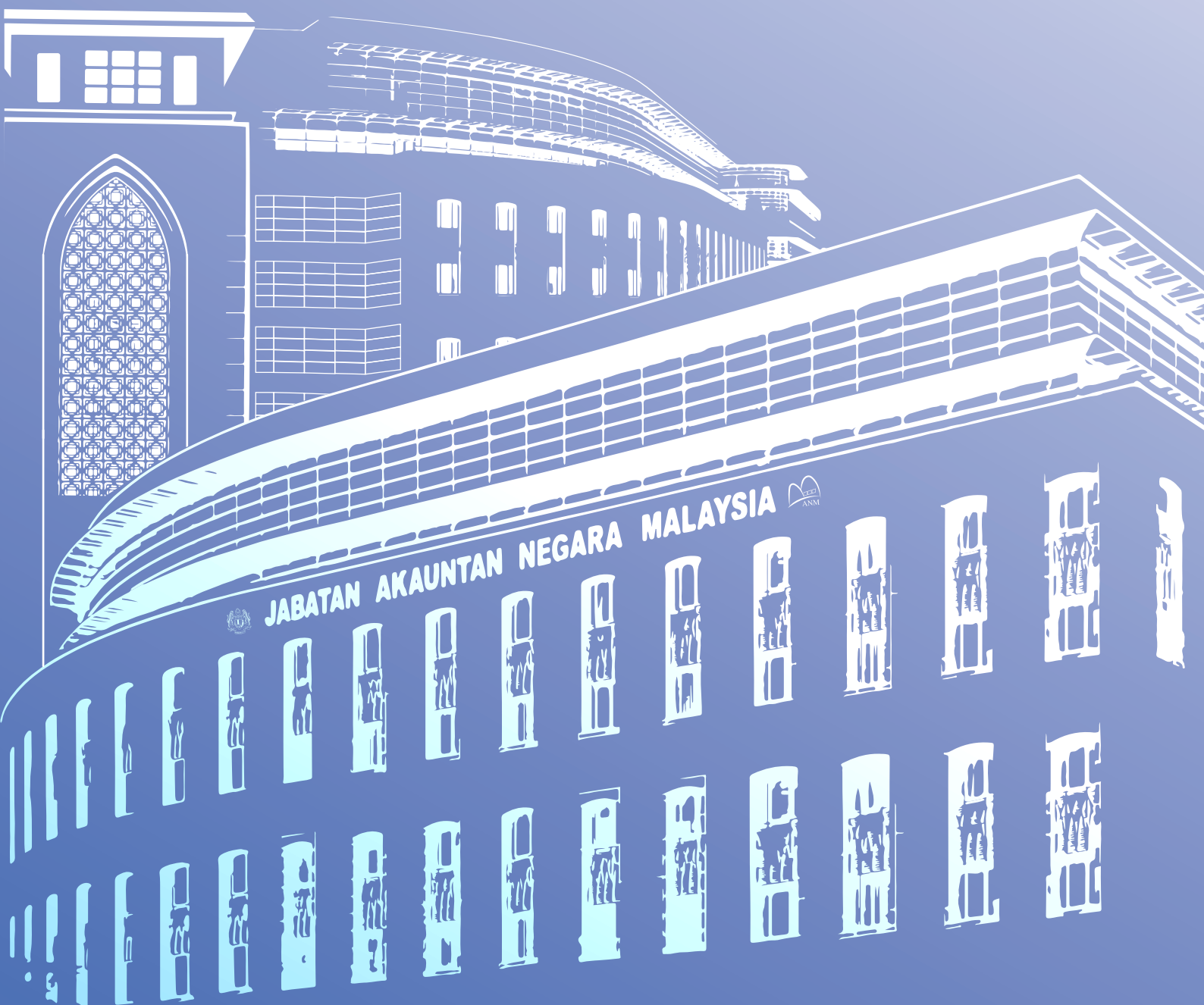
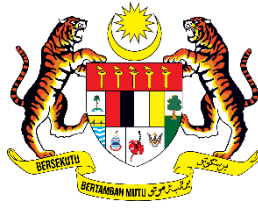


Malaysian Public Sector Accounting Pronouncements Handbook 2023

Volume 2



Excellent Accounting @ Your Service



GOVERNMENT OF MALAYSIA

Malaysian Public Sector Accounting Standards

MPSAS

Volume 2

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MPSAS 29 - FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT

Acknowledgement

The Malaysian Public Sector Accounting Standard (MPSAS) 29 is based on International Public Sector Accounting Standard (IPSAS) 29, *Financial Instruments: Recognition And Measurement*, from the *Handbook of International Public Sector Accounting Pronouncements* of the International Public Sector Accounting Standards Board, published by the International Federation of Accountants (IFAC) in 2018 and is used with permission of IFAC.

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MPSAS 29 – FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT

History of MPSAS

This version includes amendments resulting from MPSASs issued up to December 2022.

MPSAS 29, *Financial Instruments: Recognition and Measurement* was issued in April 2015.

Since then, MPSAS 29 has been amended by the following MPSASs:

- *Improvements to MPSASs 2023* (issued December 2022)
- MPSAS 40, *Public Sector Combinations* (issued October 2021)
- MPSAS 35, *Consolidated Financial Statements* (issued March 2016)
- MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)* (issued November 2015)

Table of Amended Paragraphs in MPSAS 29

Paragraph Affected	How Affected	Affected By
2	Amended	MPSAS 40 October 2021 MPSAS 37 December 2016 MPSAS 35 March 2016
7	Deleted	Improvements to MPSASs 2023 December 2022
8	Deleted	Improvements to MPSASs 2023 December 2022
17	Amended	MPSAS 35 March 2016
89	Amended	MPSAS 35 March 2016
114	Deleted	MPSAS 33 November 2015
115	Deleted	MPSAS 33 November 2015
116	Deleted	MPSAS 33 November 2015
117	Deleted	MPSAS 33 November 2015
118	Deleted	MPSAS 33 November 2015
119	Deleted	MPSAS 33 November 2015
120	Deleted	MPSAS 33 November 2015
121	Deleted	MPSAS 33 November 2015
122	Deleted	MPSAS 33 November 2015
123	Deleted	MPSAS 33 November 2015

MPSAS 29 – Financial Instruments: Recognition and Measurement

Paragraph Affected	How Affected	Affected By
125A	New	MPSAS 33 November 2015
125C	New	MPSAS 37 December 2016 MPSAS 35 March 2016
125D	New	MPSAS 40 October 2021
125E	New	Improvements to MPSASs 2023 December 2022
125F	New	Improvements to MPSASs 2023 December 2022
126	Amended	MPSAS 33 November 2015
AG2	Amended	MPSAS 37 December 2016
AG8	Amended	Improvements to MPSASs 2023 December 2022
AG35	Amended	MPSAS 40 October 2021
AG51	Amended	MPSAS 35 March 2016
AG52	Amended	MPSAS 35 March 2016
AG53	Amended	MPSAS 35 March 2016
AG131	Amended	MPSAS 40 October 2021
B4	Amended	MPSAS 40 October 2021
C2	Amended	MPSAS 37 December 2016

MPSAS 29 – FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT

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Malaysian Public Sector Accounting Standard (MPSAS) 29, *Financial Instruments: Recognition And Measurement*, is set out in paragraphs 1–126. All the paragraphs have equal authority. MPSAS 29, *Financial Instruments: Recognition And Measurement*, should be read in the context of its objective, and the *Preface to Malaysian Public Sector Accounting Standards*. MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

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

Scope

2. **This Standard shall be applied by all entities to all types of financial instruments, except:**
 - (a) **Those interests in controlled entities, associates and joint ventures that are accounted for in accordance with MPSAS 34, *Separate Financial Statements*, MPSAS 35, *Consolidated Financial Statements*, MPSAS 36, *Investments in Associates and Joint Ventures*. However, in some cases MPSAS 34, *Separate Financial Statements*, MPSAS 35, *Consolidated Financial Statements*, or MPSAS 36, *Investments in Associates and Joint Ventures*, require or permit an entity to account for an interest in a controlled entity, associate, or joint venture in accordance with some or all of the requirements of this Standard. Entities shall also apply this Standard to derivatives on an interest in a controlled entity, associate, or joint venture unless the derivative meets the definition of an equity instrument of the entity in MPSAS 28, *Financial Instruments: Presentation*.**
 - (b) **Rights and obligations under leases to which MPSAS 13, *Leases*, applies. However:**
 - (i) **Lease receivables recognized by a lessor are subject to the derecognition and impairment provisions of this Standard (see paragraphs 17–39, 67, 68, 72, and Appendix A paragraphs AG51–AG67 and AG117–AG126);**
 - (ii) **Finance lease payables recognized by a lessee are subject to the derecognition provisions of this Standard (see paragraphs 41–44 and Appendix A paragraphs AG72–AG80); and**
 - (iii) **Derivatives that are embedded in leases are subject to the embedded derivatives provisions of this Standard (see paragraphs 11–15 and Appendix A paragraphs AG40–AG46).**
 - (c) **Employers' rights and obligations under employee benefit plans, to which MPSAS 25, *Employee Benefits*, applies.**
 - (d) **Financial instruments issued by the entity that meet the definition of an equity instrument in MPSAS 28, *Financial Instruments: Presentation*, (including options and warrants) or that are required to be classified as an equity instrument in accordance with paragraphs 15 and 16 or 17 and 18 of MPSAS 28, *Financial Instruments: Presentation*. However, the holder of such equity instruments shall apply this Standard to those instruments, unless they meet the exception in (a) above.**
 - (e) **Rights and obligations arising under:**

- (i) An insurance contract, other than an issuer's rights and obligations arising under an insurance contract that meets the definition of a financial guarantee contract in paragraph 10; or
- (ii) A contract that is within the scope of the relevant international or national accounting standard dealing with insurance contracts because it contains a discretionary participation feature.

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

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

3. **The following loan commitments are within the scope of this Standard:**
 - (a) **Loan commitments that the entity designates as financial liabilities at fair value through surplus or deficit. An entity that has a past practice of selling the assets resulting from its loan commitments shortly after origination shall apply this Standard to all its loan commitments in the same class.**
 - (b) **Loan commitments that can be settled net in cash or by delivering or issuing another financial instrument. These loan commitments are derivatives. A loan commitment is not regarded as settled net merely because the loan is paid out in installments (e.g., a mortgage construction loan that is paid out in installments in line with the progress of construction).**
 - (c) **Commitments to provide a loan at a below-market interest rate. Paragraph 49(d) specifies the subsequent measurement of liabilities arising from these loan commitments.**
4. **This Standard shall be applied to those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale, or usage requirements.**
5. There are various ways in which a contract to buy or sell a non-financial item can be settled net in cash or another financial instrument or by exchanging financial instruments. These include:
 - (a) When the terms of the contract permit either party to settle it net in cash or another financial instrument or by exchanging financial instruments;
 - (b) When the ability to settle net in cash or another financial instrument, or by exchanging financial instruments, is not explicit in the terms of the contract, but the entity has a practice of settling similar contracts net in cash or another financial instrument or by exchanging financial instruments (whether with the counterparty, by entering into offsetting contracts or by selling the contract before its exercise or lapse);
 - (c) When, for similar contracts, the entity has a practice of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin; and
 - (d) When the non-financial item that is the subject of the contract is readily convertible to cash.

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

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

Definitions

9. The terms defined in MPSAS 28, *Financial Instruments: Presentation*, are used in this Standard with the meanings specified in paragraph 9 of MPSAS 28, *Financial Instruments: Presentation*. MPSAS 28, *Financial Instruments: Presentation*, defines the following terms:
 - Financial instrument;
 - Financial asset;
 - Financial liability;
 - Equity instrument;
 and provides guidance on applying those definitions.
10. **The following terms are used in this Standard with the meanings specified:**

Definition of a derivative

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

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

Definitions of four categories of financial instruments

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

- (a) **It is classified as held for trading. A financial asset or financial liability is classified as held for trading if:**
 - (i) **It is acquired or incurred principally for the purpose of selling or repurchasing it in the near term;**

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

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

Investments in equity instruments that do not have a quoted market price in an active market, and whose fair value cannot be reliably¹ measured (see paragraph 48(c) and Appendix A paragraphs AG113 and AG114), shall not be designated as at fair value through surplus or deficit.

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

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

- (a) Those that the entity upon initial recognition designates as at fair value through surplus or deficit;
- (b) Those that the entity designates as available for sale; and

¹ Information that is reliable is free from material error and bias, and can be depended on by users to faithfully represent that which it purports to represent or could reasonably be expected to represent.

- (c) Those that meet the definition of loans and receivables.

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

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

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

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

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

Available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified as:

- (a) Loans and receivables;
- (b) Held-to-maturity investments; or
- (c) Financial assets at fair value through surplus or deficit.

Definition of a financial guarantee contract

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

Definitions relating to recognition and measurement

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

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

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

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

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

Definitions relating to hedge accounting

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

A forecast transaction is an uncommitted but anticipated future transaction.

A hedging instrument is a designated derivative or (for a hedge of the risk of changes in foreign currency exchange rates only) a designated non-derivative financial asset or non-derivative financial liability whose fair value or cash flows are expected to offset changes

in the fair value or cash flows of a designated hedged item (paragraphs 81–86 and Appendix A paragraphs AG127–AG130 elaborate on the definition of a hedging instrument).

A **hedged item** is an asset, liability, firm commitment, highly probable forecast transaction or net investment in a foreign operation that:

- (a) Exposes the entity to risk of changes in fair value or future cash flows; and
- (b) Is designated as being hedged (paragraphs 87–94 and Appendix A paragraphs AG131–AG141 elaborate on the definition of hedged items).

Hedge effectiveness is the degree to which changes in the fair value or cash flows of the hedged item that are attributable to a hedged risk are offset by changes in the fair value or cash flows of the hedging instrument (see Appendix A paragraphs AG145–AG156).

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

Embedded Derivatives

11. An embedded derivative is a component of a hybrid (combined) instrument that also includes a non-derivative host contract—with the effect that some of the cash flows of the combined instrument vary in a 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 from that instrument, is not an embedded derivative, but a separate financial instrument.
12. **An embedded derivative shall be separated from the host contract 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 contract (see Appendix A paragraphs AG43 and AG46);
 - (b) A separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
 - (c) The hybrid (combined) instrument is not measured at fair value with changes in fair value recognized in surplus or deficit (i.e., a derivative that is embedded in a financial asset or financial liability at fair value through surplus or deficit is not separated).

If an embedded derivative is separated, the host contract shall be accounted for under this Standard if it is a financial instrument, and in accordance with other appropriate Standards if it is not a financial instrument. This Standard does not address whether an embedded derivative shall be presented separately in the statement of financial position.

13. Notwithstanding paragraph 12, if a contract contains one or more embedded derivatives, an entity may designate the entire hybrid (combined) contract as a financial asset or financial liability at fair value through surplus or deficit unless:
- (a) The embedded derivative(s) does 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 (combined) instrument is first considered that separation of the embedded derivative(s) is prohibited, such as a prepayment option embedded in a loan that permits the holder to prepay the loan for approximately its amortized cost.
14. If an entity is required by this Standard to separate an embedded derivative from its host contract, 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 (combined) contract as at fair value through surplus or deficit. Similarly, if an entity is unable to measure separately the embedded derivative that would have to be separated on reclassification of a hybrid (combined) contract out of fair value through surplus or deficit category, that reclassification is prohibited. In such circumstances the hybrid (combined) contract remains classified as at fair value through surplus or deficit in its entirety.
15. If an entity is unable to determine reliably the fair value of an embedded derivative on the basis of its terms and conditions (e.g., because the embedded derivative is based on an unquoted equity instrument), the fair value of the embedded derivative is the difference between the fair value of the hybrid (combined) instrument and the fair value of the host contract, if those can be determined under this Standard. If the entity is unable to determine the fair value of the embedded derivative using this method, paragraph 14 applies and the hybrid (combined) instrument is designated as at fair value through surplus or deficit.

Recognition and Derecognition

Initial Recognition

16. An entity shall recognize a financial asset or a financial liability in its statement of financial position when, and only when, the entity becomes a party to the contractual provisions of the instrument. (See paragraph 40 with respect to regular way purchases of financial assets).

Derecognition of a Financial Asset

17. In consolidated financial statements, paragraphs 18–25 and Appendix A paragraphs AG49–AG67 are applied at a consolidated level. Hence, an entity first consolidates all controlled entities in accordance with MPSAS 35, *Consolidated Financial Statements*, and then applies paragraphs 18–25 and Appendix A paragraphs AG49–AG67 to the resulting economic entity.

18. Before evaluating whether, and to what extent, derecognition is appropriate under paragraphs 19 - 25, 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 19–25 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 19–25 are applied to the interest cash flows.
 - (ii) The part comprises only a fully proportionate (pro rata) share of the cash flows from a financial asset (or a group of similar financial assets). For example, when an entity enters into an arrangement whereby the counterparty obtains the rights to a 90 percent share of all cash flows of a debt instrument, paragraphs 19–25 are applied to 90 percent of those cash flows. If there is more than one counterparty, each counterparty is not required to have a proportionate share of the cash flows provided that the transferring entity has a fully proportionate share.
 - (iii) The part comprises only a fully proportionate (pro rata) share of specifically identified cash flows from a financial asset (or a group of similar financial assets). For example, when an entity enters into an arrangement whereby the counterparty obtains the rights to a 90 percent share of interest cash flows from a financial asset, paragraphs 19–25 are applied to 90 percent of those interest cash flows. If there is more than one counterparty, each counterparty is not required to have a proportionate share of the specifically identified cash flows provided that the transferring entity has a fully proportionate share.
 - (b) In all other cases, paragraphs 19–25 are applied to the financial asset in its entirety (or to the group of similar financial assets in their entirety). For example, when an entity transfers:
 - (i) The rights to the first or the last 90 percent of cash collections from a financial asset (or a group of financial assets); or
 - (ii) The rights to 90 percent of the cash flows from a group of receivables, but provides a guarantee to compensate the buyer for any credit losses up to 8 percent of the principal amount of the receivables, paragraphs 19– 25 are applied to the financial asset (or a group of similar financial assets) in its entirety.

In paragraphs 19–28, 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.

19. **An entity shall derecognize a financial asset when, and only when:**
- (a) **The contractual rights to the cash flows from the financial asset expire or are waived; or**
 - (b) **It transfers the financial asset as set out in paragraphs 20 and 21 and the transfer qualifies for derecognition in accordance with paragraph 22.**
- (See paragraph 40 for regular way sales of financial assets).**
20. **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 21.**
21. **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 MPSAS 2, *Cash Flow Statements*) during the short settlement period from the collection date to the date of required remittance to the eventual recipients, and interest earned on such investments is passed to the eventual recipients.**
22. **When an entity transfers a financial asset (see paragraph 20), it shall evaluate the extent to which it retains the risks and rewards of ownership of the financial asset. In this case:**
- (a) **If the entity transfers substantially all the risks and rewards of ownership of the financial asset, the entity shall derecognize the financial asset and recognize separately as assets or liabilities any rights and obligations created or retained in the transfer.**
 - (b) **If the entity retains substantially all the risks and rewards of ownership of the financial asset, the entity shall continue to recognize the financial asset.**

- (c) **If the entity neither transfers nor retains substantially all the risks and rewards of ownership of the financial asset, the entity shall determine whether it has retained control of the financial asset. In this case:**
- (i) **If the entity has not retained control, it shall derecognize the financial asset and recognize separately as assets or liabilities any rights and obligations created or retained in the transfer.**
 - (ii) **If the entity has retained control, it shall continue to recognize the financial asset to the extent of its continuing involvement in the financial asset (see paragraph 32).**
23. The transfer of risks and rewards (see paragraph 22) 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 21).
24. 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 is 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.
25. Whether the entity has retained control (see paragraph 22(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 (see paragraph 22(a) and (c)(i))

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

servicing asset shall be recognized for the servicing right at an amount determined on the basis of an allocation of the carrying amount of the larger financial asset in accordance with paragraph 29.

27. **If, as a result of a transfer, a financial asset is derecognized in its entirety but the transfer results in the entity obtaining a new financial asset or assuming a new financial liability, or a servicing liability, the entity shall recognize the new financial asset, financial liability or servicing liability at fair value.**
28. **On derecognition of a financial asset in its entirety, the difference between:**
 - (a) **The carrying amount; and**
 - (b) **The sum of:**
 - (i) **The consideration received (including any new asset obtained less any new liability assumed); and**
 - (ii) **Any cumulative gain or loss that had been recognized directly in net assets/equity (see paragraph 64(b));**

shall be recognized in surplus or deficit.

29. **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 18(a)) and the part transferred qualifies for derecognition in its entirety, the previous carrying amount of the larger financial asset shall be allocated between the part that continues to be recognized and the part that is derecognized, based on the relative fair values of those parts on the date of the transfer. For this purpose, a retained servicing asset shall be treated as a part that continues to be recognized. The difference between:**
 - (a) **The carrying amount allocated to the part derecognized; and**
 - (b) **The sum of:**
 - (i) **The consideration received for the part derecognized (including any new asset obtained less any new liability assumed); and**
 - (ii) **Any cumulative gain or loss allocated to it that had been recognized directly in net assets/equity (see paragraph 64(b));**

shall be recognized in surplus or deficit. A cumulative gain or loss that had been recognized in net assets/equity is allocated between the part that continues to be recognized and the part that is derecognized, based on the relative fair values of those parts.

30. **When an entity allocates the previous carrying amount of a larger financial asset between the part that continues to be recognized and the part that is derecognized, the fair value of the part that continues to be recognized needs to be determined. When the entity has a history of selling parts similar to the part that continues to be recognized or other market transactions exist for such parts, recent prices of actual transactions provide the best estimate of its fair value. When there are no price quotes or recent market transactions to support the fair value of the part that**

continues to be recognized in an exchange transaction, the best estimate of the fair value is the difference between the fair value of the larger financial asset as a whole and the consideration received from the transferee for the part that is derecognized.

Transfers that do not Qualify for Derecognition (see paragraph 22(b))

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

Continuing Involvement in Transferred Assets (see paragraph 22(c)(ii))

32. **If an entity neither transfers nor retains substantially all the risks and rewards of ownership of a transferred asset, and retains control of the transferred asset, the entity continues to recognize the transferred asset to the extent of its continuing involvement. The extent of the entity's continuing involvement in the transferred asset is the extent to which it is exposed to changes in the value of the transferred asset. For example:**
- (a) When the entity's continuing involvement takes the form of guaranteeing the transferred asset, the extent of the entity's continuing involvement is the lower of:**
 - (i) The amount of the asset; and**
 - (ii) The maximum amount of the consideration received that the entity could be required to repay ("the guarantee amount").**
 - (b) When the entity's continuing involvement takes the form of a written or purchased option (or both) on the transferred asset, the extent of the entity's continuing involvement is the amount of the transferred asset that the entity may repurchase. However, in 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 AG63).**
 - (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.**
33. **When an entity continues to recognize an asset to the extent of its continuing involvement, the entity also recognizes an associated liability. Despite the other measurement requirements in this Standard, the transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the entity has retained. The associated liability is measured in such a way that the net carrying amount of the transferred asset and the associated liability is:**

- (a) The amortized cost of the rights and obligations retained by the entity, if the transferred asset is measured at amortized cost; or
 - (b) Equal to the fair value of the rights and obligations retained by the entity when measured on a stand-alone basis, if the transferred asset is measured at fair value.
34. The entity shall continue to recognize any revenue arising on the transferred asset to the extent of its continuing involvement and shall recognize any expense incurred on the associated liability.
35. For the purpose of subsequent measurement, recognized changes in the fair value of the transferred asset and the associated liability are accounted for consistently with each other in accordance with paragraph 64, and shall not be offset.
36. If an entity's continuing involvement is in only a part of a financial asset (e.g., when an entity retains an option to repurchase part of a transferred asset, or retains a residual interest that does not result in the retention of substantially all the risks and rewards of ownership and the entity retains control), the entity allocates the previous carrying amount of the financial asset between the part it continues to recognize under continuing involvement, and the part it no longer recognizes on the basis of the relative fair values of those parts on the date of the transfer. For this purpose, the requirements of paragraph 30 apply. The difference between:
- (a) The carrying amount allocated to the part that is no longer recognized; and
 - (b) The sum of:
 - (i) The consideration received for the part no longer recognized; and
 - (ii) Any cumulative gain or loss allocated to it that had been recognized directly in net assets/equity (see paragraph 64(b));
- shall be recognized in surplus or deficit. A cumulative gain or loss that had been recognized in net assets/equity is allocated between the part that continues to be recognized and the part that is no longer recognized on the basis of the relative fair values of those parts.
37. If the transferred asset is measured at amortized cost, the option in this Standard to designate a financial liability as at fair value through surplus or deficit is not applicable to the associated liability.

All Transfers

38. If a transferred asset continues to be recognized, the asset and the associated liability shall not be offset. Similarly, the entity shall not offset any revenue arising from the transferred asset with any expense incurred on the associated liability (see MPSAS 28, *Financial Instruments: Presentation*, paragraph 47).

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

Regular Way Purchase or Sale of a Financial Asset

40. A regular way purchase or sale of financial assets shall be recognized and derecognized, as applicable, using trade date accounting or settlement date accounting (see Appendix A paragraphs AG68–AG71).

Derecognition of a Financial Liability

41. 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, cancelled or expires.
42. 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.
43. The difference between the carrying amount of a financial liability (or part of a financial liability) extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, shall be recognized in surplus or deficit. Where an obligation is waived by the lender or assumed by a third party as part of a non-exchange transaction, an entity applies MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfer)*.

44. If an entity repurchases a part of a financial liability, the entity shall allocate the previous carrying amount of the financial liability between the part that continues to be recognized and the part that is derecognized based on the relative fair values of those parts on the date of the repurchase. The difference between:
- (a) The carrying amount allocated to the part derecognized; and
 - (b) The consideration paid, including any non-cash assets transferred or liabilities assumed, for the part derecognized;
- shall be recognized in surplus or deficit.

Measurement

Initial Measurement of Financial Assets and Financial Liabilities

45. **When a financial asset or financial liability is recognized initially, an entity shall measure it at its fair value plus, in the case of a financial asset or financial liability not at fair value through surplus or deficit, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.**
46. When an entity uses settlement date accounting for an asset that is subsequently measured at cost or amortized cost, the asset is recognized initially at its fair value on the trade date (see Appendix A paragraphs AG68– AG71).

Subsequent Measurement of Financial Assets

47. For the purpose of measuring a financial asset after initial recognition, this Standard classifies financial assets into the following four categories defined in paragraph 10:
- (a) Financial assets at fair value through surplus or deficit;
 - (b) Held-to-maturity investments;
 - (c) Loans and receivables; and
 - (d) Available-for-sale financial assets.

These categories apply to measurement and surplus or deficit recognition under this Standard. The entity may use other descriptors for these categories or other categorizations when presenting information in the financial statements. The entity shall disclose in the notes the information required by MPSAS 30, *Financial Instruments: Disclosures*.

48. **After initial recognition, an entity shall measure financial assets, including derivatives that are assets, at their fair values, without any deduction for transaction costs it may incur on sale or other disposal, except for the following financial assets:**
- (a) **Loans and receivables as defined in paragraph 10, which shall be measured at amortized cost using the effective interest method;**

- (b) **Held-to-maturity investments as defined in paragraph 10, which shall be measured at amortized cost using the effective interest method; and**
- (c) **Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments, which shall be measured at cost (see Appendix A paragraphs AG113 and AG114).**

Financial assets that are designated as hedged items are subject to measurement under the hedge accounting requirements in paragraphs 99–113. All financial assets except those measured at fair value through surplus or deficit are subject to review for impairment in accordance with paragraphs 67–79 and Appendix A paragraphs AG117– AG126.

Subsequent Measurement of Financial Liabilities

49. **After initial recognition, an entity shall measure all financial liabilities at amortized cost using the effective interest method, except for:**
- (a) **Financial liabilities at fair value through surplus or deficit. Such liabilities, including derivatives that are liabilities, shall be measured at fair value except for a derivative liability that is linked to and must be settled by delivery of an unquoted equity instrument whose fair value cannot be reliably measured, which shall be measured at cost.**
 - (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 31 and 33 apply to the measurement of such financial liabilities.**
 - (c) **Financial guarantee contracts as defined in paragraph 10. After initial recognition, an issuer of such a contract shall (unless paragraph 49(a) or (b) applies) measure it at the higher of:**
 - (i) **The amount determined in accordance with MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*; and**
 - (ii) **The amount initially recognized (see paragraph 45) less, when appropriate, cumulative amortization recognized in accordance with MPSAS 9, *Revenue from Exchange Transactions*.**
 - (d) **Commitments to provide a loan at a below-market interest rate. After initial recognition, an issuer of such a commitment shall (unless paragraph 49(a) applies) measure it at the higher of:**
 - (i) **The amount determined in accordance with MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*; and**
 - (ii) **The amount initially recognized (see paragraph 45) less, when appropriate, cumulative amortization recognized in accordance with MPSAS 9, *Revenue from Exchange Transactions*.**

Financial liabilities that are designated as hedged items are subject to the hedge accounting requirements in paragraphs 99–113.

Fair Value Measurement Considerations

50. **In determining the fair value of a financial asset or a financial liability for the purpose of applying this Standard, MPSAS 28, *Financial Instruments: Presentation*, or MPSAS 30 *Financial Instruments: Disclosures*, an entity shall apply paragraphs AG101–AG115 of Appendix A.**
51. The best evidence of fair value is quoted prices in an active market. If the market for a financial instrument is not active, an entity establishes fair value by using a valuation technique. The objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal operating considerations. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, if available, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the entity uses that technique. The chosen valuation technique makes maximum use of market inputs and relies as little as possible on entity-specific inputs. It incorporates all factors that market participants would consider in setting a price and is consistent with accepted economic methodologies for pricing financial instruments. Periodically, an entity calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on any available observable market data.
52. 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.

Reclassifications

53. **An entity:**
- (a) **Shall not reclassify a derivative out of the fair value through surplus or deficit category while it is held or issued;**
 - (b) **Shall not reclassify any financial instrument out of the fair value through surplus or deficit category if upon initial recognition it was designated by the entity as at fair value through surplus or deficit; and**
 - (c) **May, if a financial asset is no longer held for the purpose of selling or repurchasing it in the near term (notwithstanding that the financial asset may have been acquired or incurred principally for the purpose of selling or repurchasing it in the near term), reclassify that financial asset out of the fair value through surplus or deficit category if the requirements in paragraph 55 or 57 are met.**

An entity shall not reclassify any financial instrument into the fair value through surplus or deficit category after initial recognition.

54. The following changes in circumstances are not reclassifications for the purposes of paragraph 53:
- (a) A derivative that was previously a designated and effective hedging instrument in a cash flow hedge or net investment hedge no longer qualifies as such; and
 - (b) A derivative becomes a designated and effective hedging instrument in a cash flow hedge or net investment hedge.
55. A financial asset to which paragraph 53(c) applies (except a financial asset of the type described in paragraph 57) may be reclassified out of the fair value through surplus or deficit category only in rare circumstances.
56. If an entity reclassifies a financial asset out of the fair value through surplus or deficit category in accordance with paragraph 55, the financial asset shall be reclassified at its fair value on the date of reclassification. Any gain or loss already recognized in surplus or deficit shall not be reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortized cost, as applicable.
57. A financial asset to which paragraph 53(c) applies that would have met the definition of loans and receivables (if the financial asset had not been required to be classified as held for trading at initial recognition) may be reclassified out of the fair value through surplus or deficit category if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity.
58. A financial asset classified as available for sale that would have met the definition of loans and receivables (if it had not been designated as available for sale) may be reclassified out of the available-for-sale category to the loans and receivables category if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity.
59. If an entity reclassifies a financial asset out of the fair value through surplus or deficit category in accordance with paragraph 57 or out of the available-for-sale category in accordance with paragraph 58, it shall reclassify the financial asset at its fair value on the date of reclassification. For a financial asset reclassified in accordance with paragraph 57, any gain or loss already recognized in surplus or deficit shall not be reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortized cost, as applicable. For a financial asset reclassified out of the available-for-sale category in accordance with paragraph 58, any previous gain or loss on that asset that has been recognized directly in net assets/equity in accordance with paragraph 64(b) shall be accounted for in accordance with paragraph 63.
60. **If, as a result of a change in intention or ability, it is no longer appropriate to classify an investment as held to maturity, it shall be reclassified as available for sale and remeasured at fair value, and the difference between its carrying amount and fair value shall be accounted for in accordance with paragraph 64(b).**

61. **Whenever sales or reclassification of more than an insignificant amount of held-to-maturity investments do not meet any of the conditions in paragraph 10, any remaining held-to-maturity investments shall be reclassified as available for sale. On such reclassification, the difference between their carrying amount and fair value shall be accounted for in accordance with paragraph 64(b).**
62. **If a reliable measure becomes available for a financial asset or financial liability for which such a measure was previously not available, and the asset or liability is required to be measured at fair value if a reliable measure is available (see paragraphs 48(c) and 49), the asset or liability shall be remeasured at fair value, and the difference between its carrying amount and fair value shall be accounted for in accordance with paragraph 64.**
63. **If, as a result of a change in intention or ability or in the rare circumstance that a reliable measure of fair value is no longer available (see paragraphs 48(c) and 49) or because the “two preceding financial years” referred to in paragraph 10 have passed, it becomes appropriate to carry a financial asset or financial liability at cost or amortized cost rather than at fair value, the fair value carrying amount of the financial asset or the financial liability on that date becomes its new cost or amortized cost, as applicable. Any previous gain or loss on that asset that has been recognized directly in net assets/equity in accordance with paragraph 64(b) shall be accounted for as follows:**
 - (a) **In the case of a financial asset with a fixed maturity, the gain or loss shall be amortized to surplus or deficit over the remaining life of the held-to-maturity investment using the effective interest method. Any difference between the new amortized cost and maturity amount shall also be amortized over the remaining life of the financial asset using the effective interest method, similar to the amortization of a premium and a discount. If the financial asset is subsequently impaired, any gain or loss that has been recognized directly in net assets/equity is recognized in surplus or deficit in accordance with paragraph 76.**
 - (b) **In the case of a financial asset that does not have a fixed maturity, the gain or loss shall remain in net assets/equity until the financial asset is sold or otherwise disposed of, when it shall be recognized in surplus or deficit. If the financial asset is subsequently impaired any previous gain or loss that has been recognized directly in net assets/equity is recognized in surplus or deficit in accordance with paragraph 76.**

Gains and Losses

64. **A gain or loss arising from a change in the fair value of a financial asset or financial liability that is not part of a hedging relationship (see paragraphs 99–113), shall be recognized, as follows.**
 - (a) **A gain or loss on a financial asset or financial liability classified as at fair value through surplus or deficit shall be recognized in surplus or deficit.**
 - (b) **A gain or loss on an available-for-sale financial asset shall be recognized directly in net assets/equity through the statement of changes in net assets/equity (see**

MPSAS 1, *Presentation of Financial Statements*, except for impairment losses (see paragraphs 76–79) and foreign exchange gains and losses (see Appendix A paragraph AG116), until the financial asset is derecognized, at which time the cumulative gain or loss previously recognized in net assets/equity shall be recognized in surplus or deficit. However, interest calculated using the effective interest method (see paragraph 10) is recognized in surplus or deficit (see MPSAS 9, *Revenue from Exchange Transactions*). Dividends or similar distributions on an available-for-sale equity instrument are recognized in surplus or deficit when the entity’s right to receive payment is established (see MPSAS 9, *Revenue from Exchange Transactions*).

65. **For financial assets and financial liabilities carried at amortized cost (see paragraphs 48 and 49), a gain or loss is recognized in surplus or deficit when the financial asset or financial liability is derecognized or impaired, and through the amortization process. However, for financial assets or financial liabilities that are hedged items (see paragraphs 87–94 and Appendix A paragraphs AG131–AG141) the accounting for the gain or loss shall follow paragraphs 99–113.**
66. **If an entity recognizes financial assets using settlement date accounting (see paragraph 40 and Appendix A paragraphs AG68 and AG71), any change in the fair value of the asset to be received during the period between the trade date and the settlement date is not recognized for assets carried at cost or amortized cost (other than impairment losses). For assets carried at fair value, however, the change in fair value shall be recognized in surplus or deficit or in net assets/equity, as appropriate under paragraph 64.**

Impairment and Uncollectibility of Financial Assets

67. **An entity shall assess at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets is impaired. If any such evidence exists, the entity shall apply paragraph 72 (for financial assets carried at amortized cost), paragraph 75 (for financial assets carried at cost) or paragraph 76 (for available-for-sale financial assets) to determine the amount of any impairment loss.**
68. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a “loss event”) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. It may not be possible to identify a single, discrete event that caused the impairment. Rather the combined effect of several events may have caused the impairment. Losses expected as a result of future events, no matter how likely, are not recognized. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the holder of the asset about the following loss events:
 - (a) Significant financial difficulty of the issuer or obligor;
 - (b) A breach of contract, such as a default or delinquency in interest or principal payments;

- (c) The lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
 - (d) It becoming probable that the borrower will enter bankruptcy or other financial reorganization;
 - (e) The disappearance of an active market for that financial asset because of financial difficulties; or
 - (f) Observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:
 - (i) Adverse changes in the payment status of borrowers in the group (e.g., an increased number of delayed payments); or
 - (ii) National or local economic conditions that correlate with defaults on the assets in the group (e.g., an increase in the unemployment rate in the geographical area of the borrowers, a decrease in oil prices for loan assets to oil producers, or adverse changes in industry conditions that affect the borrowers in the group).
69. The disappearance of an active market because an entity's financial instruments are no longer publicly traded is not evidence of impairment. A downgrade of an entity's credit rating is not, of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information. A decline in the fair value of a financial asset below its cost or amortized cost is not necessarily evidence of impairment (e.g., a decline in the fair value of an investment in a debt instrument that results from an increase in the risk-free interest rate).
70. In addition to the types of events in paragraph 68, objective evidence of impairment for an investment in an equity instrument includes information about significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the issuer operates, and indicates that the cost of the investment in the equity instrument may not be recovered. A significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is also objective evidence of impairment.
71. In some cases the observable data required to estimate the amount of an impairment loss on a financial asset may be limited or no longer fully relevant to current circumstances. For example, this may be the case when a borrower is in financial difficulties and there are few available historical data relating to similar borrowers. In such cases, an entity uses its experienced judgment to estimate the amount of any impairment loss. Similarly an entity uses its experienced judgment to adjust observable data for a group of financial assets to reflect current circumstances (see paragraph AG122). The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability².

² 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.

Financial Assets Carried at Amortized Cost

72. **If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortized cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). The carrying amount of the asset shall be reduced either directly or through use of an allowance account. The amount of the loss shall be recognized in surplus or deficit.**
73. An entity first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant (see paragraph 68). If an entity determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.
74. **If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized (such as an improvement in the debtor's credit rating), the previously recognized impairment loss shall be reversed either directly or by adjusting an allowance account. The reversal shall not result in a carrying amount of the financial asset that exceeds what the amortized cost would have been had the impairment not been recognized at the date the impairment is reversed. The amount of the reversal shall be recognized in surplus or deficit.**

Financial Assets Carried at Cost

75. **If there is objective evidence that an impairment loss has been incurred on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, or on a derivative asset that is linked to and must be settled by delivery of such an unquoted equity instrument, the amount of the impairment loss is measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset (see paragraph 48(c) and Appendix A paragraphs AG113 and AG114). Such impairment losses shall not be reversed.**

Available-For-Sale Financial Assets

76. **When a decline in the fair value of an available-for-sale financial asset has been recognized directly in net assets/equity and there is objective evidence that the asset is impaired (see paragraph 68), the cumulative loss that had been recognized directly in net assets/equity shall be removed from net assets/equity and recognized in surplus or deficit even though the financial asset has not been derecognized.**

77. **The amount of the cumulative loss that is removed from net assets/equity and recognized in surplus or deficit under paragraph 76 shall be the difference between the acquisition cost (net of any principal repayment and amortization) and current fair value, less any impairment loss on that financial asset previously recognized in surplus or deficit.**
78. **Impairment losses recognized in surplus or deficit for an investment in an equity instrument classified as available for sale shall not be reversed through surplus or deficit.**
79. **If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in surplus or deficit, the impairment loss shall be reversed, with the amount of the reversal recognized in surplus or deficit.**

Hedging

80. **If there is a designated hedging relationship between a hedging instrument and a hedged item as described in paragraphs 95–98 and Appendix A paragraphs AG142–AG144, accounting for the gain or loss on the hedging instrument and the hedged item shall follow paragraphs 99–113.**

Hedging Instruments

Qualifying Instruments

81. This Standard does not restrict the circumstances in which a derivative may be designated as a hedging instrument provided the conditions in paragraph 98 are met, except for some written options (see Appendix A paragraph AG127). However, a non-derivative financial asset or non-derivative financial liability may be designated as a hedging instrument only for a hedge of a foreign currency risk.
82. For hedge accounting purposes, only instruments that involve a party external to the reporting entity (i.e., external to the economic entity or individual entity that is being reported on) can be designated as hedging instruments. Although individual entities within an economic entity or divisions within an entity may enter into hedging transactions with other entities within the economic entity or divisions within the entity, any such transactions within the economic entity are eliminated on consolidation. Therefore, such hedging transactions do not qualify for hedge accounting in the consolidated financial statements of the economic entity. However, they may qualify for hedge accounting in the individual or separate financial statements of individual entities within the economic entity provided that they are external to the individual entity that is being reported on.

Designation of Hedging Instruments

83. There is normally a single fair value measure for a hedging instrument in its entirety, and the factors that cause changes in fair value are co-dependent. Thus, a hedging relationship is designated by an entity for a hedging instrument in its entirety. 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 excluding change in its time value; and
- (b) Separating the interest element and the spot price of a forward contract.

These exceptions are permitted because the intrinsic value of the option and the premium on the forward can generally be measured separately. A dynamic hedging strategy that assesses both the intrinsic value and time value of an option contract can qualify for hedge accounting.

- 84. A proportion of the entire hedging instrument, such as 50 percent of the notional amount, may be designated as the hedging instrument in a hedging relationship. However, a hedging relationship may not be designated for only a portion of the time period during which a hedging instrument remains outstanding.
- 85. A single hedging instrument may be designated as a hedge of more than one type of risk provided that:
 - (a) The risks hedged can be identified clearly;
 - (b) The effectiveness of the hedge can be demonstrated; and
 - (c) It is possible to ensure that there is specific designation of the hedging instrument and different risk positions.
- 86. Two or more derivatives, or proportions of them (or, in the case of a hedge of currency risk, two or more non-derivatives or proportions of them, or a combination of derivatives and non-derivatives or proportions of them), may be viewed in combination and jointly designated as the hedging instrument, including when the risk(s) arising from some derivatives offset(s) those arising from others. However, an interest rate collar or other derivative instrument that combines a written option and a purchased option does not qualify as a hedging instrument if it is, in effect, a net written option (for which a net premium is received). Similarly, two or more instruments (or proportions of them) may be designated as the hedging instrument only if none of them is a written option or a net written option.

Hedged Items

Qualifying Items

- 87. A hedged item can be a recognized asset or liability, an unrecognized firm commitment, a highly probable forecast transaction or a net investment in a foreign operation. The hedged item can be:
 - (a) A single asset, liability, firm commitment, highly probable forecast transaction or net investment in a foreign operation;
 - (b) A group of assets, liabilities, firm commitments, highly probable forecast transactions or net investments in foreign operations with similar risk characteristics; or
 - (c) In a portfolio hedge of interest rate risk only, a portion of the portfolio of financial assets or financial liabilities that share the risk being hedged.

88. Unlike loans and receivables, a held-to-maturity investment cannot be a hedged item with respect to interest-rate risk or prepayment risk because designation of an investment as held to maturity requires an intention to hold the investment until maturity without regard to changes in the fair value or cash flows of such an investment attributable to changes in interest rates. However, a held-to-maturity investment can be a hedged item with respect to risks from changes in foreign currency exchange rates and credit risk.
89. For hedge accounting purposes, only assets, liabilities, firm commitments or highly probable forecast transactions that involve a party external to the entity can be designated as hedged items. It follows that hedge accounting can be applied to transactions between entities in the same economic entity only in the individual or separate financial statements of those entities and not in the consolidated financial statements of the economic entity except for the consolidated financial statement of an investment entity, as defined in MPSAS 35, *Consolidated Financial Statements*, where transaction between an investment entity and its controlled entities measured at fair value through surplus or deficit will not be eliminated in the consolidated financial statements. As an exception, the foreign currency risk of monetary item within an economic entity (e.g., a payable/receivable between two controlled entities) may qualify as a hedged item in the consolidated financial statements if it results in an exposure to foreign exchange rate gains or losses that are not fully eliminated on consolidation in accordance with MPSAS 4, *The Effect of Changes in Foreign Exchange Rates*. In accordance with MPSAS 4, *The Effect of Changes in Foreign Exchange Rates*, foreign exchange rate gains and losses on monetary items within an economic entity are not fully eliminated on consolidation when the monetary item is transacted between two entities within the economic entity that have different functional currencies. In addition, the foreign currency risk of a highly probable forecast transaction within the economic entity may qualify as a hedged item in consolidated financial statements provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated surplus or deficit.

Designation of Financial Items as Hedged Items

90. If the hedged item is a financial asset or financial liability, it may be a hedged item with respect to the risks associated with only a portion of its cash flows or fair value (such as one or more selected contractual cash flows or portions of them or a percentage of the fair value) provided that effectiveness can be measured. For example, an identifiable and separately measurable portion of the interest rate exposure of an interest-bearing asset or interest-bearing liability may be designated as the hedged risk (such as a risk-free interest rate or benchmark interest rate component of the total interest rate exposure of a hedged financial instrument).
91. In a fair value hedge of the interest rate exposure of a portfolio of financial assets or financial liabilities (and only in such a hedge), the portion hedged may be designated in terms of an amount of a currency (e.g., an amount of dollars, euro, pounds or rand) rather than as individual assets (or liabilities). Although the portfolio may, for risk management purposes, include assets and liabilities, the amount designated is an amount of assets or an amount of liabilities. Designation of a net amount including assets and liabilities is not permitted. The entity may hedge a portion of the interest rate risk associated with this designated amount. For example, in the case of a hedge of a portfolio containing prepayable assets, the entity may hedge the change in fair value that is attributable to a change in the hedged interest rate on the basis of expected,

rather than contractual, repricing dates. When the portion hedged is based on expected repricing dates, the effect that changes in the hedged interest rate have on those expected repricing dates shall be included when determining the change in the fair value of the hedged item. Consequently, if a portfolio that contains prepayable items is hedged with a non-prepayable derivative, ineffectiveness arises if the dates on which items in the hedged portfolio are expected to prepay are revised, or actual prepayment dates differ from those expected.

Designation of Non-Financial Items as Hedged Items

92. **If the hedged item is a non-financial asset or non-financial liability, it shall be designated as a hedged item:**
- (a) **For foreign currency risks; or**
 - (b) **In its entirety for all risks, because of the difficulty of isolating and measuring the appropriate portion of the cash flows or fair value changes attributable to specific risks other than foreign currency risks.**

Designation of Groups of Items as Hedged Items

93. Similar assets or similar liabilities shall be aggregated and hedged as a group only if the individual assets or individual liabilities in the group share the risk exposure that is designated as being hedged. Furthermore, the change in fair value attributable to the hedged risk for each individual item in the group shall be expected to be approximately proportional to the overall change in fair value attributable to the hedged risk of the group of items.
94. Because an entity assesses hedge effectiveness by comparing the change in the fair value or cash flow of a hedging instrument (or group of similar hedging instruments) and a hedged item (or group of similar hedged items), comparing a hedging instrument with an overall net position (e.g., the net of all fixed rate assets and fixed rate liabilities with similar maturities), rather than with a specific hedged item, does not qualify for hedge accounting.

Hedge Accounting

95. Hedge accounting recognizes the offsetting effects on surplus or deficit of changes in the fair values of the hedging instrument and the hedged item.
96. **Hedging relationships are of three types:**
- (a) **Fair value hedge: a hedge of the exposure to changes in fair value of a recognized asset or liability or an unrecognized firm commitment, or an identified portion of such an asset, liability or firm commitment, that is attributable to a particular risk and could affect surplus or deficit.**
 - (b) **Cash flow hedge: a hedge of the exposure to variability in cash flows that:**
 - (i) **Is attributable to a particular risk associated with a recognized asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction; and**

- (ii) Could affect surplus or deficit.
 - (c) **Hedge of a net investment in a foreign operation as defined in MPSAS 4, *The Effect of Changes in Foreign Exchange Rates*.**
97. A hedge of the foreign currency risk of a firm commitment may be accounted for as a fair value hedge or as a cash flow hedge.
98. **A hedging relationship qualifies for hedge accounting under paragraphs 99–113 if, and only if, all of the following conditions are met.**
- (a) **At the inception of the hedge there is formal designation and documentation of the hedging relationship and the entity’s risk management objective and strategy for undertaking the hedge. That documentation shall include identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the hedging instrument’s effectiveness in offsetting the exposure to changes in the hedged item’s fair value or cash flows attributable to the hedged risk.**
 - (b) **The hedge is expected to be highly effective (see Appendix A paragraphs AG145–AG156) in achieving offsetting changes in fair value or cash flows attributable to the hedged risk, consistently with the originally documented risk management strategy for that particular hedging relationship.**
 - (c) **For cash flow hedges, a forecast transaction that is the subject of the hedge must be highly probable and must present an exposure to variations in cash flows that could ultimately affect surplus or deficit.**
 - (d) **The effectiveness of the hedge can be reliably measured, i.e., the fair value or cash flows of the hedged item that are attributable to the hedged risk and the fair value of the hedging instrument can be reliably measured (see paragraphs 48 and 49 and Appendix A paragraphs AG113 and AG114 for guidance on determining fair value).**
 - (e) **The hedge is assessed on an ongoing basis and determined actually to have been highly effective throughout the financial reporting periods for which the hedge was designated.**

Fair Value Hedges

99. **If a fair value hedge meets the conditions in paragraph 98 during the period, it shall be accounted for as follows:**
- (a) **The gain or loss from remeasuring the hedging instrument at fair value (for a derivative hedging instrument) or the foreign currency component of its carrying amount measured in accordance with MPSAS 4, *The Effect of Changes in Foreign Exchange Rates*, (for a non-derivative hedging instrument) shall be recognized in surplus or deficit; and**

- (b) **The gain or loss on the hedged item attributable to the hedged risk shall adjust the carrying amount of the hedged item and be recognized in surplus or deficit. This applies if the hedged item is otherwise measured at cost. Recognition of the gain or loss attributable to the hedged risk in surplus or deficit applies if the hedged item is an available-for-sale financial asset.**

100. For a fair value hedge of the interest rate exposure of a portion of a portfolio of financial assets or financial liabilities (and only in such a hedge), the requirement in paragraph 99(b) may be met by presenting the gain or loss attributable to the hedged item either:

- (a) In a single separate line item within assets, for those repricing time periods for which the hedged item is an asset; or
- (b) In a single separate line item within liabilities, for those repricing time periods for which the hedged item is a liability.

The separate line items referred to in (a) and (b) above shall be presented next to financial assets or financial liabilities. Amounts included in these line items shall be removed from the statement of financial position when the assets or liabilities to which they relate are derecognized.

101. If only particular risks attributable to a hedged item are hedged, recognized changes in the fair value of the hedged item unrelated to the hedged risk are recognized as set out in paragraph 64.

102. **An entity shall discontinue prospectively the hedge accounting specified in paragraph 99 if:**

- (a) **The hedging instrument expires or is sold, terminated or exercised (for this purpose, the replacement or rollover of a hedging instrument into another hedging instrument is not an expiration or termination if such replacement or rollover is part of the entity's documented hedging strategy);**
- (b) **The hedge no longer meets the criteria for hedge accounting in paragraph 98; or**
- (c) **The entity revokes the designation.**

103. **Any adjustment arising from paragraph 99(b) to the carrying amount of a hedged financial instrument for which the effective interest method is used (or, in the case of a portfolio hedge of interest rate risk, to the separate line item in the statement of financial position described in paragraph 100) shall be amortized to surplus or deficit. Amortization may begin as soon as an adjustment exists and shall begin no later than when the hedged item ceases to be adjusted for changes in its fair value attributable to the risk being hedged. The adjustment is based on a recalculated effective interest rate at the date amortization begins. However, if, in the case of a fair value hedge of the interest rate exposure of a portfolio of financial assets or financial liabilities (and only in such a hedge), amortizing using a recalculated effective interest rate is not practicable, the adjustment shall be amortized using a straight-line method. The adjustment shall be amortized fully by maturity of the financial instrument or, in the case of a portfolio hedge of interest rate risk, by expiry of the relevant repricing time period.**

104. When an unrecognized firm commitment is designated as a hedged item, the subsequent cumulative change in the fair value of the firm commitment attributable to the hedged risk is recognized as an asset or liability with a corresponding gain or loss recognized in surplus or deficit (see paragraph 99(b)). The changes in the fair value of the hedging instrument are also recognized in surplus or deficit.
105. When an entity enters into a firm commitment to acquire an asset or assume a liability that is a hedged item in a fair value hedge, the initial carrying amount of the asset or liability that results from the entity meeting the firm commitment is adjusted to include the cumulative change in the fair value of the firm commitment attributable to the hedged risk that was recognized in the statement of financial position.

Cash Flow Hedges

106. **If a cash flow hedge meets the conditions in paragraph 98 during the period, it shall be accounted for as follows:**
 - (a) **The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge (see paragraph 98) shall be recognized directly in net assets/equity through the statement of changes in net assets/equity; and**
 - (b) **The ineffective portion of the gain or loss on the hedging instrument shall be recognized in surplus or deficit.**
107. More specifically, a cash flow hedge is accounted for as follows:
 - (a) The separate component of net assets/equity associated with the hedged item is adjusted to the lesser of the following (in absolute amounts):
 - (i) The cumulative gain or loss on the hedging instrument from inception of the hedge; and
 - (ii) The cumulative change in fair value (present value) of the expected future cash flows on the hedged item from inception of the hedge;
 - (b) Any remaining gain or loss on the hedging instrument or designated component of it (that is not an effective hedge) is recognized in surplus or deficit; and
 - (c) If an entity's documented risk management strategy for a particular hedging relationship excludes from the assessment of hedge effectiveness a specific component of the gain or loss or related cash flows on the hedging instrument (see paragraphs 83, 84, and 98(a)), that excluded component of gain or loss is recognized in accordance with paragraph 64.
108. **If a hedge of a forecast transaction subsequently results in the recognition of a financial asset or a financial liability, the associated gains or losses that were recognized directly in net assets/equity in accordance with paragraph 106 shall be reclassified into surplus or deficit in the same period or periods during which the hedged forecast cash flows affects surplus or deficit (such as in the periods that interest revenue or interest expense is recognized). However, if an entity expects that all or a portion of a loss recognized directly**

in net assets/equity will not be recovered in one or more future periods, it shall reclassify into surplus or deficit the amount that is not expected to be recovered.

109. If a hedge of a forecast transaction subsequently results in the recognition of a non-financial asset or a non-financial liability, or a forecast transaction for a non-financial asset or non-financial liability becomes a firm commitment for which fair value hedge accounting is applied, then the entity shall adopt (a) or (b) below:
 - (a) It reclassifies the associated gains and losses that were recognized directly in net assets/equity in accordance with paragraph 106 into surplus or deficit in the same period or periods during which the asset acquired or liability assumed affects surplus or deficit (such as in the periods that depreciation or inventories are recognized as an expense). However, if an entity expects that all or a portion of a loss recognized directly in net assets/equity will not be recovered in one or more future periods, it shall reclassify from net assets/equity into surplus or deficit the amount that is not expected to be recovered.
 - (b) It removes the associated gains and losses that were recognized directly in net assets/equity in accordance with paragraph 106, and includes them in the initial cost or other carrying amount of the asset or liability.
110. An entity shall adopt either (a) or (b) in paragraph 109 as its accounting policy and shall apply it consistently to all hedges to which paragraph 109 relates.
111. For cash flow hedges other than those covered by paragraphs 108 and 109, amounts that had been recognized directly in net assets/equity shall be recognized in surplus or deficit in the same period or periods during which the hedged forecast cash flows affects surplus or deficit (e.g., when a forecast sale occurs).
112. In any of the following circumstances an entity shall discontinue prospectively the hedge accounting specified in paragraphs 106 - 111:
 - (a) The hedging instrument expires or is sold, terminated or exercised (for this purpose, the replacement or rollover of a hedging instrument into another hedging instrument is not an expiration or termination if such replacement or rollover is part of the entity's documented hedging strategy). In this case, the cumulative gain or loss on the hedging instrument that remains recognized directly in net assets/equity from the period when the hedge was effective (see paragraph 106(a)) shall remain separately recognized in net assets/equity until the forecast transaction occurs. When the transaction occurs, paragraph 108, 109, or 111 applies.
 - (b) The hedge no longer meets the criteria for hedge accounting in paragraph 98. In this case, the cumulative gain or loss on the hedging instrument that remains recognized directly in net assets/equity from the period when the hedge was effective (see paragraph 106(a)) shall remain separately recognized in net assets/equity until the forecast transaction occurs. When the transaction occurs, paragraph 108, 109, or 111 applies.

- (c) The forecast transaction is no longer expected to occur, in which case any related cumulative gain or loss on the hedging instrument that has been recognized directly in net assets/equity from the period when the hedge was effective (see paragraph 106(a)) shall be recognized in surplus or deficit. A forecast transaction that is no longer highly probable (see paragraph 98(c)) may still be expected to occur.
- (d) The entity revokes the designation. For hedges of a forecast transaction, the cumulative gain or loss on the hedging instrument that remains recognized directly in net assets/equity from the period when the hedge was effective (see paragraph 106(a)) shall remain separately recognized in net assets/equity until the forecast transaction occurs or is no longer expected to occur. When the transaction occurs, paragraph 108, 109, or 111 applies. If the transaction is no longer expected to occur, the cumulative gain or loss that had been recognized directly in net assets/equity shall be recognized in surplus or deficit.

Hedges of a Net Investment

113. Hedges of a net investment in a foreign operation, including a hedge of a monetary item that is accounted for as part of the net investment (see MPSAS 4, *The Effect of Changes in Foreign Exchange Rates*), shall be accounted for similarly to cash flow hedges:
- (a) The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge (see paragraph 98) shall be recognized directly in net assets/equity through the statement of changes in net assets/equity (see MPSAS 1, *Presentation of Financial Statements*); and
 - (b) The ineffective portion shall be recognized in surplus or deficit.

The gain or loss on the hedging instrument relating to the effective portion of the hedge that has been recognized directly in net assets/equity shall be recognized in surplus or deficit in accordance with paragraphs 56–57 of MPSAS 4, *The Effect of Changes in Foreign Exchange Rates*, on disposal of the foreign operation.

Transition

- 114. [Deleted]
- 115. [Deleted]
- 116. [Deleted]
- 117. [Deleted]
- 118. [Deleted]
- 119. [Deleted]
- 120. [Deleted]
- 121. [Deleted]

122. [Deleted]

123. [Deleted]

Effective Date

124. An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2017, it shall disclose that fact.
125. An entity shall not apply this Standard before January 1, 2017 unless it also applies MPSAS 28, *Financial Instruments: Presentation*, and MPSAS 30, *Financial Instruments: Disclosure*.
- 125A. Paragraphs 114, 115, 116, 117, 118, 119, 120, 121, 122 and 126 were amended by MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)* issued in November 2015. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, for a period beginning before January 1, 2017, the amendments shall also be applied for that earlier period.
- 125B. Paragraph 2 was amended by MPSAS 32, *Service Concession Arrangements: Grantor* issued in March 2016. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2017, it shall disclose that fact and at the same time apply MPSAS 32, *Service Concession Arrangements: Grantor*, the amendments to paragraphs 6 and 42A of MPSAS 5, *Borrowing Costs*, the amendments to paragraphs 25– 27 and 85B of MPSAS 13, *Leases*, the amendments to paragraphs 5, 7 and 107C of MPSAS 17, *Property, Plant and Equipment*, and the amendments to paragraphs 6 and 132A of MPSAS 31, *Intangible Assets*.
- 125C. MPSAS 35, *Consolidated Financial Statements* issued in March 2016 and MPSAS 37, *Joint Arrangements*, issued in August 2016, amended paragraphs 2(a), 17, 89, AG2, AG14, AG51–53 and C2. An entity shall apply those amendments when it applies MPSAS 35, *Consolidated Financial Statements*, and MPSAS 37, *Joint Arrangements*.
- 125D. Paragraphs 2, AG35, AG131 and B4 were amended by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2023 it shall disclose that fact and apply MPSAS 40, *Public Sector Combinations*, at the same time.

- 125E. Paragraph AG8 was amended by *Improvements to MPSASs 2023, (MPSASs Improvements due to IPSAS Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities)*, issued in December 2022. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2024. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2024 it shall disclose that fact.
- 125F. Paragraphs 7 and 8 were deleted by *Improvements to MPSASs 2023 (The Applicability of MPSASs)*, issued in December 2022. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2024. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2024, it shall disclose that fact.
126. When an entity adopts the accrual basis MPSASs of accounting as defined in MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of MPSASs.

Appendix A

Application Guidance

This Appendix is an integral part of MPSAS 29, Financial Instruments: Recognition and Measurement.

Scope (paragraphs 2–8)

AG1. This Standard does not change the requirements relating to employee benefit plans that comply with the relevant international or national accounting standard on accounting and reporting by retirement benefit plans and royalty agreements based on the volume of sales or service revenues that are accounted for under MPSAS 9, *Revenue from Exchange Transactions*.

Investments in Controlled Entities, Associates, and Joint Ventures

AG2. Sometimes, an entity makes what it views as a “strategic investment” in equity instruments issued by another entity, with the intention of establishing or maintaining a long-term operating relationship with the entity in which the investment is made. The investor or joint venture entity uses MPSAS 36, *Investment in Associates and Joint Venture*, to determine whether the equity method of accounting is appropriate for such an investment. If the equity method is not appropriate, the entity applies this Standard to that strategic investment.

Insurance Contracts

AG3. This Standard applies to the financial assets and financial liabilities of insurers, other than rights and obligations that paragraph 2(e) excludes because they arise from insurance contracts. An entity does however apply this Standard to:

- Financial guarantee contracts, except those where the issuer elects to treat such contracts as insurance contracts in accordance with MPSAS 28, *Financial Instruments: Presentation*; and
- 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.

AG4. Financial guarantee contracts may have various legal forms, such as a guarantee, some types of letter of credit, a credit default contract or an insurance contract. Their accounting treatment does not depend on their legal form. The following are examples of the appropriate treatment (see paragraph 2(e)):

- (a) Although a financial guarantee contract meets the definition of an insurance contract 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 MPSAS 28, *Financial Instruments: Presentation*, if the issuer has previously adopted an accounting policy that treated financial guarantee contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either this Standard or the relevant

international or national accounting standard on insurance contracts to such financial guarantee contracts. If this Standard applies paragraph 45 requires the issuer to recognize a financial guarantee contract initially at fair value. If the financial guarantee contract was issued to an unrelated party in a stand-alone arm's length transaction, its fair value at inception is likely to equal the premium received, unless there is evidence to the contrary. Subsequently, unless the financial guarantee contract was designated at inception as at fair value through surplus or deficit or unless paragraphs 31–39 and AG62–67 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 MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*; and
 - (ii) The amount initially recognized less, when appropriate, cumulative amortization recognized in accordance with MPSAS 9, *Revenue from Exchange Transactions* (see paragraph 49(c)).
- (b) Some credit-related guarantees do not, as a precondition for payment, require that the holder is exposed to, and has incurred a loss on, the failure of the debtor to make payments on the guaranteed asset when due. An example of such a guarantee is one that requires payments in response to changes in a specified credit rating or credit index. Such guarantees are not financial guarantee contracts, as defined in this Standard, and are not insurance contracts. Such guarantees are derivatives and the issuer applies this Standard to them.
- (c) If a financial guarantee contract was issued in connection with the sale of goods, the issuer applies MPSAS 9, *Revenue from Exchange Transactions*, in determining when it recognizes the revenue from the guarantee and from the sale of goods.

AG5. Some contracts require a payment based on climatic, geological or other physical variables. (Those based on climatic variables are sometimes referred to as “weather derivatives”). If those contracts are not insurance contracts, they are within the scope of this Standard.

Rights and Obligations Arising from Non-Exchange Revenue Transactions

AG6. Rights and obligations (assets and liabilities) may arise from non-exchange revenue transactions, for example, an entity may receive cash from a multi-lateral agency to perform certain activities. Where the performance of those activities is subject to conditions, an asset and a liability is recognized simultaneously. Where the asset is a financial asset, it is recognized in accordance with MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfer)*, and initially measured in accordance with MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfer)*, and this Standard. A liability that is initially recognized as a result of conditions imposed on the use of an asset is outside the scope of this Standard and is dealt with in MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfer)*. After initial recognition, if circumstances indicate that recognition of a liability in accordance with MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfer)*, is no longer appropriate, an entity considers whether a financial liability should be

recognized in accordance with this Standard. Other liabilities that may arise from non-exchange revenue transactions are recognized and measured in accordance with this Standard if they meet the definition of a financial liability in MPSAS 28, *Financial Instruments: Presentation*.

Definitions (paragraphs 9 and 10)

Designation as at Fair Value through Surplus or Deficit

- AG7. Paragraph 10 of this Standard allows an entity to designate a financial asset, a financial liability, or a group of financial instruments (financial assets, financial liabilities or both) as at fair value through surplus or deficit provided that doing so results in more relevant information.
- AG8. The decision of an entity to designate a financial asset or financial liability as at fair value through surplus or deficit is similar to an accounting policy choice (although, unlike an accounting policy choice, it is not required to be applied consistently to all similar transactions). When an entity has such a choice, paragraph 17(b) of MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, requires the chosen policy to result in the financial statements providing faithfully representative and more relevant information about the effects of transactions, other events and conditions on the entity's financial position, financial performance or cash flows. In the case of designation as at fair value through surplus or deficit, paragraph 10 sets out the two circumstances when the requirement for more relevant information will be met. Accordingly, to choose such designation in accordance with paragraph 10, the entity needs to demonstrate that it falls within one (or both) of these two circumstances.

Paragraph 10(b)(i): Designation Eliminates or Significantly Reduces a Measurement or Recognition Inconsistency that Would Otherwise Arise

- AG9. Under MPSAS 29, *Financial Instruments: Recognition and Measurement*, measurement of a financial asset or financial liability and classification of recognized changes in its value are determined by the item's classification and whether the item is part of a designated hedging relationship. Those requirements can create a measurement or recognition inconsistency (sometimes referred to as an "accounting mismatch") when, for example, in the absence of designation as at fair value through surplus or deficit, a financial asset would be classified as available for sale (with most changes in fair value recognized directly in net assets/equity) and a liability the entity considers related would be measured at amortized cost (with changes in fair value not recognized). In such circumstances, an entity may conclude that its financial statements would provide more relevant information if both the asset and the liability were classified as at fair value through surplus or deficit.
- AG10. The following examples show when this condition could be met. In all cases, an entity may use this condition to designate financial assets or financial liabilities as at fair value through surplus or deficit only if it meets the principle in paragraph 10(b)(i).
- (a) An entity has liabilities whose cash flows are contractually based on the performance of assets that would otherwise be classified as available for sale. For example, an insurer may have liabilities containing a discretionary participation feature that pay benefits

based on realized and/or unrealized investment returns of a specified pool of the insurer's assets. If the measurement of those liabilities reflects current market prices, classifying the assets as at fair value through surplus or deficit means that changes in the fair value of the financial assets are recognized in surplus or deficit in the same period as related changes in the value of the liabilities.

- (b) An entity has liabilities under insurance contracts whose measurement incorporates current information, and financial assets it considers related that would otherwise be classified as available for sale or measured at amortized cost.
 - (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. However, only some of the instruments would be measured at fair value through surplus or deficit (i.e., are derivatives, or are classified as held for trading). It may also be the case that the requirements for hedge accounting are not met, for example because the requirements for effectiveness in paragraph 98 are not met.
 - (d) 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 the entity does not qualify for hedge accounting because none of the instruments is a derivative. Furthermore, in the absence of hedge accounting there is a significant inconsistency in the recognition of gains and losses. For example:
 - (i) The entity has financed a portfolio of fixed rate assets that would otherwise be classified as available for sale with fixed rate debentures whose changes in fair value tend to offset each other. Reporting both the assets and the debentures at fair value through surplus or deficit corrects the inconsistency that would otherwise arise from measuring the assets at fair value with changes reported in net assets/equity and the debentures at amortized cost.
 - (ii) The entity has financed a specified group of loans by issuing traded bonds whose changes in fair value tend to offset each other. If, in addition, the entity regularly buys and sells the bonds but rarely, if ever, buys and sells the loans, reporting both the loans and the bonds at fair value through surplus or deficit eliminates the inconsistency in the timing of recognition of gains and losses that would otherwise result from measuring them both at amortized cost and recognizing a gain or loss each time a bond is repurchased.
- AG11. In cases such as those described in the preceding paragraph, to designate, at initial recognition, the financial assets and financial liabilities not otherwise so measured as at fair value through surplus or deficit may eliminate or significantly reduce the measurement or recognition inconsistency and produce more relevant information. For practical purposes, the entity need not enter into all of the assets and liabilities giving rise to the measurement or recognition inconsistency at exactly the same time. A reasonable delay is permitted provided that each transaction is designated as at fair value through surplus or deficit at its initial recognition and, at that time, any remaining transactions are expected to occur.
- AG12. It would not be acceptable to designate only some of the financial assets and financial liabilities giving rise to the inconsistency as at fair value through surplus or deficit if to do so

would not eliminate or significantly reduce the inconsistency and would therefore not result in more relevant information. However, it would be acceptable to designate only some of a number of similar financial assets or similar financial liabilities if doing so achieves a significant reduction (and possibly a greater reduction than other allowable designations) in the inconsistency. For example, assume an entity has a number of similar financial liabilities that sum to RM100³ and a number of similar financial assets that sum to RM50 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 (e.g., individual liabilities with a combined total of RM45) as at fair value through surplus or deficit. However, because designation as at fair value through surplus or deficit can be applied only to the whole of a financial instrument, the entity in this example must designate one or more liabilities in their entirety. It could not designate either a component of a liability (e.g., changes in value attributable to only one risk, such as changes in a benchmark interest rate) or a proportion (i.e., percentage) of a liability.

Paragraph 10(b)(ii): A Group of Financial Assets, Financial Liabilities or Both is Managed and its Performance is Evaluated on a Fair Value basis, in accordance with a Documented Risk Management or Investment Strategy

- AG13. An entity may manage and evaluate the performance of a group of financial assets, financial liabilities or both in such a way that measuring that group at fair value through surplus or deficit results in more relevant information. The focus in this instance is on the way the entity manages and evaluates performance, rather than on the nature of its financial instruments.
- AG14. The following examples show when this condition could be met. In all cases, an entity may use this condition to designate financial assets or financial liabilities as at fair value through surplus or deficit only if it meets the principle in paragraph 10(b)(ii).
- (a) The entity is a venture capital organization, mutual fund, unit trust or similar entity whose business is investing in financial assets with a view to profiting from their total return in the form of interest, dividends or similar distributions and changes in fair value. MPSAS 36, *Investment in Associates and Joint Venture*, allows such investments to be measured at fair value through surplus or deficit in accordance with this Standard. An entity may apply the same accounting policy to other investments managed on a total return basis but over which its influence is insufficient for them to be within the scope of MPSAS 36, *Investment in Associates and Joint Venture*.
 - (b) 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. A similar example could be an entity that originates fixed interest rate loans and manages the resulting benchmark interest rate risk using a mix of derivative and non-derivative financial instruments.

³ In this Standard, monetary amounts are denominated in “Ringgit Malaysia” (RM).

- (c) The entity is an insurer that holds a portfolio of financial assets, manages that portfolio so as to maximize its total return (i.e., interest, dividends or similar distributions and changes in fair value), and evaluates its performance on that basis. The portfolio may be held to back specific liabilities, net assets/equity or both. If the portfolio is held to back specific liabilities, the condition in paragraph 10(b)(ii) may be met for the assets regardless of whether the insurer also manages and evaluates the liabilities on a fair value basis. The condition in paragraph 10(b)(ii) may be met when the insurer's objective is to maximize total return on the assets over the longer term even if amounts paid to holders of participating contracts depend on other factors such as the amount of gains realized in a shorter period (e.g., a year) or are subject to the insurer's discretion.
- AG15. 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 instruments as at fair value through surplus or deficit on the basis of this condition shall so designate all eligible financial instruments that are managed and evaluated together.
- AG16. Documentation of the entity's strategy need not be extensive but should be sufficient to demonstrate compliance with paragraph 10(b)(ii). Such documentation is not required for each individual item, but may be on a portfolio basis. For example, if the performance management system within an entity as approved by the entity's key management personnel – clearly demonstrates that its performance is evaluated on a total return basis, no further documentation is required to demonstrate compliance with paragraph 10(b)(ii).

Effective Interest Rate

- AG17. In some cases, financial assets are acquired at a deep discount that reflects incurred credit losses. Entities include such incurred credit losses in the estimated cash flows when computing the effective interest rate.
- AG18. When applying the effective interest method, an entity generally amortizes any fees, points paid or received, transaction costs and other premiums or discounts included in the calculation of the effective interest rate over the expected life of the 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 instrument. In such a case, the appropriate amortization period is the period to the next such repricing date. For example, if a premium or discount on a floating rate instrument reflects interest that has accrued on the instrument since interest was last paid, or changes in market rates since the floating interest rate was reset to market rates, it will be amortized to the next date when the floating interest is reset to market rates. This is because the premium or discount relates to the period to the next interest reset date because, at that date, the variable to which the premium or discount relates (i.e., interest rates) is reset to market rates. If, however, the premium or discount results from a change in the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates, it is amortized over the expected life of the instrument.

- AG19. For floating rate financial assets and floating rate financial liabilities, periodic re-estimation of cash flows to reflect movements in market rates of interest alters the effective interest rate. If a floating rate financial asset or floating rate financial liability is recognized initially at an amount equal to the principal receivable or payable on maturity, re-estimating the future interest payments normally has no significant effect on the carrying amount of the asset or liability.
- AG20. If an entity revises its estimates of payments or receipts, the entity shall adjust the carrying amount of the financial asset or financial liability (or group of financial instruments) to reflect actual and revised estimated cash flows. The entity recalculates the carrying amount by computing the present value of estimated future cash flows at the financial instrument's original effective interest rate or, when applicable, the revised effective interest rate calculated in accordance with paragraph 103. The adjustment is recognized in surplus or deficit as revenue or expense. If a financial asset is reclassified in accordance with paragraph 55, 57, or 58, and the entity subsequently increases its estimates of future cash receipts as a result of increased recoverability of those cash receipts, the effect of that increase shall be recognized as an adjustment to the effective interest rate from the date of the change in estimate rather than as an adjustment to the carrying amount of the asset at the date of the change in estimate.

Derivatives

- AG21. 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 RM1,000⁴ if the six-month interbank offered rate increases by 100 basis points. Such a contract is a derivative even though a notional amount is not specified.
- AG22. 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 (see paragraphs 4–6).
- AG23. 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.

⁴ In this Standard, monetary amounts are denominated in "Ringgit Malaysia" (RM).

- AG24. A regular way purchase or sale gives rise to a fixed price commitment between trade date and settlement date that meets the definition of a derivative. However, because of the short duration of the commitment it is not recognized as a derivative financial instrument. Rather, this Standard provides for special accounting for such regular way contracts (see paragraphs 40 and AG68–AG71).
- AG25. 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.

Transaction Costs

- AG26. Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisers, brokers, and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs, or internal administrative or holding costs.

Financial Assets and Financial Liabilities Held for Trading

- AG27. 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.
- AG28. 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.

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

Held-to-Maturity Investments

- AG29. An entity does not have a positive intention to hold to maturity an investment in a financial asset with a fixed maturity if:
- (a) The entity intends to hold the financial asset for an undefined period;
 - (b) The entity stands ready to sell the financial asset (other than if a situation arises that is non-recurring and could not have been reasonably anticipated by the entity) in response to changes in market interest rates or risks, liquidity needs, changes in the availability of and the yield on alternative investments, changes in financing sources, and terms or changes in foreign currency risk; or
 - (c) The issuer has a right to settle the financial asset at an amount significantly below its amortized cost.
- AG30. A debt instrument with a variable interest rate can satisfy the criteria for a held-to-maturity investment. Equity instruments cannot be held-to-maturity investments either because they have an indefinite life (such as ordinary shares) or because the amounts the holder may receive can vary in a manner that is not predetermined (such as for share options, warrants and similar rights). With respect to the definition of held-to-maturity investments, fixed or determinable payments and fixed maturity mean that a contractual arrangement defines the amounts and dates of payments to the holder, such as interest and principal payments. A significant risk of non-payment does not preclude classification of a financial asset as held to maturity as long as its contractual payments are fixed or determinable and the other criteria for that classification are met. If the terms of a perpetual debt instrument provide for interest payments for an indefinite period, the instrument cannot be classified as held to maturity because there is no maturity date.
- AG31. The criteria for classification as a held-to-maturity investment are met for a financial asset that is callable by the issuer if the holder intends and is able to hold it until it is called or until maturity and the holder would recover substantially all of its carrying amount. The call option of the issuer, if exercised, simply accelerates the asset's maturity. However, if the financial asset is callable on a basis that would result in the holder not recovering substantially all of its carrying amount, the financial asset cannot be classified as a held-to-maturity investment. The entity considers any premium paid and capitalized transaction costs in determining whether the carrying amount would be substantially recovered.
- AG32. A financial asset that is puttable (i.e., the holder has the right to require that the issuer repay or redeem the financial asset before maturity) cannot be classified as a held-to-maturity investment because paying for a put feature in a financial asset is inconsistent with expressing an intention to hold the financial asset until maturity.
- AG33. For most financial assets, fair value is a more appropriate measure than amortized cost. The held-to-maturity classification is an exception, but only if the entity has a positive intention and the ability to hold the investment to maturity. When an entity's actions cast doubt on its intention and ability to hold such investments to maturity, paragraph 10 precludes the use of the exception for a reasonable period of time.

- AG34. A disaster scenario that is only remotely possible, such as a run on a bank or a similar situation affecting an insurer, is not something that is assessed by an entity in deciding whether it has the positive intention and ability to hold an investment to maturity.
- 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:
- (a) A significant deterioration in the issuer’s creditworthiness. For example, a sale following a downgrade in a credit rating by an external rating agency would not necessarily raise a question about the entity’s intention to hold other investments to maturity if the downgrade provides evidence of a significant deterioration in the issuer’s creditworthiness judged by reference to the credit rating at initial recognition. Similarly, if an entity uses internal ratings for assessing exposures, changes in those internal ratings may help to identify issuers for which there has been a significant deterioration in creditworthiness, provided the entity’s approach to assigning internal ratings and changes in those ratings give a consistent, reliable and objective measure of the credit quality of the issuers. If there is evidence that a financial asset is impaired (see paragraphs 67 and 68), the deterioration in creditworthiness is often regarded as significant.
 - (b) A change in tax law that eliminates or significantly reduces the tax-exempt status of interest on the held-to-maturity investment (but not a change in tax law that revises the marginal tax rates applicable to interest revenue).
 - (c) A major public sector 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 public sector 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).
 - (d) A change in statutory or regulatory requirements significantly modifying either what constitutes a permissible investment or the maximum level of particular types of investments, thereby causing an entity to dispose of a held-to-maturity investment.
 - (e) A significant increase in the industry’s regulatory capital requirements that causes the entity to downsize by selling held-to-maturity investments.
 - (f) A significant increase in the risk weights of held-to-maturity investments used for regulatory risk-based capital purposes.
- AG36. An entity does not have a demonstrated ability to hold to maturity an investment in a financial asset with a fixed maturity if:
- (a) It does not have the financial resources available to continue to finance the investment until maturity; or

- (b) It is subject to an existing legal or other constraint that could frustrate its intention to hold the financial asset to maturity. (However, an issuer's call option does not necessarily frustrate an entity's intention to hold a financial asset to maturity—see paragraph AG31).

- AG37. Circumstances other than those described in paragraphs AG29–AG36 can indicate that an entity does not have a positive intention or the ability to hold an investment to maturity.
- AG38. An entity assesses its intention and ability to hold its held-to-maturity investments to maturity not only when those financial assets are initially recognized, but also at the end of each subsequent reporting period.

Loans and Receivables

- AG39. Any non-derivative financial asset with fixed or determinable payments (including loan assets, receivables, investments in debt instruments and deposits held in banks) could potentially meet the definition of loans and receivables. However, a financial asset that is quoted in an active market (such as a quoted debt instrument, see paragraph AG103) does not qualify for classification as a loan or receivable. Financial assets that do not meet the definition of loans and receivables may be classified as held-to-maturity investments if they meet the conditions for that classification (see paragraphs 10 and AG29–AG38). On initial recognition of a financial asset that would otherwise be classified as a loan or receivable, an entity may designate it as a financial asset at fair value through surplus or deficit, or available for sale.

Embedded Derivatives (paragraphs 11–13)

- AG40. 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 characteristics of the net assets/equity 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.
- AG41. 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.
- AG42. Generally, multiple embedded derivatives in a single instrument are treated as a single compound embedded derivative. However, embedded derivatives that are classified as equity instruments (see MPSAS 28, *Financial Instruments: Presentation*) are accounted for separately from those classified as assets or liabilities. In addition, if an instrument 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.

