG5.~~B2.5~~Financial guarantee contracts may have various legal forms, such as a guarantee, some types of letter of credit, a credit default contract or an insurance contract. Their accounting treatment does not depend on their legal form. The following are examples of the appropriate treatment (see paragraph 2~~.1~~(e)):

[Need to align with PBE IFRS 17]

(a) Although a financial guarantee contract meets the definition of an insurance contract in PBE IFRS 17 (see paragraph 7(e) of PBE IFRS 17) if the risk transferred is significant, the issuer applies this Standard. Nevertheless, an entity may elect, under certain circumstances, to treat financial guarantee contracts as insurance contracts of financial instruments using PBE IPSAS 28 if the issuer has previously adopted an accounting policy that treated financial guarantee contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either this Standard or PBE IFRS 4 to such financial guarantee contracts. ~~Nevertheless, if the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting that is applicable to insurance contracts, the issuer may elect to apply either this Standard or IFRS 17 to such financial guarantee contracts.~~ If this Standard applies, paragraph 57~~5.1.1~~ requires the issuer to recognise a financial guarantee contract initially at fair value. If the financial guarantee contract was issued to an unrelated party in a stand-alone arm's length transaction, its fair value at inception is likely to equal the premium received, unless there is evidence to the contrary. Subsequently, unless the financial guarantee contract was designated at inception as at fair value through ~~profit or loss~~surplus or deficit or unless paragraphs 26–34~~3.2.15–3.2.23~~ and AG32–AG38~~B3.2.12–B3.2.17~~ apply (when a transfer of a financial asset does not qualify for derecognition or the continuing involvement approach applies), the issuer measures it at the higher of:

(i) the amount determined in accordance with paragraphs 73–93~~Section 5.5~~; and

(ii) the amount initially recognised less, when appropriate, the cumulative amortisation~~amount of income~~ recognised in accordance with the principles of PBE IPSAS 9~~IFRS 15~~ (see paragraph 45~~4.2.1~~(c)).

(b) Some credit-related guarantees do not, as a precondition for payment, require that the holder is exposed to, and has incurred a loss on, the failure of the debtor to make payments on the guaranteed asset when due. An example of such a guarantee is one that requires payments in response to changes in a specified credit rating or credit index. Such guarantees are not financial guarantee contracts as defined in this Standard, and are not insurance contracts as defined in PBE IFRS 17. Such guarantees are derivatives and the issuer applies this Standard to them.

(c) If a financial guarantee contract was issued in connection with the sale of goods, the issuer applies PBE IPSAS 9~~IFRS 15~~ in determining when it recognises the revenue from the guarantee and from the sale of goods.

~~B2.6 Assertions that an issuer regards contracts as insurance contracts are typically found throughout the issuer's communications with customers and regulators, contracts, business documentation and financial statements. Furthermore, insurance contracts are often subject to accounting requirements that are distinct from the requirements for other types of transaction, such as contracts issued by banks or commercial companies. In such cases, an issuer's financial statements typically include a statement that the issuer has used those accounting requirements.~~

AG6. Rights and obligations (assets and liabilities) may arise from non-exchange revenue transactions, for example, an entity may receive cash from a multi-lateral agency to perform certain activities. Where the performance of those activities is subject to conditions, an asset and a liability is recognised simultaneously. Where the asset is a financial asset, it is recognised in accordance with PBE IPSAS 23, and initially measured in accordance with PBE IPSAS 23 and this Standard. A liability that is initially recognised as a result of conditions imposed on the use of an asset is outside the scope of this Standard and is dealt with in PBE IPSAS 23. After initial recognition, if circumstances indicate that recognition of a liability in accordance with PBE IPSAS 23 is no longer appropriate, an entity considers whether a financial liability should be recognised in accordance with this Standard. Other liabilities that may arise from non-exchange revenue transactions are recognised and measured in accordance with this Standard if they meet the definition of a financial liability in PBE IPSAS 28.

Definitions

Derivatives

AG7.~~BA.1~~ Typical examples of derivatives are futures and forward, swap and option contracts. A derivative usually has a notional amount, which is an amount of currency, a number of shares, a number of units of weight or volume or other units specified in the contract. However, a derivative instrument does not require the holder or writer to invest or receive the notional amount at the inception of the contract. Alternatively, a derivative could require a fixed payment or payment of an amount that can change (but not proportionally with a change in the underlying) as a result of some future event that is unrelated to a notional amount. For example, a contract may require a fixed payment of CU1,000 if the six-month interbank offered rate~~LIBOR~~ increases by 100 basis points. Such a contract is a derivative even though a notional amount is not specified.

AG8.~~BA.2~~ The definition of a derivative in this Standard includes contracts that are settled gross by delivery of the underlying item (e.g., a forward contract to purchase a fixed rate debt instrument). An entity may have a contract to buy or sell a non-financial item that can be settled net in cash or another financial instrument or by exchanging financial instruments (e.g., a contract to buy or sell a commodity at a fixed price at a future date). Such a contract is within the scope of this Standard unless it was entered into and continues to be held for the purpose of delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements. However, this Standard applies to such contracts for an entity's expected purchase, sale or usage requirements if the entity makes a designation in accordance with paragraph 6~~2.5~~ (see paragraphs 5–8~~2.4–2.7~~).

AG9.~~BA.3~~ One of the defining characteristics of a derivative is that it has an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors. An option contract meets that definition because the premium is less than the investment that would be required to obtain the underlying financial instrument to which the option is linked. A currency swap that requires an initial exchange of different currencies of equal fair values meets the definition because it has a zero initial net investment.

AG10.~~BA.4~~ A regular way purchase or sale gives rise to a fixed price commitment between trade date and settlement date that meets the definition of a derivative. However, because of the short duration of the commitment it is not recognised as a derivative financial instrument. Instead, this Standard provides for special accounting for such regular way contracts (see paragraphs 11~~3.1.2~~ and AG17–20~~B3.1.3–B3.1.6~~).

AG11.~~BA.5~~ The definition of a derivative refers to non-financial variables that are not specific to a party to the contract. These include an index of earthquake losses in a particular region and an index of temperatures in a particular city. Non-financial variables specific to a party to the contract include the occurrence or non-occurrence of a fire that damages or destroys an asset of a party to the contract. A change in the fair value of a non-financial asset is specific to the owner if the fair value reflects not only changes in market prices for such assets (a financial variable) but also the condition of the specific non-financial asset held (a non-financial variable). For example, if a guarantee of the residual value of a specific car exposes the guarantor to the risk of changes in the car's physical condition, the change in that residual value is specific to the owner of the car.

Financial assets and liabilities held for trading

AG12.~~BA.6~~ Trading generally reflects active and frequent buying and selling, and financial instruments held for trading generally are used with the objective of generating a profit from short-term fluctuations in price or dealer's margin.

AG13.~~BA.7~~ Financial liabilities held for trading include:

(a) Derivative liabilities that are not accounted for as hedging instruments;

(b) Obligations to deliver financial assets borrowed by a short seller (i.e., an entity that sells financial assets it has borrowed and does not yet own);

(c) Financial liabilities that are incurred with a management model~~an intention~~ to repurchase them in the near term (e.g., a quoted debt instrument that the issuer may buy back in the near term depending on changes in its fair value); and

(d) Financial liabilities that are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking.

AG14.~~BA.8~~ The fact that a liability is used to fund trading activities does not in itself make that liability one that is held for trading.

Recognition and derecognition ~~(Chapter 3)~~

Initial recognition ~~(Section 3.1)~~

AG15.~~B3.1.1~~ As a consequence of the principle in paragraph 10 ~~3.1.1~~, an entity recognises all of its contractual rights and obligations under derivatives in its statement of financial position as assets and liabilities, respectively, except for derivatives that prevent a transfer of financial assets from being accounted for as a sale (see paragraph AG35~~B3.2.14~~). If a transfer of a financial asset does not qualify for derecognition, the transferee does not recognise the transferred asset as its asset (see paragraph AG36~~B3.2.15~~).

AG16.~~B3.1.2~~ The following are examples of applying the principle in paragraph 10~~3.1.1~~:

(a) Unconditional receivables and payables are recognised as assets or liabilities when the entity becomes a party to the contract and, as a consequence, has a legal right to receive or a legal obligation to pay cash.

(b) Assets to be acquired and liabilities to be incurred as a result of a firm commitment to purchase or sell goods or services are generally not recognised until at least one of the parties has performed under the agreement. For example, an entity that receives a firm order does not generally recognise an asset (and the entity that places the order does not recognise a liability) at the time of the commitment but, instead, delays recognition until the ordered goods or services have been shipped, delivered or rendered. If a firm commitment to buy or sell non-financial items is within the scope of this Standard in accordance with paragraphs 5–8~~2.4–2.7~~, its net fair value is recognised as an asset or a liability on the commitment date (see paragraph AG92~~B4.1.30~~(c)). In addition, if a previously unrecognised firm commitment is designated as a hedged item in a fair value hedge, any change in the net fair value attributable to the hedged risk is recognised as an asset or a liability after the inception of the hedge (see paragraphs 137~~6.5.8~~(b) and 138~~6.5.9~~).

(c) A forward contract that is within the scope of this Standard (see paragraph 2~~.1~~) is recognised as an asset or a liability on the commitment date, instead of on the date on which settlement takes place. When an entity becomes a party to a forward contract, the fair values of the right and obligation are often equal, so that the net fair value of the forward is zero. If the net fair value of the right and obligation is not zero, the contract is recognised as an asset or liability.

(d) Option contracts that are within the scope of this Standard (see paragraph 2~~.1~~) are recognised as assets or liabilities when the holder or writer becomes a party to the contract.

(e) Planned future transactions, no matter how likely, are not assets and liabilities because the entity has not become a party to a contract.

Regular way purchase or sale of financial assets

AG17.~~B3.1.3~~ A regular way purchase or sale of financial assets is recognised using either trade date accounting or settlement date accounting as described in paragraphs AG19~~B3.1.5~~ and AG20~~B3.1.6~~. An entity shall apply the same method consistently for all purchases and sales of financial assets that are classified in the same way in accordance with this Standard. For this purpose assets that are mandatorily measured at fair value through ~~profit or loss~~surplus or deficit form a separate classification from assets designated as measured at fair value through ~~profit or loss~~surplus or deficit. In addition, investments in equity instruments accounted for using the option provided in paragraph 106~~5.7.5~~ form a separate classification.

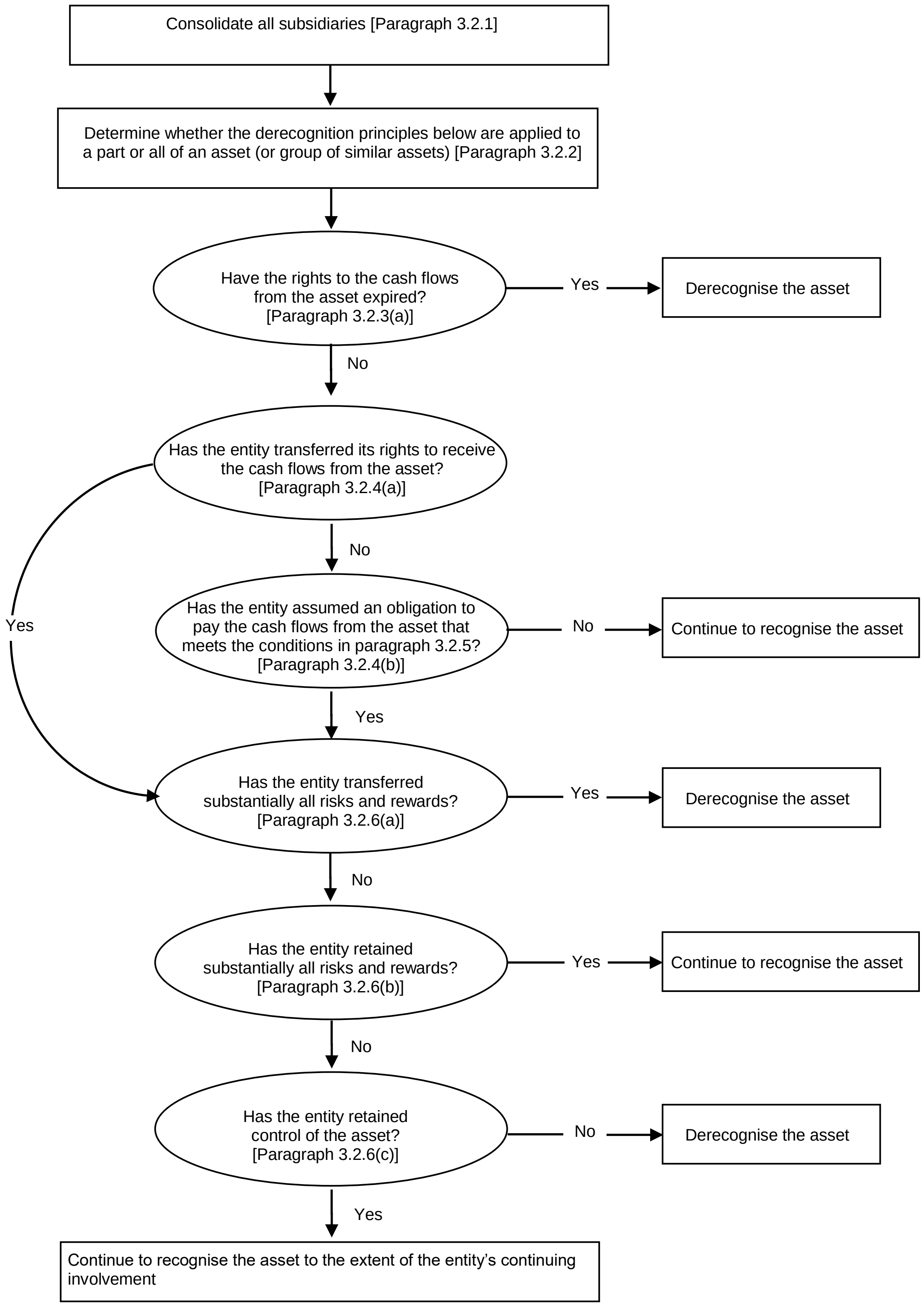
AG18.~~B3.1.4~~ A contract that requires or permits net settlement of the change in the value of the contract is not a regular way contract. Instead, such a contract is accounted for as a derivative in the period between the trade date and the settlement date.

AG19.~~B3.1.5~~ The trade date is the date that an entity commits itself to purchase or sell an asset. Trade date accounting refers to (a) the recognition of an asset to be received and the liability to pay for it on the trade date, and (b) derecognition of an asset that is sold, recognition of any gain or loss on disposal and the recognition of a receivable from the buyer for payment on the trade date. Generally, interest does not start to accrue on the asset and corresponding liability until the settlement date when title passes.

AG20.~~B3.1.6~~ The settlement date is the date that an asset is delivered to or by an entity. Settlement date accounting refers to (a) the recognition of an asset on the day it is received by the entity, and (b) the derecognition of an asset and recognition of any gain or loss on disposal on the day that it is delivered by the entity. When settlement date accounting is applied an entity accounts for any change in the fair value of the asset to be received during the period between the trade date and the settlement date in the same way as it accounts for the acquired asset. In other words, the change in value is not recognised for assets measured at amortised cost; it is recognised in ~~profit or loss~~surplus or deficit for assets classified as financial assets measured at fair value through ~~profit or loss~~surplus or deficit; and it is recognised in other comprehensive ~~income~~revenue and expense for financial assets measured at fair value through other comprehensive ~~income~~revenue and expense in accordance with paragraph 41~~4.1.2A~~ and for investments in equity instruments accounted for in accordance with paragraph 106~~5.7.5~~.

Derecognition of financial assets ~~(Section 3.2)~~

AG21.~~B3.2.1~~ [Diagram to be replaced by one from IPSAS 41] The following flow chart illustrates the evaluation of whether and to what extent a financial asset is derecognised.



Arrangements under which an entity retains the contractual rights to receive the cash flows of a financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients (paragraph 15~~3.2.4~~(b))

AG22.~~B3.2.2~~ The situation described in paragraph 15~~3.2.4~~(b) (when an entity retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients) occurs, for example, if the entity is a trust, and issues to investors beneficial interests in the underlying financial assets that it owns and provides servicing of those financial assets. In that case, the financial assets qualify for derecognition if the conditions in paragraphs 16~~3.2.5~~ and 17~~3.2.6~~ are met.

AG23.~~B3.2.3~~ In applying paragraph 16~~3.2.5~~, the entity could be, for example, the originator of the financial asset, or it could be a group that includes a subsidiary that has acquired the financial asset and passes on cash flows to unrelated third party investors.

Evaluation of the transfer of risks and rewards of ownership (paragraph 17~~3.2.6~~)

AG24.~~B3.2.4~~ Examples of when an entity has transferred substantially all the risks and rewards of ownership are:

(a) An unconditional sale of a financial asset;

(b) A sale of a financial asset together with an option to repurchase the financial asset at its fair value at the time of repurchase; and

(c) A sale of a financial asset together with a put or call option that is deeply out of the money (i.e., an option that is so far out of the money it is highly unlikely to go into the money before expiry).

AG25.~~B3.2.5~~ Examples of when an entity has retained substantially all the risks and rewards of ownership are:

(a) A sale and repurchase transaction where the repurchase price is a fixed price or the sale price plus a lender's return;

(b) A securities lending agreement;

(c) A sale of a financial asset together with a total return swap that transfers the market risk exposure back to the entity;

(d) A sale of a financial asset together with a deep in-the-money put or call option (i.e., an option that is so far in the money that it is highly unlikely to go out of the money before expiry); and

(e) A sale of short-term receivables in which the entity guarantees to compensate the transferee for credit losses that are likely to occur.

AG26.~~B3.2.6~~ If an entity determines that as a result of the transfer, it has transferred substantially all the risks and rewards of ownership of the transferred asset, it does not recognise the transferred asset again in a future period, unless it reacquires the transferred asset in a new transaction.

Evaluation of the transfer of control

AG27.~~B3.2.7~~ An entity has not retained control of a transferred asset if the transferee has the practical ability to sell the transferred asset. An entity has retained control of a transferred asset if the transferee does not have the practical ability to sell the transferred asset. A transferee has the practical ability to sell the transferred asset if it is traded in an active market because the transferee could repurchase the transferred asset in the market if it needs to return the asset to the entity. For example, a transferee may have the practical ability to sell a transferred asset if the transferred asset is subject to an option that allows the entity to repurchase it, but the transferee can readily obtain the transferred asset in the market if the option is exercised. A transferee does not have the practical ability to sell the transferred asset if the entity retains such an option and the transferee cannot readily obtain the transferred asset in the market if the entity exercises its option.

AG28.~~B3.2.8~~ The transferee has the practical ability to sell the transferred asset only if the transferee can sell the transferred asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without imposing additional restrictions on the transfer. The critical question is what the transferee is able to do in practice, not what contractual rights the transferee has concerning what it can do with the transferred asset or what contractual prohibitions exist. In particular:

(a) A contractual right to dispose of the transferred asset has little practical effect if there is no market for the transferred asset, and

(b) An ability to dispose of the transferred asset has little practical effect if it cannot be exercised freely. For that reason:

(i) The transferee's ability to dispose of the transferred asset must be independent of the actions of others (i.e., it must be a unilateral ability), and

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

AG29.~~B3.2.9~~ That the transferee is unlikely to sell the transferred asset does not, of itself, mean that the transferor has retained control of the transferred asset. However, if a put option or guarantee constrains the transferee from selling the transferred asset, then the transferor has retained control of the transferred asset. For example, if a put option or guarantee is sufficiently valuable it constrains the transferee from selling the transferred asset because the transferee would, in practice, not sell the transferred asset to a third party without attaching a similar option or other restrictive conditions. Instead, the transferee would hold the transferred asset so as to obtain payments under the guarantee or put option. Under these circumstances the transferor has retained control of the transferred asset.

Transfers that qualify for derecognition

AG30.~~B3.2.10~~ An entity may retain the right to a part of the interest payments on transferred assets as compensation for servicing those assets. The part of the interest payments that the entity would give up upon termination or transfer of the servicing contract is allocated to the servicing asset or servicing liability. The part of the interest payments that the entity would not give up is an interest-only strip receivable. For example, if the entity would not give up any interest upon termination or transfer of the servicing contract, the entire interest spread is an interest-only strip receivable. For the purposes of applying paragraph 24~~3.2.13~~, the fair values of the servicing asset and interest-only strip receivable are used to allocate the carrying amount of the receivable between the part of the asset that is derecognised and the part that continues to be recognised. If there is no servicing fee specified or the fee to be received is not expected to compensate the entity adequately for performing the servicing, a liability for the servicing obligation is recognised at fair value.

AG31.~~B3.2.11~~ When measuring the fair values of the part that continues to be recognised and the part that is derecognised for the purposes of applying paragraph 24~~3.2.13~~, an entity applies the fair value measurement requirements in ~~IFRS 13 *Fair Value Measurement* in addition to paragraph 3.2.14.~~paragraphs 66–68 and AG144–AG155.

Transfers that do not qualify for derecognition

AG32.~~B3.2.12~~ The following is an application of the principle outlined in paragraph 26~~3.2.15~~. If a guarantee provided by the entity for default losses on the transferred asset prevents a transferred asset from being derecognised because the entity has retained substantially all the risks and rewards of ownership of the transferred asset, the transferred asset continues to be recognised in its entirety and the consideration received is recognised as a liability.

Sale of Future Flows Arising from a Sovereign Right

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

Continuing Involvement in Transferred Assets

AG34.~~B3.2.13~~ The following are examples of how an entity measures a transferred asset and the associated liability under paragraph 27~~3.2.16~~.

All Assets

(a) If a guarantee provided by an entity to pay for default losses on a transferred asset prevents the transferred asset from being derecognised to the extent of the continuing involvement, the transferred asset at the date of the transfer is measured at the lower of (i) the carrying amount of the asset and (ii) the maximum amount of the consideration received in the transfer that the entity could be required to repay ('the guarantee amount'). The associated liability is initially measured at the guarantee amount plus the fair value of the guarantee (which is normally the consideration received for the guarantee). Subsequently, the initial fair value of the guarantee is recognised in ~~profit or loss~~surplus or deficit on a time proportion basis (see PBE IPSAS 9) ~~when (or as) the obligation is satisfied (in accordance with the principles of IFRS 15)~~ and the carrying value of the asset is reduced by any loss allowance.

Assets Measured at Amortised Cost

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

Assets Measured at Fair Value

(c) If a call option right retained by an entity prevents a transferred asset from being derecognised and the entity measures the transferred asset at fair value, the asset continues to be measured at its fair value. The associated liability is measured at (i) the option exercise price less the time value of the option if the option is in or at the money, or (ii) the fair value of the transferred asset less the time value of the option if the option is out of the money. The adjustment to the measurement of the associated liability ensures that the net carrying amount of the asset and the associated liability is the fair value of the call option right. For example, if the fair value of the underlying asset is CU80, the option exercise price is CU95 and the time value of the option is CU5, the carrying amount of the associated liability is CU75 (CU80 – CU5) and the carrying amount of the transferred asset is CU80 (i.e., its fair value).

(d) If a put option written by an entity prevents a transferred asset from being derecognised and the entity measures the transferred asset at fair value, the associated liability is measured at the option exercise price plus the time value of the option. The measurement of the asset at fair value is limited to the lower of the fair value and the option exercise price because the entity has no right to increases in the fair value of the transferred asset above the exercise price of the option. This ensures that the net carrying amount of the asset and the associated liability is the fair value of the put option obligation. For example, if the fair value of the underlying asset is CU120, the option exercise price is CU100 and the time value of the option is CU5, the carrying amount of the associated liability is CU105 (CU100 + CU5) and the carrying amount of the asset is CU100 (in this case the option exercise price).

(e) If a collar, in the form of a purchased call and written put, prevents a transferred asset from being derecognised and the entity measures the asset at fair value, it continues to measure the asset at fair value. The associated liability is measured at (i) the sum of the call exercise price and fair value of the put option less the time value of the call option, if the call option is in or at the money, or (ii) the sum of the fair value of the asset and the fair value of the put option less the time value of the call option if the call option is out of the money. The adjustment to the associated liability ensures that the net carrying amount of the asset and the associated liability is the fair value of the options held and written by the entity. For example, assume an entity transfers a financial asset that is measured at fair value while simultaneously purchasing a call with an exercise price of CU120 and writing a put with an exercise price of CU80. Assume also that the fair value of the asset is CU100 at the date of the transfer. The time value of the put and call are CU1 and CU5 respectively. In this case, the entity recognises an asset of CU100 (the fair value of the asset) and a liability of CU96 [(CU100 + CU1) – CU5]. This gives a net asset value of CU4, which is the fair value of the options held and written by the entity.

All Transfers

AG35.~~B3.2.14~~ To the extent that a transfer of a financial asset does not qualify for derecognition, the transferor's contractual rights or obligations related to the transfer are not accounted for separately as derivatives if recognising both the derivative and either the transferred asset or the liability arising from the transfer would result in recognising the same rights or obligations twice. For example, a call option retained by the transferor may prevent a transfer of financial assets from being accounted for as a sale. In that case, the call option is not separately recognised as a derivative asset.

AG36.~~B3.2.15~~ To the extent that a transfer of a financial asset does not qualify for derecognition, the transferee does not recognise the transferred asset as its asset. The transferee derecognises the cash or other consideration paid and recognises a receivable from the transferor. If the transferor has both a right and an obligation to reacquire control of the entire transferred asset for a fixed amount (such as under a repurchase agreement), the transferee may measure its receivable at amortised cost if it meets the criteria in paragraph 40~~4.1.2~~.

Examples

AG37.~~B3.2.16~~ The following examples illustrate the application of the derecognition principles of this Standard.

(a) *Repurchase agreements and securities lending*. If a financial asset is sold under an agreement to repurchase it at a fixed price or at the sale price plus a lender's return or if it is loaned under an agreement to return it to the transferor, it is not derecognised because the transferor retains substantially all the risks and rewards of ownership. If the transferee obtains the right to sell or pledge the asset, the transferor reclassifies the asset in its statement of financial position, for example, as a loaned asset or repurchase receivable.

(b) *Repurchase agreements and securities lending—assets that are substantially the same*. If a financial asset is sold under an agreement to repurchase the same or substantially the same asset at a fixed price or at the sale price plus a lender's return or if a financial asset is borrowed or loaned under an agreement to return the same or substantially the same asset to the transferor, it is not derecognised because the transferor retains substantially all the risks and rewards of ownership.

(c) *Repurchase agreements and securities lending—right of substitution*. If a repurchase agreement at a fixed repurchase price or a price equal to the sale price plus a lender's return, or a similar securities lending transaction, provides the transferee with a right to substitute assets that are similar and of equal fair value to the transferred asset at the repurchase date, the asset sold or lent under a repurchase or securities lending transaction is not derecognised because the transferor retains substantially all the risks and rewards of ownership.

(d) *Repurchase right of first refusal at fair value*. If an entity sells a financial asset and retains only a right of first refusal to repurchase the transferred asset at fair value if the transferee subsequently sells it, the entity derecognises the asset because it has transferred substantially all the risks and rewards of ownership.

(e) *Wash sale transaction*. The repurchase of a financial asset shortly after it has been sold is sometimes referred to as a wash sale. Such a repurchase does not preclude derecognition provided that the original transaction met the derecognition requirements. However, if an agreement to sell a financial asset is entered into concurrently with an agreement to repurchase the same asset at a fixed price or the sale price plus a lender's return, then the asset is not derecognised.

(f) *Put options and call options that are deeply in the money*. If a transferred financial asset can be called back by the transferor and the call option is deeply in the money, the transfer does not qualify for derecognition because the transferor has retained substantially all the risks and rewards of ownership. Similarly, if the financial asset can be put back by the transferee and the put option is deeply in the money, the transfer does not qualify for derecognition because the transferor has retained substantially all the risks and rewards of ownership.

(g) *Put options and call options that are deeply out of the money*. A financial asset that is transferred subject only to a deep out-of-the-money put option held by the transferee or a deep out-of-the-money call option held by the transferor is derecognised. This is because the transferor has transferred substantially all the risks and rewards of ownership.

(h) *Readily obtainable assets subject to a call option that is neither deeply in the money nor deeply out of the money*. If an entity holds a call option on an asset that is readily obtainable in the market and the option is neither deeply in the money nor deeply out of the money, the asset is derecognised. This is because the entity (i) has neither retained nor transferred substantially all the risks and rewards of ownership, and (ii) has not retained control. However, if the asset is not readily obtainable in the market, derecognition is precluded to the extent of the amount of the asset that is subject to the call option because the entity has retained control of the asset.

(i) *A not readily obtainable asset subject to a put option written by an entity that is neither deeply in the money nor deeply out of the money*. If an entity transfers a financial asset that is not readily obtainable in the market, and writes a put option that is not deeply out of the money, the entity neither retains nor transfers substantially all the risks and rewards of ownership because of the written put option. The entity retains control of the asset if the put option is sufficiently valuable to prevent the transferee from selling the asset, in which case the asset continues to be recognised to the extent of the transferor's continuing involvement (see paragraph AG29~~B3.2.9~~). The entity transfers control of the asset if the put option is not sufficiently valuable to prevent the transferee from selling the asset, in which case the asset is derecognised.

(j) *Assets subject to a fair value put or call option or a forward repurchase agreement*. A transfer of a financial asset that is subject only to a put or call option or a forward repurchase agreement that has an exercise or repurchase price equal to the fair value of the financial asset at the time of repurchase results in derecognition because of the transfer of substantially all the risks and rewards of ownership.

(k) *Cash-settled call or put options*. An entity evaluates the transfer of a financial asset that is subject to a put or call option or a forward repurchase agreement that will be settled net in cash to determine whether it has retained or transferred substantially all the risks and rewards of ownership. If the entity has not retained substantially all the risks and rewards of ownership of the transferred asset, it determines whether it has retained control of the transferred asset. That the put or the call or the forward repurchase agreement is settled net in cash does not automatically mean that the entity has transferred control (see paragraphs AG29~~B3.2.9~~ and (g), (h) and (i) above).

(l) *Removal of accounts provision*. A removal of accounts provision is an unconditional repurchase (call) option that gives an entity the right to reclaim assets transferred subject to some restrictions. Provided that such an option results in the entity neither retaining nor transferring substantially all the risks and rewards of ownership, it precludes derecognition only to the extent of the amount subject to repurchase (assuming that the transferee cannot sell the assets). For example, if the carrying amount and proceeds from the transfer of loan assets are CU100,000 and any individual loan could be called back but the aggregate amount of loans that could be repurchased could not exceed CU10,000, CU90,000 of the loans would qualify for derecognition.

(m) *Clean-up calls*. An entity, which may be a transferor, that services transferred assets may hold a clean-up call to purchase remaining transferred assets when the amount of outstanding assets falls to a specified level at which the cost of servicing those assets becomes burdensome in relation to the benefits of servicing. Provided that such a clean-up call results in the entity neither retaining nor transferring substantially all the risks and rewards of ownership and the transferee cannot sell the assets, it precludes derecognition only to the extent of the amount of the assets that is subject to the call option.

(n) *Subordinated retained interests and credit guarantees*. An entity may provide the transferee with credit enhancement by subordinating some or all of its interest retained in the transferred asset. Alternatively, an entity may provide the transferee with credit enhancement in the form of a credit guarantee that could be unlimited or limited to a specified amount. If the entity retains substantially all the risks and rewards of ownership of the transferred asset, the asset continues to be recognised in its entirety. If the entity retains some, but not substantially all, of the risks and rewards of ownership and has retained control, derecognition is precluded to the extent of the amount of cash or other assets that the entity could be required to pay.

(o) *Total return swaps*. An entity may sell a financial asset to a transferee and enter into a total return swap with the transferee, whereby all of the interest payment cash flows from the underlying asset are remitted to the entity in exchange for a fixed payment or variable rate payment and any increases or declines in the fair value of the underlying asset are absorbed by the entity. In such a case, derecognition of all of the asset is prohibited.

(p) *Interest rate swaps*. An entity may transfer to a transferee a fixed rate financial asset and enter into an interest rate swap with the transferee to receive a fixed interest rate and pay a variable interest rate based on a notional amount that is equal to the principal amount of the transferred financial asset. The interest rate swap does not preclude derecognition of the transferred asset provided the payments on the swap are not conditional on payments being made on the transferred asset.

(q) *Amortising interest rate swaps*. An entity may transfer to a transferee a fixed rate financial asset that is paid off over time, and enter into an amortising interest rate swap with the transferee to receive a fixed interest rate and pay a variable interest rate based on a notional amount. If the notional amount of the swap amortises so that it equals the principal amount of the transferred financial asset outstanding at any point in time, the swap would generally result in the entity retaining substantial prepayment risk, in which case the entity either continues to recognise all of the transferred asset or continues to recognise the transferred asset to the extent of its continuing involvement. Conversely, if the amortisation of the notional amount of the swap is not linked to the principal amount outstanding of the transferred asset, such a swap would not result in the entity retaining prepayment risk on the asset. Hence, it would not preclude derecognition of the transferred asset provided the payments on the swap are not conditional on interest payments being made on the transferred asset and the swap does not result in the entity retaining any other significant risks and rewards of ownership on the transferred asset.

(r) *Write-off*. An entity has no reasonable expectations of recovering the contractual cash flows on a financial asset in its entirety or a portion thereof.

AG38.~~B3.2.17~~ This paragraph illustrates the application of the continuing involvement approach when the entity's continuing involvement is in a part of a financial asset.

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

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

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

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

The entity calculates the gain or loss on the sale of the 90 per cent share of cash flows. Assuming that separate fair values of the 90 per cent part transferred and the 10 per cent part retained are not available at the date of the transfer, the entity allocates the carrying amount of the asset in accordance with paragraph 25~~3.2.14 of IFRS 9~~ as follows:

	Fair value	*Percentage*	*Allocated carrying amount*
Portion transferred	9,090	90%	9,000
Portion retained	1,010	10%	1,000
Total	**10,100**		**10,000**

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

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

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

	Debit	*Credit*
Original asset	—	9,000
Asset recognised for subordination or the residual interest	1,000	—
Asset for the consideration received in the form of excess spread	40	—
~~Profit or loss~~Surplus or deficit (gain on transfer)	—	90
Liability	—	1,065
Cash received	9,115	—
Total	**10,155**	**10,155**

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

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

Derecognition of Financial Liabilities ~~(Section 3.3)~~

AG39.~~B3.3.1~~ A financial liability (or part of it) is extinguished when the debtor either:

(a) Discharges the liability (or part of it) by paying the creditor, normally with cash, other financial assets, goods or services; or

(b) Is legally released from primary responsibility for the liability (or part of it) either by process of law or by the creditor. (If the debtor has given a guarantee this condition may still be met.)