AG43. The economic characteristics and risks of an embedded derivative are not closely related to the host contract (paragraph 12(a)) in the following examples. In these examples, assuming the conditions in paragraph 12(b) and (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) A call option embedded in an equity instrument that enables the issuer to reacquire that equity instrument at a specified price is not closely related to the host equity instrument from the perspective of the holder (from the issuer's perspective, the call option is an equity instrument provided it meets the conditions for that classification under MPSAS 28, *Financial Instruments: Presentation*, in which case it is excluded from the scope of this Standard).
- (c) 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.
- (d) 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.
- (e) 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 oil – are not closely related to the host instrument because the risks inherent in the host and the embedded derivative are dissimilar.
- (f) An equity conversion feature embedded in a convertible debt instrument is not closely related to the host debt instrument from the perspective of the holder of the instrument (from the issuer's perspective, the equity conversion option is an equity instrument and excluded from the scope of this Standard provided it meets the conditions for that classification under MPSAS 28, *Financial Instruments: Presentation*).
- (g) 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 the option's exercise price is approximately equal on each exercise date to the amortized cost of the host debt instrument or the carrying amount of the host insurance contract. From the perspective of the issuer of a convertible debt instrument with an embedded call or put option feature, the assessment of whether the call or put option is closely related to the host

debt contract is made before separating the element of net assets/equity under MPSAS 28, *Financial Instruments: Presentation*.

- (h) 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.
- AG44. An example of a hybrid instrument is a financial instrument that gives the holder a right to put the financial instrument back to the issuer in exchange for an amount of cash or other financial assets that varies on the basis of the change in an equity or commodity index that may increase or decrease (a “puttable instrument”). Unless the issuer on initial recognition designates the puttable instrument as a financial liability at fair value through surplus or deficit, it is required to separate an embedded derivative (i.e., the indexed principal payment) under paragraph 12 because the host contract is a debt instrument under paragraph AG40 and the indexed principal payment is not closely related to a host debt instrument under paragraph AG43(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.
- AG45. 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 combined instrument 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.
- AG46. 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 combined instrument can be settled in such a way that the holder would not recover substantially all of its recognized investment or the embedded derivative could at least double the holder’s initial rate of return on the host contract and could result in a rate of return that is at least twice what the market return would be for a contract with the same terms as the host contract.
 - (b) An embedded floor or cap on the interest rate on a debt contract or insurance contract is closely related to the host contract, provided the cap is at or above the market rate of interest and the floor is at or below the market rate of interest when the contract is issued, and the cap or floor is not leveraged in relation to the host contract. Similarly, provisions included in a contract to purchase or sell an asset (e.g., a commodity) that establish a cap and a floor on the price to be paid or received for the asset are closely related to the host contract if both the cap and floor were out of the money at inception and are not leveraged.

- (c) An embedded foreign currency derivative that provides a stream of principal or interest payments that are denominated in a foreign currency and is embedded in a host debt instrument (e.g., a dual currency bond) is closely related to the host debt instrument. Such a derivative is not separated from the host instrument because MPSAS 4, *The Effect of Changes in Foreign Exchange Rates*, requires foreign currency gains and losses on monetary items to be recognized in surplus or deficit.
- (d) An embedded foreign currency derivative in a host contract that is an insurance contract or not a financial instrument (such as a contract for the purchase or sale of a non-financial item where the price is denominated in a foreign currency) is closely related to the host contract provided it is not leveraged, does not contain an option feature, and requires payments denominated in one of the following currencies:
 - (i) The functional currency of any substantial party to that contract;
 - (ii) The currency in which the price of the related good or service that is acquired or delivered is routinely denominated in commercial transactions around the world (such as the US dollar for crude oil transactions); or
 - (iii) A currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place (e.g., a relatively stable and liquid currency that is commonly used in local 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) Contingent rentals based on related sales; or
 - (iii) Contingent rentals 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

- AG47. When an entity becomes a party to a hybrid (combined) instrument that contains one or more embedded derivatives, paragraph 12 requires the entity to identify any such embedded derivative, assess whether it is required to be separated from the host contract and, for those that are required to be separated, measure the derivatives at fair value at initial recognition and subsequently. These requirements can be more complex, or result in less reliable measures, than measuring the entire instrument at fair value through surplus or deficit. For that reason this Standard permits the entire instrument to be designated as at fair value through surplus or deficit.
- AG48. Such designation may be used whether paragraph 12 requires the embedded derivatives to be separated from the host contract or prohibits such separation. However, paragraph 13 would not justify designating the hybrid (combined) instrument as at fair value through surplus or deficit in the cases set out in paragraph 12(a) and (b) because doing so would not reduce complexity or increase reliability.

Recognition and Derecognition (paragraphs 16–44)

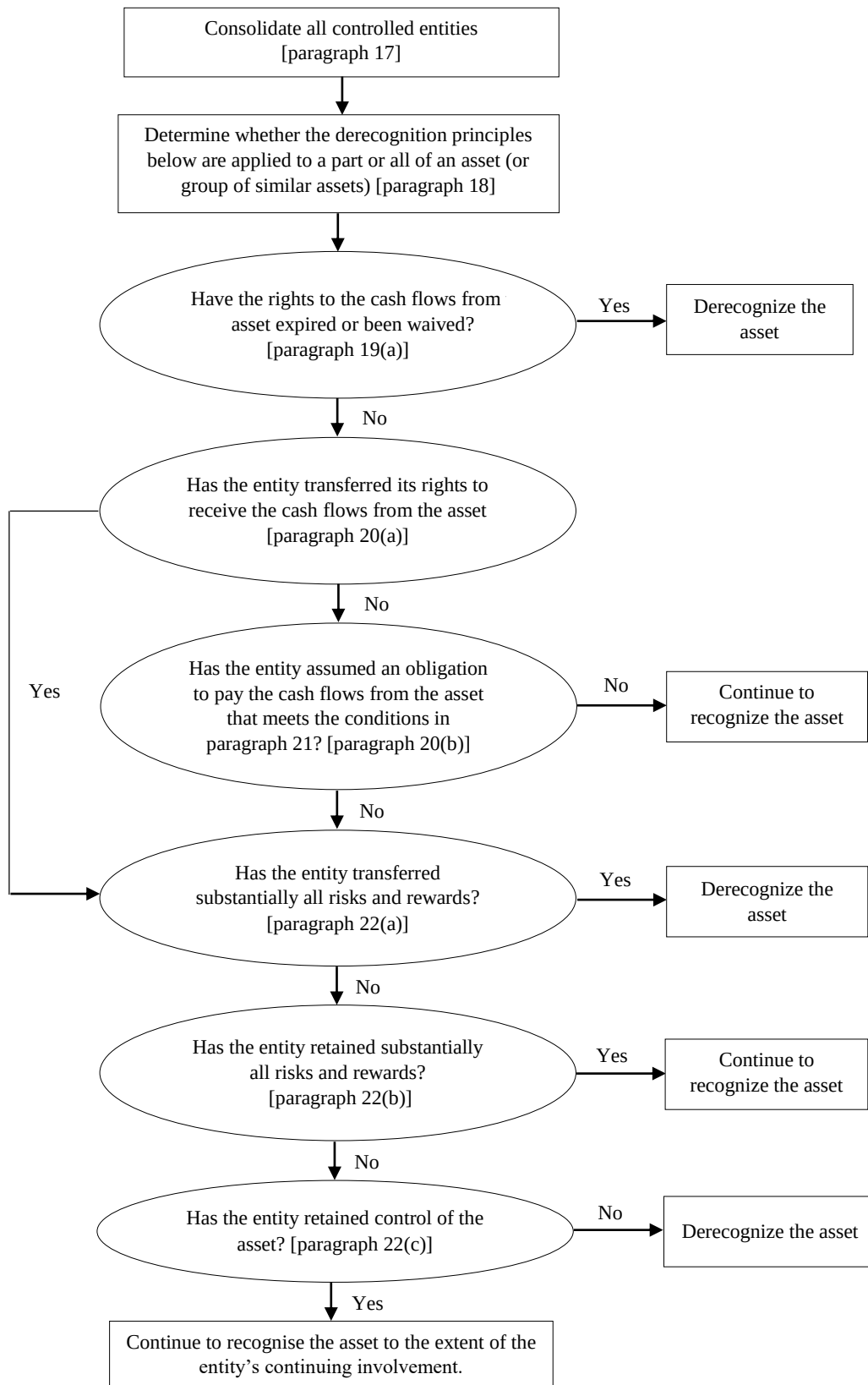
Initial Recognition (paragraph 16)

- AG49. As a consequence of the principle in paragraph 16, an entity recognizes all of its contractual rights and obligations under derivatives in its statement of financial position as assets and liabilities, respectively, except for derivatives that prevent a transfer of financial assets from being accounted for as a sale (see paragraph AG64). If a transfer of a financial asset does not qualify for derecognition, the transferee does not recognize the transferred asset as its asset (see paragraph AG65).
- AG50. The following are examples of applying the principle in paragraph 16:
- (a) Unconditional receivables and payables are recognized as assets or liabilities when the entity becomes a party to the contract and, as a consequence, has a legal right to receive or a legal obligation to pay cash.
 - (b) Assets to be acquired and liabilities to be incurred as a result of a firm commitment to purchase or sell goods or services are generally not recognized until at least one of the parties has performed under the agreement. For example, an entity that receives a firm order does not generally recognize an asset (and the entity that places the order does not recognize a liability) at the time of the commitment but, rather, 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 under paragraphs 4–6, its net fair value is recognized as an asset or liability on the commitment date (see (c) below). In addition, if a previously unrecognized firm commitment is designated as a hedged item in a fair value hedge, any change in the net fair value attributable to the hedged risk is recognized as an asset or liability after the inception of the hedge (see paragraphs 104 and 105).

- (c) A forward contract that is within the scope of this Standard (see paragraphs 2–6) is recognized as an asset or a liability on the commitment date, rather than on the date on which settlement takes place. When an entity becomes a party to a forward contract, the fair values of the right and obligation are often equal, so that the net fair value of the forward is zero. If the net fair value of the right and obligation is not zero, the contract is recognized as an asset or liability.
- (d) Option contracts that are within the scope of this Standard (see paragraphs 2–6) are recognized as assets or liabilities when the holder or writer becomes a party to the contract.
- (e) Planned future transactions, no matter how likely, are not assets and liabilities because the entity has not become a party to a contract.

Derecognition of a Financial Asset (paragraphs 17–39)

AG51. The following flow chart illustrates the evaluation of whether and to what extent a financial asset is derecognized.



Arrangements under Which an Entity Retains the Contractual Rights to Receive the Cash Flows of a Financial Asset, but Assumes a Contractual Obligation to Pay the Cash Flows to One or More Recipients (paragraph 20(b))

- AG52. The situation described in paragraph 20(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 21 and 22 are met.
- AG53. In applying paragraph 21, the entity could be, for example, the originator of the financial asset, or it could be a group that includes a controlled entity that has acquired the financial asset and passes on cash flows to unrelated third party investors.

Evaluation of the Transfer of Risks and Rewards of Ownership (paragraph 22)

- AG54. 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).
- AG55. 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.
- AG56. If an entity determines that as a result of the transfer, it has transferred substantially all the risks and rewards of ownership of the transferred asset, it does not recognize the transferred asset again in a future period, unless it reacquires the transferred asset in a new transaction.

Evaluation of the Transfer of Control

AG57. 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.

AG58. 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).

AG59. 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

AG60. 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 29, the fair values of the servicing asset and interest-only strip receivable are used to allocate the carrying amount of the receivable between the part of the asset that is derecognized and the part that continues to be recognized. If there is no servicing fee specified or the fee to be received is not expected to compensate the entity adequately for performing the servicing, a liability for the servicing obligation is recognized at fair value.

- AG61. In estimating the fair values of the part that continues to be recognized and the part that is derecognized for the purposes of applying paragraph 29, an entity applies the fair value measurement requirements in paragraphs 50–52 and AG101–AG115 in addition to paragraph 30.

Transfers that do not Qualify for Derecognition

- AG62. The following is an application of the principle outlined in paragraph 31. If a guarantee provided by the entity for default losses on the transferred asset prevents a transferred asset from being derecognized because the entity has retained substantially all the risks and rewards of ownership of the transferred asset, the transferred asset continues to be recognized in its entirety and the consideration received is recognized as a liability.

Continuing Involvement in Transferred Assets

- AG63. The following are examples of how an entity measures a transferred asset and the associated liability under paragraph 32.

All assets

- (a) If a guarantee provided by an entity to pay for default losses on a transferred asset prevents the transferred asset from being derecognized to the extent of the continuing involvement, the transferred asset at the date of the transfer is measured at the lower of:
- (i) The carrying amount of the asset; and
 - (ii) The maximum amount of the consideration received in the transfer that the entity could be required to repay (“the guarantee amount”).

The associated liability is initially measured at the guarantee amount plus the fair value of the guarantee (which is normally the consideration received for the guarantee). Subsequently, the initial fair value of the guarantee is recognized in surplus or deficit on a time proportion basis (see MPSAS 9, *Revenue from Exchange Transactions*) and the carrying value of the asset is reduced by any impairment losses.

Assets measured at amortized cost

- (b) If a put option obligation written by an entity or call option right held by an entity prevents a transferred asset from being derecognized and the entity measures the transferred asset at amortized cost, the associated liability is measured at its cost (i.e., the consideration received) adjusted for the amortization of any difference between that

cost and the amortized cost of the transferred asset at the expiration date of the option. For example, assume that the amortized cost and carrying amount of the asset on the date of the transfer is RM98 and that the consideration received is RM95. The amortized cost of the asset on the option exercise date will be RM100. The initial carrying amount of the associated liability is RM95 and the difference between RM95 and RM100 is recognized in surplus or deficit using the effective interest method. If the option is exercised, any difference between the carrying amount of the associated liability and the exercise price is recognized in surplus or deficit.

Assets measured at fair value

- (c) If a call option right retained by an entity prevents a transferred asset from being derecognized and the entity measures the transferred asset at fair value, the asset continues to be measured at its fair value. The associated liability is measured at (i) the option exercise price less the time value of the option if the option is in or at the money, or (ii) the fair value of the transferred asset less the time value of the option if the option is out of the money. The adjustment to the measurement of the associated liability ensures that the net carrying amount of the asset and the associated liability is the fair value of the call option right. For example, if the fair value of the underlying asset is RM80, the option exercise price is RM 95 and the time value of the option is RM 5, the carrying amount of the associated liability is RM 75 ($RM\ 80 - RM\ 5$) and the carrying amount of the transferred asset is RM 80 (i.e., its fair value).
- (d) If a put option written by an entity prevents a transferred asset from being derecognized and the entity measures the transferred asset at fair value, the associated liability is measured at the option exercise price plus the time value of the option. The measurement of the asset at fair value is limited to the lower of the fair value and the option exercise price because the entity has no right to increases in the fair value of the transferred asset above the exercise price of the option. This ensures that the net carrying amount of the asset and the associated liability is the fair value of the put option obligation. For example, if the fair value of the underlying asset is RM 120, the option exercise price is RM 100 and the time value of the option is RM 5, the carrying amount of the associated liability is RM 105 ($RM\ 100 + RM\ 5$) and the carrying amount of the asset is RM 100 (in this case the option exercise price).

If a collar, in the form of a purchased call and written put, prevents a transferred asset from being derecognized and the entity measures the asset at fair value, it continues to measure the asset at fair value. The associated liability is measured at:

- (i) The sum of the call exercise price and fair value of the put option less the time value of the call option, if the call option is in or at the money; or
- (ii) The sum of the fair value of the asset and the fair value of the put option less the time value of the call option if the call option is out of the money.

The adjustment to the associated liability ensures that the net carrying amount of the asset and the associated liability is the fair value of the options held and written by the entity. For example, assume an entity transfers a financial asset that is measured at fair value while simultaneously purchasing a call with an exercise price of RM 120 and writing a put with an

exercise price of RM 80. Assume also that the fair value of the asset is RM 100 at the date of the transfer. The time value of the put and call are RM 1 and RM 5 respectively. In this case, the entity recognizes an asset of RM 100 (the fair value of the asset) and a liability of RM 96 [(RM 100 + RM 1) – RM 5]. This gives a net asset value of RM 4, which is the fair value of the options held and written by the entity.

All Transfers

- AG64. To the extent that a transfer of a financial asset does not qualify for derecognition, the transferor's contractual rights or obligations related to the transfer are not accounted for separately as derivatives if recognizing both the derivative and either the transferred asset or the liability arising from the transfer would result in recognizing the same rights or obligations twice. For example, a call option retained by the transferor may prevent a transfer of financial assets from being accounted for as a sale. In that case, the call option is not separately recognized as a derivative asset.
- AG65. To the extent that a transfer of a financial asset does not qualify for derecognition, the transferee does not recognize the transferred asset as its asset. The transferee derecognizes the cash or other consideration paid and recognizes a receivable from the transferor. If the transferor has both a right and an obligation to reacquire control of the entire transferred asset for a fixed amount (such as under a repurchase agreement), the transferee may account for its receivable as a loan or receivable.

Examples

- AG66. The following examples illustrate the application of the derecognition principles of this Standard.
- (a) Repurchase agreements and securities lending. If a financial asset is sold under an agreement to repurchase it at a fixed price or at the sale price plus a lender's return or if it is loaned under an agreement to return it to the transferor, it is not derecognized because the transferor retains substantially all the risks and rewards of ownership. If the transferee obtains the right to sell or pledge the asset, the transferor reclassifies the asset in its statement of financial position, for example, as a loaned asset or repurchases receivable.
 - (b) Repurchase agreements and securities lending—assets that are substantially the same. If a financial asset is sold under an agreement to repurchase the same or substantially the same asset at a fixed price or at the sale price plus a lender's return or if a financial asset is borrowed or loaned under an agreement to return the same or substantially the same asset to the transferor, it is not derecognized because the transferor retains substantially all the risks and rewards of ownership.
 - (c) Repurchase agreements and securities lending—right of substitution. If a repurchase agreement at a fixed repurchase price or a price equal to the sale price plus a lender's return, or a similar securities lending transaction, provides the transferee with a right to substitute assets that are similar and of equal fair value to the transferred asset at the repurchase date, the asset sold or lent under a repurchase or securities lending transaction is not derecognized because the transferor retains substantially all the risks and rewards of ownership.

- (d) Repurchase right of first refusal at fair value. If an entity sells a financial asset and retains only a right of first refusal to repurchase the transferred asset at fair value if the transferee subsequently sells it, the entity derecognizes the asset because it has transferred substantially all the risks and rewards of ownership.
- (e) Wash sale transaction. The repurchase of a financial asset shortly after it has been sold is sometimes referred to as a wash sale. Such a repurchase does not preclude derecognition provided that the original transaction met the derecognition requirements. However, if an agreement to sell a financial asset is entered into concurrently with an agreement to repurchase the same asset at a fixed price or the sale price plus a lender's return, then the asset is not derecognized.
- (f) Put options and call options that are deeply in the money. If a transferred financial asset can be called back by the transferor and the call option is deeply in the money, the transfer does not qualify for derecognition because the transferor has retained substantially all the risks and rewards of ownership. Similarly, if the financial asset can be put back by the transferee and the put option is deeply in the money, the transfer does not qualify for derecognition because the transferor has retained substantially all the risks and rewards of ownership.
- (g) Put options and call options that are deeply out of the money. A financial asset that is transferred subject only to a deep out-of-the-money put option held by the transferee or a deep out-of-the-money call option held by the transferor is derecognized. This is because the transferor has transferred substantially all the risks and rewards of ownership.
- (h) Readily obtainable assets subject to a call option that is neither deeply in the money nor deeply out of the money. If an entity holds a call option on an asset that is readily obtainable in the market and the option is neither deeply in the money nor deeply out of the money, the asset is derecognized. This is because the entity:
 - (i) Has neither retained nor transferred substantially all the risks and rewards of ownership; and
 - (ii) Has not retained control.

However, if the asset is not readily obtainable in the market, derecognition is precluded to the extent of the amount of the asset that is subject to the call option because the entity has retained control of the asset.

- (i) A not readily obtainable asset subject to a put option written by an entity that is neither deeply in the money nor deeply out of the money. If an entity transfers a financial asset that is not readily obtainable in the market, and writes a put option that is not deeply out of the money, the entity neither retains nor transfers substantially all the risks and rewards of ownership because of the written put option. The entity retains control of the asset if the put option is sufficiently valuable to prevent the transferee from selling the asset, in which case the asset continues to be recognized to the extent of the transferor's continuing involvement (see paragraph AG64). The entity transfers control

of the asset if the put option is not sufficiently valuable to prevent the transferee from selling the asset, in which case the asset is derecognized.

- (j) Assets subject to a fair value put or call option or a forward repurchase agreement. A transfer of a financial asset that is subject only to a put or call option or a forward repurchase agreement that has an exercise or repurchase price equal to the fair value of the financial asset at the time of repurchase results in derecognition because of the transfer of substantially all the risks and rewards of ownership.
- (k) Cash settled call or put options. An entity evaluates the transfer of a financial asset that is subject to a put or call option or a forward repurchase agreement that will be settled net in cash to determine whether it has retained or transferred substantially all the risks and rewards of ownership. If the entity has not retained substantially all the risks and rewards of ownership of the transferred asset, it determines whether it has retained control of the transferred asset. That the put or the call or the forward repurchase agreement is settled net in cash does not automatically mean that the entity has transferred control (see paragraphs AG59 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 RM100,000 and any individual loan could be called back but the aggregate amount of loans that could be repurchased could not exceed RM10,000, RM90,000 of the loans would qualify for derecognition.
- (m) Clean-up calls. An entity, which may be a transferor, that services transferred assets may hold a clean-up call to purchase remaining transferred assets when the amount of outstanding assets falls to a specified level at which the cost of servicing those assets becomes burdensome in relation to the benefits of servicing. Provided that such a clean-up call results in the entity neither retaining nor transferring substantially all the risks and rewards of ownership and the transferee cannot sell the assets, it precludes derecognition only to the extent of the amount of the assets that is subject to the call option.
- (n) Subordinated retained interests and credit guarantees. An entity may provide the transferee with credit enhancement by subordinating some or all of its interest retained in the transferred asset. Alternatively, an entity may provide the transferee with credit enhancement in the form of a credit guarantee that could be unlimited or limited to a specified amount. If the entity retains substantially all the risks and rewards of ownership of the transferred asset, the asset continues to be recognized in its entirety. If the entity retains some, but not substantially all, of the risks and rewards of ownership and has retained control, derecognition is precluded to the extent of the amount of cash or other assets that the entity could be required to pay.

- (o) Total return swaps. An entity may sell a financial asset to a transferee and enter into a total return swap with the transferee, whereby all of the interest payment cash flows from the underlying asset are remitted to the entity in exchange for a fixed payment or variable rate payment and any increases or declines in the fair value of the underlying asset are absorbed by the entity. In such a case, derecognition of all of the asset is prohibited.
- (p) Interest rate swaps. An entity may transfer to a transferee a fixed rate financial asset and enter into an interest rate swap with the transferee to receive a fixed interest rate and pay a variable interest rate based on a notional amount that is equal to the principal amount of the transferred financial asset. The interest rate swap does not preclude derecognition of the transferred asset provided the payments on the swap are not conditional on payments being made on the transferred asset.
- (q) Amortizing interest rate swaps. An entity may transfer to a transferee a fixed rate financial asset that is paid off over time, and enter into an amortizing interest rate swap with the transferee to receive a fixed interest rate and pay a variable interest rate based on a notional amount. If the notional amount of the swap amortizes so that it equals the principal amount of the transferred financial asset outstanding at any point in time, the swap would generally result in the entity retaining substantial prepayment risk, in which case the entity either continues to recognize all of the transferred asset or continues to recognize the transferred asset to the extent of its continuing involvement. Conversely, if the amortization of the notional amount of the swap is not linked to the principal amount outstanding of the transferred asset, such a swap would not result in the entity retaining prepayment risk on the asset. Hence, it would not preclude derecognition of the transferred asset provided the payments on the swap are not conditional on interest payments being made on the transferred asset and the swap does not result in the entity retaining any other significant risks and rewards of ownership on the transferred asset.

AG67. This paragraph illustrates the application of the continuing involvement approach when the entity's continuing involvement is in a part of a financial asset.

Assume an entity has a portfolio of prepayable loans whose coupon and effective interest rate is 10 percent and whose principal amount and amortized cost is RM 10,000. It enters into a transaction in which, in return for a payment of RM 9,115, the transferee obtains the right to RM 9,000 of any collections of principal plus interest thereon at 9.5 percent. The entity retains rights to RM1,000 of any collections of principal plus interest thereon at 10 percent, plus the excess spread of 0.5 percent on the remaining RM 9,000 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 RM 1,000 until that interest is exhausted. The fair value of the loans at the date of the transaction is RM 10,100 and the estimated fair value of the excess spread of 0.5 percent is RM 40.

The entity determines that it has transferred some significant risks and rewards of ownership (e.g., 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 RM1,000, plus (b) the subordination of that retained interest to provide credit enhancement to the transferee for credit losses.

The entity calculates that RM 9,090 (90 percent × RM 10,100) of the consideration received of RM 9,115 represents the consideration for a fully proportionate 90 percent share. The remainder of the consideration received (RM 25) represents consideration received for subordinating its retained interest to provide credit enhancement to the transferee for credit losses. In addition, the excess spread of 0.5 percent represents consideration received for the credit enhancement. Accordingly, the total consideration received for the credit enhancement is RM 65 (RM 25 + RM 40).

The entity calculates the gain or loss on the sale of the 90 percent share of cash flows. Assuming that separate fair values of the 90 percent part transferred and the 10 percent part retained are not available at the date of the transfer, the entity allocates the carrying amount of the asset in accordance with paragraph 30 as follows:

	<i>Estimated fair value</i>	<i>Percentage</i>	<i>Allocated carrying amount</i>
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 percent share of the cash flows by deducting the allocated carrying amount of the portion transferred from the consideration received, i.e., RM 90 (RM 9,090 – RM 9,000). The carrying amount of the portion retained by the entity is RM 1,000.

In addition, the entity recognizes the continuing involvement that results from the subordination of its retained interest for credit losses. Accordingly, it recognizes an asset of RM 1,000 (the maximum amount of the cash flows it would not receive under the subordination), and an associated liability of RM 1,065 (which is the maximum amount of the cash flows it would not receive under the subordination, i.e., RM 1,000 plus the fair value of the subordination of RM 65). The entity uses all of the above information to account for the transaction as follows:

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

Immediately following the transaction, the carrying amount of the asset is RM 2,040 comprising RM 1,000, representing the allocated cost of the portion retained, and RM 1,040, representing the entity's additional continuing involvement from the subordination of its retained interest for credit losses (which includes the excess spread of RM 40).

In subsequent periods, the entity recognizes the consideration received for the credit enhancement (RM 65) on a time proportion basis, accrues interest on the recognized asset using the effective interest method and recognizes any credit impairment on the recognized assets. As an example of the latter, assume that in the following year there is a credit impairment loss on the underlying loans of RM 300. The entity reduces its recognized asset by RM 600 (RM 300 relating to its retained interest and RM 300 relating to the additional continuing involvement that arises from the subordination of its retained interest for credit losses), and reduces its recognized liability by RM 300. The net result is a charge to surplus or deficit for credit impairment of RM 300.

Regular Way Purchase or Sale of a Financial Asset (paragraph 40)

- AG68. A regular way purchase or sale of financial assets is recognized using either trade date accounting or settlement date accounting as described in paragraphs AG70 and AG71. The method used is applied consistently for all purchases and sales of financial assets that belong to the same category of financial assets defined in paragraph 10. For this purpose assets that are held for trading form a separate category from assets designated at fair value through surplus or deficit.
- AG69. 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.
- AG70. 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.

- AG71. The settlement date is the date that an asset is delivered to or by an entity. Settlement date accounting refers to:
- (a) The recognition of an asset on the day it is received by the entity; and
 - (b) The derecognition of an asset and recognition of any gain or loss on disposal on the day that it is delivered by the entity.

When settlement date accounting is applied an entity accounts for any change in the fair value of the asset to be received during the period between the trade date and the settlement date in the same way as it accounts for the acquired asset. In other words, the change in value is not recognized for assets carried at cost or amortized cost; it is recognized in surplus or deficit for assets classified as financial assets at fair value through surplus or deficit; and it is recognized in net assets/equity for assets classified as available for sale.

Derecognition of a Financial Liability (paragraphs 41–44)

- AG72. 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).
- AG73. 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.
- AG74. 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.
- AG75. If a debtor pays a third party to assume an obligation and notifies its creditor that the third party has assumed its debt obligation, the debtor does not derecognize the debt obligation unless the condition in paragraph AG72(b) is met. If the debtor pays a third party to assume an obligation and obtains a legal release from its creditor, the debtor has extinguished the debt. However, if the debtor agrees to make payments on the debt to the third party or direct to its original creditor, the debtor recognizes a new debt obligation to the third party.
- AG76. 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 MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfer)*.
- AG77. Lenders will sometimes waive their right to collect debt owed by a public sector entity, for example, a national government may cancel a loan owed by a local government. This waiver of debt would constitute a legal release of the debt owing by the borrower to the lender. Where an entity’s obligations have been waived as part of a non-exchange transaction it applies the derecognition requirements of this Standard as well as paragraphs 84 to 87 of MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfer)*.
- AG78. Although legal release, whether judicially or by the creditor, results in derecognition of a liability, the entity may recognize a new liability if the derecognition criteria in paragraphs 17–39 are not met for the financial assets transferred. If those criteria are not met, the transferred assets are not derecognized, and the entity recognizes a new liability relating to the transferred assets.
- AG79. For the purpose of paragraph 42, the terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10 percent different from the discounted present value of the remaining cash flows of the original financial liability. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognized as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortized over the remaining term of the modified liability.

AG80. 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 this circumstance the debtor:

- (a) Recognizes a new financial liability based on the fair value of its obligation for the guarantee; and
- (b) Recognizes a gain or loss based on the difference between:
 - (i) Any proceeds paid; and
 - (ii) The carrying amount of the original financial liability less the fair value of the new financial liability.

Measurement (paragraphs 45–86)

Non-Exchange Revenue Transactions

AG81. The initial recognition and measurement of assets and liabilities resulting from non-exchange revenue transactions is dealt with in MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfer)*. Assets resulting from non-exchange revenue transactions can arise out of both contractual and non-contractual arrangements (see MPSAS 28, *Financial Instruments: Presentation*, paragraphs AG20 and AG21). Where these assets arise out of contractual arrangements and otherwise meet the definition of a financial instrument, they are:

- (a) Initially recognized in accordance with MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfer)*;
- (b) Initially measured:
 - (i) At fair value using the principles in MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfer)*; and
 - (ii) Taking account of transaction costs that are directly attributable to the acquisition of the financial asset in accordance with paragraph 45 of this Standard, where the asset is subsequently measured other than at fair value through surplus or deficit.

(See paragraphs IE46 to IE50 accompanying this Standard).

Initial Measurement of Financial Assets and Financial Liabilities (paragraph 45)

AG82. The fair value of a financial instrument on initial recognition is normally the transaction price (i.e., the fair value of the consideration given or received, see also paragraph AG108). However, if part of the consideration given or received is for something other than the financial instrument, the fair value of the financial instrument is estimated, using a valuation technique (see paragraphs AG106–AG112). For example, the fair value of a long-term loan or receivable that carries no interest can be estimated as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating. Any additional amount lent is an expense or a reduction of revenue unless it qualifies for recognition as some other type of asset.

- AG83. If an entity originates a loan that bears an off-market interest rate (e.g., 5 percent when the market rate for similar loans is 8 percent), and receives an up-front fee as compensation, the entity recognizes the loan at its fair value, i.e., net of the fee it receives. The entity accretes the discount to surplus or deficit using the effective interest rate method.

Concessionary Loans

- AG84. Concessionary loans are granted to or received by an entity at below market terms. Examples of concessionary loans granted by entities 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.
- AG85. 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.
- AG86. 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 MPSAS 29, *Financial Instruments: Recognition and Measurement*.
- AG87. As concessionary loans are granted or received at below market terms, the transaction price on initial recognition of the loan may not be its fair value. At initial recognition, an entity therefore analyzes the substance of the loan granted or received into its component parts, and accounts for those components using the principles in paragraphs AG88 and AG89 below.
- AG88. An entity firstly assesses whether the substance of the concessionary loan is in fact a loan, a grant, a contribution from owners or a combination thereof, by applying the principles in MPSAS 28, *Financial Instruments: Presentation*, and paragraphs 42–58 of MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfer)*. 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 AG101–AG115. 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 AG82).
- AG89. 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 MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfer)*.

- (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 MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfer)*, as well as paragraphs IE40 to IE41 accompanying this Standard.

- AG90. After initial recognition, an entity subsequently measures concessionary loans using the categories of financial instruments defined in paragraph 10.

Non-Exchange Revenue Transactions

- AG91. [Deleted]

Valuing Financial Guarantees Issued Through a Non-Exchange Transaction

- AG92. Only contractual financial guarantees (or guarantees that are in substance, contractual) are within the scope of this Standard (See AG3 and AG4 of MPSAS 28, *Financial Instruments: Presentation*). 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.
- AG93. In paragraph 10 a “financial guarantee contract” is defined as “a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.” Under the requirements of this Standard, financial guarantee contracts, like other financial assets and financial liabilities, are required to be initially recognized at fair value. Paragraphs 50–52 of this Standard provide commentary and guidance on determining fair value and this is complemented by Application Guidance in paragraphs AG101–AG115. Subsequent measurement for financial guarantee contracts is at the higher of the amount determined in accordance with MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, and the amount initially recognized less, when appropriate, cumulative amortization in accordance with MPSAS 9, *Revenue from Exchange Transactions*.
- AG94. In the public sector, guarantees are frequently provided by way of non-exchange transactions, i.e., at no or nominal consideration. This type of guarantee is provided generally to further the entity’s economic and social objectives. Such purposes include supporting infrastructure projects, supporting corporate entities at times of economic distress, guaranteeing the bond issues of entities in other tiers of governments and the loans of employees to finance motor vehicles that are to be used for performance of their duties as employees. Where there is consideration for a financial guarantee, an entity should determine whether that consideration arises from an exchange transaction and whether the consideration represents a fair value. If the consideration does represent a fair value, entities should recognize the financial guarantee at the amount of the consideration. Subsequent measurement should be at the higher of the amount determined in accordance with MPSAS 19, *Provisions, Contingent Liabilities and*

Contingent Assets, and the amount initially recognized, less, when appropriate, cumulative amortization recognized in accordance with MPSAS 9, *Revenue from Exchange Transactions*. 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.

- AG95. At initial recognition, where no fee is charged or where the consideration is not fair value, an entity firstly considers whether there are quoted prices available in an active market for financial guarantee contracts directly equivalent to that entered into. Evidence of an active market includes recent arm's length market transactions between knowledgeable willing parties, and reference to the current fair value of another financial guarantee contract that is substantially the same as that provided at nil or nominal consideration by the issuer. The fact that a financial guarantee contract has been entered into at no consideration by the debtor to the issuer is not, of itself, conclusive evidence of the absence of an active market. Guarantees may be available from commercial issuers, but a public sector entity may agree to enter into a financial guarantee contract for a number of non-commercial reasons. For example, if a debtor is unable to afford a commercial fee, and initiation of a project in fulfillment of one of the entity's social or policy objectives would be put at risk unless a financial guarantee contract is issued, it may approach a public sector entity or government to issue a financial guarantee contract
- AG96. Where there is no active market for a directly equivalent guarantee contract; the entity considers whether a valuation technique other than observation of an active market is available and provides a reliable measure of fair value. Such a valuation technique may rely on mathematical models which consider financial risk. For example, National Government W guarantees a bond issue of Municipality X. As Municipality X has a government guarantee backing its bond issue, its bonds have a lower coupon than if they were not secured by a government guarantee. This is because the guarantee lowers the risk profile of the bonds for investors. The guarantee fee could be determined by using the credit spread between what the coupon rate would have been had the issue not been backed by a government guarantee and the rate with the guarantee in place. Where a fair value is obtainable either by observation of an active market or through another valuation technique, the entity recognizes the financial guarantee at that fair value in the statement of financial position and recognizes an expense of an equivalent amount in the statement of financial performance. When using a valuation technique that is not based on observation of an active market an entity needs to satisfy itself that the output of any model is reliable and understandable.
- AG97. 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 apply the principles of MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, to the financial guarantee contract at initial recognition. The entity assesses whether a present obligation has arisen as a result of a past event related to a financial guarantee contract whether it is probable that such a present obligation will result in a cash outflow in accordance with the terms of the contract and whether a reliable estimate can be made of the outflow. It is possible that a present obligation related to a financial guarantee contract will arise at initial recognition where, for example, an entity enters into a financial guarantee contract to guarantee loans to a large number of small enterprises and, based on past experience, is aware that a proportion of these enterprises will default.

Subsequent Measurement of Financial Assets (paragraphs 47 and 48)

- AG98. If a financial instrument that was previously recognized as a financial asset is measured at fair value and its fair value falls below zero, it is a financial liability measured in accordance with paragraph 49.
- AG99. The following example illustrates the accounting for transaction costs on the initial and subsequent measurement of an available-for-sale financial asset. An asset is acquired for RM100 plus a purchase commission of RM2. Initially, the asset is recognized at RM102. The end of the reporting period occurs one day later, when the quoted market price of the asset is RM100. If the asset were sold, a commission of RM3 would be paid. On that date, the asset is measured at RM100 (without regard to the possible commission on sale) and a loss of RM2 is recognized in net assets/equity. If the available-for-sale financial asset has fixed or determinable payments, the transaction costs are amortized to surplus or deficit using the effective interest method. If the available-for-sale financial asset does not have fixed or determinable payments, the transaction costs are recognized in surplus or deficit when the asset is derecognized or becomes impaired.
- AG100. Instruments that are classified as loans and receivables are measured at amortized cost without regard to the entity's intention to hold them to maturity.

Fair Value Measurement Considerations (paragraphs 50–52)

- AG101. 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.
- AG102. 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

- AG103. 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.

AG104. 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.

AG105. 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

AG106. 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.

AG107. 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.

AG108. 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. The best evidence of the fair value of a financial instrument at initial recognition, in an exchange transaction, is the transaction price (i.e., the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets.

- AG109. The subsequent measurement of the financial asset or financial liability and the subsequent recognition of gains and losses shall be consistent with the requirements of this Standard. The application of paragraph AG108 may result in no gain or loss being recognized on the initial recognition of a financial asset or financial liability. In such a case, MPSAS 29, *Financial Instruments: Recognition and Measurement*, requires that a gain or loss shall be recognized after initial recognition only to the extent that it arises from a change in a factor (including time) that market participants would consider in setting a price.
- AG110. 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.
- AG111. 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.

- AG112. 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. Short-term receivables and payables with no stated interest rate may be measured at the original invoice amount if the effect of discounting is immaterial.

No Active Market: Equity Instruments

- AG113. The fair value of investments in equity instruments that do not have a quoted market price in an active market and derivatives that are linked to and must be settled by delivery of such an unquoted equity instrument (see paragraphs 48(c) and 49) is reliably measurable if:
- (a) The variability in the range of reasonable fair value estimates is not significant for that instrument; or
 - (b) The probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value.

- AG114. There are many situations in which the variability in the range of reasonable fair value estimates of investments in equity instruments that do not have a quoted market price and derivatives that are linked to and must be settled by delivery of such an unquoted equity instrument (see paragraphs 48(c) and 49) is likely not to be significant. Normally it is possible to estimate the fair value of a financial asset that an entity has acquired from an outside party. However, if the range of reasonable fair value estimates is significant and the probabilities of the various estimates cannot be reasonably assessed, an entity is precluded from measuring the instrument at fair value.

Inputs to Valuation Techniques

- AG115. 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 52).
- (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.

Gains and Losses (paragraphs 64–66)

AG116. An entity applies MPSAS 4, *The Effect of Changes in Foreign Exchange Rates*, to financial assets and financial liabilities that are monetary items in accordance with MPSAS 4, *The Effect of Changes in Foreign Exchange Rates*, and denominated in a foreign currency. Under MPSAS 4, *The Effect of Changes in Foreign Exchange Rates*, any foreign exchange gains and losses on monetary assets and monetary liabilities are recognized in surplus or deficit. An exception is a monetary item that is designated as a hedging instrument in either a cash flow hedge (see paragraphs 106–112) or a hedge of a net investment (see paragraph 113). For the purpose of recognizing foreign exchange gains and losses under MPSAS 4, *The Effect of Changes in Foreign Exchange Rates*, a monetary available-for-sale financial asset is treated as if it were carried at amortized cost in the foreign currency. Accordingly, for such a financial asset, exchange differences resulting from changes in amortized cost are recognized in surplus or deficit and other changes in carrying amount are recognized in accordance with paragraph 64(b). For available-for-sale financial assets that are not monetary items under

MPSAS 4, *The Effect of Changes in Foreign Exchange Rates*, (e.g., equity instruments), the gain or loss that is recognized directly in net assets/equity under paragraph 64(b) includes any related foreign exchange component. 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 recognized in surplus or deficit.

Impairment and Uncollectibility of Financial Assets (paragraphs 67–79)

Financial Assets Carried at Amortized Cost (paragraphs 72–74)

- AG117. Impairment of a financial asset carried at amortized cost is measured using the financial instrument's original effective interest rate because discounting at the current market rate of interest would, in effect, impose fair value measurement on financial assets that are otherwise measured at amortized cost. If the terms of a loan, receivable or held-to-maturity investment are renegotiated or otherwise modified because of financial difficulties of the borrower or issuer, impairment is measured using the original effective interest rate before the modification of terms. Cash flows relating to short-term receivables are not discounted if the effect of discounting is immaterial. If a loan, receivable or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss under paragraph 72 is the current effective interest rate(s) determined under the contract. As a practical expedient, a creditor may measure impairment of a financial asset carried at amortized cost on the basis of an instrument's fair value using an observable market price. The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.
- AG118. The process for estimating impairment considers all credit exposures, not only those of low credit quality. For example, if an entity uses an internal credit grading system it considers all credit grades, not only those reflecting a severe credit deterioration.
- AG119. The process for estimating the amount of an impairment loss may result either in a single amount or in a range of possible amounts. In the latter case, the entity recognizes an impairment loss equal to the best estimate within the range taking into account all relevant information available before the financial statements are issued about conditions existing at the end of the reporting period (paragraph 47 of MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, contains guidance on how to determine the best estimate in a range of possible outcomes).
- AG120. For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics that are indicative of the debtors' ability to pay all amounts due according to the contractual terms (e.g., on the basis of a credit risk evaluation or grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors.) The characteristics chosen are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated. However, loss probabilities and other loss statistics differ at a group level between (a) assets that have been individually evaluated for impairment and found not to be impaired and (b) assets that have not been individually evaluated for impairment, with the result that a different amount of impairment may be required. If an entity does not have a group of assets with similar risk characteristics, it does not make the additional assessment.

- AG121. Impairment losses recognized on a group basis represent an interim step pending the identification of impairment losses on individual assets in the group of financial assets that are collectively assessed for impairment. As soon as information is available that specifically identifies losses on individually impaired assets in a group, those assets are removed from the group.
- AG122. Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Entities that have no entity-specific loss experience or insufficient experience, use peer group experience for comparable groups of financial assets. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect and are 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 incurred losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.
- AG123. As an example of applying paragraph AG122, an entity may determine, on the basis of historical experience, that one of the main causes of default on loans is the death of the borrower. The entity may observe that the death rate is unchanged from one year to the next. Nevertheless, some of the borrowers in the entity's group of loans may have died in that year, indicating that an impairment loss has occurred on those loans, even if, at the year-end, the entity is not yet aware which specific borrowers have died. It would be appropriate for an impairment loss to be recognized for these "incurred but not reported" losses. However, it would not be appropriate to recognize an impairment loss for deaths that are expected to occur in a future period, because the necessary loss event (the death of the borrower) has not yet occurred.
- AG124. When using historical loss rates in estimating future cash flows, it is important that information about historical loss rates is applied to groups that are defined in a manner consistent with the groups for which the historical loss rates were observed. Therefore, the method used should enable each group to be associated with information about past loss experience in groups of assets with similar credit risk characteristics and relevant observable data that reflect current conditions.
- AG125. Formula-based approaches or statistical methods may be used to determine impairment losses in a group of financial assets (e.g., for smaller balance loans) as long as they are consistent with the requirements in paragraphs 72–74 and AG120–AG124. Any model used would incorporate the effect of the time value of money, consider the cash flows for all of the remaining life of an asset (not only the next year), consider the age of the loans within the portfolio and not give rise to an impairment loss on initial recognition of a financial asset.

Interest Revenue after Impairment Recognition

- AG126. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest revenue is thereafter recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Hedging (paragraphs 80–113)

Hedging Instruments (paragraphs 81–86)

Qualifying Instruments (paragraphs 81 and 82)

- AG127. The potential loss on an option that an entity writes could be significantly greater than the potential gain in value of a related hedged item. In other words, a written option is not effective in reducing the surplus or deficit exposure of a hedged item. Therefore, 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 (e.g., a written call option used to hedge a callable liability). In contrast, a purchased option has potential gains equal to or greater than losses and therefore has the potential to reduce surplus or deficit exposure from changes in fair values or cash flows. Accordingly, it can qualify as a hedging instrument.
- AG128. A held-to-maturity investment carried at amortized cost may be designated as a hedging instrument in a hedge of foreign currency risk.
- AG129. An investment in an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured or a derivative that is linked to and must be settled by delivery of such an unquoted equity instrument (see paragraphs 48(c) and 49) cannot be designated as a hedging instrument.
- AG130. An entity's own equity instruments are not financial assets or financial liabilities of the entity and therefore cannot be designated as hedging instruments.

Hedged items (paragraphs 87–94)

Qualifying items (paragraphs 87–89)

- AG131. A firm commitment to acquire an entity or an integrated set of activities in a public sector 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.
- AG132. An equity method investment cannot be a hedged item in a fair value hedge because the equity method recognizes in surplus or deficit the investor's share of the associate's surplus or deficit, rather than changes in the investment's fair value. For a similar reason, an investment in a consolidated controlled entity cannot be a hedged item in a fair value hedge because consolidation recognizes in surplus or deficit the controlled entity's surplus or deficit, rather than 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.
- AG133. Paragraph 89 states that in consolidated financial statements the foreign currency risk of a highly probable forecast transaction within the economic entity may qualify as a hedged item in a cash flow hedge, provided the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated surplus or deficit. For this purpose an entity can be a controlling entity, controlled entity, associate, joint venture or branch. If the foreign currency risk of a forecast transaction within the economic entity does not affect consolidated surplus or deficit,

the transaction cannot qualify as a hedged item. This is usually the case for royalty payments, interest payments or management charges between members of the same economic entity unless there is a related external transaction. However, when the foreign currency risk of a forecast transaction within the economic entity will affect consolidated surplus or deficit, the transaction can qualify as a hedged item. An example is forecast sales or purchases of inventories between members of the same economic entity if there is an onward sale of the inventory to a party external to the economic entity. Similarly, a forecast sale of property, plant and equipment within the economic entity from the entity that constructed it to the entity that will use the property, plant and equipment in its operations may affect consolidated surplus or deficit. This could occur, for example, because the plant and equipment will be depreciated by the purchasing entity and the amount initially recognized for the plant and equipment may change if the forecast transaction within the economic entity is denominated in a currency other than the functional currency of the purchasing entity.

- AG134. If a hedge of a forecast transaction within the economic entity qualifies for hedge accounting, any gain or loss that is recognized directly in net assets/equity in accordance with paragraph 106(a) shall be reclassified into surplus or deficit in the same period or periods during which the foreign currency risk of the hedged transaction affects consolidated surplus or deficit.
- AG135. An entity can designate all changes in the cash flows or fair value of a hedged item in a hedging relationship. 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, only cash flow losses that result from an increase in the price above the specified level are designated. The hedged risk does not include the time value of a purchased option because the time value is not a component of the forecast transaction that affects surplus or deficit (paragraph 96(b)).

Designation of Financial Items as Hedged Items (paragraphs 90 and 91)

- AG136. If a portion of the cash flows of a financial asset or financial liability is designated as the hedged item, that designated portion must be less than the total cash flows of the asset or liability. For example, in the case of a liability whose effective interest rate is below a market related interest rate, an entity cannot designate (a) a portion of the liability equal to the principal amount plus interest at a market related rate and (b) a negative residual portion. However, the entity may designate all of the cash flows of the entire financial asset or financial liability as the hedged item and hedge them for only one particular risk (e.g., only for changes that are attributable to changes in the market rate). For example, in the case of a financial liability whose effective interest rate is 100 basis points below the market rate, an entity can designate as the hedged item the entire liability (i.e., principal plus interest at the market rate minus 100 basis points) and hedge the change in the fair value or cash flows of that entire liability that is attributable to changes in the market rate. The entity may also choose a hedge ratio of other than one to one in order to improve the effectiveness of the hedge as described in paragraph AG140.
- AG137. In addition, if a fixed rate financial instrument is hedged sometime after its origination and interest rates have changed in the meantime, the entity can designate a portion 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 it first designates the hedged item. For example, assume an entity originates a fixed rate financial asset of RM100 that has an effective interest rate of 6 percent at a time when the market rate is 4 percent. It begins to hedge that asset some time later when the market rate has increased to 8 percent and the fair value of the asset has decreased to RM90. The entity calculates that if it had purchased the asset on the date it first designates it as the hedged item for its then fair value of RM90, the effective yield would have been 9.5 percent. Because the market rate is less than this effective yield, the entity can designate a portion of the market rate of 8 percent that consists partly of the contractual interest cash flows and partly of the difference between the current fair value (i.e., RM90) and the amount repayable on maturity (i.e., RM100).

AG138. Paragraph 90 permits an entity to designate something other than the entire fair value change or cash flow variability of a financial instrument. For example:

- (a) All of the cash flows of a financial instrument may be designated for cash flow or fair value changes attributable to some (but not all) risks; or
- (b) Some (but not all) of the cash flows of a financial instrument may be designated for cash flow or fair value changes attributable to all or only some risks (i.e., a “portion” of the cash flows of the financial instrument may be designated for changes attributable to all or only some risks).

AG139. To be eligible for hedge accounting, the designated risks and portions must be separately identifiable components of the financial instrument, and changes in the cash flows or fair value of the entire financial instrument arising from changes in the designated risks and portions must be reliably measurable. For example:

- (a) For a fixed rate financial instrument hedged for changes in fair value attributable to changes in a risk-free or benchmark interest rate, the risk-free or benchmark rate is normally regarded as both a separately identifiable component of the financial instrument and reliably measurable.
- (b) Inflation is not separately identifiable and reliably measurable and cannot be designated as a risk or a portion of a financial instrument unless the requirements in (c) are met.

A contractually specified inflation portion of the cash flows of a recognized inflation-linked bond (assuming 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 portion.

Designation of Non-Financial Items as Hedged Items (paragraph 92)

AG140. Changes in the price of an ingredient or component of a non-financial asset or non-financial liability generally do not have a predictable, separately measurable effect on the price of the item that is comparable to the effect of, say, a change in market interest rates on the price of a bond. Thus, a non-financial asset or non-financial liability is a hedged item only in its entirety or for foreign exchange risk. If there is a difference between the terms of the hedging instrument and the hedged item (such as for a hedge of the forecast purchase of Brent Crude oil using a forward contract to purchase Light Sweet Crude oil on otherwise similar terms),

the hedging relationship nonetheless can qualify as a hedge relationship provided all the conditions in paragraph 98 are met, including that the hedge is expected to be highly effective. For this purpose, the amount of the hedging instrument may be greater or less than that of the hedged item if this improves the effectiveness of the hedging relationship. For example, a regression analysis could be performed to establish a statistical relationship between the hedged item (e.g., a transaction in Brent Crude oil) and the hedging instrument (e.g., a transaction in Light Sweet Crude oil). If there is a valid statistical relationship between the two variables (i.e., between the unit prices of Brent Crude oil and Light Sweet Crude oil), the slope of the regression line can be used to establish the hedge ratio that will maximize expected effectiveness. For example, if the slope of the regression line is 1.02, a hedge ratio based on 0.98 quantities of hedged items to 1.00 quantities of the hedging instrument maximizes expected effectiveness. However, the hedging relationship may result in ineffectiveness that is recognized in surplus or deficit during the term of the hedging relationship.

Designation of Groups of Items as Hedged Items (paragraphs 93 and 94)

- AG141. A hedge of an overall net position (e.g., the net of all fixed rate assets and fixed rate liabilities with similar maturities), rather than of a specific hedged item, does not qualify for hedge accounting. However, almost the same effect on surplus or deficit of hedge accounting for this type of hedging relationship can be achieved by designating as the hedged item part of the underlying items. For example, if a bank has RM100 of assets and RM90 of liabilities with risks and terms of a similar nature and hedges the net RM10 exposure, it can designate as the hedged item RM10 of those assets. This designation can be used if such assets and liabilities are fixed rate instruments, in which case it is a fair value hedge, or if they are variable rate instruments, in which case it is a cash flow hedge. Similarly, if an entity has a firm commitment to make a purchase in a foreign currency of RM100 and a firm commitment to make a sale in the foreign currency of RM90, it can hedge the net amount of RM10 by acquiring a derivative and designating it as a hedging instrument associated with RM10 of the firm purchase commitment of RM100.

Hedge Accounting (paragraphs 95–113)

- AG142. An example of a fair value hedge is a hedge of exposure to changes in the fair value of a fixed rate debt instrument as a result of changes in interest rates. Such a hedge could be entered into by the issuer or by the holder.
- AG143. An example of a cash flow hedge is the use of a swap to change floating rate debt to fixed rate debt (i.e., a hedge of a future transaction where the future cash flows being hedged are the future interest payments).
- AG144. A hedge of a firm commitment (e.g., a hedge of the change in fuel price relating to an unrecognized contractual commitment by an electric utility to purchase fuel at a fixed price) is a hedge of an exposure to a change in fair value. Accordingly, such a hedge is a fair value hedge. However, under paragraph 97 a hedge of the foreign currency risk of a firm commitment could alternatively be accounted for as a cash flow hedge.

Assessing Hedge Effectiveness

AG145. A hedge is regarded as highly effective only if both of the following conditions are met:

- (a) At the inception of the hedge and in subsequent periods, the hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. Such an expectation can be demonstrated in various ways, including a comparison of past changes in the fair value or cash flows of the hedged item that are attributable to the hedged risk with past changes in the fair value or cash flows of the hedging instrument, or by demonstrating a high statistical correlation between the fair value or cash flows of the hedged item and those of the hedging instrument. The entity may choose a hedge ratio of other than one to one in order to improve the effectiveness of the hedge as described in paragraph AG140.
- (b) The actual results of the hedge are within a range of 80-125 percent. For example, if actual results are such that the loss on the hedging instrument is RM120 and the gain on the cash instrument is RM100, offset can be measured by $120/100$, which is 120 percent, or by $100/120$, which is 83 percent. In this example, assuming the hedge meets the condition in (a), the entity would conclude that the hedge has been highly effective.

AG146. Effectiveness is assessed, at a minimum, at the time an entity prepares its annual financial statements.

AG147. This Standard does not specify a single method for assessing hedge effectiveness. The method an entity adopts for assessing hedge effectiveness depends on its risk management strategy. For example, if the entity's risk management strategy is to adjust the amount of the hedging instrument periodically to reflect changes in the hedged position, the entity needs to demonstrate that the hedge is expected to be highly effective only for the period until the amount of the hedging instrument is next adjusted. In some cases, an entity adopts different methods for different types of hedges. An entity's documentation of its hedging strategy includes its procedures for assessing effectiveness. Those procedures state whether the assessment includes all of the gain or loss on a hedging instrument or whether the instrument's time value is excluded.

AG148. If an entity hedges less than 100 percent of the exposure on an item, such as 85 percent, it shall designate the hedged item as being 85 percent of the exposure and shall measure ineffectiveness based on the change in that designated 85 percent exposure. However, when hedging the designated 85 percent exposure, the entity may use a hedge ratio of other than one to one if that improves the expected effectiveness of the hedge, as explained in paragraph AG140.

AG149. If the principal terms of the hedging instrument and of the hedged asset, liability, firm commitment or highly probable forecast transaction are the same, the changes in fair value and cash flows attributable to the risk being hedged may be likely to offset each other fully, both when the hedge is entered into and afterwards. For example, an interest rate swap is likely to be an effective hedge if the notional and principal amounts, term, repricing dates, dates of interest and principal receipts and payments, and basis for measuring interest rates are the same for the hedging instrument and the hedged item. In addition, a hedge of a highly probable forecast purchase of a commodity with a forward contract is likely to be highly effective if:

- (a) The forward contract is for the purchase of the same quantity of the same commodity at the same time and location as the hedged forecast purchase;
- (b) The fair value of the forward contract at inception is zero; and
- (c) Either the change in the discount or premium on the forward contract is excluded from the assessment of effectiveness and recognized in surplus or deficit or the change in expected cash flows on the highly probable forecast transaction is based on the forward price for the commodity.

AG150. Sometimes the hedging instrument offsets only part of the hedged risk. For example, a hedge would not be fully effective if the hedging instrument and hedged item are denominated in different currencies that do not move in tandem. Also, a hedge of interest rate risk using a derivative would not be fully effective if part of the change in the fair value of the derivative is attributable to the counterparty's credit risk.

AG151. To qualify for hedge accounting, the hedge must relate to a specific identified and designated risk, and not merely to the entity's general operational risks, and must ultimately affect the entity's surplus or deficit. A hedge of the risk of obsolescence of a physical asset or the risk of legislative changes relating to the rehabilitation of damage to the environment is not eligible for hedge accounting; effectiveness cannot be measured because those risks are not measurable reliably.

AG152. Paragraph 83(a) permits an entity to separate the intrinsic value and time value of an option contract and designate as the hedging instrument only the change in the intrinsic value of the option contract. Such a designation may result in a hedging relationship that is perfectly effective in achieving offsetting changes in cash flows attributable to a hedged one-sided risk of a forecast transaction, if the principal terms of the forecast transaction and hedging instrument are the same.

AG153. If an entity designates a purchased option in its entirety as the hedging instrument of a one-sided risk arising from a forecast transaction, the hedging relationship will not be perfectly effective. This is because the premium paid for the option includes time value and, as stated in paragraph AG135, a designated one-sided risk does not include the time value of an option. Therefore, in this situation, there will be no offset between the cash flows relating to the time value of the option premium paid and the designated hedged risk.

AG154. In the case of interest rate risk, hedge effectiveness may be assessed by preparing a maturity schedule for financial assets and financial liabilities that shows the net interest rate exposure for each time period, provided that the net exposure is associated with a specific asset or liability (or a specific group of assets or liabilities or a specific portion of them) giving rise to the net exposure, and hedge effectiveness is assessed against that asset or liability.

AG155. In assessing the effectiveness of a hedge, an entity generally considers the time value of money. The fixed interest rate on a hedged item need not exactly match the fixed interest rate on a swap designated as a fair value hedge. Nor does the variable interest rate on an interest-bearing asset or liability need to be the same as the variable interest rate on a swap designated as a cash flow hedge. A swap's fair value derives from its net settlements. The fixed and variable rates on a swap can be changed without affecting the net settlement if both are changed by the same amount.

AG156. If an entity does not meet hedge effectiveness criteria, the entity discontinues hedge accounting from the last date on which compliance with hedge effectiveness was demonstrated. However, if the entity identifies the event or change in circumstances that caused the hedging relationship to fail the effectiveness criteria, and demonstrates that the hedge was effective before the event or change in circumstances occurred, the entity discontinues hedge accounting from the date of the event or change in circumstances.

Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk

AG157. For a fair value hedge of interest rate risk associated with a portfolio of financial assets or financial liabilities, an entity would meet the requirements of this Standard if it complies with the procedures set out in (a)–(i) and paragraphs AG158–AG175 below.

- (a) As part of its risk management process the entity identifies a portfolio of items whose interest rate risk it wishes to hedge. The portfolio may comprise only assets, only liabilities or both assets and liabilities. The entity may identify two or more portfolios (e.g., the entity may group its available-for-sale assets into a separate portfolio), in which case it applies the guidance below to each portfolio separately.
- (b) The entity analyses the portfolio into repricing time periods based on expected, rather than contractual, repricing dates. The analysis into repricing time periods may be performed in various ways including scheduling cash flows into the periods in which they are expected to occur, or scheduling notional principal amounts into all periods until repricing is expected to occur.
- (c) On the basis of this analysis, the entity decides the amount it wishes to hedge. The entity designates as the hedged item an amount of assets or liabilities (but not a net amount) from the identified portfolio equal to the amount it wishes to designate as being hedged. This amount also determines the percentage measure that is used for testing effectiveness in accordance with paragraph AG169(b).
- (d) The entity designates the interest rate risk it is hedging. This risk could be a portion of the interest rate risk in each of the items in the hedged position, such as a benchmark interest rate (e.g., a swap rate).
- (e) The entity designates one or more hedging instruments for each repricing time period.
- (f) Using the designations made in (c)–(e) above, the entity assesses at inception and in subsequent periods, whether the hedge is expected to be highly effective during the period for which the hedge is designated.
- (g) Periodically, the entity measures the change in the fair value of the hedged item (as designated in (c)) that is attributable to the hedged risk (as designated in (d)), on the basis of the expected repricing dates determined in (b). Provided that the hedge is determined actually to have been highly effective when assessed using the entity's documented method of assessing effectiveness, the entity recognizes the change in fair value of the hedged item as a gain or loss in surplus or deficit and in one of two line items in the statement of financial position as described in paragraph 100. The change in fair value need not be allocated to individual assets or liabilities.

- (h) The entity measures the change in fair value of the hedging instrument(s) (as designated in (e)) and recognizes it as a gain or loss in surplus or deficit. The fair value of the hedging instrument(s) is recognized as an asset or liability in the statement of financial position.
- (i) Any ineffectiveness will be recognized in surplus or deficit as the difference between the change in fair value referred to in (g) and that referred to in (h) (effectiveness is measured using the same materiality considerations as in other MPSASs).

AG158. This approach is described in more detail below. The approach shall be applied only to a fair value hedge of the interest rate risk associated with a portfolio of financial assets or financial liabilities.

AG159. The portfolio identified in paragraph AG157(a) could contain assets and liabilities. Alternatively, it could be a portfolio containing only assets, or only liabilities. The portfolio is used to determine the amount of the assets or liabilities the entity wishes to hedge. However, the portfolio is not itself designated as the hedged item.

AG160. In applying paragraph AG157(b), the entity determines the expected repricing date of an item as the earlier of the dates when that item is expected to mature or to reprice to market rates. The expected repricing dates are estimated at the inception of the hedge and throughout the term of the hedge, based on historical experience and other available information, including information and expectations regarding prepayment rates, interest rates and the interaction between them. Entities that have no entity-specific experience or insufficient experience use peer group experience for comparable financial instruments. These estimates are reviewed periodically and updated in the light of experience. In the case of a fixed rate item that is prepayable, the expected repricing date is the date on which the item is expected to prepay unless it reprices to market rates on an earlier date. For a group of similar items, the analysis into time periods based on expected repricing dates may take the form of allocating a percentage of the group, rather than individual items, to each time period. An entity may apply other methodologies for such allocation purposes. For example, it may use a prepayment rate multiplier for allocating amortizing loans to time periods based on expected repricing dates. However, the methodology for such an allocation shall be in accordance with the entity's risk management procedures and objectives.

AG161. As an example of the designation set out in paragraph AG157(c), if in a particular repricing time period an entity estimates that it has fixed rate assets of RM 100 and fixed rate liabilities of RM 80 and decides to hedge all of the net position of RM 20, it designates as the hedged item assets in the amount of RM 20 (a portion of the assets is designated as the Standard permits an entity to designate any amount of the available qualifying assets or liabilities, i.e., in this example any amount of the assets between RM 0 and RM 100). The designation is expressed as an "amount of a currency" (e.g., an amount of RM, dollars, euro, pounds or rand) rather than as individual assets. It follows that all of the assets (or liabilities) from which the hedged amount is drawn – i.e., all of the RM 100 of assets in the above example – must be:

- (a) Items whose fair value changes in response to changes in the interest rate being hedged; and

- (b) Items that could have qualified for fair value hedge accounting if they had been designated as hedged individually. In particular, because paragraph 52 of the Standard specifies that the fair value of a financial liability with a demand feature (such as demand deposits and some types of time deposits) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid, such an item cannot qualify for fair value hedge accounting for any time period beyond the shortest period in which the holder can demand payment. In the above example, the hedged position is an amount of assets. Hence, such liabilities are not a part of the designated hedged item, but are used by the entity to determine the amount of the asset that is designated as being hedged. If the position the entity wished to hedge was an amount of liabilities, the amount representing the designated hedged item must be drawn from fixed rate liabilities other than liabilities that the entity can be required to repay in an earlier time period, and the percentage measure used for assessing hedge effectiveness in accordance with paragraph AG169(b) would be calculated as a percentage of these other liabilities. For example, assume that an entity estimates that in a particular repricing time period it has fixed rate liabilities of RM 100, comprising RM 40 of demand deposits and RM 60 of liabilities with no demand feature, and RM 70 of fixed rate assets. If the entity decides to hedge all of the net position of RM 30, it designates as the hedged item liabilities of RM 30 or 50 percent ($\text{RM } 30 / (\text{RM } 100 - \text{RM } 40) = 50 \text{ percent}$) of the liabilities with no demand feature.

AG162. The entity also complies with the other designation and documentation requirements set out in paragraph 98(a). For a portfolio hedge of interest rate risk, this designation and documentation specifies the entity's policy for all of the variables that are used to identify the amount that is hedged and how effectiveness is measured, including the following:

- (a) Which assets and liabilities are to be included in the portfolio hedge and the basis to be used for removing them from the portfolio.
- (b) How the entity estimates repricing dates, including what interest rate assumptions underlie estimates of prepayment rates and the basis for changing those estimates. The same method is used for both the initial estimates made at the time an asset or liability is included in the hedged portfolio and for any later revisions to those estimates.
- (c) The number and duration of repricing time periods.
- (d) How often the entity will test effectiveness and which of the two methods in paragraph AG169 it will use.
- (e) The methodology used by the entity to determine the amount of assets or liabilities that are designated as the hedged item and, accordingly, the percentage measure used when the entity tests effectiveness using the method described in paragraph AG169(b).
- (f) When the entity tests effectiveness using the method described in paragraph AG169(b), whether the entity will test effectiveness for each repricing time period individually, for all time periods in aggregate, or by using some combination of the two.

The policies specified in designating and documenting the hedging relationship shall be in accordance with the entity's risk management procedures and objectives. Changes in policies shall not be made arbitrarily. They shall be justified on the basis of changes in market conditions and other factors and be founded on and consistent with the entity's risk management procedures and objectives.

AG163. The hedging instrument referred to in paragraph AG157(e) may be a single derivative or a portfolio of derivatives all of which contain exposure to the hedged interest rate risk designated in paragraph AG157(d). Such a portfolio of derivatives may contain offsetting risk positions. However, it may not include written options or net written options, because paragraph 86 of the Standard and paragraph AG127 do not permit such options to be designated as hedging instruments (except when a written option is designated as an offset to a purchased option). If the hedging instrument hedges the amount designated in paragraph AG157(c) for more than one repricing time period, it is allocated to all of the time periods that it hedges. However, the whole of the hedging instrument must be allocated to those repricing time periods because paragraph 84 of the Standard does not permit a hedging relationship to be designated for only a portion of the time period during which a hedging instrument remains outstanding.

AG164. When the entity measures the change in the fair value of a prepayable item in accordance with paragraph AG157(g), a change in interest rates affects the fair value of the prepayable item in two ways: it affects the fair value of the contractual cash flows and the fair value of the prepayment option that is contained in a prepayable item. Paragraph 90 of the Standard permits an entity to designate a portion of a financial asset or financial liability, sharing a common risk exposure, as the hedged item, provided effectiveness can be measured. For prepayable items, paragraph 91 permits this to be achieved by designating the hedged item in terms of the change in the fair value that is attributable to changes in the designated interest rate on the basis of expected, rather than contractual, repricing dates. However, the effect that changes in the hedged interest rate have on those expected repricing dates shall be included when determining the change in the fair value of the hedged item. Consequently, if the expected repricing dates are revised (e.g., to reflect a change in expected prepayments), or if actual repricing dates differ from those expected, ineffectiveness will arise as described in paragraph AG169. Conversely, changes in expected repricing dates that:

- (a) Clearly arise from factors other than changes in the hedged interest rate;
- (b) Are uncorrelated with changes in the hedged interest rate; and
- (c) Can be reliably separated from changes that are attributable to the hedged interest rate (e.g., changes in prepayment rates clearly arising from a change in demographic factors or tax regulations rather than changes in interest rate) are excluded when determining the change in the fair value of the hedged item, because they are not attributable to the hedged risk. If there is uncertainty about the factor that gave rise to the change in expected repricing dates or the entity is not able to separate reliably the changes that arise from the hedged interest rate from those that arise from other factors, the change is assumed to arise from changes in the hedged interest rate.

- AG165. The Standard does not specify the techniques used to determine the amount referred to in paragraph AG157(g), namely the change in the fair value of the hedged item that is attributable to the hedged risk. If statistical or other estimation techniques are used for such measurement, management must expect the result to approximate closely that which would have been obtained from measurement of all the individual assets or liabilities that constitute the hedged item. It is not appropriate to assume that changes in the fair value of the hedged item equal changes in the value of the hedging instrument.
- AG166. Paragraph 100 requires that if the hedged item for a particular repricing time period is an asset, the change in its value is presented in a separate line item within assets. Conversely, if the hedged item for a particular repricing time period is a liability, the change in its value is presented in a separate line item within liabilities. These are the separate line items referred to in paragraph AG157(g). Specific allocation to individual assets (or liabilities) is not required.
- AG167. Paragraph AG157(i) notes that ineffectiveness arises to the extent that the change in the fair value of the hedged item that is attributable to the hedged risk differs from the change in the fair value of the hedging derivative. Such a difference may arise for a number of reasons, including:
- (a) Actual repricing dates being different from those expected, or expected repricing dates being revised;
 - (b) Items in the hedged portfolio becoming impaired or being derecognized;
 - (c) The payment dates of the hedging instrument and the hedged item being different; and
 - (d) Other causes (e.g., when a few of the hedged items bear interest at a rate below the benchmark rate for which they are designated as being hedged, and the resulting ineffectiveness is not so great that the portfolio as a whole fails to qualify for hedge accounting).

Such ineffectiveness (applying the same materiality considerations in other MPSASs) shall be identified and recognized in surplus or deficit.

- AG168. Generally, the effectiveness of the hedge will be improved:
- (a) If the entity schedules items with different prepayment characteristics in a way that takes account of the differences in prepayment behaviour.
 - (b) When the number of items in the portfolio is larger. When only a few items are contained in the portfolio, relatively high ineffectiveness is likely if one of the items prepays earlier or later than expected. Conversely, when the portfolio contains many items, the prepayment behaviour can be predicted more accurately.
 - (c) When the repricing time periods used are narrower (e.g., 1-month as opposed to 3-month repricing time periods). Narrower repricing time periods reduce the effect of any mismatch between the repricing and payment dates (within the repricing time period) of the hedged item and those of the hedging instrument.

- (d) The greater the frequency with which the amount of the hedging instrument is adjusted to reflect changes in the hedged item (e.g., because of changes in prepayment expectations).

AG169. An entity tests effectiveness periodically. If estimates of repricing dates change between one date on which an entity assesses effectiveness and the next, it shall calculate the amount of effectiveness either:

- (a) As the difference between the change in the fair value of the hedging instrument (see paragraph AG157(h)) and the change in the value of the entire hedged item that is attributable to changes in the hedged interest rate (including the effect that changes in the hedged interest rate have on the fair value of any embedded prepayment option); or
- (b) Using the following approximation. The entity:
 - (i) Calculates the percentage of the assets (or liabilities) in each repricing time period that was hedged, on the basis of the estimated repricing dates at the last date it tested effectiveness.
 - (ii) Applies this percentage to its revised estimate of the amount in that repricing time period to calculate the amount of the hedged item based on its revised estimate.
 - (iii) Calculates the change in the fair value of its revised estimate of the hedged item that is attributable to the hedged risk and presents it as set out in paragraph AG157(g).
 - (iv) Recognizes ineffectiveness equal to the difference between the amount determined in (iii) and the change in the fair value of the hedging instrument (see paragraph AG157(h)).

AG170. When measuring effectiveness, the entity distinguishes revisions to the estimated repricing dates of existing assets (or liabilities) from the origination of new assets (or liabilities), with only the former giving rise to ineffectiveness. All revisions to estimated repricing dates (other than those excluded in accordance with paragraph AG164), including any reallocation of existing items between time periods, are included when revising the estimated amount in a time period in accordance with paragraph AG169(b)(ii) and hence when measuring effectiveness. Once ineffectiveness has been recognized as set out above, the entity establishes a new estimate of the total assets (or liabilities) in each repricing time period, including new assets (or liabilities) that have been originated since it last tested effectiveness, and designates a new amount as the hedged item and a new percentage as the hedged percentage. The procedures set out in paragraph AG169(b) are then repeated at the next date it tests effectiveness.

AG171. Items that were originally scheduled into a repricing time period may be derecognized because of earlier than expected prepayment or write-offs caused by impairment or sale. When this occurs, the amount of change in fair value included in the separate line item referred to in paragraph AG157(g) that relates to the derecognized item shall be removed from the statement of financial position, and included in the gain or loss that arises on derecognition of the item. For this purpose, it is necessary to know the repricing time period(s) into which the

derecognized item was scheduled, because this determines the repricing time period(s) from which to remove it and hence the amount to remove from the separate line item referred to in paragraph AG157(g). When an item is derecognized, if it can be determined in which time period it was included, it is removed from that time period. If not, it is removed from the earliest time period if the derecognition resulted from higher than expected prepayments, or allocated to all time periods containing the derecognized item on a systematic and rational basis if the item was sold or became impaired.

- AG172. In addition, any amount relating to a particular time period that has not been derecognized when the time period expires is recognized in surplus or deficit at that time (see paragraph 100). For example, assume an entity schedules items into three repricing time periods. At the previous redesignation, the change in fair value reported in the single line item in the statement of financial position was an asset of RM 25. That amount represents amounts attributable to periods 1, 2 and 3 of RM 7, RM 8 and RM 10, respectively. At the next redesignation, the assets attributable to period 1 have been either realized or rescheduled into other periods. Therefore, RM 7 is derecognized from the statement of financial position and recognized in surplus or deficit. RM 8 and RM 10 are now attributable to periods 1 and 2, respectively. These remaining periods are then adjusted, as necessary, for changes in fair value as described in paragraph AG157(g).
- AG173. As an illustration of the requirements of the previous two paragraphs, assume that an entity scheduled assets by allocating a percentage of the portfolio into each repricing time period. Assume also that it scheduled RM 100 into each of the first two time periods. When the first repricing time period expires, RM 110 of assets are derecognized because of expected and unexpected repayments. In this case, all of the amount contained in the separate line item referred to in paragraph AG157(g) that relates to the first time period is removed from the statement of financial position, plus 10 percent of the amount that relates to the second time period.
- AG174. If the hedged amount for a repricing time period is reduced without the related assets (or liabilities) being derecognized, the amount included in the separate line item referred to in paragraph AG157(g) that relates to the reduction shall be amortized in accordance with paragraph 104.
- AG175. An entity may wish to apply the approach set out in paragraphs AG157–AG174 to a portfolio hedge that had previously been accounted for as a cash flow hedge in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*. Such an entity would revoke the previous designation of a cash flow hedge in accordance with paragraph 112(d), and apply the requirements set out in that paragraph. It would also redesignate the hedge as a fair value hedge and apply the approach set out in paragraphs AG157–AG174 prospectively to subsequent accounting periods.

Appendix B**Reassessment of Embedded Derivatives**

This Appendix is an integral part of MPSAS 29, Financial Instruments: Recognition and Measurement.

Introduction

- B1. MPSAS 29, *Financial Instruments: Recognition and Measurement*, paragraph 11 describes an embedded derivative as “a component of a hybrid (combined) instrument that also includes a non-derivative host contract - with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative.”
- B2. MPSAS 29, *Financial Instruments: Recognition and Measurement*, paragraph 12 requires an embedded derivative to be separated from the host contract and accounted for as a derivative 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 contract;
 - (b) A separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
 - (c) The hybrid (combined) instrument is not measured at fair value with changes in fair value recognized in surplus or deficit (i.e., a derivative that is embedded in a financial asset or financial liability at fair value through surplus or deficit is not separated).
- B3. MPSAS 29, *Financial Instruments: Recognition and Measurement*, requires an entity, when it first becomes a party to a contract, to assess whether any embedded derivatives contained in the contract are required to be separated from the host contract and accounted for as derivatives under the Standard. This appendix addresses whether:
- (a) MPSAS 29, *Financial Instruments: Recognition and Measurement*, requires such an assessment to be made only when the entity first becomes a party to the contract, or if the assessment should be reconsidered throughout the life of the contract.
 - (b) A first-time adopter makes its assessment on the basis of the conditions that existed when the entity first became a party to the contract, or those prevailing when the entity adopts this Standard for the first time.
- B4. This appendix applies to all embedded derivatives within the scope of MPSAS 29, *Financial Instruments: Recognition and Measurement*, except the acquisition of contracts with embedded derivatives in a public sector combination or their possible reassessment at the date of acquisition.

Application of MPSAS 29, *Financial Instruments: Recognition and Measurement*, to the Reassessment of Embedded Derivatives

- B5. 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 either:
- (a) A change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract; or
 - (b) Reclassification of a financial asset out of fair value through surplus or deficit category, in which cases an assessment 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.

- B6. The assessment whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative on reclassification of a financial asset out of the fair value through surplus or deficit category in accordance with paragraph B5 shall be made on the basis of the circumstances that existed when the entity first became a party to the contract.
- B7. On first time adoption of MPSAS 29, *Financial Instruments: Recognition and Measurement*, an entity shall assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative on the basis of the conditions that existed at the later of the date it first became a party to the contract and the date a reassessment is required by paragraph B5.

Appendix C

Hedges of a Net Investment in a Foreign Operation

This Appendix is an integral part of MPSAS 29, Financial Instruments: Recognition and Measurement.

Introduction

- C1. Many reporting entities have investments in foreign operations (as defined in MPSAS 4, *The Effects of Changes in Foreign Exchange Rates*, paragraph 10). Such foreign operations may be controlled entities, associates, joint ventures or branches. MPSAS 4, *The Effects of Changes in Foreign Exchange Rates*, requires an entity to determine the functional currency of each of its foreign operations as the currency of the primary economic environment of that operation. When translating the results and financial position of a foreign operation into a presentation currency, the entity is required to recognize foreign exchange differences directly in net assets/equity until it disposes of the foreign operation.
- C2. Hedge accounting of the foreign currency risk arising from a net investment in a foreign operation will apply only when the net assets of that foreign operation are included in the financial statements. This will be the case for consolidated financial statements, financial statements in which investments such as associates or joint ventures are accounted for using the equity method, and financial statements that include a branch or joint operations as defined in MPSAS 37, *Joint Arrangements*. 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.
- C3. MPSAS 29, *Financial Instruments: Recognition and Measurement*, requires the designation of an eligible hedged item and eligible hedging instruments in a hedge accounting relationship. If there is a designated hedging relationship, in the case of a net investment hedge, the gain or loss on the hedging instrument that is determined to be an effective hedge of the net investment is recognized directly in net assets/equity and is included with the foreign exchange differences arising on translation of the results and financial position of the foreign operation.
- C4. This appendix applies to an entity that hedges the foreign currency risk arising from its net investments in foreign operations and wishes to qualify for hedge accounting in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*. It should not be applied by analogy to other types of hedge accounting. This appendix refers to such an entity as a controlling entity and to the financial statements in which the net assets of foreign operations are included as consolidated financial statements. All references to a controlling entity apply equally to an entity that has a net investment in a foreign operation that is a joint venture, an associate or a branch.
- C5. This appendix provides guidance on:
 - (a) Identifying the foreign currency risks that qualify as a hedged risk in the hedge of a net investment in a foreign operation, given that an entity with many foreign operations may be exposed to a number of foreign currency risks. It specifically addresses:

- (i) Whether the controlling entity may designate as a hedged risk only the foreign exchange differences arising from a difference between the functional currencies of the controlling entity and its foreign operation, or whether it may also designate as the hedged risk the foreign exchange differences arising from the difference between the presentation currency of the controlling entity's consolidated financial statements and the functional currency of the foreign operation; and
 - (ii) If the controlling entity holds the foreign operation indirectly, whether the hedged risk may include only the foreign exchange differences arising from differences in functional currencies between the foreign operation and its immediate controlling entity, or whether the hedged risk may also include any foreign exchange differences between the functional currency of the foreign operation and any intermediate or ultimate controlling entity (i.e., whether the fact that the net investment in the foreign operation is held through an intermediate controlling entity affects the economic risk to the ultimate controlling entity).
- (b) Where in an economic entity the hedging instrument can be held. It specifically addresses:
 - (i) MPSAS 29, *Financial Instruments: Recognition and Measurement*, allows an entity to designate either a derivative or a non-derivative financial instrument (or a combination of derivative and non-derivative financial instruments) as hedging instruments for foreign currency risk. This appendix addresses whether the nature of the hedging instrument (derivative or non-derivative) or the method of consolidation affects the assessment of hedge effectiveness.
 - (ii) This appendix also addresses where, within an economic entity, hedging instruments that are hedges of a net investment in a foreign operation can be held to qualify for hedge accounting i.e., whether a qualifying hedge accounting relationship can be established only if the entity hedging its net investment is a party to the hedging instrument or whether any entity within the economic entity, regardless of its functional currency, can hold the hedging instrument.
- (c) How an entity should determine what amount of the gain or loss recognized in net assets/equity should be recognized directly in surplus or deficit for both the hedging instrument and the hedged item as MPSAS 4, *The Effects of Changes in Foreign Exchange Rates*, and MPSAS 29, *Financial Instruments: Recognition and Measurement*, require cumulative amounts recognized directly in net assets/equity relating to both the foreign exchange differences arising on translation of the results and financial position of the foreign operation and the gain or loss on the hedging instrument that is determined to be an effective hedge of the net investment to be recognized directly when the controlling entity disposes of the foreign operation. It specifically addresses:
 - (i) When a foreign operation that was hedged is disposed of, what amounts from the controlling entity's foreign currency translation reserve in respect of the hedging instrument and of that foreign operation should be recognized in surplus or deficit in the controlling entity's consolidated financial statements; and

- (ii) Whether the method of consolidation affects the determination of the amounts to be recognized in surplus or deficit.