AG40.~~B3.3.2~~ If an issuer of a debt instrument repurchases that instrument, the debt is extinguished even if the issuer is a market maker in that instrument or intends to resell it in the near term.

AG41.~~B3.3.3~~ Payment to a third party, including a trust (sometimes called 'in-substance defeasance'), does not, by itself, relieve the debtor of its primary obligation to the creditor, in the absence of legal release.

AG42.~~B3.3.4~~ If a debtor pays a third party to assume an obligation and notifies its creditor that the third party has assumed its debt obligation, the debtor does not derecognise the debt obligation unless the condition in paragraph AG39~~B3.3.1~~(b) is met. If the debtor pays a third party to assume an obligation and obtains a legal release from its creditor, the debtor has extinguished the debt. However, if the debtor agrees to make payments on the debt to the third party or direct to its original creditor, the debtor recognises a new debt obligation to the third party.

AG43. If a third party assumes an obligation of an entity, and the entity provides either no or only nominal consideration to that third party in return, an entity applies the derecognition requirements of this Standard as well as paragraphs 84 to 87 of PBE IPSAS 23 *Revenue from Non-Exchange Transactions*.

AG44. Lenders will sometimes waive their right to collect debt owed by a public sector entity, for example, a central government may cancel a loan owed by a local government. This waiver of debt would constitute a legal release of the debt owing by the borrower to the lender. Where an entity's obligations have been waived as part of a non-exchange transaction it applies the derecognition requirements of this Standard as well as paragraphs 84 to 87 of PBE IPSAS 23.

AG45.~~B3.3.5~~ Although legal release, whether judicially or by the creditor, results in derecognition of a liability, the entity may recognise a new liability if the derecognition criteria in paragraphs 12–34~~3.2.1–3.2.23~~ are not met for the financial assets transferred. If those criteria are not met, the transferred assets are not derecognised, and the entity recognises a new liability relating to the transferred assets.

AG46.~~B3.3.6~~ For the purpose of paragraph 36~~3.3.2~~, the terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10 per cent different from the discounted present value of the remaining cash flows of the original financial liability. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortised over the remaining term of the modified liability.

AG47.~~B3.3.7~~ In some cases, a creditor releases a debtor from its present obligation to make payments, but the debtor assumes a guarantee obligation to pay if the party assuming primary responsibility defaults. In these circumstances the debtor:

(a) Recognises a new financial liability based on the fair value of its obligation for the guarantee;~~,~~ and

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

Classification ~~(Chapter 4)~~

Classification of Financial Assets ~~(Section 4.1)~~

The Entity's Management~~business~~ Model for Managing Financial Assets

AG48.~~B4.1.1~~ Paragraph 39~~4.1.1~~(a) requires an entity to classify financial assets on the basis of the entity's management~~business~~ model for managing the financial assets, unless paragraph 44~~4.1.5~~ applies. An entity assesses whether its financial assets meet the condition in paragraph 40~~4.1.2~~(a) or the condition in paragraph 41~~4.1.2A~~(a) on the basis of the management~~business~~ model as determined by the entity's key management personnel (as defined in PBE IPSAS 20~~IAS 24~~ *Related Party Disclosures*).

AG49.~~B4.1.2~~ An entity's management~~business~~ model is determined at a level that reflects how groups of financial assets are managed together to achieve a particular ~~business~~ objective. The entity's management~~business~~ model does not depend on management's intentions for an individual instrument. Accordingly, this condition is not an instrument-by-instrument approach to classification and should be determined on a higher level of aggregation. However, a single entity may have more than one ~~business~~ management model for ~~managing~~ its financial instruments. Consequently, classification need not be determined at the reporting entity level. For example, an entity may hold a portfolio of investments that it manages in order to collect contractual cash flows and another portfolio of investments that it manages in order to trade to realise fair value changes. Similarly, in some circumstances, it may be appropriate to separate a portfolio of financial assets into subportfolios in order to reflect the level at which an entity manages those financial assets. For example, that may be the case if an entity originates or purchases a portfolio of mortgage loans and manages some of the loans with an objective of collecting contractual cash flows and manages the other loans with an objective of selling them.

AG50.~~B4.1.2A~~ An entity's management~~business~~ model refers to how an entity manages its financial assets in order to generate cash flows. That is, the entity's management~~business~~ model determines whether cash flows will result from collecting contractual cash flows, selling financial assets or both. Consequently, this assessment is not performed on the basis of scenarios that the entity does not reasonably expect to occur, such as so-called 'worst case' or 'stress case' scenarios. For example, if an entity expects that it will sell a particular portfolio of financial assets only in a stress case scenario, that scenario would not affect the entity's assessment of the management~~business~~ model for those assets if the entity reasonably expects that such a scenario will not occur. If cash flows are realised in a way that is different from the entity's expectations at the date that the entity assessed the management~~business~~ model (for example, if the entity sells more or fewer financial assets than it expected when it classified the assets), that does not give rise to a prior period error in the entity's financial statements (see PBE IPSAS 3~~IAS 8~~ *Accounting Policies, Changes in Accounting Estimates and Errors*) nor does it change the classification of the remaining financial assets held within that management~~business~~ model (i.e., those assets that the entity recognised in prior periods and still holds) as long as the entity considered all relevant information that was available at the time that it made the management~~business~~ model assessment. However, when an entity assesses the management~~business~~ model for newly originated or newly purchased financial assets, it must consider information about how cash flows were realised in the past, along with all other relevant information.

AG51.~~B4.1.2B~~ An entity's management~~business~~ model for managing financial assets is a matter of fact and not merely an assertion. It is typically observable through the activities that the entity undertakes to achieve the objective of the management~~business~~ model. An entity will need to use judgement when it assesses its management~~business~~ model for managing financial assets and that assessment is not determined by a single factor or activity. Instead, the entity must consider all relevant evidence that is available at the date of the assessment. Such relevant evidence includes, but is not limited to:

(a) How the performance of the management~~business~~ model and the financial assets held within that management~~business~~ model are evaluated and reported to the entity's key management personnel;

(b) The risks that affect the performance of the management~~business~~ model (and the financial assets held within that management~~business~~ model) and, in particular, the way in which those risks are managed; and

(c) How management is~~managers of the business are~~ compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected).

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

AG52.~~B4.1.2C~~ Financial assets that are held within a management~~business~~ model whose objective is to hold assets in order to collect contractual cash flows are managed to realise cash flows by collecting contractual payments over the life of the instrument. That is, the entity manages the assets held within the portfolio to collect those particular contractual cash flows (instead of managing the overall return on the portfolio by both holding and selling assets). In determining whether cash flows are going to be realised by collecting the financial assets' contractual cash flows, it is necessary to consider the frequency, value and timing of sales in prior periods, the reasons for those sales and expectations about future sales activity. However sales in themselves do not determine the management~~business~~ model and therefore cannot be considered in isolation. Instead, information about past sales and expectations about future sales provide evidence related to how the entity's stated objective for managing the financial assets is achieved and, specifically, how cash flows are realised. An entity must consider information about past sales within the context of the reasons for those sales and the conditions that existed at that time as compared to current conditions.

AG53.~~B4.1.3~~ Although the objective of an entity's management~~business~~ model may be to hold financial assets in order to collect contractual cash flows, the entity need not hold all of those instruments until maturity. Thus an entity's management~~business~~ model can be to hold financial assets to collect contractual cash flows even when sales of financial assets occur or are expected to occur in the future.

AG54.~~B4.1.3A~~ The management~~business~~ model may be to hold assets to collect contractual cash flows even if the entity sells financial assets when there is an increase in the assets' credit risk. To determine whether there has been an increase in the assets' credit risk, the entity considers reasonable and supportable information, including forward looking information. Irrespective of their frequency and value, sales due to an increase in the assets' credit risk are not inconsistent with a management~~business~~ model whose objective is to hold financial assets to collect contractual cash flows because the credit quality of financial assets is relevant to the entity's ability to collect contractual cash flows. Credit risk management activities that are aimed at minimising potential credit losses due to credit deterioration are integral to such a management~~business~~ model. Selling a financial asset because it no longer meets the credit criteria specified in the entity's documented investment policy is an example of a sale that has occurred due to an increase in credit risk. However, in the absence of such a policy, the entity may demonstrate in other ways that the sale occurred due to an increase in credit risk.

AG55.~~B4.1.3B~~ Sales that occur for other reasons, such as sales made to manage credit concentration risk (without an increase in the assets' credit risk), may also be consistent with a business model whose objective is to hold financial assets in order to collect contractual cash flows. In particular, such sales may be consistent with a management~~business~~ model whose objective is to hold financial assets in order to collect contractual cash flows if those sales are infrequent (even if significant in value) or insignificant in value both individually and in aggregate (even if frequent). If more than an infrequent number of such sales are made out of a portfolio and those sales are more than insignificant in value (either individually or in aggregate), the entity needs to assess whether and how such sales are consistent with an objective of collecting contractual cash flows. Whether a third party imposes the requirement to sell the financial assets, or that activity is at the entity's discretion, is not relevant to this assessment. An increase in the frequency or value of sales in a particular period is not necessarily inconsistent with an objective to hold financial assets in order to collect contractual cash flows, if an entity can explain the reasons for those sales and demonstrate why those sales do not reflect a change in the entity's management~~business~~ model. In addition, sales may be consistent with the objective of holding financial assets in order to collect contractual cash flows if the sales are made close to the maturity of the financial assets and the proceeds from the sales approximate the collection of the remaining contractual cash flows.

AG56.~~B4.1.4~~ The following are examples of when the objective of an entity's management~~business~~ model may be to hold financial assets to collect the contractual cash flows. This list of examples is not exhaustive. Furthermore, the examples are not intended to discuss all factors that may be relevant to the assessment of the entity's management~~business~~ model nor specify the relative importance of the factors.

Example	Analysis
Example 1 An entity holds investments to collect their contractual cash flows. The funding needs of the entity are predictable and the maturity of its financial assets is matched to the entity's estimated funding needs. The entity performs credit risk management activities with the objective of minimising credit losses. In the past, sales have typically occurred when the financial assets' credit risk has increased such that the assets no longer meet the credit criteria specified in the entity's documented investment policy. In addition, infrequent sales have occurred as a result of unanticipated funding needs. Reports to key management personnel focus on the credit quality of the financial assets and the contractual return. The entity also monitors fair values of the financial assets, among other information.	Although the entity considers, among other information, the financial assets' fair values from a liquidity perspective (i.e., the cash amount that would be realised if the entity needs to sell assets), the entity's objective is to hold the financial assets in order to collect the contractual cash flows. Sales would not contradict that objective if they were in response to an increase in the assets' credit risk, for example if the assets no longer meet the credit criteria specified in the entity's documented investment policy. Infrequent sales resulting from unanticipated funding needs (e.g., in a stress case scenario) also would not contradict that objective, even if such sales are significant in value.
Example 2 An entity's management~~business~~ model is to purchase portfolios of financial assets, such as loans. Those portfolios may or may not include financial assets that are credit-impaired. If payment on the loans is not made on a timely basis, the entity attempts to realise the contractual cash flows through various means—for example, by contacting the debtor by mail, telephone or other methods. The entity's objective is to collect the contractual cash flows and the entity does not manage any of the loans in this portfolio with an objective of realising cash flows by selling them. In some cases, the entity enters into interest rate swaps to change the interest rate on particular financial assets in a portfolio from a floating interest rate to a fixed interest rate.	The objective of the entity's management~~business~~ model is to hold the financial assets in order to collect the contractual cash flows. The same analysis would apply even if the entity does not expect to receive all of the contractual cash flows (e.g., some of the financial assets are credit-impaired at initial recognition). Moreover, the fact that the entity enters into derivatives to modify the cash flows of the portfolio does not in itself change the entity's management~~business~~ model.

Example	**Analysis**
Example 3 An entity has a management~~business~~ model with the objective of originating student loans ~~to customers~~ and subsequently selling those loans to a securitisation vehicle. The securitisation vehicle issues instruments to investors. The originating entity controls the securitisation vehicle and thus consolidates it. The securitisation vehicle collects the contractual cash flows from the loans and passes them on to its investors. It is assumed for the purposes of this example that the loans continue to be recognised in the consolidated statement of financial position because they are not derecognised by the securitisation vehicle.	The consolidated economic entity~~group~~ originated the loans with the objective of holding them to collect the contractual cash flows. However, the originating entity has an objective of realising cash flows on the loan portfolio by selling the loans to the securitisation vehicle, so for the purposes of its separate financial statements it would not be considered to be managing this portfolio in order to collect the contractual cash flows.
Example 4 A local government entity that issues bonds ~~financial institution~~ holds financial assets to meet redemption ~~liquidity~~ needs in a 'stress case' scenario (e.g., a run on the government's issued securities~~bank's deposits~~). The entity does not anticipate selling these assets except in such scenarios. The entity monitors the credit quality of the financial assets and its objective in managing the financial assets is to collect the contractual cash flows. The entity evaluates the performance of the assets on the basis of interest revenue earned and credit losses realised. However, the entity also monitors the fair value of the financial assets from a liquidity perspective to ensure that the cash amount that would be realised if the entity needed to sell the assets in a stress case scenario would be sufficient to meet the entity's liquidity needs. Periodically, the entity makes sales that are insignificant in value to demonstrate liquidity.	The objective of the entity's management~~business~~ model is to hold the financial assets to collect contractual cash flows. The analysis would not change even if during a previous stress case scenario the entity had sales that were significant in value in order to meet its redemption~~liquidity~~ needs. Similarly, recurring sales activity that is insignificant in value is not inconsistent with holding financial assets to collect contractual cash flows. In contrast, if an entity holds financial assets to meet its everyday redemption~~liquidity~~ needs and meeting that objective involves frequent sales that are significant in value, the objective of the entity's management~~business~~ model is not to hold the financial assets to collect contractual cash flows. Similarly, if the entity is required by its regulator to routinely sell financial assets to demonstrate that the assets are liquid, and the value of the assets sold is significant, the entity's management~~business~~ model is not to hold financial assets to collect contractual cash flows. Whether a third party imposes the requirement to sell the financial assets, or that activity is at the entity's discretion, is not relevant to the analysis.

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

AG57.~~B4.1.4A~~ An entity may hold financial assets in a management~~business~~ model whose objective is achieved by both collecting contractual cash flows and selling financial assets. In this type of management~~business~~ model, the entity's key management personnel have made a decision that both collecting contractual cash flows and selling financial assets are integral to achieving the objective of the management~~business~~ model. There are various objectives that may be consistent with this type of management~~business~~ model. For example, the objective of the management~~business~~ model may be to manage everyday liquidity needs, to maintain a particular interest yield profile or to match the duration of the financial assets to the duration of the liabilities that those assets are funding. To achieve such an objective, the entity will both collect contractual cash flows and sell financial assets.

AG58.~~B4.1.4B~~ Compared to a management~~business~~ model whose objective is to hold financial assets to collect contractual cash flows, this management~~business~~ model will typically involve greater frequency and value of sales. This is because selling financial assets is integral to achieving the management~~business~~ model's objective instead of being only incidental to it. However, there is no threshold for the frequency or value of sales that must occur in this management~~business~~ model because both collecting contractual cash flows and selling financial assets are integral to achieving its objective.

AG59.~~B4.1.4C~~ The following are examples of when the objective of the entity's management~~business~~ model may be achieved by both collecting contractual cash flows and selling financial assets. This list of examples is not exhaustive. Furthermore, the examples are not intended to describe all the factors that may be relevant to the assessment of the entity's management~~business~~ model nor specify the relative importance of the factors.

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

Example	**Analysis**
Example 7 A social security fund ~~An insurer~~ holds financial assets in order to fund social security~~insurance contract~~ liabilities. The fund~~insurer~~ uses the proceeds from the contractual cash flows on the financial assets to settle social security ~~insurance contract~~ liabilities as they come due. To ensure that the contractual cash flows from the financial assets are sufficient to settle those liabilities, the fund~~insurer~~ undertakes significant buying and selling activity on a regular basis to rebalance its portfolio of assets and to meet cash flow needs as they arise.	The objective of the management~~business~~ model is to fund the social security ~~insurance contract~~ liabilities. To achieve this objective, the entity collects contractual cash flows as they come due and sells financial assets to maintain the desired profile of the asset portfolio. Thus both collecting contractual cash flows and selling financial assets are integral to achieving the management~~business~~ model's objective.

Other Management~~business~~ Models

AG60.~~B4.1.5~~ Financial assets are measured at fair value through ~~profit or loss~~surplus or deficit if they are not held within a management~~business~~ model whose objective is to hold assets to collect contractual cash flows or within a management~~business~~ model whose objective is achieved by both collecting contractual cash flows and selling financial assets (but see also paragraph 106~~5.7.5~~). One management~~business~~ model that results in measurement at fair value through ~~profit or loss~~surplus or deficit is one in which an entity manages the financial assets with the objective of realising cash flows through the sale of the assets. The entity makes decisions based on the assets' fair values and manages the assets to realise those fair values. In this case, the entity's objective will typically result in active buying and selling. Even though the entity will collect contractual cash flows while it holds the financial assets, the objective of such a management~~business~~ model is not achieved by both collecting contractual cash flows and selling financial assets. This is because the collection of contractual cash flows is not integral to achieving the management~~business~~ model's objective; instead, it is incidental to it.

AG61.~~B4.1.6~~ A portfolio of financial assets that is managed and whose performance is evaluated on a fair value basis (as described in paragraph 46~~4.2.2~~(b)) is neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets. The entity is primarily focused on fair value information and uses that information to assess the assets' performance and to make decisions. In addition, a portfolio of financial assets that meets the definition of held for trading is not held to collect contractual cash flows or held both to collect contractual cash flows and to sell financial assets. For such portfolios, the collection of contractual cash flows is only incidental to achieving the management~~business~~ model's objective. Consequently, such portfolios of financial assets must be measured at fair value through ~~profit or loss~~surplus or deficit.

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

AG62.~~B4.1.7~~ Paragraph 39~~4.1.1~~(b) requires an entity to classify a financial asset on the basis of its contractual cash flow characteristics if the financial asset is held within a management~~business~~ model whose objective is to hold assets to collect contractual cash flows or within a management~~business~~ model whose objective is achieved by both collecting contractual cash flows and selling financial assets, unless paragraph 44~~4.1.5~~ applies. To do so, the condition in paragraphs 40~~4.1.2~~(b) and 41~~4.1.2A~~(b) requires an entity to determine whether the asset's contractual cash flows are solely payments of principal and interest on the principal amount outstanding.

AG63.~~B4.1.7A~~ Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding are consistent with a basic lending arrangement. In a basic lending arrangement, consideration for the time value of money (see paragraphs AG67–AG71~~B4.1.9A–B4.1.9E~~) and credit risk are typically the most significant elements of interest. However, in such an arrangement, interest can also include consideration for other basic lending risks (for example, liquidity risk) and costs (for example, administrative costs) associated with holding the financial asset for a particular period of time. In addition, interest can include a profit margin that is consistent with a basic lending arrangement. In extreme economic circumstances, interest can be negative if, for example, the holder of a financial asset either explicitly or implicitly pays for the deposit of its money for a particular period of time (and that fee exceeds the consideration that the holder receives for the time value of money, credit risk and other basic lending risks and costs). However, contractual terms that introduce exposure to risks or volatility in the contractual cash flows that is unrelated to a basic lending arrangement, such as exposure to changes in equity prices, ~~or~~ commodity prices, a specific profitability or income threshold being reached by the borrower or lender, or the achievement (or otherwise) of specific financial or other ratios, do not give rise to contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. An originated or a purchased financial asset can be a basic lending arrangement irrespective of whether it is a loan in its legal form.

AG64.~~B4.1.7B~~ In accordance with paragraph 42~~4.1.3~~(a), principal is the fair value of the financial asset at initial recognition. However that principal amount may change over the life of the financial asset (for example, if there are repayments of principal).

AG65.~~B4.1.8~~ An entity shall assess whether contractual cash flows are solely payments of principal and interest on the principal amount outstanding for the currency in which the financial asset is denominated.

AG66.~~B4.1.9~~ Leverage is a contractual cash flow characteristic of some financial assets. Leverage increases the variability of the contractual cash flows with the result that they do not have the economic characteristics of interest. Stand-alone option, forward and swap contracts are examples of financial assets that include such leverage. Thus, such contracts do not meet the condition in paragraphs 40~~4.1.2~~(b) and 41~~4.1.2A~~(b) and cannot be subsequently measured at amortised cost or fair value through other comprehensive ~~income~~revenue and expense.

Consideration for the Time Value of Money

AG67.~~B4.1.9A~~ Time value of money is the element of interest that provides consideration for only the passage of time. That is, the time value of money element does not provide consideration for other risks or costs associated with holding the financial asset. In order to assess whether the element provides consideration for only the passage of time, an entity applies judgement and considers relevant factors such as the currency in which the financial asset is denominated and the period for which the interest rate is set.

AG68.~~B4.1.9B~~ However, in some cases, the time value of money element may be modified (i.e., imperfect). That would be the case, for example, if a financial asset's interest rate is periodically reset but the frequency of that reset does not match the tenor of the interest rate (for example, the interest rate resets every month to a one-year rate) or if a financial asset's interest rate is periodically reset to an average of particular short- and long-term interest rates. In such cases, an entity must assess the modification to determine whether the contractual cash flows represent solely payments of principal and interest on the principal amount outstanding. In some circumstances, the entity may be able to make that determination by performing a qualitative assessment of the time value of money element whereas, in other circumstances, it may be necessary to perform a quantitative assessment.

AG69.~~B4.1.9C~~ When assessing a modified time value of money element, the objective is to determine how different the contractual (undiscounted) cash flows could be from the (undiscounted) cash flows that would arise if the time value of money element was not modified (the benchmark cash flows). For example, if the financial asset under assessment contains a variable interest rate that is reset every month to a one-year interest rate, the entity would compare that financial asset to a financial instrument with identical contractual terms and the identical credit risk except the variable interest rate is reset monthly to a one-month interest rate. If the modified time value of money element could result in contractual (undiscounted) cash flows that are significantly different from the (undiscounted) benchmark cash flows, the financial asset does not meet the condition in paragraphs 40~~4.1.2~~(b) and 41~~4.1.2A~~(b). To make this determination, the entity must consider the effect of the modified time value of money element in each reporting period and cumulatively over the life of the financial instrument. The reason for the interest rate being set in this way is not relevant to the analysis. If it is clear, with little or no analysis, whether the contractual (undiscounted) cash flows on the financial asset under the assessment could (or could not) be significantly different from the (undiscounted) benchmark cash flows, an entity need not perform a detailed assessment.

AG70.~~B4.1.9D~~ When assessing a modified time value of money element, an entity must consider factors that could affect future contractual cash flows. For example, if an entity is assessing a bond with a five-year term and the variable interest rate is reset every six months to a five-year rate, the entity cannot conclude that the contractual cash flows are solely payments of principal and interest on the principal amount outstanding simply because the interest rate curve at the time of the assessment is such that the difference between a five-year interest rate and a six-month interest rate is not significant. Instead, the entity must also consider whether the relationship between the five-year interest rate and the six-month interest rate could change over the life of the instrument such that the contractual (undiscounted) cash flows over the life of the instrument could be significantly different from the (undiscounted) benchmark cash flows. However, an entity must consider only reasonably possible scenarios instead of every possible scenario. If an entity concludes that the contractual (undiscounted) cash flows could be significantly different from the (undiscounted) benchmark cash flows, the financial asset does not meet the condition in paragraphs

40~~4.1.2~~(b) and 41~~4.1.2A~~(b) and therefore cannot be measured at amortised cost or fair value through other comprehensive ~~income~~revenue and expense.

AG71.~~B4.1.9E~~ In some jurisdictions, the government or a regulatory authority sets interest rates. For example, such government regulation of interest rates may be part of a broad macroeconomic policy or it may be introduced to encourage entities to invest in a particular sector of the economy. In some of these cases, the objective of the time value of money element is not to provide consideration for only the passage of time. However, despite paragraphs AG67–AG70~~B4.1.9A–B4.1.9D~~, a regulated interest rate shall be considered a proxy for the time value of money element for the purpose of applying the condition in paragraphs 40~~4.1.2~~(b) and 41~~4.1.2A~~(b) if that regulated interest rate provides consideration that is broadly consistent with the passage of time and does not provide exposure to risks or volatility in the contractual cash flows that are inconsistent with a basic lending arrangement.

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

AG72.~~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 (i.e., the trigger) that would change the timing or amount of the contractual cash flows. While the nature of the contingent event in itself is not a determinative factor in assessing whether the contractual cash flows are solely payments of principal and interest, it may be an indicator. For example, compare a financial instrument with an interest rate that is reset to a higher rate if the debtor misses a particular number of payments to a financial instrument with an interest rate that is reset to a higher rate if a specified equity index reaches a particular level. It is more likely in the former case that the contractual cash flows over the life of the instrument will be solely payments of principal and interest on the principal amount outstanding because of the relationship between missed payments and an increase in credit risk. (See also paragraph AG80~~B4.1.18~~.)

AG73.~~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 (i.e., the debtor) to prepay a debt instrument or permits the holder (i.e., the creditor) to put a debt instrument back to the issuer before maturity and the prepayment amount substantially represents unpaid amounts of principal and interest on the principal amount outstanding, which may include reasonable ~~additional~~ compensation for the early termination of the contract; and [Amended by *Prepayment Features with Negative Compensation* (Amendments to IFRS 9) issued 2017]

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

AG74.~~B4.1.12~~ Despite paragraph AG72~~B4.1.10~~, a financial asset that would otherwise meet the condition in paragraphs 40~~4.1.2~~(b) and 41~~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~~revenue and expense (subject to meeting the condition in paragraph 40~~4.1.2~~(a) or the condition in paragraph 41~~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. [Amended by *Prepayment Features with Negative Compensation* (Amendments to IFRS 9) issued 2017]

AG74.1~~B4.1.12A~~ For the purpose of applying paragraphs AG73~~B4.1.11~~(b) and AG74~~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). [Added by *Prepayment Features with Negative Compensation* (Amendments to IFRS 9) issued 2017]

AG75.~~B4.1.13~~ The following examples illustrate contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. This list of examples is not exhaustive.

Instrument	**Analysis**
Instrument A Instrument A is a bond with a stated maturity date. Payments of principal and interest on the principal amount outstanding are linked to an inflation index of the currency in which the instrument is issued. The inflation link is not leveraged and the principal is protected.	The contractual cash flows are solely payments of principal and interest on the principal amount outstanding. Linking payments of principal and interest on the principal amount outstanding to an unleveraged inflation index resets the time value of money to a current level. In other words, the interest rate on the instrument reflects 'real' interest. Thus, the interest amounts are consideration for the time value of money on the principal amount outstanding. However, if the interest payments were indexed to another variable such as the debtor's performance (e.g., the debtor's surplus or deficit~~net income~~) or an equity index, the contractual cash flows are not payments of principal and interest on the principal amount outstanding (unless the indexing to the debtor's performance results in an adjustment that only compensates the holder for changes in the credit risk of the instrument, such that contractual cash flows are solely payments of principal and interest). That is because the contractual cash flows reflect a return that is inconsistent with a basic lending arrangement (see paragraph AG63~~B4.1.7A~~).
Instrument B Instrument B is a variable interest rate instrument with a stated maturity date that permits the borrower to choose the market interest rate on an ongoing basis. For example, at each interest rate reset date, the borrower can choose to pay the three-month interbank offered rate~~LIBOR~~ for a three-month term or the one-month interbank offered rate ~~LIBOR~~ for a one-month term.	The contractual cash flows are solely payments of principal and interest on the principal amount outstanding as long as the interest paid over the life of the instrument reflects consideration for the time value of money, for the credit risk associated with the instrument and for other basic lending risks and costs, as well as a profit margin (see paragraph AG63~~B4.1.7A~~). The fact that the interbank offered ~~LIBOR~~ interest rate is reset during the life of the instrument does not in itself disqualify the instrument. However, if the borrower is able to choose to pay a one-month interest rate that is reset every three months, the interest rate is reset with a frequency that does not match the tenor of the interest rate. Consequently, the time value of money element is modified. Similarly, if an instrument has a contractual interest rate that is based on a term that can exceed the instrument's remaining life (for example, if an instrument with a five-year maturity pays a variable rate that is reset periodically but always reflects a five-year maturity), the time value of money element is modified. That is because the interest payable in each period is disconnected from the interest period.

Instrument	Analysis
	In such cases, the entity must qualitatively or quantitatively assess the contractual cash flows against those on an instrument that is identical in all respects except the tenor of the interest rate matches the interest period to determine if the cash flows are solely payments of principal and interest on the principal amount outstanding. (But see paragraph AG71~~B4.1.9E~~ for guidance on regulated interest rates.) For example, in assessing a bond with a five-year term that pays a variable rate that is reset every six months but always reflects a five-year maturity, an entity considers the contractual cash flows on an instrument that resets every six months to a six-month interest rate but is otherwise identical. The same analysis would apply if the borrower is able to choose between the lender's various published interest rates (e.g., the borrower can choose between the lender's published one-month variable interest rate and the lender's published three-month variable interest rate).
Instrument C Instrument C is a bond with a stated maturity date and pays a variable market interest rate. That variable interest rate is capped.	The contractual cash flows of both: (a) an instrument that has a fixed interest rate and (b) an instrument that has a variable interest rate are payments of principal and interest on the principal amount outstanding as long as the interest reflects consideration for the time value of money, for the credit risk associated with the instrument during the term of the instrument and for other basic lending risks and costs, as well as a profit margin. (See paragraph AG63~~B4.1.7A~~) Consequently, an instrument that is a combination of (a) and (b) (e.g., a bond with an interest rate cap) can have cash flows that are solely payments of principal and interest on the principal amount outstanding. Such a contractual term may reduce cash flow variability by setting a limit on a variable interest rate (e.g., an interest rate cap or floor) or increase the cash flow variability because a fixed rate becomes variable.
Instrument D Instrument D is a full recourse loan and is secured by collateral.	The fact that a full recourse loan is collateralised does not in itself affect the analysis of whether the contractual cash flows are solely payments of principal and interest on the principal amount outstanding.

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

AG76.~~B4.1.14~~ The following examples illustrate contractual cash flows that are not solely payments of principal and interest on the principal amount outstanding. This list of examples is not exhaustive.

Instrument	Analysis
Instrument F Instrument F is a bond that is convertible into a fixed number of equity instruments of the issuer.	The holder would analyse the convertible bond in its entirety. The contractual cash flows are not payments of principal and interest on the principal amount outstanding because they reflect a return that is inconsistent with a basic lending arrangement (see paragraph AG63~~B4.1.7A~~); ie the return is linked to the value of the equity of the issuer.
Instrument G Instrument G is a loan that pays an inverse floating interest rate (i.e., the interest rate has an inverse relationship to market interest rates).	The contractual cash flows are not solely payments of principal and interest on the principal amount outstanding. The interest amounts are not consideration for the time value of money on the principal amount outstanding.
Instrument H Instrument H is a perpetual instrument but the issuer may call the instrument at any point and pay the holder the par amount plus accrued interest due. Instrument H pays a market interest rate but payment of interest cannot be made unless the issuer is able to remain solvent immediately afterwards. Deferred interest does not accrue additional interest.	The contractual cash flows are not payments of principal and interest on the principal amount outstanding. That is because the issuer may be required to defer interest payments and additional interest does not accrue on those deferred interest amounts. As a result, interest amounts are not consideration for the time value of money on the principal amount outstanding. If interest accrued on the deferred amounts, the contractual cash flows could be payments of principal and interest on the principal amount outstanding.

Instrument	Analysis
	The fact that Instrument H is perpetual does not in itself mean that the contractual cash flows are not payments of principal and interest on the principal amount outstanding. In effect, a perpetual instrument has continuous (multiple) extension options. Such options may result in contractual cash flows that are payments of principal and interest on the principal amount outstanding if interest payments are mandatory and must be paid in perpetuity. Also, the fact that Instrument H is callable does not mean that the contractual cash flows are not payments of principal and interest on the principal amount outstanding unless it is callable at an amount that does not substantially reflect payment of outstanding principal and interest on that principal amount outstanding. Even if the callable amount includes an amount that reasonably compensates the holder for the early termination of the instrument, the contractual cash flows could be payments of principal and interest on the principal amount outstanding. (See also paragraph AG74~~B4.1.12~~.)

AG77.~~B4.1.15~~ In some cases a financial asset may have contractual cash flows that are described as principal and interest but those cash flows do not represent the payment of principal and interest on the principal amount outstanding as described in paragraphs 40~~4.1.2~~(b), 41~~4.1.2A~~(b) and 42~~4.1.3~~ of this Standard.

AG78.~~B4.1.16~~ This may be the case if the financial asset represents an investment in particular assets or cash flows and hence the contractual cash flows are not solely payments of principal and interest on the principal amount outstanding. For example, if the contractual terms stipulate that the financial asset's cash flows increase as more automobiles use a particular toll road, those contractual cash flows are inconsistent with a basic lending arrangement. As a result, the instrument would not satisfy the condition in paragraphs 40~~4.1.2~~(b) and 41~~4.1.2A~~(b). This could be the case when a creditor's claim is limited to specified assets of the debtor or the cash flows from specified assets (for example, a 'non-recourse' financial asset).

AG79.~~B4.1.17~~ However, the fact that a financial asset is non-recourse does not in itself necessarily preclude the financial asset from meeting the condition in paragraphs 40~~4.1.2~~(b) and 41~~4.1.2A~~(b). In such situations, the creditor is required to assess ('look through to') the particular underlying assets or cash flows to determine whether the contractual cash flows of the financial asset being classified are payments of principal and interest on the principal amount outstanding. If the terms of the financial asset give rise to any other cash flows or limit the cash flows in a manner inconsistent with payments representing principal and interest, the financial asset does not meet the condition in paragraphs 40~~4.1.2~~(b) and 41~~4.1.2A~~(b). Whether the underlying assets are financial assets or non-financial assets does not in itself affect this assessment.