Application of MPSAS 29, *Financial Instruments: Recognition and Measurement*, 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

- C6. Hedge accounting may be applied only to the foreign exchange differences arising between the functional currency of the foreign operation and the controlling entity's functional currency.
- C7. In a hedge of the foreign currency risks arising from a net investment in a foreign operation, the hedged item can be an amount of net assets equal to or less than the carrying amount of the net assets of the foreign operation in the consolidated financial statements of the controlling entity. The carrying amount of the net assets of a foreign operation that may be designated as the hedged item in the consolidated financial statements of a controlling entity depends on whether any lower level controlling entity of the foreign operation has applied hedge accounting for all or part of the net assets of that foreign operation and that accounting has been maintained in the controlling entity's consolidated financial statements.
- C8. The hedged risk may be designated as the foreign currency exposure arising between the functional currency of the foreign operation and the functional currency of any controlling entity (the immediate, intermediate or ultimate controlling entity) of that foreign operation. The fact that the net investment is held through an intermediate controlling entity does not affect the nature of the economic risk arising from the foreign currency exposure to the ultimate controlling entity.
- C9. An exposure to foreign currency risk arising from a net investment in a foreign operation may qualify for hedge accounting only once in the consolidated financial statements. Therefore, if the same net assets of a foreign operation are hedged by more than one controlling entity within the economic entity (e.g., both a direct and an indirect controlling entity) for the same risk, only one hedging relationship will qualify for hedge accounting in the consolidated financial statements of the ultimate controlling entity. A hedging relationship designated by one controlling entity in its consolidated financial statements need not be maintained by another higher level controlling entity. However, if it is not maintained by the higher level controlling entity, the hedge accounting applied by the lower level controlling entity must be reversed before the higher level controlling entity's hedge accounting is recognized.

Where the Hedging Instrument can be Held

- C10. 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 (except the foreign operation that itself is being hedged), as long as the designation, documentation and effectiveness requirements of MPSAS 29, *Financial Instruments: Recognition and Measurement*, paragraph 98 that relate to a net investment hedge are satisfied. In particular, the hedging strategy of the economic entity should be clearly

documented because of the possibility of different designations at different levels of the economic entity.

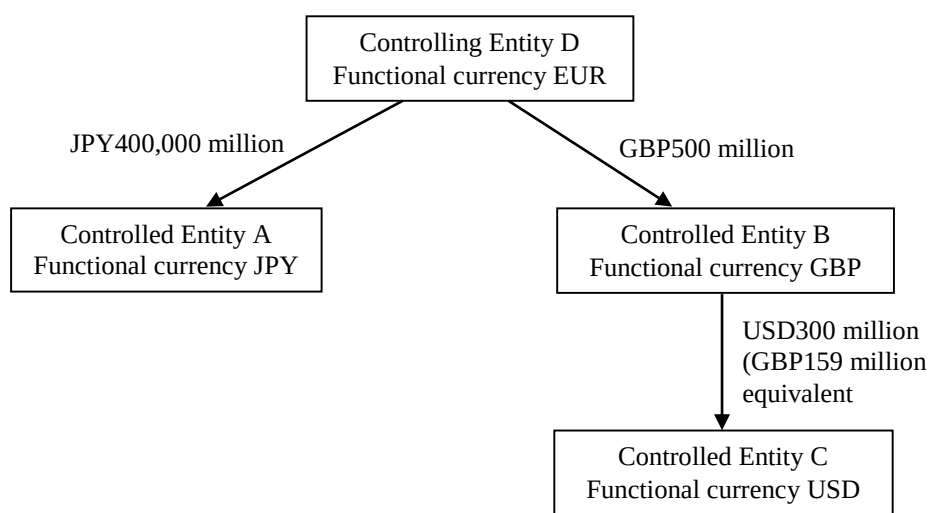
- C11. For the purpose of assessing effectiveness, the change in value of the hedging instrument in respect of foreign exchange risk is computed by reference to the functional currency of the controlling entity against whose functional currency the hedged risk is measured, in accordance with the hedge accounting documentation. Depending on where the hedging instrument is held, in the absence of hedge accounting the total change in value might be recognized in surplus or deficit, directly in net assets/equity, or both. However, the assessment of effectiveness is not affected by whether the change in value of the hedging instrument is recognized in surplus or deficit or directly in net assets/equity. As part of the application of hedge accounting, the total effective portion of the change is included directly in net assets/equity. The assessment of effectiveness is not affected by whether the hedging instrument is a derivative or a non-derivative instrument or by the method of consolidation.

Disposal of a Hedged Foreign Operation

- C12. When a foreign operation that was hedged is disposed of, the amount reclassified to surplus or deficit from the foreign currency translation reserve in the consolidated financial statements of the controlling entity in respect of the hedging instrument is the amount that MPSAS 29, *Financial Instruments: Recognition and Measurement*, paragraph 113 requires to be identified. That amount is the cumulative gain or loss on the hedging instrument that was determined to be an effective hedge.
- C13. The amount recognized in surplus or deficit upon transfer from the foreign currency translation reserve in the consolidated financial statements of a controlling entity in respect of the net investment in that foreign operation in accordance with MPSAS 4, *The Effects of Changes in Foreign Exchange Rates*, paragraph 57 is the amount included in that controlling entity's foreign currency translation reserve in respect of that foreign operation. In the ultimate controlling entity's consolidated financial statements, the aggregate net amount recognized in the foreign currency translation reserve in respect of all foreign operations is not affected by the consolidation method. However, whether the ultimate controlling entity uses the direct or the step-by-step method of consolidation, this may affect the amount included in its foreign currency translation reserve in respect of an individual foreign operation.
- C14. 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).
- C15. The use of the step-by-step method of consolidation may result in a different amount being recognized in surplus or deficit from that used to determine hedge effectiveness. This difference may be eliminated by determining the amount relating to that foreign operation that would have arisen if the direct method of consolidation had been used. Making this adjustment is not required by MPSAS 4, *The Effect of Changes in Foreign Exchanges Rates*. However, it is an accounting policy choice that should be followed consistently for all net investments.

Example

- C16. The following example illustrates the application of the preceding paragraphs using the entity structure illustrated below. In all cases the hedging relationships described would be tested for effectiveness in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, although this testing is not discussed. Controlling Entity D, being the ultimate controlling entity, presents its consolidated financial statements in its functional currency of euro (EUR). Each of the controlled entities i.e., Controlled Entity A, Controlled Entity B and Controlled Entity C, is wholly owned. Controlling Entity D £500 million net investment in Controlled Entity B (functional currency pounds sterling (GBP)) includes the £159 million equivalent of Controlled Entity B's US\$300 million net investment in Controlled Entity C (functional currency US dollars (USD)). In other words, Controlled Entity B's net assets other than its investment in Controlled Entity C are £341 million.



Nature of Hedged Risk for which a Hedging Relationship may be Designated (paragraphs C6–C9)

- C17. Controlling Entity D can hedge its net investment in each of Controlled Entities A, B and C for the foreign exchange risk between their respective functional currencies (Japanese yen (JPY), pounds sterling and US dollars) and euro. In addition, Controlled Entity D can hedge the USD/GBP foreign exchange risk between the functional currencies of Controlled Entity B and Controlled Entity C. In its consolidated financial statements, Controlled Entity B can hedge its net investment in Controlled Entity C for the foreign exchange risk between their functional currencies of US dollars and pounds sterling. In the following examples the designated risk is the spot foreign exchange risk because the hedging instruments are not derivatives. If the hedging instruments were forward contracts, Controlling Entity D could designate the forward foreign exchange risk.

Amount of Hedged item for which a Hedging Relationship may be Designated (paragraphs C6–C9)

- C18. Controlling Entity D wishes to hedge the foreign exchange risk from its net investment in Controlled Entity C. Assume that Controlled Entity A has an external borrowing of US\$300 million. The net assets of Controlled Entity A at the start of the reporting period are ¥400,000 million including the proceeds of the external borrowing of US\$300 million.

- C19. The hedged item can be an amount of net assets equal to or less than the carrying amount of Controlling Entity D's net investment in Controlled Entity C (US\$300 million) in its consolidated financial statements. In its consolidated financial statements Controlling Entity D can designate the US\$300 million external borrowing in Controlled Entity A as a hedge of the EUR/USD spot foreign exchange risk associated with its net investment in the US\$300 million net assets of Controlled Entity C. In this case, both the EUR/USD foreign exchange difference on the US\$300 million external borrowing in Controlled Entity A and the EUR/USD foreign exchange difference on the US\$300 million net investment in Controlled Entity C are included in the foreign currency translation reserve in Controlling Entity D's consolidated financial statements after the application of hedge accounting.
- C20. In the absence of hedge accounting, the total USD/EUR foreign exchange difference on the US\$300 million external borrowing in Controlled Entity A would be recognized in Controlling Entity D's consolidated financial statements as follows:
- USD/JPY spot foreign exchange rate change, translated to euro, in surplus or deficit; and
 - JPY/EUR spot foreign exchange rate change directly in net assets/equity.

Instead of the designation in paragraph C19, in its consolidated financial statements Controlling Entity D can designate the US\$300 million external borrowing in Controlled Entity A as a hedge of the GBP/USD spot foreign exchange risk between Controlled Entity C and Controlled Entity B. In this case, the total USD/EUR foreign exchange difference on the US\$300 million external borrowing in Entity A would instead be recognized in Controlled Entity D's consolidated financial statements as follows:

- The GBP/USD spot foreign exchange rate change in the foreign currency translation reserve relating to Controlled Entity C;
 - GBP/JPY spot foreign exchange rate change, translated to euro, in surplus or deficit; and
 - JPY/EUR spot foreign exchange rate change directly in net assets/equity.
- C21. Controlling Entity D cannot designate the US\$300 million external borrowing in Controlled Entity A as a hedge of both the EUR/USD spot foreign exchange risk and the GBP/USD spot foreign exchange risk in its consolidated financial statements. A single hedging instrument can hedge the same designated risk only once. Controlled Entity B cannot apply hedge accounting in its consolidated financial statements because the hedging instrument is held outside the economic entity comprising Controlled Entity B and Controlled Entity C.

Where in an Economic Entity can the Hedging Instrument be Held (paragraphs C10 and C11)?

- C22. As noted in paragraph C20, the total change in value in respect of foreign exchange risk of the US\$300 million external borrowing in Controlled Entity A would be recorded in both surplus or deficit (USD/JPY spot risk) and directly in net assets/equity (EUR/JPY spot risk) in Controlling Entity D's consolidated financial statements in the absence of hedge accounting. Both amounts are included for the purpose of assessing the effectiveness of the hedge designated in paragraph C19 because the change in value of both the hedging instrument and the hedged item are computed by reference to the euro functional currency of Controlling Entity D against the US dollar functional currency of Controlled Entity C, in accordance with the

hedge documentation. The method of consolidation (i.e., direct method or step-by-step method) does not affect the assessment of the effectiveness of the hedge.

Amounts Recognized in Surplus or Deficit on Disposal of a Foreign Operation (paragraphs C12 and C13)

- C23. When Controlled Entity C is disposed of, the amounts are recognized in surplus or deficit in Controlling Entity D's consolidated financial statements upon transfer from its foreign currency translation reserve (FCTR) are:
- (a) In respect of the US\$300 million external borrowing of Controlled Entity A, the amount that MPSAS 29, *Financial Instruments: Recognition and Measurement*, requires to be identified, i.e., the total change in value in respect of foreign exchange risk that was recognized directly in net assets/equity as the effective portion of the hedge; and
 - (b) In respect of the US\$300 million net investment in Controlled Entity C, the amount determined by the entity's consolidation method. If Controlling Entity D uses the direct method, its FCTR in respect of Controlled Entity C will be determined directly by the EUR/USD foreign exchange rate. If Controlling Entity D uses the step-by-step method, its FCTR in respect of Controlled Entity C will be determined by the FCTR recognized by Controlled Entity B reflecting the GBP/USD foreign exchange rate, translated to Controlling Entity D's functional currency using the EUR/GBP foreign exchange rate. Controlling Entity D's use of the step-by-step method of consolidation in prior periods does not require it to or preclude it from determining the amount of FCTR to be recognized in surplus or deficit when it disposes of Controlled Entity C to be the amount that it would have recognized if it had always used the direct method, depending on its accounting policy.

Hedging More Than One Foreign Operation (paragraphs C7, C9, and C11)

- C24. The following examples illustrate that in the consolidated financial statements of Controlling Entity D, the risk that can be hedged is always the risk between its functional currency (euro) and the functional currencies of Controlled Entities B and C. No matter how the hedges are designated, the maximum amounts that can be effective hedges to be included in the foreign currency translation reserve in Controlling Entity D's consolidated financial statements when both foreign operations are hedged are US\$300 million for EUR/USD risk and £341 million for EUR/GBP risk. Other changes in value due to changes in foreign exchange rates are included in Controlling Entity D's consolidated surplus or deficit. Of course, it would be possible for Controlling Entity D to designate US\$300 million only for changes in the USD/GBP spot foreign exchange rate or £500 million only for changes in the GBP/EUR spot foreign exchange rate.

Entity D Holds Both USD and GBP Hedging Instruments

- C25. Controlling Entity D may wish to hedge the foreign exchange risk in relation to its net investment in Controlled Entity B as well as that in relation to Controlled Entity C. Assume that Controlling Entity D holds suitable hedging instruments denominated in US dollars and pounds sterling that it could designate as hedges of its net investments in Controlled Entity B and

Controlled Entity C. The designations Controlling Entity D can make in its consolidated financial statements include, but are not limited to, the following:

- (a) US\$300 million hedging instrument designated as a hedge of the US\$300 million of net investment in Controlled Entity C with the risk being the spot foreign exchange exposure (EUR/USD) between Controlling Entity D and Controlled Entity C and up to £341 million hedging instrument designated as a hedge of £341 million of the net investment in Controlled Entity B with the risk being the spot foreign exchange exposure (EUR/GBP) between Controlling Entity D and Controlled Entity B.
 - (b) US\$300 million hedging instrument designated as a hedge of the US\$300 million of net investment in Controlled Entity C with the risk being the spot foreign exchange exposure (GBP/USD) between Controlled Entity B and Controlled Entity C and up to £500 million hedging instrument designated as a hedge of £500 million of the net investment in Controlled Entity B with the risk being the spot foreign exchange exposure (EUR/GBP) between Controlling Entity D and Controlled Entity B.
- C26. The EUR/USD risk from Controlling Entity D's net investment in Controlled Entity C is a different risk from the EUR/GBP risk from Controlling Entity D's net investment in Controlled Entity B. However, in the case described in paragraph C25(a), by its designation of the USD hedging instrument it holds, Controlling Entity D has already fully hedged the EUR/USD risk from its net investment in Controlled Entity C. If Controlling Entity D also designated a GBP instrument it holds as a hedge of its £500 million net investment in Controlled Entity B, £159 million of that net investment, representing the GBP equivalent of its USD net investment in Controlled Entity C, would be hedged twice for GBP/EUR risk in Controlling Entity D's consolidated financial statements.
- C27. In the case described in paragraph C25(b), if Controlling Entity D designates the hedged risk as the spot foreign exchange exposure (GBP/USD) between Controlled Entity B and Controlled Entity C, only the GBP/USD part of the change in the value of its US\$300 million hedging instrument is included in Controlling Entity D's foreign currency translation reserve relating to Controlled Entity C. The remainder of the change (equivalent to the GBP/EUR change on £159 million) is included in Controlling Entity D's consolidated surplus or deficit, as in paragraph C20. Because the designation of the USD/GBP risk between Controlled entities B and C does not include the GBP/EUR risk, Controlled Entity D is also able to designate up to £500 million of its net investment in Controlled Entity B with the risk being the spot foreign exchange exposure (GBP/EUR) between Controlling Entity D and Controlled Entity B.

Entity B Holds the USD Hedging Instrument

- C28. Assume that Controlled Entity B holds US\$300 million of external debt, the proceeds of which were transferred to Controlling Entity D by an inter-entity loan denominated in pounds sterling. Because both its assets and liabilities increased by £159 million, Controlled Entity B's net assets are unchanged. Controlled Entity B could designate the external debt as a hedge of the GBP/USD risk of its net investment in Controlled Entity C in its consolidated financial statements. Controlling Entity D could maintain Controlled Entity B's designation of that hedging instrument as a hedge of its US\$300 million net investment in Controlled Entity C for the GBP/USD risk (see paragraph C9) and Controlling Entity D could designate the GBP hedging instrument it holds as a hedge of its entire £500 million net investment in Controlled

Entity B. The first hedge, designated by Controlled Entity B, would be assessed by reference to Controlled Entity B's functional currency (pounds sterling) and the second hedge, designated by Controlling Entity D, would be assessed by reference to Controlling Entity D's functional currency (euro). In this case, only the GBP/USD risk from Controlling Entity D's net investment in Controlled Entity C has been hedged in Controlling Entity D's consolidated financial statements by the USD hedging instrument, not the entire EUR/USD risk. Therefore, the entire EUR/GBP risk from Controlling Entity D's £500 million net investment in Controlled Entity B may be hedged in the consolidated financial statements of Controlling Entity D.

- C29. However, the accounting for Controlled Entity D's £159 million loan payable to Controlled Entity B must also be considered. If Controlling Entity D's loan payable is not considered part of its net investment in Controlled Entity B because it does not satisfy the conditions in MPSAS 4, *The Effects of Changes in Foreign Exchange Rates*, paragraph 18, the GBP/EUR foreign exchange difference arising on translating it would be included in Controlling Entity D's consolidated surplus or deficit. If the £159 million loan payable to Controlled Entity B is considered part of Controlling Entity D's net investment, that net investment would be only £341 million and the amount Controlling Entity D could designate as the hedged item for GBP/EUR risk would be reduced from £500 million to £341 million accordingly.
- C30. If Controlling Entity D reversed the hedging relationship designated by Controlled Entity B, Controlling Entity D could designate the US\$300 million external borrowing held by Controlled Entity B as a hedge of its US\$300 million net investment in Controlled Entity C for the EUR/USD risk and designate the GBP hedging instrument it holds itself as a hedge of only up to £341 million of the net investment in Controlled Entity B. In this case the effectiveness of both hedges would be computed by reference to Controlling Entity D's functional currency (euro). Consequently, both the USD/GBP change in value of the external borrowing held by Controlled Entity B and the GBP/EUR change in value of Controlling Entity D's loan payable to Controlled Entity B (equivalent to USD/EUR in total) would be included in the foreign currency translation reserve in Controlling Entity D's consolidated financial statements. Because Controlling Entity D has already fully hedged the EUR/USD risk from its net investment in Controlled Entity C, it can hedge only up to £341 million for the EUR/GBP risk of its net investment in Controlled Entity B.

Implementation Guidance

This guidance accompanies, but is not part of, MPSAS 29, Financial Instruments: Recognition and Measurement.

Section A: Scope

A.1 *Practice of Settling Net: Forward Contract to Purchase a Commodity*

Entity XYZ enters into a fixed price forward contract to purchase one million litres of oil in accordance with its expected usage requirements. The contract permits XYZ to take physical delivery of the oil at the end of twelve months or to pay or receive a net settlement in cash, based on the change in fair value of oil. Is the contract accounted for as a derivative?

While such a contract meets the definition of a derivative, it is not necessarily accounted for as a derivative. The contract is a derivative instrument because there is no initial net investment, the contract is based on the price of oil, and it is to be settled at a future date. However, if XYZ intends to settle the contract by taking delivery and has no history for similar contracts of settling net in cash or of taking delivery of the oil and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin, the contract is not accounted for as a derivative under MPSAS 29, *Financial Instruments: Recognition and Measurement*. Instead, it is accounted for as an executory contract.

A.2 *Option to Put a Non-Financial Asset*

Entity XYZ owns an office building. XYZ enters into a put option with an investor that permits XYZ to put the building to the investor for RM150 million. The current value of the building is RM175 million. The option expires in five years. The option, if exercised, may be settled through physical delivery or net cash, at XYZ's option. How do both XYZ and the investor account for the option?

XYZ's accounting depends on XYZ's intention and past practice for settlement. Although the contract meets the definition of a derivative, XYZ does not account for it as a derivative if XYZ intends to settle the contract by delivering the building if XYZ exercises its option and there is no past practice of settling net (MPSAS 29, *Financial Instruments: Recognition and Measurement*, paragraph 4 and MPSAS 29, *Financial Instruments: Recognition and Measurement*, paragraph AG22).

The investor, however, cannot conclude that the option was entered into to meet the investor's expected purchase, sale or usage requirements because the investor does not have the ability to require delivery (MPSAS 29, *Financial Instruments: Recognition and Measurement*, paragraph 6). In addition, the option may be settled net in cash. Therefore, the investor has to account for the contract as a derivative. Regardless of past practices, the investor's intention does not affect whether settlement is by delivery or in cash. The investor has written an option, and a written option in which the holder has a choice of physical settlement or net cash settlement can never satisfy the normal delivery requirement for the exemption from MPSAS 29, *Financial Instruments: Recognition and Measurement*, because the option writer does not have the ability to require delivery.

However, if the contract were a forward contract rather than an option, and if the contract required physical delivery and the reporting entity had no past practice of settling net in cash or of taking delivery

of the building and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin, the contract would not be accounted for as a derivative.

Section B: Definitions

B.1 *Definition of a Derivative: Examples of Derivatives and Underlyings*

What are examples of common derivative contracts and the identified underlying?

MPSAS 29, *Financial Instruments: Recognition and Measurement*, defines a derivative as follows:

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

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

Type of contract	Main pricing-settlement variable (underlying variable)
Interest rate swap	Interest rates
Currency swap (foreign exchange swap)	Currency rates
Commodity swap	Commodity prices
Equity swap	Equity prices (equity instruments of another entity)
Credit swap	Credit rating, credit index or credit price
Total return swap	Total fair value of the reference asset and interest rates
Purchased or written treasury bond option (call or put)	Interest rates
Purchased or written currency option (call or put)	Currency rates
Purchased or written commodity option (call or put)	Commodity prices
Purchased or written stock option (call or put)	Equity prices (equity instruments of another entity)
Interest rate futures linked to government debt (treasury futures)	Interest rates
Currency futures	Currency rates
Commodity futures	Commodity prices

Type of contract	Main pricing-settlement variable (underlying variable)
Interest rate forward linked to government debt (treasury forward)	Interest rates
Currency forward	Currency rates
Commodity forward	Commodity prices
Equity forward	Equity prices (equity instruments of another entity)

The above list provides examples of contracts that normally qualify as derivatives under MPSAS 29, *Financial Instruments: Recognition and Measurement*. The list is not exhaustive. Any contract that has an underlying may be a derivative. Moreover, even if an instrument meets the definition of a derivative contract, special provisions of MPSAS 29, *Financial Instruments: Recognition and Measurement*, may apply, for example, if it is a weather derivative (see MPSAS 29.AG5), a contract to buy or sell a non-financial item such as commodity (see MPSAS 29.4 and MPSAS 29.AG22) or a contract settled in an entity's own shares (see MPSAS 28.25–MPSAS 28.29). Therefore, an entity must evaluate the contract to determine whether the other characteristics of a derivative are present and whether special provisions apply.

B.2 *Definition of a Derivative: Settlement at a Future Date, Interest Rate Swap with Net or Gross Settlement*

For the purpose of determining whether an interest rate swap is a derivative financial instrument under MPSAS 29, *Financial Instruments: Recognition and Measurement*, does it make a difference whether the parties pay the interest payments to each other (gross settlement) or settle on a net basis?

No. The definition of a derivative does not depend on gross or net settlement.

To illustrate: Entity ABC enters into an interest rate swap with a counterparty (XYZ) that requires ABC to pay a fixed rate of 8 percent and receive a variable amount based on three-month LIBOR, reset on a quarterly basis. The fixed and variable amounts are determined based on a RM100 million notional amount. ABC and XYZ do not exchange the notional amount. ABC pays or receives a net cash amount each quarter based on the difference between 8 percent and three-month KLIBOR. Alternatively, settlement may be on a gross basis.

The contract meets the definition of a derivative regardless of whether there is net or gross settlement because its value changes in response to changes in an underlying variable (KLIBOR), there is no initial net investment, and settlements occur at future dates.

B.3 *Definition of a Derivative: Prepaid Interest Rate Swap (Fixed Rate Payment Obligation Prepaid at Inception or Subsequently)*

If a party prepays its obligation under a pay-fixed, receive-variable interest rate swap at inception, is the swap a derivative financial instrument?

Yes.

To illustrate: Entity S enters into a RM100 million notional amount five-year pay-fixed, receive-variable interest rate swap with Counterparty C. The interest rate of the variable part of the swap is reset on a quarterly basis to three-month KLIBOR. The interest rate of the fixed part of the swap is 10 percent per year. Entity S prepays its fixed obligation under the swap of RM50 million (RM100 million $\times$ 10 percent $\times$ 5 years) at inception, discounted using market interest rates, while retaining the right to receive interest payments on the RM100 million reset quarterly based on three-month KLIBOR over the life of the swap.

The initial net investment in the interest rate swap is significantly less than the notional amount on which the variable payments under the variable leg will be calculated. The contract requires an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, such as a variable rate bond. Therefore, the contract fulfills the “no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors” provision of MPSAS 29, *Financial Instruments: Recognition and Measurement*. Even though Entity S has no future performance obligation, the ultimate settlement of the contract is at a future date and the value of the contract changes in response to changes in the KLIBOR index. Accordingly, the contract is regarded as a derivative contract.

Would the answer change if the fixed rate payment obligation is prepaid subsequent to initial recognition?

If the fixed leg is prepaid during the term, that would be regarded as a termination of the old swap and an origination of a new instrument that is evaluated under MPSAS 29, *Financial Instruments: Recognition and Measurement*.

B.4 Definition of a Derivative: Prepaid Pay-Variable, Receive-Fixed Interest Rate Swap

If a party prepays its obligation under a pay-variable, receive-fixed interest rate swap at inception of the contract or subsequently, is the swap a derivative financial instrument?

No. A prepaid pay-variable, receive-fixed interest rate swap is not a derivative if it is prepaid at inception and it is no longer a derivative if it is prepaid after inception because it provides a return on the prepaid (invested) amount comparable to the return on a debt instrument with fixed cash flows. The prepaid amount fails the “no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors” criterion of a derivative.

To illustrate: Entity S enters into a RM100 million notional amount five-year pay-variable, receive-fixed interest rate swap with Counterparty C. The variable leg of the swap is reset on a quarterly basis to three-month KLIBOR. The fixed interest payments under the swap are calculated as 10 percent times the swap’s notional amount, i.e., RM10 million per year. Entity S prepays its obligation under the variable leg of the swap at inception at current market rates, while retaining the right to receive fixed interest payments of 10 percent on RM100 million per year.

The cash inflows under the contract are equivalent to those of a financial instrument with a fixed annuity stream since Entity S knows it will receive RM10 million per year over the life of the swap. Therefore, all else being equal, the initial investment in the contract should equal that of other financial instruments that consist of fixed annuities. Thus, the initial net investment in the pay-variable, receive-fixed interest

rate swap is equal to the investment required in a non-derivative contract that has a similar response to changes in market conditions. For this reason, the instrument fails the “no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors” criterion of MPSAS 29, *Financial Instruments: Recognition and Measurement*. Therefore, the contract is not accounted for as a derivative under MPSAS 29, *Financial Instruments: Recognition and Measurement*. By discharging the obligation to pay variable interest rate payments, Entity S in effect provides a loan to Counterparty C.

B.5 *Definition of a Derivative: Offsetting Loans*

Entity A makes a five-year fixed rate loan to Entity B, while B at the same time makes a five-year variable rate loan for the same amount to A. There are no transfers of principal at inception of the two loans, since A and B have a netting agreement. Is this a derivative under MPSAS 29, *Financial Instruments: Recognition and Measurement*?

Yes. This meets the definition of a derivative (that is to say, there is an underlying variable, no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, and future settlement). The contractual effect of the loans is the equivalent of an interest rate swap arrangement with no initial net investment. Non-derivative transactions are aggregated and treated as a derivative when the transactions result, in substance, in a derivative. Indicators of this would include:

- They are entered into at the same time and in contemplation of one another;
- They have the same counterparty;
- They relate to the same risk; and
- There is no apparent economic need or substantive business purpose for structuring the transactions separately that could not also have been accomplished in a single transaction.

The same answer would apply if Entity A and Entity B did not have a netting agreement, because the definition of a derivative instrument in MPSAS 29.10 does not require net settlement.

B.6 *Definition of a Derivative: Option Not Expected to be Exercised*

The definition of a derivative in MPSAS 29.10 requires that the instrument “is settled at a future date.” Is this criterion met even if an option is expected not to be exercised, for example, because it is out of the money?

Yes. An option is settled upon exercise or at its maturity. Expiry at maturity is a form of settlement even though there is no additional exchange of consideration.

B.7 *Definition of a Derivative: Foreign Currency Contract Based on Sales Volume*

A South African entity, Entity XYZ, whose functional currency is the South African rand, sells electricity to Mozambique denominated in US dollars. XYZ enters into a contract with an investment bank to convert US dollars to rand at a fixed exchange rate. The contract requires XYZ to remit rand based on its sales volume in Mozambique in exchange for US dollars at a fixed exchange rate of 6.00. Is that contract a derivative?

Yes. The contract has two underlying variables (the foreign exchange rate and the volume of sales), no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, and a payment provision. MPSAS 29, *Financial Instruments: Recognition and Measurement*, does not exclude from its scope derivatives that are based on sales volume.

B.8 *Definition of a Derivative: Prepaid Forward*

An entity enters into a forward contract to purchase shares of stock in one year at the forward price. It prepays at inception based on the current price of the shares. Is the forward contract a derivative?

No. The forward contract fails the “no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors” test for a derivative.

To illustrate: Entity XYZ enters into a forward contract to purchase one million T ordinary shares in one year. The current market price of T is RM 50 per share; the one-year forward price of T is RM 55 per share. XYZ is required to prepay the forward contract at inception with a RM50 million payment. The initial investment in the forward contract of RM 50 million is less than the notional amount applied to the underlying, one million shares at the forward price of RM 55 per share, i.e., RM55 million. However, the initial net investment approximates the investment that would be required for other types of contracts that would be expected to have a similar response to changes in market factors because T’s shares could be purchased at inception for the same price of RM 50. Accordingly, the prepaid forward contract does not meet the initial net investment criterion of a derivative instrument.

B.9 *Definition of a Derivative: Initial Net Investment*

Many derivative instruments, such as futures contracts and exchange traded written options, require margin accounts. Is the margin account part of the initial net investment?

No. The margin account is not part of the initial net investment in a derivative instrument. Margin accounts are a form of collateral for the counterparty or clearing house and may take the form of cash, securities or other specified assets, typically liquid assets. Margin accounts are separate assets that are accounted for separately.

B.10 *Definition of Held for Trading: Portfolio with a Recent Actual Pattern of Short-Term Profit-Taking*

The definition of a financial asset or financial liability held for trading states that “a financial asset or financial liability is classified as held for trading if it is ... part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking.” What is a “portfolio” for the purposes of applying this definition?

Although the term “portfolio” is not explicitly defined in MPSAS 29, *Financial Instruments: Recognition and Measurement*, the context in which it is used suggests that a portfolio is a group of financial assets or financial liabilities that are managed as part of that group (MPSAS 29.10). If there is evidence of a recent actual pattern of short-term profit-taking on financial instruments included in such

a portfolio, those financial instruments qualify as held for trading even though an individual financial instrument may in fact be held for a longer period of time.

B.11 *Definition of Held for Trading: Balancing a Portfolio*

Entity A has an investment portfolio of debt and equity instruments. The documented portfolio management guidelines specify that the equity exposure of the portfolio should be limited to between 30 and 50 percent of total portfolio value. The investment manager of the portfolio is authorized to balance the portfolio within the designated guidelines by buying and selling equity and debt instruments. Is Entity A permitted to classify the instruments as available for sale?

It depends on Entity A's intentions and past practice. If the portfolio manager is authorized to buy and sell instruments to balance the risks in a portfolio, but there is no intention to trade and there is no past practice of trading for short-term profit, the instruments can be classified as available for sale. If the portfolio manager actively buys and sells instruments to generate short-term profits, the financial instruments in the portfolio are classified as held for trading.

B.12 *Definition of Held-to-Maturity Financial Assets: Index-Linked Principal*

Entity A purchases a five-year equity-index-linked note with an original issue price of RM 10 at a market price of RM12 at the time of purchase. The note requires no interest payments before maturity. At maturity, the note requires payment of the original issue price of RM 10 plus a supplemental redemption amount that depends on whether a specified share price index exceeds a predetermined level at the maturity date. If the share index does not exceed or is equal to the predetermined level, no supplemental redemption amount is paid. If the share index exceeds the predetermined level, the supplemental redemption amount equals the product of 1.15 and the difference between the level of the share index at maturity and the level of the share index when the note was issued divided by the level of the share index at the time of issue. Entity A has the positive intention and ability to hold the note to maturity. Can Entity A classify the note as a held-to-maturity investment?

Yes. The note can be classified as a held-to-maturity investment because it has a fixed payment of RM 10 and fixed maturity and Entity A has the positive intention and ability to hold it to maturity (MPSAS 29.10). However, the equity index feature is a call option not closely related to the debt host, which must be separated as an embedded derivative under MPSAS 29.12. The purchase price of RM 12 is allocated between the host debt instrument and the embedded derivative. For example, if the fair value of the embedded option at acquisition is RM 4, the host debt instrument is measured at RM8 on initial recognition. In this case, the discount of RM 2 that is implicit in the host bond (principal of RM10 minus the original carrying amount of RM 8) is amortized to surplus or deficit over the term to maturity of the note using the effective interest method.

B.13 *Definition of Held-to-Maturity Financial Assets: Index-Linked Interest*

Can a bond with a fixed payment at maturity and a fixed maturity date be classified as a held-to-maturity investment if the bond's interest payments are indexed to the price of a commodity, and the entity has the positive intention and ability to hold the bond to maturity?

Yes. However, the commodity-indexed interest payments result in an embedded derivative that is separated and accounted for as a derivative at fair value (MPSAS 29.12). MPSAS 29.14 is not applicable since it should be straightforward to separate the host debt investment (the fixed payment at maturity) from the embedded derivative (the index-linked interest payments).

B.14 *Definition of Held-to-Maturity Financial Assets: Sale Following Rating Downgrade*

Would a sale of a held-to-maturity investment following a downgrade of the issuer's credit rating by a rating agency raise a question about the entity's intention to hold other investments to maturity?

Not necessarily. A downgrade is likely to indicate a decline in the issuer's creditworthiness. MPSAS 29, *Financial Instruments: Recognition and Measurement*, specifies that a sale due to a significant deterioration in the issuer's creditworthiness could satisfy the condition in MPSAS 29, *Financial Instruments: Recognition and Measurement*, and therefore not raise a question about the entity's intention to hold other investments to maturity. However, the deterioration in creditworthiness must be significant judged by reference to the credit rating at initial recognition. Also, the rating downgrade must not have been reasonably anticipated when the entity classified the investment as held to maturity in order to meet the condition in MPSAS 29, *Financial Instruments: Recognition and Measurement*. A credit downgrade of a notch within a class or from one rating class to the immediately lower rating class could often be regarded as reasonably anticipated. If the rating downgrade in combination with other information provides evidence of impairment, the deterioration in creditworthiness often would be regarded as significant.

B.15 *Definition of Held-to-Maturity Financial Assets: Permitted Sales*

Would sales of held-to-maturity financial assets due to a change in management compromise the classification of other financial assets as held to maturity?

Yes. A change in management is not identified under MPSAS 29.AG35 as an instance where sales or transfers from held-to-maturity do not compromise the classification as held to maturity. Sales in response to such a change in management would, therefore, call into question the entity's intention to hold investments to maturity.

To illustrate: Entity X has a portfolio of financial assets that is classified as held to maturity. In the current period, at the direction of the governing body, the senior management team has been replaced. The new management wishes to sell a portion of the held-to-maturity financial assets in order to carry out an expansion strategy designated and approved by the governing body. Although the previous management team had been in place since the entity's inception and Entity X had never before undergone a major restructuring, the sale nevertheless calls into question Entity X's intention to hold remaining held-to-maturity financial assets to maturity.

B.16 *Definition of Held-to-Maturity Investments: Sales in Response to Entity-Specific Capital Requirements*

In some countries, regulators of banks or other industries may set entity-specific capital requirements that are based on an assessment of the risk in that particular entity. MPSAS 29.AG35(e) indicates that an entity that sells held-to-maturity investments in response to an unanticipated significant increase by the regulator in the industry's capital requirements may do

so under MPSAS 29, *Financial Instruments: Recognition and Measurement*, without necessarily raising a question about its intention to hold other investments to maturity. Would sales of held-to-maturity investments that are due to a significant increase in entity-specific capital requirements imposed by regulators (i.e., capital requirements applicable to a particular entity, but not to the industry) raise such doubt?

Yes, such sales “taint” the entity’s intention to hold other financial assets as held to maturity unless it can be demonstrated that the sales fulfil the condition in MPSAS 29.10 in that they result from an increase in capital requirements, which is an isolated event that is beyond the entity’s control, is non-recurring and could not have been reasonably anticipated by the entity.

B.17 *Definition of Held-to-Maturity Financial Assets: Pledged Collateral, Repurchase Agreements (repos), and Securities Lending Agreements*

An entity cannot have a demonstrated ability to hold to maturity an investment if it is subject to a constraint that could frustrate its intention to hold the financial asset to maturity. Does this mean that a debt instrument that has been pledged as collateral or transferred to another party under a repo or securities lending transaction, and continues to be recognized cannot be classified as a held-to-maturity investment?

No. An entity’s intention and ability to hold debt instruments to maturity is not necessarily constrained if those instruments have been pledged as collateral or are subject to a repurchase agreement or securities lending agreement. However, an entity does not have the positive intention and ability to hold the debt instruments until maturity if it does not expect to be able to maintain or recover access to the instruments.

B.18 *Definition of Held-to-Maturity Financial Assets: “Tainting”*

In response to unsolicited tender offers, Entity A sells a significant amount of financial assets classified as held to maturity on economically favourable terms. Entity A does not classify any financial assets acquired after the date of the sale as held to maturity. However, it does not reclassify the remaining held-to-maturity investments since it maintains that it still intends to hold them to maturity. Is Entity A in compliance with MPSAS 29, *Financial Instruments: Recognition and Measurement*?

No. Whenever a sale or transfer of more than an insignificant amount of financial assets classified as held to maturity (HTM) results in the conditions in MPSAS 29.10 and MPSAS 29.AG35 not being satisfied, no instruments should be classified in that category. Accordingly, any remaining HTM assets are reclassified as available-for-sale financial assets. The reclassification is recorded in the reporting period in which the sales or transfers occurred and is accounted for as a change in classification under MPSAS 29.60. MPSAS 29.10 makes it clear that at least two full financial years must pass before an entity can again classify financial assets as HTM.

B.19 *Definition of Held-to-Maturity Investments: Sub-Categorization for the Purpose of Applying the “Tainting” Rule*

Can an entity apply the conditions for held-to-maturity classification in MPSAS 29.10 separately to different categories of held-to-maturity financial assets, such as debt instruments denominated in US dollars and debt instruments denominated in euro?

No. The “tainting rule” in MPSAS 29.10 is clear. If an entity has sold or reclassified more than an insignificant amount of held-to-maturity investments, it cannot classify any financial assets as held-to-maturity financial assets.

B.20 *Definition of Held-to-Maturity Investments: Application of the “Tainting” Rule on Consolidation*

Can an entity apply the conditions in MPSAS 29.10 separately to held-to-maturity financial assets held by different entities in an economic entity, for example, if separate entities are in different countries with different legal or economic environments?

No. If an entity has sold or reclassified more than an insignificant amount of investments classified as held-to-maturity in the consolidated financial statements, it cannot classify any financial assets as held-to-maturity financial assets in the consolidated financial statements unless the conditions in MPSAS 29.10 are met.

B.21 *Definition of Loans and Receivables: Equity Instrument*

Can an equity instrument, such as a preference share, with fixed or determinable payments be classified within loans and receivables by the holder?

Yes. If a non-derivative equity instrument would be recorded as a liability by the issuer, and it has fixed or determinable payments and is not quoted in an active market, it can be classified within loans and receivables by the holder, provided the definition is otherwise met. MPSAS 27.13–MPSAS 27.27 provide guidance about the classification of a financial instrument as a liability or as an equity instrument from the perspective of the issuer of a financial instrument. If an instrument meets the definition of an equity instrument under MPSAS 28, *Financial Instruments: Presentation*, it cannot be classified within loans and receivables by the holder.

B.22 *Definition of Loans and Receivables: Banks’ Deposits in Other Banks*

Banks make term deposits with a central bank or other banks. Sometimes, the proof of deposit is negotiable, sometimes not. Even if negotiable, the depositor bank may or may not intend to sell it. Would such a deposit fall within loans and receivables under MPSAS 29.10?

Such a deposit meets the definition of loans and receivables, whether or not the proof of deposit is negotiable, unless the depositor bank intends to sell the instrument immediately or in the near term, in which case the deposit is classified as a financial asset held for trading.

B.23 *Definition of Amortized Cost: Perpetual Debt Instruments with Fixed or Market-Based Variable Rate*

Sometimes entities purchase or issue debt instruments that are required to be measured at amortized cost and in respect of which the issuer has no obligation to repay the principal amount. Interest may be paid either at a fixed rate or at a variable rate. Would the difference between the initial amount paid or received and zero (“the maturity amount”) be amortized immediately on initial recognition for the purpose of determining amortized cost if the rate of interest is fixed or specified as a market-based variable rate?

No. Since there are no repayments of principal, there is no amortization of the difference between the initial amount and the maturity amount if the rate of interest is fixed or specified as a market-based variable rate. Because interest payments are fixed or market-based and will be paid in perpetuity, the amortized cost (the present value of the stream of future cash payments discounted at the effective interest rate) equals the principal amount in each period (MPSAS 29.10).

B.24 *Definition of Amortized Cost: Perpetual Debt Instruments with Decreasing Interest Rate*

If the stated rate of interest on a perpetual debt instrument decreases over time, would amortized cost equal the principal amount in each period?

No. From an economic perspective, some or all of the interest payments are repayments of the principal amount. For example, the interest rate may be stated as 16 percent for the first ten years and as zero percent in subsequent periods. In that case, the initial amount is amortized to zero over the first ten years using the effective interest method, since a portion of the interest payments represents repayments of the principal amount. The amortized cost is zero after year 10 because the present value of the stream of future cash payments in subsequent periods is zero (there are no further cash payments of either principal or interest in subsequent periods).

B.25 *Example of Calculating Amortized Cost: Financial Asset*

Financial assets that are excluded from fair valuation and have a fixed maturity should be measured at amortized cost. How is amortized cost calculated?

Under MPSAS 29, *Financial Instruments: Recognition and Measurement*, amortized cost is calculated using the effective interest method. The effective interest rate inherent in a financial instrument is the rate that exactly discounts the estimated cash flows associated with the financial instrument through the expected life of the instrument or, where appropriate, a shorter period to the net carrying amount at initial recognition. The computation includes all fees and points paid or received that are an integral part of the effective interest rate, directly attributable transaction costs and all other premiums or discounts.

The following example illustrates how amortized cost is calculated using the effective interest method. Entity A purchases a debt instrument with five years remaining to maturity for its fair value of RM1,000 (including transaction costs). The instrument has a principal amount of RM1,250 and carries fixed interest of 4.7 percent that is paid annually ($\text{RM1,250} \times 4.7 \text{ percent} = \text{RM59}$ per year). The contract also specifies that the borrower has an option to prepay the instrument and that no penalty will be charged for prepayment. At inception, the entity expects the borrower not to prepay.

It can be shown that in order to allocate interest receipts and the initial discount over the term of the debt instrument at a constant rate on the carrying amount, they must be accrued at the rate of 10 percent annually. The table below provides information about the amortized cost, interest revenue and cash flows of the debt instrument in each reporting period.

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Year	(a) Amortized cost at the beginning of the year	(b = a × 10%) Interest revenue	(c) Cash flows	(d = a + b – c) Amortized cost at the end of the year
20X0	1,000	100	59	1,041
20X1	1,041	104	59	1,086
20X2	1,086	109	59	1,136
20X3	1,136	113	59	1,190
20X4	1,190	119	1,250 + 59	–

On the first day of 20X2 the entity revises its estimate of cash flows. It now expects that 50 percent of the principal will be prepaid at the end of 20X2 and the remaining 50 percent at the end of 20X4. In accordance with MPSAS 29.AG20, the opening balance of the debt instrument in 20X2 is adjusted. The adjusted amount is calculated by discounting the amount the entity expects to receive in 20X2 and subsequent years using the original effective interest rate (10 percent). This results in the new opening balance in 20X2 of RM1,138. The adjustment of RM52 (RM1,138 – RM1,086) is recorded in surplus or deficit in 20X2. The table below provides information about the amortized cost, interest revenue and cash flows as they would be adjusted taking into account the change in estimate.

Year	(a) Amortized cost at the beginning of the year	(b = a × 10%) Interest revenue	(c) Cash flows	(d = a + b – c) Amortized cost at the end of the year
20X0	1,000	100	59	1,041
20X1	1,041	104	59	1,086
20X2	1,086 + 52	114	625 + 59	568
20X3	568	57	30	595
20X4	595	60	625 + 30	–

If the debt instrument becomes impaired, say, at the end of 20X3, the impairment loss is calculated as the difference between the carrying amount (RM595) and the present value of estimated future cash flows discounted at the original effective interest rate (10 percent).

B.26 Example of Calculating Amortized Cost: Debt Instruments with Stepped Interest Payments

Sometimes entities purchase or issue debt instruments with a predetermined rate of interest that increases or decreases progressively (“stepped interest”) over the term of the debt instrument. If a debt instrument with stepped interest and no embedded derivative is issued at RM1,250 and has a maturity amount of RM1,250, would the amortized cost equal RM1,250 in each reporting period over the term of the debt instrument?

No. Although there is no difference between the initial amount and maturity amount, an entity uses the effective interest method to allocate interest payments over the term of the debt instrument to achieve a constant rate on the carrying amount (MPSAS 29.10).

The following example illustrates how amortized cost is calculated using the effective interest method for an instrument with a predetermined rate of interest that increases or decreases over the term of the debt instrument (“stepped interest”).

On January 1, 2000, Entity A issues a debt instrument for a price of RM1,250. The principal amount is RM1,250 and the debt instrument is repayable on December 31, 2004. The rate of interest is specified in the debt agreement as a percentage of the principal amount as follows: 6.0 percent in 2000 (RM75), 8.0 percent in 2001 (RM100), 10.0 percent in 2002 (RM125), 12.0 percent in 2003 (RM150), and 16.4 percent in 2004 (RM205). In this case, the interest rate that exactly discounts the stream of future cash payments through maturity is 10 percent. Therefore, cash interest payments are reallocated over the term of the debt instrument for the purposes of determining amortized cost in each period. In each period, the amortized cost at the beginning of the period is multiplied by the effective interest rate of 10 percent and added to the amortized cost. Any cash payments in the period are deducted from the resulting number. Accordingly, the amortized cost in each period is as follows:

Year	(a) Amortized cost at the beginning of the year	(b = a × 10%) Interest revenue	(c) Cash flows	(d = a + b – c) Amortized cost at the end of the year
20X0	1,250	125	75	1,300
20X1	1,300	130	100	1,330
20X2	1,330	133	125	1,338
20X3	1,338	134	150	1,322
20X4	1,322	133	1,250 + 205	–

B.27 Regular Way Contracts: No Established Market

Can a contract to purchase a financial asset be a regular way contract if there is no established market for trading such a contract?

Yes. MPSAS 29.10 refers to terms that require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned. Marketplace, as that term is used in MPSAS 29.10, is not limited to a formal stock exchange or organized over-the-counter market. Rather, it means the environment in which the financial asset is customarily exchanged. An acceptable time frame would be the period reasonably and customarily required for the parties to complete the transaction and prepare and execute closing documents.

For example, a market for private issue financial instruments can be a marketplace.

B.28 Regular Way Contracts: Forward Contract

Entity ABC enters into a forward contract to purchase one million of M's ordinary shares in two months for RM10 per share. The contract is not an exchange-traded contract. The contract requires ABC to take physical delivery of the shares and pay the counterparty RM10 million in cash. M's shares trade in an active public market at an average of 100,000 shares a day. Regular way delivery is three days. Is the forward contract regarded as a regular way contract?

No. The contract must be accounted for as a derivative because it is not settled in the way established by regulation or convention in the marketplace concerned.

B.29 *Regular Way Contracts: Which Customary Settlement Provisions Apply?*

If an entity's financial instruments trade in more than one active market and the settlement provisions differ in the various active markets, which provisions apply in assessing whether a contract to purchase those financial instruments is a regular way contract?

The provisions that apply are those in the market in which the purchase actually takes place.

To illustrate: Entity XYZ purchases one million shares of Entity ABC on a US stock exchange, for example, through a broker. The settlement date of the contract is six business days later. Trades for equity shares on US exchanges customarily settle in three business days. Because the trade settles in six business days, it does not meet the exemption as a regular way trade.

However, if XYZ did the same transaction on a foreign exchange that has a customary settlement period of six business days, the contract would meet the exemption for a regular way trade.

B.30 *Regular Way Contracts: Share Purchase by Call Option*

Entity A purchases a call option in a public market permitting it to purchase 100 shares of Entity XYZ at any time over the next three months at a price of RM100 per share. If Entity A exercises its option, it has 14 days to settle the transaction according to regulation or convention in the options market. XYZ shares are traded in an active public market that requires three-day settlement. Is the purchase of shares by exercising the option a regular way purchase of shares?

Yes. The settlement of an option is governed by regulation or convention in the marketplace for options and, therefore, upon exercise of the option it is no longer accounted for as a derivative because settlement by delivery of the shares within 14 days is a regular way transaction.

B.31 *Recognition and Derecognition of Financial Liabilities Using Trade Date or Settlement Date Accounting*

MPSAS 29, *Financial Instruments: Recognition and Measurement*, has special rules about recognition and derecognition of financial assets using trade date or settlement date accounting. Do these rules apply to transactions in financial instruments that are classified as financial liabilities, such as transactions in deposit liabilities and trading liabilities?

No. MPSAS 29, *Financial Instruments: Recognition and Measurement*, does not contain any specific requirements about trade date accounting and settlement date accounting in the case of transactions in financial instruments that are classified as financial liabilities. Therefore, the general recognition and derecognition requirements in MPSAS 29.18 and MPSAS 29.41 apply. MPSAS 29.16 states that financial liabilities are recognized on the date the entity “becomes a party to the contractual provisions of the instrument.” Such contracts generally are not recognized unless one of the parties has performed or the contract is a derivative contract not exempted from the scope of MPSAS 29, *Financial Instruments: Recognition and Measurement*. MPSAS 29.41 specifies that financial liabilities are derecognized only when they are extinguished, i.e., when the obligation specified in the contract is discharged or cancelled or expires.

Section C: Embedded Derivatives

C.1 *Embedded Derivatives: Separation of Host Debt Instrument*

If an embedded non-option derivative is required to be separated from a host debt instrument, how are the terms of the host debt instrument and the embedded derivative identified? For example, would the host debt instrument be a fixed rate instrument, a variable rate instrument or a zero coupon instrument?

The terms of the host debt instrument reflect the stated or implied substantive terms of the hybrid instrument. In the absence of implied or stated terms, the entity makes its own judgment of the terms. However, an entity may not identify a component that is not specified or may not establish terms of the host debt instrument in a manner that would result in the separation of an embedded derivative that is not already clearly present in the hybrid instrument, that is to say, it cannot create a cash flow that does not exist. For example, if a five-year debt instrument has fixed interest payments of RM40,000 annually and a principal payment at maturity of RM1,000,000 multiplied by the change in an equity price index, it would be inappropriate to identify a floating rate host contract and an embedded equity swap that has an offsetting floating rate leg in lieu of identifying a fixed rate host. In that example, the host contract is a fixed rate debt instrument that pays RM40,000 annually because there are no floating interest rate cash flows in the hybrid instrument.

In addition, the terms of an embedded non-option derivative, such as a forward or swap, must be determined so as to result in the embedded derivative having a fair value of zero at the inception of the hybrid instrument. If it were permitted to separate embedded non-option derivatives on other terms, a single hybrid instrument could be decomposed into an infinite variety of combinations of host debt instruments and embedded derivatives, for example, by separating embedded derivatives with terms that create leverage, asymmetry or some other risk exposure not already present in the hybrid instrument. Therefore, it is inappropriate to separate an embedded non-option derivative on terms that result in a fair value other than zero at the inception of the hybrid instrument. The determination of the terms of the embedded derivative is based on the conditions existing when the financial instrument was issued.

C.2 *Embedded Derivatives: Separation of Embedded Option*

The response to Question C.1 states that the terms of an embedded non-option derivative should be determined so as to result in the embedded derivative having a fair value of zero at the initial recognition of the hybrid instrument. When an embedded option-based derivative is separated, must the terms of the embedded option be determined so as to result in the embedded derivative having either a fair value of zero or an intrinsic value of zero (that is to say, be at the money) at the inception of the hybrid instrument?

No. The economic behaviour of a hybrid instrument with an option-based embedded derivative depends critically on the strike price (or strike rate) specified for the option feature in the hybrid instrument, as discussed below. Therefore, the separation of an option-based embedded derivative (including any embedded put, call, cap, floor, capton, floortion or swaption feature in a hybrid instrument) should be based on the stated terms of the option feature documented in the hybrid instrument. As a result, the embedded derivative would not necessarily have a fair value or intrinsic value equal to zero at the initial recognition of the hybrid instrument.

If an entity were required to identify the terms of an embedded option-based derivative so as to achieve a fair value of the embedded derivative of zero, the strike price (or strike rate) generally would have to

be determined so as to result in the option being infinitely out of the money. This would imply a zero probability of the option feature being exercised. However, since the probability of the option feature in a hybrid instrument being exercised generally is not zero, it would be inconsistent with the likely economic behaviour of the hybrid instrument to assume an initial fair value of zero. Similarly, if an entity were required to identify the terms of an embedded option-based derivative so as to achieve an intrinsic value of zero for the embedded derivative, the strike price (or strike rate) would have to be assumed to equal the price (or rate) of the underlying variable at the initial recognition of the hybrid instrument. In this case, the fair value of the option would consist only of time value. However, such an assumption would not be consistent with the likely economic behavior of the hybrid instrument, including the probability of the option feature being exercised, unless the agreed strike price was indeed equal to the price (or rate) of the underlying variable at the initial recognition of the hybrid instrument.

The economic nature of an option-based embedded derivative is fundamentally different from a forward-based embedded derivative (including forwards and swaps), because the terms of a forward are such that a payment based on the difference between the price of the underlying and the forward price will occur at a specified date, while the terms of an option are such that a payment based on the difference between the price of the underlying and the strike price of the option may or may not occur depending on the relationship between the agreed strike price and the price of the underlying at a specified date or dates in the future. Adjusting the strike price of an option-based embedded derivative, therefore, alters the nature of the hybrid instrument. On the other hand, if the terms of a non-option embedded derivative in a host debt instrument were determined so as to result in a fair value of any amount other than zero at the inception of the hybrid instrument, that amount would essentially represent a borrowing or lending. Accordingly, as discussed in the answer to Question C.1, it is not appropriate to separate a non-option embedded derivative in a host debt instrument on terms that result in a fair value other than zero at the initial recognition of the hybrid instrument.

C.3 Embedded Derivatives: Accounting for a Convertible Bond

What is the accounting treatment of an investment in a bond (financial asset) that is convertible into equity instruments of the issuing entity or another entity before maturity?

An investment in a convertible bond that is convertible before maturity generally cannot be classified as a held-to-maturity investment because that would be inconsistent with paying for the conversion feature – the right to convert into equity instruments before maturity.

An investment in a convertible bond can be classified as an available-for-sale financial asset provided it is not purchased for trading purposes. The equity conversion option is an embedded derivative.

If the bond is classified as available for sale (i.e., fair value changes recognized in net assets/equity until the bond is sold), the equity conversion option (the embedded derivative) is separated. The amount paid for the bond is split between the debt instrument without the conversion option and the equity conversion option. Changes in the fair value of the equity conversion option are recognized in surplus or deficit unless the option is part of a cash flow hedging relationship.

If the convertible bond is measured at fair value with changes in fair value recognized in surplus or deficit, separating the embedded derivative from the host bond is not permitted.

C.4 *Embedded Derivatives: Equity Kicker*

In some instances, venture capital entities providing subordinated loans agree that if and when the borrower lists its shares on a stock exchange, the venture capital entity is entitled to receive shares of the borrowing entity free of charge or at a very low price (an “equity kicker”) in addition to interest and repayment of principal. As a result of the equity kicker feature, the interest on the subordinated loan is lower than it would otherwise be. Assuming that the subordinated loan is not measured at fair value with changes in fair value recognized in surplus or deficit (MPSAS 29.12(c)), does the equity kicker feature meet the definition of an embedded derivative even though it is contingent upon the future listing of the borrower?

Yes. The economic characteristics and risks of an equity return are not closely related to the economic characteristics and risks of a host debt instrument (MPSAS 29.12(a)). The equity kicker meets the definition of a derivative because it has a value that changes in response to the change in the price of the shares of the borrower, it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, and it is settled at a future date (MPSAS 29.12(b) and MPSAS 29.10(a)). The equity kicker feature meets the definition of a derivative even though the right to receive shares is contingent upon the future listing of the borrower. MPSAS 29.AG21 states that a derivative could require a payment as a result of some future event that is unrelated to a notional amount. An equity kicker feature is similar to such a derivative except that it does not give a right to a fixed payment, but an option right, if the future event occurs.

C.5 *Embedded Derivatives: Identifying Debt or Equity Instruments as Host Contracts*

Entity A purchases a five-year “debt” instrument issued by Entity B with a principal amount of RM1 million that is indexed to the share price of Entity C. At maturity, Entity A will receive from Entity B the principal amount plus or minus the change in the fair value of 10,000 shares of Entity C. The current share price is RM110. No separate interest payments are made by Entity B. The purchase price is RM1 million. Entity A classifies the debt instrument as available for sale. Entity A concludes that the instrument is a hybrid instrument with an embedded derivative because of the equity-indexed principal. For the purposes of separating an embedded derivative, is the host contract an equity instrument or a debt instrument?

The host contract is a debt instrument because the hybrid instrument has a stated maturity, i.e., it does not meet the definition of an equity instrument (MPSAS 28.9 and MPSAS 28.14). It is accounted for as a zero coupon debt instrument. Thus, in accounting for the host instrument, Entity A imputes interest on RM1 million over five years using the applicable market interest rate at initial recognition. The embedded non-option derivative is separated so as to have an initial fair value of zero (see Question C.1).

C.6 *Embedded Derivatives: Synthetic Instruments*

Entity A acquires a five-year floating rate debt instrument issued by Entity B. At the same time, it enters into a five-year pay-variable, receive-fixed interest rate swap with Entity C. Entity A regards the combination of the debt instrument and swap as a synthetic fixed rate instrument and classifies the instrument as a held-to-maturity investment, since it has the positive intention and ability to hold it to maturity. Entity A contends that separate accounting for the swap is inappropriate since MPSAS 29. AG46(a) requires an embedded derivative to be classified together with its host instrument if the derivative is linked to an interest rate that can change the amount of interest that would otherwise be paid or received on the host debt contract. Is the entity’s analysis correct?

No. Embedded derivative instruments are terms and conditions that are included in non-derivative host contracts. It is generally inappropriate to treat two or more separate financial instruments as a single combined instrument (“synthetic instrument” accounting) for the purpose of applying MPSAS 29, *Financial Instruments: Recognition and Measurement*. Each of the financial instruments has its own terms and conditions and each may be transferred or settled separately. Therefore, the debt instrument and the swap are classified separately. The transactions described here differ from the transactions discussed in Question B.5, which had no substance apart from the resulting interest rate swap.

C.7 Embedded Derivatives: Purchases and Sales Contracts in Foreign Currency Instruments

A supply contract provides for payment in a currency other than:

- (a) **The functional currency of either party to the contract;**
- (b) **The currency in which the product is routinely denominated in commercial transactions around the world; and**
- (c) **The currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place.**

Is there an embedded derivative that should be separated under MPSAS 29, *Financial Instruments: Recognition and Measurement*?

Yes. To illustrate: a Norwegian entity agrees to sell oil to an entity in France. The oil contract is denominated in Swiss francs, although oil contracts are routinely denominated in US dollars in commercial transactions around the world, and Norwegian krone are commonly used in contracts to purchase or sell non-financial items in Norway. Neither entity carries out any significant activities in Swiss francs. In this case, the Norwegian entity regards the supply contract as a host contract with an embedded foreign currency forward to purchase Swiss francs. The French entity regards the supply contract as a host contract with an embedded foreign currency forward to sell Swiss francs. Each entity includes fair value changes on the currency forward in surplus or deficit unless the reporting entity designates it as a cash flow hedging instrument, if appropriate.

C.8 Embedded Foreign Currency Derivatives: Unrelated Foreign Currency Provision

Entity A, which measures items in its financial statements on the basis of the euro (its functional currency), enters into a contract with Entity B, which has the Norwegian krone as its functional currency, to purchase oil in six months for 1,000 US dollars. The host oil contract is not within the scope of MPSAS 29, *Financial Instruments: Recognition and Measurement*, because it was entered into and continues to be for the purpose of delivery of a non-financial item in accordance with the entity’s expected purchase, sale or usage requirements (MPSAS 29.4 and MPSAS 29.AG22). The oil contract includes a leveraged foreign exchange provision that states that the parties, in addition to the provision of, and payment for, oil will exchange an amount equal to the fluctuation in the exchange rate of the US dollar and Norwegian krone applied to a notional amount of 100,000 US dollars. Under MPSAS 29.12, is that embedded derivative (the leveraged foreign exchange provision) regarded as closely related to the host oil contract?

No, that leveraged foreign exchange provision is separated from the host oil contract because it is not closely related to the host oil contract (MPSAS 29.AG46(d)).

The payment provision under the host oil contract of 1,000 US dollars can be viewed as a foreign currency derivative because the US dollar is neither Entity A’s nor Entity B’s functional currency. This

foreign currency derivative would not be separated because it follows from MPSAS 29.AG45(d) that a crude oil contract that requires payment in US dollars is not regarded as a host contract with a foreign currency derivative.

The leveraged foreign exchange provision that states that the parties will exchange an amount equal to the fluctuation in the exchange rate of the US dollar and Norwegian krone applied to a notional amount of 100,000 US dollars is in addition to the required payment for the oil transaction. It is unrelated to the host oil contract and therefore separated from the host oil contract and accounted for as an embedded derivative under MPSAS 29.12.

C.9 Embedded Foreign Currency Derivatives: Currency of International Commerce

MPSAS 29.AG46(d) refers to the currency in which the price of the related goods or services is routinely denominated in commercial transactions around the world. Could it be a currency that is used for a certain product or service in commercial transactions within the local area of one of the substantial parties to the contract?

No. The currency in which the price of the related goods or services is routinely denominated in commercial transactions around the world is only a currency that is used for similar transactions all around the world, not just in one local area. For example, if cross-border transactions in natural gas in North America are routinely denominated in US dollars and such transactions are routinely denominated in euro in Europe, neither the US dollar nor the euro is a currency in which the goods or services are routinely denominated in commercial transactions around the world.

C.10 Embedded Derivatives: Holder Permitted, But Not Required, to Settle Without Recovering Substantially all of its Recognized Investment

If the terms of a combined instrument permit, but do not require, the holder to settle the combined instrument in a manner that causes it not to recover substantially all of its recognized investment and the issuer does not have such a right (e.g., a puttable debt instrument), does the contract satisfy the condition in MPSAS 29.AG46(a) that the holder would not recover substantially all of its recognized investment?

No. The condition that “the holder would not recover substantially all of its recognized investment” is not satisfied if the terms of the combined instrument permit, but do not require, the investor to settle the combined instrument in a manner that causes it not to recover substantially all of its recognized investment and the issuer has no such right. Accordingly, an interest-bearing host contract with an embedded interest rate derivative with such terms is regarded as closely related to the host contract. The condition that “the holder would not recover substantially all of its recognized investment” applies to situations in which the holder can be forced to accept settlement at an amount that causes the holder not to recover substantially all of its recognized investment.

C.11 Embedded Derivatives: Reliable Determination of Fair Value

If an embedded derivative that is required to be separated cannot be reliably measured because it will be settled by an unquoted equity instrument whose fair value cannot be reliably measured, is the embedded derivative measured at cost?

No. In this case, the entire combined contract is treated as a financial instrument held for trading (MPSAS 29.14). If the fair value of the combined instrument can be reliably measured, the combined contract is measured at fair value. The entity might conclude, however, that the equity component of

the combined instrument may be sufficiently significant to preclude it from obtaining a reliable estimate of the entire instrument. In that case, the combined instrument is measured at cost less impairment.

Section D: Recognition and Derecognition

D.1 *Initial Recognition*

D.1.1 **Recognition: Cash Collateral**

Entity B transfers cash to Entity A as collateral for another transaction with Entity A (e.g., a securities borrowing transaction). The cash is not legally segregated from Entity A's assets. Should Entity A recognize the cash collateral it has received as an asset?

Yes. The ultimate realization of a financial asset is its conversion into cash and, therefore, no further transformation is required before the economic benefits of the cash transferred by Entity B can be realized by Entity A. Therefore, Entity A recognizes the cash as an asset and a payable to Entity B while Entity B derecognizes the cash and recognizes a receivable from Entity A.

D.2 *Regular Way Purchase or Sale of a Financial Asset*

D.2.1 **Trade Date vs. Settlement Date: Amounts to be Recorded for a Purchase**

How are the trade date and settlement date accounting principles in the Standard applied to a purchase of a financial asset?

The following example illustrates the application of the trade date and settlement date accounting principles in the Standard for a purchase of a financial asset. On December 29, 20X1, an entity commits itself to purchase a financial asset for RM 1,000, which is its fair value on commitment (trade) date. Transaction costs are immaterial. On December 31, 20X1 (financial year-end) and on January 4, 20X2 (settlement date) the fair value of the asset is RM 1,002 and RM 1,003, respectively. The amounts to be recorded for the asset will depend on how it is classified and whether trade date or settlement date accounting is used, as shown in the two tables below.

Settlement Date Accounting			
Balances	Held-to-maturity investments carried at amortized cost	Available-for-sale assets remeasured to fair value with changes in net assets/equity	Assets at fair value through surplus or deficit remeasured to fair value with changes in surplus or deficit
December 29, 20X1			
Financial asset	—	—	—
Financial liability	—	—	—
December 31, 20X1			
Receivable	—	2	2
Financial asset	—	—	—
Financial liability	—	—	—
Net assets/equity (fair value adjustment)	—	(2)	—
Accumulated surplus or deficit (through surplus or deficit)	—	—	(2)
January 4, 20X2			
Receivable	—	—	—
Financial asset	1,000	1,003	1,003
Financial liability	—	—	—
Net assets/equity (fair value adjustment)	—	(3)	—
Accumulated surplus or deficit (through surplus or deficit)	—	—	(3)

Trade Date Accounting			
Balances	Held-to-maturity investments carried at amortized cost	Available-for-sale assets remeasured to fair value with changes in net assets/equity	Assets at fair value through surplus or deficit remeasured to fair value with changes in surplus or deficit
December 29, 20X1			
Financial asset	1,000	1,000	1,000
Financial liability	(1,000)	(1,000)	(1,000)
December 31, 20X1			
Receivable	–	–	–
Financial asset	1,000	1,002	1,002
Financial liability	(1,000)	(1,000)	(1,000)
Net assets/equity (fair value adjustment)	–	(2)	–
Accumulated surplus or deficit (through surplus or deficit)	–	–	(2)
January 4, 20X2			
Receivable	–	–	–
Financial asset	1,000	1,003	1,003
Financial liability	–	–	–
Net assets/equity (fair value adjustment)	–	(3)	–
Accumulated surplus or deficit (through surplus or deficit)	–	–	(3)

D.2.2 Trade Date vs. Settlement Date: Amounts to be Recorded for a Sale

How are the trade date and settlement date accounting principles in the Standard applied to a sale of a financial asset?

The following example illustrates the application of the trade date and settlement date accounting principles in the Standard for a sale of a financial asset. On December 29, 20X2 (trade date) an entity enters into a contract to sell a financial asset for its current fair value of RM1,010. The asset was acquired one year earlier for RM1,000 and its amortized cost is RM1,000. On December 31, 20X2 (financial year-end), the fair value of the asset is RM1,012. On January 4, 20X3 (settlement date), the fair value is RM1,013. The amounts to be recorded will depend on how the asset is classified and whether trade date or settlement date accounting is used as shown in the two tables below (any interest that might have accrued on the asset is disregarded).

A change in the fair value of a financial asset that is sold on a regular way basis is not recorded in the financial statements between trade date and settlement date even if the entity applies settlement date accounting because the seller's right to changes in the fair value ceases on the trade date.

Settlement Date Accounting			
Balances	Held-to-maturity investments carried at amortized cost	Available-for-sale assets remeasured to fair value with changes in net assets/equity	Assets at fair value through surplus or deficit remeasured to fair value with changes in surplus or deficit
December 29, 20X2			
Receivable	—	—	—
Financial asset	1,000	1,010	1,010
Net assets/equity (fair value adjustment)	—	10	—
Accumulated surplus or deficit (through surplus or deficit)	—	—	10
December 31, 20X2			
Receivable	—	—	—
Financial asset	1,000	1,010	1,010
Net assets/equity (fair value adjustment)	—	10	—
Accumulated surplus or deficit (through surplus or deficit)	—	—	10
January 4, 20X3			
Net assets/equity (fair value adjustment)	—	—	—
Accumulated surplus or deficit (through surplus or deficit)	10	10	10

Trade Date Accounting			
Balances	Held-to-maturity investments carried at amortized cost	Available-for-sale assets remeasured to fair value with changes in net assets/equity	Assets at fair value through surplus or deficit remeasured to fair value with changes in surplus or deficit
December 29, 20X2			
Receivable	1,010	1,010	1,010
Financial asset	–	–	–
Equity (fair value adjustment)	–	–	–
Accumulated surplus or deficit (through surplus or deficit)	10	10	10
December 31, 20X2			
Receivable	1,010	1,010	1,010
Financial asset	–	–	–
Net assets/equity (fair value adjustment)	–	–	–
Accumulated surplus or deficit (through surplus or deficit)	10	10	10
January 4, 20X3			
Net assets/equity (fair value adjustment)	–	–	–
Accumulated surplus or deficit (through surplus or deficit)	10	10	10

D.2.3 Settlement Date Accounting: Exchange of Non-Cash Financial Assets

If an entity recognizes sales of financial assets using settlement date accounting, would a change in the fair value of a financial asset to be received in exchange for the non-cash financial asset that is sold be recognized in accordance with MPSAS 29.66?

It depends. Any change in the fair value of the financial asset to be received would be accounted for under MPSAS 29.66 if the entity applies settlement date accounting for that category of financial assets. However, if the entity classifies the financial asset to be received in a category for which it applies trade date accounting, the asset to be received is recognized on the trade date as described in MPSAS 29.AG70. In that case, the entity recognizes a liability of an amount equal to the carrying amount of the financial asset to be delivered on settlement date.

To illustrate: on December 29, 20X2 (trade date) Entity A enters into a contract to sell Note Receivable A, which is carried at amortized cost, in exchange for Bond B, which will be classified as held for trading and measured at fair value. Both assets have a fair value of RM 1,010 on December, 29, while the amortized cost of Note Receivable A is RM 1,000. Entity A uses settlement date accounting for loans and receivables and trade date accounting for assets held for trading. On December 31, 20X2 (financial year-end), the fair value of Note Receivable A is RM 1,012 and the fair value of Bond B is RM 1,009. On January, 4 20X3, the fair value of Note Receivable A is RM 1,013 and the fair value of Bond B is RM 1,007. The following entries are made:

December 29, 20X2

Dr	Bond B	RM1,010	
	Cr Payable		RM1,010

December 31, 20X2

Dr	Trading loss	RM1	
	Cr Bond B		RM 1

January 4, 20X3

Dr	Payable	RM 1,010	
Dr	Trading loss	RM 2	
	Cr Note Receivable A		RM 1,000
	Cr Bond B		RM 2
	Cr Realization gain		RM 10

Section E: Measurement

E.1 *Initial Measurement of Financial Assets and Financial Liabilities*

E.1.1 **Initial Measurement: Transaction Costs**

Transaction costs should be included in the initial measurement of financial assets and financial liabilities other than those at fair value through surplus or deficit. How should this requirement be applied in practice?

For financial assets, incremental costs that are directly attributable to the acquisition of the asset, for example fees and commissions, are added to the amount originally recognized. For financial liabilities, directly related costs of issuing debt are deducted from the amount of debt originally recognized. For financial instruments that are measured at fair value through surplus or deficit, transaction costs are not added to the fair value measurement at initial recognition.

For financial instruments that are carried at amortized cost, such as held-to-maturity investments, loans and receivables, and financial liabilities that are not at fair value through surplus or deficit, transaction costs are included in the calculation of amortized cost using the effective interest method and, in effect, amortized through surplus or deficit over the life of the instrument.

For available-for-sale financial assets, transaction costs are recognized in other net assets/equity as part of a change in fair value at the next remeasurement. If an available-for-sale financial asset has fixed or determinable payments and does not have an indefinite life, the transaction costs are amortized to surplus or deficit using the effective interest method. If an available-for-sale financial asset does not have fixed or determinable payments and has an indefinite life, the transaction costs are recognized in surplus or deficit when the asset is derecognized or becomes impaired.

Transaction costs expected to be incurred on transfer or disposal of a financial instrument are not included in the measurement of the financial instrument.

E.2 *Fair Value Measurement Considerations*

E.2.1 **Fair Value Measurement Considerations for Investment Funds**

MPSAS 29.AG104 states that the current bid price is usually the appropriate price to be used in measuring the fair value of an asset held. The rules applicable to some investment funds require net asset values to be reported to investors on the basis of mid-market prices. In these circumstances, would it be appropriate for an investment fund to measure its assets on the basis of mid-market prices?

No. The existence of regulations that require a different measurement for specific purposes does not justify a departure from the general requirement in MPSAS 29.AG104 to use the current bid price in the absence of a matching liability position. In its financial statements, an investment fund measures its assets at current bid prices. In reporting its net asset value to investors, an investment fund may wish to provide a reconciliation between the fair values recognized in its statement of financial position and the prices used for the net asset value calculation.

E.2.2 **Fair Value Measurement: Large Holding**

Entity A holds 15 percent of the share capital in Entity B. The shares are publicly traded in an active market. The currently quoted price is RM100. Daily trading volume is 0.1 percent of outstanding shares. Because Entity A believes that the fair value of the Entity B shares it owns, if sold as a block, is greater than the quoted market price, Entity A obtains several independent estimates of the price it would obtain if it sells its holding. These estimates indicate that Entity A would be able to obtain a price of RM 105, i.e., a 5 percent premium above the quoted price. Which figure should Entity A use for measuring its holding at fair value?

Under MPSAS 29.AG103, a published price quotation in an active market is the best estimate of fair value. Therefore, Entity A uses the published price quotation (RM 100). Entity A cannot depart from the quoted market price solely because independent estimates indicate that Entity A would obtain a higher (or lower) price by selling the holding as a block.

E.3 *Gains and Losses*

E.3.1 **Available-For-Sale Financial Assets: Exchange of Shares**

Entity A holds a small number of shares in Entity B. The shares are classified as available for sale. On December 20, 20X0, the fair value of the shares is RM120 and the cumulative gain recognized in net assets/equity is RM20. On the same day, Entity B is acquired by Entity C. As a result, Entity A receives shares in Entity C in exchange for those it had in Entity B of equal fair value. Under MPSAS 29.64(b), should Entity A reclassify the cumulative gain of RM20 recognized in net assets/equity to surplus or deficit?

Yes. The transaction qualifies for derecognition under MPSAS 29, *Financial Instruments: Recognition and Measurement*. MPSAS 29.64(b) requires the cumulative gain or loss on an available-for-sale financial asset that has been recognized in net assets/equity to be recognized in surplus or deficit when the asset is derecognized. In the exchange of shares, Entity A disposes of the shares it had in Entity B and receives shares in Entity C.

E.3.2 MPSAS 29, *Financial Instruments: Recognition and Measurement*, and MPSAS 4, *The Effect of Changes in Foreign Exchanges Rate*, Available-For-Sale Financial Assets: Separation of Currency Component

For an available-for-sale monetary financial asset, the entity recognizes changes in the carrying amount relating to changes in foreign exchange rates in surplus or deficit in accordance with MPSAS 4.27(a) and MPSAS 4.32 and other changes in the carrying amount in net assets/equity in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*. How is the cumulative gain or loss that is recognized in net assets/equity determined?

It is the difference between the amortized cost (adjusted for impairment, if any) and fair value of the available-for-sale monetary financial asset in the functional currency of the reporting entity. For the purpose of applying MPSAS 4.32 the asset is treated as an asset measured at amortized cost in the foreign currency.

To illustrate: on December 31, 20X1 Entity A acquires a bond denominated in a foreign currency (FC) for its fair value of FC1,000. The bond has five years remaining to maturity and a principal amount of FC1,250, carries fixed interest of 4.7 percent that is paid annually ($FC1,250 \times 4.7$ percent = FC59 per year), and has an effective interest rate of 10 percent. Entity A classifies the bond as available for sale, and thus recognizes gains and losses in net assets/equity. The entity's functional currency is its local currency (LC). The exchange rate is FC1 to LC1.5 and the carrying amount of the bond is LC1,500 ($= FC1,000 \times 1.5$).

Dr	Bond	LC1,500	
	Cr Cash		LC1,500

On December 31, 20X2, the foreign currency has appreciated and the exchange rate is FC1 to LC2. The fair value of the bond is FC1,060 and thus the carrying amount is LC2,120 ($= FC1,060 \times 2$). The amortized cost is FC1,041 ($= LC2,082$). In this case, the cumulative gain or loss to be recognized and accumulated in net assets/equity is the difference between the fair value and the amortized cost on December 31, 20X2, i.e., LC38 ($= LC2,120 - LC2,082$).

Interest received on the bond on December 31, 20X2 is FC59 ($= LC118$). Interest revenue determined in accordance with the effective interest method is FC100 ($= 1,000 \times 10$ percent). The average exchange rate during the year is FC1 to LC1.75. For the purpose of this question, it is assumed that the use of the average exchange rate provides a reliable approximation of the spot rates applicable to the accrual of interest revenue during the year (MPSAS 4.25). Thus, reported interest revenue is LC175 ($= FC100 \times 1.75$) including accretion of the initial discount of LC72 ($= [FC100 - FC59] \times 1.75$). Accordingly, the exchange difference on the bond that is recognized in surplus or deficit is LC510 ($= LC2,082 - LC1,500 - LC72$). Also, there is an exchange gain on the interest receivable for the year of LC15 ($= FC59 \times [2.00 - 1.75]$).

Dr	Bond	LC620	
Dr	Cash	LC118	
	Cr Interest revenue		LC175
	Cr Exchange gain		LC525
	Cr Fair value change in net assets/equity		LC38

On December 31, 20X3, the foreign currency has appreciated further and the exchange rate is FC1 to LC2.50. The fair value of the bond is FC1,070 and thus the carrying amount is LC2,675 ($= FC1,070 \times 2.50$). The amortized cost is FC1,086 ($= LC2,715$). The cumulative gain or loss to be accumulated in

net assets/equity is the difference between the fair value and the amortized cost on December 31, 20X3, i.e., negative LC40 (= LC2,675 – LC2,715). Thus, the amount recognized in net assets/equity equals the change in the difference during 20X3 of LC78 (= LC40 + LC38).

Interest received on the bond on December 31, 20X3 is FC59 (= LC148). Interest revenue determined in accordance with the effective interest method is FC104 (= FC1,041 × 10 percent). The average exchange rate during the year is FC1 to LC2.25. For the purpose of this question, it is assumed that the use of the average exchange rate provides a reliable approximation of the spot rates applicable to the accrual of interest revenue during the year (MPSAS 4.25). Thus, recognized interest revenue is LC234 (= FC104 × 2.25) including accretion of the initial discount of LC101 (= [FC104 – FC59] × 2.25). Accordingly, the exchange difference on the bond that is recognized in surplus or deficit is LC532 (= LC2,715 – LC2,082 – LC101). Also, there is an exchange gain on the interest receivable for the year of LC15 (= FC59 × [2.50 – 2.25]).