AG80.~~B4.1.18~~ A contractual cash flow characteristic does not affect the classification of the financial asset if it could have only a de minimis effect on the contractual cash flows of the financial asset. To make this determination, an entity must consider the possible effect of the contractual cash flow characteristic in each reporting period and cumulatively over the life of the financial instrument. In addition, if a contractual cash flow characteristic could have an effect on the contractual cash flows that is more than de minimis (either in a single reporting period or cumulatively) but that cash flow characteristic is not genuine, it does not affect the classification of a financial asset. A cash flow characteristic is not genuine if it affects the instrument's contractual cash flows only on the occurrence of an event that is extremely rare, highly abnormal and very unlikely to occur.

AG81.~~B4.1.19~~ In almost every lending transaction the creditor's instrument is ranked relative to the instruments of the debtor's other creditors. An instrument that is subordinated to other instruments may have contractual cash flows that are payments of principal and interest on the principal amount outstanding if the debtor's non-payment is a breach of contract and the holder has a contractual right to unpaid amounts of principal and interest on the principal amount outstanding even in the event of the debtor's bankruptcy. For example, a trade receivable that ranks its creditor as a general creditor would qualify as having payments of principal and interest on the principal amount outstanding. This is the case even if the debtor issued loans that are collateralised, which in the event of bankruptcy would give that loan holder priority over the claims of the general creditor in respect of the collateral but does not affect the contractual right of the general creditor to unpaid principal and other amounts due.

Contractually Linked Instruments

AG82.~~B4.1.20~~ In some types of transactions, an issuer may prioritise payments to the holders of financial assets using multiple contractually linked instruments that create concentrations of credit risk (tranches). Each tranche has a subordination ranking that specifies the order in which any cash flows generated by the issuer are allocated to the tranche. In such situations, the holders of a tranche have the right to payments of principal and interest on the principal amount outstanding only if the issuer generates sufficient cash flows to satisfy higher-ranking tranches.

AG83.~~B4.1.21~~ In such transactions, a tranche has cash flow characteristics that are payments of principal and interest on the principal amount outstanding only if:

(a) The contractual terms of the tranche being assessed for classification (without looking through to the underlying pool of financial instruments) give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding (e.g., the interest rate on the tranche is not linked to a commodity index);

(b) The underlying pool of financial instruments has the cash flow characteristics set out in paragraphs AG85~~B4.1.23~~ and AG86~~B4.1.24~~; and

(c) The exposure to credit risk in the underlying pool of financial instruments inherent in the tranche is equal to or lower than the exposure to credit risk of the underlying pool of financial instruments (for example, the credit rating of the tranche being assessed for classification is equal to or higher than the credit rating that would apply to a single tranche that funded the underlying pool of financial instruments).

AG84.~~B4.1.22~~ An entity must look through until it can identify the underlying pool of instruments that are creating (instead of passing through) the cash flows. This is the underlying pool of financial instruments.

AG85.~~B4.1.23~~ The underlying pool must contain one or more instruments that have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.

AG86.~~B4.1.24~~ The underlying pool of instruments may also include instruments that:

(a) Reduce the cash flow variability of the instruments in paragraph AG85~~B4.1.23~~ and, when combined with the instruments in paragraph AG85~~B4.1.23~~, result in cash flows that are solely payments of principal and interest on the principal amount outstanding (e.g., an interest rate cap or floor or a contract that reduces the credit risk on some or all of the instruments in paragraph AG85~~B4.1.23~~); or

(b) Align the cash flows of the tranches with the cash flows of the pool of underlying instruments in paragraph AG85~~B4.1.23~~ to address differences in and only in:

    (i) Whether the interest rate is fixed or floating;

    (ii) The currency in which the cash flows are denominated, including inflation in that currency; or

    (iii) The timing of the cash flows.

AG87.~~B4.1.25~~ If any instrument in the pool does not meet the conditions in either paragraph AG85~~B4.1.23~~ or paragraph AG86~~B4.1.24~~, the condition in paragraph 83~~B4.1.21~~(b) is not met. In performing this assessment, a detailed instrument-by-instrument analysis of the pool may not be necessary. However, an entity must use judgement and perform sufficient analysis to determine whether the instruments in the pool meet the conditions in paragraphs AG85–AG86~~B4.1.23–B4.1.24~~. (See also paragraph AG80~~B4.1.18~~ for guidance on contractual cash flow characteristics that have only a de minimis effect.)

AG88.~~B4.1.26~~ If the holder cannot assess the conditions in paragraph AG83~~B4.1.21~~ at initial recognition, the tranche must be measured at fair value through ~~profit or loss~~surplus or deficit. If the underlying pool of instruments can change after initial recognition in such a way that the pool may not meet the conditions in paragraphs A85–AG86~~B4.1.23–B4.1.24~~, the tranche does not meet the conditions in paragraph AG83~~B4.1.21~~ and must be measured at fair value through ~~profit or loss~~surplus or deficit. However, if the underlying pool includes instruments that are collateralised by assets that do not meet the conditions in paragraphs AG85–AG86~~B4.1.23–B4.1.24~~, the ability to take possession of such assets shall be disregarded for the purposes of applying this paragraph unless the entity acquired the tranche with the management model~~intention~~ of controlling the collateral.

Option to Designate a Financial Asset or Financial Liability as at Fair Value Through ~~profit or loss~~Surplus or Deficit ~~(Sections 4.1 and 4.2)~~

AG89.~~B4.1.27~~ Subject to the conditions in paragraphs 44~~4.1.5~~ and 46~~4.2.2~~, this Standard allows an entity to designate a financial asset, a financial liability, or a group of financial instruments (financial assets, financial liabilities or both) as at fair value through ~~profit or loss~~surplus or deficit provided that doing so results in more relevant information.

AG90.~~B4.1.28~~ The decision of an entity to designate a financial asset or financial liability as at fair value through ~~profit or loss~~surplus or deficit is similar to an accounting policy choice (although, unlike an accounting policy choice, it is not required to be applied consistently to all similar transactions). When an entity has such a choice, paragraph 12~~14(b)~~ of PBE IPSAS 3~~IAS 8~~ requires the chosen policy to result in the financial statements providing reliable and more relevant information about the effects of transactions, other events and conditions on the entity's financial position, financial performance or cash flows. For example, in the case of designation of a financial liability as at fair value through ~~profit or loss~~surplus or deficit, paragraph 46~~4.2.2~~ sets out the two circumstances when the requirement for more relevant information will be met. Accordingly, to choose such designation in accordance with paragraph 46~~4.2.2~~, the entity needs to demonstrate that it falls within one (or both) of these two circumstances.

Designation Eliminates or Significantly Reduces an Accounting Mismatch

AG91.~~B4.1.29~~ Measurement of a financial asset or financial liability and classification of recognised changes in its value are determined by the item's classification and whether the item is part of a designated hedging relationship. Those requirements can create a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') when, for example, in the absence of designation as at fair value through ~~profit or loss~~surplus or deficit, a financial asset would be classified as subsequently measured at fair value through ~~profit or loss~~surplus or deficit and a liability the entity considers related would be subsequently measured at amortised cost (with changes in fair value not recognised). In such circumstances, an entity may conclude that its financial statements would provide more relevant information if both the asset and the liability were measured as at fair value through ~~profit or loss~~surplus or deficit.

AG92.~~B4.1.30~~ The following examples show when this condition could be met. In all cases, an entity may use this condition to designate financial assets or financial liabilities as at fair value through ~~profit or loss~~surplus or deficit only if it meets the principle in paragraph 44~~4.1.5~~ or 46~~4.2.2~~(a):

(a) An entity has contracts within the scope of PBE IFRS 17 (the measurement of which incorporates current information) and financial assets that it considers to be related and that would otherwise be measured at either fair value through other comprehensive ~~income~~revenue and expense or amortised cost.

(b) An entity has financial assets, financial liabilities or both that share a risk, such as interest rate risk, and that gives rise to opposite changes in fair value that tend to offset each other. However, only some of the instruments would be measured at fair value through ~~profit or loss~~surplus or deficit (for example, those that are derivatives, or are classified as held for trading). It may also be the case that the requirements for hedge accounting are not met because, for example, the requirements for hedge effectiveness in paragraph 129~~6.4.1~~ are not met.

(c) An entity has financial assets, financial liabilities or both that share a risk, such as interest rate risk, that gives rise to opposite changes in fair value that tend to offset each other and none of the financial assets or financial liabilities qualifies for designation as a hedging instrument because they are not measured at fair value through ~~profit or loss~~surplus or deficit. Furthermore, in the absence of hedge accounting there is a significant inconsistency in the recognition of gains and losses. For example, the entity has financed a specified group of loans by issuing traded bonds whose changes in fair value tend to offset each other. If, in addition, the entity regularly buys and sells the bonds but rarely, if ever, buys and sells the loans, reporting both the loans and the bonds at fair value through ~~profit or loss~~surplus or deficit eliminates the inconsistency in the timing of the recognition of the gains and losses that would otherwise result from measuring them both at amortised cost and recognising a gain or loss each time a bond is repurchased.

AG93.~~B4.1.31~~ In cases such as those described in the preceding paragraph, to designate, at initial recognition, the financial assets and financial liabilities not otherwise so measured as at fair value through ~~profit or loss~~surplus or deficit may eliminate or significantly reduce the measurement or recognition inconsistency and produce more relevant information. For practical purposes, the entity need not enter into all of the assets and liabilities giving rise to the measurement or recognition inconsistency at exactly the same time. A reasonable delay is permitted provided that each transaction is designated as at fair value through ~~profit or~~

~~loss~~surplus or deficit at its initial recognition and, at that time, any remaining transactions are expected to occur.

AG94.~~B4.1.32~~ It would not be acceptable to designate only some of the financial assets and financial liabilities giving rise to the inconsistency as at fair value through ~~profit or loss~~surplus or deficit if to do so would not eliminate or significantly reduce the inconsistency and would therefore not result in more relevant information. However, it would be acceptable to designate only some of a number of similar financial assets or similar financial liabilities if doing so achieves a significant reduction (and possibly a greater reduction than other allowable designations) in the inconsistency. For example, assume an entity has a number of similar financial liabilities that sum to CU100 and a number of similar financial assets that sum to CU50 but are measured on a different basis. The entity may significantly reduce the measurement inconsistency by designating at initial recognition all of the assets but only some of the liabilities (for example, individual liabilities with a combined total of CU45) as at fair value through ~~profit or loss~~surplus or deficit. However, because designation as at fair value through ~~profit or loss~~surplus or deficit can be applied only to the whole of a financial instrument, the entity in this example must designate one or more liabilities in their entirety. It could not designate either a component of a liability (e.g., changes in value attributable to only one risk, such as changes in a benchmark interest rate) or a proportion (i.e., percentage) of a liability.

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

AG95.~~B4.1.33~~ An entity may manage and evaluate the performance of a group of financial liabilities or financial assets and financial liabilities in such a way that measuring that group at fair value through ~~profit or loss~~surplus or deficit results in more relevant information. The focus in this instance is on the way the entity manages and evaluates performance, instead of on the nature of its financial instruments.

AG96.~~B4.1.34~~ For example, an entity may use this condition to designate financial liabilities as at fair value through ~~profit or loss~~surplus or deficit if it meets the principle in paragraph 46~~4.2.2~~(b) and the entity has financial assets and financial liabilities that share one or more risks and those risks are managed and evaluated on a fair value basis in accordance with a documented policy of asset and liability management. An example could be an entity that has issued ‘structured products’ containing multiple embedded derivatives and manages the resulting risks on a fair value basis using a mix of derivative and non-derivative financial instruments.

AG97.~~B4.1.35~~ As noted above, this condition relies on the way the entity manages and evaluates performance of the group of financial instruments under consideration. Accordingly, (subject to the requirement of designation at initial recognition) an entity that designates financial liabilities as at fair value through ~~profit or loss~~surplus or deficit on the basis of this condition shall so designate all eligible financial liabilities that are managed and evaluated together.

AG98.~~B4.1.36~~ Documentation of the entity’s strategy need not be extensive but should be sufficient to demonstrate compliance with paragraph 46~~4.2.2~~(b). Such documentation is not required for each individual item, but may be on a portfolio basis. For example, if the performance management system for a department—as approved by the entity’s key management personnel—clearly demonstrates that its performance is evaluated on this basis, no further documentation is required to demonstrate compliance with paragraph 46~~4.2.2~~(b).

Embedded Derivatives ~~(Section 4.3)~~

AG99.~~B4.3.1~~ When an entity becomes a party to a hybrid contract with a host that is not an asset within the scope of this Standard, paragraph 49~~4.3.3~~ requires the entity to identify any embedded derivative, assess whether it is required to be separated from the host contract and, for those that are required to be separated, measure the derivatives at fair value at initial recognition and subsequently at fair value through ~~profit or loss~~surplus or deficit.

AG100.~~B4.3.2~~ If a host contract has no stated or predetermined maturity and represents a residual interest in the net assets of an entity, then its economic characteristics and risks are those of an equity instrument, and an embedded derivative would need to possess equity characteristics related to the same entity to be regarded as closely related. If the host contract is not an equity instrument and meets the definition of a financial instrument, then its economic characteristics and risks are those of a debt instrument.

AG101.~~B4.3.3~~ An embedded non-option derivative (such as an embedded forward or swap) is separated from its host contract on the basis of its stated or implied substantive terms, so as to result in it having a fair value of zero at initial recognition. An embedded option-based derivative (such as an embedded put, call, cap, floor or swaption) is separated from its host contract on the basis of the stated terms of the option feature. The initial carrying amount of the host instrument is the residual amount after separating the embedded derivative.

AG102.~~B4.3.4~~ Generally, multiple embedded derivatives in a single hybrid contract are treated as a single compound embedded derivative. However, embedded derivatives that are classified as equity (see PBE IPSAS 28~~IAS 32~~ *Financial Instruments: Presentation*) are accounted for separately from those classified as assets or liabilities. In addition, if a hybrid contract has more than one embedded derivative and those derivatives relate to different risk exposures and are readily separable and independent of each other, they are accounted for separately from each other.

AG103.~~B4.3.5~~ The economic characteristics and risks of an embedded derivative are not closely related to the host contract (paragraph 49~~4.3.3~~(a)) in the following examples. In these examples, assuming the conditions in paragraph 49~~4.3.3~~(b) and 49(c) are met, an entity accounts for the embedded derivative separately from the host contract.

(a) A put option embedded in an instrument that enables the holder to require the issuer to reacquire the instrument for an amount of cash or other assets that varies on the basis of the change in an equity or commodity price or index is not closely related to a host debt instrument.

(b) An option or automatic provision to extend the remaining term to maturity of a debt instrument is not closely related to the host debt instrument unless there is a concurrent adjustment to the approximate current market rate of interest at the time of the extension. If an entity issues a debt instrument and the holder of that debt instrument writes a call option on the debt instrument to a third party, the issuer regards the call option as extending the term to maturity of the debt instrument provided the issuer can be required to participate in or facilitate the remarketing of the debt instrument as a result of the call option being exercised.

(c) Equity-indexed interest or principal payments embedded in a host debt instrument or insurance contract—by which the amount of interest or principal is indexed to the value of equity instruments—are not closely related to the host instrument because the risks inherent in the host and the embedded derivative are dissimilar.

(d) Commodity-indexed interest or principal payments embedded in a host debt instrument or insurance contract—by which the amount of interest or principal is indexed to the price of a commodity (such as gold)—are not closely related to the host instrument because the risks inherent in the host and the embedded derivative are dissimilar.

(e) A call, put, or prepayment option embedded in a host debt contract or host insurance contract is not closely related to the host contract unless:

  (i) The option's exercise price is approximately equal on each exercise date to the amortised cost of the host debt instrument or the carrying amount of the host insurance contract; or

  (ii) The exercise price of a prepayment option reimburses the lender for an amount up to the approximate present value of lost interest for the remaining term of the host contract. Lost interest is the product of the principal amount prepaid multiplied by the interest rate differential. The interest rate differential is the excess of the effective interest rate of the host contract over the effective interest rate the entity would receive at the prepayment date if it reinvested the principal amount prepaid in a similar contract for the remaining term of the host contract.

  The assessment of whether the call or put option is closely related to the host debt contract is made before separating the equity element of a convertible debt instrument in accordance with PBE IPSAS 28~~IAS 32~~.

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

AG104.~~B4.3.6~~ An example of a hybrid contract is a financial instrument that gives the holder a right to put the financial instrument back to the issuer in exchange for an amount of cash or other financial assets that varies on the basis of the change in an equity or commodity index that may increase or decrease (a 'puttable instrument'). Unless the issuer on initial recognition designates the puttable instrument as a financial liability at fair value through ~~profit or loss~~surplus or deficit, it is required to separate an embedded derivative (i.e., the indexed principal payment) under paragraph 49~~4.3.3~~ because the host contract is a debt instrument under paragraph AG100~~B4.3.2~~ and the indexed principal payment is not closely related to a host debt instrument under paragraph AG103~~B4.3.5~~(a). Because the principal payment can increase and decrease, the embedded derivative is a non-option derivative whose value is indexed to the underlying variable.

AG105.~~B4.3.7~~ In the case of a puttable instrument that can be put back at any time for cash equal to a proportionate share of the net asset value of an entity (such as units of an open-ended mutual fund or some unit-linked investment products), the effect of separating an embedded derivative and accounting for each component is to measure the hybrid contract at the redemption amount that is payable at the end of the reporting period if the holder exercised its right to put the instrument back to the issuer.

AG106.~~B4.3.8~~ The economic characteristics and risks of an embedded derivative are closely related to the economic characteristics and risks of the host contract in the following examples. In these examples, an entity does not account for the embedded derivative separately from the host contract.

(a) An embedded derivative in which the underlying is an interest rate or interest rate index that can change the amount of interest that would otherwise be paid or received on an interest-bearing host debt contract or insurance contract is closely related to the host contract unless the hybrid contract can be settled in such a way that the holder would not recover substantially all of its recognised investment or the embedded derivative could at least double the holder's initial rate of return on the host contract and could result in a rate of return that is at least twice what the market return would be for a contract with the same terms as the host contract.

(b) An embedded floor or cap on the interest rate on a debt contract or insurance contract is closely related to the host contract, provided the cap is at or above the market rate of interest and the floor is at or below the market rate of interest when the contract is issued, and the cap or floor is not leveraged in relation to the host contract. Similarly, provisions included in a contract to purchase or sell an asset (e.g., a commodity) that establish a cap and a floor on the price to be paid or received for the asset are closely related to the host contract if both the cap and floor were out of the money at inception and are not leveraged.

(c) An embedded foreign currency derivative that provides a stream of principal or interest payments that are denominated in a foreign currency and is embedded in a host debt instrument (for example, a dual currency bond) is closely related to the host debt instrument. Such a derivative is not separated from the host instrument because PBE IPSAS 4~~IAS 21~~ *The Effects of Changes in Foreign Exchange Rates* requires foreign currency gains and losses on monetary items to be recognised in ~~profit or loss~~surplus or deficit.

(d) An embedded foreign currency derivative in a host contract that is an insurance contract or not a financial instrument (such as a contract for the purchase or sale of a non-financial item where the price is denominated in a foreign currency) is closely related to the host contract provided it is not leveraged, does not contain an option feature, and requires payments denominated in one of the following currencies:

  (i) The functional currency of any substantial party to that contract;

  (ii) The currency in which the price of the related good or service that is acquired or delivered is routinely denominated in commercial transactions around the world (such as the US dollar for crude oil transactions); or

  (iii) A currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place (e.g., a relatively stable and liquid currency that is commonly used in local business transactions or external trade).

(e) An embedded prepayment option in an interest-only or principal-only strip is closely related to the host contract provided the host contract (i) initially resulted from separating the right to receive contractual cash flows of a financial instrument that, in and of itself, did not contain an embedded derivative, and (ii) does not contain any terms not present in the original host debt contract.

(f) An embedded derivative in a host lease contract is closely related to the host contract if the embedded derivative is (i) an inflation-related index such as an index of lease payments to a consumer price index (provided that the lease is not leveraged and the index relates to inflation in the entity's own economic environment), (ii) variable lease payments based on related sales or (iii) variable lease payments based on variable interest rates.

(g) A unit-linking feature embedded in a host financial instrument or host insurance contract is closely related to the host instrument or host contract if the unit-denominated payments are measured at current unit values that reflect the fair values of the assets of the fund. A unit-linking feature is a contractual term that requires payments denominated in units of an internal or external investment fund.

(h) A derivative embedded in an insurance contract is closely related to the host insurance contract if the embedded derivative and host insurance contract are so interdependent that an entity cannot measure the embedded derivative separately (i.e., without considering the host contract).

Instruments Containing Embedded Derivatives

AG107.~~B4.3.9~~ As noted in paragraph AG99~~B4.3.1~~, when an entity becomes a party to a hybrid contract with a host that is not an asset within the scope of this Standard and with one or more embedded derivatives, paragraph 49~~4.3.3~~ requires the entity to identify any such embedded derivative, assess whether it is required to be separated from the host contract and, for those that are required to be separated, measure the derivatives at fair value at initial recognition and subsequently. These requirements can be more complex, or result in less reliable measures, than measuring the entire instrument at fair value through ~~profit or loss~~surplus or deficit. For that reason this Standard permits the entire hybrid contract to be designated as at fair value through ~~profit or loss~~surplus or deficit.

AG108.~~B4.3.10~~ Such designation may be used whether paragraph 49~~4.3.3~~ requires the embedded derivatives to be separated from the host contract or prohibits such separation. However, paragraph 51~~4.3.5~~ would not justify designating the hybrid contract as at fair value through ~~profit or loss~~surplus or deficit in the cases set out in paragraph 51~~4.3.5~~(a) and 51(b) because doing so would not reduce complexity or increase reliability.

Reassessment of Embedded Derivatives

AG109.~~B4.3.11~~ In accordance with paragraph 49~~4.3.3~~, an entity shall assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required. An entity determines whether a modification to cash flows is significant by considering the extent to which the expected future cash flows associated with the embedded derivative, the host contract or both have changed and whether the change is significant relative to the previously expected cash flows on the contract.

AG110.~~B4.3.12~~ Paragraph AG109~~B4.3.11~~ does not apply to embedded derivatives in contracts acquired in:

(a) A business combination (as defined in PBE IFRS 3 *Business Combinations*);

(b) A combination of entities or businesses under common control as described in paragraphs B1–B4 of PBE IFRS 3; or

(c) The formation of a joint venture as defined in PBE IPSAS 37 ~~IFRS 11~~ *Joint Arrangements*

or their possible reassessment at the date of acquisition.

~~Reclassification of financial assets (Section 4.4)~~

Reclassification of Financial Assets

AG111.~~B4.4.1~~ Paragraph 54~~4.4.1~~ requires an entity to reclassify financial assets if the entity changes its management~~business~~ model for managing those financial assets. Such changes are expected to be very infrequent. Such changes are determined by the entity's senior management as a result of external or internal changes and must be significant to the entity's operations and demonstrable to external parties. Accordingly, a change in an entity's management~~business~~ model will occur only when an entity either begins or ceases to perform an activity that is significant to its operations; for example, when the entity has acquired, disposed of or terminated a business line. Examples of a change in management~~business~~ model include the following:

(a) A government agency extends loans to small business owners and has a management model to sell the loan portfolios to private entities at a discount due to the long collection cycle of these loans. The entity enters into a long-term contract with a third-party collection service provider. The loan portfolios are no longer for sale, as they are held to collect the contractual cash flows with the aid of the collections service provider.

(b) A department of government decides to end its support for its national auto manufacturing industry by no longer providing favourable loans. That department no longer issues new loans and the department is actively marketing its loan portfolio for sale.

~~(a) An entity has a portfolio of commercial loans that it holds to sell in the short term. The entity acquires a company that manages commercial loans and has a business model that holds the loans in order to collect the contractual cash flows. The portfolio of commercial loans is no longer for sale, and the portfolio is now managed together with the acquired commercial loans and all are held to collect the contractual cash flows.~~

(b) ~~A financial services firm decides to shut down its retail mortgage business. That business no longer accepts new business and the financial services firm is actively marketing its mortgage loan portfolio for sale.~~

AG112.~~B4.4.2~~ A change in the objective of the entity's management~~business~~ model must be effected before the reclassification date. For example, if a federal mortgage and housing corporation~~financial services firm~~ decides on ~~15~~ February 15 to shut down its retail mortgage business and hence must reclassify all affected financial assets on ~~1~~ April 1 (i.e., the first day of the entity's next reporting period), the entity must not accept new retail mortgage business or otherwise engage in activities consistent with its former management~~business~~ model after ~~15~~ February 15.

AG113.~~B4.4.3~~ The following are not changes in ~~business~~ management model:

(a) A change in intention related to particular financial assets (even in circumstances of significant changes in market conditions).

(b) The temporary disappearance of a particular market for financial assets.

(c) A transfer of financial assets between parts of the entity with different management~~business~~ models.

Measurement ~~(Chapter 5)~~

Non-Exchange Revenue Transactions

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

(a) Initially recognised in accordance with PBE IPSAS 23;

(b) Initially measured:

(i) At fair value using the principles in PBE IPSAS 23; and

(ii) Taking account of transaction costs that are directly attributable to the acquisition of the financial asset in accordance with paragraph 57 of this Standard, where the asset is subsequently measured other than at fair value through surplus or deficit.

Initial Measurement ~~(Section 5.1)~~

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

AG115.~~B5.1.1~~ The fair value of a financial instrument at initial recognition is normally the transaction price (i.e., the fair value of the consideration given or received, see also paragraph AG117~~B5.1.2A and IFRS 13~~). However, if part of the consideration given or received is for something other than the financial instrument, ~~an entity shall measure~~ the fair value of the financial instrument is estimated, using a valuation technique (see paragraphs AG149–AG154). For example, the fair value of a long-term loan or receivable that carries no interest can be measured as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating. Any additional amount lent is an expense or a reduction of revenue~~income~~ unless it qualifies for recognition as some other type of asset.

AG116.~~B5.1.2~~ If an entity originates a loan that bears an off-market interest rate (e.g., 5 per cent when the market rate for similar loans is 8 per cent), and receives an upfront fee as compensation, the entity recognises the loan at its fair value, ie net of the fee it receives.

AG117.~~B5.1.2A~~ The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price ~~(i.e., the fair value of the consideration given or received, see also IFRS 13)~~. If an entity determines that the fair value at initial recognition differs from the transaction price as mentioned in paragraph 58~~5.1.1A~~, the entity shall account for that instrument at that date as follows:

(a) At the measurement required by paragraph 57~~5.1.1~~ if that fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e., a Level 1 input) or based on a valuation technique that uses only data from observable markets. An entity shall recognise the difference between the fair value at initial recognition and the transaction price as a gain or loss.

(b) In all other cases, at the measurement required by paragraph 57~~5.1.1~~, adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the entity shall recognise that deferred difference as a gain or loss only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the asset or liability.

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

Concessionary Loans

[Need to recheck this section for any NZ specific changes and against PBE iFRS 9 for other comprehensive revenue and expense]

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

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

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

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

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

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

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

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

(a) Where the loan is received by an entity, the difference is accounted for in accordance with PBE IPSAS 23.

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

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

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

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

Equity Instruments Arising from Non-Exchange Transactions

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

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

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

Valuing Financial Guarantees Issued Through a Non-Exchange Transaction

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

AG132. In paragraph 9, "financial guarantee contract" is defined as "a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument." Under the requirements of this Standard, financial guarantee contracts, like other financial assets and financial liabilities, are required to be initially recognised at fair value. Paragraphs 66–68 of this Standard provide commentary and guidance on determining fair value and this is complemented by Application Guidance in paragraphs AG144–AG155. Subsequent measurement for financial guarantee contracts is at the higher of the amount of the loss allowance determined in accordance with paragraphs 73–93 and the amount initially recognised less, when appropriate, cumulative amortisation in accordance with PBE IPSAS 9 *Revenue from Exchange Transactions*.

AG133. In the public sector, guarantees are frequently provided by way of non-exchange transactions, i.e., at no or nominal consideration. This type of guarantee is provided generally to further the entity's economic and social objectives. Such purposes include supporting infrastructure projects, supporting corporate entities at times of economic distress, guaranteeing the bond issues of entities in other tiers of governments and the loans of employees to finance motor vehicles that are to be used for performance of their duties as employees. Where there is consideration for a financial guarantee, an entity should determine whether that consideration arises from an exchange transaction and whether the consideration represents a fair value. If the consideration does represent a fair value, entities should recognise the financial guarantee at the amount of the consideration. Subsequent measurement should be at the higher of the amount of the loss allowance determined in accordance with paragraphs 73–93 and the amount initially recognised, less, when appropriate, cumulative amortisation recognised in accordance with PBE IPSAS 9. Where the entity concludes that the consideration is not a fair value, an entity determines the carrying value at initial recognition in the same way as if no consideration had been paid.

AG134. At initial recognition, where no fee is charged or where the consideration is not fair value, an entity firstly considers whether there are quoted prices available in an active market for financial guarantee contracts directly equivalent to that entered into. Evidence of an active market includes recent arm's length market transactions between knowledgeable willing parties, and reference to the current fair value of another financial guarantee contract that is substantially the same as that provided at nil or nominal consideration by the issuer. The fact that a financial guarantee contract has been entered into at no consideration by the debtor to the issuer is not, of itself, conclusive evidence of the absence of an active market. Guarantees may be available from commercial issuers, but a public sector entity may agree to enter into a financial guarantee contract for a number of non-commercial reasons. For example, if a debtor is unable to afford a commercial fee, and initiation of a project in fulfilment of one of the entity's social or policy objectives would be put at risk unless a financial guarantee contract is issued, it may approach a public sector entity or government to issue a financial guarantee contract.

AG135. Where there is no active market for a directly equivalent guarantee contract; the entity considers whether a valuation technique other than observation of an active market is available and provides a reliable measure of fair value. Such a valuation technique may rely on mathematical models which consider financial risk. For example, National Government W guarantees a bond issue of Municipality X. As Municipality X has a government guarantee backing its bond issue, its bonds have a lower coupon than if they were not secured by a government guarantee. This is because the guarantee lowers the risk profile of the bonds for investors. The guarantee fee could be determined by using the credit spread between what the coupon rate would have been had the issue not been backed by a government guarantee and the rate with the guarantee in place. Where a fair value is obtainable either by observation of an active market or through another valuation technique, the entity recognises the financial guarantee at that fair value in the statement of financial position and recognises an expense of an equivalent amount in the statement of financial performance. When using a valuation technique that is not based on observation of an active market an entity needs to satisfy itself that the output of any model is reliable and understandable.

AG136. If no reliable measure of fair value can be determined, either by direct observation of an active market or through another valuation technique, an entity is required to measure the financial guarantee contract at the amount of the loss allowance determined in accordance with paragraphs 73 to 93.

Subsequent Measurement ~~(Sections 5.2 and 5.3)~~

AG137.~~B5.2.1~~ If a financial instrument that was previously recognised as a financial asset is measured at fair value through ~~profit or loss~~surplus or deficit and its fair value decreases below zero, it is a financial liability measured in accordance with paragraph 45~~4.2.1~~. However, hybrid contracts with hosts that are assets within the scope of this Standard are always measured in accordance with paragraph 48~~4.3.2~~.

AG138.~~B5.2.2~~ The following example illustrates the accounting for transaction costs on the initial and subsequent measurement of a financial asset measured at fair value with changes through other comprehensive ~~income~~revenue and expense in accordance with either paragraph 106~~5.7.5~~ or 41~~4.1.2A~~. An entity acquires a financial asset for CU100 plus a purchase commission of CU2. Initially, the entity recognises the asset at CU102. The reporting period ends one day later, when the quoted market price of the asset is CU100. If the asset were sold, a commission of CU3 would be paid. On that date, the entity measures the asset at CU100 (without regard to the possible commission on sale) and recognises a loss of CU2 in other comprehensive ~~income~~revenue and expense. If the financial asset is measured at fair value through other comprehensive ~~income~~revenue and expense in accordance with paragraph 41~~4.1.2A~~, the transaction costs are amortised to ~~profit or loss~~surplus or deficit using the effective interest method.

AG139.~~B5.2.2A~~ The subsequent measurement of a financial asset or financial liability and the subsequent recognition of gains and losses described in paragraph AG117~~B5.1.2A~~ shall be consistent with the requirements of this Standard.

Investments in Equity Instruments and Contracts on Those Investments

AG140.~~B5.2.3~~ All investments in equity instruments and contracts on those instruments must be measured at fair value. However, in limited circumstances, cost may be an appropriate estimate of fair value. That may be the case if insufficient more recent information is available to measure fair value, or if there is a wide range of possible fair value measurements and cost represents the best estimate of fair value within that range.

AG141.~~B5.2.4~~ Indicators that cost might not be representative of fair value include:

(a) A significant change in the performance of the investee compared with budgets, plans or milestones.

(b) Changes in expectation that the investee's technical product milestones will be achieved.

(c) A significant change in the market for the investee's equity or its products or potential products.

(d) A significant change in the global economy or the economic environment in which the investee operates.

(e) A significant change in the performance of comparable entities, or in the valuations implied by the overall market.

(f) Internal matters of the investee such as fraud, commercial disputes, litigation, changes in management or strategy.

(g) Evidence from external transactions in the investee's equity, either by the investee (such as a fresh issue of equity), or by transfers of equity instruments between third parties.

AG142.~~B5.2.5~~ The list in paragraph AG141~~B5.2.4~~ is not exhaustive. An entity shall use all information about the performance and operations of the investee that becomes available after the date of initial recognition. To the extent that any such relevant factors exist, they may indicate that cost might not be representative of fair value. In such cases, the entity must measure fair value.

AG143.~~B5.2.6~~ Cost is never the best estimate of fair value for investments in quoted equity instruments (or contracts on quoted equity instruments).

Fair Value Measurement Considerations

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

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

Active Market: Quoted Price

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

AG147. The appropriate quoted market price for an asset held or liability to be issued is usually the current bid price and, for an asset to be acquired or liability held, the asking price. When an entity has assets and liabilities with offsetting market risks, it may use mid-market prices as a basis for establishing fair values for the offsetting risk positions and apply the bid or asking price to the net open position as appropriate. When current bid and asking prices are unavailable, the price of the most recent transaction provides evidence of the current fair value as long as there has not been a significant change in economic circumstances since the time of the transaction. If conditions have changed since the time of the transaction (e.g., a change in the risk-free interest rate following the most recent price quote for a government bond), the fair value reflects the change in conditions by reference to current prices or rates for similar financial instruments, as appropriate. Similarly, if the entity can demonstrate that the last transaction price is not fair value (e.g., because it reflected the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale), that price is adjusted. The fair value of a portfolio of financial instruments is the product of the number of units of the instrument and its quoted market price. If a published price quotation in an active market does not exist for a financial instrument in its entirety, but active markets exist for its component parts, fair value is determined on the basis of the relevant market prices for the component parts.

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

No Active Market: Valuation Technique

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

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

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

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

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

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

Inputs to Valuation Techniques

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

(a) The time value of money (i.e., interest at the basic or risk-free rate). Basic interest rates can usually be derived from observable government bond prices and are often quoted in financial publications. These rates typically vary with the expected dates of the projected cash flows along a yield curve of interest rates for different time horizons. For practical reasons, an entity may use a well-accepted and readily observable general market rate, such as a swap rate, as the benchmark rate. (If the rate used is not the risk-free interest rate, the credit risk adjustment appropriate to the particular financial instrument is determined on the basis of its credit risk in relation to the credit risk in this benchmark rate). In some countries, the central government's bonds may carry a significant credit risk and may not provide a stable benchmark basic interest rate for instruments denominated in that currency. Some entities in these countries may have a better credit standing and a lower borrowing rate than the central government. In such a case, basic interest rates may be more appropriately determined by reference to interest rates for the highest rated corporate bonds issued in the currency of that jurisdiction.

(b) Credit risk. The effect on fair value of credit risk (i.e., the premium over the basic interest rate for credit risk) may be derived from observable market prices for traded instruments of different credit quality or from observable interest rates charged by lenders for loans of various credit ratings.

(c) Foreign currency exchange prices. Active currency exchange markets exist for most major currencies, and prices are quoted daily in financial publications.

(d) Commodity prices. There are observable market prices for many commodities.

(e) Equity prices. Prices (and indexes of prices) of traded equity instruments are readily observable in some markets. Present value based techniques may be used to estimate the current market price of equity instruments for which there are no observable prices.

(f) Volatility (i.e., magnitude of future changes in price of the financial instrument or other item). Measures of the volatility of actively traded items can normally be reasonably estimated on the basis of historical market data or by using volatilities implied in current market prices.

(g) Prepayment risk and surrender risk. Expected prepayment patterns for financial assets and expected surrender patterns for financial liabilities can be estimated on the basis of historical data. (The fair value of a financial liability that can be surrendered by the counterparty cannot be less than the present value of the surrender amount – see paragraph 68).

(h) Servicing costs for a financial asset or a financial liability. Costs of servicing can be estimated using comparisons with current fees charged by other market participants. If the costs of servicing a financial asset or financial liability are significant and other market participants would face comparable costs, the issuer would consider them in determining the fair value of that financial asset or financial liability. It is likely that the fair value at inception of a contractual right to future fees equals the origination costs paid for them, unless future fees and related costs are out of line with market comparables.

Amortised cost measurement ~~(Section 5.4)~~

Effective interest method

AG156.~~B5.4.1~~ In applying the effective interest method, an entity identifies fees that are an integral part of the effective interest rate of a financial instrument. The description of fees for financial services may not be indicative of the nature and substance of the services provided. Fees that are an integral part of the effective interest rate of a financial instrument are treated as an adjustment to the effective interest rate, unless the financial instrument is measured at fair value, with the change in fair value being recognised in ~~profit or loss~~surplus or deficit. In those cases, the fees are recognised as revenue or expense when the instrument is initially recognised.

AG157.~~B5.4.2~~ Fees that are an integral part of the effective interest rate of a financial instrument include:

(a) Origination fees received by the entity relating to the creation or acquisition of a financial asset. Such fees may include compensation for activities such as evaluating the borrower’s financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction. These fees are an integral part of generating an involvement with the resulting financial instrument.

(b) Commitment fees received by the entity to originate a loan when the loan commitment is not measured in accordance with paragraph 45~~4.2.1~~(a) and it is probable that the entity will enter into a specific lending arrangement. These fees are regarded as compensation for an ongoing involvement with the acquisition of a financial instrument. If the commitment expires without the entity making the loan, the fee is recognised as revenue on expiry.

(c) Origination fees paid on issuing financial liabilities measured at amortised cost. These fees are an integral part of generating an involvement with a financial liability. An entity distinguishes fees and costs that are an integral part of the effective interest rate for the financial liability from origination fees and transaction costs relating to the right to provide services, such as investment management services.

AG158.~~B5.4.3~~ Fees that are not an integral part of the effective interest rate of a financial instrument and are accounted for in accordance with PBE IPSAS 9~~IFRS 15~~ include:

(a) Fees charged for servicing a loan;

(b) Commitment fees to originate a loan when the loan commitment is not measured in accordance with paragraph 45~~4.2.1~~(a) and it is unlikely that a specific lending arrangement will be entered into; and

(c) Loan syndication fees received by an entity that arranges a loan and retains no part of the loan package for itself (or retains a part at the same effective interest rate for comparable risk as other participants).

AG159.~~B5.4.4~~ When applying the effective interest method, an entity generally amortises any fees, points paid or received, transaction costs and other premiums or discounts that are included in the calculation of the effective interest rate over the expected life of the financial instrument. However, a shorter period is used if this is the period to which the fees, points paid or received, transaction costs, premiums or discounts relate. This will be the case when the variable to which the fees, points paid or received, transaction costs, premiums or discounts relate is repriced to market rates before the expected maturity of the financial instrument. In such a case, the appropriate amortisation period is the period to the next such repricing date. For example, if a premium or discount on a floating-rate financial instrument reflects the interest that has accrued on that financial instrument since the interest was last paid, or changes in the market rates since the floating interest rate was reset to the market rates, it will be amortised to the next date when the floating interest is reset to market rates. This is because the premium or discount relates to the period to the next interest reset date because, at that date, the variable to which the premium or discount relates (i.e., interest rates) is reset to the market rates. If, however, the premium or discount results from a change in the credit spread over the floating rate specified in the financial instrument, or other variables that are not reset to the market rates, it is amortised over the expected life of the financial instrument.

AG160.~~B5.4.5~~ For floating-rate financial assets and floating-rate financial liabilities, periodic re-estimation of cash flows to reflect the movements in the market rates of interest alters the effective interest rate. If a floating-rate financial asset or a floating-rate financial liability is recognised initially at an amount equal to the principal receivable or payable on maturity, re-estimating the future interest payments normally has no significant effect on the carrying amount of the asset or the liability.

AG161.~~B5.4.6~~ If an entity revises its estimates of payments or receipts (excluding modifications in accordance with paragraph 71~~5.4.3~~ and changes in estimates of expected credit losses), it shall adjust the gross carrying amount of the financial asset or amortised cost of a financial liability (or group of financial instruments) to reflect actual and revised estimated contractual cash flows. The entity recalculates the gross carrying amount of the financial asset or amortised cost of the financial liability as the present value of the estimated future contractual cash flows that are discounted at the financial instrument's original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets) or, when applicable, the revised effective interest rate calculated in accordance with paragraph 139~~6.5.10~~. The adjustment is recognised in ~~profit or loss~~surplus or deficit as revenue~~income~~ or expense.

AG162.~~B5.4.7~~ In some cases a financial asset is considered credit-impaired at initial recognition because the credit risk is very high, and in the case of a purchase it is acquired at a deep discount. An entity is required to include the initial expected credit losses in the estimated cash flows when calculating the credit-adjusted effective interest rate for financial assets that are considered to be purchased or originated credit-impaired at initial recognition. However, this does not mean that a credit-adjusted effective interest rate should be applied solely because the financial asset has high credit risk at initial recognition.

Transaction costs

AG163.~~B5.4.8~~ Transaction costs include fees and commission paid to agents (including employees acting as selling agents), advisers, brokers and dealers, levies by regulatory agencies and security exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

Write-off

AG164.~~B5.4.9~~ Write-offs can relate to a financial asset in its entirety or to a portion of it. For example, an entity plans to enforce the collateral on a financial asset and expects to recover no more than 30 per cent of the financial asset from the collateral. If the entity has no reasonable prospects of recovering any further cash flows from the financial asset, it should write off the remaining 70 per cent of the financial asset.

Impairment ~~(Section 5.5)~~

Collective and individual assessment basis

AG165~~B5.5.1~~ In order to meet the objective of recognising lifetime expected credit losses for significant increases in credit risk since initial recognition, it may be necessary to perform the assessment of significant increases in credit risk on a collective basis by considering information that is indicative of significant increases in credit risk on, for example, a group or sub-group of financial instruments. This is to ensure that an entity meets the objective of recognising lifetime expected credit losses when there are significant increases in credit risk, even if evidence of such significant increases in credit risk at the individual instrument level is not yet available.

AG166.~~B5.5.2~~ Lifetime expected credit losses are generally expected to be recognised before a financial instrument becomes past due. Typically, credit risk increases significantly before a financial instrument becomes past due or other lagging borrower-specific factors (for example, a modification or restructuring) are observed. Consequently when reasonable and supportable information that is more forward-looking than past due information is available without undue cost or effort, it must be used to assess changes in credit risk.

AG167.~~B5.5.3~~ However, depending on the nature of the financial instruments and the credit risk information available for particular groups of financial instruments, an entity may not be able to identify significant changes in credit risk for individual financial instruments before the financial instrument becomes past due. This may be the case for financial instruments such as retail loans for which there is little or no updated credit risk information that is routinely obtained and monitored on an individual instrument until a customer breaches the contractual terms. If changes in the credit risk for individual financial instruments are not captured before they become past due, a loss allowance based only on credit information at an individual financial instrument level would not faithfully represent the changes in credit risk since initial recognition.

AG168.~~B5.5.4~~ In some circumstances an entity does not have reasonable and supportable information that is available without undue cost or effort to measure lifetime expected credit losses on an individual instrument basis. In that case, lifetime expected credit losses shall be recognised on a collective basis that considers comprehensive credit risk information. This comprehensive credit risk information must incorporate not only past due information but also all relevant credit information, including forward-looking macroeconomic information, in order to approximate the result of recognising lifetime expected credit losses when there has been a significant increase in credit risk since initial recognition on an individual instrument level.

AG169.~~B5.5.5~~ For the purpose of determining significant increases in credit risk and recognising a loss allowance on a collective basis, an entity can group financial instruments on the basis of shared credit risk characteristics with the objective of facilitating an analysis that is designed to enable significant increases in credit risk to be identified on a timely basis. The entity should not obscure this information by grouping financial instruments with different risk characteristics. Examples of shared credit risk characteristics may include, but are not limited to, the:

(a) instrument type;

(b) credit risk ratings;

(c) collateral type;

(d) date of initial recognition;

(e) remaining term to maturity;

(f) industry;

(g) geographical location of the borrower; and

(h) the value of collateral relative to the financial asset if it has an impact on the probability of a default occurring (for example, non-recourse loans in some jurisdictions or loan-to-value ratios).

AG170.~~B5.5.6~~ Paragraph 76~~5.5.4~~ requires that lifetime expected credit losses are recognised on all financial instruments for which there has been significant increases in credit risk since initial recognition. In order to meet this objective, if an entity is not able to group financial instruments for which the credit risk is considered to have increased significantly since initial recognition based on shared credit risk characteristics, the entity should recognise lifetime expected credit losses on a portion of the financial assets for which credit risk is deemed to have increased significantly. The aggregation of financial instruments to assess whether there are changes in credit risk on a collective basis may change over time as new information becomes available on groups of, or individual, financial instruments.

Timing of Recognising Lifetime Expected Credit Losses

AG171.~~B5.5.7~~ The assessment of whether lifetime expected credit losses should be recognised is based on significant increases in the likelihood or risk of a default occurring since initial recognition (irrespective of whether a financial instrument has been repriced to reflect an increase in credit risk) instead of on evidence of a financial asset being credit-impaired at the reporting date or an actual default occurring. Generally, there will be a significant increase in credit risk before a financial asset becomes credit-impaired or an actual default occurs.

AG172.~~B5.5.8~~ For loan commitments, an entity considers changes in the risk of a default occurring on the loan to which a loan commitment relates. For financial guarantee contracts, an entity considers the changes in the risk that the specified debtor will default on the contract.

AG173.~~B5.5.9~~ The significance of a change in the credit risk since initial recognition depends on the risk of a default occurring as at initial recognition. Thus, a given change, in absolute terms, in the risk of a default occurring will be more significant for a financial instrument with a lower initial risk of a default occurring compared to a financial instrument with a higher initial risk of a default occurring.

AG174.~~B5.5.10~~ The risk of a default occurring on financial instruments that have comparable credit risk is higher the longer the expected life of the instrument; for example, the risk of a default occurring on an AAA-rated bond with an expected life of 10 years is higher than that on an AAA-rated bond with an expected life of five years.

AG175.~~B5.5.11~~ Because of the relationship between the expected life and the risk of a default occurring, the change in credit risk cannot be assessed simply by comparing the change in the absolute risk of a default occurring over time. For example, if the risk of a default occurring for a financial instrument with an expected life of 10 years at initial recognition is identical to the risk of a default occurring on that financial instrument when its expected life in a subsequent period is only five years, that may indicate an increase in credit risk. This is because the risk of a default occurring over the expected life usually decreases as time passes if the credit risk is unchanged and the financial instrument is closer to maturity. However, for financial instruments that only have significant payment obligations close to the maturity of the financial instrument the risk of a default occurring may not necessarily decrease as time passes. In such a case, an entity should also consider other qualitative factors that would demonstrate whether credit risk has increased significantly since initial recognition.

AG176.~~B5.5.12~~ An entity may apply various approaches when assessing whether the credit risk on a financial instrument has increased significantly since initial recognition or when measuring expected credit losses. An entity may apply different approaches for different financial instruments. An approach that does not include an explicit probability of default as an input per se, such as a credit loss rate approach, can be consistent with the requirements in this Standard, provided that an entity is able to separate the changes in the risk of a default occurring from changes in other drivers of expected credit losses, such as collateral, and considers the following when making the assessment:

(a) The change in the risk of a default occurring since initial recognition;

(b) The expected life of the financial instrument; and

(c) Reasonable and supportable information that is available without undue cost or effort that may affect credit risk.

AG177.~~B5.5.13~~ The methods used to determine whether credit risk has increased significantly on a financial instrument since initial recognition should consider the characteristics of the financial instrument (or group of financial instruments) and the default patterns in the past for comparable financial instruments. Despite the requirement in paragraph 81~~5.5.9~~, for financial instruments for which default patterns are not concentrated at a specific point during the expected life of the financial instrument, changes in the risk of a default occurring over the next 12 months may be a reasonable approximation of the changes in the lifetime risk of a default occurring. In such cases, an entity may use changes in the risk of a default occurring over the next 12 months to determine whether credit risk has increased significantly since initial recognition, unless circumstances indicate that a lifetime assessment is necessary.

AG178.~~B5.5.14~~ However, for some financial instruments, or in some circumstances, it may not be appropriate to use changes in the risk of a default occurring over the next 12 months to determine whether lifetime expected credit losses should be recognised. For example, the change in the risk of a default occurring in the next 12 months may not be a suitable basis for determining whether credit risk has increased on a financial instrument with a maturity of more than 12 months when:

(a) The financial instrument only has significant payment obligations beyond the next 12 months;

(b) Changes in relevant macroeconomic or other credit-related factors occur that are not adequately reflected in the risk of a default occurring in the next 12 months; or

(c) Changes in credit-related factors only have an impact on the credit risk of the financial instrument (or have a more pronounced effect) beyond 12 months.

Determining Whether Credit Risk has Increased Significantly since Initial Recognition

AG179.~~B5.5.15~~ When determining whether the recognition of lifetime expected credit losses is required, an entity shall consider reasonable and supportable information that is available without undue cost or effort and that may affect the credit risk on a financial instrument in accordance with paragraph 90~~5.5.17~~(c). An entity need not undertake an exhaustive search for information when determining whether credit risk has increased significantly since initial recognition.

AG180.~~B5.5.16~~ Credit risk analysis is a multifactor and holistic analysis; whether a specific factor is relevant, and its weight compared to other factors, will depend on the type of product, characteristics of the financial instruments and the borrower as well as the geographical region. An entity shall consider reasonable and supportable information that is available without undue cost or effort and that is relevant for the particular financial instrument being assessed. However, some factors or indicators may not be identifiable on an individual financial instrument level. In such a case, the factors or indicators should be assessed for appropriate portfolios, groups of portfolios or portions of a portfolio of financial instruments to determine whether the requirement in paragraph 75~~5.5.3~~ for the recognition of lifetime expected credit losses has been met.

AG181.~~B5.5.17~~ The following non-exhaustive list of information may be relevant in assessing changes in credit risk:

(a) Significant changes in internal price indicators of credit risk as a result of a change in credit risk since inception, including, but not limited to, the credit spread that would result if a particular financial instrument or similar financial instrument with the same terms and the same counterparty were newly originated or issued at the reporting date.

(b) Other changes in the rates or terms of an existing financial instrument that would be significantly different if the instrument was newly originated or issued at the reporting date (such as more stringent covenants, increased amounts of collateral or guarantees, or higher revenue~~income~~ coverage) because of changes in the credit risk of the financial instrument since initial recognition.

(c) Significant changes in external market indicators of credit risk for a particular financial instrument or similar financial instruments with the same expected life. Changes in market indicators of credit risk include, but are not limited to:

(i) The credit spread;

(ii) The credit default swap prices for the borrower;

(iii) The length of time or the extent to which the fair value of a financial asset has been less than its amortised cost; and

(iv) Other market information related to the borrower, such as changes in the price of a borrower's debt and equity instruments.

(d) An actual or expected significant change in the financial instrument's external credit rating.

(e) An actual or expected internal credit rating downgrade for the borrower or decrease in behavioural scoring used to assess credit risk internally. Internal credit ratings and internal behavioural scoring are more reliable when they are mapped to external ratings or supported by default studies.

(f) Existing or forecast adverse changes in business, financial or economic conditions that are expected to cause a significant change in the borrower's ability to meet its debt obligations, such as an actual or expected increase in interest rates or an actual or expected significant increase in unemployment rates.

(g) An actual or expected significant change in the operating results of the borrower. Examples include actual or expected declining revenues or margins, increasing operating risks, working capital deficiencies, decreasing asset quality, increased balance sheet leverage, liquidity, management problems or changes in the scope of operation~~business~~ or organisational structure (such as the discontinuance of a segment of the entity~~business~~) that results in a significant change in the borrower's ability to meet its debt obligations.

(h) Significant increases in credit risk on other financial instruments of the same borrower.

(i) An actual or expected significant adverse change in the regulatory, economic, or technological environment of the borrower that results in a significant change in the borrower's ability to meet its debt obligations, such as a decline in the demand for the borrower's sales product because of a shift in technology.

(j) Significant changes in the value of the collateral supporting the obligation or in the quality of third-party guarantees or credit enhancements, which are expected to reduce the borrower's economic incentive to make scheduled contractual payments or to otherwise have an effect on the probability of a default occurring. For example, if the value of collateral declines because house prices decline, borrowers in some jurisdictions have a greater incentive to default on their mortgages.

(k) A significant change in the quality of the guarantee provided by an entity's owners ~~shareholder~~ (or an individual's guarantors~~parents~~) if the shareholder (or guarantors~~parents~~) have an incentive and financial ability to prevent default by capital or cash infusion.

(l) Significant changes, such as reductions in financial support from a controlling~~parent~~ entity or other affiliate or an actual or expected significant change in the quality of credit enhancement, that are expected to reduce the borrower's economic incentive to make scheduled contractual payments. Credit quality enhancements or support include the consideration of the financial condition of the guarantor and/or, for interests issued in securitisations, whether subordinated interests are expected to be capable of absorbing expected credit losses (for example, on the loans underlying the security).

(m) Expected changes in the loan documentation including an expected breach of contract that may lead to covenant waivers or amendments, interest payment holidays, interest rate step-ups, requiring additional collateral or guarantees, or other changes to the contractual framework of the instrument.

(n) Significant changes in the expected performance and behaviour of the borrower, including changes in the payment status of borrowers in the economic entity~~group~~ (for example, an increase in the expected number or extent of delayed contractual payments ~~or significant increases in the expected number of credit card borrowers who are expected to approach or exceed their credit limit or who are expected to be paying the minimum monthly amount~~).

(o) Changes in the entity's credit management approach in relation to the financial instrument; i.e., based on emerging indicators of changes in the credit risk of the financial instrument, the entity's credit risk management practice is expected to become more active or to be focused on managing the instrument, including the instrument becoming more closely monitored or controlled, or the entity specifically intervening with the borrower.

(p) Past due information, including the rebuttable presumption as set out in paragraph 83~~5.5.11~~.

AG182.~~B5.5.18~~ In some cases, the qualitative and non-statistical quantitative information available may be sufficient to determine that a financial instrument has met the criterion for the recognition of a loss allowance at an amount equal to lifetime expected credit losses. That is, the information does not need to flow through a statistical model or credit ratings process in order to determine whether there has been a significant increase in the credit risk of the financial instrument. In other cases, an entity may need to consider other information, including information from its statistical models or credit ratings processes. Alternatively, the entity may base the assessment on both types of information, i.e., qualitative factors that are not captured through the internal ratings process and a specific internal rating category at the reporting date, taking into consideration the credit risk characteristics at initial recognition, if both types of information are relevant.

More than 30 Days Past Due Rebuttable Presumption

AG183.~~B5.5.19~~ The rebuttable presumption in paragraph 83~~5.5.11~~ is not an absolute indicator that lifetime expected credit losses should be recognised, but is presumed to be the latest point at which lifetime expected credit losses should be recognised even when using forward-looking information (including macroeconomic factors on a portfolio level).

AG184.~~B5.5.20~~ An entity can rebut this presumption. However, it can do so only when it has reasonable and supportable information available that demonstrates that even if contractual payments become more than 30 days past due, this does not represent a significant increase in the credit risk of a financial instrument. For example when non-payment was an administrative oversight, instead of resulting from financial difficulty of the borrower, or the entity has access to historical evidence that demonstrates that there is no correlation between significant increases in the risk of a default occurring and financial assets on which payments are more than 30 days past due, but that evidence does identify such a correlation when payments are more than 60 days past due.

AG185.~~B5.5.21~~ An entity cannot align the timing of significant increases in credit risk and the recognition of lifetime expected credit losses to when a financial asset is regarded as credit-impaired or an entity's internal definition of default.

Financial Instruments that have Low Credit Risk at the Reporting Date

AG186.~~B5.5.22~~ The credit risk on a financial instrument is considered low for the purposes of paragraph 82~~5.5.10~~, if the financial instrument has a low risk of default, the borrower has a strong capacity to meet its contractual cash flow obligations in the near term and adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil its contractual cash flow obligations. Financial instruments are not considered to have low credit risk when they are regarded as having a low risk of loss simply because of the value of collateral and the financial instrument without that collateral would not be considered low credit risk. Financial instruments are also not considered to have low credit risk simply because they have a lower risk of default than the entity's other financial instruments or relative to the credit risk of the jurisdiction within which an entity operates.

AG187.~~B5.5.23~~ To determine whether a financial instrument has low credit risk, an entity may use its internal credit risk ratings or other methodologies that are consistent with a globally understood definition of low credit risk and that consider the risks and the type of financial instruments that are being assessed. An external rating of 'investment grade' is an example of a financial instrument that may be considered as having low credit risk. However, financial instruments are not required to be externally rated to be considered to have low credit risk. They should, however, be considered to have low credit risk from a market participant perspective taking into account all of the terms and conditions of the financial instrument.

AG188.~~B5.5.24~~ Lifetime expected credit losses are not recognised on a financial instrument simply because it was considered to have low credit risk in the previous reporting period and is not considered to have low credit risk at the reporting date. In such a case, an entity shall determine whether there has been a significant increase in credit risk since initial recognition and thus whether lifetime expected credit losses are required to be recognised in accordance with paragraph 75~~5.5.3~~.

Modifications

AG189.~~B5.5.25~~ In some circumstances, the renegotiation or modification of the contractual cash flows of a financial asset can lead to the derecognition of the existing financial asset in accordance with this Standard. When the modification of a financial asset results in the derecognition of the existing financial asset and the subsequent recognition of the modified financial asset, the modified asset is considered a 'new' financial asset for the purposes of this Standard.

AG190.~~B5.5.26~~ Accordingly the date of the modification shall be treated as the date of initial recognition of that financial asset when applying the impairment requirements to the modified financial asset. This typically means measuring the loss allowance at an amount equal to 12-month expected credit losses until the requirements for the recognition of lifetime expected credit losses in paragraph 75~~5.5.3~~ are met. However, in some unusual circumstances following a modification that results in derecognition of the original financial asset, there may be evidence that the modified financial asset is credit-impaired at initial recognition, and thus, the financial asset should be recognised as an originated credit-impaired financial asset. This might occur, for example, in a situation in which there was a substantial modification of a distressed asset that resulted in the derecognition of the original financial asset. In such a case, it may be possible for the modification to result in a new financial asset which is credit-impaired at initial recognition.

AG191.~~B5.5.27~~ If the contractual cash flows on a financial asset have been renegotiated or otherwise modified, but the financial asset is not derecognised, that financial asset is not automatically considered to have lower credit risk. An entity shall assess whether there has been a significant increase in credit risk since initial recognition on the basis of all reasonable and supportable information that is available without undue cost or effort. This includes historical and forward-looking information and an assessment of the credit risk over the expected life of the financial asset, which includes information about the circumstances that led to the modification. Evidence that the criteria for the recognition of lifetime expected credit losses are no longer met may include a history of up-to-date and timely payment performance against the modified contractual terms. Typically a customer would need to demonstrate consistently good payment behaviour over a period of time before the credit risk is considered to have decreased. For example, a history of missed or incomplete payments would not typically be erased by simply making one payment on time following a modification of the contractual terms.

Measurement of Expected Credit Losses

Expected Credit Losses

AG192.~~B5.5.28~~ Expected credit losses are a probability-weighted estimate of credit losses (i.e., the present value of all cash shortfalls) over the expected life of the financial instrument. A cash shortfall is the difference between the cash flows that are due to an entity in accordance with the contract and the cash flows that the entity expects to receive. Because expected credit losses consider the amount and timing of payments, a credit loss arises even if the entity expects to be paid in full but later than when contractually due.

AG193.~~B5.5.29~~ For financial assets, a credit loss is the present value of the difference between:

(a) The contractual cash flows that are due to an entity under the contract; and

(b) The cash flows that the entity expects to receive.

AG194.~~B5.5.30~~ For undrawn loan commitments, a credit loss is the present value of the difference between:

(a) The contractual cash flows that are due to the entity if the holder of the loan commitment draws down the loan; and

(b) The cash flows that the entity expects to receive if the loan is drawn down.

AG195.~~B5.5.31~~ An entity's estimate of expected credit losses on loan commitments shall be consistent with its expectations of drawdowns on that loan commitment, i.e., it shall consider the expected portion of the loan commitment that will be drawn down within 12 months of the reporting date when estimating 12-month expected credit losses, and the expected portion of the loan commitment that will be drawn down over the expected life of the loan commitment when estimating lifetime expected credit losses.

AG196.~~B5.5.32~~ For a financial guarantee contract, the entity is required to make payments only in the event of a default by the debtor in accordance with the terms of the instrument that is guaranteed. Accordingly, cash shortfalls are the expected payments to reimburse the holder for a credit loss that it incurs less any amounts that the entity expects to receive from the holder, the debtor or any other party. If the asset is fully guaranteed, the estimation of cash shortfalls for a financial guarantee contract would be consistent with the estimations of cash shortfalls for the asset subject to the guarantee.

AG197.~~B5.5.33~~ For a financial asset that is credit-impaired at the reporting date, but that is not a purchased or originated credit-impaired financial asset, an entity shall measure the expected credit losses as the difference between the asset's gross carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. Any adjustment is recognised in ~~profit or loss~~surplus or deficit as an impairment gain or loss.

AG198.~~B5.5.34~~ When measuring a loss allowance for a lease receivable, the cash flows used for determining the expected credit losses should be consistent with the cash flows used in measuring the lease receivable in accordance with PBE IPSAS 13~~IFRS 16~~ *Leases*.

AG199.~~B5.5.35~~ An entity may use practical expedients when measuring expected credit losses if they are consistent with the principles in paragraph 90~~5.5.17~~. An example of a practical expedient is the calculation of the expected credit losses on trade receivables using a provision matrix. The entity would use its historical credit loss experience (adjusted as appropriate in accordance with paragraphs AG215–AG216~~B5.5.51–B5.5.52~~) for ~~trade~~ receivables to estimate the 12-month expected credit losses or the lifetime expected credit losses on the financial assets as relevant. A provision matrix might, for example, specify fixed provision rates depending on the number of days that a trade receivable is past due (for example, 1 per cent if not past due, 2 per cent if less than 30 days past due, 3 per cent if more than 30 days but less than 90 days past due, 20 per cent if 90–180 days past due etc). Depending on the diversity of its customer base, the entity would use appropriate groupings if its historical credit loss experience shows significantly different loss patterns for different customer segments. Examples of criteria that might be used to group assets include geographical region, product type, customer rating, collateral or trade credit insurance and type of customer (such as other government entities or individuals~~wholesale or retail~~).

Definition of D~~d~~efault

AG200.~~B5.5.36~~ Paragraph 81~~5.5.9~~ requires that when determining whether the credit risk on a financial instrument has increased significantly, an entity shall consider the change in the risk of a default occurring since initial recognition.

AG201.~~B5.5.37~~ When defining default for the purposes of determining the risk of a default occurring, an entity shall apply a default definition that is consistent with the definition used for internal credit risk management purposes for the relevant financial instrument and consider qualitative indicators (for example, financial covenants) when appropriate. However, there is a rebuttable presumption that default does not occur later than when a financial asset is 90 days past due unless an entity has reasonable and supportable information to demonstrate that a more lagging default criterion is more appropriate. The definition of default used for these purposes shall be applied consistently to all financial instruments unless information becomes available that demonstrates that another default definition is more appropriate for a particular financial instrument.

Period over Which t~~T~~o Estimate Expected Credit Losses

AS202.~~B5.5.38~~ In accordance with paragraph 92~~5.5.19~~, the maximum period over which expected credit losses shall be measured is the maximum contractual period over which the entity is exposed to credit risk. For loan commitments and financial guarantee contracts, this is the maximum contractual period over which an entity has a present contractual obligation to extend credit.

AG203.~~B5.5.39~~ However, in accordance with paragraph 93~~5.5.20~~, some financial instruments include both a loan and an undrawn commitment component and the entity's contractual ability to demand repayment and cancel the undrawn commitment does not limit the entity's exposure to credit losses to the contractual notice period. For example, revolving credit facilities, such as line of credit provided by a government owned bank~~credit cards and overdraft facilities~~, can be contractually withdrawn by the lender with as little as one day's notice. However, in practice lenders continue to extend credit for a longer period and may only withdraw the facility after the credit risk of the borrower increases, which could be too late to prevent some or all of the expected credit losses. These financial instruments generally have the following characteristics as a result of the nature of the financial instrument, the way in which the financial instruments are managed, and the nature of the available information about significant increases in credit risk:

(a) The financial instruments do not have a fixed term or repayment structure and usually have a short contractual cancellation period (for example, one day);

(b) The contractual ability to cancel the contract is not enforced in the normal day-to-day management of the financial instrument and the contract may only be cancelled when the entity becomes aware of an increase in credit risk at the facility level; and

(c) The financial instruments are managed on a collective basis.

AG204.~~B5.5.40~~ When determining the period over which the entity is expected to be exposed to credit risk, but for which expected credit losses would not be mitigated by the entity's normal credit risk management actions, an entity should consider factors such as historical information and experience about:

(a) The period over which the entity was exposed to credit risk on similar financial instruments;

(b) The length of time for related defaults to occur on similar financial instruments following a significant increase in credit risk; and

(c) The credit risk management actions that an entity expects to take once the credit risk on the financial instrument has increased, such as the reduction or removal of undrawn limits.

Probability-weighted Outcome

AG205.~~B5.5.41~~ The purpose of estimating expected credit losses is neither to estimate a worst-case scenario nor to estimate the best-case scenario. Instead, an estimate of expected credit losses shall always reflect the possibility that a credit loss occurs and the possibility that no credit loss occurs even if the most likely outcome is no credit loss.

AG206.~~B5.5.42~~ Paragraph 90~~5.5.17~~(a) requires the estimate of expected credit losses to reflect an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes. In practice, this may not need to be a complex analysis. In some cases, relatively simple modelling may be sufficient, without the need for a large number of detailed simulations of scenarios. For example, the average credit losses of a large group of financial instruments with shared risk characteristics may be a reasonable estimate of the probability-weighted amount. In other situations, the identification of scenarios that specify the amount and timing of the cash flows for particular outcomes and the estimated probability of those outcomes will probably be needed. In those situations, the expected credit losses shall reflect at least two outcomes in accordance with paragraph 91~~5.5.18~~.

AG207.~~B5.5.43~~ For lifetime expected credit losses, an entity shall estimate the risk of a default occurring on the financial instrument during its expected life. 12-month expected credit losses are a portion of the lifetime expected credit losses and represent the lifetime cash shortfalls that will result if a default occurs in the 12 months after the reporting date (or a shorter period if the expected life of a financial instrument is less than 12 months), weighted by the probability of that default occurring. Thus, 12-month expected credit losses are neither the lifetime expected credit losses that an entity will incur on financial instruments that it predicts will default in the next 12 months nor the cash shortfalls that are predicted over the next 12 months.

Time Value of Money

AG208.~~B5.5.44~~ Expected credit losses shall be discounted to the reporting date, not to the expected default or some other date, using the effective interest rate determined at initial recognition or an approximation thereof. If a financial instrument has a variable interest rate, expected credit losses shall be discounted using the current effective interest rate determined in accordance with paragraph AG160~~B5.4.5~~.

AG209.~~B5.5.45~~ For purchased or originated credit-impaired financial assets, expected credit losses shall be discounted using the credit-adjusted effective interest rate determined at initial recognition.

AG210.~~B5.5.46~~ Expected credit losses on lease receivables shall be discounted using the same discount rate used in the measurement of the lease receivable in accordance with PBE IPSAS 13~~IFRS 16~~.

AG211.~~B5.5.47~~ The expected credit losses on a loan commitment shall be discounted using the effective interest rate, or an approximation thereof, that will be applied when recognising the financial asset resulting from the loan commitment. This is because for the purpose of applying the impairment requirements, a financial asset that is recognised following a draw down on a loan commitment shall be treated as a continuation of that commitment instead of as a new financial instrument. The expected credit losses on the financial asset shall therefore be measured considering the initial credit risk of the loan commitment from the date that the entity became a party to the irrevocable commitment.