Dr	Bond	LC555	
Dr	Cash	LC148	
Dr	Fair value change in net assets/equity	LC78	
	Cr Interest revenue		LC234
	Cr Exchange gain		LC547

E.3.3 MPSAS 29, *Financial Instruments: Recognition and Measurement* and MPSAS 4, *The Effect of Changes in Foreign Exchange Rate, Exchange Differences Arising on Translation of Foreign Entities: Net Assets/Equity or, Surplus or Deficit?*

MPSAS 4.37 and MPSAS 4.57 states that all exchange differences resulting from translating the financial statements of a foreign operation should be recognized in net assets/equity until disposal of the net investment. This would include exchange differences arising from financial instruments carried at fair value, which would include both financial assets classified as at fair value through surplus or deficit and financial assets that are available for sale.

MPSAS 29.64 requires that changes in fair value of financial assets classified as at fair value through surplus or deficit should be recognized in surplus or deficit and changes in fair value of available-for-sale investments should be recognized in net assets/equity.

If the foreign operation is a controlled entity whose financial statements are consolidated with those of its controlling entity, in the consolidated financial statements how are MPSAS 29.64 and MPSAS 4.44 applied?

MPSAS 29, *Financial Instruments: Recognition and Measurement*, applies in the accounting for financial instruments in the financial statements of a foreign operation and MPSAS 4, *The Effects of Changes in Foreign Exchange Rates*, applies in translating the financial statements of a foreign operation for incorporation in the financial statements of the reporting entity.

To illustrate: Entity A is domiciled in Country X and its functional currency and presentation currency are the local currency of Country X (LCX). A has a foreign controlled entity (Entity B) in Country Y whose functional currency is the local currency of Country Y (LCY). B is the owner of a debt instrument, which is held for trading and therefore carried at fair value under MPSAS 29, *Financial Instruments: Recognition and Measurement*.

In B's financial statements for year 20X0, the fair value and carrying amount of the debt instrument is LCY100 in the local currency of Country Y. In A's consolidated financial statements, the asset is translated into the local currency of Country X at the spot exchange rate applicable at the end of the

reporting period (2.00). Thus, the carrying amount is LCX200 ($= \text{LCY}100 \times 2.00$) in the consolidated financial statements.

At the end of year 20X1, the fair value of the debt instrument has increased to LCY110 in the local currency of Country Y. B recognizes the trading asset at LCY110 in its statement of financial position and recognizes a fair value gain of LCY10 in its surplus or deficit. During the year, the spot exchange rate has increased from 2.00 to 3.00 resulting in an increase in the fair value of the instrument from LCX200 to LCX330 ($= \text{LCY}110 \times 3.00$) in the currency of Country X. Therefore, Entity A recognizes the trading asset at LCX330 in its consolidated financial statements.

Entity A translates the statement of changes in net assets/equity of B “at the exchange rates at the dates of the transactions” (MPSAS 4.44(b)). Since the fair value gain has accrued through the year, A uses the average rate as a practical approximation ($[3.00 + 2.00] / 2 = 2.50$, in accordance with MPSAS 4.25). Therefore, while the fair value of the trading asset has increased by LCX130 ($= \text{LCX}330 - \text{LCX}200$), Entity A recognizes only LCX25 ($= \text{LCY}10 \times 2.5$) of this increase in consolidated surplus or deficit to comply with MPSAS 4.44(b). The resulting exchange difference, i.e., the remaining increase in the fair value of the debt instrument ($\text{LCX}130 - \text{LCX}25 = \text{LCX}105$), is accumulated in net assets/equity until the disposal of the net investment in the foreign operation in accordance with MPSAS 4.57.

E.3.4 MPSAS 29, *Financial Instruments: Recognition and Measurement*, and MPSAS 4, *The Effect of Changes in Foreign Exchange Rates*: Interaction between MPSAS 29 and MPSAS 4

MPSAS 29, *Financial Instruments: Recognition and Measurement*, includes requirements about the measurement of financial assets and financial liabilities and the recognition of gains and losses on remeasurement in surplus or deficit. MPSAS 4, *The Effects of Changes in Foreign Exchange Rates*, includes rules about the reporting of foreign currency items and the recognition of exchange differences in surplus or deficit. In what order are MPSAS 4, *The Effects of Changes in Foreign Exchange Rates*, and MPSAS 29, *Financial Instruments: Recognition and Measurement*, applied?

Statement of Financial Position

Generally, the measurement of a financial asset or financial liability at fair value, cost or amortized cost is first determined in the foreign currency in which the item is denominated in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*. Then, the foreign currency amount is translated into the functional currency using the closing rate or a historical rate in accordance with MPSAS 4, *The Effects of Changes in Foreign Exchange Rates*, (MPSAS 29.AG116). For example, if a monetary financial asset (such as a debt instrument) is carried at amortized cost under MPSAS 29, *Financial Instruments: Recognition and Measurement*, amortized cost is calculated in the currency of denomination of that financial asset. Then, the foreign currency amount is recognized using the closing rate in the entity’s financial statements (MPSAS 4.27). That applies regardless of whether a monetary item is measured at cost, amortized cost or fair value in the foreign currency (MPSAS 4.28). A non-monetary financial asset (such as an investment in an equity instrument) is translated using the closing rate if it is carried at fair value in the foreign currency (MPSAS 4.27(c)) and at a historical rate if it is not carried at fair value under MPSAS 29, *Financial Instruments: Recognition and Measurement*, because its fair value cannot be reliably measured (MPSAS 4.27(b) and MPSAS 29.48).

As an exception, if the financial asset or financial liability is designated as a hedged item in a fair value hedge of the exposure to changes in foreign currency rates under MPSAS 29, *Financial Instruments: Recognition and Measurement*, the hedged item is remeasured for changes in foreign currency rates even if it would otherwise have been recognized using a historical rate under MPSAS 4, *The Effects of Changes in Foreign Exchange Rates*, (MPSAS 29.99), i.e., the foreign currency amount is recognized using the closing rate. This exception applies to non-monetary items that are carried in terms of historical cost in the foreign currency and are hedged against exposure to foreign currency rates (MPSAS 4.27(b)).

Surplus or Deficit

The recognition of a change in the carrying amount of a financial asset or financial liability in surplus or deficit depends on a number of factors, including whether it is an exchange difference or other change in carrying amount, whether it arises on a monetary item (e.g., most debt instruments) or non-monetary item (such as most equity investments), whether the associated asset or liability is designated as a cash flow hedge of an exposure to changes in foreign currency rates, and whether it results from translating the financial statements of a foreign operation. The issue of recognizing changes in the carrying amount of a financial asset or financial liability held by a foreign operation is addressed in a separate question (see Question E.3.3).

Any exchange difference arising on recognizing a monetary item at a rate different from that at which it was initially recognized during the period, or recognized in previous financial statements, is recognized in surplus or deficit or in net assets/equity in accordance with MPSAS 4, *The Effects of Changes in Foreign Exchange Rates*, (MPSAS 29.AG116, MPSAS 4.32 and MPSAS 4.37), unless the monetary item is designated as a cash flow hedge of a highly probable forecast transaction in foreign currency, in which case the requirements for recognition of gains and losses on cash flow hedges in MPSAS 29, *Financial Instruments: Recognition and Measurement*, apply (MPSAS 29.106). Differences arising from recognizing a monetary item at a foreign currency amount different from that at which it was previously recognized are accounted for in a similar manner, since all changes in the carrying amount relating to foreign currency movements should be treated consistently. All other changes in the statement of financial position measurement of a monetary item are recognized in surplus or deficit or in net assets/equity in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*. For example, although an entity recognizes gains and losses on available-for-sale monetary financial assets in net assets/equity (MPSAS 29.64(b)), the entity nevertheless recognizes the changes in the carrying amount relating to changes in foreign exchange rates in surplus or deficit (MPSAS 4.27(a)).

Any changes in the carrying amount of a non-monetary item are recognized in surplus or deficit or in net assets/equity in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, (MPSAS 29.AG116). For example, for available-for-sale financial assets the entire change in the carrying amount, including the effect of changes in foreign currency rates, is recognized in net assets/equity. If the non-monetary item is designated as a cash flow hedge of an unrecognized firm commitment or a highly probable forecast transaction in foreign currency, the requirements for recognition of gains and losses on cash flow hedges in MPSAS 29, *Financial Instruments: Recognition and Measurement*, apply (MPSAS 29.106).

When some portion of the change in carrying amount is recognized in net assets/equity and some portion is recognized in surplus or deficit, for example, if the amortized cost of a foreign currency bond classified as available for sale has increased in foreign currency (resulting in a gain in surplus or deficit) but its fair value has decreased in the functional currency (resulting in a loss recognized in net assets/equity), an entity cannot offset those two components for the purposes of determining gains or losses that should be recognized in surplus or deficit or in net assets/equity.

E.4 *Impairment and Uncollectibility of Financial Assets*

E.4.1 **Objective Evidence of Impairment**

Does MPSAS 29, *Financial Instruments: Recognition and Measurement*, require that an entity be able to identify a single, distinct past causative event to conclude that it is probable that an impairment loss on a financial asset has been incurred?

No. MPSAS 29.68 states “It may not be possible to identify a single, discrete event that caused the impairment. Rather the combined effect of several events may have caused the impairment.” Also, MPSAS 29.69 states that “a downgrade of an entity’s credit rating is not, of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information.” Other factors that an entity considers in determining whether it has objective evidence that an impairment loss has been incurred include information about the debtors’ or issuers’ liquidity, solvency and business and financial risk exposures, levels of and trends in delinquencies for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees. These and other factors may, either individually or taken together, provide sufficient objective evidence that an impairment loss has been incurred in a financial asset or group of financial assets.

E.4.2 **Impairment: Future Losses**

Does MPSAS 29, *Financial Instruments: Recognition and Measurement*, permit the recognition of an impairment loss through the establishment of an allowance for future losses when a loan is given? For example, if Entity A lends RM1,000 to Customer B, can it recognize an immediate impairment loss of RM10 if Entity A, based on historical experience, expects that 1 percent of the principal amount of loans given will not be collected?

No. MPSAS 29.45 requires a financial asset to be initially measured at fair value. For a loan asset, the fair value is the amount of cash lent adjusted for any fees and costs (unless a portion of the amount lent is compensation for other stated or implied rights or privileges). In addition, MPSAS 29.67 requires that an impairment loss is recognized only if there is objective evidence of impairment as a result of a past event that occurred after initial recognition. Accordingly, it is inconsistent with MPSAS 29.45 and MPSAS 29.67 to reduce the carrying amount of a loan asset on initial recognition through the recognition of an immediate impairment loss.

E.4.3 **Assessment of Impairment: Principal and Interest**

Because of Customer B’s financial difficulties, Entity A is concerned that Customer B will not be able to make all principal and interest payments due on a loan in a timely manner. It negotiates a restructuring of the loan. Entity A expects that Customer B will be able to meet its obligations under the restructured terms. Would Entity A recognize an impairment loss if the restructured terms are as reflected in any of the following cases?

- (a) **Customer B will pay the full principal amount of the original loan five years after the original due date, but none of the interest due under the original terms.**
- (b) **Customer B will pay the full principal amount of the original loan on the original due date, but none of the interest due under the original terms.**
- (c) **Customer B will pay the full principal amount of the original loan on the original due date with interest only at a lower interest rate than the interest rate inherent in the original loan.**

- (d) **Customer B will pay the full principal amount of the original loan five years after the original due date and all interest accrued during the original loan term, but no interest for the extended term.**
- (e) **Customer B will pay the full principal amount of the original loan five years after the original due date and all interest, including interest for both the original term of the loan and the extended term.**

MPSAS 29.67 indicates that an impairment loss has been incurred if there is objective evidence of impairment. The amount of the impairment loss for a loan measured at amortized cost is the difference between the carrying amount of the loan and the present value of future principal and interest payments discounted at the loan's original effective interest rate. In cases (a)–(d) above, the present value of the future principal and interest payments discounted at the loan's original effective interest rate will be lower than the carrying amount of the loan. Therefore, an impairment loss is recognized in those cases.

In case (e), even though the timing of payments has changed, the lender will receive interest on interest, and the present value of the future principal and interest payments discounted at the loan's original effective interest rate will equal the carrying amount of the loan. Therefore, there is no impairment loss. However, this fact pattern is unlikely given Customer B's financial difficulties.

E.4.4 Assessment of Impairment: Fair Value Hedge

A loan with fixed interest rate payments is hedged against the exposure to interest rate risk by a receive-variable, pay-fixed interest rate swap. The hedge relationship qualifies for fair value hedge accounting and is reported as a fair value hedge. Thus, the carrying amount of the loan includes an adjustment for fair value changes attributable to movements in interest rates. Should an assessment of impairment in the loan take into account the fair value adjustment for interest rate risk?

Yes. The loan's original effective interest rate before the hedge becomes irrelevant once the carrying amount of the loan is adjusted for any changes in its fair value attributable to interest rate movements. Therefore, the original effective interest rate and amortized cost of the loan are adjusted to take into account recognized fair value changes. The adjusted effective interest rate is calculated using the adjusted carrying amount of the loan.

An impairment loss on the hedged loan is calculated as the difference between its carrying amount after adjustment for fair value changes attributable to the risk being hedged and the estimated future cash flows of the loan discounted at the adjusted effective interest rate. When a loan is included in a portfolio hedge of interest rate risk, the entity should allocate the change in the fair value of the hedged portfolio to the loans (or groups of similar loans) being assessed for impairment on a systematic and rational basis.

E.4.5 Impairment: Provision Matrix

An entity calculates impairment in the unsecured portion of loans and receivables on the basis of a provision matrix that specifies fixed provision rates for the number of days a loan has been classified as non-performing (zero percent if less than 90 days, 20 percent if 90–180 days, 50 percent if 181–365 days and 100 percent if more than 365 days). Can the results be considered to be appropriate for the purpose of calculating the impairment loss on loans and receivables under MPSAS 29.72?

Not necessarily. MPSAS 29.72 requires impairment or bad debt losses to be calculated as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial instrument's original effective interest rate.

E.4.6 Impairment: Excess Losses

Does MPSAS 29, *Financial Instruments: Recognition and Measurement*, permit an entity to recognize impairment or bad debt losses in excess of impairment losses that are determined on the basis of objective evidence about impairment in identified individual financial assets or identified groups of similar financial assets?

No. MPSAS 29, *Financial Instruments: Recognition and Measurement*, does not permit an entity to recognize impairment or bad debt losses in addition to those that can be attributed to individually identified financial assets or identified groups of financial assets with similar credit risk characteristics (MPSAS 29.73) on the basis of objective evidence about the existence of impairment in those assets (MPSAS 29.67). Amounts that an entity might want to set aside for additional possible impairment in financial assets, such as reserves that cannot be supported by objective evidence about impairment, are not recognized as impairment or bad debt losses under MPSAS 29, *Financial Instruments: Recognition and Measurement*. However, if an entity determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics (MPSAS 29.73).

E.4.7 Recognition of Impairment on a Portfolio

MPSAS 29.72 requires that impairment be recognized for financial assets carried at amortized cost. MPSAS 29.73 states that impairment may be measured and recognized individually or on a portfolio basis for a group of similar financial assets. If one asset in the group is impaired but the fair value of another asset in the group is above its amortized cost, does MPSAS 29, *Financial Instruments: Recognition and Measurement*, allow non-recognition of the impairment of the first asset?

No. If an entity knows that an individual financial asset carried at amortized cost is impaired, MPSAS 29.72 requires that the impairment of that asset should be recognized. It states: "the amount of the loss is measured as the difference between *the asset's* carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate" (emphasis added). Measurement of impairment on a portfolio basis under MPSAS 29.73 may be applied to groups of small balance items and to financial assets that are individually assessed and found not to be impaired when there is indication of impairment in a group of similar assets and impairment cannot be identified with an individual asset in that group.

E.4.8 Impairment: Recognition of Collateral

If an impaired financial asset is secured by collateral that does not meet the recognition criteria for assets in other Standards, is the collateral recognized as an asset separate from the impaired financial asset?

No. The measurement of the impaired financial asset reflects the fair value of the collateral. The collateral is not recognized as an asset separate from the impaired financial asset unless it meets the recognition criteria for an asset in another Standard.

E.4.9 **Impairment of Non-Monetary Available-For-Sale Financial Asset**

If a non-monetary financial asset, such as an equity instrument, measured at fair value with gains and losses recognized in net assets/equity becomes impaired, should the cumulative net loss recognized in net assets/equity, including any portion attributable to foreign currency changes, be reclassified from net assets/equity to surplus or deficit as a reclassification adjustment?

Yes. MPSAS 29.76 states that when a decline in the fair value of an available-for-sale financial asset has been recognized in net assets/equity and there is objective evidence that the asset is impaired, the cumulative net loss that had been recognized in net assets/equity should be recognized in surplus or deficit even though the asset has not been derecognized. Any portion of the cumulative net loss that is attributable to foreign currency changes on that asset that had been recognized in net assets/equity is also recognized in surplus or deficit. Any subsequent losses, including any portion attributable to foreign currency changes, are also recognized in surplus or deficit until the asset is derecognized.

E.4.10 **Impairment: Whether the Available-For-Sale Reserve in Net Assets/Equity can be Negative**

MPSAS 29, *Financial Instruments: Recognition and Measurement*, requires that gains and losses arising from changes in fair value on available-for-sale financial assets are recognized in net assets/equity. If the aggregate fair value of such assets is less than their carrying amount, should the aggregate net loss that has been recognized in net assets/equity be recognized in surplus or deficit?

Not necessarily. The relevant criterion is not whether the aggregate fair value is less than the carrying amount, but whether there is objective evidence that a financial asset or group of assets is impaired. An entity assesses at the end of each reporting period whether there is any objective evidence that a financial asset or group of assets may be impaired, in accordance with MPSAS 29.68–70. MPSAS 29.69 states that a downgrade of an entity's credit rating is not, of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information. Additionally, a decline in the fair value of a financial asset below its cost or amortized cost is not necessarily evidence of impairment (e.g., a decline in the fair value of an investment in a debt instrument that results from an increase in the basic, risk-free interest rate).

Section F: Hedging

F.1 *Hedging Instruments*

F.1.1 **Hedging the Fair Value Exposure of a Bond Denominated in a Foreign Currency**

Entity J, whose functional currency is the Japanese yen, has issued 5 million five-year US dollar fixed rate debt. Also, it owns a 5 million five-year fixed rate US dollar bond which it has classified as available for sale. Can Entity J designate its US dollar liability as a hedging instrument in a fair value hedge of the entire fair value exposure of its US dollar bond?

No. MPSAS 29.81 permits a non-derivative to be used as a hedging instrument only for a hedge of a foreign currency risk. Entity J's bond has a fair value exposure to foreign currency and interest rate changes and credit risk.

Alternatively, can the US dollar liability be designated as a fair value hedge or cash flow hedge of the foreign currency component of the bond?

Yes. However, hedge accounting is unnecessary because the amortized cost of the hedging instrument and the hedged item are both remeasured using closing rates. Regardless of whether Entity J designates the relationship as a cash flow hedge or a fair value hedge, the effect on surplus or deficit is the same. Any gain or loss on the non-derivative hedging instrument designated as a cash flow hedge is immediately recognized in surplus or deficit to correspond with the recognition of the change in spot rate on the hedged item in surplus or deficit as required by MPSAS 4, *The Effect of Changes in Foreign Exchanges Rate*.

F.1.2 **Hedging with a Non-Derivative Financial Asset or Liability**

Entity J's functional currency is the Japanese yen. It has issued a fixed rate debt instrument with semi-annual interest payments that matures in two years with principal due at maturity of 5 million US dollars. It has also entered into a fixed price sales commitment for 5 million US dollars that matures in two years and is not accounted for as a derivative because it meets the exemption for normal sales in paragraph 4. Can Entity J designate its US dollar liability as a fair value hedge of the entire fair value exposure of its fixed price sales commitment and qualify for hedge accounting?

No. MPSAS 29.81 permits a non-derivative asset or liability to be used as a hedging instrument only for a hedge of a foreign currency risk.

Alternatively, can Entity J designate its US dollar liability as a cash flow hedge of the foreign currency exposure associated with the future receipt of US dollars on the fixed price sales commitment?

Yes. MPSAS 29, *Financial Instruments: Recognition and Measurement*, permits the designation of a non-derivative asset or liability as a hedging instrument in either a cash flow hedge or a fair value hedge of the exposure to changes in foreign exchange rates of a firm commitment (MPSAS 29.97). Any gain or loss on the non-derivative hedging instrument that is recognized in net assets/equity during the period preceding the future sale is recognized in surplus or deficit when the sale takes place (MPSAS 29.106).

Alternatively, can Entity J designate the sales commitment as the hedging instrument instead of the hedged item?

No. Only a derivative instrument or a non-derivative financial asset or liability can be designated as a hedging instrument in a hedge of a foreign currency risk. A firm commitment cannot be designated as a hedging instrument. However, if the foreign currency component of the sales commitment is required to be separated as an embedded derivative under MPSAS 29.12 and MPSAS 29.AG46, it could be designated as a hedging instrument in a hedge of the exposure to changes in the fair value of the maturity amount of the debt attributable to foreign currency risk.

F.1.3 Hedge Accounting: Use of Written Options in Combined Hedging Instruments

Issue (a) – Does MPSAS 29.AG127 preclude the use of an interest rate collar or other derivative instrument that combines a written option component and a purchased option component as a hedging instrument?

It depends. An interest rate collar or other derivative instrument that includes a written option cannot be designated as a hedging instrument if it is a net written option, because MPSAS 29.AG127 precludes the use of a written option as a hedging instrument unless it is designated as an offset to a purchased option. An interest rate collar or other derivative instrument that includes a written option may be designated as a hedging instrument, however, if the combination is a net purchased option or zero cost collar.

Issue (b) – What factors indicate that an interest rate collar or other derivative instrument that combines a written option component and a purchased option component is not a net written option?

The following factors taken together suggest that an interest rate collar or other derivative instrument that includes a written option is not a net written option.

- (a) No net premium is received either at inception or over the life of the combination of options. The distinguishing feature of a written option is the receipt of a premium to compensate the writer for the risk incurred.
- (b) Except for the strike prices, the critical terms and conditions of the written option component and the purchased option component are the same (including underlying variable or variables, currency denomination and maturity date). Also, the notional amount of the written option component is not greater than the notional amount of the purchased option component.

F.1.4 Internal Hedges

Some entities use internal derivative contracts (internal hedges) to transfer risk exposures between different entities within an economic entity or divisions within a single legal entity. Does MPSAS 29.82 prohibit hedge accounting in such cases?

Yes, if the derivative contracts are internal to the entity being reported on. MPSAS 29, *Financial Instruments: Recognition and Measurement*, does not specify how an entity should manage its risk. However, it states that internal hedging transactions do not qualify for hedge accounting. This applies both:

- (a) In consolidated financial statements for hedging transactions within an economic entity; and
- (b) In the individual or separate financial statements of a legal entity for hedging transactions between divisions in the entity. The principles of preparing consolidated financial statements in

MPSAS 35.40 require that a controlling entity “Eliminate in full intra-economic entity assets and liabilities, net assets/equity, revenue, expenses and cash flows relating to transactions between entities of the economic entity.”

On the other hand, hedging transaction within an economic entity may be designated as a hedge in the individual or separate financial statements of an individual entity, if the transaction is an external transaction from the perspective of the economic entity. In addition, if the internal contract is offset with an external party the external contract may be regarded as the hedging instrument and the hedging relationship may qualify for hedge accounting.

The following summarizes the application of MPSAS 29, *Financial Instruments: Recognition and Measurement*, to internal hedging transactions.

- MPSAS 29, *Financial Instruments: Recognition and Measurement*, does not preclude an entity from using internal derivative contracts for risk management purposes and it does not preclude internal derivatives from being accumulated at the treasury level or some other central location so that risk can be managed on an entity-wide basis or at some higher level than the separate legal entity or division.
- Internal derivative contracts between two separate entities within an economic entity can qualify for hedge accounting by those entities in their individual or separate financial statements, even though the internal contracts are not offset by derivative contracts with a party external to the economic entity.
- Internal derivative contracts between two separate divisions within the same legal entity can qualify for hedge accounting in the individual or separate financial statements of that legal entity only if those contracts are offset by derivative contracts with a party external to the legal entity.
- Internal derivative contracts between separate divisions within the same legal entity and between separate entities within the economic entity can qualify for hedge accounting in the consolidated financial statements only if the internal contracts are offset by derivative contracts with a party external to the economic entity.
- If the internal derivative contracts are not offset by derivative contracts with external parties, the use of hedge accounting by individual entities and divisions using internal contracts must be reversed on consolidation.

To illustrate: the treasury division of Entity A enters into an internal interest rate swap with another division of the same entity. The purpose is to hedge the interest rate risk exposure of a loan (or group of similar loans) in the loan portfolio. Under the swap, the treasury division pays fixed interest payments to the trading division and receives variable interest rate payments in return.

If a hedging instrument is not acquired from an external party, MPSAS 29, *Financial Instruments: Recognition and Measurement*, does not allow hedge accounting treatment for the hedging transaction undertaken by the treasury and other divisions. MPSAS 29.82 indicates that only derivatives that involve a party external to the entity can be designated as hedging instruments and, further, that any gains or losses on transactions within an economic entity or within individual entities should be eliminated on consolidation. Therefore, transactions between different divisions within Entity A do not qualify for hedge accounting treatment in the financial statements of Entity A. Similarly, transactions between different entities within an economic entity do not qualify for hedge accounting treatment in consolidated financial statements.

However, if in addition to the internal swap in the above example the trading division enters into an interest rate swap or other contract with an external party that offsets the exposure hedged in the internal swap, hedge accounting is permitted under MPSAS 29, *Financial Instruments: Recognition and Measurement*. For the purposes of MPSAS 29, *Financial Instruments: Recognition and Measurement*, the hedged item is the loan (or group of similar loans) in the treasury division and the hedging instrument is the external interest rate swap or other contract.

The trading division may aggregate several internal swaps or portions of them that are not offsetting each other and enter into a single third party derivative contract that offsets the aggregate exposure. Under MPSAS 29, *Financial Instruments: Recognition and Measurement*, such external hedging transactions may qualify for hedge accounting treatment provided that the hedged items in the treasury division are identified and the other conditions for hedge accounting are met. It should be noted, however, that MPSAS 29.88 does not permit hedge accounting treatment for held-to-maturity investments if the hedged risk is the exposure to interest rate changes.

F.1.5 Offsetting Internal Derivative Contracts Used to Manage Interest Rate Risk

If a central treasury function enters into internal derivative contracts with controlled entities and various divisions within the economic entity to manage interest rate risk on a centralized basis, can those contracts qualify for hedge accounting in the consolidated financial statements if, before laying off the risk, the internal contracts are first netted against each other and only the net exposure is offset in the marketplace with external derivative contracts?

No. An internal contract designated at the controlled entity level or by a division as a hedge results in the recognition of changes in the fair value of the item being hedged in surplus or deficit (a fair value hedge) or in the recognition of the changes in the fair value of the internal derivative in net assets/equity (a cash flow hedge). There is no basis for changing the measurement attribute of the item being hedged in a fair value hedge unless the exposure is offset with an external derivative. There is also no basis for recognizing the gain or loss on the internal derivative in net assets/equity for one entity and recognizing it in surplus or deficit by the other entity unless it is offset with an external derivative. In cases where two or more internal derivatives are used to manage interest rate risk on assets or liabilities at the controlled entity or division level and those internal derivatives are offset at the treasury level, the effect of designating the internal derivatives as hedging instruments is that the hedged non-derivative exposures at the controlled entity or division levels would be used to offset each other on consolidation. Accordingly, since MPSAS 29.81 does not permit designating non-derivatives as hedging instruments, except for foreign currency exposures, the results of hedge accounting from the use of internal derivatives at the controlled entity or division level that are not laid off with external parties must be reversed on consolidation.

It should be noted, however, that there will be no effect on surplus or deficit and net assets/equity of reversing the effect of hedge accounting in consolidation for internal derivatives that offset each other at the consolidation level if they are used in the same type of hedging relationship at the controlled entity or division level and, in the case of cash flow hedges, where the hedged items affect surplus or deficit in the same period. Just as the internal derivatives offset at the treasury level, their use as fair value hedges by two separate entities or divisions within the consolidated group will also result in the offset of the fair value amounts recognized in surplus or deficit, and their use as cash flow hedges by two separate entities or divisions within the economic entity will also result in the fair value amounts being offset against each other in net assets/equity. However, there may be an effect on individual line items in both the consolidated statement of changes in net assets/equity and the consolidated statement of financial position, for example when internal derivatives that hedge assets (or liabilities) in a fair value hedge are offset by internal derivatives that are used as a fair value hedge of other assets (or

liabilities) that are recognized in a different line item in the statement of financial position or statement of changes in net assets/equity. In addition, to the extent that one of the internal contracts is used as a cash flow hedge and the other is used in a fair value hedge, gains and losses recognized would not offset since the gain (or loss) on the internal derivative used as a fair value hedge would be recognized in surplus or deficit and the corresponding loss (or gain) on the internal derivative used as a cash flow hedge would be recognized in net assets/equity.

Question F.1.4 describes the application of MPSAS 29, *Financial Instruments: Recognition and Measurement*, to internal hedging transactions.

F.1.6 Offsetting Internal Derivative Contracts Used to Manage Foreign Currency Risk

If a central treasury function enters into internal derivative contracts with controlled entities and various divisions within the economic entity to manage foreign currency risk on a centralized basis, can those contracts be used as a basis for identifying external transactions that qualify for hedge accounting in the consolidated financial statements if, before laying off the risk, the internal contracts are first netted against each other and only the net exposure is offset by entering into a derivative contract with an external party?

It depends. MPSAS 35, *Consolidated Financial Statements*, requires all internal transactions to be eliminated in consolidated financial statements. As stated in MPSAS 29.82, internal hedging transactions do not qualify for hedge accounting in the consolidated financial statements of the economic entity. Therefore, if an entity wishes to achieve hedge accounting in the consolidated financial statements, it must designate a hedging relationship between a qualifying external hedging instrument and a qualifying hedged item.

As discussed in Question F.1.5, the accounting effect of two or more internal derivatives that are used to manage interest rate risk at the controlled entity or division level and are offset at the treasury level is that the hedged non-derivative exposures at those levels would be used to offset each other on consolidation. There is no effect on surplus or deficit or net assets/equity if:

- (a) The internal derivatives are used in the same type of hedge relationship (i.e., fair value or cash flow hedges); and
- (b) In the case of cash flow hedges, any derivative gains and losses that are initially recognized in net assets/equity are recognized in surplus or deficit in the same period(s).

When these two conditions are met, the gains and losses on the internal derivatives that are recognized in surplus or deficit or in net assets/equity will offset on consolidation resulting in the same surplus or deficit and net assets/equity as if the derivatives had been eliminated. However, there may be an effect on individual line items, in both the consolidated statement of changes in net assets/equity, and the consolidated statement of financial position, that would need to be eliminated. In addition, there is an effect on surplus or deficit and net assets/equity if some of the offsetting internal derivatives are used in cash flow hedges, while others are used in fair value hedges. There is also an effect on surplus or deficit and net assets/equity for offsetting internal derivatives that are used in cash flow hedges if the derivative gains and losses that are initially recognized in net assets/equity are recognized in surplus or deficit in different periods (because the hedged items affect surplus or deficit in different periods).

As regards foreign currency risk, provided that the internal derivatives represent the transfer of foreign currency risk on underlying non-derivative financial assets or liabilities, hedge accounting can be applied because MPSAS 29.81 permits a non-derivative financial asset or liability to be designated as

a hedging instrument for hedge accounting purposes for a hedge of a foreign currency risk. Accordingly, in this case the internal derivative contracts can be used as a basis for identifying external transactions that qualify for hedge accounting in the consolidated financial statements even if they are offset against each other. However, for consolidated financial statements, it is necessary to designate the hedging relationship so that it involves only external transactions.

Furthermore, the entity cannot apply hedge accounting to the extent that two or more offsetting internal derivatives represent the transfer of foreign currency risk on underlying forecast transactions or unrecognized firm commitments. This is because an unrecognized firm commitment or forecast transaction does not qualify as a hedging instrument under MPSAS 29, *Financial Instruments: Recognition and Measurement*. Accordingly, in this case the internal derivatives cannot be used as a basis for identifying external transactions that qualify for hedge accounting in the consolidated financial statements. As a result, any cumulative net gain or loss on an internal derivative that has been included in the initial carrying amount of an asset or liability (basis adjustment) or recognized in net assets/equity would have to be reversed on consolidation if it cannot be demonstrated that the offsetting internal derivative represented the transfer of a foreign currency risk on a financial asset or liability to an external hedging instrument.

F.1.7 Internal Derivatives: Examples of Applying Question F.1.6

In each case, FC = foreign currency, LC = local currency (which is the entity's functional currency), and TC = treasury center.

Case 1: Offset of Fair Value Hedges

Controlled Entity A has trade receivables of FC100, due in 60 days, which it hedges using a forward contract with TC. Controlled Entity B has payables of FC50, also due in 60 days, which it hedges using a forward contract with TC.

TC nets the two internal derivatives and enters into a net external forward contract to pay FC50 and receive LC in 60 days.

At the end of month 1, FC weakens against LC. A incurs a foreign exchange loss of LC10 on its receivables, offset by a gain of LC10 on its forward contract with TC. B makes a foreign exchange gain of LC5 on its payables offset by a loss of LC5 on its forward contract with TC. TC makes a loss of LC10 on its internal forward contract with A, a gain of LC5 on its internal forward contract with B, and a gain of LC5 on its external forward contract.

At the end of month 1, the following entries are made in the individual or separate financial statements of A, B and TC. Entries reflecting transactions or events within the economic entity are shown in italics.

A's entries

Dr	Foreign exchange loss	LC10	
	Cr	Receivables	LC10
Dr	<i>Internal contract TC</i>	<i>LC10</i>	
	Cr	<i>Internal gain TC</i>	<i>LC10</i>

B's entries

Dr	Payables	LC5	
	Cr Foreign exchange gain		LC5
Dr	Internal loss TC	LC5	
	Cr Internal contract TC		LC5

TC's entries

Dr	Internal loss A	LC10	
	Cr Internal contract A		LC10
Dr	Internal contract B	LC5	
	Cr Internal gain B		LC5
Dr	External forward contract	LC5	
	Cr Foreign exchange gain		LC5

Both A and B could apply hedge accounting in their individual financial statements provided all conditions in MPSAS 29, *Financial Instruments: Recognition and Measurement*, are met. However, in this case, no hedge accounting is required because gains and losses on the internal derivatives and the offsetting losses and gains on the hedged receivables and payables are recognized immediately in surplus or deficit of A and B without hedge accounting.

In the consolidated financial statements, the internal derivative transactions are eliminated. In economic terms, the payable in B hedges FC50 of the receivables in A. The external forward contract in TC hedges the remaining FC50 of the receivable in A. Hedge accounting is not necessary in the consolidated financial statements because monetary items are measured at spot foreign exchange rates under MPSAS 4, *The Effects of Changes in Foreign Exchange Rates*, irrespective of whether hedge accounting is applied.

The net balances before and after elimination of the accounting entries relating to the internal derivatives are the same, as set out below. Accordingly, there is no need to make any further accounting entries to meet the requirements of MPSAS 29, *Financial Instruments: Recognition and Measurement*.

	<i>Debit</i>	<i>Credit</i>
Receivables	–	LC10
Payables	LC5	–
External forward contract	LC5	–
Gains and losses	–	–
Internal contracts	–	–

Case 2: Offset of Cash Flow Hedges

To extend the example, A also has highly probable future revenues of FC200 on which it expects to receive cash in 90 days. B has highly probable future expenses of FC500 (rental for offices), also to be paid for in 90 days. A and B enter into separate forward contracts with TC to hedge these exposures and TC enters into an external forward contract to receive FC300 in 90 days.

As before, FC weakens at the end of month 1. A incurs a “loss” of LC20 on its anticipated revenues because the LC value of these revenues decreases. This is offset by a “gain” of LC20 on its forward contract with TC.

B incurs a “gain” of LC50 on its anticipated advertising cost because the LC value of the expense decreases. This is offset by a “loss” of LC50 on its transaction with TC.

TC incurs a “gain” of LC50 on its internal transaction with B, a “loss” of LC20 on its internal transaction with A and a loss of LC30 on its external forward contract.

A and B complete the necessary documentation, the hedges are effective, and both A and B qualify for hedge accounting in their individual financial statements. A recognizes the gain of LC20 on its internal derivative transaction in net assets/equity and B recognizes the loss of LC50 in net assets/equity. TC does not claim hedge accounting, but measures both its internal and external derivative positions at fair value, which net to zero.

At the end of month 1, the following entries are made in the individual or separate financial statements of A, B and TC. Entries reflecting transactions or events within the economic entity are shown in italics.

A’s entries

<i>Dr</i>	<i>Internal contract TC</i>	<i>LC20</i>	
<i>Cr</i>	<i>Net assets/equity</i>		<i>LC20</i>

B’s entries

<i>Dr</i>	<i>Net assets/equity</i>	<i>LC50</i>	
<i>Cr</i>	<i>Internal contract TC</i>		<i>LC50</i>

TC’s entries

<i>Dr</i>	<i>Internal loss A</i>	<i>LC20</i>	
<i>Cr</i>	<i>Internal contract Cr A</i>		<i>LC20</i>
<i>Dr</i>	<i>Internal contract B</i>	<i>LC50</i>	
<i>Cr</i>	<i>Internal gain B</i>		<i>LC50</i>
<i>Dr</i>	<i>Foreign exchange loss</i>	<i>LC30</i>	
<i>Cr</i>	<i>External forward contract</i>		<i>LC30</i>

For the consolidated financial statements, TC’s external forward contract on FC300 is designated, at the beginning of month 1, as a hedging instrument of the first FC300 of B’s highly probable future expenses. MPSAS 29, *Financial Instruments: Recognition and Measurement*, requires that in the consolidated financial statements at the end of month 1, the accounting effects of the internal derivative transactions must be eliminated.

However, the net balances before and after elimination of the accounting entries relating to the internal derivatives are the same, as set out below. Accordingly, there is no need to make any further accounting entries in order for the requirements of MPSAS 29, *Financial Instruments: Recognition and Measurement*, to be met.

	<i>Debit</i>	<i>Credit</i>
External forward contract	–	LC30
Net assets/equity	LC30	–
Gains and losses	–	–
Internal contracts	–	–

Case 3: Offset of Fair Value and Cash Flow Hedges

Assume that the exposures and the internal derivative transactions are the same as in cases 1 and 2. However, instead of entering into two external derivatives to hedge separately the fair value and cash flow exposures, TC enters into a single net external derivative to receive FC250 in exchange for LC in 90 days.

TC has four internal derivatives, two maturing in 60 days and two maturing in 90 days. These are offset by a net external derivative maturing in 90 days. The interest rate differential between FC and LC is minimal, and therefore the ineffectiveness resulting from the mismatch in maturities is expected to have a minimal effect on surplus or deficit in TC.

As in cases 1 and 2, A and B apply hedge accounting for their cash flow hedges and TC measures its derivatives at fair value. A recognizes a gain of LC20 on its internal derivative transaction in net assets/equity and B recognizes a loss of LC50 on its internal derivative transaction in net assets/equity.

At the end of month 1, the following entries are made in the individual or separate financial statements of A, B and TC. Entries reflecting transactions or events within the economic entity are shown in italics.

A's entries

Dr	Foreign exchange loss	LC10	
Cr	Receivables		LC10
Dr	<i>Internal contract TC</i>	<i>LC10</i>	
Cr	<i>Internal gain TC</i>		<i>LC10</i>
Dr	<i>Internal contract TC</i>	<i>LC20</i>	
Cr	<i>Net assets/equity</i>		<i>LC20</i>

B's entries

Dr	Payables	LC5	
Cr	Foreign exchange gain		LC5
Dr	<i>Internal loss TC</i>	<i>LC5</i>	
Cr	<i>Internal contract TC</i>		<i>LC5</i>
Dr	<i>Net assets/equity</i>	<i>LC50</i>	
Cr	<i>Internal contract TC</i>		<i>LC50</i>

TC's entries

Dr	<i>Internal loss A</i>	<i>LC10</i>	
Cr	<i>Internal contract A</i>		<i>LC10</i>
Dr	<i>Internal loss A</i>	<i>LC20</i>	
Cr	<i>Internal contract A</i>		<i>LC20</i>
Dr	<i>Internal contract B</i>	<i>LC5</i>	
Cr	<i>Internal gain B</i>		<i>LC5</i>
Dr	<i>Internal contract B</i>	<i>LC50</i>	
Cr	<i>Internal gain B</i>		<i>LC50</i>
Dr	Foreign exchange loss	LC25	
Cr	External forward contract		LC25

TOTAL (for the internal derivatives)	A	B	Total
	<i>LC</i>	<i>LC</i>	<i>TC</i>
Surplus or deficit (fair value hedges)	10	(5)	5
Net assets/equity (cash flow hedges)	20	(50)	(30)
Total	30	(55)	(25)

Combining these amounts with the external transactions (i.e., those not marked in italics above) produces the total net balances before elimination of the internal derivatives as follows:

	<i>Debit</i>	<i>Credit</i>
Receivables	–	LC10
Payables	LC5	–
Forward contract	–	LC25
Net assets/equity	LC30	–
Gains and losses	–	–
Internal contracts	–	–

For the consolidated financial statements, the following designations are made at the beginning of month 1:

- The payable of FC50 in B is designated as a hedge of the first FC50 of the highly probable future revenues in A. Therefore, at the end of month 1, the following entries are made in the consolidated financial statements: Dr Payable LC5; Cr Net assets/equity LC5;
- The receivable of FC100 in A is designated as a hedge of the first FC100 of the highly probable future expenses in B. Therefore, at the end of month 1, the following entries are made in the consolidated financial statements: Dr Net assets/equity LC10; Cr Receivable LC10; and
- The external forward contract on FC250 in TC is designated as a hedge of the next FC250 of highly probable future expenses in B. Therefore, at the end of month 1, the following entries are made in the consolidated financial statements: Dr Net assets/equity LC25; Cr External forward contract LC25.

In the consolidated financial statements at the end of month 1, MPSAS 29, *Financial Instruments: Recognition and Measurement*, requires the accounting effects of the internal derivative transactions to be eliminated.

However, the total net balances before and after elimination of the accounting entries relating to the internal derivatives are the same, as set out below. Accordingly, there is no need to make any further accounting entries to meet the requirements of MPSAS 29, *Financial Instruments: Recognition and Measurement*.

	<i>Debit</i>	<i>Credit</i>
Receivables	–	LC10
Payables	LC5	–
Forward contract	–	LC25
Net assets/equity	LC30	–
Gains and losses	–	–
Internal contracts	–	–

Case 4: Offset of Fair Value and Cash Flow Hedges with Adjustment to Carrying Amount of Inventory

Assume similar transactions as in case 3, except that the anticipated cash outflow of FC500 in B relates to the purchase of inventory that is delivered after 60 days. Assume also that the entity has a policy of basis-adjusting hedged forecast non-financial items. At the end of month 2, there are no further changes in exchange rates or fair values. At that date, the inventory is delivered and the loss of LC50 on B's

internal derivative, recognized in net assets/equity in month 1, is adjusted against the carrying amount of inventory in B. The gain of LC20 on A's internal derivative is recognized in net assets/equity as before.

In the consolidated financial statements, there is now a mismatch compared with the result that would have been achieved by unwinding and redesignating the hedges. The external derivative (FC250) and a proportion of the receivable (FC50) offset FC300 of the anticipated inventory purchase. There is a natural hedge between the remaining FC200 of anticipated cash outflow in B and the anticipated cash inflow of FC200 in A. This relationship does not qualify for hedge accounting under MPSAS 29, *Financial Instruments: Recognition and Measurement*, and this time there is only a partial offset between gains and losses on the internal derivatives that hedge these amounts.

At the end of months 1 and 2, the following entries are made in the individual or separate financial statements of A, B and TC. Entries reflecting transactions or events within the economic entity are shown in italics.

A's entries (all at the end of month 1)

Dr	Foreign exchange loss	LC10	
	Cr Receivables		LC10
Dr	<i>Internal contract TC</i>	<i>LC10</i>	
	Cr <i>Internal gain TC</i>		<i>LC10</i>
Dr	<i>Internal contract TC</i>	<i>LC20</i>	
	Cr <i>Net assets/equity</i>		<i>LC20</i>

B's entries

At the end of month 1:

Dr	Payables	LC5	
	Cr Foreign exchange gain		LC5
Dr	<i>Internal loss TC</i>	<i>LC5</i>	
	Cr <i>Internal contract TC</i>		<i>LC5</i>
Dr	<i>Net assets/equity</i>	<i>LC50</i>	
	Cr <i>Internal contract TC</i>		<i>LC50</i>

At the end of month 2:

Dr	Inventory	LC50	
	Cr Net assets/equity		LC50

TC's entries (all at the end of month 1)

Dr	<i>Internal loss A</i>	<i>LC10</i>	
	Cr <i>Internal contract A</i>		<i>LC10</i>
Dr	<i>Internal loss A</i>	<i>LC20</i>	
	Cr <i>Internal contract A</i>		<i>LC20</i>
Dr	<i>Internal contract B</i>	<i>LC5</i>	
	Cr <i>Internal gain B</i>		<i>LC5</i>
Dr	<i>Internal contract B</i>	<i>LC50</i>	
	Cr <i>Internal gain B</i>		<i>LC50</i>
Dr	Foreign exchange loss	LC25	
	Cr Forward		LC25

TOTAL (for the internal derivatives)	<i>A</i>	<i>B</i>	<i>Total</i>
	<i>LC</i>	<i>LC</i>	<i>TC</i>
Surplus or deficit (fair value hedges)	10	(5)	5
Net assets/equity (cash flow hedges)	20	–	20
Basis adjustment (inventory)	–	(50)	(50)
Total	30	(55)	(25)

Combining these amounts with the external transactions (i.e., those not marked in italics above) produces the total net balances before elimination of the internal derivatives as follows:

	<i>Debit</i>	<i>Credit</i>
Receivables	–	LC10
Payables	LC5	–
Forward contract	–	LC25
Net assets/equity	–	LC20
Basis adjustment (inventory)	LC50	–
Gains and losses	–	–
Internal contracts	–	–

For the consolidated financial statements, the following designations are made at the beginning of month 1:

- The payable of FC50 in B is designated as a hedge of the first FC50 of the highly probable future revenues in A. Therefore, at the end of month 1, the following entry is made in the consolidated financial statements: Dr Payables LC5; Cr Net assets/equity LC5.
- The receivable of FC100 in A is designated as a hedge of the first FC100 of the highly probable future expenses in B. Therefore, at the end of month 1, the following entries are made in the consolidated financial statements: Dr Net assets/equity LC10; Cr Receivable LC10; and at the end of month 2, Dr Inventory LC10; Cr Net assets/equity LC10.
- The external forward contract on FC250 in TC is designated as a hedge of the next FC250 of highly probable future expenses in B. Therefore, at the end of month 1, the following entry is made in the consolidated financial statements: Dr Net assets/equity LC25; Cr External forward contract LC25; and at the end of month 2, Dr Inventory LC25; Cr Net assets/equity LC25.

The total net balances after elimination of the accounting entries relating to the internal derivatives are as follows:

	<i>Debit</i>	<i>Credit</i>
Receivables	–	LC10
Payables	LC5	–
Forward contract	–	LC25
Net assets/equity	–	LC5
Basis adjustment (inventory)	LC35	–
Gains and losses	–	–
Internal contracts	–	–

These total net balances are different from those that would be recognized if the internal derivatives were not eliminated, and it is these net balances that MPSAS 29, *Financial Instruments: Recognition and Measurement*, requires to be included in the consolidated financial statements. The accounting entries required to adjust the total net balances before elimination of the internal derivatives are as follows:

- (a) To reclassify LC15 of the loss on B's internal derivative that is included in inventory to reflect that FC150 of the forecast purchase of inventory is not hedged by an external instrument (neither the external forward contract of FC250 in TC nor the external payable of FC100 in A); and
- (b) To reclassify the gain of LC15 on A's internal derivative to reflect that the forecast revenues of FC150 to which it relates is not hedged by an external instrument.

The net effect of these two adjustments is as follows:

Dr	Net assets/equity	LC15	
	Cr	Inventory	LC15

F.1.8 Combination of Written and Purchased Options

In most cases, MPSAS 29.AG127 prohibits the use of written options as hedging instruments. If a combination of a written option and purchased option (such as an interest rate collar) is transacted as a single instrument with one counterparty, can an entity split the derivative instrument into its written option component and purchased option component and designate the purchased option component as a hedging instrument?

No. MPSAS 29.83 specifies that a hedging relationship is designated by an entity for a hedging instrument in its entirety. The only exceptions permitted are splitting the time value and intrinsic value of an option and splitting the interest element and spot price on a forward. Question F.1.3 addresses the issue of whether and when a combination of options is considered as a written option.

F.1.9 Delta-Neutral Hedging Strategy

Does MPSAS 29, *Financial Instruments: Recognition and Measurement*, permit an entity to apply hedge accounting for a “delta-neutral” hedging strategy and other dynamic hedging strategies under which the quantity of the hedging instrument is constantly adjusted in order to maintain a desired hedge ratio, for example, to achieve a delta-neutral position insensitive to changes in the fair value of the hedged item?

Yes. MPSAS 29.83 states that “a dynamic hedging strategy that assesses both the intrinsic value and time value of an option contract can qualify for hedge accounting.” For example, a portfolio insurance strategy that seeks to ensure that the fair value of the hedged item does not drop below a certain level, while allowing the fair value to increase, may qualify for hedge accounting.

To qualify for hedge accounting, the entity must document how it will monitor and update the hedge and measure hedge effectiveness, be able to track properly all terminations and redesignations of the hedging instrument, and demonstrate that all other criteria for hedge accounting in MPSAS 29.98 are met. Also, it must be able to demonstrate an expectation that the hedge will be highly effective for a specified short period of time during which the hedge is not expected to be adjusted.

F.1.10 Hedging Instrument: Out of the Money Put Option

Entity A has an investment in one share of Entity B, which it has classified as available for sale. To give itself partial protection against decreases in the share price of Entity B, Entity A acquires a put option on one share of Entity B and designates the change in the intrinsic value of the put as a hedging instrument in a fair value hedge of changes in the fair value of its share in Entity B. The put gives Entity A the right to sell one share of Entity B at a strike price of RM 90. At the inception of the hedging relationship, the share has a quoted price of RM 100. Since the put option gives Entity A the right to dispose of the share at a price of RM 90, the put should normally be fully effective in offsetting price declines below RM 90 on an intrinsic value basis. Price changes above RM 90 are not hedged. In this case, are changes in the fair value of the share of Entity B for prices above RM90 regarded as hedge ineffectiveness under MPSAS 29.98 and recognized in surplus or deficit under MPSAS 29.99?

No. MPSAS 29.83 permits Entity A to designate changes in the intrinsic value of the option as the hedging instrument. The changes in the intrinsic value of the option provide protection against the risk of variability in the fair value of one share of Entity B below or equal to the strike price of the put of RM 90. For prices above RM 90, the option is out of the money and has no intrinsic value. Accordingly, gains and losses on one share of Entity B for prices above RM 90 are not attributable to the hedged risk for the purposes of assessing hedge effectiveness and recognizing gains and losses on the hedged item.

Therefore, Entity A recognizes changes in the fair value of the share in net assets/equity if it is associated with variation in its price above RM90 (MPSAS 29.64 and MPSAS 29.101). Changes in the fair value of the share associated with price declines below RM 90 form part of the designated fair value hedge and are recognized in surplus or deficit under MPSAS 29.99(b). Assuming the hedge is effective, those changes are offset by changes in the intrinsic value of the put, which are also recognized in surplus or deficit (MPSAS 29.99(a)). Changes in the time value of the put are excluded from the designated hedging relationship and recognized in surplus or deficit under MPSAS 29.65(a).

F.1.11 Hedging Instrument: Proportion of the Cash Flows of a Cash Instrument

In the case of foreign exchange risk, a non-derivative financial asset or non-derivative financial liability can potentially qualify as a hedging instrument. Can an entity treat the cash flows for specified periods during which a financial asset or financial liability that is designated as a hedging instrument remains outstanding as a proportion of the hedging instrument under MPSAS 29.84, and exclude the other cash flows from the designated hedging relationship?

No. MPSAS 29.84 indicates that a hedging relationship may not be designated for only a portion of the time period in which the hedging instrument is outstanding. For example, the cash flows during the first three years of a ten-year borrowing denominated in a foreign currency cannot qualify as a hedging instrument in a cash flow hedge of the first three years of revenue in the same foreign currency. On the other hand, a non-derivative financial asset or financial liability denominated in a foreign currency may potentially qualify as a hedging instrument in a hedge of the foreign currency risk associated with a hedged item that has a remaining time period until maturity that is equal to or longer than the remaining maturity of the hedging instrument (see Question F.2.17).

F.1.12 Hedges of More Than One Type of Risk

Issue (a) – Normally a hedging relationship is designated between an entire hedging instrument and a hedged item so that there is a single measure of fair value for the hedging instrument. Does this preclude designating a single financial instrument simultaneously as a hedging instrument in both a cash flow hedge and a fair value hedge?

No. For example, entities commonly use a combined interest rate and currency swap to convert a variable rate position in a foreign currency to a fixed rate position in the functional currency. MPSAS 29.85 allows the swap to be designated separately as a fair value hedge of the currency risk and a cash flow hedge of the interest rate risk provided the conditions in MPSAS 29.85 are met.

Issue (b) – If a single financial instrument is a hedging instrument in two different hedges, is special disclosure required?

MPSAS 30.25 requires disclosures separately for designated fair value hedges, cash flow hedges and hedges of a net investment in a foreign operation. The instrument in question would be reported in the MPSAS 30.25 disclosures separately for each type of hedge.

F.1.13 Hedging Instrument: Dual Foreign Currency Forward Exchange Contract

Entity A's functional currency is the Japanese yen. Entity A has a five-year floating rate US dollar liability and a ten-year fixed rate pound sterling-denominated note receivable. The principal amounts of the asset and liability when converted into the Japanese yen are the same. Entity A enters into a single foreign currency forward contract to hedge its foreign currency exposure on both instruments under which it receives US dollars and pays pounds sterling at the end of five years. If Entity A designates the forward exchange contract as a hedging instrument in a cash flow hedge against the foreign currency exposure on the principal repayments of both instruments, can it qualify for hedge accounting?

Yes. MPSAS 29.85 permits designating a single hedging instrument as a hedge of multiple types of risk if three conditions are met. In this example, the derivative hedging instrument satisfies all of these conditions, as follows.

- (a) The risks hedged can be identified clearly. The risks are the exposures to changes in the exchange rates between US dollars and yen, and yen and pounds, respectively.
- (b) The effectiveness of the hedge can be demonstrated. For the pound sterling loan, the effectiveness is measured as the degree of offset between the fair value of the principal repayment in pounds sterling and the fair value of the pound sterling payment on the forward exchange contract. For the US dollar liability, the effectiveness is measured as the degree of offset between the fair value of the principal repayment in US dollars and the US dollar receipt on the forward exchange contract. Even though the receivable has a ten-year life and the forward protects it for only the first five years, hedge accounting is permitted for only a portion of the exposure as described in Question F.2.17.
- (c) It is possible to ensure that there is specific designation of the hedging instrument and different risk positions. The hedged exposures are identified as the principal amounts of the liability and the note receivable in their respective currency of denomination.

F.1.14 Concurrent Offsetting Swaps and Use of One as a Hedging Instrument

Entity A enters into an interest rate swap and designates it as a hedge of the fair value exposure associated with fixed rate debt. The fair value hedge meets the hedge accounting criteria of MPSAS 29, *Financial Instruments: Recognition and Measurement*. Entity A simultaneously enters into a second interest rate swap with the same swap counterparty that has terms that fully offset the first interest rate swap. Is Entity A required to view the two swaps as one unit and therefore precluded from applying fair value hedge accounting to the first swap?

It depends. MPSAS 29, *Financial Instruments: Recognition and Measurement*, is transaction-based. If the second swap was not entered into in contemplation of the first swap or there is a substantive business purpose for structuring the transactions separately, then the swaps are not viewed as one unit.

For example, some entities have a policy that requires a centralized treasury (which is a controlled entity in an economic entity) enter into third-party derivative contracts on behalf of other controlled entities within the organization to hedge the controlled entities' interest rate risk exposures. The treasury also enters into internal derivative transactions with those controlled entities in order to track those hedges operationally within the organization. Because the treasury also enters into derivative contracts as part of its trading operations, or because it may wish to rebalance the risk of its overall portfolio, it may enter into a derivative contract with the same third party during the same business day that has substantially the same terms as a contract entered into as a hedging instrument on behalf of another controlled entity. In this case, there is a valid business purpose for entering into each contract.

Judgment is applied to determine whether there is a substantive business purpose for structuring the transactions separately. For example, if the sole purpose is to obtain fair value accounting treatment for the debt, there is no substantive business purpose.

F.2 Hedged Items

F.2.1 Whether a Derivative can be Designated as a Hedged Item

Does MPSAS 29, *Financial Instruments: Recognition and Measurement*, permit designating a derivative instrument (whether a stand-alone or separately recognized embedded derivative) as a hedged item either individually or as part of a hedged group in a fair value or cash flow hedge, for example, by designating a pay-variable, receive-fixed Forward Rate Agreement (FRA) as a cash flow hedge of a pay-fixed, receive-variable FRA?

No. Derivative instruments are always deemed held for trading and measured at fair value with gains and losses recognized in surplus or deficit unless they are designated and effective hedging instruments (MPSAS 29.10). As an exception, MPSAS 29.AG127 permits the designation of a purchased option as the hedged item in a fair value hedge.

F.2.2 Cash Flow Hedge: Anticipated Issue of Fixed Rate Debt

Is hedge accounting allowed for a hedge of an anticipated issue of fixed rate debt?

Yes. This would be a cash flow hedge of a highly probable forecast transaction that will affect surplus or deficit (MPSAS 29.96) provided that the conditions in MPSAS 29.98 are met.

To illustrate: Entity R periodically issues new bonds to refinance maturing bonds, provide working capital and for various other purposes. When Entity R decides it will be issuing bonds, it may hedge the risk of changes in the long-term interest rate from the date it decides to issue the bonds to the date the bonds are issued. If long-term interest rates go up, the bond will be issued either at a higher rate or with a higher discount or smaller premium than was originally expected. The higher rate being paid or decrease in proceeds is normally offset by the gain on the hedge. If long-term interest rates go down, the bond will be issued either at a lower rate or with a higher premium or a smaller discount than was originally expected. The lower rate being paid or increase in proceeds is normally offset by the loss on the hedge.

For example, in August 2000 Entity R decided it would issue RM200 million seven-year bonds in January 2001. Entity R performed historical correlation studies and determined that a seven-year treasury bond adequately correlates to the bonds Entity R expected to issue, assuming a hedge ratio of 0.93 futures contracts to one debt unit.

Therefore, Entity R hedged the anticipated issue of the bonds by selling (shorting) RM186 million worth of futures on seven-year treasury bonds. From August 2000 to January 2001 interest rates increased. The short futures positions were closed in January 2001, the date the bonds were issued, and resulted in a RM1.2 million gain that will offset the increased interest payments on the bonds and, therefore, will affect surplus or deficit over the life of the bonds. The hedge qualifies as a cash flow hedge of the interest rate risk on the forecast issue of debt.

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 public sector combination).

Internally generated core deposit intangibles are not recognized as intangible assets under MPSAS 31, *Intangible Assets*. Because they are not recognized, they cannot be designated as a hedged item.

If a core deposit intangible is acquired together with a related portfolio of deposits, the core deposit intangible is required to be recognized separately as an intangible asset (or as part of the related acquired portfolio of deposits) if it meets the recognition criteria in MPSAS 31, *Intangible Assets*. A recognized core deposit intangible asset could be designated as a hedged item, but only if it meets the conditions in paragraph 98, including the requirement in paragraph 98 that the effectiveness of the hedge can be measured reliably. Because it is often difficult to measure reliably the fair value of a core deposit intangible asset other than on initial recognition, it is unlikely that the requirement in paragraph 98(d) will be met.

F.2.4 Hedge Accounting: Hedging of Future Foreign Currency Revenue Streams

Is hedge accounting permitted for a currency borrowing that hedges an expected but not contractual revenue stream in foreign currency?

Yes, if the revenues are highly probable. Under MPSAS 29.96(b) a hedge of an anticipated sale may qualify as a cash flow hedge. For example, an entity which owns and operates a cross-border toll road may use sophisticated models based on experience and economic data to project its revenues in various currencies. If it can demonstrate that forecast revenues for a period of time into the future in a particular currency are “highly probable,” as required by MPSAS 29.98, it may designate a currency borrowing as a cash flow hedge of the future revenue stream. The portion of the gain or loss on the borrowing that is determined to be an effective hedge is recognized in net assets/equity until the revenues occur.

It is unlikely that an entity can reliably predict 100 percent of revenues for a future year. On the other hand, it is possible that a portion of predicted revenues, normally those expected in the short term, will meet the “highly probable” criterion.

F.2.5 Cash Flow Hedges: “All in One” Hedge

If a derivative instrument is expected to be settled gross by delivery of the underlying asset in exchange for the payment of a fixed price, can the derivative instrument be designated as the hedging instrument in a cash flow hedge of that gross settlement assuming the other cash flow hedge accounting criteria are met?

Yes. A derivative instrument that will be settled gross can be designated as the hedging instrument in a cash flow hedge of the variability of the consideration to be paid or received in the future transaction that will occur on gross settlement of the derivative contract itself because there would be an exposure to variability in the purchase or sale price without the derivative. This applies to all fixed price contracts that are accounted for as derivatives under MPSAS 29, *Financial Instruments: Recognition and Measurement*.

For example, if an entity enters into a fixed price contract to sell a commodity and that contract is accounted for as a derivative under MPSAS 29, *Financial Instruments: Recognition and Measurement*, (e.g., because the entity has a practice of settling such contracts net in cash or 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), the entity may designate the fixed price contract as a cash flow hedge of the variability of the consideration to be received on the sale of the asset (a future transaction) even though the fixed price contract is the contract under which the asset will be sold. Also, if an entity enters into a forward contract to purchase a debt instrument that will be settled by delivery, but the forward contract is a derivative because its term exceeds the regular way delivery period in the marketplace, the entity may designate the forward as a cash flow hedge of the variability of the consideration to be paid to acquire the debt instrument (a future transaction), even though the derivative is the contract under which the debt instrument will be acquired.

F.2.6 Hedge Relationships: Entity-Wide Risk

An entity has a fixed rate asset and a fixed rate liability, each having the same principal amount. Under the terms of the instruments, interest payments on the asset and liability occur in the same period and the net cash flow is always positive because the interest rate on the asset exceeds the interest rate on the liability. The entity enters into an interest rate swap to receive a floating interest rate and pay a fixed interest rate on a notional amount equal to the principal of the asset and designates the interest rate swap as a fair value hedge of the fixed rate asset. Does the hedging relationship qualify for hedge accounting even though the effect of the interest rate swap on an entity-wide basis is to create an exposure to interest rate changes that did not previously exist?

Yes. MPSAS 29, *Financial Instruments: Recognition and Measurement*, does not require risk reduction on an entity-wide basis as a condition for hedge accounting. Exposure is assessed on a transaction basis and, in this instance, the asset being hedged has a fair value exposure to interest rate increases that is offset by the interest rate swap.

F.2.7 Cash Flow Hedge: Forecast Transaction Related to an Entity’s Net Assets/Equity

Can a forecast transaction in the entity’s own equity instruments or forecast dividend or similar payments to owners be designated as a hedged item in a cash flow hedge?

No. To qualify as a hedged item, the forecast transaction must expose the entity to a particular risk that can affect surplus or deficit (MPSAS 29.96). The classification of financial instruments as liabilities or net assets/equity generally provides the basis for determining whether transactions or other payments

relating to such instruments are recognized in surplus or deficit MPSAS 28, *Financial Instruments: Presentation*. For example, distributions to holders of an equity instrument are debited by the issuer directly to net assets/equity (MPSAS 28.40). Therefore, such distributions cannot be designated as a hedged item. However, a declared dividend or similar distribution that has not yet been paid and is recognized as a financial liability may qualify as a hedged item, for example, for foreign currency risk if it is denominated in a foreign currency.

F.2.8 Hedge Accounting: Risk of a Transaction Not Occurring

Does MPSAS 29, *Financial Instruments: Recognition and Measurement*, permit an entity to apply hedge accounting to a hedge of the risk that a transaction will not occur, for example, if that would result in less revenue to the entity than expected?

No. The risk that a transaction will not occur is an overall operational risk that is not eligible as a hedged item. Hedge accounting is permitted only for risks associated with recognized assets and liabilities, firm commitments, highly probable forecast transactions and net investments in foreign operations (MPSAS 29.96).

F.2.9 Held-to-Maturity Investments: Hedging Variable Interest Rate Payments

Can an entity designate a pay-variable, receive-fixed interest rate swap as a cash flow hedge of a variable rate, held-to-maturity investment?

No. It is inconsistent with the designation of a debt investment as being held to maturity to designate a swap as a cash flow hedge of the debt investment's variable interest rate payments. MPSAS 29.88 states that a held-to-maturity investment cannot be a hedged item with respect to interest rate risk or prepayment risk "because designation of an investment as held to maturity requires an intention to hold the investment until maturity without regard to changes in the fair value or cash flows of such an investment attributable to changes in interest rates."

F.2.10 Hedged Items: Purchase of Held-to-Maturity Investment

An entity forecasts the purchase of a financial asset that it intends to classify as held to maturity when the forecast transaction occurs. It enters into a derivative contract with the intent to lock in the current interest rate and designates the derivative as a hedge of the forecast purchase of the financial asset. Can the hedging relationship qualify for cash flow hedge accounting even though the asset will be classified as a held-to-maturity investment?

Yes. With respect to interest rate risk, MPSAS 29, *Financial Instruments: Recognition and Measurement*, prohibits hedge accounting for financial assets that are classified as held-to-maturity (MPSAS 29.88). However, even though the entity intends to classify the asset as held to maturity, the instrument is not classified as such until the transaction occurs.

F.2.11 Cash Flow Hedges: Reinvestment of Funds Obtained from Held-to-Maturity Investments

An entity owns a variable rate asset that it has classified as held to maturity. It enters into a derivative contract with the intention to lock in the current interest rate on the reinvestment of variable rate cash flows, and designates the derivative as a cash flow hedge of the forecast future interest receipts on debt instruments resulting from the reinvestment of interest receipts on the held-to-maturity asset. Assuming that the other hedge accounting criteria are met, can the

hedging relationship qualify for cash flow hedge accounting even though the interest payments that are being reinvested come from an asset that is classified as held to maturity?

Yes. MPSAS 29.88 states that a held-to-maturity investment cannot be a hedged item with respect to interest rate risk. Question F.2.8 specifies that this applies not only to fair value hedges, i.e., hedges of the exposure to fair value interest rate risk associated with held-to-maturity investments that pay fixed interest, but also to cash flow hedges, i.e., hedges of the exposure to cash flow interest rate risk associated with held-to-maturity investments that pay variable interest at current market rates. However, in this instance, the derivative is designated as an offset of the exposure to cash flow risk associated with forecast future interest receipts on debt instruments resulting from the forecast reinvestment of variable rate cash flows on the held-to-maturity investment. The source of the funds forecast to be reinvested is not relevant in determining whether the reinvestment risk can be hedged. Accordingly, designation of the derivative as a cash flow hedge is permitted. This answer applies also to a hedge of the exposure to cash flow risk associated with the forecast future interest receipts on debt instruments resulting from the reinvestment of interest receipts on a fixed rate asset classified as held to maturity.

F.2.12 Hedge Accounting: Prepayable Financial Asset

If the issuer has the right to prepay a financial asset, can the investor designate the cash flows after the prepayment date as part of the hedged item?

Cash flows after the prepayment date may be designated as the hedged item to the extent it can be demonstrated that they are “highly probable” (MPSAS 29.98). For example, cash flows after the prepayment date may qualify as highly probable if they result from a group or pool of similar assets (e.g., mortgage loans) for which prepayments can be estimated with a high degree of accuracy or if the prepayment option is significantly out of the money. In addition, the cash flows after the prepayment date may be designated as the hedged item if a comparable option exists in the hedging instrument.

F.2.13 Fair Value Hedge: Risk That Could Affect Surplus or Deficit

Is fair value hedge accounting permitted for exposure to interest rate risk in fixed rate loans that are classified as loans and receivables?

Yes. Under MPSAS 29, *Financial Instruments: Recognition and Measurement*, loans and receivables are carried at amortized cost. Many entities hold the bulk of their loans and receivables until maturity. Thus, changes in the fair value of such loans and receivables that are due to changes in market interest rates will not affect surplus or deficit. MPSAS 29.96 specifies that a fair value hedge is a hedge of the exposure to changes in fair value that is attributable to a particular risk and that can affect surplus or deficit. Therefore, MPSAS 29.96 may appear to preclude fair value hedge accounting for loans and receivables. However, it follows from MPSAS 29.88 that loans and receivables can be hedged items with respect to interest rate risk since they are not designated as held-to-maturity investments. The entity could sell them and the change in fair values would affect surplus or deficit. Thus, fair value hedge accounting is permitted for loans and receivables.

F.2.14 Intragroup and Intra-entity Hedging Transactions

An Australian entity, whose functional currency is the Australian dollar, has forecast purchases in Japanese yen that are highly probable. The Australian entity is wholly owned by a Swiss entity, which prepares consolidated financial statements (which include the Australian subsidiary) in Swiss francs. The Swiss controlling entity enters into a forward contract to hedge the change in yen relative to the Australian dollar. Can that hedge qualify for hedge accounting in the

consolidated financial statements, or must the Australian controlled that has the foreign currency exposure be a party to the hedging transaction?

The hedge can qualify for hedge accounting provided the other hedge accounting criteria in MPSAS 29, *Financial Instruments: Recognition and Measurement*, are met. Since the Australian entity did not hedge the foreign currency exchange risk associated with the forecast purchases in yen, the effects of exchange rate changes between the Australian dollar and the yen will affect the Australian entity's surplus or deficit and, therefore, would also affect consolidated surplus or deficit. MPSAS 29, *Financial Instruments: Recognition and Measurement*, does not require that the operating unit that is exposed to the risk being hedged be a party to the hedging instrument.

F.2.15 Internal Contracts: Single Offsetting External Derivative

An entity uses what it describes as internal derivative contracts to document the transfer of responsibility for interest rate risk exposures from individual divisions to a central treasury function. The central treasury function aggregates the internal derivative contracts and enters into a single external derivative contract that offsets the internal derivative contracts on a net basis. For example, if the central treasury function has entered into three internal receive-fixed, pay-variable interest rate swaps that lay off the exposure to variable interest cash flows on variable rate liabilities in other divisions and one internal receive-variable, pay-fixed interest rate swap that lays off the exposure to variable interest cash flows on variable rate assets in another division, it would enter into an interest rate swap with an external counterparty that exactly offsets the four internal swaps. Assuming that the hedge accounting criteria are met, in the entity's financial statements would the single offsetting external derivative qualify as a hedging instrument in a hedge of a part of the underlying items on a gross basis?

Yes, but only to the extent the external derivative is designated as an offset of cash inflows or cash outflows on a gross basis. MPSAS 29.94 indicates that a hedge of an overall net position does not qualify for hedge accounting. However, it does permit designating a part of the underlying items as the hedged position on a gross basis. Therefore, even though the purpose of entering into the external derivative was to offset internal derivative contracts on a net basis, hedge accounting is permitted if the hedging relationship is defined and documented as a hedge of a part of the underlying cash inflows or cash outflows on a gross basis. An entity follows the approach outlined in MPSAS 29.94 and MPSAS 29.AG141 to designate part of the underlying cash flows as the hedged position.

F.2.16 Internal Contracts: External Derivative Contracts that are Settled Net

Issue (a) – An entity uses internal derivative contracts to transfer interest rate risk exposures from individual divisions to a central treasury function. For each internal derivative contract, the central treasury function enters into a derivative contract with a single external counterparty that offsets the internal derivative contract. For example, if the central treasury function has entered into a receive-5 percent-fixed, pay-LIBOR interest rate swap with another division that has entered into the internal contract with central treasury to hedge the exposure to variability in interest cash flows on a pay-LIBOR borrowing, central treasury would enter into a pay-5 percent-fixed, receive-LIBOR interest rate swap on the same principal terms with the external counterparty. Although each of the external derivative contracts is formally documented as a separate contract, only the net of the payments on all of the external derivative contracts is settled since there is a netting agreement with the external counterparty. Assuming that the other hedge accounting criteria are met, can the individual external derivative contracts, such as the pay-5 percent-fixed, receive-LIBOR interest rate swap above, be designated as hedging instruments of underlying gross exposures, such as the exposure to changes in variable interest payments on the pay-LIBOR borrowing above, even though the external derivatives are settled on a net basis?

Generally, yes. External derivative contracts that are legally separate contracts and serve a valid business purpose, such as laying off risk exposures on a gross basis, qualify as hedging instruments even if those external contracts are settled on a net basis with the same external counterparty, provided the hedge accounting criteria in MPSAS 29, *Financial Instruments: Recognition and Measurement*, are met. See also Question F.1.13.

Issue (b) – Treasury observes that by entering into the external offsetting contracts and including them in the centralized portfolio, it is no longer able to evaluate the exposures on a net basis. Treasury wishes to manage the portfolio of offsetting external derivatives separately from other exposures of the entity. Therefore, it enters into an additional, single derivative to offset the risk of the portfolio. Can the individual external derivative contracts in the portfolio still be designated as hedging instruments of underlying gross exposures even though a single external derivative is used to offset fully the market exposure created by entering into the external contracts?

Generally, yes. The purpose of structuring the external derivative contracts in this manner is consistent with the entity's risk management objectives and strategies. As indicated above, external derivative contracts that are legally separate contracts and serve a valid purpose qualify as hedging instruments. Moreover, the answer to Question F.1.13 specifies that hedge accounting is not precluded simply because the entity has entered into a swap that mirrors exactly the terms of another swap with the same counterparty if there is a substantive purpose for structuring the transactions separately.

F.2.17 Partial Term Hedging

MPSAS 29.84 indicates that a hedging relationship may not be designated for only a portion of the time period during which a hedging instrument remains outstanding. Is it permitted to designate a derivative as hedging only a portion of the time period to maturity of a hedged item?

Yes. A financial instrument may be a hedged item for only a portion of its cash flows or fair value, if effectiveness can be measured and the other hedge accounting criteria are met.

To illustrate: Entity A acquires a 10 percent fixed rate government bond with a remaining term to maturity of ten years. Entity A classifies the bond as available-for-sale. To hedge itself against fair value exposure on the bond associated with the present value of the interest rate payments until year 5, Entity A acquires a five-year pay-fixed, receive-floating swap. The swap may be designated as hedging the fair value exposure of the interest rate payments on the government bond until year 5 and the change in value of the principal payment due at maturity to the extent affected by changes in the yield curve relating to the five years of the swap.

F.2.18 Hedging Instrument: Cross-Currency Interest Rate Swap

Entity A's functional currency is the Japanese yen. Entity A has a five-year floating rate US dollar liability and a 10-year fixed rate pound sterling-denominated note receivable. Entity A wishes to hedge the foreign currency exposure on its asset and liability and the fair value interest rate exposure on the receivable and enters into a matching cross-currency interest rate swap to receive floating rate US dollars and pay fixed rate pounds sterling and to exchange the dollars for the pounds at the end of five years. Can Entity A designate the swap as a hedging instrument in a fair value hedge against both foreign currency risk and interest rate risk, although both the pound sterling and US dollar are foreign currencies to Entity A?

Yes. MPSAS 29.90 permits hedge accounting for components of risk, if effectiveness can be measured. Also, MPSAS 29.85 permits designating a single hedging instrument as a hedge of more than one type of risk if the risks can be identified clearly, effectiveness can be demonstrated, and specific designation of the hedging instrument and different risk positions can be ensured. Therefore, the swap may be designated as a hedging instrument in a fair value hedge of the pound sterling receivable against exposure to changes in its fair value associated with changes in UK interest rates for the initial partial term of five years and the exchange rate between pounds and US dollars. The swap is measured at fair value with changes in fair value recognized in surplus or deficit. The carrying amount of the receivable is adjusted for changes in its fair value caused by changes in UK interest rates for the first five-year portion of the yield curve. The receivable and payable are remeasured using spot exchange rates under MPSAS 4, *The Effects of Changes in Foreign Exchange Rates*, and the changes to their carrying amounts recognized in surplus or deficit.

F.2.19 Hedged Items: Hedge of Foreign Currency Risk of Publicly Traded Shares

Entity A acquires shares in Entity B on a foreign stock exchange for their fair value of 1,000 in foreign currency (FC). It classifies the shares as available for sale. To protect itself from the exposure to changes in the foreign exchange rate associated with the shares, it enters into a forward contract to sell FC750. Entity A intends to roll over the forward exchange contract for as long as it retains the shares. Assuming that the other hedge accounting criteria are met, could the forward exchange contract qualify as a hedge of the foreign exchange risk associated with the shares?

Yes, but only if there is a clear and identifiable exposure to changes in foreign exchange rates. Therefore, hedge accounting is permitted if:

- (a) The equity instrument is not traded on an exchange (or in another established marketplace) where trades are denominated in the same currency as the functional currency of Entity A; and
- (b) Dividends to Entity A are not denominated in that currency. Thus, if a share is traded in multiple currencies and one of those currencies is the functional currency of the reporting entity, hedge accounting for the foreign currency component of the share price is not permitted.

If so, could the forward exchange contract be designated as a hedging instrument in a hedge of the foreign exchange risk associated with the portion of the fair value of the shares up to FC750 in foreign currency?

Yes. MPSAS 29, *Financial Instruments: Recognition and Measurement*, permits designating a portion of the cash flow or fair value of a financial asset as the hedged item if effectiveness can be measured (MPSAS 29.90). Therefore, Entity A may designate the forward exchange contract as a hedge of the foreign exchange risk associated with only a portion of the fair value of the shares in foreign currency. It could either be designated as a fair value hedge of the foreign exchange exposure of FC750 associated with the shares or as a cash flow hedge of a forecast sale of the shares, provided the timing of the sale is identified. Any variability in the fair value of the shares in foreign currency would not affect the assessment of hedge effectiveness unless the fair value of the shares in foreign currency was to fall below FC750.

F.2.20 **Hedge Accounting: Stock Index**

An entity may acquire a portfolio of shares to replicate a stock index and a put option on the index to protect itself from fair value losses. Does MPSAS 29, *Financial Instruments: Recognition and Measurement*, permit designating the put on the stock index as a hedging instrument in a hedge of the portfolio of shares?

No. If similar financial instruments are aggregated and hedged as a group, MPSAS 29.93 states that the change in fair value attributable to the hedged risk for each individual item in the group is expected to be approximately proportional to the overall change in fair value attributable to the hedged risk of the group. In the scenario above, the change in the fair value attributable to the hedged risk for each individual item in the group (individual share prices) is not expected to be approximately proportional to the overall change in fair value attributable to the hedged risk of the group.

F.2.21 **Hedge Accounting: Netting of Assets and Liabilities**

May an entity group financial assets together with financial liabilities for the purpose of determining the net cash flow exposure to be hedged for hedge accounting purposes?

An entity's hedging strategy and risk management practices may assess cash flow risk on a net basis but MPSAS 29.94 does not permit designating a net cash flow exposure as a hedged item for hedge accounting purposes. MPSAS 29.AG141 provides an example of how an entity might assess its risk on a net basis (with similar assets and liabilities grouped together) and then qualify for hedge accounting by hedging on a gross basis.

F.3 *Hedge Accounting*

F.3.1 **Cash Flow Hedge: Fixed Interest Rate Cash Flows**

An entity issues a fixed rate debt instrument and enters into a receive-fixed, pay-variable interest rate swap to offset the exposure to interest rate risk associated with the debt instrument. Can the entity designate the swap as a cash flow hedge of the future interest cash outflows associated with the debt instrument?

No. MPSAS 29.96(b) states that a cash flow hedge is "a hedge of the exposure to variability in cash flows." In this case, the issued debt instrument does not give rise to any exposure to variability in cash flows since the interest payments are fixed. The entity may designate the swap as a fair value hedge of the debt instrument, but it cannot designate the swap as a cash flow hedge of the future cash outflows of the debt instrument.

F.3.2 **Cash Flow Hedge: Reinvestment of Fixed Interest Rate Cash Flows**

An entity manages interest rate risk on a net basis. On January 1, 2001, it forecasts aggregate cash inflows of RM100 on fixed rate assets and aggregate cash outflows of RM90 on fixed rate liabilities in the first quarter of 2002. For risk management purposes it uses a receive-variable, pay-fixed Forward Rate Agreement (FRA) to hedge the forecast net cash inflow of RM10. The entity designates as the hedged item the first RM10 of cash inflows on fixed rate assets in the first quarter of 2002. Can it designate the receive-variable, pay-fixed FRA as a cash flow hedge of the exposure to variability to cash flows in the first quarter of 2002 associated with the fixed rate assets?