AG212.~~B5.5.48~~ Expected credit losses on financial guarantee contracts or on loan commitments for which the effective interest rate cannot be determined shall be discounted by applying a discount rate that reflects the current market assessment of the time value of money and the risks that are specific to the cash flows but only if, and to the extent that, the risks are taken into account by adjusting the discount rate instead of adjusting the cash shortfalls being discounted.

Reasonable and Supportable Information

AG213.~~B5.5.49~~ For the purpose of this Standard, reasonable and supportable information is that which is reasonably available at the reporting date without undue cost or effort, including information about past events, current conditions and forecasts of future economic conditions. Information that is available for financial reporting purposes is considered to be available without undue cost or effort.

AG214.~~B5.5.50~~ An entity is not required to incorporate forecasts of future conditions over the entire expected life of a financial instrument. The degree of judgement that is required to estimate expected credit losses depends on the availability of detailed information. As the forecast horizon increases, the availability of detailed information decreases and the degree of judgement required to estimate expected credit losses increases. The estimate of expected credit losses does not require a detailed estimate for periods that are far in the future—for such periods, an entity may extrapolate projections from available, detailed information.

AG215.~~B5.5.51~~ An entity need not undertake an exhaustive search for information but shall consider all reasonable and supportable information that is available without undue cost or effort and that is relevant to the estimate of expected credit losses, including the effect of expected prepayments. The information used shall include factors that are specific to the borrower, general economic conditions and an assessment of both the current as well as the forecast direction of conditions at the reporting date. An entity may use various sources of data, that may be both internal (entity-specific) and external. Possible data sources include internal historical credit loss experience, internal ratings, credit loss experience of other entities and external ratings, reports and statistics. Entities that have no, or insufficient, sources of entity-specific data may use peer group experience for the comparable financial instrument (or groups of financial instruments).

AG216.~~B5.5.52~~ Historical information is an important anchor or base from which to measure expected credit losses. However, an entity shall adjust historical data, such as credit loss experience, on the basis of current observable data to reflect the effects of the current conditions and its forecasts of future conditions that did not affect the period on which the historical data is based, and to remove the effects of the conditions in the historical period that are not relevant to the future contractual cash flows. In some cases, the best reasonable and supportable information could be the unadjusted historical information, depending on the nature of the historical information and when it was calculated, compared to circumstances at the reporting date and the characteristics of the financial instrument being considered. Estimates of changes in expected credit losses should reflect, and be directionally consistent with, changes in related observable data from period to period (such as changes in unemployment rates, property prices, commodity prices, payment status or other factors that are indicative of credit losses on the financial instrument or in the group of financial instruments and in the magnitude of those changes). An entity shall regularly review the methodology and assumptions used for estimating expected credit losses to reduce any differences between estimates and actual credit loss experience.

AG217.~~B5.5.53~~ When using historical credit loss experience in estimating expected credit losses, it is important that information about historical credit loss rates is applied to groups that are defined in a manner that is consistent with the groups for which the historical credit loss rates were observed. Consequently, the method used shall enable each group of financial assets to be associated with information about past credit loss experience in groups of financial assets with similar risk characteristics and with relevant observable data that reflects current conditions.

AG218.~~B5.5.54~~ Expected credit losses reflect an entity's own expectations of credit losses. However, when considering all reasonable and supportable information that is available without undue cost or effort in estimating expected credit losses, an entity should also consider observable market information about the credit risk of the particular financial instrument or similar financial instruments.

Collateral

AG219.~~B5.5.55~~ For the purposes of measuring expected credit losses, the estimate of expected cash shortfalls shall reflect the cash flows expected from collateral and other credit enhancements that are part of the contractual terms and are not recognised separately by the entity. The estimate of expected cash shortfalls on a collateralised financial instrument reflects the amount and timing of cash flows that are expected from foreclosure on the collateral less the costs of obtaining and selling the collateral, irrespective of whether foreclosure is probable (i.e., the estimate of expected cash flows considers the probability of a foreclosure and the cash flows that would result from it). Consequently, any cash flows that are expected from the realisation of the collateral beyond the contractual maturity of the contract should be included in this analysis. Any collateral obtained as a result of foreclosure is not recognised as an asset that is separate from the collateralised financial instrument unless it meets the relevant recognition criteria for an asset in this or other Standards.

Reclassification of Financial Assets ~~(Section 5.6)~~

AG220.~~B5.6.1~~ If an entity reclassifies financial assets in accordance with paragraph 54~~4.4.1~~, paragraph 94~~5.6.1~~ requires that the reclassification is applied prospectively from the reclassification date. Both the amortised cost measurement category and the fair value through other comprehensive ~~income~~revenue and expense measurement category require that the effective interest rate is determined at initial recognition. Both of those measurement categories also require that the impairment requirements are applied in the same way. Consequently, when an entity reclassifies a financial asset between the amortised cost measurement category and the fair value through other comprehensive ~~income~~revenue and expense measurement category:

(a) The recognition of interest revenue will not change and therefore the entity continues to use the same effective interest rate.

(b) The measurement of expected credit losses will not change because both measurement categories apply the same impairment approach. However if a financial asset is reclassified out of the fair value through other comprehensive ~~income~~revenue and expense measurement category and into the amortised cost measurement category, a loss allowance would be recognised as an adjustment to the gross carrying amount of the financial asset from the reclassification date. If a financial asset is reclassified out of the amortised cost measurement category and into the fair value through other comprehensive ~~income~~revenue and expense measurement category, the loss allowance would be derecognised (and thus would no longer be recognised as an adjustment to the gross carrying amount) but instead would be recognised as an accumulated impairment amount (of an equal amount) in other comprehensive ~~income~~revenue and expense and would be disclosed from the reclassification date.

AG221.~~B5.6.2~~ However, an entity is not required to separately recognise interest revenue or impairment gains or losses for a financial asset measured at fair value through ~~profit or loss~~surplus or deficit. Consequently, when an entity reclassifies a financial asset out of the fair value through ~~profit or loss~~surplus or deficit measurement category, the effective interest rate is determined on the basis of the fair value of the asset at the reclassification date. In addition, for the purposes of applying paragraphs 73–93~~Section 5.5~~ to the financial asset from the reclassification date, the date of the reclassification is treated as the date of initial recognition.

Gains and Losses ~~(Section 5.7)~~

AG222.~~B5.7.1~~ Paragraph 106~~5.7.5~~ permits an entity to make an irrevocable election to present in other comprehensive ~~income~~revenue and expense changes in the fair value of an investment in an equity instrument that is not held for trading. This election is made on an instrument-by-instrument (i.e., share-by-share) basis. Amounts presented in other comprehensive ~~income~~revenue and expense shall not be subsequently transferred to ~~profit or loss~~surplus or deficit. However, the entity may transfer the cumulative gain or loss within net assets/equity. Dividends on such investments are recognised in ~~profit or loss~~surplus or deficit in accordance with paragraph 107~~5.7.6~~ unless the dividend clearly represents a recovery of part of the cost of the investment.

AG223.~~B5.7.1A~~ Unless paragraph 44~~4.1.5~~ applies, paragraph 41~~4.1.2A~~ requires that a financial asset is measured at fair value through other comprehensive ~~income~~revenue and expense if the contractual terms of the financial asset give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding and the asset is held in a management~~business~~ model whose objective is achieved by both collecting contractual cash flows and selling financial assets. This measurement category recognises information in ~~profit or loss~~surplus or deficit as if the financial asset is measured at amortised cost, while the financial asset is measured in the statement of financial position at fair value. Gains or losses, other than those that are recognised in ~~profit or loss~~surplus or deficit in accordance with paragraphs 111–112~~5.7.10–5.7.11~~, are recognised in other comprehensive ~~income~~revenue and expense. When these financial assets are derecognised, cumulative gains or losses previously recognised in other comprehensive ~~income~~revenue and expense are reclassified to ~~profit or loss~~surplus or deficit. This reflects the gain or loss that would have been recognised in ~~profit or loss~~surplus or deficit upon derecognition if the financial asset had been measured at amortised cost.

AG224.~~B5.7.2~~ An entity applies PBE IPSAS 4~~IAS 21~~ to financial assets and financial liabilities that are monetary items in accordance with PBE IPSAS 4~~IAS 21~~ and denominated in a foreign currency. PBE IPSAS 4~~IAS 21~~ requires any foreign exchange gains and losses on monetary assets and monetary liabilities to be recognised in ~~profit or loss~~surplus or deficit. An exception is a monetary item that is designated as a hedging instrument in a cash flow hedge (see paragraph 140~~6.5.11~~), a hedge of a net investment (see paragraph 142~~6.5.13~~) or a fair value hedge of an equity instrument for which an entity has elected to present changes in fair value in other comprehensive ~~income~~revenue and expense in accordance with paragraph 106~~5.7.5~~ (see paragraph 137~~6.5.8~~).

AG225.~~B5.7.2A~~ For the purpose of recognising foreign exchange gains and losses under PBE IPSAS 4~~IAS 21~~, a financial asset measured at fair value through other comprehensive ~~income~~revenue and expense in accordance with paragraph 41~~4.1.2A~~ is treated as a monetary item. Accordingly, such a financial asset is treated as an asset measured at amortised cost in the foreign currency. Exchange differences on the amortised cost are recognised in ~~profit or loss~~surplus or deficit and other changes in the carrying amount are recognised in accordance with paragraph 111~~5.7.10~~.

AG226.~~B5.7.3~~ Paragraph 106~~5.7.5~~ permits an entity to make an irrevocable election to present in other comprehensive ~~income~~revenue and expense subsequent changes in the fair value of particular investments in equity instruments. Such an investment is not a monetary item. Accordingly, the gain or loss that is presented in other comprehensive ~~income~~revenue and expense in accordance with paragraph 106~~5.7.5~~ includes any related foreign exchange component.

AG227.~~B5.7.4~~ If there is a hedging relationship between a non-derivative monetary asset and a non-derivative monetary liability, changes in the foreign currency component of those financial instruments are presented in ~~profit or loss~~surplus or deficit.

Liabilities Designated as at Fair Value Through ~~Profit Or Loss~~Surplus or Deficit

AG228.~~B5.7.5~~ When an entity designates a financial liability as at fair value through ~~profit or loss~~surplus or deficit, it must determine whether presenting in other comprehensive ~~income~~revenue and expense the effects of changes in the liability's credit risk would create or enlarge an accounting mismatch in ~~profit or loss~~surplus or deficit. An accounting mismatch would be created or enlarged if presenting the effects of changes in the liability's credit risk in other comprehensive ~~income~~revenue and expense would result in a greater mismatch in ~~profit or loss~~surplus or deficit than if those amounts were presented in ~~profit or loss~~surplus or deficit.

AG229.~~B5.7.6~~ To make that determination, an entity must assess whether it expects that the effects of changes in the liability's credit risk will be offset in ~~profit or loss~~surplus or deficit by a change in the fair value of another financial instrument measured at fair value through ~~profit or loss~~surplus or deficit. Such an expectation must be based on an economic relationship between the characteristics of the liability and the characteristics of the other financial instrument.

AG230.~~B5.7.7~~ That determination is made at initial recognition and is not reassessed. For practical purposes the entity need not enter into all of the assets and liabilities giving rise to an accounting mismatch at exactly the same time. A reasonable delay is permitted provided that any remaining transactions are expected to occur. An entity must apply consistently its methodology for determining whether presenting in other comprehensive ~~income~~revenue and expense the effects of changes in the liability's credit risk would create or enlarge an accounting mismatch in ~~profit or loss~~surplus or deficit. However, an entity may use different methodologies when there are different economic relationships between the characteristics of the liabilities designated as at fair value through ~~profit or loss~~surplus or deficit and the characteristics of the other financial instruments. PBE IPSAS 30~~IFRS 7~~ requires an entity to provide qualitative disclosures in the notes to the financial statements about its methodology for making that determination.

AG231.~~B5.7.8~~ If such a mismatch would be created or enlarged, the entity is required to present all changes in fair value (including the effects of changes in the credit risk of the liability) in ~~profit or loss~~surplus or deficit. If such a mismatch would not be created or enlarged, the entity is required to present the effects of changes in the liability's credit risk in other comprehensive ~~income~~revenue and expense.

AG232.~~B5.7.9~~ Amounts presented in other comprehensive ~~income~~revenue and expense shall not be subsequently transferred to ~~profit or loss~~surplus or deficit. However, the entity may transfer the cumulative gain or loss within net assets/equity.

AG233.~~B5.7.10~~ The following example describes a situation in which an accounting mismatch would be created in ~~profit or loss~~surplus or deficit if the effects of changes in the credit risk of the liability were presented in other comprehensive ~~income~~revenue and expense. A Federal Mortgage and Housing Corporation~~mortgage bank~~ provides loans to customers and funds those loans by selling bonds with matching characteristics (e.g., amount outstanding, repayment profile, term and currency) in the market. The contractual terms of the loan permit the mortgage customer to prepay its loan (i.e., satisfy its obligation to the bank) by buying the corresponding bond at fair value in the market and delivering that bond to the Mortgage and Housing Corporation~~mortgage bank~~. As a result of that contractual prepayment right, if the credit quality of the bond worsens (and, thus, the fair value of the Mortgage and Housing Corporation's~~mortgage bank's~~ liability decreases), the fair value of the Mortgage and Housing Corporation's~~mortgage bank's~~ loan asset also decreases. The change in the fair value of the asset reflects the mortgage customer's contractual right to prepay the mortgage loan by buying the underlying bond at fair value (which, in this example, has decreased) and delivering the bond to the Mortgage and Housing Corporation~~mortgage bank~~. Consequently, the effects of changes in the credit risk of the liability (the bond) will be offset in ~~profit or loss~~surplus or deficit by a corresponding change in the fair value of a financial asset (the loan). If the effects of changes in the liability's credit risk were presented in other comprehensive ~~income~~revenue and expense there would be an accounting mismatch in ~~profit or loss~~surplus or deficit. Consequently, the Mortgage and Housing Corporation~~mortgage bank~~ is required to present all changes in fair value of the liability (including the effects of changes in the liability's credit risk) in ~~profit or loss~~surplus or deficit.

AG234.~~B5.7.11~~ In the example in paragraph AG233~~B5.7.10~~, there is a contractual linkage between the effects of changes in the credit risk of the liability and changes in the fair value of the financial asset (i.e., as a result of the mortgage customer's contractual right to prepay the loan by buying the bond at fair value and delivering the bond to the Mortgage and Housing Corporation~~mortgage bank~~). However, an accounting mismatch may also occur in the absence of a contractual linkage.

AG235.~~B5.7.12~~ For the purposes of applying the requirements in paragraphs 108~~5.7.7~~ and 109~~5.7.8~~, an accounting mismatch is not caused solely by the measurement method that an entity uses to determine the effects of changes in a liability's credit risk. An accounting mismatch in ~~profit or loss~~surplus or deficit would arise only when the effects of changes in the liability's credit risk (as defined in PBE IPSAS 30~~IFRS 7~~) are expected to be offset by changes in the fair value of another financial instrument. A mismatch that arises solely as a result of the measurement method (i.e., because an entity does not isolate changes in a liability's credit risk from some other changes in its fair value) does not affect the determination required by paragraphs 109~~5.7.7~~ and 109~~5.7.8~~. For example, an entity may not isolate changes in a liability's credit risk from changes in liquidity risk. If the entity presents the combined effect of both factors in other comprehensive ~~income~~revenue and expense, a mismatch may occur because changes in liquidity risk may be included in the fair value measurement of the entity's financial assets and the entire fair value change of those assets is presented in ~~profit or loss~~surplus or deficit. However, such a mismatch is caused by measurement imprecision, not the offsetting relationship described in paragraph AG229~~B5.7.6~~ and, therefore, does not affect the determination required by paragraphs 108~~5.7.7~~ and 109~~5.7.8~~.

The M~~m~~eaning of 'C~~c~~redit ~~r~~Risk' (paragraphs 108~~5.7.7~~ and 109~~5.7.8~~)

AG236.~~B5.7.13~~ PBE IPSAS 30~~IFRS 7~~ defines credit risk as 'the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation'. The requirement in paragraph 108~~5.7.7~~(a) relates to the risk that the issuer will fail to perform on that particular liability. It does not necessarily relate to the creditworthiness of the issuer. For example, if an entity issues a collateralised liability and a non-collateralised liability that are otherwise identical, the credit risk of those two liabilities will be different, even though they are issued by the same entity. The credit risk on the collateralised liability will be less than the credit risk of the non-collateralised liability. The credit risk for a collateralised liability may be close to zero.

AG237.~~B5.7.14~~ For the purposes of applying the requirement in paragraph 108~~5.7.7~~(a), credit risk is different from asset-specific performance risk. Asset-specific performance risk is not related to the risk that an entity will fail to discharge a particular obligation but instead it is related to the risk that a single asset or a group of assets will perform poorly (or not at all).

AG238.~~B5.7.15~~ The following are examples of asset-specific performance risk:

(a) A liability with a unit-linking feature whereby the amount due to investors is contractually determined on the basis of the performance of specified assets. The effect of that unit-linking feature on the fair value of the liability is asset-specific performance risk, not credit risk.

(b) A liability issued by a structured entity with the following characteristics. The entity is legally isolated so the assets in the entity are ring-fenced solely for the benefit of its investors, even in the event of bankruptcy. The entity enters into no other transactions and the assets in the entity cannot be hypothecated. Amounts are due to the entity's investors only if the ring-fenced assets generate cash flows. Thus, changes in the fair value of the liability primarily reflect changes in the fair value of the assets. The effect of the performance of the assets on the fair value of the liability is asset-specific performance risk, not credit risk.

Determining the Effects of Changes in Credit Risk

AG239.~~B5.7.16~~ For the purposes of applying the requirement in paragraph 108~~5.7.7~~(a), an entity shall determine the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability either:

(a) As the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk (see paragraphs AG240~~B5.7.17~~ and AG241~~B5.7.18~~); or

(b) Using an alternative method the entity believes more faithfully represents the amount of change in the liability's fair value that is attributable to changes in its credit risk.

AG240.~~B5.7.17~~ Changes in market conditions that give rise to market risk include changes in a benchmark interest rate, the price of another entity's financial instrument, a commodity price, a foreign exchange rate or an index of prices or rates.

AG241.~~B5.7.18~~ If the only significant relevant changes in market conditions for a liability are changes in an observed (benchmark) interest rate, the amount in paragraph AG239~~B5.7.16~~(a) can be estimated as follows:

(a) First, the entity computes the liability's internal rate of return at the start of the period using the fair value of the liability and the liability's contractual cash flows at the start of the period. It deducts from this rate of return the observed (benchmark) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.

(b) Next, the entity calculates the present value of the cash flows associated with the liability using the liability's contractual cash flows at the end of the period and a discount rate equal to the sum of (i) the observed (benchmark) interest rate at the end of the period and (ii) the instrument-specific component of the internal rate of return as determined in (a).

(c) The difference between the fair value of the liability at the end of the period and the amount determined in (b) is the change in fair value that is not attributable to changes in the observed (benchmark) interest rate. This is the amount to be presented in other comprehensive ~~income~~revenue and expense in accordance with paragraph 108~~5.7.7~~(a).

AG242.~~B5.7.19~~ The example in paragraph AG241~~B5.7.18~~ assumes that changes in fair value arising from factors other than changes in the instrument's credit risk or changes in observed (benchmark) interest rates are not significant. This method would not be appropriate if changes in fair value arising from other factors are significant. In those cases, an entity is required to use an alternative method that more faithfully measures the effects of changes in the liability's credit risk (see paragraph AG239~~B5.7.16~~(b)). For example, if the instrument in the example contains an embedded derivative, the change in fair value of the embedded derivative is excluded in determining the amount to be presented in other comprehensive ~~income~~revenue and expense in accordance with paragraph 108~~5.7.7~~(a).

AG243.~~B5.7.20~~ As with all fair value measurements, an entity's measurement method for determining the portion of the change in the liability's fair value that is attributable to changes in its credit risk must make maximum use of relevant observable inputs and minimum use of unobservable inputs.

Hedge Accounting~~(Chapter 6)~~

Hedging Instruments ~~(Section 6.2)~~

Qualifying Instruments

AG244.~~B6.2.1~~ Derivatives that are embedded in hybrid contracts, but that are not separately accounted for, cannot be designated as separate hedging instruments.

AG245.~~B6.2.2~~ An entity's own equity instruments are not financial assets or financial liabilities of the entity and therefore cannot be designated as hedging instruments.

AG246.~~B6.2.3~~ For hedges of foreign currency risk, the foreign currency risk component of a non-derivative financial instrument is determined in accordance with PBE IPSAS 4~~IAS 21~~.

Written Options

AG247.~~B6.2.4~~ This Standard does not restrict the circumstances in which a derivative that is measured at fair value through ~~profit or loss~~surplus or deficit may be designated as a hedging instrument, except for some written options. A written option does not qualify as a hedging instrument unless it is designated as an offset to a purchased option, including one that is embedded in another financial instrument (for example, a written call option used to hedge a callable liability).

Designation of Hedging Instruments

AG248.~~B6.2.5~~ For hedges other than hedges of foreign currency risk, when an entity designates a non-derivative financial asset or a non-derivative financial liability measured at fair value through ~~profit or loss~~surplus or deficit as a hedging instrument, it may only designate the non-derivative financial instrument in its entirety or a proportion of it.

AG249.~~B6.2.6~~ A single hedging instrument may be designated as a hedging instrument of more than one type of risk, provided that there is a specific designation of the hedging instrument and of the different risk positions as hedged items. Those hedged items can be in different hedging relationships.

Hedged Items ~~(Section 6.3)~~

Qualifying Items

AG250.~~B6.3.1~~ A firm commitment to acquire an operation~~business~~ in a business combination cannot be a hedged item, except for foreign currency risk, because the other risks being hedged cannot be specifically identified and measured. Those other risks are general business risks.

AG251.~~B6.3.2~~ An equity method investment cannot be a hedged item in a fair value hedge. This is because the equity method recognises in ~~profit or loss~~surplus or deficit the investor's share of the investee's ~~profit or loss~~surplus or deficit, instead of changes in the investment's fair value. For a similar reason, an investment in a consolidated controlled entity~~subsidiary~~ cannot be a hedged item in a fair value hedge. This is because consolidation recognises in ~~profit or loss~~surplus or deficit the controlled entity's~~subsidiary's~~ ~~profit or loss~~surplus or deficit, instead of changes in the investment's fair value. A hedge of a net investment in a foreign operation is different because it is a hedge of the foreign currency exposure, not a fair value hedge of the change in the value of the investment.

AG252.~~B6.3.3~~ Paragraph 125~~6.3.4~~ permits an entity to designate as hedged items aggregated exposures that are a combination of an exposure and a derivative. When designating such a hedged item, an entity assesses whether the aggregated exposure combines an exposure with a derivative so that it creates a different aggregated exposure that is managed as one exposure for a particular risk (or risks). In that case, the entity may designate the hedged item on the basis of the aggregated exposure. For example:

(a) An entity may hedge a given quantity of highly probable oil~~coffee~~ purchases in 15 months' time against price risk (based on US dollars) using a 15-month futures contract for oil~~coffee~~. The highly probable oil~~coffee~~ purchases and the futures contract for oil~~coffee~~ in combination can be viewed as a 15-month fixed-amount US dollar foreign currency risk exposure for risk management purposes (i.e., like any fixed-amount US dollar cash outflow in 15 months' time).

(b) An entity may hedge the foreign currency risk for the entire term of a 10-year fixed-rate debt denominated in a foreign currency. However, the entity requires fixed-rate exposure in its functional currency only for a short to medium term (say two years) and floating rate exposure in its functional currency for the remaining term to maturity. At the end of each of the two-year intervals (i.e., on a two-year rolling basis) the entity fixes the next two years' interest rate exposure (if the interest level is such that the entity wants to fix interest rates). In such a situation an entity may enter into a 10-year fixed-to-floating cross-currency interest rate swap that swaps the fixed-rate foreign currency debt into a variable-rate functional currency exposure. This is overlaid with a two-year interest rate swap that—on the basis of the functional currency—swaps variable-rate debt into fixed-rate debt. In effect, the fixed-rate foreign currency debt and the 10-year fixed-to-floating cross-currency interest rate swap in combination are viewed as a 10-year variable-rate debt functional currency exposure for risk management purposes.

AG253.~~B6.3.4~~ When designating the hedged item on the basis of the aggregated exposure, an entity considers the combined effect of the items that constitute the aggregated exposure for the purpose of assessing hedge effectiveness and measuring hedge ineffectiveness. However, the items that constitute the aggregated exposure remain accounted for separately. This means that, for example:

(a) Derivatives that are part of an aggregated exposure are recognised as separate assets or liabilities measured at fair value; and

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

AG254.~~B6.3.5~~ Paragraph 127~~6.3.6~~ states that in consolidated financial statements the foreign currency risk of a highly probable forecast intragroup transaction may qualify as a hedged item in a cash flow hedge, provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and that the foreign currency risk will affect consolidated ~~profit or loss~~surplus or deficit. For this purpose an entity can be a controlling entity~~parent~~, controlled entity~~subsidiary~~, associate, joint arrangement or branch. If the foreign currency risk of a forecast ~~intragroup~~ transaction within the economic entity does not affect consolidated ~~profit or loss~~surplus or deficit, the ~~intragroup~~ transaction cannot qualify as a hedged item. This is usually the case for royalty payments, interest payments or management charges between members of the same economic entity~~group~~, unless there is a related external transaction. However, when the foreign currency risk of a forecast ~~intragroup~~ transaction within an economic entity will affect consolidated ~~profit or loss~~surplus or deficit, the ~~intragroup~~ transaction within te economic entity can qualify as a hedged item. An example is forecast sales or purchases of inventories between members of the same economic entity ~~group~~ if there is an onward sale of the inventory to a party external to the economic entity~~group~~. Similarly, a forecast ~~intragroup~~ sale of plant and equipment within the economic entity from the ~~group~~ entity that manufactured it to an ~~group~~ entity that will use the plant and equipment in its operations may affect consolidated ~~profit or loss~~surplus or deficit. This could occur, for example, because the plant and equipment will be depreciated by the purchasing entity and the amount initially recognised for the plant and equipment may change if the forecast ~~intragroup~~ transaction within the economic entity is denominated in a currency other than the functional currency of the purchasing entity.

AG255.~~B6.3.6~~ If a hedge of a forecast ~~intragroup~~ transaction within an economic entity~~qualifies~~ for hedge accounting, any gain or loss is recognised in, and taken out of, other comprehensive ~~income~~revenue and expense in accordance with paragraph 140~~6.5.11~~. The relevant period or periods during which the foreign currency risk of the hedged transaction affects ~~profit or loss~~surplus or deficit is when it affects consolidated ~~profit or loss~~surplus or deficit.

Designation of Hedged Items

AG256.~~B6.3.7~~ A component is a hedged item that is less than the entire item. Consequently, a component reflects only some of the risks of the item of which it is a part or reflects the risks only to some extent (for example, when designating a proportion of an item).

Risk Components

AG257.~~B6.3.8~~ To be eligible for designation as a hedged item, a risk component must be a separately identifiable component of the financial or the non-financial item, and the changes in the cash flows or the fair value of the item attributable to changes in that risk component must be reliably measurable.

AG258.~~B6.3.9~~ When identifying what risk components qualify for designation as a hedged item, an entity assesses such risk components within the context of the particular market structure to which the risk or risks relate and in which the hedging activity takes place. Such a determination requires an evaluation of the relevant facts and circumstances, which differ by risk and market.

AG259.~~B6.3.10~~ When designating risk components as hedged items, an entity considers whether the risk components are explicitly specified in a contract (contractually specified risk components) or whether they are implicit in the fair value or the cash flows of an item of which they are a part (non-contractually specified risk components). Non-contractually specified risk components can relate to items that are not a contract (for example, forecast transactions) or contracts that do not explicitly specify the component (for example, a firm commitment that includes only one single price instead of a pricing formula that references different underlyings). For example:

(a) Entity A has a long-term supply contract for natural gas that is priced using a contractually specified formula that references commodities and other factors (for example, gas oil, fuel oil and other components such as transport charges). Entity A hedges the gas oil component in that supply contract using a gas oil forward contract. Because the gas oil component is specified by the terms and conditions of the supply contract it is a contractually specified risk component. Hence, because of the pricing formula, Entity A concludes that the gas oil price exposure is separately identifiable. At the same time, there is a market for gas oil forward contracts. Hence, Entity A concludes that the gas oil price exposure is reliably measurable. Consequently, the gas oil price exposure in the supply contract is a risk component that is eligible for designation as a hedged item.

(b) Entity B hedges its future coffee purchases based on its production forecast. Hedging starts up to 15 months before delivery for part of the forecast purchase volume. Entity B increases the hedged volume over time (as the delivery date approaches). Entity B uses two different types of contracts to manage its coffee price risk:

(i) Exchange-traded coffee futures contracts; and

(ii) Coffee supply contracts for Arabica coffee from Colombia delivered to a specific manufacturing site. These contracts price a tonne of coffee based on the exchange-traded coffee futures contract price plus a fixed price differential plus a variable logistics services charge using a pricing formula. The coffee supply contract is an executory contract in accordance with which Entity B takes actual delivery of coffee.

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

(c) Entity C hedges part of its future jet fuel purchases on the basis of its consumption forecast up to 24 months before delivery and increases the volume that it hedges over time. Entity C hedges this exposure using different types of contracts depending on the time horizon of the hedge, which affects the market liquidity of the derivatives. For the longer time horizons (12–24 months) Entity C uses crude oil contracts because only these have sufficient market liquidity. For time horizons of 6–12 months Entity C uses gas oil derivatives because they are sufficiently liquid. For time horizons up to six months Entity C uses jet fuel contracts. Entity C's analysis of the market structure for oil and oil products and its evaluation of the relevant facts and circumstances is as follows:

(i) Entity C operates in a geographical area in which Brent is the crude oil benchmark. Crude oil is a raw material benchmark that affects the price of various refined oil products as their most basic input. Gas oil is a benchmark for refined oil products, which is used as a pricing reference for oil distillates more generally. This is also reflected in the types of derivative financial instruments for the crude oil and refined oil products markets of the environment in which Entity C operates, such as:

- The benchmark crude oil futures contract, which is for Brent crude oil;
- The benchmark gas oil futures contract, which is used as the pricing reference for distillates—for example, jet fuel spread derivatives cover the price differential between jet fuel and that benchmark gas oil; and
- The benchmark gas oil crack spread derivative (i.e., the derivative for the price differential between crude oil and gas oil—a refining margin), which is indexed to Brent crude oil.

(ii) The pricing of refined oil products does not depend on which particular crude oil is processed by a particular refinery because those refined oil products (such as gas oil or jet fuel) are standardised products.

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

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

AG260.~~B6.3.11~~ When designating a risk component as a hedged item, the hedge accounting requirements apply to that risk component in the same way as they apply to other hedged items that are not risk components. For example, the qualifying criteria apply, including that the hedging relationship must meet the hedge effectiveness requirements, and any hedge ineffectiveness must be measured and recognised.

AG261.~~B6.3.12~~ An entity can also designate only changes in the cash flows or fair value of a hedged item above or below a specified price or other variable (a 'one-sided risk'). The intrinsic value of a purchased option hedging instrument (assuming that it has the same principal terms as the designated risk), but not its time value, reflects a one-sided risk in a hedged item. For example, an entity can designate the variability of future cash flow outcomes resulting from a price increase of a forecast commodity purchase. In such a situation, the entity designates only cash flow losses that result from an increase in the price above the specified level. The hedged risk does not include the time value of a purchased option, because the time value is not a component of the forecast transaction that affects ~~profit or loss~~surplus or deficit.

AG262.~~B6.3.13~~ There is a rebuttable presumption that unless inflation risk is contractually specified, it is not separately identifiable and reliably measurable and hence cannot be designated as a risk component of a financial instrument. However, in limited cases, it is possible to identify a risk component for inflation risk that is separately identifiable and reliably measurable because of the particular circumstances of the inflation environment and the relevant debt market.

AG263.~~B6.3.14~~ For example, an entity issues debt in an environment in which inflation-linked bonds have a volume and term structure that results in a sufficiently liquid market that allows constructing a term structure of zero-coupon real interest rates. This means that for the respective currency, inflation is a relevant factor that is separately considered by the debt markets. In those circumstances the inflation risk component could be determined by discounting the cash flows of the hedged debt instrument using the term structure of zero-coupon real interest rates (i.e., in a manner similar to how a risk-free (nominal) interest rate component can be determined). Conversely, in many cases an inflation risk component is not separately identifiable and reliably measurable. For example, an entity issues only nominal interest rate debt in an environment with a market for inflation-linked bonds that is not sufficiently liquid to allow a term structure of zero-coupon real interest rates to be constructed. In this case the analysis of the market structure and of the facts and circumstances does not support the entity concluding that inflation is a relevant factor that is separately considered by the debt markets. Hence, the entity cannot overcome the rebuttable presumption that inflation risk that is not contractually specified is not separately identifiable and reliably measurable. Consequently, an inflation risk component would not be eligible for designation as the hedged item. This applies irrespective of any inflation hedging instrument that the entity has actually entered into. In particular, the entity cannot simply impute the terms and conditions of the actual inflation hedging instrument by projecting its terms and conditions onto the nominal interest rate debt.

AG264.~~B6.3.15~~ A contractually specified inflation risk component of the cash flows of a recognised inflation-linked bond (assuming that there is no requirement to account for an embedded derivative separately) is separately identifiable and reliably measurable, as long as other cash flows of the instrument are not affected by the inflation risk component.

Components of a Nominal Amount

AG265.~~B6.3.16~~ There are two types of components of nominal amounts that can be designated as the hedged item in a hedging relationship: a component that is a proportion of an entire item or a layer component. The type of component changes the accounting outcome. An entity shall designate the component for accounting purposes consistently with its risk management objective.

AG266.~~B6.3.17~~ An example of a component that is a proportion is 50 per cent of the contractual cash flows of a loan.

AG267.~~B6.3.18~~ A layer component may be specified from a defined, but open, population, or from a defined nominal amount. Examples include:

(a) Part of a monetary transaction volume, for example, the next FC10 cash flows from sales denominated in a foreign currency after the first FC20 in March 201X;[8]

(b) A part of a physical volume, for example, the bottom layer, measuring 5 million cubic metres, of the natural gas stored in location XYZ;

(c) A part of a physical or other transaction volume, for example, the first 100 barrels of the oil purchases in June 201X or the first 100 MWh of electricity sales in June 201X; or

(d) A layer from the nominal amount of the hedged item, for example, the last CU80 million of a CU100 million firm commitment, the bottom layer of CU20 million of a CU100 million fixed-rate bond or the top layer of CU30 million from a total amount of CU100 million of fixed-rate debt that can be prepaid at fair value (the defined nominal amount is CU100 million).

AG268.~~B6.3.19~~ If a layer component is designated in a fair value hedge, an entity shall specify it from a defined nominal amount. To comply with the requirements for qualifying fair value hedges, an entity shall remeasure the hedged item for fair value changes (i.e., remeasure the item for fair value changes attributable to the hedged risk). The fair value hedge adjustment must be recognised in ~~profit or loss~~surplus or deficit no later than when the item is derecognised. Consequently, it is necessary to track the item to which the fair value hedge adjustment relates. For a layer component in a fair value hedge, this requires an entity to track the nominal amount from which it is defined. For example, in paragraph AG267~~B6.3.18~~(d), the total defined nominal amount of CU100 million must be tracked in order to track the bottom layer of CU20 million or the top layer of CU30 million.

AG269.~~B6.3.20~~ A layer component that includes a prepayment option is not eligible to be designated as a hedged item in a fair value hedge if the prepayment option's fair value is affected by changes in the hedged risk, unless the designated layer includes the effect of the related prepayment option when determining the change in the fair value of the hedged item.

Relationship Between Components and the Total Cash Flows of an Item

AG270.~~B6.3.21~~ If a component of the cash flows of a financial or a non-financial item is designated as the hedged item, that component must be less than or equal to the total cash flows of the entire item. However, all of the cash flows of the entire item may be designated as the hedged item and hedged for only one particular risk (for example, only for those changes that are attributable to changes in a market related interest rate~~LIBOR~~ or a benchmark commodity price).

AG271.~~B6.3.22~~ For example, in the case of a financial liability whose effective interest rate is below a market related interest rate~~LIBOR~~, an entity cannot designate:

(a) A component of the liability equal to interest at the market rate~~LIBOR~~ (plus the principal amount in case of a fair value hedge); and

(b) A negative residual component.

AG272.~~B6.3.23~~ However, in the case of a fixed-rate financial liability whose effective interest rate is (for example) 100 basis points below the market rate~~LIBOR~~, an entity can designate as the hedged item the change in the value of that entire liability (i.e., principal plus interest at the market rate~~LIBOR~~ minus 100 basis points) that is attributable to changes in the market rate~~LIBOR~~. If a fixed-rate financial instrument is hedged some time after its origination and interest rates have changed in the meantime, the entity can designate a risk component equal to a benchmark rate that is higher than the contractual rate paid on the item. The entity can do so provided that the benchmark rate is less than the effective interest rate calculated on the assumption that the entity had purchased the instrument on the day when it first designates the hedged item. For example, assume that an entity originates a fixed-rate financial asset of CU100 that has an effective interest rate of 6 per cent at a time when the market rate~~LIBOR~~ is 4 per cent. It begins to hedge that asset some time

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

later when the market rate~~LIBOR~~ has increased to 8 per cent and the fair value of the asset has decreased to CU90. The entity calculates that if it had purchased the asset on the date it first designates the related market rate ~~LIBOR~~ interest rate risk as the hedged item, the effective yield of the asset based on its then fair value of CU90 would have been 9.5 per cent. Because the market rate ~~LIBOR~~ is less than this effective yield, the entity can designate the market rate ~~a LIBOR~~ component of 8 per cent that consists partly of the contractual interest cash flows and partly of the difference between the current fair value (i.e., CU90) and the amount repayable on maturity (i.e., CU100).

AG273.~~B6.3.24~~ If a variable-rate financial liability bears interest of (for example) three-month interbank offered rate~~LIBOR~~ minus 20 basis points (with a floor at zero basis points), an entity can designate as the hedged item the change in the cash flows of that entire liability (i.e., three-month interbank offered rate ~~LIBOR~~ minus 20 basis points—including the floor) that is attributable to changes in the interbank offered rate~~LIBOR~~. Hence, as long as the three-month interbank offered rate ~~LIBOR~~ forward curve for the remaining life of that liability does not fall below 20 basis points, the hedged item has the same cash flow variability as a liability that bears interest at the three-month interbank offered rate ~~LIBOR~~ with a zero or positive spread. However, if the three-month interbank offered rate ~~LIBOR~~ forward curve for the remaining life of that liability (or a part of it) falls below 20 basis points, the hedged item has a lower cash flow variability than a liability that bears interest at the three-month interbank offered rate ~~LIBOR~~ with a zero or positive spread.

AG274.~~B6.3.25~~ A similar example of a non-financial item is a specific type of crude oil from a particular oil field that is priced off the relevant benchmark crude oil. If an entity sells that crude oil under a contract using a contractual pricing formula that sets the price per barrel at the benchmark crude oil price minus CU10 with a floor of CU15, the entity can designate as the hedged item the entire cash flow variability under the sales contract that is attributable to the change in the benchmark crude oil price. However, the entity cannot designate a component that is equal to the full change in the benchmark crude oil price. Hence, as long as the forward price (for each delivery) does not fall below CU25, the hedged item has the same cash flow variability as a crude oil sale at the benchmark crude oil price (or with a positive spread). However, if the forward price for any delivery falls below CU25, the hedged item has a lower cash flow variability than a crude oil sale at the benchmark crude oil price (or with a positive spread).

Qualifying Criteria for Hedge Accounting ~~(Section 6.4)~~

Hedge Effectiveness

AG275.~~B6.4.1~~ Hedge effectiveness is the extent to which changes in the fair value or the cash flows of the hedging instrument offset changes in the fair value or the cash flows of the hedged item (for example, when the hedged item is a risk component, the relevant change in fair value or cash flows of an item is the one that is attributable to the hedged risk). Hedge ineffectiveness is the extent to which the changes in the fair value or the cash flows of the hedging instrument are greater or less than those on the hedged item.

AG276.~~B6.4.2~~ When designating a hedging relationship and on an ongoing basis, an entity shall analyse the sources of hedge ineffectiveness that are expected to affect the hedging relationship during its term. This analysis (including any updates in accordance with paragraph AG314~~B6.5.21~~ arising from rebalancing a hedging relationship) is the basis for the entity's assessment of meeting the hedge effectiveness requirements.

AG277.~~B6.4.3~~ For the avoidance of doubt, the effects of replacing the original counterparty with a clearing counterparty and making the associated changes as described in paragraph 135~~6.5.6~~ shall be reflected in the measurement of the hedging instrument and therefore in the assessment of hedge effectiveness and the measurement of hedge effectiveness.

Economic Relationship Between the Hedged Item and the Hedging Instrument

AG278.~~B6.4.4~~ The requirement that an economic relationship exists means that the hedging instrument and the hedged item have values that generally move in the opposite direction because of the same risk, which is the hedged risk. Hence, there must be an expectation that the value of the hedging instrument and the value of the hedged item will systematically change in response to movements in either the same underlying or underlyings that are economically related in such a way that they respond in a similar way to the risk that is being hedged (for example, Brent and WTI crude oil).

AG279.~~B6.4.5~~ If the underlyings are not the same but are economically related, there can be situations in which the values of the hedging instrument and the hedged item move in the same direction, for example, because the price differential between the two related underlyings changes while the underlyings themselves do not move significantly. That is still consistent with an economic relationship between the hedging instrument and the hedged item if the values of the hedging instrument and the hedged item are still expected to typically move in the opposite direction when the underlyings move.

AG280.~~B6.4.6~~ The assessment of whether an economic relationship exists includes an analysis of the possible behaviour of the hedging relationship during its term to ascertain whether it can be expected to meet the risk management objective. The mere existence of a statistical correlation between two variables does not, by itself, support a valid conclusion that an economic relationship exists.

The Effect of Credit Risk

AG281.~~B6.4.7~~ Because the hedge accounting model is based on a general notion of offset between gains and losses on the hedging instrument and the hedged item, hedge effectiveness is determined not only by the economic relationship between those items (i.e., the changes in their underlyings) but also by the effect of credit risk on the value of both the hedging instrument and the hedged item. The effect of credit risk means that even if there is an economic relationship between the hedging instrument and the hedged item, the level of offset might become erratic. This can result from a change in the credit risk of either the hedging instrument or the hedged item that is of such a magnitude that the credit risk dominates the value changes that result from the economic relationship (i.e., the effect of the changes in the underlyings). A level of magnitude that gives rise to dominance is one that would result in the loss (or gain) from credit risk frustrating the effect of changes in the underlyings on the value of the hedging instrument or the hedged item, even if those changes were significant. Conversely, if during a particular period there is little change in the underlyings, the fact that even small credit risk-related changes in the value of the hedging instrument or the hedged item might affect the value more than the underlyings does not create dominance.

AG282.~~B6.4.8~~ An example of credit risk dominating a hedging relationship is when an entity hedges an exposure to commodity price risk using an uncollateralised derivative. If the counterparty to that derivative experiences a severe deterioration in its credit standing, the effect of the changes in the counterparty's credit standing might outweigh the effect of changes in the commodity price on the fair value of the hedging instrument, whereas changes in the value of the hedged item depend largely on the commodity price changes.

Hedge Ratio

AG283.~~B6.4.9~~ In accordance with the hedge effectiveness requirements, the hedge ratio of the hedging relationship must be the same as that resulting from the quantity of the hedged item that the entity actually hedges and the quantity of the hedging instrument that the entity actually uses to hedge that quantity of hedged item. Hence, if an entity hedges less than 100 per cent of the exposure on an item, such as 85 per cent, it shall designate the hedging relationship using a hedge ratio that is the same as that resulting from 85 per cent of the exposure and the quantity of the hedging instrument that the entity actually uses to hedge those 85 per cent. Similarly, if, for example, an entity hedges an exposure using a nominal amount of 40 units of a financial instrument, it shall designate the hedging relationship using a hedge ratio that is the same as that resulting from that quantity of 40 units (i.e., the entity must not use a hedge ratio based on a higher quantity of units that it might hold in total or a lower quantity of units) and the quantity of the hedged item that it actually hedges with those 40 units.

AG284.~~B6.4.10~~ However, the designation of the hedging relationship using the same hedge ratio as that resulting from the quantities of the hedged item and the hedging instrument that the entity actually uses shall not reflect an imbalance between the weightings of the hedged item and the hedging instrument that would in turn create hedge ineffectiveness (irrespective of whether recognised or not) that could result in an accounting outcome that would be inconsistent with the purpose of hedge accounting. Hence, for the purpose of designating a hedging relationship, an entity must adjust the hedge ratio that results from the quantities of the hedged item and the hedging instrument that the entity actually uses if that is needed to avoid such an imbalance.

AG285.~~B6.4.11~~ Examples of relevant considerations in assessing whether an accounting outcome is inconsistent with the purpose of hedge accounting are:

(a) Whether the intended hedge ratio is established to avoid recognising hedge ineffectiveness for cash flow hedges, or to achieve fair value hedge adjustments for more hedged items with the aim of increasing the use of fair value accounting, but without offsetting fair value changes of the hedging instrument; and

(b) Whether there is a commercial reason for the particular weightings of the hedged item and the hedging instrument, even though that creates hedge ineffectiveness. For example, an entity enters into and designates a quantity of the hedging instrument that is not the quantity that it determined as the best hedge of the hedged item because the standard volume of the hedging instruments does not allow it to enter into that exact quantity of hedging instrument (a 'lot size issue'). An example is an entity that hedges 1,000 tonnes of oil~~coffee~~ purchases with standard oil~~coffee~~

futures contracts that have a contract size of 1,000 barrels~~37,500 lbs (pounds)~~. The entity could only use either five or six contracts (equivalent to 980~~85.0~~ and 1,120~~102.1~~ tonnes respectively) to hedge the purchase volume of 1,000 tonnes. In that case, the entity designates the hedging relationship using the hedge ratio that results from the number of oil~~coffee~~ futures contracts that it actually uses, because the hedge ineffectiveness resulting from the mismatch in the weightings of the hedged item and the hedging instrument would not result in an accounting outcome that is inconsistent with the purpose of hedge accounting.

Frequency of Assessing Whether the Hedge Effectiveness Requirements are Met

AG286.~~B6.4.12~~ An entity shall assess at the inception of the hedging relationship, and on an ongoing basis, whether a hedging relationship meets the hedge effectiveness requirements. At a minimum, an entity shall perform the ongoing assessment at each reporting date or upon a significant change in the circumstances affecting the hedge effectiveness requirements, whichever comes first. The assessment relates to expectations about hedge effectiveness and is therefore only forward-looking.

Methods for Assessing Whether the Hedge Effectiveness Requirements are Met

AG287.~~B6.4.13~~ This Standard does not specify a method for assessing whether a hedging relationship meets the hedge effectiveness requirements. However, an entity shall use a method that captures the relevant characteristics of the hedging relationship including the sources of hedge ineffectiveness. Depending on those factors, the method can be a qualitative or a quantitative assessment.

AG288.~~B6.4.14~~ For example, when the critical terms (such as the nominal amount, maturity and underlying) of the hedging instrument and the hedged item match or are closely aligned, it might be possible for an entity to conclude on the basis of a qualitative assessment of those critical terms that the hedging instrument and the hedged item have values that will generally move in the opposite direction because of the same risk and hence that an economic relationship exists between the hedged item and the hedging instrument (see paragraphs AG278–AG280~~B6.4.4–B6.4.6~~).

AG289.~~B6.4.15~~ The fact that a derivative is in or out of the money when it is designated as a hedging instrument does not in itself mean that a qualitative assessment is inappropriate. It depends on the circumstances whether hedge ineffectiveness arising from that fact could have a magnitude that a qualitative assessment would not adequately capture.

AG290.~~B6.4.16~~ Conversely, if the critical terms of the hedging instrument and the hedged item are not closely aligned, there is an increased level of uncertainty about the extent of offset. Consequently, the hedge effectiveness during the term of the hedging relationship is more difficult to predict. In such a situation it might only be possible for an entity to conclude on the basis of a quantitative assessment that an economic relationship exists between the hedged item and the hedging instrument (see paragraphs AG278–AG280~~B6.4.4–B6.4.6~~). In some situations a quantitative assessment might also be needed to assess whether the hedge ratio used for designating the hedging relationship meets the hedge effectiveness requirements (see paragraphs AG283–AG285~~B6.4.9–B6.4.11~~). An entity can use the same or different methods for those two different purposes.

AG291.~~B6.4.17~~ If there are changes in circumstances that affect hedge effectiveness, an entity may have to change the method for assessing whether a hedging relationship meets the hedge effectiveness requirements in order to ensure that the relevant characteristics of the hedging relationship, including the sources of hedge ineffectiveness, are still captured.

AG292.~~B6.4.18~~ An entity's risk management is the main source of information to perform the assessment of whether a hedging relationship meets the hedge effectiveness requirements. This means that the management information (or analysis) used for decision-making purposes can be used as a basis for assessing whether a hedging relationship meets the hedge effectiveness requirements.

AG293.~~B6.4.19~~ An entity's documentation of the hedging relationship includes how it will assess the hedge effectiveness requirements, including the method or methods used. The documentation of the hedging relationship shall be updated for any changes to the methods (see paragraph AG291~~B6.4.17~~).

Accounting for Qualifying Hedging Relationships ~~(Section 6.5)~~

AG294.~~B6.5.1~~ An example of a fair value hedge is a hedge of exposure to changes in the fair value of a fixed-rate debt instrument arising from changes in interest rates. Such a hedge could be entered into by the issuer or by the holder.

AG295.~~B6.5.2~~ The purpose of a cash flow hedge is to defer the gain or loss on the hedging instrument to a period or periods in which the hedged expected future cash flows affect ~~profit or loss~~surplus or deficit. An example of a cash flow hedge is the use of a swap to change floating rate debt (whether measured at amortised cost or fair value) to fixed-rate debt (i.e., a hedge of a future transaction in which the future cash flows being hedged are the future interest payments). Conversely, a forecast purchase of an equity instrument that, once acquired, will be accounted for at fair value through ~~profit or loss~~surplus or deficit, is an example of an item that cannot be the hedged item in a cash flow hedge, because any gain or loss on the hedging instrument that would be deferred could not be appropriately reclassified to ~~profit or loss~~surplus or deficit during a period in which it would achieve offset. For the same reason, a forecast purchase of an equity instrument that, once acquired, will be accounted for at fair value with changes in fair value presented in other comprehensive ~~income~~revenue and expense also cannot be the hedged item in a cash flow hedge.

AG296.~~B6.5.3~~ A hedge of a firm commitment (for example, a hedge of the change in fuel price relating to an unrecognised contractual commitment by an electric utility to purchase fuel at a fixed price) is a hedge of an exposure to a change in fair value. Accordingly, ~~-~~such a hedge is a fair value hedge. However, in accordance with paragraph 133~~6.5.4~~, a hedge of the foreign currency risk of a firm commitment could alternatively be accounted for as a cash flow hedge.

Measurement of Hedge Ineffectiveness

AG297.~~B6.5.4~~ When measuring hedge ineffectiveness, an entity shall consider the time value of money. Consequently, the entity determines the value of the hedged item on a present value basis and therefore the change in the value of the hedged item also includes the effect of the time value of money.

AG298.~~B6.5.5~~ To calculate the change in the value of the hedged item for the purpose of measuring hedge ineffectiveness, an entity may use a derivative that would have terms that match the critical terms of the hedged item (this is commonly referred to as a 'hypothetical derivative'), and, for example for a hedge of a forecast transaction, would be calibrated using the hedged price (or rate) level. For example, if the hedge was for a two-sided risk at the current market level, the hypothetical derivative would represent a hypothetical forward contract that is calibrated to a value of nil at the time of designation of the hedging relationship. If the hedge was for example for a one-sided risk, the hypothetical derivative would represent the intrinsic value of a hypothetical option that at the time of designation of the hedging relationship is at the money if the hedged price level is the current market level, or out of the money if the hedged price level is above (or, for a hedge of a long position, below) the current market level. Using a hypothetical derivative is one possible way of calculating the change in the value of the hedged item. The hypothetical derivative replicates the hedged item and hence results in the same outcome as if that change in value was determined by a different approach. Hence, using a 'hypothetical derivative' is not a method in its own right but a mathematical expedient that can only be used to calculate the value of the hedged item. Consequently, a 'hypothetical derivative' cannot be used to include features in the value of the hedged item that only exist in the hedging instrument (but not in the hedged item). An example is debt denominated in a foreign currency (irrespective of whether it is fixed-rate or variable-rate debt). When using a hypothetical derivative to calculate the change in the value of such debt or the present value of the cumulative change in its cash flows, the hypothetical derivative cannot simply impute a charge for exchanging different currencies even though actual derivatives under which different currencies are exchanged might include such a charge (for example, cross-currency interest rate swaps).

AG299.~~B6.5.6~~ The change in the value of the hedged item determined using a hypothetical derivative may also be used for the purpose of assessing whether a hedging relationship meets the hedge effectiveness requirements.

Rebalancing the Hedging Relationship and Changes to the Hedge Ratio

AG300.~~B6.5.7~~ Rebalancing refers to the adjustments made to the designated quantities of the hedged item or the hedging instrument of an already existing hedging relationship for the purpose of maintaining a hedge ratio that complies with the hedge effectiveness requirements. Changes to designated quantities of a hedged item or of a hedging instrument for a different purpose do not constitute rebalancing for the purpose of this Standard.

AG301.~~B6.5.8~~ Rebalancing is accounted for as a continuation of the hedging relationship in accordance with paragraphs AG302–AG314~~B6.5.9–B6.5.21~~. On rebalancing, the hedge ineffectiveness of the hedging relationship is determined and recognised immediately before adjusting the hedging relationship.

AG302.~~B6.5.9~~ Adjusting the hedge ratio allows an entity to respond to changes in the relationship between the hedging instrument and the hedged item that arise from their underlyings or risk variables. For example, a hedging relationship in which the hedging instrument and the hedged item have different but related underlyings changes in response to a change in the relationship between those two underlyings (for example, different but related reference indices, rates or prices). Hence, rebalancing allows the continuation of a hedging relationship in situations in which the relationship between the hedging instrument and the hedged item changes in a way that can be compensated for by adjusting the hedge ratio.

AG303.~~B6.5.10~~ For example, an entity hedges an exposure to Foreign Currency A using a currency derivative that references Foreign Currency B and Foreign Currencies A and B are pegged (i.e., their exchange rate is maintained within a band or at an exchange rate set by a central bank or other authority). If the exchange rate between Foreign Currency A and Foreign Currency B were changed (i.e., a new band or rate was set), rebalancing the hedging relationship to reflect the new exchange rate would ensure that the hedging relationship would continue to meet the hedge effectiveness requirement for the hedge ratio in the new circumstances. In contrast, if there was a default on the currency derivative, changing the hedge ratio could not ensure that the hedging relationship would continue to meet that hedge effectiveness requirement. Hence, rebalancing does not facilitate the continuation of a hedging relationship in situations in which the relationship between the hedging instrument and the hedged item changes in a way that cannot be compensated for by adjusting the hedge ratio.

AG304.~~B6.5.11~~ Not every change in the extent of offset between the changes in the fair value of the hedging instrument and the hedged item's fair value or cash flows constitutes a change in the relationship between the hedging instrument and the hedged item. An entity analyses the sources of hedge ineffectiveness that it expected to affect the hedging relationship during its term and evaluates whether changes in the extent of offset are:

(a) Fluctuations around the hedge ratio, which remains valid (i.e., continues to appropriately reflect the relationship between the hedging instrument and the hedged item); or

(b) An indication that the hedge ratio no longer appropriately reflects the relationship between the hedging instrument and the hedged item.

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

AG305.~~B6.5.12~~ Fluctuation around a constant hedge ratio (and hence the related hedge ineffectiveness) cannot be reduced by adjusting the hedge ratio in response to each particular outcome. Hence, in such circumstances, the change in the extent of offset is a matter of measuring and recognising hedge ineffectiveness but does not require rebalancing.

AG306.~~B6.5.13~~ Conversely, if changes in the extent of offset indicate that the fluctuation is around a hedge ratio that is different from the hedge ratio that is currently used for that hedging relationship, or that there is a trend leading away from that hedge ratio, hedge ineffectiveness can be reduced by adjusting the hedge ratio, whereas retaining the hedge ratio would increasingly produce hedge ineffectiveness. Hence, in such circumstances, an entity must evaluate whether the hedging relationship reflects an imbalance between the weightings of the hedged item and the hedging instrument that would create hedge ineffectiveness (irrespective of whether recognised or not) that could result in an accounting outcome that would be inconsistent with the purpose of hedge accounting. If the hedge ratio is adjusted, it also affects the measurement and recognition of hedge ineffectiveness because, on rebalancing, the hedge ineffectiveness of the hedging relationship must be determined and recognised immediately before adjusting the hedging relationship in accordance with paragraph AG301~~B6.5.8~~.

AG307.~~B6.5.14~~ Rebalancing means that, for hedge accounting purposes, after the start of a hedging relationship an entity adjusts the quantities of the hedging instrument or the hedged item in response to changes in circumstances that affect the hedge ratio of that hedging relationship. Typically, that adjustment should reflect adjustments in the quantities of the hedging instrument and the hedged item that it actually uses. However, an entity must adjust the hedge ratio that results from the quantities of the hedged item or the hedging instrument that it actually uses if:

(a) The hedge ratio that results from changes to the quantities of the hedging instrument or the hedged item that the entity actually uses would reflect an imbalance that would create hedge ineffectiveness that could result in an accounting outcome that would be inconsistent with the purpose of hedge accounting; or

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

AG308.~~B6.5.15~~ Rebalancing does not apply if the risk management objective for a hedging relationship has changed. Instead, hedge accounting for that hedging relationship shall be discontinued (despite that an entity might designate a new hedging relationship that involves the hedging instrument or hedged item of the previous hedging relationship as described in paragraph AG321~~B6.5.28~~).

AG309.~~B6.5.16~~ If a hedging relationship is rebalanced, the adjustment to the hedge ratio can be effected in different ways:

(a) The weighting of the hedged item can be increased (which at the same time reduces the weighting of the hedging instrument) by:

(i) Increasing the volume of the hedged item; or

(ii) Decreasing the volume of the hedging instrument.

(b) The weighting of the hedging instrument can be increased (which at the same time reduces the weighting of the hedged item) by:

(i) Increasing the volume of the hedging instrument; or

(ii) Decreasing the volume of the hedged item.

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

AG310.~~B6.5.17~~ Adjusting the hedge ratio by increasing the volume of the hedged item does not affect how the changes in the fair value of the hedging instrument are measured. The measurement of the changes in the value of the hedged item related to the previously designated volume also remains unaffected. However, from the date of rebalancing, the changes in the value of the hedged item also include the change in the value of the additional volume of the hedged item. These changes are measured starting from, and by reference to, the date of rebalancing instead of the date on which the hedging relationship was designated. For example, if an entity originally hedged a volume of 100 tonnes of a commodity at a forward price of CU80 (the forward price at inception of the hedging relationship) and added a volume of 10 tonnes on rebalancing when the forward price was CU90, the hedged item after rebalancing would comprise two layers: 100 tonnes hedged at CU80 and 10 tonnes hedged at CU90.

AG311.~~B6.5.18~~ Adjusting the hedge ratio by decreasing the volume of the hedging instrument does not affect how the changes in the value of the hedged item are measured. The measurement of the changes in the fair value of the hedging instrument related to the volume that continues to be designated also remains unaffected. However, from the date of rebalancing, the volume by which the hedging instrument was decreased is no longer part of the hedging relationship. For example, if an entity originally hedged the price risk of a commodity using a derivative volume of 100 tonnes as the hedging instrument and reduces that volume by 10 tonnes on rebalancing, a nominal amount of 90 tonnes of the hedging instrument volume would remain (see paragraph AG309~~B6.5.16~~ for the consequences for the derivative volume (i.e., the 10 tonnes) that is no longer a part of the hedging relationship).

AG312.~~B6.5.19~~ Adjusting the hedge ratio by increasing the volume of the hedging instrument does not affect how the changes in the value of the hedged item are measured. The measurement of the changes in the fair value of the hedging instrument related to the previously designated volume also remains unaffected. However, from the date of rebalancing, the changes in the fair value of the hedging instrument also include the changes in the value of the additional volume of the hedging instrument. The changes are measured starting from, and by reference to, the date of rebalancing instead of the date on which the hedging relationship was designated. For example, if an entity originally hedged the price risk of a commodity using a derivative volume of 100 tonnes as the hedging instrument and added a volume of 10 tonnes on rebalancing, the hedging instrument after rebalancing would comprise a total derivative volume of 110 tonnes. The change in the fair value of the hedging instrument is the total change in the fair value of the derivatives that make up the total volume of 110 tonnes. These derivatives could (and probably would) have different critical terms, such as their forward rates, because they were entered into at different points in time (including the possibility of designating derivatives into hedging relationships after their initial recognition).

AG313.~~B6.5.20~~ Adjusting the hedge ratio by decreasing the volume of the hedged item does not affect how the changes in the fair value of the hedging instrument are measured. The measurement of the changes in the value of the hedged item related to the volume that continues to be designated also remains unaffected. However, from the date of rebalancing, the volume by which the hedged item was decreased is no longer part of the hedging relationship. For example, if an entity originally hedged a volume of 100 tonnes of a commodity at a forward price of CU80 and reduces that volume by 10 tonnes on rebalancing, the hedged item after rebalancing would be 90 tonnes hedged at CU80. The 10 tonnes of the hedged item that are no longer part of the hedging relationship would be accounted for in accordance with the requirements for the discontinuation of hedge accounting (see paragraphs 135–136~~6.5.6–6.5.7~~ and AG315–AG321~~B6.5.22–B6.5.28~~).

AG314.~~B6.5.21~~ When rebalancing a hedging relationship, an entity shall update its analysis of the sources of hedge ineffectiveness that are expected to affect the hedging relationship during its (remaining) term (see paragraph AG276~~B6.4.2~~). The documentation of the hedging relationship shall be updated accordingly.

Discontinuation of Hedge Accounting

AG315.~~B6.5.22~~ Discontinuation of hedge accounting applies prospectively from the date on which the qualifying criteria are no longer met.

AG316.~~B6.5.23~~ An entity shall not de-designate and thereby discontinue a hedging relationship that:

(a) Still meets the risk management objective on the basis of which it qualified for hedge accounting (i.e., the entity still pursues that risk management objective); and

(b) Continues to meet all other qualifying criteria (after taking into account any rebalancing of the hedging relationship, if applicable).

AG317.~~B6.5.24~~ For the purposes of this Standard, an entity's risk management strategy is distinguished from its risk management objectives. The risk management strategy is established at the highest level at which an entity determines how it manages its risk. Risk management strategies typically identify the risks to which the entity is exposed and set out how the entity responds to them. A risk management strategy is typically in place for a longer period and may include some flexibility to react to changes in circumstances that occur while that strategy is in place (for example, different interest rate or commodity price levels that result in a different extent of hedging). This is normally set out in a general document that is cascaded down through an entity through policies containing more specific guidelines. In contrast, the risk management objective for a hedging relationship applies at the level of a particular hedging relationship. It relates to how the particular hedging instrument that has been designated is used to hedge the particular exposure that has been designated as the hedged item. Hence, a risk management strategy can involve many different hedging relationships whose risk management objectives relate to executing that overall risk management strategy. For example:

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

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

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

AG318.~~B6.5.25~~ The discontinuation of hedge accounting can affect:

(a) A hedging relationship in its entirety; or

(b) A part of a hedging relationship (which means that hedge accounting continues for the remainder of the hedging relationship).

AG319.~~B6.5.26~~ A hedging relationship is discontinued in its entirety when, as a whole, it ceases to meet the qualifying criteria. For example:

(a) The hedging relationship no longer meets the risk management objective on the basis of which it qualified for hedge accounting (i.e., the entity no longer pursues that risk management objective);

(b) The hedging instrument or instruments have been sold or terminated (in relation to the entire volume that was part of the hedging relationship); or

(c) There is no longer an economic relationship between the hedged item and the hedging instrument or the effect of credit risk starts to dominate the value changes that result from that economic relationship.

AG320.~~B6.5.27~~ A part of a hedging relationship is discontinued (and hedge accounting continues for its remainder) when only a part of the hedging relationship ceases to meet the qualifying criteria. For example:

(a) On rebalancing of the hedging relationship, the hedge ratio might be adjusted in such a way that some of the volume of the hedged item is no longer part of the hedging relationship (see paragraph AG313~~B6.5.20~~); hence, hedge accounting is discontinued only for the volume of the hedged item that is no longer part of the hedging relationship; or

(b) When the occurrence of some of the volume of the hedged item that is (or is a component of) a forecast transaction is no longer highly probable, hedge accounting is discontinued only for the volume of the hedged item whose occurrence is no longer highly probable. However, if an entity has a history of having designated hedges of forecast transactions and having subsequently determined that the forecast transactions are no longer expected to occur, the entity's ability to predict forecast transactions accurately is called into question when predicting similar forecast transactions. This affects the assessment of whether similar forecast transactions are highly probable (see paragraph 124~~6.3.3~~) and hence whether they are eligible as hedged items.

AG321.~~B6.5.28~~ An entity can designate a new hedging relationship that involves the hedging instrument or hedged item of a previous hedging relationship for which hedge accounting was (in part or in its entirety) discontinued. This does not constitute a continuation of a hedging relationship but is a restart. For example:

(a) A hedging instrument experiences such a severe credit deterioration that the entity replaces it with a new hedging instrument. This means that the original hedging relationship failed to achieve the risk management objective and is hence discontinued in its entirety. The new hedging instrument is designated as the hedge of the same exposure that was hedged previously and forms a new hedging relationship. Hence, the changes in the fair value or the cash flows of the hedged item are measured starting from, and by reference to, the date of designation of the new hedging relationship instead of the date on which the original hedging relationship was designated.

(b) A hedging relationship is discontinued before the end of its term. The hedging instrument in that hedging relationship can be designated as the hedging instrument in another hedging relationship (for example, when adjusting the hedge ratio on rebalancing by increasing the volume of the hedging instrument or when designating a whole new hedging relationship).

Accounting for the Time Value of Options

AG322.~~B6.5.29~~ An option can be considered as being related to a time period because its time value represents a charge for providing protection for the option holder over a period of time. However, the relevant aspect for the purpose of assessing whether an option hedges a transaction or time-period related hedged item are the characteristics of that hedged item, including how and when it affects ~~profit or loss~~surplus or deficit. Hence, an entity shall assess the type of hedged item (see paragraph 144~~6.5.15~~(a)) on the basis of the nature of the hedged item (regardless of whether the hedging relationship is a cash flow hedge or a fair value hedge):

(a) The time value of an option relates to a transaction related hedged item if the nature of the hedged item is a transaction for which the time value has the character of costs of that transaction. An example is when the time value of an option relates to a hedged item that results in the recognition of an item whose initial measurement includes transaction costs (for example, an entity hedges a commodity purchase, whether it is a forecast transaction or a firm commitment, against the commodity price risk and includes the transaction costs in the initial measurement of the inventory). As a consequence of including the time value of the option in the initial measurement of the particular hedged item, the time value affects ~~profit or loss~~surplus or deficit at the same time as that hedged item. Similarly, an entity that hedges a sale of a commodity, whether it is a forecast transaction or a firm commitment, would include the time value of the option as part of the cost related to that sale (hence, the time value would be recognised in ~~profit or loss~~surplus or deficit in the same period as the revenue from the hedged sale).

(b) The time value of an option relates to a time-period related hedged item if the nature of the hedged item is such that the time value has the character of a cost for obtaining protection against a risk over a particular period of time (but the hedged item does not result in a transaction that involves the notion of a transaction cost in accordance with (a)). For example, if commodity inventory is hedged against a fair value decrease for six months using a commodity option with a corresponding life, the time value of the option would be allocated to ~~profit or loss~~surplus or deficit (i.e., amortised on a systematic and rational basis) over that six-month period. Another example is a hedge of a net investment in a foreign operation that is hedged for 18 months using a foreign-exchange option, which would result in allocating the time value of the option over that 18-month period.