No. The FRA does not qualify as a cash flow hedge of the cash flow relating to the fixed rate assets because they do not have a cash flow exposure. The entity could, however, designate the FRA as a hedge of the fair value exposure that exists before the cash flows are remitted.

In some cases, the entity could also hedge the interest rate exposure associated with the forecast reinvestment of the interest and principal it receives on fixed rate assets (see Question F.6.2). However, in this example, the FRA does not qualify for cash flow hedge accounting because it increases rather than reduces the variability of interest cash flows resulting from the reinvestment of interest cash flows (e.g., if market rates increase, there will be a cash inflow on the FRA and an increase in the expected interest cash inflows resulting from the reinvestment of interest cash inflows on fixed rate assets). However, potentially it could qualify as a cash flow hedge of a portion of the refinancing of cash outflows on a gross basis.

F.3.3 Foreign Currency Hedge

Entity A has a foreign currency liability payable in six months' time and it wishes to hedge the amount payable on settlement against foreign currency fluctuations. To that end, it takes out a forward contract to buy the foreign currency in six months' time. Should the hedge be treated as:

- (a) A fair value hedge of the foreign currency liability with gains and losses on revaluing the liability and the forward contract at the year-end both recognized in surplus or deficit; or**
- (b) A cash flow hedge of the amount to be settled in the future with gains and losses on revaluing the forward contract recognized net assets/equity?**

MPSAS 29, *Financial Instruments: Recognition and Measurement*, does not preclude either of these two methods. If the hedge is treated as a fair value hedge, the gain or loss on the fair value remeasurement of the hedging instrument and the gain or loss on the fair value remeasurement of the hedged item for the hedged risk are recognized immediately in surplus or deficit. If the hedge is treated as a cash flow hedge with the gain or loss on remeasuring the forward contract recognized in net assets/equity, that amount is recognized in surplus or deficit in the same period or periods during which the hedged item (the liability) affects surplus or deficit, i.e., when the liability is remeasured for changes in foreign exchange rates. Therefore, if the hedge is effective, the gain or loss on the derivative is released to surplus or deficit in the same periods during which the liability is remeasured, not when the payment occurs. See Question F.3.4.

F.3.4 Foreign Currency Cash Flow Hedge

An entity exports a product at a price denominated in a foreign currency. At the date of the sale, the entity obtains a receivable for the sale price payable in 90 days and takes out a 90-day forward exchange contract in the same currency as the receivable to hedge its foreign currency exposure.

Under, the sale is recorded at the spot rate at the date of sale, and the receivable is restated during the 90-day period for changes in exchange rates with the difference being taken to surplus or deficit (MPSAS 4.27 and MPSAS 4.32).

If the foreign exchange contract is designated as a hedging instrument, does the entity have a choice whether to designate the foreign exchange contract as a fair value hedge of the foreign currency exposure of the receivable or as a cash flow hedge of the collection of the receivable?

Yes. If the entity designates the foreign exchange contract as a fair value hedge, the gain or loss from remeasuring the forward exchange contract at fair value is recognized immediately in surplus or deficit and the gain or loss on remeasuring the receivable is also recognized in surplus or deficit.

If the entity designates the foreign exchange contract as a cash flow hedge of the foreign currency risk associated with the collection of the receivable, the portion of the gain or loss that is determined to be an effective hedge is recognized in net assets/equity, and the ineffective portion in surplus or deficit (MPSAS 29.106). The amount recognized in net assets/equity is recognized in surplus or deficit in the same period or periods during which changes in the measurement of the receivable affect surplus or deficit (MPSAS 29.111).

F.3.5 Fair Value Hedge: Variable Rate Debt Instrument

Does MPSAS 29, *Financial Instruments: Recognition and Measurement*, permit an entity to designate a portion of the risk exposure of a variable rate debt instrument as a hedged item in a fair value hedge?

Yes. A variable rate debt instrument may have an exposure to changes in its fair value due to credit risk. It may also have an exposure to changes in its fair value relating to movements in the market interest rate in the periods between which the variable interest rate on the debt instrument is reset. For example, if the debt instrument provides for annual interest payments reset to the market rate each year, a portion of the debt instrument has an exposure to changes in fair value during the year.

F.3.6 Fair Value Hedge: Inventory

MPSAS 29.96(a) states that a fair value hedge is “a hedge of the exposure to changes in fair value of a recognized asset or liability ... that is attributable to a particular risk and could affect surplus or deficit.” Can an entity designate inventories, such as oil inventory, as the hedged item in a fair value hedge of the exposure to changes in the price of the inventories, such as the oil price, although inventories are measured at the lower of cost and net realizable value or cost and current replacement cost under MPSAS 12, *Inventories*?

Yes. The inventories may be hedged for changes in fair value due to changes in the copper price because the change in fair value of inventories will affect surplus or deficit when the inventories are sold or their carrying amount is written down. The adjusted carrying amount becomes the cost basis for the purpose of applying the lower of cost and net realizable value test under MPSAS 12, *Inventories*. The hedging instrument used in a fair value hedge of inventories may alternatively qualify as a cash flow hedge of the future sale of the inventory.

F.3.7 Hedge Accounting: Forecast Transaction

For cash flow hedges, a forecast transaction that is subject to a hedge must be “highly probable.” How should the term “highly probable” be interpreted?

The term “highly probable” indicates a much greater likelihood of happening than the term “more likely than not.” An assessment of the likelihood that a forecast transaction will take place is not based solely on management’s intentions because intentions are not verifiable. A transaction’s probability should be supported by observable facts and the attendant circumstances.

In assessing the likelihood that a transaction will occur, an entity should consider the following circumstances:

- (a) The frequency of similar past transactions;
- (b) The financial and operational ability of the entity to carry out the transaction;
- (c) Substantial commitments of resources to a particular activity (e.g., the undertaking of specific infrastructure projects);
- (d) The extent of loss or disruption of operations that could result if the transaction does not occur;
- (e) The likelihood that transactions with substantially different characteristics might be used to achieve the same purpose (e.g., an entity that intends to raise cash may have several ways of doing so, ranging from a short-term bank loan to an offering of debt instruments); and
- (f) The entity's operational plan.

The length of time until a forecast transaction is projected to occur is also a factor in determining probability. Other factors being equal, the more distant a forecast transaction is, the less likely it is that the transaction would be regarded as highly probable and the stronger the evidence that would be needed to support an assertion that it is highly probable.

For example, a transaction forecast to occur in five years may be less likely to occur than a transaction forecast to occur in one year. However, forecast interest payments for the next 20 years on variable rate debt would typically be highly probable if supported by an existing contractual obligation.

In addition, other factors being equal, the greater the physical quantity or future value of a forecast transaction in proportion to the entity's transactions of the same nature, the less likely it is that the transaction would be regarded as highly probable and the stronger the evidence that would be required to support an assertion that it is highly probable. For example, less evidence generally would be needed to support forecast sales of 100,000 units in the next month than 950,000 units in that month when recent sales have averaged 950,000 units per month for the past three months.

A history of having designated hedges of forecast transactions and then determining that the forecast transactions are no longer expected to occur would call into question both an entity's ability to predict forecast transactions accurately and the propriety of using hedge accounting in the future for similar forecast transactions.

F.3.8 Retrospective Designation of Hedges

Does MPSAS 29, *Financial Instruments: Recognition and Measurement*, permit an entity to designate hedge relationships retrospectively?

No. Designation of hedge relationships takes effect prospectively from the date all hedge accounting criteria in MPSAS 29.98 are met. In particular, hedge accounting can be applied only from the date the entity has completed the necessary documentation of the hedge relationship, including identification of the hedging instrument, the related hedged item or transaction, the nature of the risk being hedged, and how the entity will assess hedge effectiveness.

F.3.9 Hedge Accounting: Designation at the Inception of the Hedge

Does MPSAS 29, *Financial Instruments: Recognition and Measurement*, permit an entity to designate and formally document a derivative contract as a hedging instrument after entering into the derivative contract?

Yes, prospectively. For hedge accounting purposes, MPSAS 29, *Financial Instruments: Recognition and Measurement*, requires a hedging instrument to be designated and formally documented as such from the inception of the hedge relationship (MPSAS 29.98); in other words, a hedge relationship cannot be designated retrospectively. Also, it precludes designating a hedging relationship for only a portion of the time period during which the hedging instrument remains outstanding (MPSAS 29.84). However, it does not require the hedging instrument to be acquired at the inception of the hedge relationship.

F.3.10 Hedge Accounting: Identification of Hedged Forecast Transaction

Can a forecast transaction be identified as the purchase or sale of the last 15,000 units of a product in a specified period or as a percentage of purchases or sales during a specified period?

No. The hedged forecast transaction must be identified and documented with sufficient specificity so that when the transaction occurs, it is clear whether the transaction is or is not the hedged transaction. Therefore, a forecast transaction may be identified as the sale of the first 15,000 units of a specific product during a specified three-month period, but it could not be identified as the last 15,000 units of that product sold during a three-month period because the last 15,000 units cannot be identified when they are sold. For the same reason, a forecast transaction cannot be specified solely as a percentage of sales or purchases during a period.

F.3.11 Cash Flow Hedge: Documentation of Timing of Forecast Transaction

For a hedge of a forecast transaction, should the documentation of the hedge relationship that is established at inception of the hedge identify the date on, or time period in which, the forecast transaction is expected to occur?

Yes. To qualify for hedge accounting, the hedge must relate to a specific identified and designated risk (MPSAS 29.AG151) and it must be possible to measure its effectiveness reliably (MPSAS 29.98(d)). Also, the hedged forecast transaction must be highly probable (MPSAS 29.98(c)). To meet these criteria, an entity is not required to predict and document the exact date a forecast transaction is expected to occur. However, it is required to identify and document the time period during which the forecast transaction is expected to occur within a reasonably specific and generally narrow range of time from a most probable date, as a basis for assessing hedge effectiveness. To determine that the hedge will be highly effective in accordance with MPSAS 29.98(d), it is necessary to ensure that changes in the fair value of the expected cash flows are offset by changes in the fair value of the hedging instrument and this test may be met only if the timing of the cash flows occur within close proximity to each other. If the forecast transaction is no longer expected to occur, hedge accounting is discontinued in accordance with MPSAS 29.112(c).

F.4 *Hedge Effectiveness*

F.4.1 **Hedging on an After-Tax Basis**

Hedging is often done on an after-tax basis. Is hedge effectiveness assessed after taxes?

MPSAS 29, *Financial Instruments: Recognition and Measurement*, permits, but does not require, assessment of hedge effectiveness on an after-tax basis. If the hedge is undertaken on an after-tax basis, it is so designated at inception as part of the formal documentation of the hedging relationship and strategy.

F.4.2 **Hedge Effectiveness: Assessment on Cumulative Basis**

MPSAS 29.98(b) requires that the hedge is expected to be highly effective. Should expected hedge effectiveness be assessed separately for each period or cumulatively over the life of the hedging relationship?

Expected hedge effectiveness may be assessed on a cumulative basis if the hedge is so designated, and that condition is incorporated into the appropriate hedging documentation. Therefore, even if a hedge is not expected to be highly effective in a particular period, hedge accounting is not precluded if effectiveness is expected to remain sufficiently high over the life of the hedging relationship. However, any ineffectiveness is required to be recognized in surplus or deficit as it occurs.

To illustrate: an entity designates a LIBOR-based interest rate swap as a hedge of a borrowing whose interest rate is a UK base rate plus a margin. The UK base rate changes, perhaps, once each quarter or less, in increments of 25–50 basis points, while LIBOR changes daily. Over a period of 1–2 years, the hedge is expected to be almost perfect. However, there will be quarters when the UK base rate does not change at all, while LIBOR has changed significantly. This would not necessarily preclude hedge accounting.

F.4.3 **Hedge Effectiveness: Counterparty Credit Risk**

Must an entity consider the likelihood of default by the counterparty to the hedging instrument in assessing hedge effectiveness?

Yes. An entity cannot ignore whether it will be able to collect all amounts due under the contractual provisions of the hedging instrument. When assessing hedge effectiveness, both at the inception of the hedge and on an ongoing basis, the entity considers the risk that the counterparty to the hedging instrument will default by failing to make any contractual payments to the entity. For a cash flow hedge, if it becomes probable that a counterparty will default, an entity would be unable to conclude that the hedging relationship is expected to be highly effective in achieving offsetting cash flows. As a result, hedge accounting would be discontinued. For a fair value hedge, if there is a change in the counterparty's creditworthiness, the fair value of the hedging instrument will change, which affects the assessment of whether the hedge relationship is effective and whether it qualifies for continued hedge accounting.

F.4.4 Hedge Effectiveness: Effectiveness Tests

How should hedge effectiveness be measured for the purposes of initially qualifying for hedge accounting and for continued qualification?

MPSAS 29, *Financial Instruments: Recognition and Measurement*, does not provide specific guidance about how effectiveness tests are performed. MPSAS 29, *Financial Instruments: Recognition and Measurement*, specifies that a hedge is normally regarded as highly effective only if (a) at inception and in subsequent periods, the hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated, and (b) the actual results are within a range of 80–125 percent. MPSAS 29.AG145 also states that the expectation in (a) can be demonstrated in various ways.

The appropriateness of a given method of assessing hedge effectiveness will depend on the nature of the risk being hedged and the type of hedging instrument used. The method of assessing effectiveness must be reasonable and consistent with other similar hedges unless different methods are explicitly justified. An entity is required to document at the inception of the hedge how effectiveness will be assessed and then to apply that effectiveness test on a consistent basis for the duration of the hedge.

Several mathematical techniques can be used to measure hedge effectiveness, including ratio analysis, i.e., a comparison of hedging gains and losses with the corresponding gains and losses on the hedged item at a point in time, and statistical measurement techniques such as regression analysis. If regression analysis is used, the entity's documented policies for assessing effectiveness must specify how the results of the regression will be assessed.

F.4.5 Hedge Effectiveness: Less than 100 Percent Offset

If a cash flow hedge is regarded as highly effective because the actual risk offset is within the allowed 80–125 percent range of deviation from full offset, is the gain or loss on the ineffective portion of the hedge recognized in net assets/equity?

No. MPSAS 29.106(a) indicates that only the effective portion is recognized in net assets/equity. MPSAS 29.106(b) requires the ineffective portion to be recognized in surplus or deficit.

F.4.6 Assuming Perfect Hedge Effectiveness

If the principal terms of the hedging instrument and of the entire hedged asset or liability or hedged forecast transaction are the same, can an entity assume perfect hedge effectiveness without further effectiveness testing? No. MPSAS 29.98(e) requires an entity to assess hedges on an ongoing basis for hedge effectiveness. It cannot assume hedge effectiveness even if the principal terms of the hedging instrument and the hedged item are the same, since hedge ineffectiveness may arise because of other attributes such as the liquidity of the instruments or their credit risk (MPSAS 29.AG150). It may, however, designate only certain risks in an overall exposure as being hedged and thereby improve the effectiveness of the hedging relationship. For example, for a fair value hedge of a debt instrument, if the derivative hedging instrument has a credit risk that is equivalent to the AA-rate, it may designate only the risk related to AA-rated interest rate movements as being hedged, in which case changes in credit spreads generally will not affect the effectiveness of the hedge.

F.5 *Cash Flow Hedges*F.5.1 **Hedge Accounting: Non-Derivative Monetary Asset or Non-Derivative Monetary Liability Used as a Hedging Instrument**

If an entity designates a non-derivative monetary asset as a foreign currency cash flow hedge of the repayment of the principal of a non-derivative monetary liability, would the exchange differences on the hedged item be recognized in surplus or deficit (MPSAS 4.32) and the exchange differences on the hedging instrument be recognized in net assets/equity until the repayment of the liability (MPSAS 29.106)?

No. Exchange differences on the monetary asset and the monetary liability are both recognized in surplus or deficit in the period in which they arise (MPSAS 4.32). MPSAS 29.AG116 specifies that if there is a hedge relationship between a non-derivative monetary asset and a non-derivative monetary liability, changes in fair values of those financial instruments are recognized in surplus or deficit.

F.5.2 **Cash Flow Hedges: Performance of Hedging Instrument (1)**

Entity A has a floating rate liability of RM 1,000 with five years remaining to maturity. It enters into a five-year pay-fixed, receive-floating interest rate swap in the same currency and with the same principal terms as the liability to hedge the exposure to variable cash flow payments on the floating rate liability attributable to interest rate risk. At inception, the fair value of the swap is zero. Subsequently, there is an increase of RM 49 in the fair value of the swap. This increase consists of a change of RM 50 resulting from an increase in market interest rates and a change of minus RM 1 resulting from an increase in the credit risk of the swap counterparty. There is no change in the fair value of the floating rate liability, but the fair value (present value) of the future cash flows needed to offset the exposure to variable interest cash flows on the liability increases by RM 50. Assuming that Entity A determines that the hedge is still highly effective, is there ineffectiveness that should be recognized in surplus or deficit?

No. A hedge of interest rate risk is not fully effective if part of the change in the fair value of the derivative is attributable to the counterparty's credit risk (MPSAS 29.AG150). However, because Entity A determines that the hedge relationship is still highly effective, it recognizes the effective portion of the change in fair value of the swap, i.e., the net change in fair value of RM 49, in net assets/equity. There is no debit to surplus or deficit for the change in fair value of the swap attributable to the deterioration in the credit quality of the swap counterparty, because the cumulative change in the present value of the future cash flows needed to offset the exposure to variable interest cash flows on the hedged item, i.e., RM 50, exceeds the cumulative change in value of the hedging instrument, i.e., RM 49.

Dr	Swap	RM49	
	Cr Net assets/equity		RM49

If Entity A concludes that the hedge is no longer highly effective, it discontinues hedge accounting prospectively as from the date the hedge ceased to be highly effective in accordance with MPSAS 29.112.

Would the answer change if the fair value of the swap instead increases to RM51 of which RM50 results from the increase in market interest rates and RM1 from a decrease in the credit risk of the swap counterparty?

Yes. In this case, there is a credit to surplus or deficit of RM1 for the change in fair value of the swap attributable to the improvement in the credit quality of the swap counterparty. This is because the cumulative change in the value of the hedging instrument, i.e., RM51, exceeds the cumulative change in the present value of the future cash flows needed to offset the exposure to variable interest cash flows on the hedged item, i.e., RM50. The difference of RM1 represents the excess ineffectiveness attributable to the derivative hedging instrument, the swap, and is recognized in surplus or deficit.

Dr	Swap	RM51	
	Cr	Net assets/equity	RM50
	Cr	Surplus or deficit	RM1

F.5.3 Cash Flow Hedges: Performance of Hedging Instrument (2)

On September 30, 20X1, Entity A hedges the anticipated sale of 24 barrels of oil on March 1, 20X2 by entering into a short forward contract on 24 barrels of oil. The contract requires net settlement in cash determined as the difference between the future spot price of oil on a specified commodity exchange and RM1,000. Entity A expects to sell the oil in a different, local market. Entity A determines that the forward contract is an effective hedge of the anticipated sale and that the other conditions for hedge accounting are met. It assesses hedge effectiveness by comparing the entire change in the fair value of the forward contract with the change in the fair value of the expected cash inflows. On December 31, the spot price of oil has increased both in the local market and on the exchange. The increase in the local market exceeds the increase on the exchange. As a result, the present value of the expected cash inflow from the sale on the local market is RM1,100. The fair value of Entity A's forward contract is negative RM80. Assuming that Entity A determines that the hedge is still highly effective, is there ineffectiveness that should be recognized in surplus or deficit?

No. In a cash flow hedge, ineffectiveness is not recognized in the financial statements when the cumulative change in the fair value of the hedged cash flows exceeds the cumulative change in the value of the hedging instrument. In this case, the cumulative change in the fair value of the forward contract is RM80, while the fair value of the cumulative change in expected future cash flows on the hedged item is RM100. Since the fair value of the cumulative change in expected future cash flows on the hedged item from the inception of the hedge exceeds the cumulative change in fair value of the hedging instrument (in absolute amounts), no portion of the gain or loss on the hedging instrument is recognized in surplus or deficit (MPSAS 29.106(b)). Because Entity A determines that the hedge relationship is still highly effective, it recognizes the entire change in fair value of the forward contract (RM80) in net assets/equity.

Dr	Net assets/equity	RM80	
	Cr	Forward	RM80

If Entity A concludes that the hedge is no longer highly effective, it discontinues hedge accounting prospectively as from the date the hedge ceases to be highly effective in accordance with MPSAS 29.112.

F.5.4 Cash Flow Hedges: Forecast Transaction Occurs Before the Specified Period

An entity designates a derivative as a hedging instrument in a cash flow hedge of a forecast transaction, such as a forecast sale of a commodity. The hedging relationship meets all the hedge accounting conditions, including the requirement to identify and document the period in which the transaction is expected to occur within a reasonably specific and narrow range of time (see Question F.2.17). If, in a subsequent period, the forecast transaction is expected to occur in an earlier period than originally anticipated, can the entity conclude that this transaction is the same as the one that was designated as being hedged?

Yes. The change in timing of the forecast transaction does not affect the validity of the designation. However, it may affect the assessment of the effectiveness of the hedging relationship. Also, the hedging instrument would need to be designated as a hedging instrument for the whole remaining period of its existence in order for it to continue to qualify as a hedging instrument (see MPSAS 29.84 and Question F.2.17).

F.5.5 Cash Flow Hedges: Measuring Effectiveness for a Hedge of a Forecast Transaction in a Debt Instrument

A forecast investment in an interest-earning asset or forecast issue of an interest-bearing liability creates a cash flow exposure to interest rate changes because the related interest payments will be based on the market rate that exists when the forecast transaction occurs. The objective of a cash flow hedge of the exposure to interest rate changes is to offset the effects of future changes in interest rates so as to obtain a single fixed rate, usually the rate that existed at the inception of the hedge that corresponds with the term and timing of the forecast transaction. During the period of the hedge, it is not possible to determine what the market interest rate for the forecast transaction will be at the time the hedge is terminated or when the forecast transaction occurs. In this case, how is the effectiveness of the hedge assessed and measured?

During this period, effectiveness can be measured on the basis of changes in interest rates between the designation date and the interim effectiveness measurement date. The interest rates used to make this measurement are the interest rates that correspond with the term and occurrence of the forecast transaction that existed at the inception of the hedge and that exist at the measurement date as evidenced by the term structure of interest rates.

Generally it will not be sufficient simply to compare cash flows of the hedged item with cash flows generated by the derivative hedging instrument as they are paid or received, since such an approach ignores the entity's expectations of whether the cash flows will offset in subsequent periods and whether there will be any resulting ineffectiveness.

The discussion that follows illustrates the mechanics of establishing a cash flow hedge and measuring its effectiveness. For the purpose of the illustrations, assume that an entity expects to issue a RM100,000 one-year debt instrument in three months. The instrument will pay interest quarterly with principal due at maturity. The entity is exposed to interest rate increases and establishes a hedge of the interest cash flows of the debt by entering into a forward starting interest rate swap. The swap has a term of one year and will start in three months to correspond with the terms of the forecast debt issue. The entity will pay a fixed rate and receive a variable rate, and the entity designates the risk being hedged as the LIBOR-based interest component in the forecast issue of the debt.

Yield Curve

The yield curve provides the foundation for computing future cash flows and the fair value of such cash flows both at the inception of, and during, the hedging relationship. It is based on current market yields on applicable reference bonds that are traded in the marketplace. Market yields are converted to spot interest rates ("spot rates" or "zero coupon rates") by eliminating the effect of coupon payments on the market yield. Spot rates are used to discount future cash flows, such as principal and interest rate payments, to arrive at their fair value. Spot rates also are used to compute forward interest rates that are used to compute variable and estimated future cash flows. The relationship between spot rates and one-period forward rates is shown by the following formula:

Spot-forward relationship

$$F = \frac{(1 + SR_t)^t}{(1 + SR_{t-1})^{t-1}} - 1$$

where

F = forward rate (%)

SR = spot rate (%)

t = period in time (e.g., 1, 2, 3, 4, 5)

Also, for the purpose of this illustration, assume that the following quarterly-period term structure of interest rates using quarterly compounding exists at the inception of the hedge.

Yield curve at inception – (beginning of period 1)					
Forward periods	1	2	3	4	5
Spot rates	3.75%	4.50%	5.50%	6.00%	6.25%
Forward rates	3.75%	5.25%	7.51%	7.50%	7.25%

The one-period forward rates are computed on the basis of spot rates for the applicable maturities. For example, the current forward rate for Period 2 calculated using the formula above is equal to $[1.0450^2/1.0375] - 1 = 5.25$ percent. The current one-period forward rate for Period 2 is different from the current spot rate for Period 2, since the spot rate is an interest rate from the beginning of Period 1 (spot) to the end of Period 2, while the forward rate is an interest rate from the beginning of Period 2 to the end of Period 2.

Hedged Item

In this example, the entity expects to issue a RM 100,000 one-year debt instrument in three months with quarterly interest payments. The entity is exposed to interest rate increases and would like to eliminate the effect on cash flows of interest rate changes that may happen before the forecast transaction takes place. If that risk is eliminated, the entity would obtain an interest rate on its debt issue that is equal to the one-year forward coupon rate currently available in the marketplace in three months. That forward coupon rate, which is different from the forward (spot) rate, is 6.86 percent, computed from the term structure of interest rates shown above. It is the market rate of interest that exists at the inception of the hedge, given the terms of the forecast debt instrument. It results in the fair value of the debt being equal to par at its issue.

At the inception of the hedging relationship, the expected cash flows of the debt instrument can be calculated on the basis of the existing term structure of interest rates. For this purpose, it is assumed that interest rates do not change and that the debt would be issued at 6.86 percent at the beginning of Period 2. In this case, the cash flows and fair value of the debt instrument would be as follows at the beginning of Period 2.

Issue of Fixed Rate Debt					
Beginning of period 2 - No rate changes (spot based on forward rates)					
<i>Total</i>					
<i>Original forward periods</i>	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
<i>Remaining periods</i>		<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>
Spot rates		5.25%	6.38%	6.75%	6.88%
Forward rates		5.25%	7.51%	7.50%	7.25%
	<i>RM</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>
<i>Cash flows:</i>					
Fixed interest @6.86%		1,716	1,716	1,716	1,716
Principal					100,000
<i>Fair value:</i>					
Interest	6,592	1,694	1,663	1,632	1,603
Principal	93,408				93,408 ^(a)
Total	100,000				
(a) $RM\ 100,000 / (1 + [0.0688/4])^4$					

Since it is assumed that interest rates do not change, the fair value of the interest and principal amounts equals the par amount of the forecast transaction. The fair value amounts are computed on the basis of the spot rates that exist at the inception of the hedge for the applicable periods in which the cash flows would occur had the debt been issued at the date of the forecast transaction. They reflect the effect of discounting those cash flows on the basis of the periods that will remain after the debt instrument is issued. For example, the spot rate of 6.38 percent is used to discount the interest cash flow that is expected to be paid in Period 3, but it is discounted for only two periods because it will occur two periods after the forecast transaction.

The forward interest rates are the same as shown previously, since it is assumed that interest rates do not change. The spot rates are different but they have not actually changed. They represent the spot rates one period forward and are based on the applicable forward rates.

Hedging Instrument

The objective of the hedge is to obtain an overall interest rate on the forecast transaction and the hedging instrument that is equal to 6.86 percent, which is the market rate at the inception of the hedge for the period from Period 2 to Period 5. This objective is accomplished by entering into a forward starting interest rate swap that has a fixed rate of 6.86 percent. Based on the term structure of interest rates that exist at the inception of the hedge, the interest rate swap will have such a rate. At the inception of the hedge, the fair value of the fixed rate payments on the interest rate swap will equal the fair value of the variable rate payments, resulting in the interest rate swap having a fair value of zero. The expected cash flows of the interest rate swap and the related fair value amounts are shown as follows.

Interest Rate Swap					
<i>Total</i>					
<i>Original forward periods</i>	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
<i>Remaining periods</i>		<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>
	<i>RM</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>
<i>Cash flows:</i>					
Fixed interest @6.86%		1,716	1,716	1,716	1,716
Forecast variable interest		1,313	1,877	1,876	1,813
<i>Forecast based on forward rate</i>		<i>5.25%</i>	<i>7.51%</i>	<i>7.50%</i>	<i>7.25%</i>
Net interest		(403)	161	160	97
<i>Fair value:</i>					
<i>Discount rate (spot)</i>		<i>5.25%</i>	<i>6.38%</i>	<i>6.75%</i>	<i>6.88%</i>
Fixed interest	6,592	1,694	1,663	1,632	1,603
Forecast variable interest	6,592	1,296	1,819	1,784	1,693
Fair value of interest rate swap	0	(398)	156	152	90

At the inception of the hedge, the fixed rate on the forward swap is equal to the fixed rate the entity would receive if it could issue the debt in three months under terms that exist today.

Measuring Hedge Effectiveness

If interest rates change during the period the hedge is outstanding, the effectiveness of the hedge can be measured in various ways.

Assume that interest rates change as follows immediately before the debt is issued at the beginning of Period 2.

Yield Curve - Rates Increase 200 Basis Points					
<i>Forward periods</i>	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
<i>Remaining periods</i>		<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>
Spot rates		5.75%	6.50%	7.50%	8.00%
Forward rates		5.75%	7.25%	9.51%	9.50%

Under the new interest rate environment, the fair value of the pay-fixed at 6.86 percent, receive-variable interest rate swap that was designated as the hedging instrument would be as follows.

Fair Value of Interest Rate Swap						
<i>Total</i>						
<i>Original forward periods</i>		<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
<i>Remaining periods</i>			<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>
	<i>RM</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>
<i>Cash flows:</i>						
Fixed interest @6.86%			1,716	1,716	1,716	1,716
Forecast variable interest			1,438	1,813	2,377	2,376
<i>Forecast based on new forward rate</i>			<i>5.25%</i>	<i>7.25%</i>	<i>9.51%</i>	<i>9.50%</i>
Net interest			(279)	97	661	660
<i>Fair value:</i>						
<i>New discount rate (spot)</i>			<i>5.75%</i>	<i>6.50%</i>	<i>7.50%</i>	<i>8.00%</i>
Fixed interest	6,562		1,692	1,662	1,623	1,585
Forecast variable interest	7,615		1,417	1,755	2,248	2,195
Fair value of net interest	1,053		(275)	93	625	610

In order to compute the effectiveness of the hedge, it is necessary to measure the change in the present value of the cash flows or the value of the hedged forecast transaction. There are at least two methods of accomplishing this measurement.

Method A Compute Change in Fair Value of Debt						
<i>Total</i>						
<i>Original forward periods</i>		<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
<i>Remaining periods</i>			<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>
	<i>RM</i>		<i>RM</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>
<i>Cash flows:</i>						
Fixed interest @6.86%			1,716	1,716	1,716	1,716
Principal						100,000
<i>Fair value:</i>						
<i>New discount rate (spot)</i>			<i>5.75%</i>	<i>6.50%</i>	<i>7.50%</i>	<i>8.00%</i>
Interest	6,562		1,692	1,662	1,623	1,585
Principal	92,385					92,385 ^(a)
Total	98,947					
Fair value at inception	100,000					
Fair value difference	(1,053)					
^(a) RM100,000/(1 + [0.08/4]) ⁴						

Under Method A, a computation is made of the fair value in the new interest rate environment of debt that carries interest that is equal to the coupon interest rate that existed at the inception of the hedging relationship (6.86 percent). This fair value is compared with the expected fair value as of the beginning of Period 2 that was calculated on the basis of the term structure of interest rates that existed at the

inception of the hedging relationship, as illustrated above, to determine the change in the fair value. Note that the difference between the change in the fair value of the swap and the change in the expected fair value of the debt exactly offset in this example, since the terms of the swap and the forecast transaction match each other.

Method B Compute Change in Fair Value of Cash Flows					
<i>Total</i>					
<i>Original forward periods</i>	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
<i>Remaining periods</i>		<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>
Market rate at inception		6.86%	6.86%	6.86%	6.86%
Current forward rate		5.75%	7.25%	9.51%	9.50%
Rate difference		1.11%	(0.39%)	(2.64%)	(2.64%)
Cash flow difference (principal × rate)		RM 279	(RM 97)	(RM 661)	(RM 660)
Discount rate (<i>spot</i>)		5.75%	6.50%	7.50%	8.00%
Fair value of difference	(RM 1,053)	RM 275	(RM 93)	(RM 625)	(RM 610)

Under Method B, the present value of the change in cash flows is computed on the basis of the difference between the forward interest rates for the applicable periods at the effectiveness measurement date and the interest rate that would have been obtained if the debt had been issued at the market rate that existed at the inception of the hedge. The market rate that existed at the inception of the hedge is the one-year forward coupon rate in three months. The present value of the change in cash flows is computed on the basis of the current spot rates that exist at the effectiveness measurement date for the applicable periods in which the cash flows are expected to occur. This method also could be referred to as the “theoretical swap” method (or “hypothetical derivative” method) because the comparison is between the hedged fixed rate on the debt and the current variable rate, which is the same as comparing cash flows on the fixed and variable rate legs of an interest rate swap.

As before, the difference between the change in the fair value of the swap and the change in the present value of the cash flows exactly offset in this example, since the terms match.

Other Considerations

There is an additional computation that should be performed to compute ineffectiveness before the expected date of the forecast transaction that has not been considered for the purpose of this illustration. The fair value difference has been determined in each of the illustrations as of the expected date of the forecast transaction immediately before the forecast transaction, i.e., at the beginning of Period 2. If the assessment of hedge effectiveness is done before the forecast transaction occurs, the difference should be discounted to the current date to arrive at the actual amount of ineffectiveness. For example, if the measurement date were one month after the hedging relationship was established and the forecast transaction is now expected to occur in two months, the amount would have to be discounted for the remaining two months before the forecast transaction is expected to occur to arrive at the actual fair value. This step would not be necessary in the examples provided above because there was no ineffectiveness. Therefore, additional discounting of the amounts, which net to zero, would not have changed the result.

Under Method B, ineffectiveness is computed on the basis of the difference between the forward coupon interest rates for the applicable periods at the effectiveness measurement date and the interest rate that

would have been obtained if the debt had been issued at the market rate that existed at the inception of the hedge. Computing the change in cash flows based on the difference between the forward interest rates that existed at the inception of the hedge and the forward rates that exist at the effectiveness measurement date is inappropriate if the objective of the hedge is to establish a single fixed rate for a series of forecast interest payments. This objective is met by hedging the exposures with an interest rate swap as illustrated in the above example. The fixed interest rate on the swap is a blended interest rate composed of the forward rates over the life of the swap. Unless the yield curve is flat, the comparison between the forward interest rate exposures over the life of the swap and the fixed rate on the swap will produce different cash flows whose fair values are equal only at the inception of the hedging relationship. This difference is shown in the table below.

<i>Total</i>					
<i>Original forward periods</i>	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
<i>Remaining periods</i>		<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>
Forward rate at inception		5.25%	7.51%	7.50%	7.25%
Current forward rate		5.75%	7.25%	9.51%	9.50%
Rate difference		(0.50%)	0.26%	(2.00%)	(2.25%)
Cash flow difference (principal × rate)		(RM 125)	RM 64	(RM 501)	(RM 563)
Discount rate (spot)		5.75%	6.50%	7.50%	8.00%
Fair value of difference	(RM 1,055)	(RM 123)	RM 62	(RM 474)	(RM 520)
Fair value of interest rate swap	RM 1,053				
Ineffectiveness	(RM 2)				

If the objective of the hedge is to obtain the forward rates that existed at the inception of the hedge, the interest rate swap is ineffective because the swap has a single blended fixed coupon rate that does not offset a series of different forward interest rates. However, if the objective of the hedge is to obtain the forward coupon rate that existed at the inception of the hedge, the swap is effective, and the comparison based on differences in forward interest rates suggests ineffectiveness when none may exist. Computing ineffectiveness based on the difference between the forward interest rates that existed at the inception of the hedge and the forward rates that exist at the effectiveness measurement date would be an appropriate measurement of ineffectiveness if the hedging objective is to lock in those forward interest rates. In that case, the appropriate hedging instrument would be a series of forward contracts each of which matures on a repricing date that corresponds with the date of the forecast transactions.

It also should be noted that it would be inappropriate to compare only the variable cash flows on the interest rate swap with the interest cash flows in the debt that would be generated by the forward interest rates. That methodology has the effect of measuring ineffectiveness only on a portion of the derivative, and MPSAS 29, *Financial Instruments: Recognition and Measurement*, does not permit the bifurcation of a derivative for the purposes of assessing effectiveness in this situation (MPSAS 29.83). It is recognized, however, that if the fixed interest rate on the interest rate swap is equal to the fixed rate that would have been obtained on the debt at inception, there will be no ineffectiveness assuming that there are no differences in terms and no change in credit risk or it is not designated in the hedging relationship.

F.5.6 Cash Flow Hedges: Firm Commitment to Purchase Property, Plant and Equipment in a Foreign Currency

Entity A has the Local Currency (LC) as its functional currency and presentation currency. On June 30, 20X1, it enters into a forward exchange contract to receive Foreign Currency (FC) 100,000 and deliver LC109,600 on June 30, 20X2 at an initial cost and fair value of zero. It designates the forward exchange contract as a hedging instrument in a cash flow hedge of a firm commitment to purchase spare parts for its electricity distribution network on March 31, 20X2 and the resulting payable of FC100,000, which is to be paid on June 30, 20X2. All hedge accounting conditions in MPSAS 29, *Financial Instruments: Recognition and Measurement*, are met.

As indicated in the table below, on June 30, 20X1, the spot exchange rate is LC1.072 to FC1, while the twelve-month forward exchange rate is LC1.096 to FC1. On December 31, 20X1, the spot exchange rate is LC1.080 to FC1, while the six-month forward exchange rate is LC1.092 to FC1. On March 31, 20X2, the spot exchange rate is LC1.074 to FC1, while the three-month forward rate is LC1.076 to FC1. On June 30, 20X2, the spot exchange rate is LC1.072 to FC1. The applicable yield curve in the local currency is flat at 6 percent per year throughout the period. The fair value of the forward exchange contract is negative LC388 on December 31, 20X1 $\{[(1.092 \times 100,000) - 109,600]/1.06(6/12)\}$, negative LC1,971 on March 31, 20X2 $\{[(1.076 \times 100,000) - 109,600]/1.06(3/12)\}$, and negative LC2,400 on June 30, 20X2 $\{1.072 \times 100,000 - 109,600\}$.

Date	Spot rate	Forward rate to June 30, 20X2	Fair value of forward contract
June 30, 20X1	1.072	1.096	–
December 31, 20X1	1.080	1.092	(388)
March 31, 20X2	1.074	1.076	(1,971)
June 30, 20X2	1.072	–	(2,400)

Issue (a) – What is the accounting for these transactions if the hedging relationship is designated as being for changes in the fair value of the forward exchange contract and the entity's accounting policy is to apply basis adjustment to non-financial assets that result from hedged forecast transactions?

The accounting entries are as follows.

June 30, 20X1

Dr	Forward	LC0	
	Cr Cash		LC0

To record the forward exchange contract at its initial amount of zero (MPSAS 29.45). The hedge is expected to be fully effective because the critical terms of the forward exchange contract and the purchase contract and the assessment of hedge effectiveness are based on the forward price (MPSAS 29.AG149).

December 31, 20X1

Dr	Net assets/equity	LC388	
	Cr Forward liability		LC388

To record the change in the fair value of the forward exchange contract between June 30, 20X1 and December 31, 20X1, i.e., $LC388 - 0 = LC388$, in net assets/equity (MPSAS 29.106). The hedge is fully effective because the loss on the forward exchange contract (LC388) exactly offsets the change in cash flows associated with the purchase contract based on the forward price [$LC388 = \{([1.092 \times 100,000] - 109,600)/1.06(6/12)\} - \{([1.096 \times 100,000] - 109,600)/1.06\}$]

March 31, 20X2

Dr	Net assets/equity	LC1,583	
	Cr	Forward liability	LC1,583

To record the change in the fair value of the forward exchange contract between January 1, 20X2 and March 31, 20X2 (i.e., $LC1,971 - LC388 = LC1,583$) in net assets/equity (MPSAS 29.106). The hedge is fully effective because the loss on the forward exchange contract (LC1,583) exactly offsets the change in cash flows associated with the purchase contract based on the forward price [$LC1,583 = \{([1.076 \times 100,000] - 109,600)/1.06(3/12)\} - \{([1.092 \times 100,000] - 109,600)/1.06(6/12)\}$]

Dr	Property, plant and equipment (purchase price)	LC107,400	
Dr	Property, plant and equipment (hedging loss)	LC1,971	
	Cr	Net assets/equity	LC1,971
	Cr	Payable	LC107,400

To recognize the purchase of the spare parts at the spot rate ($1.074 \times FC100,000$) and remove the cumulative loss on the forward exchange contract that has been recognized in net assets/equity (LC1,971) and include it in the initial measurement of the spare parts purchased. Accordingly, the initial measurement of the is LC109,371 consisting of a purchase consideration of LC107,400 and a hedging loss of LC1,971.

June 30, 20X2

Dr	Payable	LC107,400	
	Cr	Cash	LC107,200
	Cr	Surplus or deficit	LC200

To record the settlement of the payable at the spot rate ($FC100,000 \times 1.072 = 107,200$) and the associated exchange gain of LC200 ($LC107,400 - LC107,200$).

Dr	Surplus or deficit	LC429	
	Cr	Forward liability	LC429

To record the loss on the forward exchange contract between April 1, 20X2 and June 30, 20X2 (i.e., $LC2,400 - LC1,971 = LC429$) in surplus or deficit. The hedge is regarded as fully effective because the loss on the forward exchange contract (LC429) exactly offsets the change in the fair value of the payable based on the forward price ($LC429 = ([1.072 \times 100,000] - 109,600 - \{([1.076 \times 100,000] - 109,600)/1.06(3/12)\})$).

Dr	Forward liability	LC2,400	
	Cr	Cash	LC2,400

To record the net settlement of the forward exchange contract.

Issue (b) – What is the accounting for these transactions if the hedging relationship instead is designated as being for changes in the spot element of the forward exchange contract and the interest element is excluded from the designated hedging relationship (MPSAS 29.83)?

The accounting entries are as follows.

June 30, 20X1

Dr	Forward	LC0	
	Cr Cash		LC0

To record the forward exchange contract at its initial amount of zero (MPSAS 29.45). The hedge is expected to be fully effective because the critical terms of the forward exchange contract and the purchase contract are the same and the change in the premium or discount on the forward contract is excluded from the assessment of effectiveness (MPSAS 29.AG149).

December 31, 20X1

Dr	Surplus or deficit (interest element)	LC1,165	
	Cr Net assets/equity (spot element)		LC777
	Cr Forward liability		LC388

To record the change in the fair value of the forward exchange contract between June 30, 20X1 and December 31, 20X1, i.e., $LC388 - 0 = LC388$. The change in the present value of spot settlement of the forward exchange contract is a gain of LC777 ($\{([1.080 \times 100,000] - 107,200)/1.06(6/12)\} - \{([1.072 \times 100,000] - 107,200)/1.06\}$), which is recognized in net assets/equity (MPSAS 29.106). The change in the interest element of the forward exchange contract (the residual change in fair value) is a loss of LC1,165 ($388 + 777$), which is recognized in surplus or deficit (MPSAS 29.83 and MPSAS 29.64(a)). The hedge is fully effective because the gain in the spot element of the forward contract (LC777) exactly offsets the change in the purchase price at spot rates ($LC777 = \{([1.080 \times 100,000] - 107,200)/1.06(6/12)\} - \{([1.072 \times 100,000] - 107,200)/1.06\}$).

March 31, 20X2

Dr	Net assets/equity (spot element)	LC580	
Dr	Surplus or deficit (interest element)	LC1,003	
	Cr Forward liability		LC1,583

To record the change in the fair value of the forward exchange contract between January 1, 20X2 and March 31, 20X2, i.e., $LC1,971 - LC388 = LC1,583$. The change in the present value of the spot settlement of the forward exchange contract is a loss of LC580 ($\{([1.074 \times 100,000] - 107,200)/1.06(3/12)\} - \{([1.080 \times 100,000] - 107,200)/1.06(6/12)\}$), which is recognized in net assets/equity (MPSAS 29.106(a)). The change in the interest element of the forward exchange contract (the residual change in fair value) is a loss of LC1,003 ($LC1,583 - LC580$), which is recognized in surplus or deficit (MPSAS 29.83 and MPSAS 29.64(a)). The hedge is fully effective because the loss in the spot element of the forward contract (LC580) exactly offsets the change in the purchase price at spot rates ($(580) = \{([1.074 \times 100,000] - 107,200)/1.06(3/12)\} - \{([1.080 \times 100,000] - 107,200)/1.06(6/12)\}$).

Dr	Property, plant and equipment (purchase price)	LC107,400	
Dr	Net assets/equity	LC197	
	Cr Property, plant and equipment (hedging gain)		LC197
	Cr Payable		LC107,400

To recognize the purchase of spare parts at the spot rate ($= 1.074 \times \text{FC}100,000$) and remove the cumulative gain on the spot element of the forward exchange contract that has been recognized in net assets/equity ($\text{LC}777 - \text{LC}580 = \text{LC}197$) and include it in the initial measurement of the spare parts. Accordingly, the initial measurement of the spare parts is $\text{LC}107,203$, consisting of a purchase consideration of $\text{LC}107,400$ and a hedging gain of $\text{LC}197$.

June 30, 20X2

Dr	Payable	LC107,400	
	Cr Cash		LC107,200
	Cr Surplus or deficit		LC200

To record the settlement of the payable at the spot rate ($\text{FC}100,000 \times 1.072 = \text{LC}107,200$) and the associated exchange gain of $\text{LC}200$ ($- [1.072 - 1.074] \times \text{FC}100,000$).

Dr	Surplus or deficit (spot element)	LC197	
Dr	Surplus or deficit (interest element)	LC232	
	Cr Forward liability		LC429

To record the change in the fair value of the forward exchange contract between April 1, 20X2 and June 30, 20X2 (i.e., $\text{LC}2,400 - \text{LC}1,971 = \text{LC}429$). The change in the present value of the spot settlement of the forward exchange contract is a loss of $\text{LC}197$ ($[1.072 \times 100,000] - 107,200 - \{([1.074 \times 100,000] - 107,200)/1.06(3/12)\}$), which is recognized in surplus or deficit. The change in the interest element of the forward exchange contract (the residual change in fair value) is a loss of $\text{LC}232$ ($\text{LC}429 - \text{LC}197$), which is recognized in surplus or deficit. The hedge is fully effective because the loss in the spot element of the forward contract ($\text{LC}197$) exactly offsets the change in the present value of the spot settlement of the payable ($\text{LC}197 = \{[1.072 \times 100,000] - 107,200 - \{([1.074 \times 100,000] - 107,200)/1.06(3/12)\}\}$).

Dr	Forward liability	LC2,400	
	Cr Cash		LC2,400

To record the net settlement of the forward exchange contract.

The following table provides an overview of the components of the change in fair value of the hedging instrument over the term of the hedging relationship. It illustrates that the way in which a hedging relationship is designated affects the subsequent accounting for that hedging relationship, including the assessment of hedge effectiveness and the recognition of gains and losses.

Period ending	Change in Spot settlement	Fair value of change in spot settlement	Change in Forward settlement	Fair value of change in forward settlement	Fair value of change in interest element
	<i>LC</i>	<i>LC</i>	<i>LC</i>	<i>LC</i>	<i>LC</i>
June 20X1	–	–	–	–	–
December 20X1	800	777	(400)	(388)	(1,165)
March 20X2	(600)	(580)	(1,600)	(1,583)	(1,003)
June 20X2	(200)	(197)	(400)	(429)	(232)
Total	–	–	(2,400)	(2,400)	(2,400)

F.6 *Hedges: Other Issues*

F.6.1 **Hedge Accounting: Management of Interest Rate Risk in Entities Such as Departments of Finance**

Entities, such as departments of finance, often manage their exposure to interest rate risk on a net basis for all or parts of their activities. They have systems to accumulate critical information throughout the entity about their financial assets, financial liabilities and forward commitments, including loan commitments. This information is used to estimate and aggregate cash flows and to schedule such estimated cash flows into the applicable future periods in which they are expected to be paid or received. The systems generate estimates of cash flows based on the contractual terms of the instruments and other factors, including estimates of prepayments and defaults. For risk management purposes, many entities use derivative contracts to offset some or all exposure to interest rate risk on a net basis.

If an entity manages interest rate risk on a net basis, can its activities potentially qualify for hedge accounting under MPSAS 29, *Financial Instruments: Recognition and Measurement*?

Yes. However, to qualify for hedge accounting the derivative hedging instrument that hedges the net position for risk management purposes must be designated for accounting purposes as a hedge of a gross position related to assets, liabilities, forecast cash inflows or forecast cash outflows giving rise to the net exposure (MPSAS 29.94, MPSAS 29.AG141 and MPSAS 29.AG154). It is not possible to designate a net position as a hedged item under MPSAS 29 *Financial Instruments: Recognition and Measurement*, because of the inability to associate hedging gains and losses with a specific item being hedged and, correspondingly, to determine objectively the period in which such gains and losses should be recognized in surplus or deficit.

Hedging a net exposure to interest rate risk can often be defined and documented to meet the qualifying criteria for hedge accounting in MPSAS 29.98 if the objective of the activity is to offset a specific, identified and designated risk exposure that ultimately affects the entity's surplus or deficit (MPSAS 29.AG153) and the entity designates and documents its interest rate risk exposure on a gross basis. Also, to qualify for hedge accounting the information systems must capture sufficient information about the amount and timing of cash flows and the effectiveness of the risk management activities in accomplishing their objective.

The factors an entity must consider for hedge accounting purposes if it manages interest rate risk on a net basis are discussed in Question F.6.2.

F.6.2 **Hedge Accounting Considerations when Interest Rate Risk is Managed on a Net Basis**

If an entity manages its exposure to interest rate risk on a net basis, what are the issues the entity should consider in defining and documenting its interest rate risk management activities to qualify for hedge accounting and in establishing and accounting for the hedge relationship?

Issues (a) – (l) below deal with the main issues. First, Issues (a) and (b) discuss the designation of derivatives used in interest rate risk management activities as fair value hedges or cash flow hedges. As noted there, hedge accounting criteria and accounting consequences differ between fair value hedges and cash flow hedges. Since it may be easier to achieve hedge accounting treatment if derivatives used in interest rate risk management activities are designated as cash flow hedging instruments, Issues (c) – (l) expand on various aspects of the accounting for cash flow hedges. Issues (c) – (f) consider the

application of the hedge accounting criteria for cash flow hedges in MPSAS 29, *Financial Instruments: Recognition and Measurement*, and Issues (g) and (h) discuss the required accounting treatment. Finally, Issues (i) – (l) elaborate on other specific issues relating to the accounting for cash flow hedges.

Issue (a) – Can a derivative that is used to manage interest rate risk on a net basis be designated under MPSAS 29, *Financial Instruments: Recognition and Measurement*, as a hedging instrument in a fair value hedge or a cash flow hedge of a gross exposure?

Both types of designation are possible under MPSAS 29, *Financial Instruments: Recognition and Measurement*. An entity may designate the derivative used in interest rate risk management activities either as a fair value hedge of assets, liabilities and firm commitments or as a cash flow hedge of forecast transactions, such as the anticipated reinvestment of cash inflows, the anticipated refinancing or rollover of a financial liability, and the cash flow consequences of the resetting of interest rates for an asset or a liability.

In economic terms, it does not matter whether the derivative instrument is regarded as a fair value hedge or as a cash flow hedge. Under either perspective of the exposure, the derivative has the same economic effect of reducing the net exposure. For example, a receive-fixed, pay-variable interest rate swap can be considered to be a cash flow hedge of a variable rate asset or a fair value hedge of a fixed rate liability. Under either perspective, the fair value or cash flows of the interest rate swap offset the exposure to interest rate changes. However, accounting consequences differ depending on whether the derivative is designated as a fair value hedge or a cash flow hedge, as discussed in Issue (b).

To illustrate: a department of finance has the following assets and liabilities with a maturity of two years.

	Variable interest	Fixed interest
	RM	RM
Assets	60	100
Liabilities	(100)	(60)
Net	(40)	40

The entity takes out a two-year swap with a notional principal of RM 40 to receive a variable interest rate and pay a fixed interest rate to hedge the net exposure. As discussed above, this may be regarded and designated either as a fair value hedge of RM 40 of the fixed rate assets or as a cash flow hedge of RM 40 of the variable rate liabilities.

Issue (b) – What are the critical considerations in deciding whether a derivative that is used to manage interest rate risk on a net basis should be designated as a hedging instrument in a fair value hedge or a cash flow hedge of a gross exposure?

Critical considerations include the assessment of hedge effectiveness in the presence of prepayment risk and the ability of the information systems to attribute fair value or cash flow changes of hedging instruments to fair value or cash flow changes, respectively, of hedged items, as discussed below.

For accounting purposes, the designation of a derivative as hedging a fair value exposure or a cash flow exposure is important because both the qualification requirements for hedge accounting and the recognition of hedging gains and losses for these categories are different. It is often easier to demonstrate high effectiveness for a cash flow hedge than for a fair value hedge.

Effects of Prepayments

Prepayment risk inherent in many financial instruments affects the fair value of an instrument and the timing of its cash flows and impacts on the effectiveness test for fair value hedges and the highly probable test for cash flow hedges, respectively.

Effectiveness is often more difficult to achieve for fair value hedges than for cash flow hedges when the instrument being hedged is subject to prepayment risk. For a fair value hedge to qualify for hedge accounting, the changes in the fair value of the derivative hedging instrument must be expected to be highly effective in offsetting the changes in the fair value of the hedged item (MPSAS 29.98(b)). This test may be difficult to meet if, for example, the derivative hedging instrument is a forward contract having a fixed term and the financial assets being hedged are subject to prepayment by the borrower. Also, it may be difficult to conclude that, for a portfolio of fixed rate assets that are subject to prepayment, the changes in the fair value for each individual item in the group will be expected to be approximately proportional to the overall changes in fair value attributable to the hedged risk of the group. Even if the risk being hedged is a benchmark interest rate, to be able to conclude that fair value changes will be proportional for each item in the portfolio, it may be necessary to disaggregate the asset portfolio into categories based on term, coupon, credit, type of loan and other characteristics.

In economic terms, a forward derivative instrument could be used to hedge assets that are subject to prepayment but it would be effective only for small movements in interest rates. A reasonable estimate of prepayments can be made for a given interest rate environment and the derivative position can be adjusted as the interest rate environment changes. If an entity's risk management strategy is to adjust the amount of the hedging instrument periodically to reflect changes in the hedged position, the entity needs to demonstrate that the hedge is expected to be highly effective only for the period until the amount of the hedging instrument is next adjusted. However, for that period, the expectation of effectiveness has to be based on existing fair value exposures and the potential for interest rate movements without consideration of future adjustments to those positions. Furthermore, the fair value exposure attributable to prepayment risk can generally be hedged with options.

For a cash flow hedge to qualify for hedge accounting, the forecast cash flows, including the reinvestment of cash inflows or the refinancing of cash outflows, must be highly probable (MPSAS 29.98(c) and the hedge expected to be highly effective in achieving offsetting changes in the cash flows of the hedged item and hedging instrument (MPSAS 29.98(b)). Prepayments affect the timing of cash flows and, therefore, the probability of occurrence of the forecast transaction. If the hedge is established for risk management purposes on a net basis, an entity may have sufficient levels of highly probable cash flows on a gross basis to support the designation for accounting purposes of forecast transactions associated with a portion of the gross cash flows as the hedged item. In this case, the portion of the gross cash flows designated as being hedged may be chosen to be equal to the amount of net cash flows being hedged for risk management purposes.

Systems Considerations

The accounting for fair value hedges differs from that for cash flow hedges. It is usually easier to use existing information systems to manage and track cash flow hedges than it is for fair value hedges.

Under fair value hedge accounting, the assets or liabilities that are designated as being hedged are remeasured for those changes in fair values during the hedge period that are attributable to the risk being hedged. Such changes adjust the carrying amount of the hedged items and, for interest sensitive assets and liabilities, may result in an adjustment of the effective interest rate of the hedged item (MPSAS 29.99). As a consequence of fair value hedging activities, the changes in fair value have to be allocated

to the assets or liabilities being hedged in order for the entity to be able to recompute their effective interest rate, determine the subsequent amortization of the fair value adjustment to surplus or deficit, and determine the amount that should be recognized in surplus or deficit when assets are sold or liabilities extinguished (MPSAS 29.99 and MPSAS 29.103). To comply with the requirements for fair value hedge accounting, it will generally be necessary to establish a system to track the changes in the fair value attributable to the hedged risk, associate those changes with individual hedged items, recompute the effective interest rate of the hedged items, and amortize the changes to surplus or deficit over the life of the respective hedged item.

Under cash flow hedge accounting, the cash flows relating to the forecast transactions that are designated as being hedged reflect changes in interest rates. The adjustment for changes in the fair value of a hedging derivative instrument is initially recognized in net assets/equity (MPSAS 29.105). To comply with the requirements for cash flow hedge accounting, it is necessary to determine when the cumulative gains and losses recognized in net assets/equity from changes in the fair value of a hedging instrument should be recognized in surplus or deficit (MPSAS 29.111 and MPSAS 29.112). For cash flow hedges, it is not necessary to create a separate system to make this determination. The system used to determine the extent of the net exposure provides the basis for scheduling the changes in the cash flows of the derivative and the recognition of such changes in surplus or deficit.

The timing of the recognition in surplus or deficit can be predetermined when the hedge is associated with the exposure to changes in cash flows. The forecast transactions that are being hedged can be associated with a specific principal amount in specific future periods composed of variable rate assets and cash inflows being reinvested or variable rate liabilities and cash outflows being refinanced, each of which creates a cash flow exposure to changes in interest rates. The specific principal amounts in specific future periods are equal to the notional amount of the derivative hedging instruments and are hedged only for the period that corresponds to the repricing or maturity of the derivative hedging instruments so that the cash flow changes resulting from changes in interest rates are matched with the derivative hedging instrument. MPSAS 29.111 specifies that the amounts recognized in net assets/equity should be recognized in surplus or deficit in the same period or periods during which the hedged item affects surplus or deficit.

Issue (c) – If a hedging relationship is designated as a cash flow hedge relating to changes in cash flows resulting from interest rate changes, what would be included in the documentation required by MPSAS 29.98(a)?

The following would be included in the documentation.

The hedging relationship – The maturity schedule of cash flows used for risk management purposes to determine exposures to cash flow mismatches on a net basis would provide part of the documentation of the hedging relationship.

The entity's risk management objective and strategy for undertaking the hedge – The entity's overall risk management objective and strategy for hedging exposures to interest rate risk would provide part of the documentation of the hedging objective and strategy.

The type of hedge – The hedge is documented as a cash flow hedge.

The hedged item – The hedged item is documented as a group of forecast transactions (interest cash flows) that are expected to occur with a high degree of probability in specified future periods, for example, scheduled on a monthly basis. The hedged item may include interest cash flows resulting from the reinvestment of cash inflows, including the resetting of interest rates on assets, or from the

refinancing of cash outflows, including the resetting of interest rates on liabilities and rollovers of financial liabilities. As discussed in Issue (e), the forecast transactions meet the probability test if there are sufficient levels of highly probable cash flows in the specified future periods to encompass the amounts designated as being hedged on a gross basis.

The hedged risk – The risk designated as being hedged is documented as a portion of the overall exposure to changes in a specified market interest rate, often the risk-free interest rate or an interbank offered rate, common to all items in the group. To help ensure that the hedge effectiveness test is met at inception of the hedge and subsequently, the designated hedged portion of the interest rate risk could be documented as being based on the same yield curve as the derivative hedging instrument.

The hedging instrument – Each derivative hedging instrument is documented as a hedge of specified amounts in specified future time periods corresponding with the forecast transactions occurring in the specified future time periods designated as being hedged.

The method of assessing effectiveness – The effectiveness test is documented as being measured by comparing the changes in the cash flows of the derivatives allocated to the applicable periods in which they are designated as a hedge to the changes in the cash flows of the forecast transactions being hedged. Measurement of the cash flow changes is based on the applicable yield curves of the derivatives and hedged items.

Issue (d) – If the hedging relationship is designated as a cash flow hedge, how does an entity satisfy the requirement for an expectation of high effectiveness in achieving offsetting changes in MPSAS 29.98(b)?

An entity may demonstrate an expectation of high effectiveness by preparing an analysis demonstrating high historical and expected future correlation between the interest rate risk designated as being hedged and the interest rate risk of the hedging instrument. Existing documentation of the hedge ratio used in establishing the derivative contracts may also serve to demonstrate an expectation of effectiveness.

Issue (e) – If the hedging relationship is designated as a cash flow hedge, how does an entity demonstrate a high probability of the forecast transactions occurring as required by MPSAS 29.98(c)?

An entity may do this by preparing a cash flow maturity schedule showing that there exist sufficient aggregate gross levels of expected cash flows, including the effects of the resetting of interest rates for assets or liabilities, to establish that the forecast transactions that are designated as being hedged are highly probable to occur. Such a schedule should be supported by management's stated intentions and past practice of reinvesting cash inflows and refinancing cash outflows.

For example, an entity may forecast aggregate gross cash inflows of RM100 and aggregate gross cash outflows of RM90 in a particular time period in the near future. In this case, it may wish to designate the forecast reinvestment of gross cash inflows of RM10 as the hedged item in the future time period. If more than RM10 of the forecast cash inflows are contractually specified and have low credit risk, the entity has strong evidence to support an assertion that gross cash inflows of RM10 are highly probable to occur and to support the designation of the forecast reinvestment of those cash flows as being hedged for a particular portion of the reinvestment period. A high probability of the forecast transactions occurring may also be demonstrated under other circumstances.

Issue (f) – If the hedging relationship is designated as a cash flow hedge, how does an entity assess and measure effectiveness under MPSAS 29.98(d) and MPSAS 29.98(e)?

Effectiveness is required to be measured at a minimum at the time an entity prepares its annual or interim financial reports. However, an entity may wish to measure it more frequently on a specified periodic basis, at the end of each month or other applicable reporting period. It is also measured whenever derivative positions designated as hedging instruments are changed or hedges are terminated to ensure that the recognition in surplus or deficit of the changes in the fair value amounts on assets and liabilities and the recognition of changes in the fair value of derivative instruments designated as cash flow hedges are appropriate.

Changes in the cash flows of the derivative are computed and allocated to the applicable periods in which the derivative is designated as a hedge and are compared with computations of changes in the cash flows of the forecast transactions. Computations are based on yield curves applicable to the hedged items and the derivative hedging instruments and applicable interest rates for the specified periods being hedged.

The schedule used to determine effectiveness could be maintained and used as the basis for determining the period in which the hedging gains and losses recognized initially in net assets/equity are recognized in surplus or deficit.

Issue (g) – If the hedging relationship is designated as a cash flow hedge, how does an entity account for the hedge?

The hedge is accounted for as a cash flow hedge in accordance with the provisions in MPSAS 29.106–MPSAS 29.111, as follows:

- (a) The portion of gains and losses on hedging derivatives determined to result from effective hedges is recognized in net assets/equity whenever effectiveness is measured; and
- (b) The ineffective portion of gains and losses resulting from hedging derivatives is recognized in surplus or deficit.

MPSAS 29.111 specifies that the amounts recognized in net assets/equity should be recognized in surplus or deficit in the same period or periods during which the hedged item affects surplus or deficit. Accordingly, when the forecast transactions occur, the amounts previously recognized in net assets/equity are recognized in surplus or deficit. For example, if an interest rate swap is designated as a hedging instrument of a series of forecast cash flows, the changes in the cash flows of the swap are removed from net assets/equity and recognized in surplus or deficit in the periods when the forecast cash flows and the cash flows of the swap offset each other.

Issue (h) – If the hedging relationship is designated as a cash flow hedge, what is the treatment of any net cumulative gains and losses recognized in net assets/equity if the hedging instrument is terminated prematurely, the hedge accounting criteria are no longer met, or the hedged forecast transactions are no longer expected to take place?

If the hedging instrument is terminated prematurely or the hedge no longer meets the criteria for qualification for hedge accounting, for example, the forecast transactions are no longer highly probable, the net cumulative gain or loss recognized in net assets/equity remains in net assets/equity until the forecast transaction occurs (MPSAS 29.112(a) and MPSAS 29.112(b)). If the hedged forecast transactions are no longer expected to occur, the net cumulative gain or loss is recognized in surplus or deficit (MPSAS 29.112(c)).

Issue (i) – MPSAS 29.84 states that a hedging relationship may not be designated for only a portion of the time period in which a hedging instrument is outstanding. If the hedging relationship is designated as a cash flow hedge, and the hedge subsequently fails the test for being highly effective, does MPSAS 29.84 preclude redesignating the hedging instrument?

No. MPSAS 29.84 indicates that a derivative instrument may not be designated as a hedging instrument for only a portion of its remaining period to maturity. MPSAS 29.84 does not refer to the derivative instrument's original period to maturity. If there is a hedge effectiveness failure, the ineffective portion of the gain or loss on the derivative instrument is recognized immediately in surplus or deficit (MPSAS 29.106) and hedge accounting based on the previous designation of the hedge relationship cannot be continued (MPSAS 29.112). In this case, the derivative instrument may be redesignated prospectively as a hedging instrument in a new hedging relationship provided this hedging relationship satisfies the necessary conditions. The derivative instrument must be redesignated as a hedge for the entire time period it remains outstanding.

Issue (j) – For cash flow hedges, if a derivative is used to manage a net exposure to interest rate risk and the derivative is designated as a cash flow hedge of forecast interest cash flows or portions of them on a gross basis, does the occurrence of the hedged forecast transaction give rise to an asset or liability that will result in a portion of the hedging gains and losses that were recognized in net assets/equity remaining in net assets/equity?

No. In the hedging relationship described in Issue (c) above, the hedged item is a group of forecast transactions consisting of interest cash flows in specified future periods. The hedged forecast transactions do not result in the recognition of assets or liabilities and the effect of interest rate changes that are designated as being hedged is recognized in surplus or deficit in the period in which the forecast transactions occur. Although this is not relevant for the types of hedges described here, if instead the derivative is designated as a hedge of a forecast purchase of a financial asset or issue of a financial liability, the associated gains or losses that were recognized in net assets/equity are recognized in surplus or deficit in the same period or periods during which the hedged forecast transaction affects surplus or deficit (such as in the periods that interest expenses are recognized). However, if an entity expects at any time that all or a portion of a net loss recognized net assets/equity will not be recovered in one or more future periods, it shall reclassify immediately into surplus or deficit the amount that is not expected to be recovered.

Issue (k) – In the answer to Issue (c) above it was indicated that the designated hedged item is a portion of a cash flow exposure. Does MPSAS 29, *Financial Instruments: Recognition and Measurement*, permit a portion of a cash flow exposure to be designated as a hedged item?

Yes. MPSAS 29, *Financial Instruments: Recognition and Measurement*, does not specifically address a hedge of a portion of a cash flow exposure for a forecast transaction. However, MPSAS 29.90 specifies that a financial asset or liability may be a hedged item with respect to the risks associated with only a portion of its cash flows or fair value, if effectiveness can be measured. The ability to hedge a portion of a cash flow exposure resulting from the resetting of interest rates for assets and liabilities suggests that a portion of a cash flow exposure resulting from the forecast reinvestment of cash inflows or the refinancing or rollover of financial liabilities can also be hedged. The basis for qualification as a hedged item of a portion of an exposure is the ability to measure effectiveness. This is further supported by MPSAS 29.92, which specifies that a non-financial asset or liability can be hedged only in its entirety or for foreign currency risk but not for a portion of other risks because of the difficulty of isolating and measuring the appropriate portion of the cash flows or fair value changes attributable to a specific risk. Accordingly, assuming effectiveness can be measured, a portion of a cash flow exposure of forecast transactions associated with, for example, the resetting of interest rates for a variable rate asset or liability can be designated as a hedged item.

Issue (l) – In the answer to Issue (c) above it was indicated that the hedged item is documented as a group of forecast transactions. Since these transactions will have different terms when they occur, including credit exposures, maturities and option features, how can an entity satisfy the tests in MPSAS 29.87 and MPSAS 29.93 requiring the hedged group to have similar risk characteristics?

MPSAS 29.87 provides for hedging a group of assets, liabilities, firm commitments or forecast transactions with similar risk characteristics. MPSAS 29.93 provides additional guidance and specifies that portfolio hedging is permitted if two conditions are met, namely: the individual items in the portfolio share the same risk for which they are designated, and the change in the fair value attributable to the hedged risk for each individual item in the group will be expected to be approximately proportional to the overall change in fair value.

When an entity associates a derivative hedging instrument with a gross exposure, the hedged item typically is a group of forecast transactions. For hedges of cash flow exposures relating to a group of forecast transactions, the overall exposure of the forecast transactions and the assets or liabilities that are repriced may have very different risks. The exposure from forecast transactions may differ depending on the terms that are expected as they relate to credit exposures, maturities, options and other features. Although the overall risk exposures may be different for the individual items in the group, a specific risk inherent in each of the items in the group can be designated as being hedged.

The items in the portfolio do not necessarily have to have the same overall exposure to risk, provided they share the same risk for which they are designated as being hedged. A common risk typically shared by a portfolio of financial instruments is exposure to changes in the risk-free or benchmark interest rate or to changes in a specified rate that has a credit exposure equal to the highest credit-rated instrument in the portfolio (i.e., the instrument with the lowest credit risk). If the instruments that are grouped into a portfolio have different credit exposures, they may be hedged as a group for a portion of the exposure. The risk they have in common that is designated as being hedged is the exposure to interest rate changes from the highest credit rated instrument in the portfolio. This ensures that the change in fair value attributable to the hedged risk for each individual item in the group is expected to be approximately proportional to the overall change in fair value attributable to the hedged risk of the group. It is likely there will be some ineffectiveness if the hedging instrument has a credit quality that is inferior to the credit quality of the highest credit-rated instrument being hedged, since a hedging relationship is designated for a hedging instrument in its entirety (MPSAS 29.83). For example, if a portfolio of assets consists of assets rated A, BB and B, and the current market interest rates for these assets are LIBOR+20 basis points, LIBOR+40 basis points and LIBOR+60 basis points, respectively, an entity may use a swap that pays fixed interest rate and for which variable interest payments based on LIBOR are made to hedge the exposure to variable interest rates. If LIBOR is designated as the risk being hedged, credit spreads above LIBOR on the hedged items are excluded from the designated hedge relationship and the assessment of hedge effectiveness.

F.6.3 Illustrative Example of Applying the Approach in Question F.6.2

The purpose of this example is to illustrate the process of establishing, monitoring and adjusting hedge positions and of qualifying for cash flow hedge accounting in applying the approach to hedge accounting described in Question F.6.2 when an entity manages its interest rate risk on an entity-wide basis. To this end, this example identifies a methodology that allows for the use of hedge accounting and takes advantage of existing risk management systems so as to avoid unnecessary changes to it and to avoid unnecessary bookkeeping and tracking.

The approach illustrated here reflects only one of a number of risk management processes that could be employed and could qualify for hedge accounting. Its use is not intended to suggest that other alternatives could not or should not be used. The approach being illustrated could also be applied in other circumstances (such as for cash flow hedges), for example, hedging the rollover of commercial paper financing.

Identifying, Assessing and Reducing Cash Flow Exposures

The discussion and illustrations that follow focus on the risk management activities of an entity, such as a department of finance that manages its interest rate risk by analyzing expected cash flows in a particular currency on an entity-wide basis. The cash flow analysis forms the basis for identifying the interest rate risk of the entity, entering into hedging transactions to manage the risk, assessing the effectiveness of risk management activities, and qualifying for and applying cash flow hedge accounting.

The illustrations that follow assume that an entity had the following expected future net cash flows and hedging positions outstanding in a specific currency, consisting of interest rate swaps, at the beginning of Period X0. The cash flows shown are expected to occur at the end of the period and, therefore, create a cash flow interest exposure in the following period as a result of the reinvestment or repricing of the cash inflows or the refinancing or repricing of the cash outflows.

The illustrations assume that the entity has an ongoing interest rate risk management program. Schedule I shows the expected cash flows and hedging positions that existed at the beginning of Period X0. It is included here to provide a starting point in the analysis. It provides a basis for considering existing hedges in connection with the evaluation that occurs at the beginning of Period X1.

Schedule I End of Period: Expected Cash Flows and Hedging Positions							
<i>Quarterly period</i>	<i>X0</i>	<i>X1</i>	<i>X2</i>	<i>X3</i>	<i>X4</i>	<i>X5</i>	<i>n</i>
<i>(units)</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>
Expected net cash flows		1,100	1,500	1,200	1,400	1,500	x,xxx
<i>Outstanding interest rate swaps:</i>							
Receive-fixed, pay- variable (notional amounts)	2,000	2,000	2,000	1,200	1,200	1,200	x,xxx
Pay-fixed, receive- variable (notional amounts)	(1,000)	(1,000)	(1,000)	(500)	(500)	(500)	x,xxx
Net exposure after outstanding swaps		100	500	500	700	800	x.xxx

The schedule depicts five quarterly periods. The actual analysis would extend over a period of many years, represented by the notation "...n." An entity that manages its interest rate risk on an entity-wide basis re-evaluates its cash flow exposures periodically. The frequency of the evaluation depends on the entity's risk management policy.

For the purposes of this illustration, the entity is re-evaluating its cash flow exposures at the end of Period X0. The first step in the process is the generation of forecast net cash flow exposures from existing interest-earning assets and interest-bearing liabilities, including the rollover of short-term assets and short-term liabilities. Schedule II below illustrates the forecast of net cash flow exposures. A common technique for assessing exposure to interest rates for risk management purposes is an interest

rate sensitivity gap analysis showing the gap between interest rate-sensitive assets and interest rate-sensitive liabilities over different time intervals. Such an analysis could be used as a starting point for identifying cash flow exposures to interest rate risk for hedge accounting purposes.

Schedule II Forecast Net Cash Flow and Repricing Exposures							
<i>Quarterly period</i>	<i>Notes</i>	<i>X1</i>	<i>X2</i>	<i>X3</i>	<i>X4</i>	<i>X5</i>	<i>n</i>
<i>(units)</i>		<i>RM</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>
CASH INFLOW AND REPRICING EXPOSURES – from assets							
<i>Principal and interest payments:</i>							
Long-term fixed rate	(1)	2,400	3,000	3,000	1,000	1,200	x,xxx
Short-term (roll over)	(1)(2)	1,575	1,579	1,582	1,586	1,591	x,xxx
Variable rate – principal payments	(1)	2,000	1,000	–	500	500	x,xxx
Variable rate – estimated interest	(2)	125	110	105	114	118	x,xxx
<i>Total expected cash inflows</i>		<i>6,100</i>	<i>5,689</i>	<i>4,687</i>	<i>3,200</i>	<i>3,409</i>	<i>x,xxx</i>
Variable rate asset balances	(3)	8,000	7,000	7,000	6,500	6,000	x,xxx
Cash inflows and repricings	(4)	14,100	12,689	11,687	9,700	9,409	x,xxx
CASH OUTFLOW AND REPRICING EXPOSURES - from liabilities							
<i>Principal and interest payments:</i>							
Long-term fixed rate	(1)	2,100	400	500	500	301	x,xxx
Short-term (roll over)	(1)(2)	735	737	738	740	742	x,xxx
Variable rate – principal payments	(1)	–	–	2,000	–	1,000	x,xxx
Variable rate – estimated interest	(2)	100	110	120	98	109	x,xxx
<i>Total expected cash outflows</i>		<i>2,935</i>	<i>1,247</i>	<i>3,358</i>	<i>1,338</i>	<i>2,152</i>	<i>x,xxx</i>
Variable rate liability balances	(3)	8,000	8,000	6,000	6,000	5,000	x,xxx
Cash outflows and repricings	(4)	10,935	9,247	9,358	7,338	7,152	x,xxx
NET EXPOSURES	(5)	3,165	3,442	2,329	2,362	2,257	x,xxx

Schedule II Forecast Net Cash Flow and Repricing Exposures

1. The cash flows are estimated using contractual terms and assumptions based on management's intentions and market factors. It is assumed that short-term assets and liabilities will continue to be rolled over in succeeding periods. Assumptions about prepayments and defaults and the withdrawal of deposits are based on market and historical data. It is assumed that principal and interest inflows and outflows will be reinvested and refinanced, respectively, at the end of each period at the then current market interest rates and share the benchmark interest rate risk to which they are exposed.
2. Forward interest rates obtained from Schedule VI are used to forecast interest payments on variable rate financial instruments and expected rollovers of short-term assets and liabilities. All forecast cash flows are associated with the specific time periods (3 months, 6 months, 9 months, and 12 months) in which they are expected to occur. For completeness, the interest cash flows resulting from reinvestments, refinancings and repricings are included in the schedule and shown gross even though only the net margin may actually be reinvested. Some entities may choose to disregard the forecast interest cash flows for risk management purposes because they may be used to absorb operating costs and any remaining amounts would not be significant enough to affect risk management decisions.
3. The cash flow forecast is adjusted to include the variable rate asset and liability balances in each period in which such variable rate asset and liability balances are repriced. The principal amounts of these assets and liabilities are not actually being paid and, therefore, do not generate a cash flow. However, since interest is computed on the principal amounts for each period based on the then current market interest rate, such principal amounts expose the entity to the same interest rate risk as if they were cash flows being reinvested or refinanced.
4. The forecast cash flow and repricing exposures that are identified in each period represent the principal amounts of cash inflows that will be reinvested or repriced and cash outflows that will be refinanced or repriced at the market interest rates that are in effect when those forecast transactions occur.
5. The net cash flow and repricing exposure is the difference between the cash inflow and repricing exposures from assets and the cash outflow and repricing exposures from liabilities. In the illustration, the entity is exposed to interest rate declines because the exposure from assets exceeds the exposure from liabilities and the excess (i.e., the net amount) will be reinvested or repriced at the current market rate and there is no offsetting refinancing or repricing of outflows.

Note that some entities may regard some portion of their non-interest bearing demand deposits as economically equivalent to long-term debt. However, these deposits do not create a cash flow exposure to interest rates and would therefore be excluded from this analysis for accounting purposes.

Schedule II Forecast net cash flow and repricing exposures provides no more than a starting point for assessing cash flow exposure to interest rates and for adjusting hedging positions. The complete analysis includes outstanding hedging positions and is shown in Schedule III Analysis of expected net exposures and hedging positions. It compares the forecast net cash flow exposures for each period (developed in Schedule II) with existing hedging positions (obtained from Schedule I), and provides a basis for considering whether adjustment of the hedging relationship should be made.

Schedule III Analysis of Expected Net Exposures and Hedging Positions						
<i>Quarterly period</i>	<i>X1</i>	<i>X2</i>	<i>X3</i>	<i>X4</i>	<i>X5</i>	<i>...n</i>
<i>(units)</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>
Net cash flow and repricing exposures (Schedule II)	3,165	3,442	2,329	2,362	2,257	x,xxx
<i>Pre-existing swaps outstanding:</i>						
Receive-fixed, pay-variable (notional amounts)	2,000	2,000	1,200	1,200	1,200	x,xxx
Pay-fixed, receive-variable (notional amounts)	(1,000)	(1,000)	(500)	(500)	(500)	x,xxx
<i>Net exposure after pre-existing swaps</i>	<i>2,165</i>	<i>2,442</i>	<i>1,629</i>	<i>1,662</i>	<i>1,557</i>	<i>x,xxx</i>
<i>Transactions to adjust outstanding hedging positions:</i>						
Receive-fixed, pay variable swap 1 (notional amount, 10-years)	2,000	2,000	2,000	2,000	2,000	x,xxx
Pay-fixed, receive-variable swap 2 (notional amount, 3-years)			(1,000)	(1,000)	(1,000)	x,xxx
Swaps ...X						x,xxx
<i>Unhedged cash flow and repricing exposure</i>	<i>165</i>	<i>442</i>	<i>629</i>	<i>662</i>	<i>557</i>	<i>x,xxx</i>

The notional amounts of the interest rate swaps that are outstanding at the analysis date are included in each of the periods in which the interest rate swaps are outstanding to illustrate the impact of the outstanding interest rate swaps on the identified cash flow exposures. The notional amounts of the outstanding interest rate swaps are included in each period because interest is computed on the notional amounts each period, and the variable rate components of the outstanding swaps are repriced to the current market rate quarterly. The notional amounts create an exposure to interest rates that in part is similar to the principal balances of variable rate assets and variable rate liabilities.

The exposure that remains after considering the existing positions is then evaluated to determine the extent to which adjustments of existing hedging positions are necessary. The bottom portion of Schedule III shows the beginning of Period X1 using interest rate swap transactions to reduce the net exposures further to within the tolerance levels established under the entity's risk management policy.

Note that in the illustration, the cash flow exposure is not entirely eliminated. Many entities do not fully eliminate risk but rather reduce it to within some tolerable limit.

Various types of derivative instruments could be used to manage the cash flow exposure to interest rate risk identified in the schedule of forecast net cash flows (Schedule II). However, for the purpose of the illustration, it is assumed that interest rate swaps are used for all hedging activities. It is also assumed that in periods in which interest rate swaps should be reduced, rather than terminating some of the outstanding interest rate swap positions, a new swap with the opposite return characteristics is added to the portfolio.