AG323.~~B6.5.30~~ The characteristics of the hedged item, including how and when the hedged item affects ~~profit or loss~~surplus or deficit, also affect the period over which the time value of an option that hedges a time-period related hedged item is amortised, which is consistent with the period over which the option's intrinsic value can affect ~~profit or loss~~surplus or deficit in accordance with hedge accounting. For example, if an interest rate option (a cap) is used to provide protection against increases in the interest expense on a floating rate bond, the time value of that cap is amortised to ~~profit or loss~~surplus or deficit over the same period over which any intrinsic value of the cap would affect ~~profit or loss~~surplus or deficit:

(a) If the cap hedges increases in interest rates for the first three years out of a total life of the floating rate bond of five years, the time value of that cap is amortised over the first three years; or

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

AG324.~~B6.5.31~~ The accounting for the time value of options in accordance with paragraph 144~~6.5.15~~ also applies to a combination of a purchased and a written option (one being a put option and one being a call option) that at the date of designation as a hedging instrument has a net nil time value (commonly referred to as a 'zero-cost collar'). In that case, an entity shall recognise any changes in time value in other comprehensive

~~income~~revenue and expense, even though the cumulative change in time value over the total period of the hedging relationship is nil. Hence, if the time value of the option relates to:

(a) A transaction related hedged item, the amount of time value at the end of the hedging relationship that adjusts the hedged item or that is reclassified to ~~profit or loss~~surplus or deficit (see paragraph 144~~6.5.15~~(b)) would be nil.

(b) A time-period related hedged item, the amortisation expense related to the time value is nil.

AG325.~~B6.5.32~~ The accounting for the time value of options in accordance with paragraph 144~~6.5.15~~ applies only to the extent that the time value relates to the hedged item (aligned time value). The time value of an option relates to the hedged item if the critical terms of the option (such as the nominal amount, life and underlying) are aligned with the hedged item. Hence, if the critical terms of the option and the hedged item are not fully aligned, an entity shall determine the aligned time value, ie how much of the time value included in the premium (actual time value) relates to the hedged item (and therefore should be treated in accordance with paragraph 144~~6.5.15~~). An entity determines the aligned time value using the valuation of the option that would have critical terms that perfectly match the hedged item.

AG326.~~B6.5.33~~ If the actual time value and the aligned time value differ, an entity shall determine the amount that is accumulated in a separate component of net assets/equity in accordance with paragraph 144~~6.5.15~~ as follows:

(a) If, at inception of the hedging relationship, the actual time value is higher than the aligned time value, the entity shall:

(i) Determine the amount that is accumulated in a separate component of net assets/equity on the basis of the aligned time value; and

(ii) Account for the differences in the fair value changes between the two time values in ~~profit or loss~~surplus or deficit.

(b) If, at inception of the hedging relationship, the actual time value is lower than the aligned time value, the entity shall determine the amount that is accumulated in a separate component of net assets/equity by reference to the lower of the cumulative change in fair value of:

(i) The actual time value; and

(ii) The aligned time value.

Any remainder of the change in fair value of the actual time value shall be recognised in ~~profit or loss~~surplus or deficit.

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

AG327.~~B6.5.34~~ A forward contract can be considered as being related to a time period because its forward element represents charges for a period of time (which is the tenor for which it is determined). However, the relevant aspect for the purpose of assessing whether a hedging instrument hedges a transaction or time-period related hedged item are the characteristics of that hedged item, including how and when it affects ~~profit or loss~~surplus or deficit. Hence, an entity shall assess the type of hedged item (see paragraphs 144(a)~~6.5.16~~ and 145~~6.5.15(a)~~) on the basis of the nature of the hedged item (regardless of whether the hedging relationship is a cash flow hedge or a fair value hedge):

(a) The forward element of a forward contract relates to a transaction related hedged item if the nature of the hedged item is a transaction for which the forward element has the character of costs of that transaction. An example is when the forward element relates to a hedged item that results in the recognition of an item whose initial measurement includes transaction costs (for example, an entity hedges an inventory purchase denominated in a foreign currency, whether it is a forecast transaction or a firm commitment, against foreign currency risk and includes the transaction costs in the initial measurement of the inventory). As a consequence of including the forward element in the initial measurement of the particular hedged item, the forward element affects ~~profit or loss~~surplus or deficit at the same time as that hedged item. Similarly, an entity that hedges a sale of a commodity denominated in a foreign currency against foreign currency risk, whether it is a forecast transaction or a firm commitment, would include the forward element as part of the cost that is related to that sale (hence, the forward element would be recognised in ~~profit or loss~~surplus or deficit in the same period as the revenue from the hedged sale).

(b) The forward element of a forward contract relates to a time-period related hedged item if the nature of the hedged item is such that the forward element has the character of a cost for obtaining protection against a risk over a particular period of time (but the hedged item does not result in a transaction that involves the notion of a transaction cost in accordance with (a)). For example, if commodity inventory is hedged against changes in fair value for six months using a commodity forward contract with a corresponding life, the forward element of the forward contract would be allocated to ~~profit or loss~~surplus or deficit (i.e., amortised on a systematic and rational basis) over that six-month period. Another example is a hedge of a net investment in a foreign operation that is hedged for 18 months using a foreign-exchange forward contract, which would result in allocating the forward element of the forward contract over that 18-month period.

AG328.~~B6.5.35~~ The characteristics of the hedged item, including how and when the hedged item affects ~~profit or loss~~surplus or deficit, also affect the period over which the forward element of a forward contract that hedges a time-period related hedged item is amortised, which is over the period to which the forward element relates. For example, if a forward contract hedges the exposure to variability in three-month interest rates for a three-month period that starts in six months' time, the forward element is amortised during the period that spans months seven to nine.

AG329.~~B6.5.36~~ The accounting for the forward element of a forward contract in accordance with paragraph 145~~6.5.16~~ also applies if, at the date on which the forward contract is designated as a hedging instrument, the forward element is nil. In that case, an entity shall recognise any fair value changes attributable to the forward element in other comprehensive ~~income~~revenue and expense, even though the cumulative fair value change attributable to the forward element over the total period of the hedging relationship is nil. Hence, if the forward element of a forward contract relates to:

(a) A transaction related hedged item, the amount in respect of the forward element at the end of the hedging relationship that adjusts the hedged item or that is reclassified to ~~profit or loss~~surplus or deficit (see paragraphs 144~~6.5.15~~(b) and 145~~6.5.16~~) would be nil.

(b) A time-period related hedged item, the amortisation amount related to the forward element is nil.

AG330.~~B6.5.37~~ The accounting for the forward element of forward contracts in accordance with paragraph 145~~6.5.16~~ applies only to the extent that the forward element relates to the hedged item (aligned forward element). The forward element of a forward contract relates to the hedged item if the critical terms of the forward contract (such as the nominal amount, life and underlying) are aligned with the hedged item. Hence, if the critical terms of the forward contract and the hedged item are not fully aligned, an entity shall determine the aligned forward element, ie how much of the forward element included in the forward contract (actual forward element) relates to the hedged item (and therefore should be treated in accordance with paragraph 144(c)~~6.5.16~~). An entity determines the aligned forward element using the valuation of the forward contract that would have critical terms that perfectly match the hedged item.

AG331.~~B6.5.38~~ If the actual forward element and the aligned forward element differ, an entity shall determine the amount that is accumulated in a separate component of net assets/equity in accordance with paragraph 145~~6.5.16~~ as follows:

(a) If, at inception of the hedging relationship, the absolute amount of the actual forward element is higher than that of the aligned forward element the entity shall:

(i) Determine the amount that is accumulated in a separate component of net assets/equity on the basis of the aligned forward element; and

(ii) Account for the differences in the fair value changes between the two forward elements in ~~profit or loss~~surplus or deficit.

(b) If, at inception of the hedging relationship, the absolute amount of the actual forward element is lower than that of the aligned forward element, the entity shall determine the amount that is accumulated in a separate component of net assets/equity by reference to the lower of the cumulative change in fair value of:

(i) The absolute amount of the actual forward element; and

(ii) The absolute amount of the aligned forward element.

Any remainder of the change in fair value of the actual forward element shall be recognised in ~~profit or loss~~surplus or deficit.

AG332.~~B6.5.39~~ When an entity separates the foreign currency basis spread from a financial instrument and excludes it from the designation of that financial instrument as the hedging instrument (see paragraph 119~~6.2.4~~(b)), the application guidance in paragraphs AG327–AG331~~B6.5.34–B6.5.38~~ applies to the foreign currency basis spread in the same manner as it is applied to the forward element of a forward contract.

Hedge of a Group of Items ~~(Section 6.6)~~

Hedge of a Net Position

Eligibility for Hedge Accounting and Designation of a Net Position

AG333.~~B6.6.1~~ A net position is eligible for hedge accounting only if an entity hedges on a net basis for risk management purposes. Whether an entity hedges in this way is a matter of fact (not merely of assertion or documentation). Hence, an entity cannot apply hedge accounting on a net basis solely to achieve a particular accounting outcome if that would not reflect its risk management approach. Net position hedging must form part of an established risk management strategy. Normally this would be approved by key management personnel as defined in PBE IPSAS 20~~IAS 24~~.

AG334.~~B6.6.2~~ For example, Entity A, whose functional currency is its local currency, has a firm commitment to pay FC150,000 for advertising expenses in nine months' time and a firm commitment to sell finished goods for FC150,000 in 15 months' time. Entity A enters into a foreign currency derivative that settles in nine months' time under which it receives FC100 and pays CU70. Entity A has no other exposures to FC. Entity A does not manage foreign currency risk on a net basis. Hence, Entity A cannot apply hedge accounting for a hedging relationship between the foreign currency derivative and a net position of FC100 (consisting of FC150,000 of the firm purchase commitment—i.e., advertising services—and FC149,900 (of the FC150,000) of the firm sale commitment) for a nine-month period.

AG335.~~B6.6.3~~ If Entity A did manage foreign currency risk on a net basis and did not enter into the foreign currency derivative (because it increases its foreign currency risk exposure instead of reducing it), then the entity would be in a natural hedged position for nine months. Normally, this hedged position would not be reflected in the financial statements because the transactions are recognised in different reporting periods in the future. The nil net position would be eligible for hedge accounting only if the conditions in paragraph 151~~6.6.6~~ are met.

AG336.~~B6.6.4~~ When a group of items that constitute a net position is designated as a hedged item, an entity shall designate the overall group of items that includes the items that can make up the net position. An entity is not permitted to designate a non-specific abstract amount of a net position. For example, an entity has a group of firm sale commitments in nine months' time for FC100 and a group of firm purchase commitments in 18 months' time for FC120. The entity cannot designate an abstract amount of a net position up to FC20. Instead, it must designate a gross amount of purchases and a gross amount of sales that together give rise to the hedged net position. An entity shall designate gross positions that give rise to the net position so that the entity is able to comply with the requirements for the accounting for qualifying hedging relationships.

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

AG337.~~B6.6.5~~ When an entity determines whether the hedge effectiveness requirements of paragraph 129~~6.4.1~~(c) are met when it hedges a net position, it shall consider the changes in the value of the items in the net position that have a similar effect as the hedging instrument in conjunction with the fair value change on the hedging instrument. For example, an entity has a group of firm sale commitments in nine months' time for FC100 and a group of firm purchase commitments in 18 months' time for FC120. It hedges the foreign currency risk of the net position of FC20 using a forward exchange contract for FC20. When determining whether the hedge effectiveness requirements of paragraph 129~~6.4.1~~(c) are met, the entity shall consider the relationship between:

(a) The fair value change on the forward exchange contract together with the foreign currency risk related changes in the value of the firm sale commitments; and

(b) The foreign currency risk related changes in the value of the firm purchase commitments.

AG338.~~B6.6.6~~ Similarly, if in the example in paragraph AG337~~B6.6.5~~ the entity had a nil net position it would consider the relationship between the foreign currency risk related changes in the value of the firm sale commitments and the foreign currency risk related changes in the value of the firm purchase commitments when determining whether the hedge effectiveness requirements of paragraph 129~~6.4.1~~(c) are met.

Cash Flow Hedges that Constitute a Net Position

AG339.~~B6.6.7~~ When an entity hedges a group of items with offsetting risk positions (i.e., a net position), the eligibility for hedge accounting depends on the type of hedge. If the hedge is a fair value hedge, then the net position may be eligible as a hedged item. If, however, the hedge is a cash flow hedge, then the net position can only be eligible as a hedged item if it is a hedge of foreign currency risk and the designation of that net position specifies the reporting period in which the forecast transactions are expected to affect ~~profit or loss~~surplus or deficit and also specifies their nature and volume.

AG340.~~B6.6.8~~ For example, an entity has a net position that consists of a bottom layer of FC100 of sales and a bottom layer of FC150 of purchases. Both sales and purchases are denominated in the same foreign currency. In order to sufficiently specify the designation of the hedged net position, the entity specifies in the original documentation of the hedging relationship that sales can be of Product A or Product B and purchases can be of Machinery Type A, Machinery Type B and Raw Material A. The entity also specifies the volumes of the transactions by each nature. The entity documents that the bottom layer of sales (FC100) is made up of a forecast sales volume of the first FC70 of Product A and the first FC30 of Product B. If those sales volumes are expected to affect ~~profit or loss~~surplus or deficit in different reporting periods, the entity would include that in the documentation, for example, the first FC70 from sales of Product A that are expected to affect ~~profit or loss~~surplus or deficit in the first reporting period and the first FC30 from sales of Product B that are expected to affect ~~profit or loss~~surplus or deficit in the second reporting period. The entity also documents that the bottom layer of the purchases (FC150) is made up of purchases of the first FC60 of Machinery Type A, the first FC40 of Machinery Type B and the first FC50 of Raw Material A. If those purchase volumes are expected to affect ~~profit or loss~~surplus or deficit in different reporting periods, the entity would include in the documentation a disaggregation of the purchase volumes by the reporting periods in which they are expected to affect ~~profit or loss~~surplus or deficit (similarly to how it documents the sales volumes). For example, the forecast transaction would be specified as:

(a) The first FC60 of purchases of Machinery Type A that are expected to affect ~~profit or loss~~surplus or deficit from the third reporting period over the next ten reporting periods;

(b) The first FC40 of purchases of Machinery Type B that are expected to affect ~~profit or loss~~surplus or deficit from the fourth reporting period over the next 20 reporting periods; and

(c) The first FC50 of purchases of Raw Material A that are expected to be received in the third reporting period and sold, ie affect ~~profit or loss~~surplus or deficit, in that and the next reporting period.

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

AG341.~~B6.6.9~~ For a cash flow hedge of a net position, the amounts determined in accordance with paragraph 140~~6.5.11~~ shall include the changes in the value of the items in the net position that have a similar effect as the hedging instrument in conjunction with the fair value change on the hedging instrument. However, the changes in the value of the items in the net position that have a similar effect as the hedging instrument are recognised only once the transactions that they relate to are recognised, such as when a forecast sale is recognised as revenue. For example, an entity has a group of highly probable forecast sales in nine months' time for FC100 and a group of highly probable forecast purchases in 18 months' time for FC120. It hedges the foreign currency risk of the net position of FC20 using a forward exchange contract for FC20. When determining the amounts that are recognised in the cash flow hedge reserve in accordance with paragraph 140~~6.5.11~~(a)–140~~6.5.11~~(b), the entity compares:

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

(b) The foreign currency risk related changes in the value of the highly probable forecast purchases.

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

AG342.~~B6.6.10~~ Similarly, if in the example the entity had a nil net position it would compare the foreign currency risk related changes in the value of the highly probable forecast sales with the foreign currency risk related changes in the value of the highly probable forecast purchases. However, those amounts are recognised only once the related forecast transactions are recognised in the financial statements.

Layers of Groups of Items Designated as the Hedged Item

AG343.~~B6.6.11~~ For the same reasons noted in paragraph AG268~~B6.3.19~~, designating layer components of groups of existing items requires the specific identification of the nominal amount of the group of items from which the hedged layer component is defined.

AG344.~~B6.6.12~~ A hedging relationship can include layers from several different groups of items. For example, in a hedge of a net position of a group of assets and a group of liabilities, the hedging relationship can comprise, in combination, a layer component of the group of assets and a layer component of the group of liabilities.

Presentation of Hedging Instrument Gains or Losses

AG345.~~B6.6.13~~ If items are hedged together as a group in a cash flow hedge, they might affect different line items in the statement of ~~profit or loss~~surplus or deficit and other comprehensive ~~income~~revenue and expense. The presentation of hedging gains or losses in that statement depends on the group of items.

AG346.~~B6.6.14~~ If the group of items does not have any offsetting risk positions (for example, a group of foreign currency expenses that affect different line items in the statement of ~~profit or loss~~surplus or deficit and other comprehensive ~~income~~revenue and expense that are hedged for foreign currency risk) then the reclassified hedging instrument gains or losses shall be apportioned to the line items affected by the hedged items. This apportionment shall be done on a systematic and rational basis and shall not result in the grossing up of the net gains or losses arising from a single hedging instrument.

AG347.~~B6.6.15~~ If the group of items does have offsetting risk positions (for example, a group of sales and expenses denominated in a foreign currency hedged together for foreign currency risk) then an entity shall present the hedging gains or losses in a separate line item in the statement of ~~profit or loss~~surplus or deficit and other comprehensive ~~income~~revenue and expense. Consider, for example, a hedge of the foreign currency risk of a net position of foreign currency sales of FC100 and foreign currency expenses of FC80 using a forward exchange contract for FC20. The gain or loss on the forward exchange contract that is reclassified from the cash flow hedge reserve to ~~profit or loss~~surplus or deficit (when the net position affects ~~profit or loss~~surplus or deficit) shall be presented in a separate line item from the hedged sales and expenses. Moreover, if the sales occur in an earlier period than the expenses, the sales revenue is still measured at the spot exchange rate in accordance with PBE IPSAS 4~~IAS 21~~. The related hedging gain or loss is presented in a separate line item, so that ~~profit or loss~~surplus or deficit reflects the effect of hedging the net position, with a corresponding adjustment to the cash flow hedge reserve. When the hedged expenses affect ~~profit or loss~~surplus or deficit in a later period, the hedging gain or loss previously recognised in the cash flow hedge reserve on the sales is reclassified to ~~profit or loss~~surplus or deficit and presented as a separate line item from those that include the hedged expenses, which are measured at the spot exchange rate in accordance with PBE IPSAS 4~~IAS 21~~.

AG348.~~B6.6.16~~ For some types of fair value hedges, the objective of the hedge is not primarily to offset the fair value change of the hedged item but instead to transform the cash flows of the hedged item. For example, an entity hedges the fair value interest rate risk of a fixed-rate debt instrument using an interest rate swap. The entity’s hedge objective is to transform the fixed-interest cash flows into floating interest cash flows. This objective is reflected in the accounting for the hedging relationship by accruing the net interest accrual on the interest rate swap in ~~profit or loss~~surplus or deficit. In the case of a hedge of a net position (for example, a net position of a fixed-rate asset and a fixed-rate liability), this net interest accrual must be presented in a separate line item in the statement of ~~profit or loss~~surplus or deficit and other comprehensive ~~income~~revenue and expense. This is to avoid the grossing up of a single instrument’s net gains or losses into offsetting gross amounts and recognising them in different line items (for example, this avoids grossing up a net interest receipt on a single interest rate swap into gross interest revenue and gross interest expense).

Effective Date and Transition ~~(Chapter 7)~~

The cover memo (agenda item 6.1) seeks feedback on the approach to transition – we will do more work on the sections dealing with transition following direction from the Board.

Transition ~~(Section 7.2)~~

Financial Assets Held for Trading

AG349.~~B7.2.1~~ At the date of initial application of this Standard, an entity must determine whether the objective of the entity's business model for managing any of its financial assets meets the condition in paragraph 40~~4.1.2~~(a) or the condition in paragraph 41~~4.1.2A~~(a) or if a financial asset is eligible for the election in paragraph 106~~5.7.5~~. For that purpose, an entity shall determine whether financial assets meet the definition of held for trading as if the entity had purchased the assets at the date of initial application.

Impairment

AG350.~~B7.2.2~~ On transition, an entity should seek to approximate the credit risk on initial recognition by considering all reasonable and supportable information that is available without undue cost or effort. An entity is not required to undertake an exhaustive search for information when determining, at the date of transition, whether there have been significant increases in credit risk since initial recognition. If an entity is unable to make this determination without undue cost or effort paragraph 178~~7.2.20~~ applies.

AG351.~~B7.2.3~~ In order to determine the loss allowance on financial instruments initially recognised (or loan commitments or financial guarantee contracts to which the entity became a party to the contract) prior to the date of initial application, both on transition and until the derecognition of those items an entity shall consider information that is relevant in determining or approximating the credit risk at initial recognition. In order to determine or approximate the initial credit risk, an entity may consider internal and external information, including portfolio information, in accordance with paragraphs AG165~~B5.5.1~~–AG170~~B5.5.6~~.

AG352.~~B7.2.4~~ An entity with little historical information may use information from internal reports and statistics (that may have been generated when deciding whether to launch a new product), information about similar products or peer group experience for comparable financial instruments, if relevant.

~~Definitions (Appendix A)~~

~~Derivatives~~

~~BA.1 Typical examples of derivatives are futures and forward, swap and option contracts. A derivative usually has a notional amount, which is an amount of currency, a number of shares, a number of units of weight or volume or other units specified in the contract. However, a derivative instrument does not require the holder or writer to invest or receive the notional amount at the inception of the contract. Alternatively, a derivative could require a fixed payment or payment of an amount that can change (but not proportionally with a change in the underlying) as a result of some future event that is unrelated to a notional amount. For example, a contract may require a fixed payment of CU1,000 if six-month LIBOR increases by 100 basis points. Such a contract is a derivative even though a notional amount is not specified.~~

~~BA.2 The definition of a derivative in this Standard includes contracts that are settled gross by delivery of the underlying item (e.g., a forward contract to purchase a fixed rate debt instrument). An entity may have a contract to buy or sell a non-financial item that can be settled net in cash or another financial instrument or by exchanging financial instruments (e.g., a contract to buy or sell a commodity at a fixed price at a future date). Such a contract is within the scope of this Standard unless it was entered into and continues to be held for the purpose of delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements. However, this Standard applies to such contracts for an entity's expected purchase, sale or usage requirements if the entity makes a designation in accordance with paragraph 2.5 (see paragraphs 2.4–2.7).~~

~~BA.3 One of the defining characteristics of a derivative is that it has an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors. An option contract meets that definition because the premium is less than the investment that would be required to obtain the underlying financial instrument to which the option is linked. A currency swap that requires an initial exchange of different currencies of equal fair values meets the definition because it has a zero initial net investment.~~

~~BA.4 A regular way purchase or sale gives rise to a fixed price commitment between trade date and settlement date that meets the definition of a derivative. However, because of the short duration of the commitment it is not recognised as a derivative financial instrument. Instead, this Standard provides for special accounting for such regular way contracts (see paragraphs 3.1.2 and B3.1.3–B3.1.6).~~

~~BA.5 The definition of a derivative refers to non-financial variables that are not specific to a party to the contract. These include an index of earthquake losses in a particular region and an index of temperatures in a particular city. Non-financial variables specific to a party to the contract include the occurrence or non-occurrence of a fire that damages or destroys an asset of a party to the contract. A change in the fair value of a non-financial asset is specific to the owner if the fair value reflects not only changes in market prices for such assets (a financial variable) but also the condition of the specific non-financial asset held (a non-financial variable). For example, if a guarantee of the residual value of a specific car exposes the guarantor to the risk of changes in the car's physical condition, the change in that residual value is specific to the owner of the car.~~

~~Financial assets and liabilities held for trading~~

~~BA.6 Trading generally reflects active and frequent buying and selling, and financial instruments held for trading generally are used with the objective of generating a profit from short-term fluctuations in price or dealer's margin.~~

~~BA.7 Financial liabilities held for trading include:~~

~~(a) derivative liabilities that are not accounted for as hedging instruments;~~

~~(b) obligations to deliver financial assets borrowed by a short seller (i.e., an entity that sells financial assets it has borrowed and does not yet own);~~

~~(c) financial liabilities that are incurred with an intention to repurchase them in the near term (e.g., a quoted debt instrument that the issuer may buy back in the near term depending on changes in its fair value); and~~

~~(d) financial liabilities that are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking.~~

~~BA.8 The fact that a liability is used to fund trading activities does not in itself make that liability one that is held for trading.~~

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

This Appendix is an integral part of PBE IPSAS 41.

Note for constituents: The text in this Appendix is marked-up from IFRIC 16.

Introduction

B1.~~1~~ Many reporting entities have investments in foreign operations (as defined in PBE IPSAS 4~~IAS 21~~ paragraph 10~~8~~). Such foreign operations may be controlled entities~~subsidiaries~~, associates, joint ventures or branches. PBE IPSAS 4~~IAS 21~~ requires an entity to determine the functional currency of each of its foreign operations as the currency of the primary economic environment of that operation. When translating the results and financial position of a foreign operation into a presentation currency, the entity is required to recognise foreign exchange differences in other comprehensive revenue and expense~~income~~ until it disposes of the foreign operation.

B2.~~2~~ Hedge accounting of the foreign currency risk arising from a net investment in a foreign operation will apply only when the net assets of that foreign operation are included in the financial statements.[9] This will be the case for consolidated financial statements, financial statements in which investments such as associates or joint ventures are accounted for using the equity method and financial statements that include a branch or joint operations as defined in PBE IPSAS 37. The item being hedged with respect to the foreign currency risk arising from the net investment in a foreign operation may be an amount of net assets equal to or less than the carrying amount of the net assets of the foreign operation.

B3.~~3~~ PBE IPSAS 41~~IFRS 9~~ requires the designation of an eligible hedged item and eligible hedging instruments in a hedge accounting relationship. If there is a designated hedging relationship, in the case of a net investment hedge, the gain or loss on the hedging instrument that is determined to be an effective hedge of the net investment is recognised in other comprehensive revenue and expense~~income~~ and is included with the foreign exchange differences arising on translation of the results and financial position of the foreign operation.

~~4 An entity with many foreign operations may be exposed to a number of foreign currency risks. This Interpretation provides guidance on identifying the foreign currency risks that qualify as a hedged risk in the hedge of a net investment in a foreign operation.~~

~~5 IFRS 9 allows an entity to designate either a derivative or a non-derivative financial instrument (or a combination of derivative and non-derivative financial instruments) as hedging instruments for foreign currency risk. This Interpretation provides guidance on where, within a group, hedging instruments that are hedges of a net investment in a foreign operation can be held to qualify for hedge accounting.~~

~~6 IAS 21 and IFRS 9 require cumulative amounts recognised in other comprehensive income relating to both the foreign exchange differences arising on translation of the results and financial position of the foreign operation and the gain or loss on the hedging instrument that is determined to be an effective hedge of the net investment to be reclassified from equity to profit or loss as a reclassification adjustment when the parent disposes of the foreign operation. This Interpretation provides guidance on how an entity should determine the amounts to be reclassified from equity to profit or loss for both the hedging instrument and the hedged item.~~

~~Scope~~

B4.~~7~~ This Appendix ~~Interpretation~~ applies to an entity that hedges the foreign currency risk arising from its net investments in foreign operations and wishes to qualify for hedge accounting in accordance with PBE IPSAS 41~~IFRS 9~~. It should not be applied by analogy to other types of hedge accounting. ~~For convenience~~ This Appendix ~~Interpretation~~ refers to such an entity as a controlling ~~parent~~ entity and to the financial statements in which the net assets of foreign operations are included as consolidated financial

~~[9] This will be the case for consolidated financial statements, financial statements in which investments such as associates or joint ventures are accounted for using the equity method and financial statements that include a branch or a joint operation as defined in IFRS 11 *Joint Arrangements*.~~

statements. All references to a controlling ~~parent~~ entity apply equally to an entity that has a net investment in a foreign operation that is a joint venture, an associate or a branch.

~~8 This Interpretation applies only to hedges of net investments in foreign operations; it should not be applied by analogy to other types of hedge accounting.~~

~~Issues~~

B5.~~9~~ ~~Investments in foreign operations may be held directly by a parent entity or indirectly by its subsidiary or subsidiaries. The issues addressed in this Interpretation are~~This Appendix provides guidance on:

(a) Identifying the foreign currency risks that qualify as a hedged risk in the hedge of a net investment in a foreign operation, given that an entity with many foreign operations may be exposed to a number of foreign currency risks. It specifically addresses~~the nature of the hedged risk and the amount of the hedged item for which a hedging relationship may be designated~~:

(i) Whether the controlling~~parent~~ entity may designate as a hedged risk only the foreign exchange differences arising from a difference between the functional currencies of the controlling~~parent~~ entity and its foreign operation, or whether it may also designate as the hedged risk the foreign exchange differences arising from the difference between the presentation currency of the controlling~~parent~~ entity's consolidated financial statements and the functional currency of the foreign operation; and

(ii) If the controlling~~parent~~ entity holds the foreign operation indirectly, whether the hedged risk may include only the foreign exchange differences arising from differences in functional currencies between the foreign operation and its immediate ~~parent~~ controlling entity, or whether the hedged risk may also include any foreign exchange differences between the functional currency of the foreign operation and any intermediate or ultimate controlling~~parent~~ entity (i.e., whether the fact that the net investment in the foreign operation is held through an intermediate parent affects the economic risk to the ultimate parent).

(b) Where in an economic entity~~group~~ the hedging instrument can be held. It specifically addresses:

(i) PBE IPSAS 41 allows an entity to designate either a derivative or a non-derivative financial instrument (or a combination of derivative and non-derivative financial instruments) as hedging instruments for foreign currency risk. This appendix addresses whether the nature of the hedging instrument (derivative or non-derivative) or the method of consolidation affects the assessment of hedge effectiveness.

(ii) This appendix also addresses where, within an economic entity, hedging instruments that are hedges of a net investment in a foreign operation can be held to qualify for hedge accounting i.e., whether a qualifying hedge accounting relationship can be established only if the entity hedging its net investment is a party to the hedging instrument or whether any entity within~~in~~ the economic entity~~group~~, regardless of its functional currency, can hold the hedging instrument.~~;~~

~~(ii) Whether the nature of the hedging instrument (derivative or non-derivative) or the method of consolidation affects the assessment of hedge effectiveness.~~

(c) [Text of (c) as per IFRIC 16] What amounts should be reclassified from net assets/equity to surplus or deficit~~profit or loss~~ as reclassification adjustments on disposal of the foreign operation:

[Text of (c) as per IPSAS 41 follows. Subject to further consideration. Need to identify which version is most appropriate for PBE Standards.]

~~(c) How an entity should determine what amount of the gain or loss recognized in net assets/equity should be recognized directly in surplus or deficit for both the hedging instrument and the hedged item as IPSAS 4 and IPSAS 41 require cumulative amounts recognized directly in net assets/equity relating to both the foreign exchange differences arising on translation of the results and financial position of the foreign operation and the gain or loss on the hedging instrument that is determined to be an effective hedge of the net investment to be recognized directly when the controlling entity disposes of the foreign operation. It specifically addresses:~~

(i) When a foreign operation that was hedged is disposed of, what amounts from the controlling~~parent~~ entity's foreign currency translation reserve in respect of the hedging instrument and ~~in respect~~ of that foreign operation should be reclassified from net assets/equity to surplus or deficit~~profit or loss~~ in the controlling~~parent~~ entity's consolidated financial statements; and

(ii) Whether the method of consolidation affects the determination of the amounts to be reclassified from net assets/equity to surplus or deficit~~profit or loss~~.

~~Consensus~~

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

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

B6.~~10~~ Hedge accounting may be applied only to the foreign exchange differences arising between the functional currency of the foreign operation and the controlling~~parent~~ entity's functional currency.

B7.~~11~~ In a hedge of the foreign currency risks arising from a net investment in a foreign operation, the hedged item can be an amount of net assets equal to or less than the carrying amount of the net assets of the foreign operation in the consolidated financial statements of the controlling~~parent~~ entity. The carrying amount of the net assets of a foreign operation that may be designated as the hedged item in the consolidated financial statements of a controlling entity~~parent~~ depends on whether any lower level controlling entity~~parent~~ of the foreign operation has applied hedge accounting for all or part of the net assets of that foreign operation and that accounting has been maintained in the controlling ~~parent~~entity's consolidated financial statements.

B8.~~12~~ The hedged risk may be designated as the foreign currency exposure arising between the functional currency of the foreign operation and the functional currency of any controlling~~parent~~ entity (the immediate, intermediate or ultimate controlling~~parent~~ entity) of that foreign operation. The fact that the net investment is held through an intermediate controlling entity~~parent~~ does not affect the nature of the economic risk arising from the foreign currency exposure to the ultimate controlling~~parent~~ entity.

B9.~~13~~ An exposure to foreign currency risk arising from a net investment in a foreign operation may qualify for hedge accounting only once in the consolidated financial statements. Therefore, if the same net assets of a foreign operation are hedged by more than one controlling~~parent~~ entity within the economic entity~~group~~ (e.g.~~for example~~, both a direct and an indirect controlling~~parent~~ entity) for the same risk, only one hedging relationship will qualify for hedge accounting in the consolidated financial statements of the ultimate controlling entity~~parent~~. A hedging relationship designated by one controlling~~parent~~ entity in its consolidated financial statements need not be maintained by another higher level controlling~~parent~~ entity. However, if it is not maintained by the higher level controlling~~parent~~ entity, the hedge accounting applied by the lower level controlling entity~~parent~~ must be reversed before the higher level controlling entity's~~parent's~~ hedge accounting is recognised.

Where the Hedging Instrument can be Held

B10.~~14~~ A derivative or a non-derivative instrument (or a combination of derivative and non-derivative instruments) may be designated as a hedging instrument in a hedge of a net investment in a foreign operation. The hedging instrument(s) may be held by any entity or entities within the economic entity~~group~~, as long as the designation, documentation and effectiveness requirements of PBE IPSAS 41~~IFRS 9~~ paragraph 129~~6.4.1~~ that relate to a net investment hedge are satisfied. In particular, the hedging strategy of the economic entity~~group~~ should be clearly documented because of the possibility of different designations at different levels of the economic entity~~group~~.

B11.~~15~~ For the purpose of assessing effectiveness, the change in value of the hedging instrument in respect of foreign exchange risk is computed by reference to the functional currency of the controlling ~~parent~~ entity against whose functional currency the hedged risk is measured, in accordance with the hedge accounting documentation. Depending on where the hedging instrument is held, in the absence of hedge accounting the total change in value might be recognised in surplus or deficit~~profit or loss~~, in other comprehensive revenue and expense~~income~~, or both. However, the assessment of effectiveness is not affected by whether the change in value of the hedging instrument is recognised in surplus or deficit~~profit or loss~~ or in other comprehensive revenue and expense~~income~~. As part of the application of hedge accounting, the total effective portion of the change is included in other comprehensive revenue and expense~~income~~. The assessment of effectiveness is not affected by whether the hedging instrument is a derivative or a non-derivative instrument or by the method of consolidation.

Disposal of a Hedged Foreign Operation

B12.~~16~~ When a foreign operation that was hedged is disposed of, the amount reclassified to surplus or deficit~~profit or loss~~ as a reclassification adjustment from the foreign currency translation reserve in the consolidated financial statements of the controlling entity~~parent~~ in respect of the hedging instrument is the amount that PBE IPSAS 41~~IFRS 9~~ paragraph 143~~6.5.14~~ requires to be identified. That amount is the cumulative gain or loss on the hedging instrument that was determined to be an effective hedge.

B13.~~17~~ The amount reclassified to surplus or deficit~~profit or loss~~ from the foreign currency translation reserve in the consolidated financial statements of a controlling entity~~parent~~ in respect of the net investment in that foreign operation in accordance with PBE IPSAS 4~~IAS 21~~ paragraph 57~~48~~ is the amount included in that controlling entity's~~parent's~~ foreign currency translation reserve in respect of that foreign operation. In the ultimate controlling entity's~~parent's~~ consolidated financial statements, the aggregate net amount recognised in the foreign currency translation reserve in respect of all foreign operations is not affected by the consolidation method. However, whether the ultimate controlling entity~~parent~~ uses the direct or the step-by-step method of consolidation,~~[10]~~ may affect the amount included in its foreign currency translation reserve in respect of an individual foreign operation.

B14. The direct method is the method of consolidation in which the financial statements of the foreign operation are translated directly into the functional currency of the ultimate controlling entity. The step-by-step method is the method of consolidation in which the financial statements of the foreign operation are first translated into the functional currency of any intermediate controlling entity(ies) and then translated into the functional currency of the ultimate controlling entity (or the presentation currency if different).

B15. The use of the step-by-step method of consolidation may result in the reclassification to surplus or deficit~~profit or loss~~ of an amount different from that used to determine hedge effectiveness. This difference may be eliminated by determining the amount relating to that foreign operation that would have arisen if the direct method of consolidation had been used. Making this adjustment is not required by PBE IPSAS 4~~IAS 21~~. However, it is an accounting policy choice that should be followed consistently for all net investments.

~~Transition~~

~~19 IAS 8 specifies how an entity applies a change in accounting policy resulting from the initial application of an Interpretation. An entity is not required to comply with those requirements when first applying the Interpretation. If an entity had designated a hedging instrument as a hedge of a net investment but the hedge does not meet the conditions for hedge accounting in this Interpretation, the entity shall apply IAS 39 to discontinue that hedge accounting prospectively.~~

~~Appendix~~
~~Application guidance~~

~~This appendix is an integral part of the Interpretation.~~

Example

B16.~~AG1~~ Th~~is~~e following example~~appendix~~ illustrates the application of the preceding paragraphs~~Interpretation~~ using the entity~~corporate~~ structure illustrated below. In all cases the hedging relationships described would be

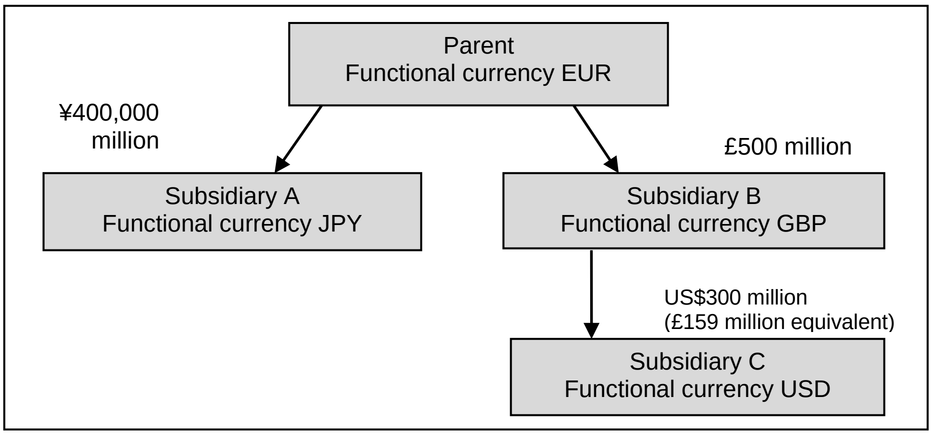
~~[10] The direct method is the method of consolidation in which the financial statements of the foreign operation are translated directly into the functional currency of the ultimate parent. The step-by-step method is the method of consolidation in which the financial statements of the foreign operation are first translated into the functional currency of any intermediate parent(s) and then translated into the functional currency of the ultimate parent (or the presentation currency if different).~~

tested for effectiveness in accordance with PBE IPSAS 41~~IFRS 9~~, although this testing is not discussed~~ in this Appendix~~. Controlling Entity D~~Parent~~, being the ultimate controlling~~parent~~ entity, presents its consolidated financial statements in its functional currency of euro (EUR). Each of the controlled entities~~subsidiaries~~ i.e., Controlled Entity A, Controlled Entity B and Controlled Entity C, is wholly owned. Controlling Entity D's~~Parent's~~ £500 million net investment in ~~Subsidiary~~ Controlled Entity B (functional currency pounds sterling (GBP)) includes the £159 million equivalent of Controlled Entity~~Subsidiary~~ B's US$300 million net investment in Controlled Entity~~Subsidiary~~ C (functional currency US dollars (USD)). In other words, Controlled Entity ~~Subsidiary~~ B's net assets other than its investment in Controlled Entity~~Subsidiary~~ C are £341 million.

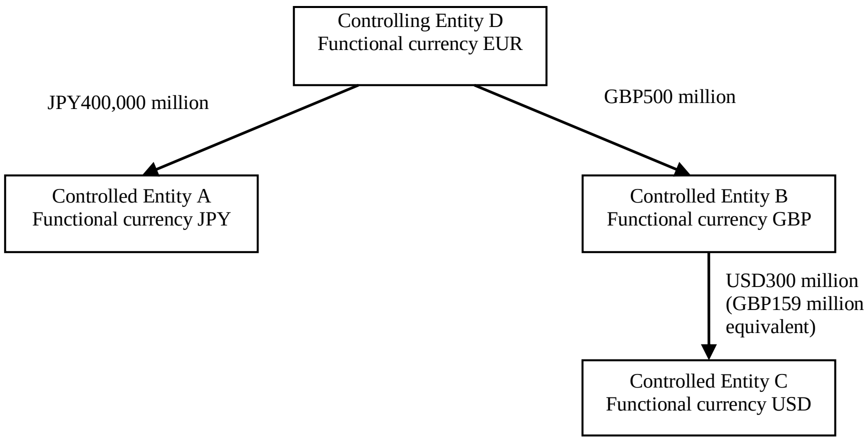
Nature of Hedged Risk for which a Hedging Relationship may be Designated (paragraphs B6–B9 ~~10–13~~)

B17.~~AG2~~ Controlling Entity D~~Parent~~ can hedge its net investment in each of Controlled Entities~~Subsidiaries~~ A, B and C for the foreign exchange risk between their respective functional currencies (Japanese yen (JPY), pounds sterling and US dollars) and euro. In addition, Controlling Entity D~~Parent~~ can hedge the USD/GBP foreign exchange risk between the functional currencies of Controlled Entity~~Subsidiary~~ B and Controlled Entity ~~Subsidiary~~ C. In its consolidated financial statements, Controlled Entity ~~Subsidiary~~ B can hedge its net investment in Controlled Entity ~~Subsidiary~~ C for the foreign exchange risk between their functional currencies of US dollars and pounds sterling. In the following examples the designated risk is the spot foreign exchange risk because the hedging instruments are not derivatives. If the hedging instruments were forward contracts, Controlling Entity D~~Parent~~ could designate the forward foreign exchange risk.

[IFRS 9 diagram.]



[IPSAS 41 diagram.]



Amount of Hedged Item for which a Hedging Relationship may be Designated (paragraphs B6–B9 ~~10–13~~)

B18.~~AG3~~ ~~Parent~~ Controlling Entity D wishes to hedge the foreign exchange risk from its net investment in~~ Subsidiary~~ Controlled Entity C. Assume that Controlled Entity~~Subsidiary~~ A has an external borrowing of US$300 million. The net assets of Controlled Entity ~~Subsidiary~~ A at the start of the reporting period are ¥400,000 million including the proceeds of the external borrowing of US$300 million.

B19.~~AG4~~ The hedged item can be an amount of net assets equal to or less than the carrying amount of ~~Parent~~Controlling Entity D's net investment in Controlled Entity~~Subsidiary~~ C (US$300 million) in its consolidated financial statements. In its consolidated financial statements ~~Parent~~Controlling Entity D can designate the US$300 million external borrowing in Controlled Entity~~Subsidiary~~ A as a hedge of the EUR/USD spot foreign exchange risk associated with its net investment in the US$300 million net assets of Controlled Entity~~Subsidiary~~ C. In this case, both the EUR/USD foreign exchange difference on the US$300 million external borrowing in Controlled Entity~~Subsidiary~~ A and the EUR/USD foreign exchange difference on the US$300 million net investment in Controlled Entity~~Subsidiary~~ C are included in the foreign currency translation reserve in ~~Parent~~Controlling Entity D's consolidated financial statements after the application of hedge accounting.

B20.~~AG5~~ In the absence of hedge accounting, the total USD/EUR foreign exchange difference on the US$300 million external borrowing in Controlled Entity~~Subsidiary~~ A would be recognised in ~~Parent~~Controlling Entity D's consolidated financial statements as follows:

- USD/JPY spot foreign exchange rate change, translated to euro, in surplus or deficit~~profit or loss,~~; and
- JPY/EUR spot foreign exchange rate change in other comprehensive revenue and expense~~income~~.

Instead of the designation in paragraph B19~~AG4~~, in its consolidated financial statements ~~Parent~~Controlling Entity D can designate the US$300 million external borrowing in Controlled Entity ~~Subsidiary~~ A as a hedge of the GBP/USD spot foreign exchange risk between Controlled Entity~~Subsidiary~~ C and Controlled Entity~~Subsidiary~~ B. In this case, the total USD/EUR foreign exchange difference on the US$300 million external borrowing in Controlled Entity~~Subsidiary~~ A would instead be recognised in ~~Parent~~Controlling Entity D's consolidated financial statements as follows:

- the GBP/USD spot foreign exchange rate change in the foreign currency translation reserve relating to Controlled Entity~~Subsidiary~~ C,
- GBP/JPY spot foreign exchange rate change, translated to euro, in surplus or deficit~~profit or loss,~~; and
- JPY/EUR spot foreign exchange rate change in other comprehensive ~~income~~revenue and expense.

B21.~~AG6~~ ~~Parent~~Controlling Entity D cannot designate the US$300 million external borrowing in Controlled Entity~~Subsidiary~~ A as a hedge of both the EUR/USD spot foreign exchange risk and the GBP/USD spot foreign exchange risk in its consolidated financial statements. A single hedging instrument can hedge the same designated risk only once. Controlled Entity~~Subsidiary~~ B cannot apply hedge accounting in its consolidated financial statements because the hedging instrument is held outside the economic entity~~group~~ comprising Controlled Entity~~Subsidiary~~ B and Controlled Entity~~Subsidiary~~ C.

Where in an Economic Entity ~~group~~ can the Hedging Instrument be Held (paragraphs B10~~14~~ and B11~~15~~)?

B22.~~AG7~~ As noted in paragraph B20~~AG5~~, the total change in value in respect of foreign exchange risk of the US$300 million external borrowing in Controlled Entity ~~Subsidiary~~ A would be recorded in both surplus or deficit~~profit or loss~~ (USD/JPY spot risk) and other comprehensive revenue and expense~~income~~ (EUR/JPY spot risk) in ~~Parent~~Controlling Entity D's consolidated financial statements in the absence of hedge accounting. Both amounts are included for the purpose of assessing the effectiveness of the hedge designated in paragraph B19~~AG4~~ because the change in value of both the hedging instrument and the hedged item are computed by reference to the euro functional currency of ~~Parent~~Controlling Entity D against the US dollar functional currency of Controlled Entity~~Subsidiary~~ C, in accordance with the hedge documentation. The method of consolidation (i.e., direct method or step-by-step method) does not affect the assessment of the effectiveness of the hedge.

Amounts Reclassified to Surplus or Deficit~~profit or loss~~ on Disposal of a Foreign Operation (paragraphs B12 and B13~~16 and 17~~)

B23.~~AG8~~ When ~~Subsidiary~~Controlled Entity C is disposed of, the amounts reclassified to surplus or deficit~~profit or loss~~ in ~~Parent~~Controlling Entity D's consolidated financial statements from its foreign currency translation reserve (FCTR) are:

(a) In respect of the US$300 million external borrowing of ~~Subsidiary~~Controlled Entity A, the amount that PBE IPSAS 41~~IFRS 9~~ requires to be identified, i.e., the total change in value in respect of foreign exchange risk that was recognised in other comprehensive revenue and expense~~income~~ as the effective portion of the hedge; and

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

Hedging More than One Foreign Operation (paragraphs B7~~11~~, B9~~13~~ and B11~~15~~)

B24.~~AG9~~ The following examples illustrate that in the consolidated financial statements of ~~Parent~~Controlling Entity D, the risk that can be hedged is always the risk between its functional currency (euro) and the functional currencies of Controlled Entities~~Subsidiaries~~ B and C. No matter how the hedges are designated, the maximum amounts that can be effective hedges to be included in the foreign currency translation reserve in ~~Parent~~Controlling Entity D's consolidated financial statements when both foreign operations are hedged are US$300 million for EUR/USD risk and £341 million for EUR/GBP risk. Other changes in value due to changes in foreign exchange rates are included in ~~Parent~~Controlling Entity D's consolidated surplus or deficit~~profit or loss~~. Of course, it would be possible for ~~Parent~~Controlling Entity D to designate US$300 million only for changes in the USD/GBP spot foreign exchange rate or £500 million only for changes in the GBP/EUR spot foreign exchange rate.

~~Parent~~Entity D Holds Both USD and GBP Hedging Instruments

B25.~~AG10~~ ~~Parent~~Controlling Entity D may wish to hedge the foreign exchange risk in relation to its net investment in ~~Subsidiary~~Controlled Entity B as well as that in relation to ~~Subsidiary~~Controlled Entity C. Assume that ~~Parent~~Controlling Entity D holds suitable hedging instruments denominated in US dollars and pounds sterling that it could designate as hedges of its net investments in ~~Subsidiary~~Controlled Entity B and ~~Subsidiary~~Controlled Entity C. The designations ~~Parent~~Controlling Entity D can make in its consolidated financial statements include, but are not limited to, the following:

(a) US$300 million hedging instrument designated as a hedge of the US$300 million of net investment in ~~Subsidiary~~Controlled Entity C with the risk being the spot foreign exchange exposure (EUR/USD) between ~~Parent~~Controlling Entity D and ~~Subsidiary~~Controlled Entity C and up to £341 million hedging instrument designated as a hedge of £341 million of the net investment in ~~Subsidiary~~Controlled Entity B with the risk being the spot foreign exchange exposure (EUR/GBP) between ~~Parent~~Controlling Entity D and ~~Subsidiary~~Controlled Entity B.

(b) US$300 million hedging instrument designated as a hedge of the US$300 million of net investment in ~~Subsidiary~~Controlled Entity C with the risk being the spot foreign exchange exposure (GBP/USD) between ~~Subsidiary~~Controlled Entity B and ~~Subsidiary~~Controlled Entity C and up to £500 million hedging instrument designated as a hedge of £500 million of the net investment in ~~Subsidiary~~Controlled Entity B with the risk being the spot foreign exchange exposure (EUR/GBP) between ~~Parent~~Controlling Entity D and ~~Subsidiary~~Controlled Entity B.

B26.~~AG11~~ The EUR/USD risk from ~~Parent~~Controlling Entity D's net investment in ~~Subsidiary~~Controlled Entity C is a different risk from the EUR/GBP risk from ~~Parent~~Controlling Entity D's net investment in ~~Subsidiary~~Controlled Entity B. However, in the case described in paragraph B25~~AG10~~(a), by its designation of the USD hedging instrument it holds, ~~Parent~~Controlling Entity D has already fully hedged the EUR/USD risk from its net investment in ~~Subsidiary~~Controlled Entity C. If ~~Parent~~Controlling Entity D also designated a GBP instrument it holds as a hedge of its £500 million net investment in ~~Subsidiary~~Controlled Entity B, £159 million of that net investment, representing the GBP equivalent of its USD net investment in ~~Subsidiary~~Controlled Entity C, would be hedged twice for GBP/EUR risk in ~~Parent~~Controlling Entity D's consolidated financial statements.

B27.~~AG12~~ In the case described in paragraph B25~~AG10~~(b), if ~~Parent~~Controlling Entity D designates the hedged risk as the spot foreign exchange exposure (GBP/USD) between ~~Subsidiary~~Controlled Entity B and ~~Subsidiary~~Controlled Entity C, only the GBP/USD part of the change in the value of its US$300 million hedging instrument is included in ~~Parent~~Controlling Entity D's foreign currency translation reserve relating to ~~Subsidiary~~Controlled Entity C. The remainder of the change (equivalent to the GBP/EUR change on £159 million) is included in ~~Parent~~Controlling Entity D's consolidated surplus or deficit~~profit or loss~~, as in paragraph B20~~AG5~~. Because the designation of the USD/GBP risk between Controlled Entities~~Subsidiaries~~ B and C does not include the GBP/EUR risk, ~~Parent~~Controlling Entity D is also able to designate up to £500 million of its net investment in ~~Subsidiary~~Controlled Entity B with the risk being the spot foreign exchange exposure (GBP/EUR) between ~~Parent~~Controlling Entity D and ~~Subsidiary~~Controlled Entity B.

~~Subsidiary~~Entity B Holds the USD Hedging Instrument

B28.~~AG13~~ Assume that ~~Subsidiary~~Controlled Entity B holds US$300 million of external debt the proceeds of which were transferred to ~~Parent~~Controlling Entity D by an inter-company loan denominated in pounds sterling. Because both its assets and liabilities increased by £159 million, ~~Subsidiary~~Controlled Entity B's net assets are unchanged. ~~Subsidiary~~Controlled Entity B could designate the external debt as a hedge of the GBP/USD risk of its net investment in ~~Subsidiary~~Controlled Entity C in its consolidated financial statements. ~~Parent~~Controlling Entity D could maintain ~~Subsidiary~~Controlled Entity B's designation of that hedging instrument as a hedge of its US$300 million net investment in ~~Subsidiary~~Controlled Entity C for the GBP/USD risk (see paragraph B9~~13~~) and ~~Parent~~Controlling Entity D could designate the GBP hedging instrument it holds as a hedge of its entire £500 million net investment in ~~Subsidiary~~Controlled Entity B. The first hedge, designated by ~~Subsidiary~~Controlled Entity B, would be assessed by reference to ~~Subsidiary~~Controlled Entity B's functional currency (pounds sterling) and the second hedge, designated by ~~Parent~~Controlling Entity D, would be assessed by reference to ~~Parent~~Controlling Entity D's functional currency (euro). In this case, only the GBP/USD risk from ~~Parent~~Controlling Entity D's net investment in ~~Subsidiary~~Controlled Entity C has been hedged in ~~Parent~~Controlling Entity D's consolidated financial statements by the USD hedging instrument, not the entire EUR/USD risk. Therefore, the entire EUR/GBP risk from ~~Parent~~Controlling Entity D's £500 million net investment in ~~Subsidiary~~Controlled Entity B may be hedged in the consolidated financial statements of ~~Parent~~Controlling Entity D.

B29.~~AG14~~ However, the accounting for ~~Parent~~Controlling Entity D's £159 million loan payable to ~~Subsidiary~~Controlled Entity B must also be considered. If ~~Parent~~Controlling Entity D's loan payable is not considered part of its net investment in ~~Subsidiary~~Controlled Entity B because it does not satisfy the conditions in PBE IPSAS 4~~IAS 21~~ paragraph 18~~15~~, the GBP/EUR foreign exchange difference arising on translating it would be included in ~~Parent~~Controlling Entity D's consolidated surplus or deficit~~profit or loss~~. If the £159 million loan payable to ~~Subsidiary~~Controlled Entity B is considered part of ~~Parent~~Controlling Entity D's net investment, that net investment would be only £341 million and the amount ~~Parent~~Controlling Entity D could designate as the hedged item for GBP/EUR risk would be reduced from £500 million to £341 million accordingly.

B30~~AG15~~If ~~Parent~~Controlling Entity D reversed the hedging relationship designated by ~~Subsidiary~~Controlled Entity B, ~~Parent~~Controlling Entity D could designate the US$300 million external borrowing held by ~~Subsidiary~~Controlled Entity B as a hedge of its US$300 million net investment in ~~Subsidiary~~Controlled Entity C for the EUR/USD risk and designate the GBP hedging instrument it holds itself as a hedge of only up to £341 million of the net investment in ~~Subsidiary~~Controlled Entity B. In this case the effectiveness of both hedges would be computed by reference to ~~Parent~~Controlling Entity D's functional currency (euro). Consequently, both the USD/GBP change in value of the external borrowing held by ~~Subsidiary~~Controlled Entity B and the GBP/EUR change in value of ~~Parent~~Controlling Entity D's loan payable to ~~Subsidiary~~Controlled Entity B (equivalent to USD/EUR in total) would be included in the foreign currency translation reserve in ~~Parent~~Controlling Entity D's consolidated financial statements. Because ~~Parent~~Controlling Entity D has already fully hedged the EUR/USD risk from its net investment in ~~Subsidiary~~Controlled Entity C, it can hedge only up to £341 million for the EUR/GBP risk of its net investment in ~~Subsidiary~~Controlled Entity B.

~~Illustrative~~ Example

[This non-integral example will be moved to the non-integral guidance.]

~~*[This example accompanies, but is not part of, IFRIC 16.]*~~

Foreign Operations (Appendix B)

IE148~~IE1~~ This example illustrates the application of paragraphs B12, B13, B14 and B15 of Appendix B~~16 and 17~~ in connection with the reclassification adjustment on the disposal of a foreign operation.

Example 19—Disposal of a Foreign Operation

Background

IE149~~IE2~~ This example assumes the economic entity~~group~~ structure set out in paragraph B16~~the application guidance~~ and that ~~Parent~~Controlling Entity D used a USD borrowing in ~~Subsidiary~~Controlled Entity A to hedge the EUR/USD risk of the net investment in ~~Subsidiary~~Controlled Entity C in ~~Parent~~Controlling Entity D's consolidated financial statements. ~~Parent~~Controlling Entity D uses the step-by-step method of consolidation. Assume the hedge was fully effective and the full USD/EUR accumulated change in the value of the hedging instrument before disposal of ~~Subsidiary~~Controlled Entity C is €24 million (gain). This is matched exactly by the fall in value of the net investment in ~~Subsidiary~~Controlled Entity C, when measured against the functional currency of ~~Parent~~Controlling Entity D (euro).

IE150~~IE3~~ If the direct method of consolidation is used, the fall in the value of ~~Parent~~Controlling Entity D's net investment in ~~Subsidiary~~Controlled Entity C of €24 million would be reflected totally in the foreign currency translation reserve relating to ~~Subsidiary~~Controlled Entity C in ~~Parent~~Controlling Entity D's consolidated financial statements. However, because ~~Parent~~Controlling Entity D uses the step-by-step method, this fall in the net investment value in ~~Subsidiary~~Controlled Entity C of €24 million would be reflected both in ~~Subsidiary~~Controlled Entity B's foreign currency translation reserve relating to ~~Subsidiary~~Controlled Entity C and in ~~Parent~~Controlling Entity D's foreign currency translation reserve relating to ~~Subsidiary~~Controlled Entity B.

IE151~~IE4~~ The aggregate amount recognised in the foreign currency translation reserve in respect of Controlled Entities~~Subsidiaries~~ B and C is not affected by the consolidation method. Assume that using the direct method of consolidation, the foreign currency translation reserves for Controlled Entities~~Subsidiaries~~ B and C in ~~Parent~~Controlling Entity D's consolidated financial statements are €62 million gain and €24 million loss respectively; using the step-by-step method of consolidation those amounts are €49 million gain and €11 million loss respectively.

Reclassification

IE152~~IE5~~ When the investment in ~~Subsidiary~~Controlled Entity C is disposed of, PBE IPSAS 41~~IFRS 9~~ requires the full €24 million gain on the hedging instrument to be reclassified to surplus or deficit~~profit or loss~~. Using the step-by-step method, the amount to be reclassified to surplus or deficit ~~profit or loss~~ in respect of the net investment in ~~Subsidiary~~Controlled Entity C would be only €11 million loss. ~~Parent~~Controlling Entity D could adjust the foreign currency translation reserves of both Controlled Entities~~Subsidiaries~~ B and C by €13 million in order to match the amounts reclassified in respect of the hedging instrument and the net investment as would have been the case if the direct method of consolidation had been used, if that was its accounting policy. An entity that had not hedged its net investment could make the same reclassification.

Appendix C: Extinguishing Financial Liabilities with Equity Instruments

This Appendix is an integral part of PBE IPSAS 41.

Note for constituents: The text in this Appendix is marked-up from IFRIC 19.

Introduction

C1.~~1~~ A debtor and creditor might renegotiate the terms of a financial liability with the result that the debtor extinguishes the liability fully or partially by issuing equity instruments to the creditor. These transactions are sometimes referred to as 'debt for equity swaps'. ~~The IFRIC has received requests for guidance on the accounting for such transactions.~~

Scope

C2.~~2~~ This Appendix~~Interpretation~~ addresses the accounting by an entity when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to a creditor of the entity to extinguish all or part of the financial liability. It does not address the accounting by the creditor.

C3.~~3~~ An entity shall not apply this Appendix~~Interpretation~~ to transactions in situations where:

(a) The creditor is also a direct or indirect shareholder and is acting in its capacity as a direct or indirect existing shareholder.

(b) The creditor and the entity are controlled by the same party or parties before and after the transaction and the substance of the transaction includes an equity distribution by, or contribution to, the entity.

(c) Extinguishing the financial liability by issuing equity shares is in accordance with the original terms of the financial liability.

C4.~~4~~ This Appendix~~Interpretation~~ addresses the following issues:

(a) Are an entity's equity instruments issued to extinguish all or part of a financial liability 'consideration paid' in accordance with paragraph 37~~3.3.3~~ of PBE IPSAS 41~~IFRS 9~~?

(b) How should an entity initially measure the equity instruments issued to extinguish such a financial liability?

(c) How should an entity account for any difference between the carrying amount of the financial liability extinguished and the initial measurement amount of the equity instruments issued?

Consensus

C5.~~5~~ The issue of an entity's equity instruments to a creditor to extinguish all or part of a financial liability is consideration paid in accordance with paragraph 37~~3.3.3~~ of PBE IPSAS 41~~IFRS 9~~. An entity shall remove a financial liability (or part of a financial liability) from its statement of financial position when, and only when, it is extinguished in accordance with paragraph 35~~3.3.1~~ of PBE IPSAS 41~~IFRS 9~~.

C6.~~6~~ When equity instruments issued to a creditor to extinguish all or part of a financial liability are recognised initially, an entity shall measure them at the fair value of the equity instruments issued, unless that fair value cannot be reliably measured.

C7.~~7~~ If the fair value of the equity instruments issued cannot be reliably measured then the equity instruments shall be measured to reflect the fair value of the financial liability extinguished. In measuring the fair value of a financial liability extinguished that includes a demand feature (eg a demand deposit), paragraph 68~~47~~ of PBE IPSAS 41~~IFRS 13~~ is not applied.

C8.~~8~~ If only part of the financial liability is extinguished, the entity shall assess whether some of the consideration paid relates to a modification of the terms of the liability that remains outstanding. If part of the consideration paid does relate to a modification of the terms of the remaining part of the liability, the entity shall allocate the consideration paid between the part of the liability extinguished and the part of the liability that remains outstanding. The entity shall consider all relevant facts and circumstances relating to the transaction in making this allocation.

C9.~~9~~ The difference between the carrying amount of the financial liability (or part of a financial liability) extinguished, and the consideration paid, shall be recognised in surplus or deficit~~profit or loss~~, in accordance with paragraph 37~~3.3.3~~ of PBE IPSAS 41~~IFRS 9~~. The equity instruments issued shall be recognised initially and measured at the date the financial liability (or part of that liability) is extinguished.

C10.~~10~~ When only part of the financial liability is extinguished, consideration shall be allocated in accordance with paragraph C8. The consideration allocated to the remaining liability shall form part of the assessment of whether the terms of that remaining liability have been substantially modified. If the remaining liability has been substantially modified, the entity shall account for the modification as the extinguishment of the original liability and the recognition of a new liability as required by paragraph 36~~3.3.2~~ of PBE IPSAS 41~~IFRS 9~~.

C11.~~11~~ An entity shall disclose a gain or loss recognised in accordance with paragraphs C9 and C10 as a separate line item in surplus or deficit~~profit or loss~~ or in the notes.

Amendments to Other Standards

Except where otherwise stated, an entity shall apply the amendments in this Appendix when it applies PBE IPSAS 41 issued in [date].

Note to the Board: These amendments will be made available at a future meeting. The draft amendments (100 pages) are available on request from staff.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, PBE IPSAS 41.

Background to the Development of IPSAS 41

BC1. In 2010 the International Public Sector Accounting Standards Board (IPSASB) issued three new standards dealing with financial instruments. These standards substantially aligned the requirements for financial instruments in IPSAS with the requirements in IFRS Standards. Even as the IPSASB issued its 2010 standards it was aware that the IASB was already in the process of updating requirements for the recognition and measurement of financial instruments. The IPSASB was also aware that the completion of IFRS 9 *Financial Instruments* could take a number of years. It therefore decided to monitor the IASB's project, with the intention of looking at adopting the requirements in IFRS 9 once that standard was complete.

BC2. The IASB issued the final version of IFRS 9 in July 2014. IFRS 9 introduced a number of changes to the recognition and measurement of financial instruments, including new classification and measurement requirements for financial assets, new hedging requirements and a new impairment model for financial assets. IFRS 9 and NZ IFRS 9 *Financial Instruments* were effective for annual periods beginning on or after from 1 January 2018.

BC3. The IPSASB began work on a project to update its financial instrument standards in 2016 and issued IPSAS 41 *Financial Instruments* in [date] 2018. IPSAS 41 is substantially converged with IFRS 9. It supersedes most of the requirements in IPSAS 29 *Financial Instruments: Recognition and Measurement*. The hedge accounting requirements in PBE IPSAS 29 remained available.

PBE IFRS 9 – An Interim Standard

BC4. In 2016 the NZASB noted that, pending the development and completion of IPSAS 41, for-profit entities and PBEs would be subject to different accounting requirements for financial instruments. The NZASB considered whether to wait for the IPSASB to complete IPSAS 41 or to develop an interim standard based on IFRS 9 for application by PBEs. The NZASB applied the *Policy Approach to Developing the Suite of PBE Standards* (*PBE Policy Approach*) and conducted outreach with constituents in making this decision. After careful consideration (as documented in the Basis for Conclusions on PBE IFRS 9), the NZASB decided to develop an interim PBE Standard based on IFRS 9. The NZASB issued PBE IFRS 9 *Financial Instruments* in January 2017. PBE IFRS 9 was available for early adoption.

BC5. In order to minimise differences between PBE IFRS 9 and the (then) forthcoming IPSAS 41 the NZASB:

(a) incorporated the modifications that the IPSASB made when developing IPSAS 29 in PBE IFRS 9; and

(b) limited the scope of the project to the updated recognition and measurement requirements in IFRS 9. The project did not address other updated requirements (such as the changes to offsetting requirements), preferring instead to wait for the IPSASB to consider these matters.

PBE IPSAS 41

BC6. Following the issue of IPSAS 41 the NZASB agreed to develop PBE IPSAS 41. The NZASB noted that this would be in accordance with New Zealand's Accounting Standards Framework and would:

(a) substantially align the requirements in PBE Standards with the most recent IPSAS;

(b) substantially align the requirements in PBE Standards with the equivalent requirements in NZ IFRS and minimise mixed group issues; and

(c) allow entities to adopt updated hedge accounting requirements that align more closely with an entity's risk management practices and that can be applied more broadly than the hedge accounting requirements in PBE IPSAS 29.

BC7. The NZASB considered that the requirements of IPSAS 41 were generally appropriate for application by public benefit entities and followed it usual processes in modifying IPSAS 41 for application by Tier 1 and Tier 2 public benefit entities. Most of the changes were to ensure coherence within the suite of PBE Standards (in terms of aligning terminology and requirements with other PBE Standards). Some language was generalised for use by PBEs. In the case of disclosure requirements added to

PBE IPSAS 30 *Financial Instruments: Disclosures* the NZASB identified disclosure concessions for Tier 2 entities and aligned these with the disclosure concessions in NZ IFRS 7 *Financial Instruments: Disclosures.*

BCX. The specific modifications considered or made by the NZASB in developing PBE IPSAS 41 are outlined below.

Heading

BCX. [Placeholder for issues]

Transition from PBE IFRS 9

BCX. PBE IFRS 9 was developed as a limited scope project. It was intended to meet the most pressing issues that mixed groups would encounter when NZ IFRS 9 became effective. The focus of the project to develop PBE IFRS 9 is discussed in more detail in the Basis for Conclusions that accompanied PBE IFRS 9. The IPSASB's project to update its financial instrument standards considered a wider range of issues than PBE IFRS 9 and this has resulted in some differences between PBE IFRS 9 and PBE IPSAS 41.

BCX. The NZASB considered these differences and …

(a) [insert]

BCX. [Discuss cut-off date for availability of PBE IFRS 9]

Illustrative Examples and Guidance

Note to the Board: The proposed non-integral Illustrative Examples and Guidance (64 pages) are not included in this draft ED. See the non-integral Illustrative Examples and Guidance in IPSAS 41 (agenda item 6.4).

HISTORY OF AMENDMENTS

Table of Pronouncements – PBE IPSAS 41 *Financial Instruments*

This table lists the pronouncements establishing and substantially amending PBE IPSAS 41.

Pronouncements	**Date approved**	**Early operative date**	**Effective date (annual reporting periods… on or after …)**
PBE IPSAS 41 *Financial Instruments*	[Date]	Early application permitted	[Proposed] 1 Jan 2022