In the illustration in Schedule III above, swap 1, a receive-fixed, pay-variable swap, is used to reduce the net exposure in Periods X1 and X2. Since it is a 10-year swap, it also reduces exposures identified in other future periods not shown. However, it has the effect of creating an over-hedged position in Periods X3–X5. Swap 2, a forward starting pay-fixed, receive-variable interest rate swap, is used to reduce the notional amount of the outstanding receive-fixed, pay-variable interest rate swaps in Periods X3–X5 and thereby reduce the over-hedged positions.

It also is noted that in many situations, no adjustment or only a single adjustment of the outstanding hedging position is necessary to bring the exposure to within an acceptable limit. However, when the entity's risk management policy specifies a very low tolerance of risk a greater number of adjustments to the hedging positions over the forecast period would be needed to further reduce any remaining risk.

To the extent that some of the interest rate swaps fully offset other interest rate swaps that have been entered into for hedging purposes, it is not necessary to include them in a designated hedging relationship for hedge accounting purposes. These offsetting positions can be combined, de-designated as hedging instruments, if necessary, and reclassified for accounting purposes from the hedging portfolio to the trading portfolio. This procedure limits the extent to which the gross swaps must continue to be designated and tracked in a hedging relationship for accounting purposes. For the purposes of this illustration it is assumed that RM500 of the pay-fixed, receive-variable interest rate swaps fully offset RM500 of the receive-fixed, pay-variable interest rate swaps at the beginning of Period X1 and for Periods X1–X5, and are de-designated as hedging instruments and reclassified to the trading account.

After reflecting these offsetting positions, the remaining gross interest rate swap positions from Schedule III are shown in Schedule IV as follows.

Schedule IV Interest Rate Swaps Designated as Hedges						
<i>Quarterly period</i>	<i>X1</i>	<i>X2</i>	<i>X3</i>	<i>X4</i>	<i>X5</i>	<i>...n</i>
<i>(units)</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>
Receive-fixed, pay-variable (notional amounts)	3,500	3,500	2,700	2,700	2,700	x,xxx
Pay-fixed, receive-variable (notional amounts)	(500)	(500)	(1,000)	(1,000)	(1,000)	x,xxx
<i>Net outstanding swaps positions</i>	<i>3,000</i>	<i>3,000</i>	<i>1,700</i>	<i>1,700</i>	<i>1,700</i>	<i>x,xxx</i>

For the purposes of the illustrations, it is assumed that swap 2, entered into at the beginning of Period X1, only partially offsets another swap being accounted for as a hedge and therefore continues to be designated as a hedging instrument.

Hedge Accounting Considerations

Illustrating the Designation of the Hedging Relationship

The discussion and illustrations thus far have focused primarily on economic and risk management considerations relating to the identification of risk in future periods and the adjustment of that risk using interest rate swaps. These activities form the basis for designating a hedging relationship for accounting purposes.

The examples in MPSAS 29, *Financial Instruments: Recognition and Measurement*, focus primarily on hedging relationships involving a single hedged item and a single hedging instrument, but there is little discussion and guidance on portfolio hedging relationships for cash flow hedges when risk is being managed centrally. In this illustration, the general principles are applied to hedging relationships involving a component of risk in a portfolio having multiple risks from multiple transactions or positions.

Although designation is necessary to achieve hedge accounting, the way in which the designation is described also affects the extent to which the hedging relationship is judged to be effective for accounting purposes and the extent to which the entity's existing system for managing risk will be required to be modified to track hedging activities for accounting purposes. Accordingly, an entity may wish to designate the hedging relationship in a manner that avoids unnecessary systems changes by taking advantage of the information already generated by the risk management system and avoids unnecessary bookkeeping and tracking. In designating hedging relationships, the entity may also consider the extent to which ineffectiveness is expected to be recognized for accounting purposes under alternative designations.

The designation of the hedging relationship needs to specify various matters. These are illustrated and discussed here from the perspective of the hedge of the interest rate risk associated with the cash inflows, but the guidance can also be applied to the hedge of the risk associated with the cash outflows. It is fairly obvious that only a portion of the gross exposures relating to the cash inflows is being hedged by the interest rate swaps. Schedule V The general hedging relationship illustrates the designation of the portion of the gross reinvestment risk exposures identified in Schedule II as being hedged by the interest rate swaps.

Schedule V The General Hedging Relationship						
<i>Quarterly period</i>	<i>X1</i>	<i>X2</i>	<i>X3</i>	<i>X4</i>	<i>X5</i>	<i>...n</i>
<i>(units)</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>	<i>RM</i>
Cash inflow repricing exposure (Schedule II)	14,100	12,689	11,687	9,700	9,409	x,xxx
Receive-fixed, pay-variable swaps (Schedule IV)	3,500	3,500	2,700	2,700	2,700	x,xxx
<i>Hedged exposure percentage</i>	<i>24.8%</i>	<i>27.6%</i>	<i>23.1%</i>	<i>27.8%</i>	<i>28.7%</i>	<i>xx.x%</i>

The hedged exposure percentage is computed as the ratio of the notional amount of the receive-fixed, pay-variable swaps that are outstanding divided by the gross exposure. Note that in Schedule V there are sufficient levels of forecast reinvestments in each period to offset more than the notional amount of the receive-fixed, pay-variable swaps and satisfy the accounting requirement that the forecast transaction is highly probable.

It is not as obvious, however, how the interest rate swaps are specifically related to the cash flow interest risks designated as being hedged and how the interest rate swaps are effective in reducing that risk. The more specific designation is illustrated in Schedule VI The specific hedging relationship below. It provides a meaningful way of depicting the more complicated narrative designation of the hedge by focusing on the hedging objective to eliminate the cash flow variability associated with future changes in interest rates and to obtain an interest rate equal to the fixed rate inherent in the term structure of interest rates that exists at the commencement of the hedge.

The expected interest from the reinvestment of the cash inflows and repricings of the assets is computed by multiplying the gross amounts exposed by the forward rate for the period. For example, the gross exposure for Period X2 of RM 14,100 is multiplied by the forward rate for Periods X2–X5 of 5.50 percent, 6.00 percent, 6.50 percent and 7.25 percent, respectively, to compute the expected interest for those quarterly periods based on the current term structure of interest rates. The hedged expected interest is computed by multiplying the expected interest for the applicable three-month period by the hedged exposure percentage.

Schedule VI The Specific Hedging Relationship								
Term structure of interest rates								
Quarterly period		X1	X2	X3	X4	X5	...n	
Spot rates		5.00%	5.25%	5.50%	5.75%	6.05%	x.xx%	
Forward rates ^(a)		5.00%	5.50%	6.00%	6.50%	7.25%	x.xx%	
Cash flow exposures and expected interest amounts								
Repricing period	Time to forecast transaction	Gross amounts exposed	RM	RM	RM	RM	Expected interest RM	RM
2	3 months	14,100	→	194	212	229	256	
3	6 months	12,689			190	206	230	xxx
4	9 months	11,687				190	212	xxx
5	12 months	9,700					176	xxx
6	15 months	9,409						xxx
Hedged percentage (Schedule V) in the previous period				24.8%	27.6%	23.1%	27.8%	xx.x%
Hedged expected interest				48	52	44	49	xx
(a) The forward interest rates are computed from the spot interest rates and rounded for the purposes of the presentation. Computations that are based on the forward interest rates are made based on the actual computed forward rate and then rounded for the purposes of the presentation.								

It does not matter whether the gross amount exposed is reinvested in long-term fixed rate debt or variable rate debt, or in short-term debt that is rolled over in each subsequent period. The exposure to changes in the forward interest rate is the same. For example, if the RM14,100 is reinvested at a fixed rate at the beginning of Period X2 for six months, it will be reinvested at 5.75 percent. The expected interest is based on the forward interest rates for Period X2 of 5.50 percent and for Period X3 of 6.00 percent, equal to a blended rate of 5.75 percent $(1.055 \times 1.060)^{0.5}$, which is the Period X2 spot rate for the next six months.

However, only the expected interest from the reinvestment of the cash inflows or repricing of the gross amount for the first three-month period after the forecast transaction occurs is designated as being hedged. The expected interest being hedged is represented by the shaded cells. The exposure for the subsequent periods is not hedged. In the example, the portion of the interest rate exposure being hedged is the forward rate of 5.50 percent for Period X2. In order to assess hedge effectiveness and compute actual hedge ineffectiveness on an ongoing basis, the entity may use the information on hedged interest cash inflows in Schedule VI and compare it with updated estimates of expected interest cash inflows (e.g., in a table that looks like Schedule II). As long as expected interest cash inflows exceed hedged interest cash inflows, the entity may compare the cumulative change in the fair value of the hedged cash inflows with the cumulative change in the fair value of the hedging instrument to compute actual hedge effectiveness. If there are insufficient expected interest cash inflows, there will be ineffectiveness. It is measured by comparing the cumulative change in the fair value of the expected interest cash flows to the extent they are less than the hedged cash flows with the cumulative change in the fair value of the hedging instrument.

Describing the Designation of the Hedging Relationship

As mentioned previously, there are various matters that should be specified in the designation of the hedging relationship that complicate the description of the designation but are necessary to limit ineffectiveness to be recognized for accounting purposes and to avoid unnecessary systems changes and bookkeeping. The example that follows describes the designation more fully and identifies additional aspects of the designation not apparent from the previous illustrations.

Example Designation

Hedging Objective

The hedging objective is to eliminate the risk of interest rate fluctuations over the hedging period, which is the life of the interest rate swap, and in effect obtain a fixed interest rate during this period that is equal to the fixed interest rate on the interest rate swap.

Type of Hedge

Cash flow hedge.

Hedging Instrument

The receive-fixed, pay-variable swaps are designated as the hedging instrument. They hedge the cash flow exposure to interest rate risk.

Each repricing of the swap hedges a three-month portion of the interest cash inflows that results from:

- The forecast reinvestment or repricing of the principal amounts shown in Schedule V.
- Unrelated investments or repricings that occur after the repricing dates on the swap over its life and involve different borrowers or lenders.

The Hedged Item—General

The hedged item is a portion of the gross interest cash inflows that will result from the reinvestment or repricing of the cash flows identified in Schedule V and are expected to occur within the periods shown on such schedule. The portion of the interest cash inflow that is being hedged has three components:

- The principal component giving rise to the interest cash inflow and the period in which it occurs;
- The interest rate component; and
- The time component or period covered by the hedge.

The Hedged Item—The Principal Component

The portion of the interest cash inflows being hedged is the amount that results from the first portion of the principal amounts being invested or repriced in each period:

- That is equal to the sum of the notional amounts of the received-fixed, pay-variable interest rate swaps that are designated as hedging instruments and outstanding in the period of the reinvestment or repricing, and
- That corresponds to the first principal amounts of cash flow exposures that are invested or repriced at or after the repricing dates of the interest rate swaps.

The Hedged Item—The Interest Rate Component

The portion of the interest rate change that is being hedged is the change in both of the following:

- The credit component of the interest rate being paid on the principal amount invested or repriced that is equal to the credit risk inherent in the interest rate swap. It is that portion of the interest rate on the investment that is equal to the interest index of the interest rate swap, such as LIBOR; and
- The yield curve component of the interest rate that is equal to the repricing period on the interest rate swap designated as the hedging instrument.

Example Designation*The Hedged Item—The Hedged Period*

The period of the exposure to interest rate changes on the portion of the cash flow exposures being hedged is:

- The period from the designation date to the repricing date of the interest rate swap that occurs within the quarterly period in which, but not before, the forecast transactions occur; and
- Its effects for the period after the forecast transactions occur equal to the repricing interval of the interest rate swap.

It is important to recognize that the swaps are not hedging the cash flow risk for a single investment over its entire life. The swaps are designated as hedging the cash flow risk from different principal investments and repricings that are made in each repricing period of the swaps over their entire term. The swaps hedge only the interest accruals that occur in the first period following the reinvestment. They are hedging the cash flow impact resulting from a change in interest rates that occurs up to the repricing of the swap. The exposure to changes in rates for the period from the repricing of the swap to the date of the hedged reinvestment of cash inflows or repricing of variable rate assets is not hedged. When the swap is repriced, the interest rate on the swap is fixed until the next repricing date and the accrual of the net swap settlements is determined. Any changes in interest rates after that date that affect the amount of the interest cash inflow are no longer hedged for accounting purposes.

*Designation Objectives*Systems Considerations

Many of the tracking and bookkeeping requirements are eliminated by designating each repricing of an interest rate swap as hedging the cash flow risk from forecast reinvestments of cash inflows and repricings of variable rate assets for only a portion of the lives of the related assets. Much tracking and bookkeeping would be necessary if the swaps were instead designated as hedging the cash flow risk from forecast principal investments and repricings of variable rate assets over the entire lives of these assets.

This type of designation avoids keeping track of gains and losses recognized in net assets/equity after the forecast transactions occur (MPSAS 29.108 and MPSAS 29.109) because the portion of the cash flow risk being hedged is that portion that will be recognized in surplus or deficit in the period immediately following the forecast transactions that corresponds with the periodic net cash settlements on the swap. If the hedge were to cover the entire life of the assets being acquired, it would be necessary to associate a specific interest rate swap with the asset being acquired. If a forecast transaction is the acquisition of a fixed rate instrument, the fair value of the swap that hedged that transaction would be recognized in surplus or deficit to adjust the interest revenue on the asset when the interest revenue is recognized. The swap would then have to be terminated or redesignated in another hedging relationship. If a forecast transaction is the acquisition of a variable rate asset, the swap would continue in the hedging relationship but it would have to be tracked back to the asset acquired so that any fair value amounts on the swap recognized in net assets/equity could be recognized in surplus or deficit upon the subsequent sale of the asset.

It also avoids the necessity of associating with variable rate assets any portion of the fair value of the swaps that is recognized in net assets/equity. Accordingly, there is no portion of the fair value of the swap that is recognized in net assets/equity that should be recognized in surplus or deficit when a forecast transaction occurs or upon the sale of a variable rate asset. This type of designation also permits flexibility in deciding how to reinvest cash flows when they occur. Since the hedged risk relates only

to a single period that corresponds with the repricing period of the interest rate swap designated as the hedging instrument, it is not necessary to determine at the designation date whether the cash flows will be reinvested in fixed rate or variable rate assets or to specify at the date of designation the life of the asset to be acquired.

Effectiveness Considerations

Ineffectiveness is greatly reduced by designating a specific portion of the cash flow exposure as being hedged.

- Ineffectiveness due to credit differences between the interest rate swap and hedged forecast cash flow is eliminated by designating the cash flow risk being hedged as the risk attributable to changes in the interest rates that correspond with the rates inherent in the swap, such as the AA rate curve. This type of designation prevents changes resulting from changes in credit spreads from being considered as ineffectiveness.
- Ineffectiveness due to duration differences between the interest rate swap and hedged forecast cash flow is eliminated by designating the interest rate risk being hedged as the risk relating to changes in the portion of the yield curve that corresponds with the period in which the variable rate leg of the interest rate swap is repriced.
- Ineffectiveness due to interest rate changes that occur between the repricing date of the interest rate swap and the date of the forecast transactions is eliminated by simply not hedging that period of time. The period from the repricing of the swap and the occurrence of the forecast transactions in the period immediately following the repricing of the swap is left unhedged. Therefore, the difference in dates does not result in ineffectiveness.

Accounting Considerations

The ability to qualify for hedge accounting using the methodology described here is founded on provisions in MPSAS 29, *Financial Instruments: Recognition and Measurement*, and on interpretations of its requirements. Some of those are described in the answer to Question F.6.2 Hedge Accounting Considerations when Interest Rate Risk is Managed on a Net Basis. Some additional and supporting provisions and interpretations are identified below.

Hedging a Portion of the Risk Exposure

The ability to identify and hedge only a portion of the cash flow risk exposure resulting from the reinvestment of cash flows or repricing of variable rate instruments is found in MPSAS 29.90 as interpreted in the answers to Questions F.6.2 Issue (k) and F.2.17 Partial Term Hedging.

Hedging Multiple Risks with a Single Instrument

The ability to designate a single interest rate swap as a hedge of the cash flow exposure to interest rates resulting from various reinvestments of cash inflows or repricings of variable rate assets that occur over the life of the swap is founded on MPSAS 29.85 as interpreted in the answer to Question F.1.12 Hedges of More Than One Type of Risk.

Hedging Similar Risks in a Portfolio

The ability to specify the forecast transaction being hedged as a portion of the cash flow exposure to interest rates for a portion of the duration of the investment that gives rise to the interest payment without specifying at the designation date the expected life of the instrument and whether it pays a fixed or variable rate is founded on the answer to Question F.6.2 Issue (I), which specifies that the items in the portfolio do not necessarily have to have the same overall exposure to risk, providing they share the same risk for which they are designated as being hedged.

Hedge Terminations

The ability to de-designate the forecast transaction (the cash flow exposure on an investment or repricing that will occur after the repricing date of the swap) as being hedged is provided for in MPSAS 29.112 dealing with hedge terminations. While a portion of the forecast transaction is no longer being hedged, the interest rate swap is not de-designated, and it continues to be a hedging instrument for the remaining transactions in the series that have not occurred. For example, assume that an interest rate swap having a remaining life of one year has been designated as hedging a series of three quarterly reinvestments of cash flows. The next forecast cash flow reinvestment occurs in three months. When the interest rate swap is repriced in three months at the then current variable rate, the fixed rate and the variable rate on the interest rate swap become known and no longer provide hedge protection for the next three months. If the next forecast transaction does not occur until three months and ten days, the ten-day period that remains after the repricing of the interest rate swap is not hedged.

F.6.4 Hedge Accounting: Premium or Discount on Forward Exchange Contract

A forward exchange contract is designated as a hedging instrument, for example, in a hedge of a net investment in a foreign operation. Is it permitted to amortize the discount or premium on the forward exchange contract to surplus or deficit over the term of the contract?

No. The premium or discount on a forward exchange contract may not be amortized to surplus or deficit under MPSAS 29, *Financial Instruments: Recognition and Measurement*. Derivatives are always measured at fair value in the statement of financial position. The gain or loss resulting from a change in the fair value of the forward exchange contract is always recognized in surplus or deficit unless the forward exchange contract is designated and effective as a hedging instrument in a cash flow hedge or in a hedge of a net investment in a foreign operation, in which case the effective portion of the gain or loss is recognized in net assets/equity. In that case, the amounts recognized in net assets/equity are recognized in surplus or deficit when the hedged future cash flows occur or on the disposal of the net investment, as appropriate. Under MPSAS 29.84(b), the interest element (time value) of the fair value of a forward may be excluded from the designated hedge relationship. In that case, changes in the interest element portion of the fair value of the forward exchange contract are recognized in surplus or deficit.

F.6.5 MPSAS 29 and MPSAS 4 Fair Value Hedge of Asset Measured at Cost

If the future sale of a ship carried at historical cost is hedged against the exposure to currency risk by foreign currency borrowing, does MPSAS 29, *Financial Instruments: Recognition and Measurement*, require the ship to be remeasured for changes in the exchange rate even though the basis of measurement for the asset is historical cost?

No. In a fair value hedge, the hedged item is remeasured. However, a foreign currency borrowing cannot be classified as a fair value hedge of a ship since a ship does not contain any separately measurable

foreign currency risk. If the hedge accounting conditions in MPSAS 29.98 are met, the foreign currency borrowing may be classified as a cash flow hedge of an anticipated sale in that foreign currency. In a cash flow hedge, the hedged item is not remeasured.

Section G: Other

G.1 Disclosure of Changes in Fair Value

MPSAS 29, *Financial Instruments: Recognition and Measurement*, requires financial assets classified as available-for-sale (AFS) and financial assets and financial liabilities at fair value through surplus or deficit to be remeasured to fair value. Unless a financial asset or a financial liability is designated as a cash flow hedging instrument, fair value changes for financial assets and financial liabilities at fair value through surplus or deficit are recognized in surplus or deficit, and fair value changes for AFS assets are recognized in net assets/equity. What disclosures are required regarding the amounts of the fair value changes during a reporting period?

MPSAS 30.23 requires items of revenue, expense and gains and losses to be disclosed. This disclosure requirement encompasses items of revenue, expense and gains and losses that arise on remeasurement to fair value. Therefore, an entity provides disclosures of fair value changes, distinguishing between changes that are recognized in surplus or deficit and changes that are recognized in net assets/equity. Further breakdown is provided of changes that relate to:

- (a) AFS assets, showing separately the amount of gain or loss recognized in net assets/equity during the period and the amount that was recognized in surplus or deficit for the period;
- (b) Financial assets or financial liabilities at fair value through surplus or deficit, showing separately those fair value changes on financial assets or financial liabilities (i) designated as such upon initial recognition and (ii) classified as held for trading in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*; and
- (c) Hedging instruments.

MPSAS 30, *Financial Instruments: Disclosures*, neither requires nor prohibits disclosure of components of the change in fair value by the way items are classified for internal purposes. For example, an entity may choose to disclose separately the change in fair value of those derivatives that in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, it categorizes as held for trading, but the entity classifies as part of risk management activities outside the trading portfolio.

In addition, MPSAS 30.10 requires disclosure of the carrying amounts of financial assets or financial liabilities at fair value through surplus or deficit, showing separately:

- (i) Those designated as such upon initial recognition; and
- (ii) Those held for trading in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*.

G.2 *MPSAS 29, Financial Instruments: Recognition and Measurement, and MPSAS 2, Hedge Accounting: Statements of Cash Flows*

How should cash flows arising from hedging instruments be classified in statements of cash flows?

Cash flows arising from hedging instruments are classified as operating, investing or financing activities, on the basis of the classification of the cash flows arising from the hedged item. While the terminology in MPSAS 2, *Cash Flow Statements*, has not been updated to reflect MPSAS 29, *Financial Instruments: Recognition and Measurement*, the classification of cash flows arising from hedging instruments in the statement of cash flows should be consistent with the classification of these instruments as hedging instruments under MPSAS 29, *Financial Instruments: Recognition and Measurement*.

Illustrative Examples

These examples accompany, but are not part of, MPSAS 29, Financial Instruments: Recognition and Measurement.

Hedging Interest Rate Risk for a Portfolio of Assets and Liabilities

- IE1. On January 1, 20X1 Entity A identifies a portfolio comprising assets and liabilities whose interest rate risk it wishes to hedge. The liabilities include demandable deposit liabilities that the depositor may withdraw at any time without notice. For risk management purposes, the entity views all of the items in the portfolio as fixed rate items.
- IE2. For risk management purposes, Entity A analyzes the assets and liabilities in the portfolio into repricing time periods based on expected repricing dates. The entity uses monthly time periods and schedules items for the next five years (i.e., it has 60 separate monthly time periods).⁵ The assets in the portfolio are prepayable assets that Entity A allocates into time periods based on the expected prepayment dates, by allocating a percentage of all of the assets, rather than individual items, into each time period. The portfolio also includes demandable liabilities that the entity expects, on a portfolio basis, to repay between one month and five years and, for risk management purposes, are scheduled into time periods on this basis. On the basis of this analysis, Entity A decides what amount it wishes to hedge in each time period.
- IE3. This example deals only with the repricing time period expiring in three months' time, i.e., the time period maturing on March 31, 20X1 (a similar procedure would be applied for each of the other 59 time periods). Entity A has scheduled assets of RM 100 million and liabilities of RM 80 million into this time period. All of the liabilities are repayable on demand.
- IE4. Entity A decides, for risk management purposes, to hedge the net position of RM20 million and accordingly enters into an interest rate swap⁶ on January 1, 20X1, 1 to pay a fixed rate and receive London Interbank Offered Rate (LIBOR), with a notional principal amount of RM20 million and a fixed life of three months.
- IE5. This example makes the following simplifying assumptions:
- (a) The coupon on the fixed leg of the swap is equal to the fixed coupon on the asset;
 - (b) The coupon on the fixed leg of the swap becomes payable on the same dates as the interest payments on the asset; and
 - (c) The interest on the variable leg of the swap is the overnight LIBOR rate. As a result, the entire fair value change of the swap arises from the fixed leg only, because the variable leg is not exposed to changes in fair value due to changes in interest rates.

⁵ In this example principal cash flows have been scheduled into time periods but the related interest cash flows have been included when calculating the change in fair value of the hedged item. Other methods of scheduling assets and liabilities are also possible. Also, in this example, monthly repricing time periods have been used. An entity may choose narrower or wider time periods.

⁶ This example uses a swap as the hedging instrument. An entity may use forward rate agreements or other derivatives as hedging instruments.

In cases when these simplifying assumptions do not hold, greater ineffectiveness will arise. (The ineffectiveness arising from (a) could be eliminated by designating as the hedged item a portion of the cash flows on the asset that are equivalent to the fixed leg of the swap).

IE6. It is also assumed that Entity A tests effectiveness on a monthly basis.

IE7. The fair value of an equivalent non-prepayable asset of RM 20 million, ignoring changes in value that are not attributable to interest rate movements, at various times during the period of the hedge is as follows:

	Jan 1, 20X1	Jan 31, 20X1	Feb 1, 20X1	Feb 28, 20X1	Mar 31, 20X1
Fair value (asset) (RM)	20,000,000	20,047,408	20,047,408	20,023,795	Nil

IE8. The fair value of the swap at various times during the period of the hedge is as follows:

	Jan 1, 20X1	Jan 31, 20X1	Feb 1, 20X1	Feb 28, 20X1	Mar 31, 20X1
Fair value (liability)(RM)	Nil	(47,408)	(47,408)	(23,795)	Nil

Accounting Treatment

IE9. On January 1, 20X1, Entity A designates as the hedged item an amount of RM20 million of assets in the three-month time period. It designates as the hedged risk the change in the value of the hedged item (i.e., the RM20 million of assets) that is attributable to changes in LIBOR. It also complies with the other designation requirements set out in paragraphs 98(d) and AG162 of the Standard.

IE10. Entity A designates as the hedging instrument the interest rate swap described in paragraph IE4.

End of Month 1 (January 31, 20X1)

IE11. On January 31, 20X1 (at the end of month 1) when Entity A tests effectiveness, LIBOR has decreased. Based on historical prepayment experience, Entity A estimates that, as a consequence, prepayments will occur faster than previously estimated. As a result it re-estimates the amount of assets scheduled into this time period (excluding new assets originated during the month) as RM96 million.

IE12. The fair value of the designated interest rate swap with a notional principal of RM20 million is (RM47,408)⁷ (the swap is a liability).

IE13. Entity A computes the change in the fair value of the hedged item, taking into account the change in estimated prepayments, as follows.

- (a) First, it calculates the percentage of the initial estimate of the assets in the time period that was hedged. This is 20 percent (RM20 million ÷ RM100 million).

⁷ See paragraph IE8.

- (b) Second, it applies this percentage (20 percent) to its revised estimate of the amount in that time period (RM96 million) to calculate the amount that is the hedged item based on its revised estimate. This is RM19.2 million.
- (c) Third, it calculates the change in the fair value of this revised estimate of the hedged item (RM19.2 million) that is attributable to changes in LIBOR. This is RM45,511 ($RM47,408^8 \times (RM19.2 \text{ million} \div RM20 \text{ million})$).

IE14. Entity A makes the following accounting entries relating to this time period:

Dr	Cash	RM172,097	
	Cr Surplus or deficit (interest revenue) ⁹		RM172,097

To recognize the interest received on the hedged amount (RM19.2 million).

Dr	Surplus or deficit (interest expense)	RM179,268	
	Cr Surplus or deficit (interest revenue)		RM179,268
	Cr Cash		Nil

To recognize the interest received and paid on the swap designated as the hedging instrument.

Dr	Surplus or deficit (loss)	RM47,408	
	Cr Derivative liability		RM47,408

To recognize the change in the fair value of the swap.

Dr	Separate line item in the statement of financial position	RM45,511	
	Cr Surplus or deficit (gain)		RM45,511

To recognize the change in the fair value of the hedged amount.

IE15. The net result on surplus or deficit (excluding interest revenue and interest expense) is to recognize a loss of (RM1,897). This represents ineffectiveness in the hedging relationship that arises from the change in estimated prepayment dates.

Beginning of Month 2

IE16. On February 1, 20X1 Entity A sells a proportion of the assets in the various time periods. Entity A calculates that it has sold $8\frac{1}{3}$ percent of the entire portfolio of assets. Because the assets were allocated into time periods by allocating a percentage of the assets (rather than individual assets) into each time period, Entity A determines that it cannot ascertain into which specific time periods the sold assets were scheduled. Hence it uses a systematic and rational basis of allocation. Based on the fact that it sold a representative selection of the assets in the portfolio, Entity A allocates the sale proportionately over all time periods.

IE17. On this basis, Entity A computes that it has sold $8\frac{1}{3}$ percent of the assets allocated to the three-month time period, i.e., RM8 million ($8\frac{1}{3}$ percent of RM96 million). The proceeds received are RM8,018,400, equal to the fair value of the assets¹⁰. On derecognition of the assets, Entity A also removes from the separate line item in the statement of financial position an amount that represents the change in the fair value of the hedged assets that it has now sold. This is $8\frac{1}{3}$ percent of the total line item balance of RM45,511, i.e., RM3,793.

⁸ i.e., RM20,047,408 – RM 20,000,000, see paragraph IE7.

⁹ This example does not show how amounts of interest revenue and interest expense are calculated.

¹⁰ The amount realized on sale of the asset is the fair value of a prepayable asset, which is less than the fair value of the equivalent non-prepayable asset shown in IE7.

- IE18. Entity A makes the following accounting entries to recognize the sale of the asset and the removal of part of the balance in the separate line item in the statement of financial position:

Dr	Cash	RM8,018,400	
	Cr Asset		RM8,000,000
	Cr Separate line item in the statement of financial position		RM3,793
	Cr Surplus or deficit (gain)		RM14,607

To recognize the sale of the asset at fair value and to recognize a gain on sale

Because the change in the amount of the assets is not attributable to a change in the hedged interest rate, no ineffectiveness arises.

- IE19. Entity A now has RM88 million of assets and RM80 millions of liabilities in this time period. Hence the net amount Entity A wants to hedge is now RM8 million and, accordingly, it designates RM8 million as the hedged amount.
- IE20. Entity A decides to adjust the hedging instrument by designating only a proportion of the original swap as the hedging instrument. Accordingly, it designates as the hedging instrument RM8 million or 40 percent of the notional amount of the original swap with a remaining life of two months and a fair value of RM18,963.¹²¹ It also complies with the other designation requirements in paragraphs 98(a) and AG162 of the Standard. The RM12 million of the notional amount of the swap that is no longer designated as the hedging instrument is either classified as held for trading with changes in fair value recognized in surplus or deficit, or is designated as the hedging instrument in a different hedge.¹¹³
- IE21. As at February 1, 20X1 and after accounting for the sale of assets, the separate line item in the statement of financial position is RM41,718 (RM45,511 – RM3,793), which represents the cumulative change in fair value of RM17.6¹¹⁴ million of assets. However, as at February 1, 20X1, Entity A is hedging only RM8 million of assets that have a cumulative change in fair value of RM18,963.¹¹⁵ The remaining separate line item in the statement of financial position of RM22,755¹¹⁶ relates to an amount of assets that Entity A still holds but is no longer hedging. Accordingly Entity A amortizes this amount over the remaining life of the time period, i.e., it amortizes RM22,755 over two months.
- IE22. Entity A determines that it is not practicable to use a method of amortization based on a recalculated effective yield and hence uses a straight-line method.

¹¹ RM 47,408 × 40 percent.

¹² The entity could instead enter into an offsetting swap with a notional principle of CU12 million to adjust its position and designate as the hedging instrument all CU20 million of the existing swap and all CU12 million of the new offsetting swap.

¹³ RM 19.2 million – (8½ × RM 19.2 million).

¹⁴ RM 41,718 × (RM 8 million/RM 17.6 million).

¹⁵ RM 41,718 – RM 18,963.

End of Month 2 (February 28, 20X1)

IE23. On February 28, 20X1 when Entity A next tests effectiveness, LIBOR is unchanged. Entity A does not revise its prepayment expectations. The fair value of the designated interest rate swap with a notional principal of RM8 million is (RM9,518)¹⁶ (the swap is a liability). Also, Entity A calculates the fair value of the RM8 million of the hedged assets as at February 28, 20X1 as RM8,009,518.¹⁷

IE24. Entity A makes the following accounting entries relating to the hedge in this time period:

Dr	Cash	RM71,707	
	Cr Surplus or deficit (interest revenue)		RM71,707

To recognize the interest received on the hedged amount (RM8 million).

Dr	Surplus or deficit (interest expense)	RM71,707	
	Cr Surplus or deficit(interest revenue)		RM62,115
	Cr Cash		RM9,592

To recognize the interest received and paid on the portion of the swap designated as the hedging instrument (RM8 million).

Dr	Derivative liability	RM9,445	
	Cr Surplus or deficit (gain)		RM9,445

To recognize the change in the fair value of the portion of the swap designated as the hedging instrument (RM8 million) (RM9,518 – RM18,963).

Dr	Surplus or deficit (loss)	RM9,445	
	Cr Separate line item in the statement of financial position		RM9,445

To recognize the change in the fair value of the hedged amount (RM8,009,518 – RM8,018,963).

IE25. The net effect on surplus or deficit (excluding interest revenue and interest expense) is nil reflecting that the hedge is fully effective.

IE26. Entity A makes the following accounting entry to amortize the line item balance for this time period:

Dr	Surplus or deficit (loss)	RM11,378	
	Cr Separate line item in the statement of financial position		RM11,378 ^(a)

To recognize the amortization charge for the period.
 (a) RM22,755 ÷ 2

End of Month 3

IE27. During the third month there is no further change in the amount of assets or liabilities in the three-month time period. On March 31, 20X1 the assets and the swap mature and all balances are recognized in surplus or deficit.

IE28. Entity A makes the following accounting entries relating to this time period:

¹⁶ RM 23,795 [see paragraph IE8] × (RM 8 million/RM 20 million).

¹⁷ RM 20,023,795 [see paragraph IE7] × (RM 8 million/RM 20 million).

Dr	Cash	RM8,071,707	
	Cr	Asset (statement of financial position)	RM8,000,000
	Cr	Surplus or deficit (interest revenue)	RM71,707

To recognize the interest and cash received on maturity of the hedged amount (RM8 million).

Dr	Surplus or deficit (interest expense)	RM71,707	
	Cr	Surplus or deficit (interest revenue)	RM62,115
	Cr	Cash	RM9,592

To recognize the interest received and paid on the portion of the swap designated as the hedging instrument (RM8 million).

Dr	Derivative liability	RM9,518	
	Cr	Surplus or deficit (gain)	RM9,518

To recognize the expiry of the portion of the swap designated as the hedging instrument (RM8 million).

Dr	Surplus or deficit (gain)	RM9,518	
	Cr	Separate line item in the statement of financial position	RM9,518

To remove the remaining line item balance on expiry of the time period.

IE29. The net effect on surplus or deficit (excluding interest revenue and interest expense) is nil reflecting that the hedge is fully effective.

IE30. Entity A makes the following accounting entry to amortize the line item balance for this time period:

Dr	Surplus or deficit (loss)	RM11,377	
	Cr	Separate line item in the statement of financial position	RM11,377 ^(a)

To recognize the amortization charge for the period.

(a) $RM22,755 \div 2$

Summary

IE31. The tables below summarize:

- (a) Changes in the separate line item in the statement of financial position;
- (b) The fair value of the derivative;
- (c) The surplus or deficit effect of the hedge for the entire three-month period of the hedge;
and
- (d) Interest revenue and interest expense relating to the amount designated as hedged.

MPSAS 29 – Financial Instruments: Recognition and Measurement

Description	Jan 1, 20X1 RM	Jan 31, 20X1 RM	Feb 1, 20X1 RM	Feb 28, 20X1 RM	Mar 31, 20X1 RM
Amount of asset hedged	20,000,000	19,200,000	8,000,000	8,000,000	8,000,000

(a) Changes in the separate line item in the statement of financial position

Brought forward:

Balance to be amortized	Nil	Nil	Nil	22,755	11,377
Remaining balance	Nil	Nil	45,511	18,963	9,518
Less: Adjustment on sale of asset	Nil	Nil	(3,793)	Nil	Nil
Adjustment for change in fair value of the hedged asset	Nil	45,511	Nil	(9,445)	(9,518)
Amortization	Nil	Nil	Nil	(11,378)	(11,377)

Carried forward:

Balance to be amortized	Nil	Nil	22,755	11,377	Nil
Remaining balance	Nil	45,511	18,963	9,518	Nil

(b) The fair value of the derivative

RM20,000,000	Nil	47,408	–	–	–
RM12,000,000	Nil	–	28,445	No longer designated as the hedging instrument.	
RM8,000,000	Nil	–	18,963	9,518	Nil
Total	Nil	47,408	47,408	9,518	Nil

(c) Effect of the hedge on surplus or deficit

Change in line item: asset	Nil	45,511	N/A	(9,445)	(9,518)
Change in derivative fair value	Nil	(47,408)	N/A	9,445	9,518
Net effect	Nil	(1,897)	N/A	Nil	Nil
Amortization	Nil	Nil	N/A	(11,378)	(11,377)

In addition, there is a gain on sale of assets of RM14,607 at February 1, 20X1.

(d) Interest revenue and interest expense relating to the amount designated as hedged

Interest revenue

– on the asset	Nil	172,097	N/A	71,707	71,707
– on the swap	Nil	179,268	N/A	62,115	62,115

Interest expense

– on the swap	Nil	(179,268)	N/A	(71,707)	(71,707)

Disposal of a Foreign Operation

- IE32. This example illustrates the application of paragraphs C12 and C13 of Appendix C in connection with the amount recognized in surplus or deficit on the disposal of a foreign operation.

Background

- IE33. This example assumes the economic entity structure set out in the application guidance and that Entity D used a USD borrowing in Entity A to hedge the EUR/USD risk of the net investment in Entity C in Entity D's consolidated financial statements. 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 Entity C is €24 million (gain). This is matched exactly by the fall in value of the net investment in Entity C, when measured against the functional currency of Entity D (euro).
- IE34. If the direct method of consolidation is used, the fall in the value of Entity D's net investment in Entity C of €24 million would be reflected totally in the foreign currency translation reserve relating to Entity C in Entity D's consolidated financial statements. However, because Entity D uses the step-by-step method, this fall in the net investment value in Entity C of €24 million would be reflected both in Entity B's foreign currency translation reserve relating to Entity C and in Entity D's foreign currency translation reserve relating to Entity B.
- IE35. The aggregate amount recognized in the foreign currency translation reserve in respect of Entities B and C is not affected by the consolidation method. Assume that using the direct method of consolidation, the foreign currency translation reserves for Entities B and C in 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

- IE36. When the investment in Entity C is disposed of, MPSAS 29, *Financial Instruments: Recognition and Measurement*, requires the full €24 million gain on the hedging instrument to be recognized in surplus or deficit. Using the step-by-step method, the amount to be recognized in surplus or deficit in respect of the net investment in Entity C would be only €11 million loss. Entity D could adjust the foreign currency translation reserves of both Entities B and C by €13 million in order to match the amounts reclassified in respect of the hedging instrument and the net investment as would have been the case if the direct method of consolidation had been used, if that was its accounting policy. An entity that had not hedged its net investment could make the same reclassification.

Receipt of a Concessionary Loan

- IE37. A local authority receives loan funding to the value of RM5 million from an international development agency to build primary healthcare clinics over a period of 5 years. The agreement stipulates that loan should be repaid over the 5 year period as follows:

Year 1: no capital repayments

Year 2: 10% of the capital

Year 3: 20% of the capital

Year 4: 30% of the capital

Year 5: 40% of the capital

Interest is paid annually in arrears, at a rate of 5% per annum on the outstanding balance of the loan. A market related rate of interest for a similar transaction is 10%.

IE38. The entity has received a concessionary loan of RM5 million, which will be repaid at 5% below the current market interest rate. The difference between the proceeds of the loan and the present value of the contractual payments in terms of the loan agreement, discounted using the market related rate of interest, is recognized as non-exchange revenue.

IE39. The journal entries to account for the concessionary loan are as follows:

1. On initial recognition, the entity recognizes the following (assuming that the entity subsequently measures concessionary loan at amortized cost):

Dr	Bank	5,000,000	
	Cr Loan (refer to Table 2 below)		4,215,450
	Cr Liability or non-exchange revenue		784,550

Recognition of the receipt of the loan at fair value

MPSAS 23 is considered in recognizing either a liability or revenue for the off-market portion of the loan. Paragraph IG54 of that Standard provides journal entries for the recognition and measurement of the off-market portion of the loan deemed to be non-exchange revenue.

2. Year 1: The entity recognizes the following:

Dr	Interest (refer to Table 3 below)	421,545	
	Cr Loan		421,545

Recognition of interest using the effective interest method (RM4,215,450 × 10%)

Dr	Loan (refer to Table 1 below)	250,000	
	Cr Bank		250,000

Recognition of interest paid on outstanding balance (RM5m × 5%)

3. Year 2: The entity recognizes the following:

Dr	Interest	438,700	
	Cr Loan		438,700

Recognition of interest using the effective interest method (RM4,386,995 × 10%)

Dr	Loan	750,000	
	Cr Bank		750,000

Recognition of interest paid on outstanding balance (RM5m × 5% + RM500,000 capital repaid)

4. Year 3: The entity recognizes the following:

Dr	Interest	407,569	
	Cr Loan		407,569

Recognition of interest using the effective interest method (RM4,075,695 × 10%)

Dr	Loan	1,225,000	
	Cr Bank		1,225,000

Recognition of interest paid on outstanding balance (RM4.5m × 5% + RM1m capital repaid)

5. Year 4: The entity recognizes the following:

Dr	Interest	325,826	
	Cr Loan		325,826

Recognition of interest using the effective interest method (RM 3,258,264 × 10%)

Dr	Loan	1,675,000	
	Cr Bank		1,675,000

Recognition of interest paid on outstanding balance (RM3.5m × 5% + RM1.5m capital repaid)

6. Year 5: The entity recognizes the following:

Dr	Interest	190,909	
	Cr Loan		190,909

Recognition of interest using the effective interest method (RM1,909,091 × 10%)

Dr	Loan	2,100,000	
	Cr Bank		2,100,000

Recognition of interest paid on outstanding balance (RM2m × 5% + RM2m capital repaid)

Calculations:

Table 1: Amortization Schedule (Using Contractual Repayments at 5% Interest)

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
	RM	RM	RM	RM	RM	RM
Capital	5,000,000	5,000,000	5,000,000	4,500,000	3,500,000	2,000,000
Interest	–	250,000	250,000	225,000	175,000	100,000
Payments	–	(250,000)	(750,000)	(1,225,000)	(1,675,000)	(2,100,000)
Balance	5,000,000	5,000,000	4,500,000	3,500,000	2,000,000	–

Table 2: Discounting Contractual Cash Flows (Based on a Market Rate of 10%)

	Year 1	Year 2	Year 3	Year 4	Year 5
	RM	RM	RM	RM	RM
Capital balance	5,000,000	4,500,000	3,500,000	2,000,000	–
Interest payable	250,000	250,000	225,000	175,000	100,000
Total payments (capital and interest)	250,000	750,000	1,225,000	1,675,000	2,100,000
Present value of payments	227,272	619,835	920,360	1,144,048	1,303,935
Total present value of payments					<u>4,215,450</u>
Proceeds received					5,000,000
Less: Present value of outflows (fair value of loan on initial recognition)					<u>4,215,450</u>
Off-market portion of loan to be recognized as non-exchange revenue					<u>784,550</u>

Table 3: Calculation of Loan Balance and Interest Using the Effective Interest Method

	Year 1	Year 2	Year 3	Year 4	Year 5
	RM	RM	RM	RM	RM
Capital	4,215,450	4,386,995	4,075,695	3,258,264	1,909,091
Interest accrual	421,545	438,700	407,569	325,827	190,909
Interest and capital payments	250,000	750,000	1,225,000	1,675,000	2,100,000
Balance	4,386,995	4,075,695	3,258,264	1,909,091	–

Payment of a Concessionary Loan

IE40. The department of education makes low interest loans available to qualifying students on flexible repayment terms as a means of promoting university education.

IE41. The department advanced RM250 million to various students at the beginning of the financial year, with the following terms and conditions:

- Capital is repaid as follows:
 - Year 1 to 3: no capital repayments
 - Year 4: 30% capital to be repaid
 - Year 5: 30% capital to be repaid
 - Year 6: 40% capital to be repaid
- Interest is calculated at 6% interest on the outstanding loan balance, and is paid annually in arrears. Assume the market rate of interest for a similar loan is 11.5%.

IE42. The journal entries to account for the concessionary loan are as follows (assuming the entity subsequently measures the concessionary loan at amortized cost):

1. On initial recognition, the entity recognizes the following:

Dr	Loan	199,345,480	
Dr	Expense	50,654,520	
Cr	Bank		250,000,000

2. Year 1: The entity recognizes the following

Dr	Loan	22,924,730	
Cr	Interest revenue		22,924,730

Interest accrual using the effective interest method $RM199,345,480 \times 11.5\%$

Dr	Bank	15,000,000	
Cr	Loan		15,000,000

Interest payment of $RM250m \times 6\%$

3. Year 2: The entity recognizes the following:

Dr	Loan	23,836,074	
Cr	Interest revenue		23,836,074

Interest accrual using the effective interest method $RM207,270,210 \times 11.5\%$

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Dr	Bank	15,000,000	
	Cr Loan		15,000,000
<i>Interest payment of RM250m × 6%</i>			
4. Year 3: The entity recognizes the following:			
Dr	Loan	24,852,223	
	Cr Interest revenue		24,852,223
<i>Interest accrual using the effective interest method RM216,106,284 × 11.5%</i>			
Dr	Bank	15,000,000	
	Cr Loan		15,000,000
5. Year 4: The entity recognizes the following:			
Dr	Loan	25,985,228	
	Cr Interest revenue		25,985,228
<i>Interest accrual using the effective interest method RM225,958,228 × 11.5%</i>			
Dr	Bank	90,000,000	
	Cr Loan		90,000,000
<i>Interest payment of RM250m X 6% + RM75m capital repaid</i>			
6. Year 5: The entity recognizes the following:			
Dr	Loan	18,623,530	
	Cr Interest revenue		18,623,530
<i>Interest accrual using the effective interest method RM161,943,735 × 11.5%</i>			
Dr	Bank	85,500,000	
	Cr Loan		85,500,000
<i>Interest payment of RM175m X6% + RM75m capital repaid</i>			
7. Year 6: The entity recognizes the following:			
Dr	Loan	10,932,735	
	Cr Interest revenue		10,932,735
<i>Interest accrual using the effective interest method RM95,067,265 × 11.5%</i>			
Dr	Bank	106,000,000	
	Cr Loan		106,000,000
<i>Recognition of capital repaid</i>			

Calculations

Table 1: Amortization Schedule (Using Contractual Repayments at 6% Interest)

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000
Capital	250,000	250,000	250,000	250,000	250,000	250,000	250,000
Interest	–	15,000	15,000	15,000	15,000	10,500	6,000
Payments	–	15,000	15,000	15,000	90,000	85,500	106,000
Balance	250,000	250,000	250,000	250,000	175,000	100,000	–

Table 2: Discounting Contractual Cash Flows (Based on a Market Rate of 11.5%)

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000
Capital balance	250,000	250,000	250,000	175,000	100,000	–
Interest payable	15,000	15,000	15,000	15,000	10,500	6,000
Total payments (capital and interest)	15,000	15,000	15,000	90,000	85,500	106,000
Present value of payments	13,452,915	12,065,394	10,820,981	58,229,497	49,612,576	55,164,117
Total present value of payments						199,345,480
Proceeds paid						250,000,000
Less: Present value of outflows (fair value of loan on initial recognition)						199,345,480
Off-market portion of loan to be recognized as expense						50,654,520

Table 3: Calculation of Loan Balance and Interest Using the Effective Interest Method

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
	RM	RM	RM	RM	RM	RM
Capital	99,345,480	07,270,210	216,106,284	225,958,228	161,943,735	95,067,265
Interest accrual	22,924,730	23,836,074	24,852,223	25,985,228	18,623,530	10,932,735
Interest and capital payments	15,000,000	15,000,000	15,000,000	90,000,000	85,500,000	106,000,000
Balance	207,270,210	216,106,284	225,958,228	161,943,735	95,067,265	–

Financial Guarantee Contract Provided at Nominal Consideration

- IE43. Entity C is a major motor vehicle manufacturer in Jurisdiction A. On January 1, 201V Government A (the issuer) enters into a financial guarantee contract with Entity B (the holder) to reimburse Entity B against the financial effects of default by Entity C (the debtor) for a 30 year loan of Ringgit Malaysia (RM) 50 million repayable in two equal instalments of RM25 million in 201X and 204Z. Entity C provides nominal consideration of RM30,000 to Government A. Prior to entering into negotiation with Government A, Entity C had approached a number of other entities to issue a guarantee, but none of these entities was prepared to issue such a guarantee. There are no recent examples of financial guarantee contracts in the motor manufacturing sector of the economy in Jurisdiction A or in neighbouring Jurisdictions D & E. Government A concludes that it cannot use a valuation technique as the use of a valuation technique does not provide a reliable measure of fair value. Government A therefore determines to measure the financial guarantee contract in accordance with MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*.
- IE44. On December, 31 201V, having reviewed the financial position and performance of Entity C, Government A determines that there is no present obligation to Entity B in respect of the financial guarantee contract. Government A does not recognize a liability in its statement of financial position. Government A makes the disclosures relating to fair value and credit risk in MPSAS 30, *Financial Instruments: Disclosures* in respect of the financial guarantee contract.

It also discloses a contingent liability of RM50 million in accordance with MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*. In its statement of financial performance Government A recognizes revenue of RM1,000 in respect of the nominal consideration payable by Entity C.

- IE45. In 201Z there has been a further downturn in the motor manufacturing sector affecting Entity C. Entity C is seeking bankruptcy protection and has defaulted on the first repayment of principal, although it has met its obligations for interest payments. Government A determines that Entity C is unlikely to recover, but negotiations are advanced with a potential acquirer (Entity D), which will restructure Entity C. Entity D has indicated that it will assume responsibility for the final instalment of the loan with Entity B, but not the initial instalment. Government A recognizes an expense and liability for RM25 million and discloses a contingent liability of RM25 million.

Interaction Between Measurement Requirements of MPSAS 23 and MPSAS 29

Background

- IE46. An individual donates shares in listed entity X to public sector entity A on January 1, 20X8. At that date, the shares in entity X have a fair value of RM1,000,000. At December 31, 20X8, the fair value of the shares is RM900,000. As part of the arrangement, entity A incurs the transfer duty to have the shares transferred into its name. These costs amount to RM10,000.
- IE47. Listed entity X provides telecommunications infrastructure and related services to the public. During 20X9, new technology was introduced into the telecommunications industry, making the infrastructure and equipment used by entity X almost obsolete. This resulted in a permanent decline in the value of listed entity X. The value of the impairment loss as at December 31, 20X9 is RM700,000. Entity A has a policy of accounting for investments in shares as an available-for-sale financial asset. Assume that the arrangement is a contractual arrangement, no present obligations arise from the donation and that the entity's reporting period ends on December 31, 20X8.

Analysis

- IE48. As entity A received the shares as a donation, it uses MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfer)*, to initially recognize the shares acquired and the related non-exchange revenue. However, because entity A has acquired a financial asset, it considers the initial measurement requirements of MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfer)*, and MPSAS 29, *Financial Instruments: Recognition and Measurement*.
- IE49. MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfer)*, prescribes that assets acquired as part of a non-exchange revenue transaction are initially measured at fair value, while MPSAS 29, *Financial Instruments: Recognition and Measurement*, prescribes that financial assets are initially measured at fair value and, depending on their classification, transaction costs may or may not be included. As the entity has a policy of accounting for investments in shares as available-for-sale financial assets, the transaction costs of RM10,000 are added to the value of the shares of RM1,000,000 on initial measurement.

- IE50. The subsequent measurement and derecognition of the shares is addressed in MPSAS 29, *Financial Instruments: Recognition and Measurement*. The entity classifies investments in shares as available-for-sale financial assets which means that the shares are measured at a fair value with any subsequent changes in fair value recognized in net assets/equity. Impairment losses are however recognized in surplus or deficit in the period in which they occur.

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

1. Acquisition of shares through donation

Dr	Available-for-sale financial asset (investment in entity X)	1,010,000	
	Cr Non-exchange revenue		1,000,000
	Cr Bank (Transfer costs paid)		10,000

2. Subsequent measurement at December 31, 20X8

Dr	Net assets/equity (fair value adjustment of investment)	110,000	
	Cr Available-for-sale financial asset (investment in entity X)		110,000

3. Subsequent measurement at December 31, 20X9

Dr	Impairment loss (surplus or deficit)	700,000	
	Cr Available-for-sale financial asset		700,000

Comparison with IPSAS 29

MPSAS 29, *Financial Instruments: Recognition and Measurement*, is drawn primarily from IPSAS 29 (2018). Main difference between MPSAS 29 and IPSAS 29 is as follows:

- In paragraph 2, IPSAS 29 refers to IPSAS 39, *Employee Benefits*, whereas MPSAS 29 refers to MPSAS 25, *Employee Benefits*, in which drawn from IPSAS 25 that has been superseded by IPSAS 39. The MPSAS is yet to adopt IPSAS 39.

MPSAS 30 - FINANCIAL INSTRUMENTS: DISCLOSURES

Acknowledgement

The Malaysian Public Sector Accounting Standard (MPSAS) 30 is based on International Public Sector Accounting Standard (IPSAS) 30, *Financial Instruments: Disclosures*, from the *Handbook of International Public Sector Accounting Pronouncements* of the International Public Sector Accounting Standards Board, published by the International Federation of Accountants (IFAC) in September 2018 and is used with permission of IFAC.

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MPSAS 30—FINANCIAL INSTRUMENTS: DISCLOSURES

History of MPSAS

This version includes amendments resulting from MPSASs issued up to December 2022.

MPSAS 30, *Financial Instruments: Disclosures* was issued in November 2015.

Since then, MPSAS 30 has been amended by the following MPSASs:

- *Improvements to MPSASs 2023* (issued December 2022)
- MPSAS 38, *Disclosure of Interests in Other Entities* (issued December 2016)
- MPSAS 37, *Joint Arrangements* (issued August 2016)
- MPSAS 35, *Consolidated Financial Statements* (issued March 2016)
- MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)* (issued November 2015)

Table of Amended Paragraphs in MPSAS 30

Paragraph Affected	How Affected	Affected By
3	Amended	MPSAS 37 August 2016 MPSAS 35 March 2016
6	Deleted	Improvements to MPSASs 2023 December 2022
7	Deleted	Improvements to MPSASs 2023 December 2022
52A	New	MPSAS 33 November 2015
52B	New	MPSAS 38 December 2016 MPSAS 37 August 2016 MPSAS 35 March 2016
52C	New	Improvements to MPSASs 2023 December 2022
52D	New	Improvements to MPSASs 2023 December 2022
53	Amended	MPSAS 33 November 2015
54	Removed	Editorial
AG6	Amended	MPSAS 38 December 2016
AG7	Amended	Improvements to MPSASs 2023 December 2022

MPSAS 30 – FINANCIAL INSTRUMENTS: DISCLOSURES

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Malaysian Public Sector Accounting Standard 30, *Financial Instruments: Disclosures* is set out in paragraphs 1-53. All the paragraphs have equal authority. MPSAS 30, *Financial Instruments: Disclosures*, should be read in the context of its objective and the *Preface to Malaysian Public Sector Accounting Standards*. MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to require entities to provide disclosures in their financial statements that enable users to evaluate:
 - (a) The significance of financial instruments for the entity's financial position and performance; and
 - (b) The nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks.
2. The principles in this Standard complement the principles for recognizing, measuring, and presenting financial assets and financial liabilities in MPSAS 28, *Financial Instruments: Presentation* and MPSAS 29, *Financial Instruments: Recognition and Measurement*.

Scope

3. **This Standard shall be applied by all entities to all types of financial instruments, except:**
 - (a) **Those interests in controlled entities, associates, or joint ventures that are accounted for in accordance with MPSAS 34, *Separate Financial Statements*, MPSAS 35, *Consolidated Financial Statements*, or MPSAS 36, *Investments in Associates and Joint Ventures*. However, in some cases, MPSAS 34, *Separate Financial Statements*, MPSAS 35, *Consolidated Financial Statements*, or MPSAS 37, *Joint Arrangements*, require or permit an entity to account for an interest in a controlled entity, associate, or joint venture using MPSAS 29, *Financial Instruments: Recognition and Measurement*; in those cases, entities shall apply the requirements of this Standard. Entities shall also apply this Standard to all derivatives linked to interests in controlled entities, associates, or joint ventures unless the derivative meets the definition of an equity instrument in MPSAS 28, *Financial Instruments: Presentation*.**
 - (b) **Employers' rights and obligations arising from employee benefit plans, to which MPSAS 25, *Employee Benefits* applies.**
 - (c) **Rights and obligations arising under insurance contracts. However, this Standard applies to:**
 - (i) **Derivatives that are embedded in insurance contracts if MPSAS 29, *Financial Instruments: Recognition and Measurement*, requires the entity to account for them separately; and**
 - (ii) **An issuer of financial guarantee contracts if the issuer applies MPSAS 29, *Financial Instruments: Recognition and Measurement*, in recognizing and measuring the contracts, but shall apply the relevant international or national accounting standard dealing with insurance contracts if the issuer elects to apply those standards in recognizing and measuring them.**

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

- (d) **Financial instruments, contracts, and obligations under share-based payment transactions to which the relevant international or national accounting standard dealing with share-based payment applies, except for contracts within the scope of paragraphs 4-6 of MPSAS 29, *Financial Instruments: Recognition and Measurement*, to which that Standard applies.**
 - (e) **Instruments that are required to be classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18 of MPSAS 28, *Financial Instruments: Presentation*.**
4. This Standard applies to recognized and unrecognized financial instruments. Recognized financial instruments include financial assets and financial liabilities that are within the scope of MPSAS 29, *Financial Instruments: Recognition and Measurement*. Unrecognized financial instruments include some financial instruments that, although outside the scope of MPSAS 29, *Financial Instruments: Recognition and Measurement*, are within the scope of this Standard (such as some loan commitments).
 5. This Standard applies to contracts to buy or sell a non-financial item that are within the scope of MPSAS 29, *Financial Instruments: Recognition and Measurement*, (see paragraphs 4-6 of MPSAS 29, *Financial Instruments: Recognition and Measurement*).
 6. [Deleted]
 7. [Deleted]

Definitions

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

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

Loans payable are financial liabilities, other than short-term trade payables on normal credit terms.

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk, and other price risk.

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the

individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.

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

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

Classes of Financial Instruments and Level of Disclosure

9. When this Standard requires disclosures by class of financial instrument, an entity shall group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. An entity shall provide sufficient information to permit reconciliation to the line items presented in the statement of financial position.

Significance of Financial Instruments for Financial Position and Financial Performance

10. An entity shall disclose information that enables users of its financial statements to evaluate the significance of financial instruments for its financial position and performance.

Statement of Financial Position

Categories of Financial Assets and Financial Liabilities

11. The carrying amounts of each of the following categories, as defined in MPSAS 29, *Financial Instruments: Recognition and Measurement*, shall be disclosed either in the statement of financial position or in the notes:
- (a) Financial assets at fair value through surplus or deficit, showing separately:
 - (i) Those designated as such upon initial recognition; and
 - (ii) Those classified as held-for-trading in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*;
 - (b) Held-to-maturity investments;
 - (c) Loans and receivables;
 - (d) Available-for-sale financial assets;
 - (e) Financial liabilities at fair value through surplus or deficit, showing separately:
 - (i) Those designated as such upon initial recognition; and
 - (ii) Those classified as held-for-trading in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*; and

- (f) Financial liabilities measured at amortized cost.

Financial Assets or Financial Liabilities at Fair Value through Surplus or Deficit

12. If the entity has designated a loan or receivable (or group of loans or receivables) as at fair value through surplus or deficit, it shall disclose:
- (a) The maximum exposure to credit risk (see paragraph 43(a)) of the loan or receivable (or group of loans or receivables) at the end of the reporting period.
 - (b) The amount by which any related credit derivatives or similar instruments mitigate that maximum exposure to credit risk.
 - (c) The amount of change, during the period and cumulatively, in the fair value of the loan or receivable (or group of loans or receivables) that is attributable to changes in the credit risk of the financial asset determined either:
 - (i) As the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk; or
 - (ii) Using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the asset.

Changes in market conditions that give rise to market risk include changes in an observed (benchmark) interest rate, commodity price, foreign exchange rate, or index of prices or rates.

- (d) The amount of the change in the fair value of any related credit derivatives or similar instruments that has occurred during the period and cumulatively since the loan or receivable was designated.
13. If the entity has designated a financial liability as at fair value through surplus or deficit in accordance with paragraph 10 of MPSAS 29, *Financial Instruments: Recognition and Measurement*, it shall disclose:
- (a) The amount of change, during the period and cumulatively, in the fair value of the financial liability that is attributable to changes in the credit risk of that liability determined either:
 - (i) As the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk (see Appendix A, paragraph AG4); or
 - (ii) Using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the liability.

Changes in market conditions that give rise to market risk include changes in a benchmark interest rate, the price of another entity's financial instrument, a commodity price, a foreign exchange rate, or an index of prices or rates. For contracts that include a

unit-linking feature, changes in market conditions include changes in the performance of the related internal or external investment fund.

- (b) The difference between the financial liability's carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation.

14. The entity shall disclose:

- (a) The methods used to comply with the requirements in paragraphs 12(c) and 13(a).
- (b) If the entity believes that the disclosure it has given to comply with the requirements in paragraph 12(c) or 13(a) does not faithfully represent the change in the fair value of the financial asset or financial liability attributable to changes in its credit risk, the reasons for reaching this conclusion and the factors it believes are relevant.

Reclassification

15. If the entity has reclassified a financial asset (in accordance with paragraphs 60–63 of MPSAS 29, *Financial Instruments: Recognition and Measurement*) as one measured:

- (a) At cost or amortized cost, rather than at fair value; or
- (b) At fair value, rather than at cost or amortized cost;

it shall disclose the amount reclassified into and out of each category and the reason for that reclassification.

16. If the entity has reclassified a financial asset out of the fair value through surplus or deficit category in accordance with paragraph 55 or 57 of MPSAS 29, *Financial Instruments: Recognition and Measurement*, or out of the available-for-sale category in accordance with paragraph 58 of MPSAS 29, *Financial Instruments: Recognition and Measurement*, it shall disclose:

- (a) The amount reclassified into and out of each category;
- (b) For each reporting period until derecognition, the carrying amounts and fair values of all financial assets that have been reclassified in the current and previous reporting periods;
- (c) If a financial asset was reclassified in accordance with paragraph 55 of MPSAS 29, *Financial Instruments: Recognition and Measurement*, the rare situation, and the facts and circumstances indicating that the situation was rare;
- (d) For the reporting period when the financial asset was reclassified, the fair value gain or loss on the financial asset recognized in surplus or deficit or in net assets/equity in that reporting period and in the previous reporting period;
- (e) For each reporting period following the reclassification (including the reporting period in which the financial asset was reclassified) until derecognition of the financial asset, the fair value gain or loss that would have been recognized in surplus or deficit or in net assets/equity if the financial asset had not been reclassified, and the gain, loss, revenue, and expense recognized in surplus or deficit; and

- (f) The effective interest rate and estimated amounts of cash flows the entity expects to recover, as at the date of reclassification of the financial asset.

Derecognition

- 17. An entity may have transferred financial assets in such a way that part or all of the financial assets do not qualify for derecognition (see paragraphs 17–39 of MPSAS 29, *Financial Instruments: Recognition and Measurement*). The entity shall disclose for each class of such financial assets:
 - (a) The nature of the assets;
 - (b) The nature of the risks and rewards of ownership to which the entity remains exposed;
 - (c) When the entity continues to recognize all of the assets, the carrying amounts of the assets, and of the associated liabilities; and
 - (d) When the entity continues to recognize the assets to the extent of its continuing involvement, the total carrying amount of the original assets, the amount of the assets that the entity continues to recognize, and the carrying amount of the associated liabilities.

Collateral

- 18. An entity shall disclose:
 - (a) The carrying amount of financial assets it has pledged as collateral for liabilities or contingent liabilities, including amounts that have been reclassified in accordance with paragraph 39(a) of MPSAS 29, *Financial Instruments: Recognition and Measurement*; and
 - (b) The terms and conditions relating to its pledge.
- 19. When an entity holds collateral (of financial or non-financial assets) and is permitted to sell or repledge the collateral in the absence of default by the owner of the collateral, it shall disclose:
 - (a) The fair value of the collateral held;
 - (b) The fair value of any such collateral sold or repledged, and whether the entity has an obligation to return it; and
 - (c) The terms and conditions associated with its use of the collateral.

Allowance Account for Credit Losses

- 20. When financial assets are impaired by credit losses and the entity records the impairment in a separate account (e.g., an allowance account used to record individual impairments or a similar account used to record a collective impairment of assets) rather than directly reducing the carrying amount of the asset, it shall disclose a reconciliation of changes in that account during the period for each class of financial assets.

Compound Financial Instruments with Multiple Embedded Derivatives

21. If an entity has issued an instrument that contains both a liability and an equity component (see paragraph 33 of MPSAS 28, *Financial Instruments: Presentation*) and the instrument has multiple embedded derivatives whose values are interdependent (such as a callable convertible debt instrument), it shall disclose the existence of those features.

Defaults and Breaches

22. For loans payable recognized at the end of the reporting period, an entity shall disclose:
- (a) Details of any defaults during the period of principal, interest, sinking fund, or redemption terms of those loans payable;
 - (b) The carrying amount of the loans payable in default at the end of the reporting period; and
 - (c) Whether the default was remedied, or the terms of the loans payable were renegotiated, before the financial statements were authorized for issue.
23. If, during the period, there were breaches of loan agreement terms other than those described in paragraph 22, an entity shall disclose the same information as required by paragraph 22 if those breaches permitted the lender to demand accelerated repayment (unless the breaches were remedied, or the terms of the loan were renegotiated, on or before the end of the reporting period).

Statement of Financial Performance

Items of Revenue, Expense, Gains, or Losses

24. An entity shall disclose the following items of revenue, expense, gains, or losses either in the statement of financial performance or in the notes:
- (a) Net gains or net losses on:
 - (i) Financial assets or financial liabilities at fair value through surplus or deficit, showing separately those on financial assets or financial liabilities designated as such upon initial recognition, and those on financial assets or financial liabilities that are classified as held for trading in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*;
 - (ii) Available-for-sale financial assets, showing separately the amount of gain or loss recognized in net assets/equity during the period and the amount reclassified from net assets/equity and recognized directly in surplus or deficit for the period;
 - (iii) Held-to-maturity investments;
 - (iv) Loans and receivables; and
 - (v) Financial liabilities measured at amortized cost;

- (b) Total interest revenue and total interest expense (calculated using the effective interest method) for financial assets or financial liabilities that are not at fair value through surplus or deficit;
- (c) Fee revenue and expense (other than amounts included in determining the effective interest rate) arising from:
 - (i) Financial assets or financial liabilities that are not at fair value through surplus or deficit; and
 - (ii) Trust and other fiduciary activities that result in the holding or investing of assets on behalf of individuals, trusts, retirement benefit plans, and other institutions;
- (d) Interest revenue on impaired financial assets accrued in accordance with paragraph AG126 of MPSAS 29, *Financial Instruments: Recognition and Measurement*; and
- (e) The amount of any impairment loss for each class of financial asset.

Other Disclosures

Accounting Policies

25. In accordance with paragraph 132 of MPSAS 1, *Presentation of Financial Statements*, an entity discloses, in the summary of significant accounting policies, the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements.

Hedge Accounting

26. An entity shall disclose the following separately for each type of hedge described in MPSAS 29, *Financial Instruments: Recognition and Measurement*, (i.e., fair value hedges, cash flow hedges, and hedges of net investments in foreign operations):
- (a) A description of each type of hedge;
 - (b) A description of the financial instruments designated as hedging instruments and their fair values at the end of the reporting period; and
 - (c) The nature of the risks being hedged.
27. For cash flow hedges, an entity shall disclose:
- (a) The periods when the cash flows are expected to occur and when they are expected to affect surplus or deficit;
 - (b) A description of any forecast transaction for which hedge accounting had previously been used, but which is no longer expected to occur;
 - (c) The amount that was recognized in net assets/equity during the period;

- (d) The amount that was reclassified from net assets/equity and included in surplus or deficit for the period, showing the amount included in each line item in the statement of financial performance; and
 - (e) The amount that was removed from net assets/equity during the period and included in the initial cost or other carrying amount of a non-financial asset or non-financial liability whose acquisition or incurrence was a hedged highly probable forecast transaction.
28. An entity shall disclose separately:
- (a) In fair value hedges, gains or losses:
 - (i) On the hedging instrument; and
 - (ii) On the hedged item attributable to the hedged risk.
 - (b) The ineffectiveness recognized in surplus or deficit that arises from cash flow hedges; and
 - (c) The ineffectiveness recognized in surplus or deficit that arises from hedges of net investments in foreign operations.

Fair Value

29. Except as set out in paragraph 35 for each class of financial assets and financial liabilities (see paragraph 9), an entity shall disclose the fair value of that class of assets and liabilities in a way that permits it to be compared with its carrying amount.
30. In disclosing fair values, an entity shall group financial assets and financial liabilities into classes, but shall offset them only to the extent that their carrying amounts are offset in the statement of financial position.
31. An entity shall disclose for each class of financial instruments the methods and, when a valuation technique is used, the assumptions applied in determining fair values of each class of financial assets or financial liabilities. For example, if applicable, an entity discloses information about the assumptions relating to prepayment rates, rates of estimated credit losses, and interest rates or discount rates. If there has been a change in valuation technique, the entity shall disclose that change and the reasons for making it.
32. To make the disclosures required by paragraph 33 an entity shall classify fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy shall have the following levels:
- (a) Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1);
 - (b) Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as price) or indirectly (i.e., derived from prices) (Level 2); and
 - (c) Inputs for the asset or liability that are not based on observable market data (unobservable inputs) (Level 3).

The level in the fair value hierarchy within which the fair value measurement is categorized in its entirety shall be determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. For this purpose, the significance of an input is assessed against the fair value measurement in its entirety. If a fair value measurement uses observable inputs that require significant adjustment based on unobservable inputs, that measurement is a Level 3 measurement. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgment, considering factors specific to the asset or liability.

33. For fair value measurements recognized in the statement of financial position an entity shall disclose for each class of financial instruments:
- (a) The level in the fair value hierarchy into which the fair value measurements are categorized in their entirety, segregating fair value measurements in accordance with the levels defined in paragraph 32.
 - (b) Any significant transfers between Level 1 and Level 2 of the fair value hierarchy and the reasons for those transfers. Transfers into each level shall be disclosed and discussed separately from transfers out of each level. For this purpose, significance shall be judged with respect to surplus or deficit, and total assets or total liabilities.
 - (c) For fair value measurements in Level 3, a reconciliation from the beginning balances to the ending balances, disclosing separately changes during the period attributable to the following:
 - (i) Total gains or losses for the period recognized in surplus or deficit, and a description of where they are presented in the statement of financial performance;
 - (ii) Total gains or losses recognized in net assets/equity;
 - (iii) Purchases, sales, issues, and settlements (each type of movement disclosed separately); and
 - (iv) Transfers into or out of Level 3 (e.g., transfers attributable to changes in the observability of market data) and the reasons for those transfers. For significant transfers, transfers into Level 3 shall be disclosed and discussed separately from transfers out of Level 3.
 - (d) The amount of total gains or losses for the period in (c)(i) above included in surplus or deficit that are attributable to gains or losses relating to those assets and liabilities held at the end of the reporting period and a description of where those gains or losses are presented in the statement of financial performance.
 - (e) For fair value measurements in Level 3, if changing one or more of the inputs to reasonably possible alternative assumptions would change fair value significantly, the entity shall state that fact and disclose the effect of those changes. The entity shall disclose how the effect of a change to a reasonably possible alternative assumption was calculated. For this purpose, significance shall be judged with respect to surplus or deficit, and total assets or total liabilities, or, when changes in fair value are recognized in net assets/equity, total equity.

An entity shall present the quantitative disclosures required by this paragraph in tabular format unless another format is more appropriate.

34. If the market for a financial instrument is not active, an entity establishes its fair value using a valuation technique (see paragraphs AG106–AG112 of MPSAS 29, *Financial Instruments: Recognition and Measurement*). Nevertheless, the best evidence of fair value at initial recognition is the transaction price (i.e., the fair value of the consideration given or received), unless conditions described in paragraph AG108 of MPSAS 29, *Financial Instruments: Recognition and Measurement*, are met. It follows that there could be a difference between the fair value at initial recognition and the amount that would be determined at that date using the valuation technique. If such a difference exists, an entity shall disclose, by class of financial instrument:
- (a) Its accounting policy for recognizing that difference in surplus or deficit to reflect a change in factors (including time) that market participants would consider in setting a price (see paragraph AG109 of MPSAS 29, *Financial Instruments: Recognition and Measurement*); and
 - (b) The aggregate difference yet to be recognized in surplus or deficit at the beginning and end of the period and a reconciliation of changes in the balance of this difference.
35. Disclosures of fair value are not required:
- (a) When the carrying amount is a reasonable approximation of fair value, for example, for financial instruments such as short-term trade receivables and payables;
 - (b) For an investment in equity instruments that do not have a quoted market price in an active market, or derivatives linked to such equity instruments, that is measured at cost in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, because its fair value cannot be measured reliably¹; and
 - (c) For a contract containing a discretionary participation feature if the fair value of that feature cannot be measured reliably.
36. In the cases described in paragraph 35(b) and (c), an entity shall disclose information to help users of the financial statements make their own judgments about the extent of possible differences between the carrying amount of those financial assets or financial liabilities and their fair value, including:
- (a) The fact that fair value information has not been disclosed for these instruments because their fair value cannot be measured reliably;
 - (b) A description of the financial instruments, their carrying amount, and an explanation of why fair value cannot be measured reliably;
 - (c) Information about the market for the instruments;

¹ Information that is reliable is free from material error and bias, and can be depended on by users to faithfully represent that which it purports to represent or could reasonably be expected to represent.

- (d) Information about whether and how the entity intends to dispose of the financial instruments; and
- (e) If financial instruments whose fair value previously could not be reliably measured are derecognized, that fact, their carrying amount at the time of derecognition, and the amount of gain or loss recognized.

Concessionary Loans

37. Concessionary loans are granted by entities on below market terms. Examples of concessionary loans granted by entities include loans to developing countries, small farms, student loans granted to qualifying students for university or college education, and housing loans granted to low income families. For concessionary loans granted an entity shall disclose:
- (a) A reconciliation between the opening and closing carrying amounts of the loans, including:
 - (i) Nominal value of new loans granted during the period;
 - (ii) The fair value adjustment on initial recognition;
 - (iii) Loans repaid during the period;
 - (iv) Impairment losses recognized;
 - (v) Any increase during the period in the discounted amount arising from the passage of time; and
 - (vi) Other changes.
 - (b) Nominal value of the loans at the end of the period;
 - (c) The purpose and terms of the various types of loans; and
 - (d) Valuation assumptions.

Nature and Extent of Risks Arising from Financial Instruments

38. **An entity shall disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period.**
39. The disclosures required by paragraphs 40-49 focus on the risks that arise from financial instruments and how they have been managed. These risks typically include, but are not limited to, credit risk, liquidity risk, and market risk.

Qualitative Disclosures

40. For each type of risk arising from financial instruments, an entity shall disclose:
- (a) The exposures to risk and how they arise;

- (b) Its objectives, policies, and processes for managing the risk and the methods used to measure the risk; and
- (c) Any changes in (a) or (b) from the previous period.

Quantitative Disclosures

41. For each type of risk arising from financial instruments, an entity shall disclose:
- (a) Summary quantitative data about its exposure to that risk at the end of the reporting period. This disclosure shall be based on the information provided internally to key management personnel of the entity (as defined in MPSAS 20, *Related Party Disclosures*), for example, the entity's governing body or chief executive officer.
 - (b) The disclosures required by paragraphs 43–49, to the extent not provided in (a), unless the risk is not material (see paragraphs 45–47 of MPSAS 1, *Presentation of Financial Statements*, for a discussion of materiality).
 - (c) Concentrations of risk if not apparent from (a) and (b).
42. If the quantitative data disclosed as at the end of the reporting period are unrepresentative of an entity's exposure to risk during the period, an entity shall provide further information that is representative.

Credit Risk

43. An entity shall disclose by class of financial instrument:
- (a) The amount that best represents its maximum exposure to credit risk at the end of the reporting period without taking account of any collateral held or other credit enhancements (e.g., netting agreements that do not qualify for offset in accordance with MPSAS 28, *Financial Instruments: Presentation*);
 - (b) In respect of the amount disclosed in (a), a description of collateral held as security and other credit enhancements;
 - (c) Information about the credit quality of financial assets that are neither past due nor impaired; and
 - (d) The carrying amount of financial assets that would otherwise be past due or impaired whose terms have been renegotiated.

Financial Assets that are Either Past Due or Impaired

44. An entity shall disclose by class of financial asset:
- (a) An analysis of the age of financial assets that are past due as at the end of the reporting period but not impaired;
 - (b) An analysis of financial assets that are individually determined to be impaired as at the end of the reporting period, including the factors the entity considered in determining that they are impaired; and

- (c) For the amounts disclosed in (a) and (b), a description of collateral held by the entity as security and other credit enhancements and, unless impracticable, an estimate of their fair value.

Collateral and Other Credit Enhancements Obtained

- 45. When an entity obtains financial or non-financial assets during the period by taking possession of collateral it holds as security or calling on other credit enhancements (e.g., guarantees), and such assets meet the recognition criteria in other Standards, an entity shall disclose:
 - (a) The nature and carrying amount of the assets obtained; and
 - (b) When the assets are not readily convertible into cash, its policies for disposing of such assets or for using them in its operations.

Liquidity Risk

- 46. An entity shall disclose:
 - (a) A maturity analysis for non-derivative financial liabilities (including issued financial guarantee contracts) that shows the remaining contractual maturities.
 - (b) A maturity analysis for derivative financial liabilities. The maturity analysis shall include the remaining contractual maturities for those derivative financial liabilities for which contractual maturities are essential for an understanding of the timing of the cash flows (see paragraph AG14).
 - (c) A description of how it manages the liquidity risk inherent in (a) and (b).

Market Risk

Sensitivity Analysis

- 47. Unless an entity complies with paragraph 48, it shall disclose:
 - (a) A sensitivity analysis for each type of market risk to which the entity is exposed at the end of the reporting period, showing how surplus or deficit and net assets/equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date;
 - (b) The methods and assumptions used in preparing the sensitivity analysis; and
 - (c) Changes from the previous period in the methods and assumptions used, and the reasons for such changes.
- 48. If an entity prepares a sensitivity analysis, such as value-at-risk, that reflects interdependencies between risk variables (e.g., interest rates and exchange rates) and uses it to manage financial risks, it may use that sensitivity analysis in place of the analysis specified in paragraph 47. The entity shall also disclose:
 - (a) An explanation of the method used in preparing such a sensitivity analysis, and of the main parameters and assumptions underlying the data provided; and

- (b) An explanation of the objective of the method used and of limitations that may result in the information not fully reflecting the fair value of the assets and liabilities involved.

Other Market Risk Disclosures

- 49. When the sensitivity analyses disclosed in accordance with paragraph 47 or 48 are unrepresentative of a risk inherent in a financial instrument (e.g., because the year-end exposure does not reflect the exposure during the year), the entity shall disclose that fact and the reason it believes the sensitivity analyses are unrepresentative.

Effective Date and Transition

- 50. An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2017, it shall disclose that fact.
- 51. An entity shall not apply this Standard before January 1, 2017, unless it also applies MPSAS 28, *Financial Instruments: Presentation*, and MPSAS 29, *Financial Instruments: Recognition and Measurement*.
- 52. If an entity applies this Standard for annual periods beginning before January 1, 2017, it need not present comparative information for the disclosures required by paragraphs 38–49 about the nature and extent of risks arising from financial instruments.
- 52A. Paragraph 53 was amended by MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards* (MPSASs), issued in November 2015. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards* (MPSASs), for a period beginning before January 1, 2017, the amendment shall also be applied for that earlier period.
- 52B. MPSAS 35, *Consolidated Financial Statements*, MPSAS 37, *Joint Arrangements*, and MPSAS 38, *Disclosures of Interest in Other Entities*, issued in March 2016, August 2016 and December 2016 respectively, amended paragraphs 3(a) and AG6. An entity shall apply that amendment when it applies MPSAS 35, *Consolidated Financial Statements*, MPSAS 37, *Joint Arrangements*, and MPSAS 38, *Financial Instruments: Presentation*.
- 52C. Paragraph AG7 was amended by *Improvements to MPSASs 2023 (MPSASs Improvement due to MPSAS Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities)*, issued in December 2022. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2024. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2024 it shall disclose that fact.
- 52D. Paragraphs 6 and 7 were deleted by *Improvements to MPSASs 2023 (The Applicability of MPSASs)*, issued in December 2022. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2024. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2024, it shall disclose that fact.

53. When an entity adopts the accrual basis MPSASs of accounting as defined in MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of MPSASs.

Appendix A

Application Guidance

This appendix is an integral part of MPSAS 30, Financial Instruments: Disclosures.

Classes of Financial Instruments and Level of Disclosure (paragraph 9)

- AG1. Paragraph 9 requires an entity to group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. The classes described in paragraph 9 are determined by the entity and are, thus, distinct from the categories of financial instruments specified in MPSAS 29, *Financial Instruments: Recognition and Measurement*, (which determine how financial instruments are measured and where changes in fair value are recognized).
- AG2. In determining classes of financial instrument, an entity shall, at a minimum:
- (a) Distinguish instruments measured at amortized cost from those measured at fair value.
 - (b) Treat as a separate class or classes those financial instruments outside the scope of this Standard.
- AG3. An entity decides, in the light of its circumstances, how much detail it provides to satisfy the requirements of this Standard, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information with different characteristics. It is necessary to strike a balance between overburdening financial statements with excessive detail that may not assist users of financial statements and obscuring important information as a result of too much aggregation. For example, an entity shall not obscure important information by including it among a large amount of insignificant detail. Similarly, an entity shall not disclose information that is so aggregated that it obscures important differences between individual transactions or associated risks.

Significance of Financial Instruments for Financial Position and Financial Performance

Financial Liabilities at Fair Value through Surplus or Deficit (paragraphs 13 and 14)

- AG4. If an entity designates a financial liability as at fair value through surplus or deficit, paragraph 13(a) requires it to disclose the amount of change in the fair value of the financial liability that is attributable to changes in the liability's credit risk. Paragraph 13(a)(i) permits an entity to determine this amount as the amount of change in the liability's fair value that is not attributable to changes in market conditions that give rise to market risk. If the only relevant changes in market conditions for a liability are changes in an observed (benchmark) interest rate, this amount can be estimated as follows:
- (a) First, the entity computes the liability's internal rate of return at the start of the period using the observed market price of the liability and the liability's contractual cash flows at the start of the period. It deducts from this rate of return the observed (benchmark) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.

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

This example assumes that changes in fair value arising from factors other than changes in the instrument's credit risk or changes in interest rates are not significant. If the instrument in the example contains an embedded derivative, the change in fair value of the embedded derivative is excluded in determining the amount to be disclosed in accordance with paragraph 13(a).

Other Disclosure—Accounting Policies (paragraph 25)

AG5. Paragraph 25 requires disclosure of the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements. For financial instruments, such disclosure may include:

- (a) For financial assets or financial liabilities designated as at fair value through surplus or deficit:
 - (i) The nature of the financial assets or financial liabilities the entity has designated as at fair value through surplus or deficit;
 - (ii) The criteria for so designating such financial assets or financial liabilities on initial recognition; and
 - (iii) How the entity has satisfied the conditions in paragraph 10, 13, or 14 of MPSAS 29, *Financial Instruments: Recognition and Measurement*, for such designation. For instruments designated in accordance with paragraph (b)(i) of the definition of a financial asset or financial liability at fair value through surplus or deficit in MPSAS 29, *Financial Instruments: Recognition and Measurement*, that disclosure includes a narrative description of the circumstances underlying the measurement or recognition inconsistency that would otherwise arise. For instruments designated in accordance with paragraph (b)(ii) of the definition of a financial asset or financial liability at fair value through surplus or deficit in MPSAS 29, *Financial Instruments: Recognition and Measurement*, that disclosure includes a narrative description of how designation at fair value through surplus or deficit is consistent with the entity's documented risk management or investment strategy.
- (b) The criteria for designating financial assets as available for sale.
- (c) Whether regular way purchases and sales of financial assets are accounted for at trade date or at settlement date (see paragraph 40 of MPSAS 29, *Financial Instruments: Recognition and Measurement*).

- (d) When an allowance account is used to reduce the carrying amount of financial assets impaired by credit losses:
 - (i) The criteria for determining when the carrying amount of impaired financial assets is reduced directly (or, in the case of a reversal of a write-down, increased directly) and when the allowance account is used; and
 - (ii) The criteria for writing off amounts charged to the allowance account against the carrying amount of impaired financial assets (see paragraph 20).
- (e) How net gains or net losses on each category of financial instrument are determined (see paragraph 24(a)), for example, whether the net gains or net losses on items at fair value through surplus or deficit include interest or revenue from dividends or similar distributions.
- (f) The criteria the entity uses to determine that there is objective evidence that an impairment loss has occurred (see paragraph 24(e)).
- (g) When the terms of financial assets that would otherwise be past due or impaired have been renegotiated, the accounting policy for financial assets that are the subject of renegotiated terms (see paragraph 43(d)).
- (h) For financial guarantee contracts issued through a non-exchange transaction, where no fair value can be determined and a provision is recognized in accordance with MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, disclosure of the circumstances that result in a provision being recognized.

Paragraph 137 of MPSAS 1, *Presentation of Financial Statements*, also requires entities to disclose, in the summary of significant accounting policies or other notes, the judgments, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognized in the financial statements.

Nature and Extent of Risks Arising from Financial Instruments (paragraphs 38–49)

AG6. The disclosures required by paragraphs 38–49 shall be either given in the financial statements or incorporated by cross-reference from the financial statements to some other statement, such as a management commentary or risk report, that is available to users of the financial statements on the same terms as the financial statements and at the same time. Without the information incorporated by cross-reference, the financial statements are incomplete. The use of such cross-referencing may be subject to jurisdictional restrictions.

Quantitative Disclosures (paragraph 41)

AG7. Paragraph 41(a) requires disclosures of summary quantitative data about an entity's exposure to risks based on the information provided internally to key management personnel of the entity. When an entity uses several methods to manage a risk exposure, the entity shall disclose information using the method or methods that provide the most relevant and faithfully representative information. MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, discusses relevance and faithful representation.

AG8. Paragraph 41(c) requires disclosures about concentrations of risk. Concentrations of risk arise from financial instruments that have similar characteristics and are affected similarly by changes in economic or other conditions. The identification of concentrations of risk requires judgment taking into account the circumstances of the entity. Disclosure of concentrations of risk shall include:

- (a) A description of how management determines concentrations;
- (b) A description of the shared characteristic that identifies each concentration (e.g., counterparty, geographical area, currency, or market); and
- (c) The amount of the risk exposure associated with all financial instruments sharing that characteristic.

Maximum Credit Risk Exposure (paragraph 43(a))

AG9. Paragraph 43(a) requires disclosure of the amount that best represents the entity's maximum exposure to credit risk. For a financial asset, this is typically the gross carrying amount, net of:

- (a) Any amounts offset in accordance with MPSAS 28, *Financial Instruments: Presentation*; and
- (b) Any impairment losses recognized in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*.

AG10. Activities that give rise to credit risk and the associated maximum exposure to credit risk include, but are not limited to:

- (a) Granting loans and receivables to customers and placing deposits with other entities. In these cases, the maximum exposure to credit risk is the carrying amount of the related financial assets.
- (b) Entering into derivative contracts (e.g., foreign exchange contracts, interest rate swaps, and credit derivatives). When the resulting asset is measured at fair value, the maximum exposure to credit risk at the end of the reporting period will equal the carrying amount.
- (c) Granting financial guarantees. In this case, the maximum exposure to credit risk is the maximum amount the entity could have to pay if the guarantee is called on, which may be significantly greater than the amount recognized as a liability.
- (d) Making a loan commitment that is irrevocable over the life of the facility or is revocable only in response to a material adverse change. If the issuer cannot settle the loan commitment net in cash or another financial instrument, the maximum credit exposure is the full amount of the commitment. This is because it is uncertain whether the amount of any undrawn portion may be drawn upon in the future. This may be significantly greater than the amount recognized as a liability.

Quantitative Liquidity Risk Disclosures (paragraphs 41(a), and 46(a) and (b))

AG11. In accordance with paragraph 41(a) an entity discloses summary quantitative data about its exposure to liquidity risk on the basis of the information provided internally to key management personnel. An entity shall explain how those data are determined. If the outflows of cash (or another financial asset) included in those data could either:

- (a) Occur significantly earlier than indicated in the data; or
- (b) Be for significantly different amounts from those indicated in the data (e.g., for a derivative that is included in the data on a net settlement basis but for which the counterparty has the option to require gross settlement);

the entity shall state that fact and provide quantitative information that enables users of its financial statements to evaluate the extent of this risk unless that information is included in the contractual maturity analyses required by paragraph 46(a) or (b).

AG12. In preparing the maturity analyses required by paragraph 46(a) and (b), an entity uses its judgment to determine an appropriate number of time bands. For example, an entity might determine that the following time bands are appropriate:

- (a) Not later than one month;
- (b) Later than one month and not later than three months;
- (c) Later than three months and not later than one year; and
- (d) Later than one year and not later than five years.

AG13. In complying with paragraph 46(a) and (b), an entity shall not separate an embedded derivative from a hybrid (combined) instrument. For such an instrument, an entity shall apply paragraph 46(a).

AG14. Paragraph 46(b) requires an entity to disclose a quantitative maturity analysis for derivative financial liabilities that shows remaining contractual maturities if the contractual maturities are essential for an understanding of the timing of the cash flows. For example, this would be the case for:

- (a) An interest rate swap with a remaining maturity of five years in a cash flow hedge of a variable rate financial asset or liability.
- (b) All loan commitments.

AG15. Paragraph 46(a) and (b) requires an entity to disclose maturity analyses for financial liabilities that show the remaining contractual maturities for some financial liabilities. In this disclosure:

- (a) When a counterparty has a choice of when an amount is paid, the liability is allocated to the earliest period in which the entity can be required to pay. For example, financial liabilities that an entity can be required to repay on demand (e.g., demand deposits) are included in the earliest time band.

- (b) When an entity is committed to make amounts available in instalments, each instalment is allocated to the earliest period in which the entity can be required to pay. For example, an undrawn loan commitment is included in the time band containing the earliest date it can be drawn down.
- (c) For issued financial guarantee contracts the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called.

AG16. The contractual amounts disclosed in the maturity analyses as required by paragraph 46(a) and (b) are the contractual undiscounted cash flows, for example:

- (a) Gross finance lease obligations (before deducting finance charges);
- (b) Prices specified in forward agreements to purchase financial assets for cash;
- (c) Net amounts for pay-floating/receive-fixed interest rate swaps for which net cash flows are exchanged;
- (d) Contractual amounts to be exchanged in a derivative financial instrument (e.g., a currency swap) for which gross cash flows are exchanged; and
- (e) Gross loan commitments.

Such undiscounted cash flows differ from the amount included in the statement of financial position because the amount in that statement is based on discounted cash flows. When the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing at the end of the reporting period. For example, when the amount payable varies with changes in an index, the amount disclosed may be based on the level of the index at the end of the period.

AG17. Paragraph 46(c) requires an entity to describe how it manages the liquidity risk inherent in the items disclosed in the quantitative disclosures required in paragraph 40(a) and (b). An entity shall disclose a maturity analysis of financial assets it holds for managing liquidity risk (e.g., financial assets that are readily saleable or expected to generate cash inflows to meet cash outflows on financial liabilities), if that information is necessary to enable users of its financial statements to evaluate the nature and extent of liquidity risk.

AG18. Other factors that an entity might consider in providing the disclosure required in paragraph 40(c) include, but are not limited to, whether the entity:

- (a) Has committed borrowing facilities (e.g., commercial paper facilities) or other lines of credit (e.g., stand-by credit facilities) that it can access to meet liquidity needs;
- (b) Holds deposits at central banks to meet liquidity needs;
- (c) Has very diverse funding sources;
- (d) Has significant concentrations of liquidity risk in either its assets or its funding sources;
- (e) Has internal control processes and contingency plans for managing liquidity risk;
- (f) Has instruments that include accelerated repayment terms (e.g., on the downgrade of the entity's credit rating);

- (g) Has instruments that could require the posting of collateral (e.g., margin calls for derivatives);
- (h) Has instruments that allows the entity to choose whether it settles its financial liabilities by delivering cash (or another financial asset) or by delivering its own shares; or
- (i) Has instruments that are subject to master netting agreements.

Market Risk-Sensitivity Analysis (paragraphs 47 and 48)

AG19. Paragraph 47(a) requires a sensitivity analysis for each type of market risk to which the entity is exposed. In accordance with paragraph AG3, an entity decides how it aggregates information to display the overall picture without combining information with different characteristics about exposures to risks from significantly different economic environments. For example:

- (a) An entity that trades financial instruments might disclose this information separately for financial instruments held for trading and those not held for trading.
- (b) An entity would not aggregate its exposure to market risks from areas of hyperinflation with its exposure to the same market risks from areas of very low inflation.

If an entity has exposure to only one type of market risk in only one economic environment, it would not show disaggregated information.

AG20. Paragraph 47(a) requires the sensitivity analysis to show the effect on surplus or deficit and net assets/equity of reasonably possible changes in the relevant risk variable (e.g., prevailing market interest rates, currency rates, equity prices, or commodity prices). For this purpose:

- (a) Entities are not required to determine what the surplus or deficit for the period would have been if relevant risk variables had been different. Instead, entities disclose the effect on surplus or deficit and net assets/equity at the end of the reporting period assuming that a reasonably possible change in the relevant risk variable had occurred at the end of the reporting period and had been applied to the risk exposures in existence at that date. For example, if an entity has a floating rate liability at the end of the year, the entity would disclose the effect on surplus or deficit (i.e., interest expense) for the current year if interest rates had varied by reasonably possible amounts.
- (b) Entities are not required to disclose the effect on surplus or deficit and net assets/equity for each change within a range of reasonably possible changes of the relevant risk variable. Disclosure of the effects of the changes at the limits of the reasonably possible range would be sufficient.

AG21. In determining what a reasonably possible change in the relevant risk variable is, an entity should consider:

- (a) The economic environments in which it operates. A reasonably possible change should not include remote or “worst case” scenarios or “stress tests”. Moreover, if the rate of change in the underlying risk variable is stable, the entity need not alter the chosen reasonably possible change in the risk variable. For example, assume that interest rates are 5 percent and an entity determines that a fluctuation in interest rates of ± 50 basis points is reasonably possible. It would disclose the effect on surplus or deficit and net assets/equity if interest rates were to change to 4.5 percent or 5.5 percent. In the next

period, interest rates have increased to 5.5 percent. The entity continues to believe that interest rates may fluctuate by ± 50 basis points (i.e., that the rate of change in interest rates is stable). The entity would disclose the effect on surplus or deficit and net assets/equity if interest rates were to change to 5 percent or 6 percent. The entity would not be required to revise its assessment that interest rates might reasonably fluctuate by ± 50 basis points, unless there is evidence that interest rates have become significantly more volatile.

- (b) The time frame over which it is making the assessment. The sensitivity analysis shall show the effects of changes that are considered to be reasonably possible over the period until the entity will next present these disclosures, which is usually its next annual reporting period.

AG22. Paragraph 48 permits an entity to use a sensitivity analysis that reflects interdependencies between risk variables, such as a value-at-risk methodology, if it uses this analysis to manage its exposure to financial risks. This applies even if such a methodology measures only the potential for loss and does not measure the potential for gain. Such an entity might comply with paragraph 48(a) by disclosing the type of value-at-risk model used (e.g., whether the model relies on Monte Carlo simulations), an explanation about how the model works and the main assumptions (e.g., the holding period and confidence level). Entities might also disclose the historical observation period and weightings applied to observations within that period, an explanation of how options are dealt with in the calculations, and which volatilities and correlations (or, alternatively, Monte Carlo probability distribution simulations) are used.

AG23. An entity shall provide sensitivity analyses for the whole of its operations, but may provide different types of sensitivity analysis for different classes of financial instruments.

Interest Rate Risk

AG24. Interest rate risk arises on interest-bearing financial instruments recognized in the statement of financial position (e.g., loans and receivables and debt instruments issued) and on some financial instruments not recognized in the statement of financial position (e.g., some loan commitments).

Currency Risk

AG25. Currency risk (or foreign exchange risk) arises on financial instruments that are denominated in a foreign currency (i.e., in a currency other than the functional currency in which they are measured). For the purpose of this Standard, currency risk does not arise from financial instruments that are non-monetary items or from financial instruments denominated in the functional currency.

AG26. A sensitivity analysis is disclosed for each currency to which an entity has significant exposure.

Other Price Risk

AG27. Other price risk arises on financial instruments because of changes in, for example, commodity prices or equity prices. To comply with paragraph 47, an entity might disclose the effect of a decrease in a specified stock market index, commodity price, or other risk variable. For example, if an entity gives residual value guarantees that are financial instruments, the entity discloses an increase or decrease in the value of the assets to which the guarantee applies.

- AG28. Two examples of financial instruments that give rise to equity price risk are (a) a holding of equities in another entity, and (b) an investment in a trust that in turn holds investments in equity instruments. Other examples include forward contracts and options to buy or sell specified quantities of an equity instrument and swaps that are indexed to equity prices. The fair values of such financial instruments are affected by changes in the market price of the underlying equity instruments.
- AG29. In accordance with paragraph 47(a), the sensitivity of surplus or deficit (that arises, for example, from instruments classified as at fair value through surplus or deficit and impairments of available-for-sale financial assets) is disclosed separately from the sensitivity of net assets/equity (that arises, for example, from instruments classified as available for sale).
- AG30. Financial instruments that an entity classifies as equity instruments are not remeasured. Neither surplus or deficit nor net assets/equity will be affected by the equity price risk of those instruments. Accordingly, no sensitivity analysis is required.

IMPLEMENTATION GUIDANCE

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Implementation Guidance

This guidance accompanies, but is not part of, MPSAS 30, Financial Instruments: Disclosures.

Introduction

- IG1. This guidance suggests possible ways to apply some of the disclosure requirements in MPSAS 30, *Financial Instruments: Disclosures*. The guidance does not create additional requirements.
- IG2. For convenience, each disclosure requirement in this Standard is discussed separately. In practice, disclosures would normally be presented as an integrated package and individual disclosures might satisfy more than one requirement. For example, information about concentrations of risk might also convey information about exposure to credit or other risk.

Materiality

- IG3. MPSAS 1, *Presentation of Financial Statements*, notes that a specific disclosure requirement in an MPSAS need not be satisfied if the information is not material. MPSAS 1, *Presentation of Financial Statements*, defines materiality as follows:

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

- IG4. MPSAS 1, *Presentation of Financial Statements*, also explains that definition as follows:

Assessing whether an omission or misstatement could influence decisions of users, and so be material, requires consideration of the characteristics of those users. Users are assumed to have a reasonable knowledge of the public sector and economic activities and accounting and a willingness to study the information with reasonable diligence. Therefore, the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making and evaluating decisions.

Classes of Financial Instruments and Level of Disclosure (paragraphs 9 and AG1-AG3)

- IG5. Paragraph AG3 states that “an entity decides in the light of its circumstances how much detail it provides to satisfy the requirements of this Standard, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information with different characteristics.” To satisfy the requirements, an entity may not need to disclose all the information suggested in this guidance.
- IG6. Paragraph 29(c) of MPSAS 1, *Presentation of Financial Statements*, requires an entity to “provide additional disclosures when compliance with the specific requirements in MPSASs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity’s financial position and financial performance.”

Significance of Financial Instruments for Financial Position and Financial Performance (paragraphs 10–36, AG4 and AG5)

Financial Liabilities at Fair Value through Surplus or Deficit (paragraphs 13(a)(i) and AG4)

- IG7. The following example illustrates the calculation that an entity might perform in accordance with paragraph AG4 of Appendix A of the Standard.
- IG8. On January 1, 20X1, an entity issues a 10-year bond with a par value of RM150,000¹ and an annual fixed coupon rate of 8 percent, which is consistent with market rates for bonds with similar characteristics.
- IG9. The entity uses the Kuala Lumpur Interbank Offered Rate (KLIBOR) as its observable (benchmark) interest rate. At the date of inception of the bond, KLIBOR is 5 percent. At the end of the first year:
- KLIBOR has decreased to 4.75 percent.
 - The fair value for the bond is RM153,811, consistent with an interest rate of 7.6 percent².
- IG10. The entity assumes a flat yield curve, all changes in interest rates result from a parallel shift in the yield curve, and the changes in KLIBOR are the only relevant changes in market conditions.
- IG11. The entity estimates the amount of change in the fair value of the bond that is not attributable to changes in market conditions that give rise to market risk as follows:

[paragraph AG4(a)] First, the entity computes the liability's internal rate of return at the start of the period using the observed market price of the liability and the liability's contractual cash flows at the start of the period. It deducts from this rate of return the observed (benchmark) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.	At the start of the period of a 10-year bond with a coupon of 8 percent, the bond's internal rate of return is 8 percent. Because the observed (benchmark) interest rate (KLIBOR) is 5 percent, the instrument-specific component of the internal rate of return is 3 percent.
[paragraph AG4(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 accordance with paragraph AG4(a).	The contractual cash flows of the instrument at the end of the period are: - Interest: RM12,000 ^(a) per year for each of years 2–10. - Principal: RM150,000 in year 10. The discount rate to be used to calculate the present value of the bond is thus 7.75 percent, which is 4.75 percent end of period KLIBOR rate, plus the 3 percent instrument-specific component. This gives a present value of RM152,367. ^(b)
[paragraph AG4(c)]	The market price of the liability at the end

¹ In this guidance monetary amounts are denominated in "currency units (RM)."

² This reflects a shift in KLIBOR from 5 percent to 4.75 percent and a movement of 0.15 percent which, in the absence of other relevant changes in market conditions, is assumed to reflect changes in credit risk of the instrument.

The difference between the observed market price of the liability at the end of the period and the amount determined in accordance with paragraph AG4(b) is the change in fair value that is not attributable to changes in the observed (benchmark) interest rate. This is the amount to be disclosed.	of the period is RM153,811. ^(c) Thus, the entity discloses RM1,444, which is RM153,811 – RM152,367, as the increase in fair value of the bond that is not attributable to changes in market conditions that give rise to market risk.
(a) $RM150,000 \times 8\% = RM12,000$ (b) $PV = [RM12,000 \times (1 - (1 + 0.0775)^{-9})/0.0775] + RM150,000 \times (1 + 0.0775)^{-9}$ (c) market price = $[RM12,000 \times (1 - (1 + 0.076)^{-9})/0.076] + RM150,000 \times (1 + 0.076)^{-9}$	

Defaults and Breaches (paragraphs 22 and 23)

IG12. Paragraphs 22 and 23 require disclosures when there are any defaults or breaches of loans payable. Any defaults or breaches may affect the classification of the liability as current or non-current in accordance with MPSAS 1, *Presentation of Financial Statements*.

Total Interest Expense (paragraph 24(b))

IG13. Total interest expense disclosed in accordance with paragraph 24(b) is a component of the finance costs, which paragraph 102(b) of MPSAS 1, *Presentation of Financial Statements*, requires to be presented separately in the statement of financial performance. The line item for finance costs may also include amounts associated with non-financial liabilities.

Fair Value (paragraphs 31–34)

IG14. MPSAS 30, *Financial Instruments: Disclosures*, requires disclosures about the level in the fair value hierarchy in which fair value measurements are categorized for assets and liabilities measured in the statement of financial position. A tabular format is required unless another format is more appropriate. An entity might disclose the following for assets to comply with paragraph 33(a). (Disclosure of comparative information is also required, but is not included in the following example).

Assets Measured at Fair Value		Fair value measurement at end of the reporting period using:		
		Level 1	Level 2	Level 3
Description	Dec 31, 20X2	RM million	RM million	RM million
Financial assets at fair value through surplus or deficit				
Trading securities	100	40	55	5
Trading derivatives	39	17	20	2
Available-for-sale financial assets				
Equity investments	75	30	40	5
Total	214	87	115	12
Note: For liabilities, a similar table might be presented.				

- IG15. MPSAS 30, *Financial Instruments: Disclosures*, requires a reconciliation from beginning to ending balances for those assets and liabilities that are measured in the statement of financial position at fair value based on a valuation technique for which any significant input is not based on observable market data (Level 3). A tabular format is required unless another format is more appropriate. An entity might disclose the following for assets to comply with paragraph 33(b). (Disclosure of comparative information is also required, but is not included in the following example).

Assets Measured at Fair Value Based on Level 3				
	Fair value measurement at the end of the reporting period			Total
	Financial assets at fair value through surplus or deficit		Available-for-sale financial assets	
	Trading securities	Trading derivatives	Equity investments	
	RM million	RM million	RM million	RM million
Opening balance	6	5	4	15
Total gains or losses				
in surplus or deficit	(2)	(2)	-	(4)
in net assets/ equity	-	-	(1)	(1)
Purchases	1	2	2	5
Issues	-	-	-	-
Settlements	-	(1)	-	(1)
Transfers out of Level 3	-	(2)	-	(2)
Closing balance	5	2	5	12
Total gains or losses for the period included in surplus or deficit for assets held at the end of the reporting period	(1)	(1)	-	(2)
(Note: For liabilities, a similar table might be presented.)				
Gains or losses included in surplus or deficit for the period (above) are presented in revenue as follows:				
Total gains or losses included in surplus or deficit for the period				Revenue
Total gains or losses for the period included in surplus or deficit for assets held at the end of the reporting period				(4)
				(2)
(Note: For liabilities, a similar table might be presented.)				

- IG16. The fair value at initial recognition of financial instruments that are not traded in active markets is determined in accordance with paragraph AG108 of MPSAS 29, *Financial Instruments: Recognition and Measurement*. However, when, after initial recognition, an entity will use a valuation technique that incorporates data not obtained from observable markets, there may be a difference between the transaction price at initial recognition and the amount determined at initial recognition using that valuation technique. In these circumstances, the difference will

be recognized in surplus or deficit in subsequent periods in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, and the entity's accounting policy. Such recognition reflects changes in factors (including time) that market participants would consider in setting a price (see paragraph AG108 of MPSAS 29, *Financial Instruments: Recognition and Measurement*). Paragraph 33 requires disclosures in these circumstances. An entity might disclose the following to comply with paragraph 34:

Background		
On January 1, 20X1 an entity purchases for RM15 million financial assets that are not traded in an active market. The entity has only one class of such financial assets. The transaction price of RM15 million is the fair value at initial recognition. After initial recognition, the entity will apply a valuation technique to establish the financial assets' fair value. This valuation technique includes variables other than data from observable markets. At initial recognition, the same valuation technique would have resulted in an amount of RM14 million, which differs from fair value by RM1 million. The entity has existing differences of RM5 million at January 1, 20X1.		
Application of Requirements		
The entity's 20X2 disclosure would include the following: <i>Accounting Policies</i> The entity uses the following valuation technique to determine the fair value of financial instruments that are not traded in an active market: [description of technique not included in this example]. Differences may arise between the fair value at initial recognition (which, in accordance with MPSAS 29, <i>Financial Instruments: Disclosures</i>, is generally the transaction price) and the amount determined at initial recognition using the valuation technique. Any such differences are [description of the entity's accounting policy]. <i>In the Notes to the Financial Statements</i> As discussed in note X, the entity uses [name of valuation technique] to measure the fair value of the following financial instruments that are not traded in an active market. However, in accordance with MPSAS 29, <i>Financial Instruments: Disclosures</i>, the fair value of an instrument at inception is generally the transaction price. If the transaction price differs from the amount determined at inception using the valuation technique, that difference is [description of the entity's accounting policy]. The differences yet to be recognized in surplus or deficit are as follows:		
	Dec 31,X2	Dec 31,X1
	RM million	RM million
Balance at beginning of year	5.3	5.0
New transactions	-	1.0
Amounts recognized in surplus or deficit during the year	(0.7)	(0.8)
Other increases	-	0.2
Other decreases	(0.1)	(0.1)
Balance at the end of year	4.5	5.3

Nature and Extent of Risks Arising from Financial Instruments (paragraphs 38–49 and AG6–AG30)

Qualitative Disclosures (paragraph 40)

IG17. The type of qualitative information an entity might disclose to meet the requirements in paragraph 40 includes, but is not limited to, a narrative description of:

- (a) The entity's exposures to risk and how they arose. Information about risk exposures might describe exposures both gross and net of risk transfer and other risk-mitigating transactions.
- (b) The entity's policies and processes for accepting, measuring, monitoring, and controlling risk, which might include:
 - (i) The structure and organization of the entity's risk management function(s), including a discussion of independence and accountability;
 - (ii) The scope and nature of the entity's risk reporting or measurement systems;
 - (iii) The entity's policies for hedging or mitigating risk, including its policies and procedures for taking collateral; and
 - (iv) The entity's processes for monitoring the continuing effectiveness of such hedges or mitigating devices.
- (c) The entity's policies and procedures for avoiding excessive concentrations of risk.

IG18. Information about the nature and extent of risks arising from financial instruments is more useful if it highlights any relationship between financial instruments that can affect the amount, timing or uncertainty of an entity's future cash flows. The extent to which a risk exposure is altered by such relationships might be apparent to users from the disclosures required by this Standard, but in some cases further disclosures might be useful.

IG19. In accordance with paragraph 40(c), entities disclose any change in the qualitative information from the previous period and explain the reasons for the change. Such changes may result from changes in exposure to risk or from changes in the way those exposures are managed.

Quantitative Disclosures (paragraphs 41–49 and AG7–AG30)

IG20. Paragraph 41 requires disclosure of quantitative data about concentrations of risk. For example, concentrations of credit risk may arise from:

- (a) Industry sectors. Thus, if an entity's counterparties are concentrated in one or more industry sectors (such as retail or wholesale), it would disclose separately exposure to risks arising from each concentration of counterparties.
- (b) Credit rating or other measure of credit quality. Thus, if an entity's counterparties are concentrated in one or more credit qualities (such as secured loans or unsecured loans) or in one or more credit ratings (such as investment grade or speculative grade), it would disclose separately exposure to risks arising from each concentration of counterparties.

- (c) Geographical distribution. Thus, if an entity's counterparties are concentrated in one or more geographical markets (such as Asia or Europe), it would disclose separately exposure to risks arising from each concentration of counterparties.
- (d) A limited number of individual counterparties or groups of closely related counterparties.

Similar principles apply to identifying concentrations of other risks, including liquidity risk and market risk. For example, concentrations of liquidity risk may arise from the repayment terms of financial liabilities, sources of borrowing facilities or reliance on a particular market in which to realize liquid assets. Concentrations of foreign exchange risk may arise if an entity has a significant net open position in a single foreign currency, or aggregate net open positions in several currencies that tend to move together.

- IG21. In accordance with paragraph AG8, disclosure of concentrations of risk includes a description of the shared characteristic that identifies each concentration. For example, the shared characteristic may refer to geographical distribution of counterparties by groups of countries, individual countries or regions within countries.
- IG22. When quantitative information at the end of the reporting period is unrepresentative of the entity's exposure to risk during the period, paragraph 42 requires further disclosure. To meet this requirement, an entity might disclose the highest, lowest, and average amount of risk to which it was exposed during the period. For example, if an entity typically has a large exposure to a particular currency, but at year-end unwinds the position, the entity might disclose a graph that shows the exposure at various times during the period, or disclose the highest, lowest, and average exposures.

Credit Risk (paragraphs 43–45, AG9 and AG10)

- IG23. Paragraph 43 requires an entity to disclose information about its exposure to credit risk by class of financial instrument. Financial instruments in the same class share economic characteristics with respect to the risk being disclosed (in this case, credit risk). For example, an entity might determine that residential mortgages, unsecured consumer loans, and commercial loans each have different economic characteristics.

Collateral and Other Credit Enhancements Pledged (paragraph 43(b))

- IG24. Paragraph 43(b) requires an entity to describe collateral available as security for assets it holds and other credit enhancements obtained. An entity might meet this requirement by disclosing:
 - (a) The policies and processes for valuing and managing collateral and other credit enhancements obtained;
 - (b) A description of the main types of collateral and other credit enhancements (examples of the latter being guarantees, credit derivatives, and netting agreements that do not qualify for offset in accordance with MPSAS 28, *Financial Instruments: Disclosures*);
 - (c) The main types of counterparties to collateral and other credit enhancements and their creditworthiness; and
 - (d) Information about risk concentrations within the collateral or other credit enhancements.

Credit Quality (paragraph 43(c))

- IG25. Paragraph 43(c) requires an entity to disclose information about the credit quality of financial assets with credit risk that are neither past due nor impaired. In doing so, an entity might disclose the following information:
- (a) An analysis of credit exposures using an external or internal credit grading system;
 - (b) The nature of the counterparty;
 - (c) Historical information about counterparty default rates; and
 - (d) Any other information used to assess credit quality.
- IG26. When the entity considers external ratings when managing and monitoring credit quality, the entity might disclose information about:
- (a) The amounts of credit exposures for each external credit grade;
 - (b) The rating agencies used;
 - (c) The amount of an entity's rated and unrated credit exposures; and
 - (d) The relationship between internal and external ratings.
- IG27. When the entity considers internal credit ratings when managing and monitoring credit quality, the entity might disclose information about:
- (a) The internal credit ratings process;
 - (b) The amounts of credit exposures for each internal credit grade; and
 - (c) The relationship between internal and external ratings.

Financial Assets that are either Past Due or Impaired (paragraph 44)

- IG28. A financial asset is past due when the counterparty has failed to make a payment when contractually due. As an example, an entity enters into a lending agreement that requires interest to be paid every month. On the first day of the next month, if interest has not been paid, the loan is past due. Past due does not mean that a counterparty will never pay, but it can trigger various actions such as renegotiation, enforcement of covenants, or legal proceedings.
- IG29. When the terms and conditions of financial assets that have been classified as past due are renegotiated, the terms and conditions of the new contractual arrangement apply in determining whether the financial asset remains past due.
- IG30. Paragraph 44(a) requires an analysis by class of the age of financial assets that are past due but not impaired. An entity uses its judgment to determine an appropriate number of time bands. For example, an entity might determine that the following time bands are appropriate:
- (a) Not more than three months;
 - (b) More than three months and not more than six months;

- (c) More than six months and not more than one year; and
- (d) More than one year.

IG31. Paragraph 44(b) requires an analysis of impaired financial assets by class. This analysis might include:

- (a) The carrying amount, before deducting any impairment loss;
- (b) The amount of any related impairment loss; and
- (c) The nature and fair value of collateral available and other credit enhancements obtained.

Market Risk (paragraphs 47–49 and AG19–AG30)

IG32. Paragraph 47(a) requires a sensitivity analysis for each type of market risk to which the entity is exposed. There are three types of market risk: interest rate risk, currency risk, and other price risk. Other price risk may include risks such as equity price risk, commodity price risk, prepayment risk (i.e., the risk that one party to a financial asset will incur a financial loss because the other party repays earlier or later than expected), and residual value risk (e.g., a lessor of motor cars that writes residual value guarantees is exposed to residual value risk). Risk variables that are relevant to disclosing market risk include, but are not limited to:

- (a) The yield curve of market interest rates. It may be necessary to consider both parallel and non-parallel shifts in the yield curve.
- (b) Foreign exchange rates.
- (c) Prices of equity instruments.
- (d) Market prices of commodities.

IG33. Paragraph 47(a) requires the sensitivity analysis to show the effect on surplus or deficit and net assets/equity of reasonably possible changes in the relevant risk variable. For example, relevant risk variables might include:

- (a) Prevailing market interest rates, for interest-sensitive financial instruments such as a variable rate loan; or
- (b) Currency rates and interest rates, for foreign currency financial instruments such as foreign currency bonds.

IG34. For interest rate risk, the sensitivity analysis might show separately the effect of a change in market interest rates on:

- (a) Interest revenue and expense;
- (b) Other line items of surplus or deficit (such as trading gains and losses); and
- (c) When applicable, net assets/equity.

An entity might disclose a sensitivity analysis for interest rate risk for each currency in which the entity has material exposures to interest rate risk.

- IG35. Because the factors affecting market risk vary depending on the specific circumstances of each entity, the appropriate range to be considered in providing a sensitivity analysis of market risk varies for each entity and for each type of market risk.
- IG36. The following example illustrates the application of the disclosure requirement in paragraph 47(a):

Interest Rate Risk

At December 31, 20X2, if interest rates at that date had been 10 basis points lower with all other variables held constant, surplus for the year would have been RM1.7 million (20X1—RM2.4 million) higher, arising mainly as a result of lower interest expense on variable borrowings, and other revenue would have been RM2.8 million (20X1—RM3.2 million) higher, arising mainly as a result of an increase in the fair value of fixed rate financial assets classified as available for sale. If interest rates had been 10 basis points higher, with all other variables held constant, surplus would have been RM1.5 million (20X1—RM2.1 million) lower, arising mainly as a result of higher interest expense on variable borrowings, revenue would have been RM3.0 million (20X1—RM3.4 million) lower, arising mainly as a result of a decrease in the fair value of fixed rate financial assets classified as available for sale. Surplus is more sensitive to interest rate decreases than increases because of borrowings with capped interest rates. The sensitivity is lower in 20X2 than in 20X1 because of a reduction in outstanding borrowings that has occurred as the entity's debt has matured (see note X). ^(a)

Foreign Currency Exchange Rate Risk

At December 31, 20X2, if the RM had weakened 10 percent against the US dollar with all other variables held constant, surplus for the year would have been RM2.8 million (20X1—RM6.4 million) lower, revenue would have been RM1.2 million (20X1—RM1.1 million) higher. Conversely, if the RM had strengthened 10 percent against the US dollar with all other variables held constant, surplus would have been RM2.8 million (20X1—RM6.4 million) higher, revenue would have been RM1.2 million (20X1—RM1.1 million) lower. The lower foreign currency exchange rate sensitivity in surplus in 20X2 compared with 20X1 is attributable to a reduction in foreign currency denominated debt. Revenue is more sensitive in 20X2 than in 20X1 because of the increased use of hedges of foreign currency purchases, offset by the reduction in foreign currency debt.

Paragraph 38(a) requires disclosure of a maturity analysis of liabilities.

Other Market Risk Disclosures (paragraph 49)

- IG37. Paragraph 49 requires the disclosure of additional information when the sensitivity analysis disclosed is unrepresentative of a risk inherent in a financial instrument. For example, this can occur when:
- (a) A financial instrument contains terms and conditions whose effects are not apparent from the sensitivity analysis (e.g., options that remain out of (or in) the money for the chosen change in the risk variable);
 - (b) Financial assets are illiquid (e.g., when there is a low volume of transactions in similar assets and an entity finds it difficult to find a counterparty); or
 - (c) An entity has a large holding of a financial asset that, if sold in its entirety, would be sold at a discount or premium to the quoted market price for a smaller holding.

IG38. In the situation in paragraph IG37(a), additional disclosure might include:

- (a) The terms and conditions of the financial instrument (e.g., the options);
- (b) The effect on surplus or deficit if the term or condition were met (i.e., if the options were exercised); and
- (c) A description of how the risk is hedged.

For example, an entity may acquire a zero cost interest rate collar that includes an out-of-the-money leveraged written option (e.g., the entity pays ten times the amount of the difference between a specified interest rate floor and the current market interest rate). The entity may regard the collar as an inexpensive economic hedge against a reasonably possible increase in interest rates. However, an unexpectedly large decrease in interest rates might trigger payments under the written option that, because of the leverage, might be significantly larger than the benefit of lower interest rates. Neither the fair value of the collar nor a sensitivity analysis based on reasonably possible changes in market variables would indicate this exposure. In this case, the entity might provide the additional information described above.

IG39. In the situation described in paragraph IG38(b), additional disclosure might include the reasons for the lack of liquidity and how the entity hedges the risk.

IG40. In the situation described in paragraph IG38(c), additional disclosure might include:

- (a) The nature of the security (e.g., entity name);
- (b) The extent of holding (e.g., 15 percent of the issued shares);
- (c) The effect on surplus or deficit; and
- (d) How the entity hedges the risk.

Comparison with IPSAS 30

MPSAS 30, *Financial Instruments: Disclosures*, is drawn primarily from IPSAS 30 (2018). Main difference between MPSAS 30 and IPSAS 30 are as follows:

- In paragraph 3(b), IPSAS 30 refers to IPSAS 39, *Employee Benefits*, whereas MPSAS 30 refers to MPSAS 25, *Employee Benefits*, in which drawn from IPSAS 25 that has been superseded by IPSAS 39. The MPSAS is yet to adopt IPSAS 39.

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MPSAS 31 - INTANGIBLE ASSETS

Acknowledgement

The Malaysian Public Sector Accounting Standard (MPSAS) 31 is based on International Public Sector Accounting Standard (IPSAS) 31, *Intangible Assets*, from the *Handbook of International Public Sector Accounting Pronouncements* of the International Public Sector Accounting Standards Board, published by the International Federation of Accountants (IFAC) in 2018 and is used with permission of IFAC.

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MPSAS 31 - INTANGIBLE ASSETS

History of MPSAS

This version includes amendments resulting from MPSASs issued up to December 2022.

MPSAS 31, *Intangible Assets* was issued in April 2014.

Since then, MPSAS 31 has been amended by the following MPSASs:

- *Improvements to MPSASs 2023* (issued December 2022)
- MPSAS 40, *Public Sector Combinations* (issued October 2021)
- MPSAS 37, *Joint Arrangements* (issued August 2016)
- MPSAS 35, *Consolidated Financial Statements* (issued March 2016)
- MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)* (issued November 2015)

Table of Amended Paragraphs in MPSAS 31

Paragraph Affected	How Affected	Affected By
3	Amended	Improvements to MPSASs 2023 December 2022 MPSAS 40 October 2021
4	Deleted	Improvements to MPSASs 2023 December 2022
5	Deleted	Improvements to MPSASs 2023 December 2022
6	Amended	MPSAS 37 August 2016 MPSAS 35 March 2016 MPSAS 40 October 2021
18	Amended	MPSAS 40 October 2021
18A	New	MPSAS 40 October 2021
24	Amended	MPSAS 40 October 2021
26A	New	MPSAS 40 October 2021
28	Amended	Improvements to MPSASs 2023 December 2022
39A	New	MPSAS 40 October 2021
39B	New	MPSAS 40 October 2021
39C	New	MPSAS 40 October 2021
39D	New	MPSAS 40 October 2021

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Paragraph Affected	How Affected	Affected By
39E	New	MPSAS 40 October 2021
40	Amended	MPSAS 40 October 2021
41	Amended	MPSAS 40 October 2021
66	Amended	MPSAS 40 October 2021
67	Amended	MPSAS 40 October 2021
79	Amended	Improvements to MPSASs 2023 December 2022
91	Amended	Improvements to MPSASs 2023 December 2022
93A	New	MPSAS 40 October 2021
96	Amended	Improvements to MPSASs 2023 December 2022
97	Amended	Improvements to MPSASs 2023 December 2022
97A	New	Improvements to MPSASs 2023 December 2022
97B	New	Improvements to MPSASs 2023 December 2022
97C	New	Improvements to MPSASs 2023 December 2022
110	Amended	Improvements to MPSASs 2023 December 2022
114A	New	MPSAS 40 October 2021
116	Amended	Improvements to MPSASs 2023 December 2022
117	Amended	Improvements to MPSASs 2023 December 2022 MPSAS 40 October 2021
129	Deleted	MPSAS 33 November 2015
130	Deleted	MPSAS 33 November 2015
131	Deleted	MPSAS 33 November 2015
131A	New	Improvements to MPSASs 2023 December 2022
132B	New	Improvements to MPSASs 2023 December 2022
132C	New	MPSAS 33 November 2015

MPSAS 31 – Intangible Assets

Paragraph Affected	How Affected	Affected By
132D	New	MPSAS 37 August 2016 MPSAS 35 March 2016
132E	New	Improvements to MPSASs 2023 December 2022
132F	New	Improvements to MPSASs 2023 December 2022
132G	New	Improvements to MPSASs 2023 December 2022
132H	New	MPSAS 40 October 2021
133	Amended	MPSAS 33 November 2015

MPSAS 31- INTANGIBLE ASSETS

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Comparison with IPSAS 31	

Malaysian Public Sector Accounting Standard (MPSAS) 31, *Intangible Assets*, is set out in paragraphs 1–133. All the paragraphs have equal authority. MPSAS 31, *Intangible Assets*, should be read in the context of its objective, and the *Preface to Malaysian Public Sector Accounting Standards*. MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Standard. This Standard requires an entity to recognize an intangible asset if, and only if, specified criteria are met. The Standard also specifies how to measure the carrying amount of intangible assets, and requires specified disclosures about intangible assets.

Scope

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for intangible assets.**
3. **This Standard shall be applied in accounting for intangible assets, except:**
 - (a) **Intangible assets that are within the scope of another Standard;**
 - (b) **Financial assets, as defined in MPSAS 28, *Financial Instruments: Presentation*;**
 - (c) **The recognition and measurement of exploration and evaluation assets (see the relevant international or national accounting standard dealing with exploration for, and evaluation of, mineral resources);**
 - (d) **Expenditure on the development and extraction of minerals, oil, natural gas and similar non-regenerative resources;**
 - (e) [Deleted]
 - (f) [Deleted]
 - (g) **Powers and rights conferred by legislation, a constitution, or by equivalent means;**
 - (h) **Deferred tax assets (see the relevant international or national accounting standard dealing with income taxes);**
 - (i) **Deferred acquisition costs, and intangible assets, arising from an insurer's contractual rights under insurance contracts within the scope of the relevant international or national accounting standard dealing with insurance contracts. In cases where the relevant international or national accounting standard does not set out specific disclosure requirements for those intangible assets, the disclosure requirements in this Standard apply to those intangible assets; and**
 - (j) [Deleted]
 - (k) **In respect of intangible heritage assets. However, the disclosure requirements of paragraphs 115–127 apply to those heritage assets that are recognized.**
4. [Deleted]
5. [Deleted]

6. If another MPSAS prescribes the accounting for a specific type of intangible asset, an entity applies that MPSAS instead of this Standard. For example, this Standard does not apply to:
 - (a) Intangible assets held by an entity for sale in the ordinary course of operations (see MPSAS 11, *Construction Contracts*, and MPSAS 12, *Inventories*);
 - (b) Leases that are within the scope of MPSAS 13, *Leases*;
 - (c) Assets arising from employee benefits (see MPSAS 25, *Employee Benefits*);
 - (d) Financial assets as defined in MPSAS 28, *Financial Instruments: Presentation*. The recognition and measurement of some financial assets are covered by MPSAS 34, *Separate Financial Statements*, MPSAS 35, *Consolidated Financial Statements*, and MPSAS 36, *Investments in Associates and Joint Ventures*;
 - (e) Recognition and initial measurement of service concession assets that are within the scope of MPSAS 32, *Service Concession Arrangements: Grantor*. However, this Standard applies to the subsequent measurement and disclosure of such assets; and
 - (f) Goodwill (see MPSAS 40, *Public Sector Combinations*).
7. Some intangible assets may be contained in or on a physical substance such as a compact disc (in the case of computer software), legal documentation (in the case of a license or patent), or film. In determining whether an asset that incorporates both intangible and tangible elements should be treated under MPSAS 17, *Property, Plant and Equipment*, or as an intangible asset under this Standard, an entity uses judgement to assess which element is more significant. For example, the navigation software for a fighter aircraft is integral to the aircraft and is treated as property, plant and equipment. The same applies to the operating system of a computer. When the software is not an integral part of the related hardware, computer software is treated as an intangible asset.
8. This Standard applies to, among other things, expenditure on advertising, training, start-up, research, and development activities. Research and development activities are directed to the development of knowledge. Therefore, although these activities may result in an asset with physical substance (e.g., a prototype), the physical element of the asset is secondary to its intangible component, i.e., the knowledge embodied in it.
9. In the case of a finance lease, the underlying asset may be either tangible or intangible. After initial recognition, a lessee accounts for an intangible asset held under a finance lease in accordance with this Standard. Rights under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents, and copyrights are excluded from the scope of MPSAS 13, *Leases*, and are within the scope of this Standard.
10. Exclusions from the scope of a Standard may occur if activities or transactions are so specialized that they give rise to accounting issues that may need to be dealt with in a different way. Such issues arise in the accounting for expenditure on the exploration for, or development and extraction of, oil, gas, and mineral deposits in extractive industries, and in the case of insurance contracts. Therefore, this Standard does not apply to expenditure on such activities and contracts. However, this Standard applies to other intangible assets used (such as computer software), and other expenditure incurred (such as start-up costs), in extractive industries, or by insurers.

Intangible Heritage Assets

11. This Standard does not require an entity to recognize intangible heritage assets that would otherwise meet the definition of, and recognition criteria for, intangible assets. If an entity does recognize intangible heritage assets, it must apply the disclosure requirements of this Standard and may, but is not required to, apply the measurement requirements of this Standard.
12. Some intangible assets are described as intangible heritage assets because of their cultural, environmental, or historical significance. Examples of intangible heritage assets include recordings of significant historical events and rights to use the likeness of a significant public person on, for example, postage stamps or collectible coins. Certain characteristics, including the following, are often displayed by intangible heritage assets (although these characteristics are not exclusive to such assets):
 - (a) Their value in cultural, environmental, and historical terms is unlikely to be fully reflected in a financial value based purely on a market price;
 - (b) Legal and/or statutory obligations may impose prohibitions or severe restrictions on disposal by sale;
 - (c) Their value may increase over time; and
 - (d) It may be difficult to estimate their useful lives, which in some cases could be several hundred years.
13. Public sector entities may have large holdings of intangible heritage assets that have been acquired over many years and by various means, including purchase, donation, bequest, and sequestration. These assets are rarely held for their ability to generate cash inflows, and there may be legal or social obstacles to using them for such purposes.
14. Some intangible heritage assets have future economic benefits or service potential other than their heritage value, for example, royalties paid to the entity for use of an historical recording. In these cases, an intangible heritage asset may be recognized and measured on the same basis as other items of cash-generating intangible assets. For other intangible heritage assets, their future economic benefit or service potential is limited to their heritage characteristics. The existence of both future economic benefits and service potential can affect the choice of measurement base.
15. The disclosure requirements in paragraphs 117–124 require entities to make disclosures about recognized intangible assets. Therefore, entities that recognize intangible heritage assets are required to disclose in respect of those assets such matters as, for example:
 - (a) The measurement basis used;
 - (b) The amortization method used, if any;
 - (c) The gross carrying amount;
 - (d) The accumulated amortization at the end of the period, if any; and
 - (e) A reconciliation of the carrying amount at the beginning and end of the period showing certain components thereof.

Definitions

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

Amortization is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

Carrying amount is the amount at which an asset is recognized after deducting any accumulated amortization and accumulated impairment losses.

Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.

An **intangible asset** is an identifiable non-monetary asset without physical substance.

Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

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

Intangible Assets

17. Entities frequently expend resources, or incur liabilities, on the acquisition, development, maintenance, or enhancement of intangible resources such as scientific or technical knowledge, design and implementation of new processes, or systems, licences, intellectual property, and trademarks (including brand names and publishing titles). Common examples of items encompassed by these broad headings are computer software, patents, copyrights, motion picture films, lists of users of a service, acquired fishing licences, acquired import quotas, and relationships with users of a service.

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 recognized as an expense when it is incurred. However, if the item is acquired in an acquisition, it forms part of the goodwill recognized at the acquisition date (see paragraph 66).
- 18A. The definition of an intangible asset requires an intangible asset to be identifiable to distinguish it from goodwill. Goodwill recognized 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 recognized. 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.

19. **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 contract, 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.**
20. For the purposes of this Standard, a binding arrangement describes an arrangement that confers similar rights and obligations on the parties to it as if it were in the form of a contract.

Control of an Asset

21. An entity controls an asset if the entity has the power to obtain the future economic benefits or service potential flowing from the underlying resource and to restrict the access of others to those benefits or that service potential. The capacity of an entity to control the future economic benefits or service potential from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control because an entity may be able to control the future economic benefits or service potential in some other way.
22. Scientific or technical knowledge may give rise to future economic benefits or service potential. An entity controls those benefits or that service potential if, for example, the knowledge is protected by legal rights such as copyrights, a restraint of trade agreement (where permitted), or by a legal duty on employees to maintain confidentiality.
23. An entity may have a team of skilled staff and may be able to identify incremental staff skills leading to future economic benefits or service potential from training. The entity may also expect that the staff will continue to make their skills available to the entity. However, an entity usually has insufficient control over the expected future economic benefits or service potential arising from a team of skilled staff and from training for these items to meet the definition of an intangible asset. For a similar reason, specific management or technical talent is unlikely to meet the definition of an intangible asset, unless it is protected by legal rights to use it and to obtain the future economic benefits or service potential expected from it, and it also meets the other parts of the definition.
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.

Future Economic Benefits or Service Potential

25. The future economic benefits or service potential flowing from an intangible asset may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the entity. For example, the use of intellectual property in a production or service process may reduce future production or service costs or improve service delivery rather than increase future revenues (e.g., an on-line system that allows citizens to renew driving licences more quickly on-line, resulting in a reduction in office staff required to perform this function while increasing the speed of processing).

Recognition and Measurement

26. The recognition of an item as an intangible asset requires an entity to demonstrate that the item meets:
- (a) The definition of an intangible asset (see paragraphs 17–25); and
 - (b) The recognition criteria (see paragraphs 28–30).

This requirement applies to the cost measured at recognition (the cost in an exchange transaction or to internally generate an intangible asset, or the fair value of an intangible asset acquired through a non-exchange transaction) and those incurred subsequently to add to, replace part of, or service it.

- 26A. Paragraphs 32–39 deal with the application of the recognition criteria to separately acquired intangible assets, and paragraphs 39A–41 deal with their application to intangible assets acquired in a public sector 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.
27. The nature of intangible assets is such that, in many cases, there are no additions to such an asset or replacements of part of it. Accordingly, most subsequent expenditures are likely to maintain the expected future economic benefits or service potential embodied in an existing intangible asset rather than meet the definition of an intangible asset and the recognition criteria in this Standard. In addition, it is often difficult to attribute subsequent expenditure directly to a particular intangible asset rather than to the entity's operations as a whole. Therefore, only rarely will subsequent expenditure—expenditure incurred after the initial recognition of an acquired intangible asset or after completion of an internally generated intangible asset—be recognized in the carrying amount of an asset. Consistent with paragraph 61, subsequent expenditure on brands, mastheads, publishing titles, lists users of a service, and items similar in substance (whether externally acquired or internally generated) is always recognized in surplus or deficit as incurred. This is because such expenditure cannot be distinguished from expenditure to develop the entity's operations as a whole.
28. **An intangible asset shall be recognized if, and only if:**
- (a) **It is probable that the expected future economic benefits or service potential that are attributable to the asset will flow to the entity; and**

- (b) **The cost or fair value of the asset can be measured reliably¹.**
29. **An entity shall assess the probability of expected future economic benefits or service potential using reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the useful life of the asset.**
30. An entity uses judgement to assess the degree of certainty attached to the flow of future economic benefits or service potential that are attributable to the use of the asset on the basis of the evidence available at the time of initial recognition, giving greater weight to external evidence.
31. **An intangible asset shall be measured initially at cost in accordance with paragraphs 32–43. Where an intangible asset is acquired through a non-exchange transaction, its initial cost at the date of acquisition, shall be measured at its fair value as at that date.**

Separate Acquisition

32. Normally, the price an entity pays to acquire separately an intangible asset will reflect expectations about the probability that the expected 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 separately acquired intangible assets.
33. In addition, the cost of a separately acquired intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.
34. The cost of a separately acquired intangible asset comprises:
- (a) Its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; and
 - (b) Any directly attributable cost of preparing the asset for its intended use.
35. Examples of directly attributable costs are:
- (a) Costs of employee benefits (as defined in MPSAS 25, *Employee Benefits*) arising directly from bringing the asset to its working condition;
 - (b) Professional fees arising directly from bringing the asset to its working condition; and
 - (c) Costs of testing whether the asset is functioning properly.
36. Examples of expenditures that are not part of the cost of an intangible asset are:
- (a) Costs of introducing a new product or service (including costs of advertising and promotional activities);

¹ Information that is reliable is free from material error and bias, and can be depended on by users to faithfully represent that which it purports to represent or could reasonably be expected to represent.

- (b) Costs of conducting operations in a new location or with a new class of users of a service (including costs of staff training); and
 - (c) Administration and other general overhead costs.
- 37. Recognition of costs in the carrying amount of an intangible asset ceases when the asset is in the condition necessary for it to be capable of operating in the manner intended by management. Therefore, costs incurred in using or redeploying an intangible asset are not included in the carrying amount of that asset. For example, the following costs are not included in the carrying amount of an intangible asset:
 - (a) Costs incurred while an asset capable of operating in the manner intended by management has yet to be brought into use; and
 - (b) Initial operating deficits, such as those incurred while demand for the asset's output builds up.
- 38. Some operations occur in connection with the development of an intangible asset, but are not necessary to bring the asset to the condition necessary for it to be capable of operating in the manner intended by management. These incidental operations may occur before or during the development activities. Because incidental operations are not necessary to bring an asset to the condition necessary for it to be capable of operating in the manner intended by management, the revenue and related expenses of incidental operations are recognized immediately in surplus or deficit, and included in their respective classifications of revenue and expense.
- 39. If payment for an intangible asset is deferred beyond normal credit terms, its cost is the cash price equivalent. The difference between this amount and the total payments is recognized as interest expense over the period of credit unless it is capitalized in accordance with the capitalization treatment permitted in MPSAS 5, *Borrowing Costs*.

Acquisition of an intangible asset as part of an acquisition (public sector combination)

- 39A. In accordance with MPSAS 40, *Public Sector Combinations*, if an intangible asset is acquired in an acquisition, the cost of that intangible asset is its fair value at the acquisition date. The fair value of an intangible asset will reflect market participants' expectations at the acquisition date about the probability that the expected 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. If an asset acquired in an acquisition is separable or arises from binding arrangements (including rights from contracts 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.
- 39B. In accordance with this Standard and MPSAS 40, *Public Sector Combinations*, an acquirer recognizes at the acquisition date, separately from goodwill, an intangible asset of the acquired operation, irrespective of whether the asset had been recognized by the acquired operation before the acquisition. This means that the acquirer recognizes as an asset separately from goodwill an in-process research and development project of the acquired operation if the project meets the definition of an intangible asset. An acquired operation'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 or other legal rights).

Intangible asset acquired in an acquisition (public sector combination)

- 39C. If an intangible asset acquired in an acquisition is separable or arises from a binding arrangement (including rights from contracts 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. An intangible asset acquired in an acquisition might be separable, but only together with a related binding arrangement, identifiable asset or liability. In such cases, the acquirer recognizes the intangible asset separately from goodwill, but together with the related item.
- 39E. The acquirer may recognize a group of complementary intangible assets as a single asset provided the individual assets have similar useful lives. For example, the terms 'brand' and 'brand name' are often used as synonyms for trademarks and other marks. However, the former are general marketing terms that are typically used to refer to a group of complementary assets such as a trademark (or service mark) and its related trade name, formulas, recipes and technological expertise.

Subsequent Expenditure on an Acquired In-process Research and Development Project

- 40. **Research or development expenditure that:**
 - (a) **Relates to an in-process research or development project acquired separately or in an acquisition and recognized as an intangible asset; and**
 - (b) **Is incurred after the acquisition of that project;**

shall be accounted for in accordance with paragraphs 52–60.
- 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 recognized as an intangible asset is:
 - (a) Recognized as an expense when incurred if it is research expenditure;
 - (b) Recognized as an expense when incurred if it is development expenditure that does not satisfy the criteria for recognition as an intangible asset in paragraph 55; and
 - (c) Added to the carrying amount of the acquired in-process research or development project if it is development expenditure that satisfies the recognition criteria in paragraph 55.

Intangible Assets Acquired through Non-Exchange Transactions

- 42. In some cases, an intangible asset may be acquired through a non-exchange transaction. This may happen when another public sector entity transfers to an entity in a non-exchange

transaction, intangible assets such as airport landing rights, licences to operate radio or television stations, import licences or quotas or rights to access other restricted resources. A private citizen, for example a Nobel Prize winner, may bequeath his or her personal papers, including the copyright to his or her publications to the national archives (a public sector entity) in a non-exchange transaction.

43. Under these circumstances the cost of the item is its fair value at the date it is acquired. For the purposes of this Standard, the measurement at recognition of an intangible asset acquired through a non-exchange transaction, at its fair value consistent with the requirements of paragraph 74, does not constitute a revaluation. Accordingly, the revaluation requirements in paragraph 74, and the supporting commentary in paragraphs 75–86 only apply when an entity elects to revalue an intangible item in subsequent reporting periods.

Exchanges of Assets

44. One or more intangible assets may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. The following discussion refers simply to an exchange of one non-monetary asset for another, but it also applies to all exchanges described in the preceding sentence. The cost of such an intangible asset is measured at fair value unless the fair value of neither the asset received nor the asset given up is reliably measurable. The acquired asset is measured in this way even if an entity cannot immediately derecognize the asset given up. If the acquired asset is not measured at fair value, its cost is measured at the carrying amount of the asset given up.
45. Paragraph 28(b) specifies that a condition for the recognition of an intangible asset is that the cost of the asset can be measured reliably. The fair value of an intangible asset for which comparable market transactions do not exist is reliably measurable if:
- (a) The variability in the range of reasonable fair value estimates is not significant for that asset: or
 - (b) The probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value.

If an entity is able to determine reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure cost unless the fair value of the asset received is more clearly evident.

Internally Generated Goodwill

46. **Internally generated goodwill shall not be recognized as an asset.**
47. In some cases, expenditure is incurred to generate future economic benefits or service potential, but it does not result in the creation of an intangible asset that meets the recognition criteria in this Standard. Such expenditure is often described as contributing to internally generated goodwill. Internally generated goodwill is not recognized as an asset because it is not an identifiable resource (i.e., it is not separable nor does it arise from binding arrangements) (including rights from contracts or other legal rights) controlled by the entity that can be measured reliably at cost.
48. Differences between the market value of an entity and the carrying amount of its identifiable net assets at any time may capture a range of factors that affect the value of the entity. However, such differences do not represent the cost of intangible assets controlled by the entity.

Internally Generated Intangible Assets

49. It is sometimes difficult to assess whether an internally generated intangible asset qualifies for recognition because of problems in:

- (a) Identifying whether and when there is an identifiable asset that will generate expected future economic benefits or service potential; and
- (b) Determining the cost of the asset reliably. In some cases, the cost of generating an intangible asset internally cannot be distinguished from the cost of maintaining or enhancing the entity's internally generated goodwill or of running day-to-day operations.

Therefore, in addition to complying with the general requirements for the recognition and initial measurement of an intangible asset, an entity applies the requirements and guidance in paragraphs 50–65 to all internally generated intangible assets.

50. To assess whether an internally generated intangible asset meets the criteria for recognition, an entity classifies the generation of the asset into:

- (a) A research phase; and
- (b) A development phase.

Although the terms “research” and “development” are defined, the terms “research phase” and “development phase” have a broader meaning for the purpose of this Standard.

51. If an entity cannot distinguish the research phase from the development phase of an internal project to create an intangible asset, the entity treats the expenditure on that project as if it were incurred in the research phase only.

Research Phase

52. **No intangible asset arising from research (or from the research phase of an internal project) shall be recognized. Expenditure on research (or on the research phase of an internal project) shall be recognized as an expense when it is incurred.**

53. In the research phase of an internal project, an entity cannot demonstrate that an intangible asset exists that will generate probable future economic benefits or service potential. Therefore, this expenditure is recognized as an expense when it is incurred.

54. Examples of research activities are:

- (a) Activities aimed at obtaining new knowledge;
- (b) The search for, evaluation and final selection of, applications of research findings or other knowledge;
- (c) The search for alternatives for materials, devices, products, processes, systems, or services; and
- (d) The formulation, design, evaluation, and final selection of possible alternatives for new or improved materials, devices, products, processes, systems, or services.

Development Phase

55. **An intangible asset arising from development (or from the development phase of an internal project) shall be recognized if, and only if, an entity can demonstrate all of the following:**
- (a) **The technical feasibility of completing the intangible asset so that it will be available for use or sale;**
 - (b) **Its intention to complete the intangible asset and use or sell it;**
 - (c) **Its ability to use or sell the intangible asset;**
 - (d) **How the intangible asset will generate probable future economic benefits or service potential. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;**
 - (e) **The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and**
 - (f) **Its ability to measure reliably the expenditure attributable to the intangible asset during its development.**
56. In the development phase of an internal project, an entity can, in some instances, identify an intangible asset and demonstrate that the asset will generate probable future economic benefits or service potential. This is because the development phase of a project is further advanced than the research phase.
57. Examples of development activities are:
- (a) The design, construction, and testing of pre-production or pre-use prototypes and models;
 - (b) The design of tools, jigs, moulds, and dies involving new technology;
 - (c) The design, construction, and operation of a pilot plant or operation that is not of a scale economically feasible for commercial production or use in providing services;
 - (d) The design, construction, and testing of a chosen alternative for new or improved materials, devices, products, processes, systems, or services; and
 - (e) Website costs and software development costs.
58. To demonstrate how an intangible asset will generate probable future economic benefits or service potential, an entity assesses the future economic benefits or service potential to be received from the asset using the principles in either MPSAS 21, *Impairment of Non-Cash-Generating Assets*, or MPSAS 26, *Impairment of Cash-Generating Assets*, as appropriate. If the asset will generate economic benefits or service potential only in combination with other assets, the entity applies the concept of cash-generating units in MPSAS 26, *Impairment of Cash-Generating Assets*.

59. Availability of resources to complete, use, and obtain the benefits from an intangible asset can be demonstrated by, for example, an operating plan showing the technical, financial, and other resources needed and the entity's ability to secure those resources. In some cases, an entity demonstrates the availability of external finance by obtaining a lender's or funder's indication of its willingness to fund the plan.
60. An entity's costing systems can often measure reliably the cost of generating an intangible asset internally, such as salary and other expenditure incurred in securing logos, copyrights or licences, or developing computer software.
61. **Internally generated brands, mastheads, publishing titles, lists of users of a service, and items similar in substance shall not be recognized as intangible assets.**
62. Expenditure on internally generated brands, mastheads, publishing titles, lists of users of a service, and items similar in substance cannot be distinguished from the cost of developing the entity's operations as a whole. Therefore, such items are not recognized as intangible assets.

Cost of an Internally Generated Intangible Asset

63. The cost of an internally generated intangible asset for the purpose of paragraph 31 is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria in paragraphs 28, 29, and 55. Paragraph 70 prohibits reinstatement of expenditure previously recognized as an expense.
64. The cost of an internally generated intangible asset comprises all directly attributable costs necessary to create, produce, and prepare the asset to be capable of operating in the manner intended by management. Examples of directly attributable costs are:
 - (a) Costs of materials and services used or consumed in generating the intangible asset;
 - (b) Costs of employee benefits (as defined in MPSAS 25, *Employee Benefits*) arising from the generation of the intangible asset;
 - (c) Fees to register a legal right; and
 - (d) Amortization of patents and licences that are used to generate the intangible asset.

MPSAS 5, *Borrowing Costs*, specifies criteria for the recognition of interest as an element of the cost of an asset that is a qualifying asset.

65. The following are not components of the cost of an internally generated intangible asset:
 - (a) Selling, administrative and other general overhead expenditure unless this expenditure can be directly attributed to preparing the asset for use;
 - (b) Identified inefficiencies and initial operating deficits incurred before the asset achieves planned performance; and
 - (c) Expenditure on training staff to operate the asset.

Recognition of an Expense

66. **Expenditure on an intangible item shall be recognized 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 and cannot be recognized as an intangible asset. If this is the case, it forms part of the amount recognized as goodwill at the acquisition date (see MPSAS 40, *Public Sector Combinations*).**
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 recognized. In the case of the supply of goods, the entity recognizes such expenditure as an expense when it has a right to access those goods. In the case of the supply of services, the entity recognizes the expenditure as an expense when it receives the services. For example, expenditure on research is recognized as an expense when it is incurred (see paragraph 52) except when it is acquired as part of an acquisition. Other examples of expenditure that is recognized as an expense when it is incurred include:
- (a) Expenditure on start-up activities (i.e., start-up costs), unless this expenditure is included in the cost of an item of property, plant, and equipment in accordance with MPSAS 17, *Property, Plant, and Equipment*. Start-up costs may consist of establishment costs such as legal and secretarial costs incurred in establishing a legal entity, expenditure to open a new facility or operation (i.e., pre-opening costs), or expenditures for starting new operations or launching new products or processes (i.e., pre-operating costs);
 - (b) Expenditure on training activities;
 - (c) Expenditure on advertising and promotional activities (including mail order catalogues and information pamphlets); and
 - (d) Expenditure on relocating or reorganizing part or all of an entity.
68. An entity has a right to access goods when it owns them. Similarly, it has a right to access goods when they have been constructed by a supplier in accordance with the terms of a supply contract and the entity could demand delivery of them in return for payment. Services are received when they are performed by a supplier in accordance with a contract to deliver them to the entity and not when the entity uses them to deliver another service, for example, to deliver information about a service to users of that service.
69. Paragraph 66 does not preclude an entity from recognizing a prepayment as an asset when payment for goods has been made in advance of the entity obtaining a right to access those goods. Similarly, paragraph 66 does not preclude an entity from recognizing a prepayment as an asset when payment for services has been made in advance of the entity receiving those services.

Past Expenses not to be Recognized as an Asset

70. **Expenditure on an intangible item that was initially recognized as an expense under this Standard shall not be recognized as part of the cost of an intangible asset at a later date.**

Subsequent Measurement

71. **An entity shall choose either the cost model in paragraph 73 or the revaluation model in paragraph 74 as its accounting policy. If an intangible asset is accounted for using the revaluation model, all the other assets in its class shall also be accounted for using the same model, unless there is no active market for those assets.**
72. A class of intangible assets is a grouping of assets of a similar nature and use in an entity's operations. The items within a class of intangible assets are revalued simultaneously to avoid selective revaluation of assets and the reporting of amounts in the financial statements representing a mixture of costs and values as at different dates.

Cost Model

73. **After initial recognition, an intangible asset shall be carried at its cost less any accumulated amortization and any accumulated impairment losses.**

Revaluation Model

74. **After initial recognition, an intangible asset shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated amortization. For the purpose of revaluations under this Standard, fair value shall be determined by reference to an active market. Revaluations shall be made with such regularity that at the reporting date the carrying amount of the asset does not differ materially from its fair value.**
75. The revaluation model does not allow:
- (a) The revaluation of intangible assets that have not previously been recognized as assets; or
 - (b) The initial recognition of intangible assets at amounts other than cost.
76. The revaluation model is applied after an asset has been initially recognized at cost. However, if only part of the cost of an intangible asset is recognized as an asset because the asset did not meet the criteria for recognition until part of the way through the process (see paragraph 63), the revaluation model may be applied to the whole of that asset. Also, the revaluation model may be applied to an intangible asset that was received through a non-exchange transaction (see paragraphs 42–43).
77. It is uncommon for an active market to exist for an intangible asset, although this may happen. For example, in some jurisdictions, an active market may exist for freely transferable homogeneous classes of licences or production quotas the entity has acquired from another entity. However, an active market cannot exist for brands, newspaper mastheads, music and film publishing rights, patents, or trademarks, because each such asset is unique. Also, although intangible assets are bought and sold, contracts are negotiated between individual buyers and sellers, and transactions are relatively infrequent. For these reasons, the price paid for one asset may not provide sufficient evidence of the fair value of another. Moreover, prices are often not available to the public.
78. The frequency of revaluations depends on the volatility of the fair values of the intangible assets being revalued. If the fair value of a revalued asset differs materially from its carrying

amount, a further revaluation is necessary. Some intangible assets may experience significant and volatile movements in fair value, thus necessitating annual revaluation. Such frequent revaluations are unnecessary for intangible assets with only insignificant movements in fair value.

79. When an intangible asset is revalued, the carrying amount of that asset is adjusted to the revalued amount. At the date of the revaluation, the asset is treated in one of the following ways:
 - (a) The gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset. For example, the gross carrying amount may be restarted by reference to observable market data or it may be restarted proportionately to the change in the carrying amount. The accumulated amortization at the date of the revaluation is adjusted to equal the differences between the gross carrying amount and the carrying amount of the asset after taking into account accumulated impairment losses; or
 - (b) The accumulated amortization is eliminated against the gross carrying amount of the asset.

The amount of the adjustment of accumulated amortization forms part of the increase or decrease in the carrying amount that accounted for in accordance with paragraphs 84 and 85.

80. **If an intangible asset in a class of revalued intangible assets cannot be revalued because there is no active market for this asset, the asset shall be carried at its cost less any accumulated amortization and impairment losses.**
81. **If the fair value of a revalued intangible asset can no longer be determined by reference to an active market, the carrying amount of the asset shall be its revalued amount at the date of the last revaluation by reference to the active market less any subsequent accumulated amortization and any subsequent accumulated impairment losses.**
82. The fact that an active market no longer exists for a revalued intangible asset may indicate that the asset may be impaired and that it needs to be tested in accordance with MPSAS 21, *Impairment of Non-Cash-Generating Assets*, or MPSAS 26, *Impairment of Cash-Generating Assets*, as appropriate.
83. If the fair value of the asset can be determined by reference to an active market at a subsequent measurement date, the revaluation model is applied from that date.
84. **If an intangible asset's carrying amount is increased as a result of a revaluation, the increase shall be credited directly to revaluation surplus. However, the increase shall be recognized in surplus or deficit to the extent that it reverses a revaluation decrease of the same asset previously recognized in surplus or deficit.**
85. **If an intangible asset's carrying amount is decreased as a result of a revaluation, the decrease shall be recognized in surplus or deficit. However, the decrease shall be recognized directly in net assets/equity to the extent of any credit balance in the revaluation surplus in respect of that asset. The decrease recognized directly in net assets/equity reduces the amount accumulated in net assets/equity under the heading of revaluation surplus.**

86. The cumulative revaluation surplus included in net assets/equity may be transferred directly to accumulated surpluses or deficits when the surplus is realized. The whole surplus may be realized on the retirement or disposal of the asset. However, some of the surplus may be realized as the asset is used by the entity; in such a case, the amount of the surplus realized is the difference between amortization based on the revalued carrying amount of the asset and amortization that would have been recognized based on the asset's historical cost. The transfer from revaluation surplus to accumulated surpluses or deficits is not made through surplus or deficit.

Useful Life

87. **An entity shall assess whether the useful life of an intangible asset is finite or indefinite and, if finite, the length of, or number of production or similar units constituting, that useful life. An intangible asset shall be regarded by the entity as having an indefinite useful life when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for, or provide service potential to, the entity.**
88. The accounting for an intangible asset is based on its useful life. An intangible asset with a finite useful life is amortized (see paragraphs 96–105), and an intangible asset with an indefinite useful life is not (see paragraphs 106–109). The Illustrative Examples accompanying this Standard illustrate the determination of useful life for different intangible assets, and the subsequent accounting for those assets based on the useful life determinations.
89. Many factors are considered in determining the useful life of an intangible asset, including:
- (a) The expected usage of the asset by the entity and whether the asset could be managed efficiently by another management team;
 - (b) Typical product life cycles for the asset and public information on estimates of useful lives of similar assets that are used in a similar way;
 - (c) Technical, technological, commercial, or other types of obsolescence;
 - (d) The stability of the industry in which the asset operates and changes in the market demand for the products or services output from the asset;
 - (e) Expected actions by competitors or potential competitors;
 - (f) The level of maintenance expenditure required to obtain the expected future economic benefits or service potential from the asset and the entity's ability and intention to reach such a level;
 - (g) The period of control over the asset and legal or similar limits on the use of the asset, such as the expiry dates of related leases; and
 - (h) Whether the useful life of the asset is dependent on the useful life of other assets of the entity.
90. The term "indefinite" does not mean "infinite." The useful life of an intangible asset reflects only that level of future maintenance expenditure required to maintain the asset at its standard of performance assessed at the time of estimating the asset's useful life, and the entity's ability

and intention to reach such a level. A conclusion that the useful life of an intangible asset is indefinite should not depend on planned future expenditure in excess of that required to maintain the asset at that standard of performance.

91. Given the history of rapid changes in technology, computer software and many other intangible assets are susceptible to technological obsolescence. Therefore, it will often be the case that their useful life is short. Expected future reductions in the selling price of an item that was produced using an intangible asset could indicate the expectation of technological or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits or service potential embodied in the asset.
92. The useful life of an intangible asset may be very long or even indefinite. Uncertainty justifies estimating the useful life of an intangible asset on a prudent basis, but it does not justify choosing a life that is unrealistically short.
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.**
- 93A. **The useful life of:**
 - (a) **A license or similar right previously granted by one combining operation to another combining operation that is recognized by the resulting entity in an amalgamation; or**
 - (b) **A reacquired right recognized 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.**
94. There may be economic, political, social, and legal factors influencing the useful life of an intangible asset. Economic, political, or social factors determine the period over which future economic benefits or service potential will be received by the entity. Legal factors may restrict the period over which the entity controls access to such economic benefits or service potential. The useful life is the shorter of the periods determined by these factors.
95. Existence of the following factors, among others, indicates that an entity would be able to renew the binding arrangements (including rights from contracts or other legal rights) without significant cost:
 - (a) There is evidence, possibly based on experience, that the binding arrangements (including rights from contracts or other legal rights) will be renewed. If renewal is contingent upon the consent of a third party, this includes evidence that the third party will give its consent;
 - (b) There is evidence that any conditions necessary to obtain renewal will be satisfied; and

- (c) The cost to the entity of renewal is not significant when compared with the future economic benefits or service potential expected to flow to the entity from renewal.

If the cost of renewal is significant when compared with the future economic benefits or service potential expected to flow to the entity from renewal, the “renewal” cost represents, in substance, the cost to acquire a new intangible asset at the renewal date.

Intangible Assets with Finite Useful Lives

Amortization Period and Amortization Method

96. **The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life. Amortization shall begin when the asset is available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Amortization shall cease at the date that the asset is derecognized. The amortization method used shall reflect the pattern in which the asset’s future economic benefits or service potential are expected to be consumed by the entity. If that pattern cannot be determined reliably, the straight-line method shall be used. The amortization charge for each period shall be recognized in surplus or deficit unless this or another Standard permits or requires it to be included in the carrying amount of another asset.**
97. A variety of amortization methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method, and the units of production method. The method used is selected on the basis of the expected pattern of consumption of the expected future economic benefits or service potential embodied in the asset and is applied consistently from period to period, unless there is a change in the expected pattern of consumption of those future economic benefits or service potential.
- 97A. There is a rebuttable presumption that an amortization method that is based on the revenue generated by an activity that includes the use of an intangible asset is inappropriate. The revenue generated by an activity that includes the use of an intangible asset typically reflects factors that are not directly linked to the consumption of the economic benefits or service potential embodied in the intangible asset. For example, revenue is affected by other inputs and processes, selling activities and changes in sales volumes and prices. The price component of revenue may be affected by inflation, which has no bearing upon the way in which an asset is consumed. This presumption can be overcome only in the limited circumstances:
- (a) In which the intangible asset is expressed as a measure of revenue, as described in paragraph 97C; or
 - (b) When it can be demonstrated that revenue and the consumption of the economic benefits or service potential of the intangible asset are highly correlated.
- 97B. In choosing an appropriate amortization method in accordance with paragraph 97, an entity could determine the predominant limiting factor that is inherent in the intangible asset. For example, the contract that sets out the entity’s rights over its use of an intangible asset might specify the entity’s use of the intangible asset as a predetermined number of years (i.e., time), as a number of units produced or as a fixed total amount of revenue to be generated. Identification of such predominant limiting factor could serve as the starting point for the

identification of the appropriate basis of amortization, but another basis may be applied if it more closely reflects the expected pattern of consumption of economic benefits or service potential.

- 97C. In the circumstance in which the predominant limiting factor that is inherent in an intangible asset is the achievement of a revenue threshold, the revenue to be generated can be an appropriate basis for amortization. For example, the right to be operate a toll road could be based on a fixed total amount of revenue to be generated from cumulative tolls charged (for example, a contract could allow operation of the toll road until the cumulative amount of tolls generated from operating the road reaches RM100 million). In the case in which revenue has been established as the predominant limiting factor in the contract for the use of the intangible asset, the revenue that is to be generated might be an appropriate basis for amortizing the intangible asset, provided that the contract specifies a fixed total amount of revenue to be generated on which amortization is to be determined.
98. Amortization is usually recognized in surplus or deficit. However, sometimes the future economic benefits or service potential embodied in an asset are absorbed in producing other assets. In this case, the amortization charge constitutes part of the cost of the other asset and is included in its carrying amount. For example, the amortization of intangible assets used in a production process is included in the carrying amount of inventories (see MPSAS 12, *Inventories*).

Residual Value

99. **The residual value of an intangible asset with a finite useful life shall be assumed to be zero unless:**
- (a) **There is a commitment by a third party to acquire the asset at the end of its useful life; or**
 - (b) **There is an active market for the asset, and:**
 - (i) **Residual value can be determined by reference to that market; and**
 - (ii) **It is probable that such a market will exist at the end of the asset's useful life.**
100. The depreciable amount of an asset with a finite useful life is determined after deducting its residual value. A residual value other than zero implies that an entity expects to dispose of the intangible asset before the end of its economic life.
101. An estimate of an asset's residual value is based on the amount recoverable from disposal using prices prevailing at the date of the estimate for the sale of a similar asset that has reached the end of its useful life and has operated under conditions similar to those in which the asset will be used. The residual value is reviewed at least at each reporting date. A change in the asset's residual value is accounted for as a change in an accounting estimate in accordance with MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.
102. The residual value of an intangible asset may increase to an amount equal to or greater than the asset's carrying amount. If it does, the asset's amortization charge is zero unless and until its residual value subsequently decreases to an amount below the asset's carrying amount.

Review of Amortization Period and Amortization Method

103. **The amortization period and the amortization method for an intangible asset with a finite useful life shall be reviewed at least at each reporting date. If the expected useful life of the asset is different from previous estimates, the amortization period shall be changed accordingly. If there has been a change in the expected pattern of consumption of the future economic benefits or service potential embodied in the asset, the amortization method shall be changed to reflect the changed pattern. Such changes shall be accounted for as changes in accounting estimates in accordance with MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.**
104. During the life of an intangible asset, it may become apparent that the estimate of its useful life is inappropriate. For example, the recognition of an impairment loss may indicate that the amortization period needs to be changed.
105. Over time, the pattern of future economic benefits or service potential expected to flow to an entity from an intangible asset may change. For example, it may become apparent that a diminishing balance method of amortization is appropriate rather than a straight-line method. Another example is if use of the rights represented by a licence is deferred pending action on other components of the entity's strategic plan. In this case, economic benefits or service potential that flow from the asset may not be received until later periods.

Intangible Assets with Indefinite Useful Lives

106. **An intangible asset with an indefinite useful life shall not be amortized.**
107. In accordance with MPSAS 21, *Impairment of Non-Cash-Generating Assets*, and MPSAS 26, *Impairment of Cash-Generating Assets*, an entity is required to test an intangible asset with an indefinite useful life or an intangible asset not yet available for use for impairment by comparing its recoverable service amount or its recoverable amount, as appropriate, with its carrying amount:
- (a) Annually; and
 - (b) Whenever there is an indication that the intangible asset may be impaired.

Review of Useful Life Assessment

108. **The useful life of an intangible asset that is not being amortized shall be reviewed each reporting period to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite shall be accounted for as a change in an accounting estimate in accordance with MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.**
109. In accordance with either MPSAS 21, *Impairment of Non-Cash-Generating Assets*, or MPSAS 26, *Impairment of Cash-Generating Assets*, as appropriate, reassessing the useful life of an intangible asset as finite rather than indefinite is an indicator that the asset may be impaired. As a result, the entity tests the asset for impairment by comparing its recoverable service amount or its recoverable amount, determined in accordance with either MPSAS 21, *Impairment of Non-Cash-Generating Assets*, or MPSAS 26, *Impairment of Cash-Generating Assets*, as appropriate, with its carrying amount, and recognizing any excess of the carrying

amount over the recoverable service amount or recoverable amount as appropriate, as an impairment loss.

Recoverability of the Carrying Amount - Impairment Losses

110. To determine whether an intangible asset is impaired, an entity applies either MPSAS 21, *Impairment of Non-Cash-Generating Assets*, or MPSAS 26, *Impairment of Cash-Generating Assets*, as appropriate. Those Standards explain when and how an entity reviews the carrying amount of its assets, how it determines the recoverable service amount or recoverable amount of an asset, as appropriate, and when it recognizes or reverses an impairment loss.

Retirements and Disposals

111. **An intangible asset shall be derecognized:**
- (a) **On disposal (including disposal through a non-exchange transaction); or**
 - (b) **When no future economic benefits or service potential are expected from its use or disposal.**
112. **The gain or loss arising from the derecognition of an intangible asset shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the asset. It shall be recognized in surplus or deficit when the asset is derecognized (unless MPSAS 13, *Leases*, requires otherwise on a sale and leaseback).**
113. The disposal of an intangible asset may occur in a variety of ways (e.g., by sale, by entering into a finance lease, or through a non-exchange transaction). In determining the date of disposal of such an asset, an entity applies the criteria in MPSAS 9, *Revenue from Exchange Transactions*, for recognizing revenue from the sale of goods. MPSAS 13, *Leases*, applies to disposal by a sale and leaseback.
114. If, in accordance with the recognition principle in paragraph 28, an entity recognizes in the carrying amount of an asset the cost of a replacement for part of an intangible asset, then it derecognizes the carrying amount of the replaced part. If it is not practicable for an entity to determine the carrying amount of the replaced part, it may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or internally generated.
- 114A In the case of:
- (a) A license or similar right previously granted by one combining operation to another combining operation that is recognized by the resulting entity in an amalgamation; or
 - (b) A reacquired right recognized 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.
115. The consideration receivable on disposal of an intangible asset is recognized initially at its fair value. If payment for the intangible asset is deferred, the consideration received is recognized initially at the cash price equivalent. The difference between the nominal amount of the consideration and the cash price equivalent is recognized as interest revenue in accordance

with MPSAS 9, *Revenue from Exchange Transactions*, reflecting the effective yield on the receivable.

116. Amortization of an intangible asset with a finite useful life does not cease when the intangible asset is no longer used, unless the asset has been fully depreciated

Disclosure

General

117. **An entity shall disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:**
- (a) **Whether the useful lives are indefinite or finite and, if finite, the useful lives or the amortization rates used;**
 - (b) **The amortization methods used for intangible assets with finite useful lives;**
 - (c) **The gross carrying amount and any accumulated amortization (aggregated with accumulated impairment losses) at the beginning and end of the period;**
 - (d) **The line item(s) of the statement of financial performance in which any amortization of intangible assets is included;**
 - (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;**
 - (ii) **Disposals;**
 - (iii) **Increases or decreases during the period resulting from revaluations under paragraphs 74, 84 and 85 (if any);**
 - (iv) **Impairment losses recognized in surplus or deficit during the period in accordance with MPSAS 21, *Impairment of Non-Cash-Generating Assets*, or MPSAS 26, *Impairment of Cash-Generating Assets* (if any);**
 - (v) **Impairment losses reversed in surplus or deficit during the period in accordance with MPSAS 21, *Impairment of Non-Cash-Generating Assets*, or MPSAS 26, *Impairment of Cash-Generating Assets* (if any);**
 - (vi) **Any amortization recognized during the period;**
 - (vii) **Net exchange differences arising on the translation of the financial statements into the presentation currency, and on the translation of a foreign operation into the presentation currency of the entity; and**
 - (viii) **Other changes in the carrying amount during the period.**

118. A class of intangible assets is a grouping of assets of a similar nature and use in an entity's operations. Examples of separate classes may include:
- (a) Brand names;
 - (b) Mastheads and publishing titles;
 - (c) Computer software;
 - (d) Licences;
 - (e) Copyrights, patents, and other industrial property rights, service, and operating rights;
 - (f) Recipes, formulae, models, designs, and prototypes; and
 - (g) Intangible assets under development.

The classes mentioned above are disaggregated (aggregated) into smaller (larger) classes if this results in more relevant information for the users of the financial statements.

119. An entity discloses information on impaired intangible assets in accordance with MPSAS 21, *Impairment of Non-Cash-Generating Assets*, or MPSAS 26, *Impairment of Cash-Generating Assets* in addition to the information required by paragraph 117(e)(iii)–(v).
120. MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, requires an entity to disclose the nature and amount of a change in an accounting estimate that has a material effect in the current period or is expected to have a material effect in subsequent periods. Such disclosure may arise from changes in:
- (a) The assessment of an intangible asset's useful life;
 - (b) The amortization method; or
 - (c) Residual values.
121. **An entity shall also disclose:**
- (a) **For an intangible asset assessed as having an indefinite useful life, the carrying amount of that asset and the reasons supporting the assessment of an indefinite useful life. In giving these reasons, the entity shall describe the factor(s) that played a significant role in determining that the asset has an indefinite useful life.**
 - (b) **A description, the carrying amount, and remaining amortization period of any individual intangible asset that is material to the entity's financial statements.**
 - (c) **For intangible assets acquired through a non-exchange transaction and initially recognized at fair value (see paragraphs 42–43):**
 - (i) **The fair value initially recognized for these assets;**
 - (ii) **Their carrying amount; and**
 - (iii) **Whether they are measured after recognition under the cost model or the revaluation model.**
 - (d) **The existence and carrying amounts of intangible assets whose title is restricted and the carrying amounts of intangible assets pledged as security for liabilities.**

- (e) **The amount of contractual commitments for the acquisition of intangible assets.**
122. When an entity describes the factor(s) that played a significant role in determining that the useful life of an intangible asset is indefinite, the entity considers the list of factors in paragraph 89.

Intangible Assets Measured after Recognition using the Revaluation Model

123. **If intangible assets are accounted for at revalued amounts, an entity shall disclose the following:**
- (a) **By class of intangible assets:**
 - (i) **The effective date of the revaluation;**
 - (ii) **The carrying amount of revalued intangible assets; and**
 - (iii) **The carrying amount that would have been recognized had the revalued class of intangible assets been measured after recognition using the cost model in paragraph 73;**
 - (b) **The amount of the revaluation surplus that relates to intangible assets at the beginning and end of the reporting period, indicating the changes during the reporting period and any restrictions on the distribution of the balance to owners; and**
 - (c) **The methods and significant assumptions applied in estimating the assets' fair values.**
124. It may be necessary to aggregate the classes of revalued assets into larger classes for disclosure purposes. However, classes are not aggregated if this would result in the combination of a class of intangible assets that includes amounts measured under both the cost and revaluation models.

Research and Development Expenditure

125. **An entity shall disclose the aggregate amount of research and development expenditure recognized as an expense during the period.**
126. Research and development expenditure comprises all expenditure that is directly attributable to research or development activities (see paragraphs 64 and 65 for guidance on the type of expenditure to be included for the purpose of the disclosure requirement in paragraph 125).

Other Information

127. An entity is encouraged, but not required, to disclose the following information:
- (a) A description of any fully amortized intangible asset that is still in use; and
 - (b) A brief description of significant intangible assets controlled by the entity but not recognized as assets because they did not meet the recognition criteria in this Standard.

Transitional Provisions

128. An entity that has previously recognized intangible assets shall apply this Standard retrospectively in accordance with MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.
129. [Deleted]
130. [Deleted]
131. [Deleted]
- 131A. Paragraph 79 was amended by *Improvements to MPSASs 2023* issued in December 2022. An entity shall apply that amendment to all revaluations recognized in annual periods beginning on or after the date of initial application of that amendment and in the immediately preceding annual period.

Effective Date

132. An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2017, it shall disclose that fact and apply MPSAS 21, *Impairment of Non-Cash-Generating Assets*, and MPSAS 26, *Impairment of Cash-Generating Assets*, at the same time.
- 132A. [Deleted]
- 132B. Paragraphs 129, 130, 131 and 133 were amended by MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, issued in November 2015. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, for a period beginning before January 1, 2017, the amendments shall also be applied for that earlier period.
- 132C. MPSAS 35, *Consolidated Financial Statements*, issued in March 2016 and MPSAS 37, *Joint Arrangements* issued in August 2016, amended paragraph 6(d). An entity shall apply that amendment when it applies MPSAS 35, *Consolidated Financial Statements*, and MPSAS 37, *Joint Arrangements*.
- 132D. Paragraphs 3, 6, 18, 24, 40, 41, 66, 67, and 117 were amended and paragraphs 18A, 26A, 39A–39E, 93A and 114A were added by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply these amendments prospectively for annual financial statements covering periods beginning on or after January 1, 2023. Therefore, amounts recognized for intangible assets and goodwill in prior public sector combinations shall not be adjusted. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2023 it shall disclose that fact and apply MPSAS 40, *Public Sector Combinations*, at the same time.

- 132E. Paragraphs 79, 91 and 97 were amended and paragraphs 97A, 97B, 97C and 131A added by *Improvements to MPSASs 2023 (General Improvements to MPSASs)*, issued in December 2022. An entity shall apply those amendments prospectively for annual financial statements covering periods beginning on or after January 1, 2024. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2024, it shall disclose that fact.
- 132F. Paragraphs 3, 96, 116 and 117 were amended by *Improvements to MPSASs 2023 (General Improvements to MPSASs)*, issued in December 2022. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2024. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2024, it shall disclose that fact.
- 132G. Paragraphs 4 and 5 were deleted by *Improvements to MPSASs 2023 (The Applicability of MPSASs)*, issued in December 2022. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2024. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2024, it shall disclose that fact.
- 132H. *Improvements to MPSASs 2023 (Impairment of Revalued Assets)*, amended paragraph 110. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2024. Earlier application is encouraged. If an entity applies that amendment for a period beginning before January 1, 2024, it shall disclose that fact.
133. When an entity adopts the accrual basis MPSASs of accounting as defined in MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of MPSASs.

Appendix A**Application Guidance**

This Appendix is an integral part of MPSAS 31, Intangible Assets.

Website Costs

- AG1. An entity may incur internal expenditure on the development and operation of its own website for internal or external access. A website designed for external access may be used for various purposes such as to disseminate information, create awareness of services, request comment on draft legislation, promote and advertise an entity's own services and products, provide electronic services, and sell services and products. A website designed for internal access may be used to store entity policies and details of users of a service, and search relevant information.
- AG2. The stages of a website's development can be described as follows:
- (a) Planning—including undertaking feasibility studies, defining objectives and specifications, evaluating alternatives, and selecting preferences;
 - (b) Application and Infrastructure Development—including obtaining a domain name, purchasing and developing hardware and operating software, installing developed applications, and stress testing;
 - (c) Graphical Design Development—including designing the appearance of web pages; and
 - (d) Content Development—including creating, purchasing, preparing, and uploading information, either textual or graphical in nature, on the website before the completion of the website's development. This information may either be stored in separate databases that are integrated into (or accessed from) the website or coded directly into the web pages.
- AG3. Once development of a website has been completed, the Operating stage begins. During this stage, an entity maintains and enhances the applications, infrastructure, graphical design, and content of the website.
- AG4. When accounting for internal expenditure on the development and operation of an entity's own website for internal or external access, the issues are:
- (a) Whether the website is an internally generated intangible asset that is subject to the requirements of this Standard; and
 - (b) The appropriate accounting treatment of such expenditure.
- AG5. This Application Guidance does not apply to expenditure on purchasing, developing, and operating hardware (e.g., web servers, staging servers, production servers, and Internet connections) of a website. Such expenditure is accounted for under MPSAS 17, *Property, Plant and Equipment*. Additionally, when an entity incurs expenditure on an Internet service provider hosting the entity's website, the expenditure is recognized as an expense when the services are received.

- AG6. MPSAS 31, *Intangible Assets*, does not apply to intangible assets held by an entity for sale in the ordinary course of operations (see MPSAS 11, *Construction Contracts*, and MPSAS 12, *Inventories*) or leases that fall within the scope of MPSAS 13, *Leases*. Accordingly, this Application Guidance does not apply to expenditure on the development or operation of a website (or website software) for sale to another entity. When a website is leased under an operating lease, the lessor applies this Application Guidance. When a website is leased under a finance lease, the lessee applies this Application Guidance after initial recognition of the leased asset.
- AG7. An entity's own website that arises from development and is for internal or external access is an internally generated intangible asset that is subject to the requirements of this Standard.
- AG8. A website arising from development is recognized as an intangible asset if, and only if, in addition to complying with the general requirements described in paragraph 28 of this Standard for recognition and initial measurement, an entity can satisfy the requirements in paragraph 55 of this Standard. In particular, an entity may be able to satisfy the requirement to demonstrate how its website will generate probable future economic benefits or service potential in accordance with paragraph 55(d) of this Standard when, for example, the website is capable of generating revenues, including direct revenues from enabling orders to be placed, or providing services using the website, rather than at a physical location using civil servants. An entity is not able to demonstrate how a website developed solely or primarily for promoting and advertising its own services and products will generate probable future economic benefits or service potential, and consequently all expenditure on developing such a website is recognized as an expense when incurred.
- AG9. Any internal expenditure on the development and operation of an entity's own website is accounted for in accordance with this Standard. The nature of each activity for which expenditure is incurred (e.g., training employees and maintaining the website) and the website's stage of development or post-development are evaluated to determine the appropriate accounting treatment (additional guidance is provided in the table included at the end of this Illustrative Examples). For example:
- (a) The Planning stage is similar in nature to the research phase in paragraphs 52–54 of this Standard. Expenditure incurred in this stage is recognized as an expense when it is incurred;
 - (b) The Application and Infrastructure Development stage, the Graphical Design stage, and the Content Development stage, to the extent that content is developed for purposes other than to advertise and promote an entity's own services and products, are similar in nature to the development phase in paragraphs 55–62 of this Standard. Expenditure incurred in these stages is included in the cost of a website recognized as an intangible asset in accordance with paragraph AG8 when the expenditure can be directly attributed and is necessary to creating, producing or preparing the website for it to be capable of operating in the manner intended by management. For example, expenditure on purchasing or creating content (other than content that advertises and promotes an entity's own services and products) specifically for a website, or expenditure to enable use of the content (e.g., a fee for acquiring a license to reproduce) on the website, is included in the cost of development when this condition is met. However, in accordance with paragraph 83 of this Standard, expenditure on an intangible item that was initially recognized as an expense in previous financial

statements is not recognized as part of the cost of an intangible asset at a later date (e.g., if the costs of a copyright have been fully amortized, and the content is subsequently provided on a website);

- (c) Expenditure incurred in the Content Development stage, to the extent that content is developed to advertise and promote an entity's own services and products (e.g., digital photographs of products), is recognized as an expense when incurred in accordance with paragraph 67(c) of this Standard. For example, when accounting for expenditure on professional services for taking digital photographs of an entity's own products and for enhancing their display, expenditure is recognized as an expense as the professional services are received during the process, not when the digital photographs are displayed on the website; and
- (d) The Operating stage begins once development of a website is complete. Expenditure incurred in this stage is recognized as an expense when it is incurred unless it meets the recognition criteria in paragraph 28 of this Standard.

AG10. A website that is recognized as an intangible asset under paragraph AG8 of this Application Guidance is measured after initial recognition by applying the requirements of paragraphs 71–86 of this Standard. The best estimate of a website's useful life should be short, as described in paragraph 91.

AG11. The guidance in paragraphs AG1–AG10 does not specifically apply to software development costs. However, an entity may apply the principles in these paragraphs.

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Illustrative Examples

These examples accompany, but are not part of, MPSAS 31, Intangible Assets.

Recognition and Measurement of an Internally-Generated Intangible Asset

Example Applying Paragraph 63 of this Standard.

- IE1. An entity developed a new system to schedule court cases more effectively that will result in increased service delivery. During the financial year ending March 31, 20X8, expenditure incurred for the development of the system was RM 1,000,² of which RM 900 was incurred before March 1, 20X8 and RM 100 was incurred between March 1, 20X8 and March 31, 20X8. The entity is able to demonstrate that, at March 1, 20X8, the newly developed system met the criteria for recognition as an intangible asset. The recoverable service amount of the system (including future cash outflows to complete the development before it is available for use) is estimated to be RM 500.
- IE2. At the end of the financial year, the developed system is recognized as an intangible asset at a cost of RM 100 (expenditure incurred since the date when the recognition criteria were met, i.e., March 1, 20X8). The RM 900 expenditure incurred before March 1, 20X8 is recognized as an expense because the recognition criteria were not met until March 1, 20X8. This expenditure does not form part of the cost of the system recognized in the statement of financial position.
- IE3. During the financial year ending March 31, 20X9, expenditure incurred is RM 2,000. At the end of this financial year, the recoverable service amount of the system (including future cash outflows to complete the system before it is available for use) is estimated to be RM 1,900.
- IE4. As at March 31, 20X9, the cost of the developed system is RM 2,100 (RM 100 expenditure recognized at the end of 20X8 plus RM 2,000 expenditure recognized in the 20X9 financial year). The entity recognizes an impairment loss of RM 200 to adjust the carrying amount of the developed system before the impairment loss (RM 2,100) to its recoverable service amount (RM 1,900). This impairment loss will be reversed in a subsequent period if the requirements for the reversal of an impairment loss in MPSAS 21, *Impairment of Non-Cash-Generating Assets*, are met.

Example Applying Paragraphs 55–65 of this Standard

- IE5. An entity is developing a system which produces statistical reports for its internal use and for sale to third-parties. The system is technically feasible, the entity is aware that there is a demand for this type of report and which third-parties are willing to pay for the product and therefore will generate probable future economic benefits. The expenditure attributable to the development of this system can be identified and measured reliably.

Assessing the Useful Lives of Intangible Assets

- IE6. The following guidance provides examples on determining the useful life of an intangible asset in accordance with this Standard.

² In this Standard, monetary amounts are denominated in “Ringgit Malaysia” (RM).

- IE7. Each of the following examples describes an acquired intangible asset, the facts and circumstances surrounding the determination of its useful life, and the subsequent accounting based on that determination.

An Acquired Patent with a Finite Useful Life

- IE8. Entity A acquires a patent over a formula for a vaccine, from Entity B to secure Entity A's ability to provide free vaccinations to its constituents. The vaccine protected by the patent is expected to be a source of service potential for at least 15 years. Entity A has a commitment from Entity C to purchase that patent in five years for 60 per cent of the fair value of the patent at the date it was acquired, and Entity A intends to sell the patent in five years.
- IE9. The patent would be amortized over its five-year useful life to Entity A, with a residual value equal to 60 per cent of the patent's fair value at the date it was acquired. The patent would also be reviewed for impairment in accordance with MPSAS 21, *Impairment of Non-Cash-Generating Assets*.

An Acquired Patent with an Indefinite Useful Life

- IE10. Entity A acquires an asset, the patent over a formula for a vaccine, from Entity B to secure Entity A's ability to provide free vaccinations to its constituents. It is expected that the formula will need to be slightly modified every 10 years to maintain its efficacy. There is evidence to support ongoing renewal of the patent. A contract with Entity B stipulates that Entity B will maintain the efficacy of the formula continuously, and evidence supports its ability to do so. The costs to renew the patent and maintain the efficacy of the formula are expected to be insignificant and will be paid to the Entity B when the improvements are made.
- IE11. An analysis of product lifecycle studies, and demographic and environmental trends, provides evidence that the patent will provide service potential to Entity A by enabling it to deliver its vaccination program for an indefinite period. Accordingly, the patent would be treated as having an indefinite useful life. Therefore, the patent would not be amortized unless its useful life is determined to be finite. The patent would be tested for impairment in accordance with MPSAS 21, *Impairment of Non-Cash-Generating Assets*.

An Acquired Copyright that has a Remaining Legal Life of 50 Years

- IE12. Entity A acquires a copyright from Entity B to enable it to reproduce and sell the copyrighted material on a cost-recovery basis to its constituency. An analysis of the habits of the entity's constituency and other trends provides evidence that the copyrighted material will generate net cash inflows for only 30 more years.
- IE13. The copyright would be amortized over its 30-year estimated useful life. The copyright also would be reviewed for impairment in accordance with MPSAS 21, *Impairment of Non-Cash-Generating Assets*.

An Acquired Broadcasting License that Expires in Five Years—Part A

- IE14. Entity A acquires a broadcasting license from Entity B. Entity A intends to provide free broadcasting services in the community. The broadcasting license is renewable every 10 years if Entity A provides at least an average level of service to its users of its service and complies with the relevant legislative requirements. The license may be renewed indefinitely at little cost and has been renewed twice before the most recent acquisition. Entity A intends to renew the license

indefinitely and evidence supports its ability to do so. Historically, there has been no compelling challenge to the license renewal. The technology used in broadcasting is not expected to be replaced by another technology at any time in the foreseeable future. Therefore, the license is expected to contribute to Entity A's ability to provide free broadcasting services indefinitely.

- IE15. Entity B does not recognize its power to grant broadcasting licenses as an intangible asset. The broadcasting license would be treated by Entity A as having an indefinite useful life because it is expected to contribute to the entity's ability to provide free broadcasting services indefinitely. Therefore, the license would not be amortized until its useful life is determined to be finite. The license would be tested for impairment in accordance with MPSAS 21, *Impairment of Non-Cash-Generating Assets*.

An Acquired Broadcasting License that Expires in Five Years—Part B

- IE16. The licensing authority subsequently decides that it will no longer renew broadcasting licenses, but rather will auction the licenses. At the time the licensing authority's decision is made, Entity A's broadcasting license has three years until it expires. Entity A expects that the license will continue to provide service potential until the license expires.

- IE17. Because the broadcasting license can no longer be renewed, its useful life is no longer indefinite. Thus, the acquired license would be amortized by Entity A over its remaining three-year useful life and immediately tested for impairment in accordance with MPSAS 21, *Impairment of Non-Cash-Generating Assets*.

An Acquired Right to Operate a Public Transit Route Between Two Cities that Expires in Three Years

- IE18. Entity A acquires from Entity B a right to operate a public transit route between two cities, which generates revenues. The transit route may be renewed every five years, and Entity A intends to comply with the applicable rules and regulations surrounding renewal. Transit route renewals are routinely granted at a minimal cost and historically have been renewed when the entity that holds the rights to the route has complied with the applicable rules and regulations. Entity A expects to provide transit services on the route indefinitely. An analysis of demand and cash flows supports those assumptions.

- IE19. Because the facts and circumstances support the public transit route providing cash flows to Entity A for an indefinite period of time, the intangible asset related to the transit route is treated as having an indefinite useful life. Therefore, the intangible asset would not be amortized until its useful life is determined to be finite. It would be tested for impairment in accordance with MPSAS 26, *Impairment of Cash-Generating Assets*, annually and whenever there is an indication that it may be impaired.

An Acquired List of Property Owners

- IE20. A local authority (Entity A) acquires a list of property owners from another public sector entity which is responsible for registering property deeds (Entity B). Entity B is at another level of government, and is not part of Entity A's reporting entity. Entity A intends to use the list to generate tax revenues and Entity A expects that it will be able to derive benefit from the information on the acquired list³ for at least one year, but no more than three years.

³ Although the local authority may intend to add property owners and other information to the database in the future, the expected benefits of the acquired database relate only to the property owners on that database at the date it was acquired. Subsequent additions would be considered to be internally-developed intangible assets, and accounted for in accordance with this Standard.

IE21. The list of property owners would be amortized over Entity A's best estimate of its useful life, say 18 months. Although Entity B may intend to add property owner names and other information to the list in the future, the expected benefits to Entity A of the acquired list relate only to the property owners on that list at the date Entity A acquired the list. The list of property owners also would be reviewed for impairment in accordance with MPSAS 21, *Impairment of Non-Cash-Generating Assets*, by assessing annually and whenever there is any indication that it may be impaired.

Examples Illustrating the Application Guidance

IE22. The purpose of the table is to illustrate examples of expenditure that occur during each of the stages described in paragraphs AG2–AG3 and to illustrate application of paragraphs AG4–AG11 to assist in clarifying their meaning. It is not intended to be a comprehensive checklist of expenditure that might be incurred.

STAGE/NATURE OF EXPENDITURE	ACCOUNTING TREATMENT
Planning	
• Undertaking feasibility studies; • Defining hardware and software specifications; • Evaluating alternative products and suppliers; and • Selecting preferences.	Recognize as an expense when incurred in accordance with paragraph 52 of this Standard.
Application and Infrastructure Development	
• Purchasing or developing hardware. • Obtaining a domain name; • Developing operating software (e.g., operating system and server software); • Developing code for the application; • Installing developed applications on the web server; and • Stress testing.	Apply the requirements of MPSAS 17, <i>Property, Plant and Equipment</i> . Recognize as an expense when incurred, unless the expenditure can be directly attributed to preparing the website to operate in the manner intended by management, and the website meets the recognition criteria in paragraphs 28 and 55 ⁴ of this Standard.
Graphical Design Development	
• Designing the appearance (e.g., layout and color) of web pages.	Recognize as an expense when incurred, unless the expenditure can be directly attributed to preparing the website to operate in the manner intended by management, and the website meets the recognition criteria in paragraphs 28 and 55 ⁵ of this Standard.

⁴ All expenditure on developing a website solely or primarily for promoting, advertising, or providing information to the public at large regarding the entity's own products and services is recognized an expense when incurred in accordance with paragraph 66 of this Standard.

⁵ See footnote 3.

STAGE/NATURE OF EXPENDITURE	ACCOUNTING TREATMENT
Content Development	
• Creating, purchasing, preparing (e.g., creating links and identifying tags), and uploading information, either textual or graphic in nature, on the website before the completion of the website's development. Examples of content include information about an entity, services, or products, and topics that subscribers access.	Recognize as an expense when incurred in accordance with paragraph 67(c) of this Standard to the extent that content is developed to advertise and promote an entity's own services and products (e.g., digital photographs of products). Otherwise, recognize as an expense when incurred, unless the expenditure can be directly attributed to preparing the website to operate in the manner intended by management, and the website meets the recognition criteria in paragraphs 28 and 55 ⁶ of this Standard.
Operating	
• Updating graphics and revising content; • Adding new functions, features, and content; • Registering the website with search engines; • Backing up data; • Reviewing security access; and • Analyzing usage of the website.	Assess whether it meets the definition of an intangible asset and the recognition criteria set out in paragraph 28 of this Standard, in which case the expenditure is recognized in the carrying amount of the website asset.
Other	
• Selling, administrative, and other general overhead expenditure unless it can be directly attributed to preparing the website for use to operate in the manner intended by management; • Clearly identified inefficiencies and initial operating deficits incurred before the website achieves planned performance (e.g., false-start testing); and • Training employees to operate the website.	Recognize as an expense when incurred in accordance with paragraphs 63–69 of this Standard.

⁶ See footnote 3.

Comparison with IPSAS 31

MPSAS 31, *Intangible Assets*, is drawn primarily from IPSAS 31 (2018). Main difference between MPSAS 31 and IPSAS 31 is as follows:

- In paragraph 6, 35 and 64, IPSAS 31 refers to IPSAS 39, *Employee Benefits* whereas MPSAS 31 refers to MPSAS 25, *Employee Benefits* in which drawn from IPSAS 25 that has been superseded by IPSAS 39. The MPSAS is yet to adopt IPSAS 39.

**MPSAS 32 - SERVICE CONCESSION ARRANGEMENTS:
GRANTOR**

Acknowledgement

The Malaysian Public Sector Accounting Standard (MPSAS) 32 is based on International Public Sector Accounting Standard (IPSAS) 32, *Service Concession Arrangements: Grantor*, from the *Handbook of International Public Sector Accounting Pronouncements* of the International Public Sector Accounting Standards Board, published by the International Federation of Accountants (IFAC) in 2018 and is used with permission of IFAC.

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MPSAS 32—SERVICE CONCESSION ARRANGEMENTS: GRANTOR

History of MPSAS

This version includes amendments resulting from MPSASs issued up to December 2022.

MPSAS 32, *Service Concession Arrangements: Grantor* was issued in March 2016.

Since then, MPSAS 32 has been amended by the following MPSASs:

- *Improvements to MPSASs 2023* (issued December 2022)
- MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)* (issued November 2015)

Table of Amended Paragraphs in MPSAS 32

Paragraph Affected	How Affected	Affected By
3	Deleted	Improvements to MPSASs 2023 December 2022
4	Deleted	Improvements to MPSASs 2023 December 2022
13	Amended	Improvements to MPSASs 2023 December 2022
32	Amended	Improvements to MPSASs 2023 December 2022
33	Amended	Improvements to MPSASs 2023 December 2022
35	Deleted	MPSAS 33 November 2015
35A	New	Improvements to MPSASs 2023 December 2022
35B	New	Improvements to MPSASs 2023 December 2022
36A	New	MPSAS 33 November 2015
36B	New	Improvements to MPSASs 2023 December 2022
36C	New	Improvements to MPSASs 2023 December 2022
37	Amended	MPSAS 33 November 2015
AG20	Amended	Improvements to MPSASs 2023 December 2022
AG35	Amended	Improvements to MPSASs 2023 December 2022

MPSAS 32 – Service Concession Arrangements: Grantor

Paragraph Affected	How Affected	Affected By
AG68	Deleted	MPSAS 33 November 2015
AG69	Deleted	MPSAS 33 November 2015
AG70	Deleted	MPSAS 33 November 2015
AG71	Deleted	MPSAS 33 November 2015
AG72	Deleted	MPSAS 33 November 2015
AG73	Deleted	MPSAS 33 November 2015

MPSAS 32 - SERVICE CONCESSION ARRANGEMENTS: GRANTOR

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Malaysian Public Sector Accounting Standard 32, *Service Concession Arrangements: Grantor*, is set out in paragraphs 1-37. All the paragraphs have equal authority. MPSAS 32, *Service Concession Arrangements: Grantor*, should be read in the context of its objective and the *Preface to Malaysian Public Sector Accounting Standards*. MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe the accounting for service concession arrangements by the grantor, a public sector entity.

Scope (see paragraphs AG1–AG2)

2. **An entity¹ that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for service concession arrangements.**
3. [Deleted]
4. [Deleted]
5. Arrangements within the scope of this Standard involve the operator providing public services related to the service concession asset on behalf of the grantor.
6. Arrangements outside the scope of this Standard are those that do not involve the delivery of public services and arrangements that involve service and management components where the asset is not controlled by the grantor (e.g., outsourcing, service contracts, or privatization).
7. This Standard does not specify the accounting by operators (guidance on accounting for service concession arrangements by the operator can be found in the relevant international or national accounting standard dealing with service concession arrangements).

Definitions (see paragraphs AG3–AG4)

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

A binding arrangement, for the purposes of this Standard, describes contracts and other arrangements that confer similar rights and obligations on the parties to it as if they were in the form of a contract.

A grantor, for the purposes of this Standard, is the entity that grants the right to use the service concession asset to the operator.

An operator, for the purposes of this Standard, is the entity that uses the service concession asset to provide public services subject to the grantor's control of the asset.

A service concession arrangement is a binding arrangement between a grantor and an operator in which:

- (a) **The operator uses the service concession asset to provide a public service on behalf of the grantor for a specified period of time; and**
- (b) **The operator is compensated for its services over the period of the service concession arrangement.**

¹ An entity for the purposes of this Standard is referred to as the grantor.

A **service concession asset** is an asset used to provide public services in a service concession arrangement that:

- (b) Is provided by the operator which:
 - (i) The operator constructs, develops, or acquires from a third party; or
 - (ii) Is an existing asset of the operator; or
- (c) Is provided by the grantor which:
 - (i) Is an existing asset of the grantor; or
 - (ii) Is an upgrade to an existing asset of the grantor.

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

Recognition and Measurement of a Service Concession Asset (see paragraphs AG5-AG35)

9. The grantor shall recognize an asset provided by the operator and an upgrade to an existing asset of the grantor as a service concession asset if:
 - (a) The grantor controls or regulates what services the operator must provide with the asset, to whom it must provide them, and at what price; and
 - (b) The grantor controls - through ownership, beneficial entitlement or otherwise - any significant residual interest in the asset at the end of the term of the arrangement.
10. This Standard applies to an asset used in a service concession arrangement for its entire useful life (a “whole-of-life” asset) if the conditions in paragraph 9(a) are met.
11. The grantor shall initially measure the service concession asset recognized in accordance with paragraph 9 (or paragraph 10 for a whole-of-life asset) at its fair value, except as noted in paragraph 12.
12. Where an existing asset of the grantor meets the conditions specified in paragraph 9(a) and 9(b) (or paragraph 10 for a whole-of-life asset), the grantor shall reclassify the existing asset as a service concession asset. The reclassified service concession asset shall be accounted for in accordance with MPSAS 17, *Property, Plant and Equipment*, or MPSAS 31, *Intangible Assets*, as appropriate.
13. After initial recognition or reclassification, service concession assets shall be accounted for in accordance with MPSAS 17, *Property, Plant and Equipment*, or MPSAS 31, *Intangible Assets*, as appropriate.

Recognition and Measurement of Liabilities (see paragraphs AG36–AG50)

14. **Where the grantor recognizes a service concession asset in accordance with paragraph 9 (or paragraph 10 for a whole-of-life asset), the grantor shall also recognize a liability. The grantor shall not recognize a liability when an existing asset of the grantor is reclassified as a service concession asset in accordance with paragraph 12, except in circumstances where additional consideration is provided by the operator, as noted in paragraph 15.**
15. **The liability recognized in accordance with paragraph 14 shall be initially measured at the same amount as the service concession asset measured in accordance with paragraph 11, adjusted by the amount of any other consideration (e.g., cash) from the grantor to the operator, or from the operator to the grantor.**
16. The nature of the liability recognized is based on the nature of the consideration exchanged between the grantor and the operator. The nature of the consideration given by the grantor to the operator is determined by reference to the terms of the binding arrangement and, when relevant, contract law.
17. In exchange for the service concession asset, the grantor may compensate the operator for the service concession asset by any combination of:
 - (a) Making payments to the operator (the “financial liability” model);
 - (b) Compensating the operator by other means (the “grant of a right to the operator” model) such as:
 - (i) Granting the operator the right to earn revenue from third-party users of the service concession asset; or
 - (ii) Granting the operator access to another revenue-generating asset for the operator’s use (e.g., a private wing of a hospital where the remainder of the hospital is used by the grantor to treat public patients or a private parking facility adjacent to a public facility).

Financial Liability Model (see paragraphs AG37–AG46)

18. **Where the grantor has an unconditional obligation to pay cash or another financial asset to the operator for the construction, development, acquisition, or upgrade of a service concession asset, the grantor shall account for the liability recognized in accordance with paragraph 14 as a financial liability.**
19. The grantor has an unconditional obligation to pay cash if it has guaranteed to pay the operator:
 - (a) Specified or determinable amounts; or
 - (b) The shortfall, if any, between amounts received by the operator from users of the public service and any specified or determinable amounts referred to in paragraph 19(a), even if the payment is contingent on the operator ensuring that the service concession asset meets specified quality or efficiency requirements.

20. MPSAS 28, *Financial Instruments: Presentation*, the derecognition requirements in MPSAS 29, *Financial Instruments: Recognition and Measurement*, and MPSAS 30, *Financial Instruments: Disclosures*, apply to the financial liability recognized under paragraph 14, except where this Standard provides requirements and guidance.
21. **The grantor shall allocate the payments to the operator and account for them according to their substance as a reduction in the liability recognized in accordance with paragraph 14, a finance charge, and charges for services provided by the operator.**
22. **The finance charge and charges for services provided by the operator in a service concession arrangement determined in accordance with paragraph 21 shall be accounted for as expenses.**
23. **Where the asset and service components of a service concession arrangement are separately identifiable, the service components of payments from the grantor to the operator shall be allocated by reference to the relative fair values of the service concession asset and the services. Where the asset and service components are not separately identifiable, the service component of payments from the grantor to the operator is determined using estimation techniques.**

Grant of a Right to the Operator Model (see paragraphs AG47–AG49)

24. **Where the grantor does not have an unconditional obligation to pay cash or another financial asset to the operator for the construction, development, acquisition, or upgrade of a service concession asset, and grants the operator the right to earn revenue from third-party users or another revenue-generating asset, the grantor shall account for the liability recognized in accordance with paragraph 14 as the unearned portion of the revenue arising from the exchange of assets between the grantor and the operator.**
25. **The grantor shall recognize revenue and reduce the liability recognized in accordance with paragraph 24 according to the economic substance of the service concession arrangement.**
26. Where the grantor compensates the operator for the service concession asset and the provision of services by granting the operator the right to earn revenue from third-party users of the service concession asset or another revenue-generating asset, the exchange is regarded as a transaction that generates revenue. As the right granted to the operator is effective for the period of the service concession arrangement, the grantor does not recognize revenue from the exchange immediately. Instead, a liability is recognized for any portion of the revenue that is not yet earned. The revenue is recognized according to the economic substance of the service concession arrangement, and the liability is reduced as revenue is recognized.

Dividing the Arrangement (see paragraph AG50)

27. **If the grantor pays for the construction, development, acquisition, or upgrade of a service concession asset partly by incurring a financial liability and partly by the grant of a right to the operator, it is necessary to account separately for each part of the total liability recognized in accordance with paragraph 14. The amount initially recognized for the total liability shall be the same amount as that specified in paragraph 15.**

28. The grantor shall account for each part of the liability referred to in paragraph 27 in accordance with paragraphs 18–26.

Other Liabilities, Commitments, Contingent Liabilities and Contingent Assets (see paragraphs AG51–AG54)

29. The grantor shall account for other liabilities, commitments, contingent liabilities, and contingent assets arising from a service concession arrangement in accordance with MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, MPSAS 28, *Financial Instruments: Presentation*, MPSAS 29, *Financial Instruments: Recognition and Measurement*, and MPSAS 30, *Financial Instruments: Disclosures*.

Other Revenues (see paragraphs AG55–AG64)

30. The grantor shall account for revenues from a service concession arrangement, other than those specified in paragraphs 24–26, in accordance with MPSAS 9, *Revenue from Exchange Transactions*.

Presentation and Disclosure (see paragraphs AG65–AG67)

31. The grantor shall present information in accordance with MPSAS 1, *Presentation of Financial Statements*.
32. All aspects of a service concession arrangement shall be considered in determining the appropriate disclosures in the notes. A grantor shall disclose the following information in respect of service concession arrangements in each reporting period:
- (a) A description of the arrangement;
 - (b) Significant terms of the arrangement that may affect the amount, timing, and certainty of future cash flows (e.g., the period of the concession, re-pricing dates, and the basis upon which re-pricing or re-negotiation is determined);
 - (c) The nature and extent (e.g., quantity, time period, or amount, as appropriate) of:
 - (i) Rights to use specified assets;
 - (ii) Rights to expect the operator to provide specified services in relation to the service concession arrangement;
 - (iii) The carrying amount of service concession assets recognized at the end of the reporting period, including existing assets of the grantor reclassified as service concession assets;
 - (iv) Rights to receive specified assets at the end of the service concession arrangement;
 - (v) Renewal and termination options;

- (vi) **Other rights and obligations (e.g., major overhaul of service concession assets); and**
 - (vii) **Obligations to provide the operator with access to service concession assets or other revenue-generating assets; and**
 - (d) **Changes in the arrangement occurring during the reporting period.**
33. The disclosures required in accordance with paragraph 32 are provided individually for each material service concession arrangement or in aggregate for service concession arrangements involving services of a similar nature (e.g., toll collections, telecommunications or water treatment services). This disclosure is in addition to the disclosures required in MPSAS 17, *Property, Plant and Equipment*, and/or MPSAS 31, *Intangible Assets*, by class of asset. Service concession assets within service concession arrangements of a similar nature that are reported in aggregate may form a subset of a class of assets disclosed in accordance with MPSAS 17, *Property, Plant and Equipment*, and/or MPSAS 31, *Intangible Assets*, or may be included in more than one class of assets disclosed in accordance with MPSAS 17, *Property, Plant and Equipment*, and/or MPSAS 31, *Intangible Assets*. For example, for the purposes of MPSAS 17, *Property, Plant and Equipment*, a toll bridge may be included in the same class as other bridges. For the purposes of this paragraph, the toll bridge may be included with service concession arrangements reported in aggregate as toll roads.

Transitional

34. **A grantor that has previously recognized service concession assets and related liabilities, revenues, and expenses shall apply this Standard retrospectively in accordance with MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.**
35. [Deleted]
- 35A. Paragraphs 13, 32, 33 and AG35 were amended by *Improvements to MPSAS 2023* issued in December 2022. An entity that has previously applied MPSAS 32, *Service Concession Arrangements: Grantor*, shall reassess the classification of service concession assets in accordance with paragraph 13. The entity shall present service concession assets in the revised classification retrospectively in accordance with MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.
- 35B. Where service concessions assets are reclassified in accordance with paragraph 35A, an entity shall account for the service concession assets as follows:
- (a) If the service concession assets have previously been measured using the cost model, and the class of assets to which those service concession assets have been reclassified is measured using the cost model, the entity shall continue to apply the cost model. The entity shall carry forward the cost of the service concession assets, along with any accumulated depreciation or amortization and any accumulated impairment losses.
 - (b) If the service concession assets have previously been measured using the cost model, and the class of assets to which those service concession assets have been reclassified is measured using the revaluation model, the entity shall either:

- (i) Revalue the service concession assets; or
 - (ii) Subject to the requirements in MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, dealing with changes in accounting policies, retrospectively apply the cost model to the remaining assets in the class of asset to which those service concession assets have been reclassified. Where information regarding the cost of the assets is not available, the entity may use the carrying amount of the assets as the deemed cost.
- (c) If the service concession assets have previously been measured using the revaluation model, and the class of assets to which those service concession assets have been reclassified is measured using the cost model, the entity shall either:
- (i) Retrospectively apply the cost model to the service concession assets. Where information regarding the cost of the assets is not available, the entity may use the carrying amount of the service concession assets as the deemed cost; or
 - (ii) Subject to the requirements in MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, dealing with changes in accounting policies, revalue the remaining assets in the class of asset to which those service concession assets have been reclassified.
- (d) If the service concession assets have previously been measured using the revaluation model, and the class of assets to which those service concession assets have been reclassified is measured using the revaluation model, the entity shall adjust the revaluation surplus in respect of each class of asset. Where previous revaluation decreases have been recognized in respect of either a service concession asset or one or more assets in the class to which the service concession asset is transferred, the entity shall consider whether transfers between revaluation surplus and accumulated surpluses or deficits are required.

Effective Date

36. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2017, it shall disclose that fact and apply MPSAS 5, *Borrowing Costs*, MPSAS 13, *Leases*, MPSAS 17, *Property, Plant and Equipment*, MPSAS 29, *Financial Instruments: Recognition and Measurement*, and MPSAS 31, *Intangible Assets*, at the same time.**
- 36A. **Paragraphs 35 and 37 were amended by MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, issued in November 2015. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, for a period beginning before January 1, 2017, the amendments shall also be applied for that earlier period.**

- 36B. Paragraphs 13, 32, 33 and AG35 were amended and paragraphs 35A and 35B added by *Improvements to MPSASs 2023 (General Improvements to MPSASs)*, issued in December 2022. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2024. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2024 it shall disclose that fact.
- 36C. Paragraphs 3 and 4 were deleted by *Improvements to MPSASs 2023 (The Applicability of MPSASs)*, issued in December 2022. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2024. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2024, it shall disclose that.
37. When an entity adopts the accrual basis MPSASs of accounting as defined in MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of MPSASs.

Appendix A

Application Guidance

This Appendix is an integral part of MPSAS 32, Service Concession Arrangements: Grantor.

Scope (see paragraphs 2–7)

AG1. This Standard is intended to “mirror” Interpretation 12 of the International Financial Reporting Interpretations Committee, *Service Concession Arrangements* (IFRIC 12), which sets out the accounting requirements for the private sector operator in a service concession arrangement. To do so, the scope, principles for recognition of an asset, and terminology are consistent with the applicable guidance in IFRIC 12. However, because this Standard deals with the accounting issues of the grantor, this Standard addresses the issues identified in IFRIC 12 from the grantor’s point of view, as follows:

- (a) The grantor recognizes a financial liability when it is obliged to make a series of payments to the operator for provision of a service concession asset (i.e., constructed, developed, acquired, or upgraded). Using the measurement requirements specified in this Standard under paragraphs 12, 14, and 20 of IFRIC 12, the operator recognizes revenue for the construction, development, acquisition, upgrade, and operation services it provides. Under paragraph 8 of IFRIC 12, the operator derecognizes an asset that it held and recognized as property, plant, and equipment before entering the service concession arrangement.
- (b) The grantor recognizes a liability when it grants the operator the right to earn revenue from third-party users of the service concession asset or another revenue-generating asset. Under paragraph 26 of IFRIC 12, the operator recognizes an intangible asset.
- (c) The grantor derecognizes an asset it grants to the operator and over which it no longer has control. Under paragraph 27 of IFRIC 12, the operator recognizes the asset and a liability in respect of any obligations it has assumed in exchange for the asset.

AG2. Paragraph 9 of this Standard specifies the conditions under which an asset, other than a whole-of-life asset, is within the scope of the Standard. Paragraph 10 of the Standard specifies the condition under which whole-of-life assets are within the scope of the Standard.

Definitions (see paragraph 8)

AG3. Paragraph 8 defines a service concession arrangement. Common features of a service concession arrangement are:

- (a) The grantor is a public sector entity;
- (b) The operator is responsible for at least some of the management of the service concession asset and related services and does not merely act as an agent on behalf of the grantor;
- (c) The arrangement sets the initial prices to be levied by the operator and regulates price revisions over the period of the service concession arrangement;

- (d) The operator is obliged to hand over the service concession asset to the grantor in a specified condition at the end of the period of the arrangement, for little or no incremental consideration, irrespective of which party initially financed it; and
- (e) The arrangement is governed by a binding arrangement that sets out performance standards, mechanisms for adjusting prices, and arrangements for arbitrating disputes.

AG4. Paragraph 8 defines a service concession asset. Examples of service concession assets are: roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks, permanent installations for military and other operations, and other non-current tangible or intangible assets used for administrative purposes in delivering public services.

Recognition and Initial Measurement of a Service Concession Asset (see paragraphs 9–13)

Recognition of a Service Concession Asset

- AG5. The assessment of whether a service concession asset should be recognized in accordance with paragraph 9 (or paragraph 10 for a whole-of-life asset) is made on the basis of all of the facts and circumstances of the arrangement.
- AG6. The control or regulation referred to in paragraph 9(a) could be by a binding arrangement, or otherwise (such as through a third party regulator that regulates other entities that operate in the same industry or sector as the grantor), and includes circumstances in which the grantor buys all of the output as well as those in which some or all of the output is bought by other users. The ability to exclude or regulate the access of others to the benefits of an asset is an essential element of control that distinguishes an entity's assets from those public goods that all entities have access to and benefit from. The binding arrangement sets the initial prices to be levied by the operator and regulates price revisions over the period of the service concession arrangement. When the binding arrangement conveys the right to control the use of the service concession asset to the grantor, the asset meets the condition specified in paragraph 9(a) regarding control in relation to those to whom the operator must provide services.
- AG7. For the purpose of paragraph 9(a), the grantor does not need to have complete control of the price: it is sufficient for the price to be regulated by the grantor, binding arrangement, or a third party regulator that regulates other entities that operate in the same industry or sector (e.g., hospitals, schools, or universities) as the grantor (e.g., by a capping mechanism). However, the condition is applied to the substance of the agreement. Non- substantive features, such as a cap that will apply only in remote circumstances, are ignored. Conversely, if, for example, an arrangement purports to give the operator freedom to set prices, but any excess profit is returned to the grantor, the operator's return is capped and the price element of the control test is met.
- AG8. Many governments have the power to regulate the behaviour of entities operating in certain sectors of the economy, either directly, or through specifically created agencies. For the purpose of paragraph 9(a), the broad regulatory powers described above do not constitute control. In this Standard, the term "regulate" is intended to be applied only in the context of the specific terms and conditions of the service concession arrangement. For example, a regulator of rail services may determine rates that apply to the rail industry as a whole. Depending on the legal framework

in a jurisdiction, such rates may be implicit in the binding arrangement governing a service concession arrangement involving the provision of railway transportation, or they may be specifically referred to therein. However, in both cases, the control of the service concession asset is derived from either the contract, or similar binding arrangement, or from the specific regulation applicable to rail services and not from the fact that the grantor is a public sector entity that is related to the regulator of rail service.

- AG9. For the purpose of paragraph 9(b), the grantor's control over any significant residual interest should both restrict the operator's practical ability to sell or pledge the asset and give the grantor a continuing right of use throughout the period of the service concession arrangement. The residual interest in the asset is the estimated current value of the asset as if it were already of the age and in the condition expected at the end of the period of the service concession arrangement.
- AG10. Control should be distinguished from management. If the grantor retains both the degree of control described in paragraph 9(a) and any significant residual interest in the asset, the operator is only managing the asset on the grantor's behalf - even though, in many cases, it may have wide managerial discretion.
- AG11. The conditions in paragraphs 9(a) and 9(b) together identify when the asset, including any replacements required, is controlled by the grantor for the whole of its economic life. For example, if the operator has to replace part of an asset during the period of the arrangement (e.g., the top layer of a road or the roof of a building), the asset is considered as a whole. Thus the condition in paragraph 9(b) is met for the whole of the asset, including the part that is replaced, if the grantor controls any significant residual interest in the final replacement of that part.
- AG12. Sometimes the use of a service concession asset is partly regulated in the manner described in paragraph 9(a) and partly unregulated. However, these arrangements take a variety of forms:
- (a) Any asset that is physically separable and capable of being operated independently and meets the definition of a cash-generating unit as defined in MPSAS 26, *Impairment of Cash-Generating Assets*, is analysed separately to determine whether the condition set out in paragraph 9(a) is met if it is used wholly for unregulated purposes (e.g., this might apply to a private wing of a hospital, where the remainder of the hospital is used by the grantor to treat public patients); and
 - (b) When purely ancillary activities (such as a hospital shop) are unregulated, the control tests are applied as if those services did not exist, because in cases in which the grantor controls the services in the manner described in paragraph 9(a), the existence of ancillary activities does not detract from the grantor's control of the service concession asset.
- AG13. The operator may have a right to use the separable asset described in paragraph AG12(a), or the facilities used to provide ancillary unregulated services described in paragraph AG12(b). In either case, there may in substance be a lease from the grantor to the operator; if so, it is accounted for in accordance with MPSAS 13, *Leases*.

Existing Asset of the Grantor

AG14. The arrangement may involve an existing asset of the grantor:

- (a) To which the grantor gives the operator access for the purpose of the service concession arrangement; or
- (b) To which the grantor gives the operator access for the purpose of generating revenues as compensation for the service concession asset.

AG15. The requirement in paragraph 11 is to measure assets recognized in accordance with paragraph 9 (or paragraph 10 for a whole-of-life asset) initially at fair value. Existing assets of the grantor used in the service concession arrangement are reclassified rather than recognized under this Standard. Only an upgrade to an existing asset of the grantor (e.g., that increases its capacity) is recognized as a service concession asset in accordance with paragraph 9, or paragraph 10 for a whole-of-life asset).

AG16. In applying the impairment tests in MPSAS 17, *Property, Plant and Equipment*, or MPSAS 31, *Intangible Assets*, as appropriate, the grantor does not necessarily consider the granting of the service concession to the operator as a circumstance that causes impairment, unless there has been a change in use of the asset that affects its future economic benefits or service potential. The grantor refers to MPSAS 21, *Impairment of Non-Cash-Generating Assets* or MPSAS 26, *Impairment of Cash-Generating Assets*, as appropriate, to determine whether any of the indicators of impairment have been triggered under such circumstances.

AG17. If the asset no longer meets the conditions for recognition in paragraph 9 (or paragraph 10 for a whole-of-life asset), the grantor follows the derecognition principles in MPSAS 17, *Property, Plant and Equipment*, or MPSAS 31, *Intangible Assets*, as appropriate. For example, if the asset is transferred to the operator on a permanent basis, it is derecognized. If the asset is transferred on a temporary basis, the grantor considers the substance of this term of the service concession arrangement in determining whether the asset should be derecognized. In such cases, the grantor also considers whether the arrangement is a lease transaction or a sale and leaseback transaction that should be accounted for in accordance with MPSAS 13, *Leases*.

AG18. When the service concession arrangement involves upgrading an existing asset of the grantor such that the future economic benefits or service potential the asset will provide are increased, the upgrade is assessed to determine whether it meets the conditions for recognition in paragraph 9 (or paragraph 10 for a whole-of-life asset). If those conditions are met, the upgrade is recognized and measured in accordance with this Standard.

Existing Asset of the Operator

AG19. The operator may provide an asset for use in the service concession arrangement that it has not constructed, developed, or acquired. If the arrangement involves an existing asset of the operator which the operator uses for the purpose of the service concession arrangement, the grantor determines whether the asset meets the conditions in paragraph 9 (or paragraph 10 for a whole-of-life asset). If the conditions for recognition are met, the grantor recognizes the asset as a service concession asset and accounts for it in accordance with this Standard.

Constructed or Developed Asset

AG20. Where a constructed or developed asset meets the conditions in paragraph 9 (or paragraph 10 for a whole-of-life asset) the grantor recognizes and measures the asset in accordance with this Standard. MPSAS 17, *Property, Plant and Equipment*, or MPSAS 31, *Intangible Assets*, as appropriate, set out the criteria for when a service concession asset should be recognized. Both MPSAS 17, *Property, Plant and Equipment*, or MPSAS 31, *Intangible Assets*, require that an asset shall be recognized if, and only if:

- (a) It is probable that future economic benefits or service potential associated with the item will flow to the entity; and
- (b) The cost or fair value of the item can be measured reliably².

AG21. Those criteria, together with the specific terms and conditions of the binding arrangement, need to be considered in determining whether to recognize the service concession asset during the period in which the asset is constructed or developed. For both property, plant, and equipment and intangible assets, the recognition criteria may be met during the construction or development period, and, if so, the grantor will normally recognize the service concession asset during that period.

AG22. The first recognition criterion requires the flow of economic benefits or service potential to the grantor. From the grantor's point of view, the primary purpose of a service concession asset is to provide service potential on behalf of the public sector grantor. Similar to an asset the grantor constructs or develops for its own use, the grantor would assess, at the time the costs of construction or development are incurred, the terms of the binding arrangement to determine whether the service potential of the service concession asset would flow to the grantor at that time.

AG23. The second recognition criterion requires that the initial cost or fair value of the asset can be measured reliably. Accordingly, to meet the recognition criteria in MPSAS 17, *Property, Plant and Equipment*, and MPSAS 31, *Intangible Assets*, as appropriate, the grantor must have reliable information about the cost or fair value of the asset during its construction or development. For example, if the service concession arrangement requires the operator to provide the grantor with progress reports during the asset's construction or development, the costs incurred may be measurable, and would therefore meet the recognition principle in MPSAS 17, *Property, Plant and Equipment*, for constructed assets or in MPSAS 31, *Intangible Assets*, for developed assets. Also, where the grantor has little ability to avoid accepting an asset constructed or developed to meet the specifications of the contract, or a similar binding arrangement, the costs are recognized as progress is made towards completion of the asset. Thus, the grantor recognizes a service concession asset and an associated liability.

² 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.

Measurement of Service Concession Assets

AG24. Paragraph 11 requires service concession assets recognized in accordance with paragraph 9 (or paragraph 10 for a whole-of-life asset) to be measured initially at fair value. In particular, fair value is used to determine the cost of a constructed or developed service concession asset or the cost of any upgrades to existing assets, on initial recognition. The requirement in paragraph 11 does not apply to existing assets of the grantor that are reclassified as service concession assets in accordance with paragraph 12 of this Standard. The use of fair value on initial recognition does not constitute a revaluation under MPSAS 17, *Property, Plant and Equipment*, and MPSAS 31, *Intangible Assets*.

AG25. The type of compensation exchanged between the grantor and the operator affects how the fair value of the service concession asset is determined on initial recognition. The paragraphs that follow outline how to determine the fair value of the asset on initial recognition based on the type of compensation exchanged:

- (a) Where payments are made by the grantor to the operator, the fair value on initial recognition of the asset represents the portion of the payments paid to the operator for the asset.
- (b) Where the grantor does not make payments to the operator for the asset, the asset is accounted for in the same way as an exchange of non-monetary assets in MPSAS 17, *Property, Plant and Equipment*, and MPSAS 31, *Intangible Assets*.

Types of Compensation

AG26. Service concession arrangements are rarely if ever the same; technical requirements vary by sector and by jurisdiction. Furthermore, the terms of the arrangement may also depend on the specific features of the overall legal framework of the particular jurisdiction. Contract laws, where they exist, may contain terms that do not have to be repeated in individual contracts.

AG27. Depending on the terms of the service concession arrangement, the grantor may compensate the operator for the service concession asset and service provision by any combination of the following:

- (a) Making payments (e.g., cash) to the operator;
- (b) Compensating the operator by other means, such as:
 - (i) Granting the operator the right to earn revenue from third-party users of the service concession asset; or
 - (ii) Granting the operator access to another revenue-generating asset for its use.

AG28. Where the grantor compensates the operator for the service concession asset by making payments to the operator, the asset and service components of the payments may be separable (e.g., the binding arrangement specifies the amount of the predetermined series of payments to be allocated to the service concession asset) or inseparable.

Separable Payments

AG29. A service concession arrangement may be separable in a variety of circumstances, including, but not limited to, the following:

- (a) Part of a payment stream that varies according to the availability of the service concession asset itself and another part that varies according to usage or performance of certain services are identified;
- (b) Different components of the service concession arrangement run for different periods or can be terminated separately. For example, an individual service component can be terminated without affecting the continuation of the rest of the arrangement; or
- (c) Different components of the service concession arrangement can be renegotiated separately. For example, a service component is market tested and some or all of the cost increases or reductions are passed on to the grantor in such a way that the part of the payment by the grantor that relates specifically to that service can be identified.

AG30. MPSAS 17, *Property, Plant and Equipment*, and MPSAS 31, *Intangible Assets*, require initial measurement of an asset acquired in an exchange transaction at cost, which is the cash price equivalent of the asset. For exchange transactions, the transaction price is considered to be fair value, unless indicated otherwise. Where the asset and service components of payments are separable, the cash price equivalent of the service concession asset is the present value of the service concession asset component of the payments. However, if the present value of the asset portion of the payments is greater than fair value, the service concession asset is initially measured at its fair value.

Inseparable Payments

AG31. Where the asset and service component of payments by the grantor to the operator are not separable, the fair value in paragraph 11 is determined using estimation techniques.

AG32. For the purpose of applying the requirements of this Standard, payments and other consideration required by the arrangement are allocated at the inception of the arrangement or upon a reassessment of the arrangement into those for the service concession asset and those for other components of the service concession arrangement (e.g., maintenance and operation services) on the basis of their relative fair values. The fair value of the service concession asset includes only amounts related to the asset and excludes amounts for other components of the service concession arrangement. In some cases, allocating the payments for the asset from payments for other components of the service concession arrangement will require the grantor to use an estimation technique. For example, a grantor may estimate the payments related to the asset by reference to the fair value of a comparable asset in an agreement that contains no other components, or by estimating the payments for the other components in the service concession arrangement by reference to comparable arrangements and then deducting these payments from the total payments under the arrangement.

Operator Receives Other Forms of Compensation

AG33. The types of transactions referred to in paragraph 17(b) are non-monetary exchange transactions. Paragraph 38 of MPSAS 17, *Property, Plant and Equipment*, and paragraph 44 of MPSAS 31, *Intangible Assets*, as appropriate, provide guidance on these circumstances.

AG34. When the operator is granted the right to earn revenue from third-party users of the service concession asset, or another revenue-generating asset, or receives non-cash compensation from the grantor, the grantor does not incur a cost directly for acquiring the service concession asset. These forms of compensation to the operator are intended to compensate the operator both for the cost of the service concession asset and for operating it during the term of the service concession arrangement. The grantor therefore needs to initially measure the asset component in a manner consistent with paragraph 11.

Subsequent Measurement

AG35. After initial recognition, a grantor applies MPSAS 17, *Property, Plant and Equipment*, and MPSAS 31, *Intangible Assets*, to the subsequent measurement and derecognition of a service concession asset. MPSAS 21, *Impairment of Non-Cash-Generating Assets*, and MPSAS 26, *Impairment of Cash-Generating Assets*, are also applied in considering whether there is any indication that a service concession asset is impaired. These requirements in these Standards are applied to all assets recognized or classified as service concession assets in accordance with this Standard.

Recognition and Measurement of Liabilities (see paragraphs 14–28)

AG36. The grantor recognizes a liability in accordance with paragraph 14 only when a service concession asset is recognized in accordance with paragraph 9 (or paragraph 10 for a whole-of-life asset). The nature of the liability recognized in accordance with paragraph 14 differs in each of the circumstances described in paragraph AG25 according to its substance.

The Financial Liability Model (see paragraphs 18–23)

AG37. When the grantor has an unconditional obligation to make a predetermined series of payments to the operator, the liability is a financial liability as defined in MPSAS 29, *Financial Instruments: Recognition and Measurement*. The grantor has an unconditional obligation if it has little, if any, discretion to avoid the obligation usually because of the binding arrangement with the operator being enforceable by law.

AG38. When the grantor provides compensation to the operator for the cost of the service concession asset and service provision in the form of a predetermined series of payments, an amount reflecting the portion of the predetermined series of payments that pertains to the asset is recognized as a liability in accordance with paragraph 14. This liability does not include the finance charge and service components of the payments specified in paragraph 21.

AG39. Where the grantor makes any payments to the operator in advance of the service concession asset being recognized, the grantor accounts for those payments as repayments.

- AG40. The finance charge specified in paragraph 21 is determined based on the operator's cost of capital specific to the service concession asset, if this is practicable to determine.
- AG41. If the operator's cost of capital specific to the service concession asset is not practicable to determine, the rate implicit in the arrangement specific to the service concession asset, the grantor's incremental borrowing rate, or another rate appropriate to the terms and conditions of the arrangement, is used.
- AG42. Where sufficient information is not available, the rate used to determine the finance charge may be estimated by reference to the rate that would be expected on acquiring a similar asset (e.g., a lease of a similar asset, in a similar location and for a similar term). The estimate of the rate should be reviewed together with:
- (a) The present value of the payments;
 - (b) The assumed fair value of the asset; and
 - (c) The assumed residual value, to ensure all figures are reasonable and mutually consistent.
- AG43. In cases when the grantor takes part in the financing (e.g., by lending the operator the funds to construct, develop, acquire, or upgrade a service concession asset, or through guarantees), it may be appropriate to use the grantor's incremental borrowing rate to determine the finance charge.
- AG44. The interest rate used to determine the finance charge may not be subsequently changed unless the asset component or the whole of the arrangement is renegotiated.
- AG45. The finance charge related to the liability in a service concession arrangement is presented consistently with other finance charges in accordance with MPSAS 28, *Financial Instruments: Presentation*, MPSAS 29, *Financial Instruments: Recognition and Measurement*, and MPSAS 30, *Financial Instruments: Disclosures*.
- AG46. The service component of payments determined in accordance with paragraph 21 is ordinarily recognized evenly over the term of the service concession arrangement because this pattern of recognition best corresponds to the service provision. In cases when specific expenses are required to be separately compensated, and their timing is known, such expenses are recognized as incurred.

Grant of a Right to the Operator Model (see paragraphs 24-26)

- AG47. When the grantor compensates the operator for the service concession asset and service provision by granting the operator the right to earn revenue from third-party users of the service concession asset, the operator is granted the right to earn revenue over the period of the service concession arrangement. Likewise, the grantor earns the benefit associated with the assets received in the service concession arrangement in exchange for the right granted to the operator over the period of the arrangement. Accordingly, the revenue is not recognized immediately. Instead, a liability is recognized for any portion of the revenue that is not yet earned. Revenue is recognized and the liability reduced in accordance with paragraph 25 based on the economic substance of the service concession arrangement, usually as access to the service concession

asset is provided to the operator over the term of the service concession arrangement. As described in paragraph AG27, the grantor may compensate the operator by a combination of payments and granting a right to earn revenue directly from third-party users. In such cases, if the operator's right to earn such third-party revenues significantly reduces or eliminates the grantor's predetermined series of payments to the operator, another basis may be more appropriate for reducing the liability (e.g., the term over which the grantor's future predetermined series of payments are reduced or eliminated).

AG48. When the grantor compensates the operator for the service concession asset and service by the provision of a revenue-generating asset, other than the service concession asset, revenue is recognized and the liability recognized in accordance with paragraph 24 is reduced in a manner similar to that described in paragraph AG47. In such cases, the grantor also considers the derecognition requirements in MPSAS 17, *Property, Plant and Equipment*, or MPSAS 31, *Intangible Assets*, as appropriate.

AG49. In some cases under the grant of a right to the operator model, there may be a "shadow toll". Some shadow tolls are paid for the construction, development, acquisition, or upgrade of the service concession asset, and its operation by the operator. In cases where the grantor pays the operator solely for the usage of the service concession asset by third-party users, such payment is compensation in exchange for the usage and not the acquisition of the service concession asset. Accordingly, such payments do not relate to the liability specified in paragraph AG48. The grantor compensates the operator only to the extent of the usage of the service concession asset, and accounts for such payments as expenses in accordance with MPSAS 1, *Presentation of Financial Statements*.

Dividing the Arrangement (see paragraphs 27-28)

AG50. If the operator is compensated for the service concession asset partly by a predetermined series of payments and partly by receiving the right to earn revenue from third-party use of either the service concession asset or another revenue-generating asset, it is necessary to account separately for each portion of the liability related to the grantor's consideration. In these circumstances, the consideration to the operator is divided into a financial liability portion for the predetermined series of payments and a liability portion for the right granted to the operator to earn revenue from third-party use of the service concession asset or another revenue-generating asset. Each portion of the liability is recognized initially at the fair value of the consideration paid or payable.

Other Liabilities, Commitments, Contingent Liabilities and Contingent Assets (see paragraph 29)

AG51. Service concession arrangements may include various forms of financial guarantees (e.g., a guarantee, security, or indemnity related to the debt incurred by the operator to finance construction, development, acquisition, or upgrade of a service concession asset), or performance guarantees (e.g., guarantee of minimum revenue streams, including compensation for short-falls).

- AG52. Certain guarantees made by a grantor may meet the definition of a financial guarantee contract. The grantor determines whether guarantees made by the grantor as part of a service concession arrangement meet the definition of a financial guarantee contract and applies MPSAS 28, *Financial Instruments: Presentation*, MPSAS 29, *Financial Instruments: Recognition and Measurement*, and MPSAS 30, *Financial Instruments: Disclosures*, in accounting for the guarantee. Where the guarantee is an insurance contract, the grantor can elect to apply the relevant international or national accounting standard dealing with insurance contracts. See MPSAS 28, *Financial Instruments: Presentation*, paragraphs AG3–AG9 for further guidance.
- AG53. Guarantees and commitments that do not meet the requirements in MPSAS 28, *Financial Instruments: Presentation*, and MPSAS 29, *Financial Instruments: Recognition and Measurement*, relating to financial guarantee contracts or are not insurance contracts are accounted for in accordance with MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*.
- AG54. Contingent assets or liabilities may arise from disputes over the terms of the service concession arrangement. Such contingencies are accounted for in accordance with MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*.

Other Revenues (see paragraph 30)

- AG55. The operator may compensate the grantor for access to the service concession asset by providing the grantor with a series of predetermined inflows of resources, including the following:
- (a) An upfront payment or a stream of payments;
 - (b) Revenue-sharing provisions;
 - (c) A reduction in a predetermined series of payments the grantor is required to make to the operator; and
 - (d) Rent payments for providing the operator access to a revenue-generating asset.
- AG56. When the operator provides an upfront payment, a stream of payments, or other consideration to the grantor for the right to use the service concession asset over the term of the service concession arrangement, the grantor accounts for these payments in accordance with MPSAS 9, *Revenue from Exchange Transactions*. The timing of the revenue recognition is determined by the terms and conditions of the service concession arrangement that specify the grantor's obligation to provide the operator with access to the service concession asset.
- AG57. Where the operator provides an upfront payment, a stream of payments, or other consideration to the grantor in addition to the service concession asset, for the right to earn the revenue from third-party use of the service concession asset, or another revenue-generating asset, any portion of the payments received from the operator not earned in the accounting period is recognized as a liability until the conditions for revenue recognition are met.
- AG58. When the conditions for revenue recognition are met, the liability is reduced as the revenue is recognized in accordance with paragraph 30.

- AG59. However, given the varying nature of the types of assets that may be used in service concession arrangements, and the number of years over which the arrangements operate, there may be more appropriate alternative methods for recognizing revenue associated with the inflows specified in the binding arrangement that better reflect the operator's economic consumption of their access to the service concession asset and/or the time value of money. For example, an annuity method that applies a compounding interest factor that more evenly recognizes revenue on a discounted basis, as opposed to on a nominal basis, may be more appropriate for a service concession arrangement with a term extending over several decades.
- AG60. When an upfront payment is received from the operator, the revenue is recognized in a way that best reflects the operator's economic consumption of its access to the service concession asset and/or the time value of money. For example, when the operator is required to pay annual instalments over the term of the service concession arrangement, or predetermined sums for specific years, the revenue is recognized over the specified term.
- AG61. For service concession arrangements under which the operator is granted the right to earn revenue from third-party users of the service concession asset, revenue relates to the inflow of economic benefits received as the services are provided and is therefore recognized on the same basis as the liability is reduced. In these cases, the grantor will often negotiate to include a revenue-sharing provision in the arrangement with the operator. Revenue-sharing as part of a service concession arrangement may be based on all revenue earned by the operator, or on revenue above a certain threshold, or on revenue more than the operator needs to achieve a specified rate of return.
- AG62. The grantor recognizes revenue generated from revenue-sharing provisions in service concession arrangements as it is earned, in accordance with the substance of the relevant agreement, after any contingent event (e.g., the achievement of a revenue threshold) is deemed to have occurred. The grantor applies MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, to determine when the contingent event has occurred.
- AG63. A reduction in the future predetermined series of payments the grantor would otherwise be required to make to the operator provides the grantor with upfront non-cash consideration. Such revenue is recognized as the liability is reduced.
- AG64. When the operator pays a nominal rent for access to a revenue-generating asset, the rental revenue is recognized in accordance with MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*.

Presentation and Disclosure (see paragraphs 31-33)

- AG65. Disclosures relating to various aspects of service concession arrangements may be addressed in existing Standards. This Standard addresses only the additional disclosures relating to service concession arrangements. Where the accounting for a particular aspect of a service concession arrangement is addressed in another Standard, the grantor follows the disclosure requirements of that Standard in addition to those set out in paragraph 32.
- AG66. MPSAS 1, *Presentation of Financial Statements*, requires finance costs to be presented separately in the statement of financial performance. The finance charge determined in accordance with paragraph 21 is included in this item.

AG67. In addition to the disclosures outlined in paragraphs 31-33, the grantor also applies the relevant presentation and disclosure requirements in other MPSASs as they pertain to assets, liabilities, revenues, and expenses recognized under this Standard.

Transition (see paragraphs 34-35)

AG68. [Deleted]

AG69. [Deleted]

AG70. [Deleted]

AG71. [Deleted]

AG72. [Deleted]

AG73. [Deleted]

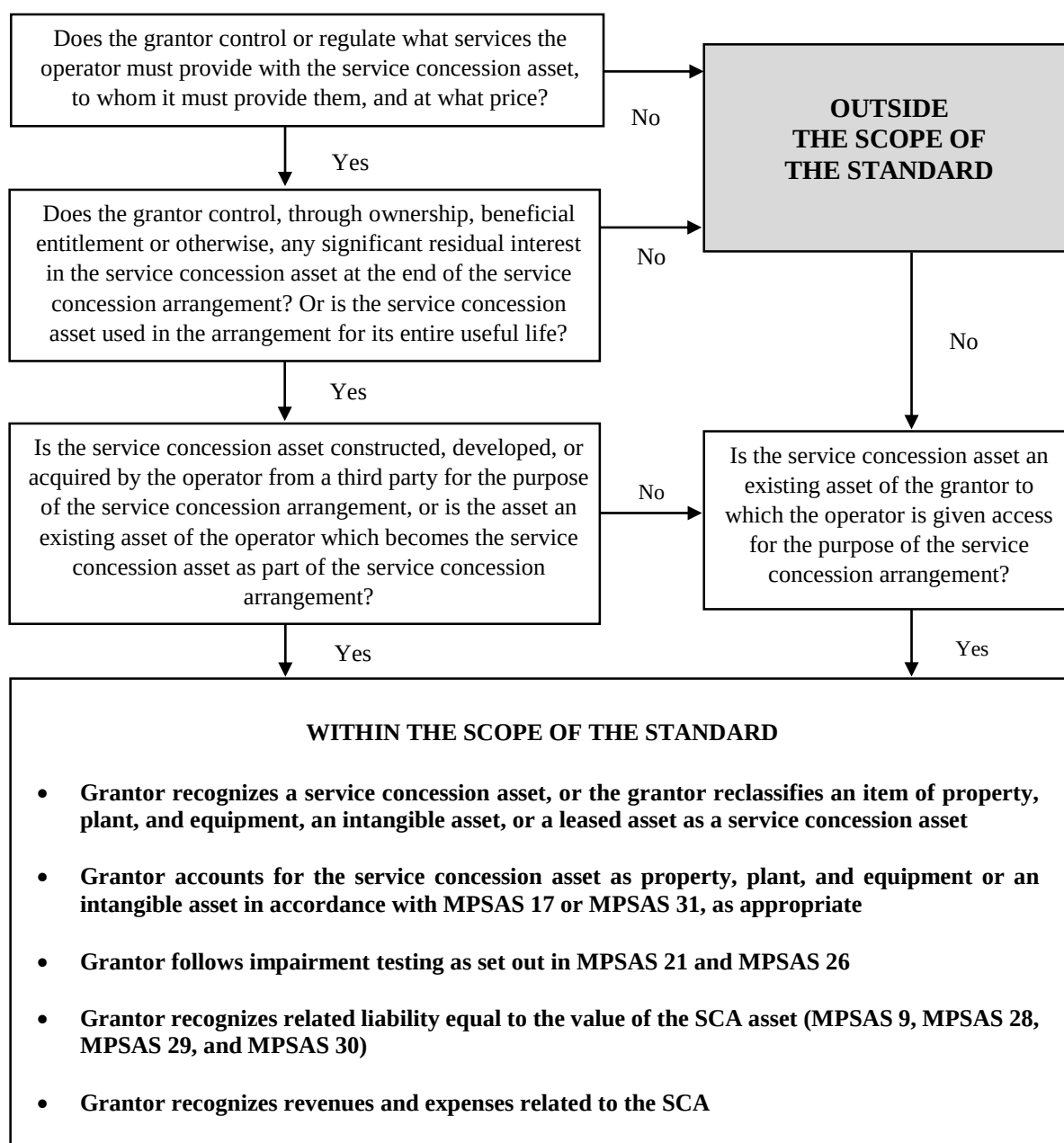
Implementation Guidance

This guidance accompanies, but is not part of, MPSAS 32, Service Concession Arrangements: Grantor.

IG1. The purpose of this Implementation Guidance is to illustrate certain aspects of the requirements of MPSAS 32, *Service Concession Arrangements: Grantor*.

Accounting Framework for Service Concession Arrangements

IG2. The diagram below summarizes the accounting for service concession arrangements established by MPSAS 32, *Service Concession Arrangements: Grantor*.



References to MPSASs that Apply to Typical Types of Arrangements Involving an Asset Combined with Provision of a Service

IG3. The table sets out the typical types of arrangements for private sector participation in the provision of public sector services and provides references to MPSASs that apply to those arrangements. The list of arrangements types is not exhaustive. The purpose of the table is to highlight the continuum of arrangements. It is not the Accountant General's Department's intention to convey the impression that bright lines exist between the accounting requirements for various types of arrangements.

IG4. Shaded text shows arrangements within the scope of MPSAS 32, *Service Concession Arrangements: Grantor*.

Category	Lessee	Service provider			Owner	
Typical arrangement types	Lease (e.g., operator leases asset from grantor)	Service and/ or maintenance contract specific tasks e.g., debt collection, facility management)	Rehabilitate-operate-transfer	Build-operate-transfer	Build-own-operate	100% Divestment/ Privatization/ Corporation
Asset ownership	Grantor				Operator	
Capital Investment	Grantor		Operator			
Demand risk	Shared	Grantor	Grantor and/ or Operator		Operator	
Typical duration	8-20 years	1-5 years	25-30 years			Indefinite (or may be limited by binding arrangement or license)
Residual interest	Grantor				Operator	
Relevant MPSASs	MPSAS 13	MPSAS 1	This MPSAS/MPSAS 17/ MPSAS 31		MPSAS 17/ MPSAS 31 (derecognition) MPSAS 9 (revenue recognition)	

Illustrative Examples

These examples accompany, but are not part of, MPSAS 32, Service Concession Arrangements: Grantor.

- IE1. These examples deal with only three of many possible types of service concession arrangements. Their purpose is to illustrate the accounting treatment for some features that are commonly found in practice. To make the illustrations as clear as possible, it has been assumed that the term of the service concession arrangement is only ten years and that the operator's annual receipts are constant over that period. In practice, terms may be much longer and annual revenues may increase with time.

Arrangement Terms (Common to All Three Examples)

- IE2. In these examples, monetary amounts are denominated in "Ringgit Malaysia" (RM).
- IE3. These terms are common to the three examples that follow:
- IE4. The terms of the arrangement require an operator to construct a road—completing construction within two years—and maintain and operate the road to a specified standard for eight years (i.e., years 3–10). The arrangement is within the scope of this Standard and the road meets the conditions for recognition of a service concession asset in paragraph 9 (or paragraph 10 for a whole-of-life asset).
- IE5. The terms of the arrangement also require the operator to resurface the road when the original surface has deteriorated below a specified condition. The operator estimates that it will have to undertake the resurfacing at the end of year 8 at a fair value of RM110. The compensation to the operator for this service is included in the predetermined series of payments and/or the revenue the operator has the right to earn from the service concession asset or another revenue-generating asset granted to the operator by the grantor.
- IE6. It is assumed that the original road surface is a separate component of the service concession asset and meets the criteria for recognition specified in MPSAS 17, *Property, Plant and Equipment*, when the service concession asset is initially recognized. It is further assumed that there is sufficient certainty regarding the timing and amount of the resurfacing work for it to be recognized as a separate component when the resurfacing occurs.³⁰ It is assumed that the expected cost of the resurfacing can be used to estimate the initial cost of the surface layers recognized as a separate component of the service concession asset. The road surface is therefore recognized as a separate component of the initial fair value of the service concession asset and measured at the estimated fair value of the resurfacing and depreciated over years 3–8. This depreciation period is shorter than that for the road base, and takes into account that resurfacing would ordinarily occur over six years, rather than 25 years. During the construction phase, it is assumed that only the road base is constructed in year 1, and that the road only becomes ready to use at the end of year 2.

³ If this was not the case (e.g., where the operator might resurface in future, or might incur additional maintenance over the period of the service concession arrangement), it might not be appropriate to recognize a component.

- IE7. Recognition of the replacement component of the road surface as a separate component of the service concession asset in year 8 also results in an increase in the liability recognized by the grantor. Where the liability relates to the grant of a right to the operator model, additional revenue in respect of this increase is recognized evenly over the term of the arrangement. However, if the expenditure represented an improvement in service potential such as a new traffic lane rather than restoration to original service capability then it would be appropriate to instead recognize revenue relevant to that improvement only once it has occurred.
- IE8. At the beginning of year 3, the total fair value of the road is RM1,050, comprised of RM940 related to the construction of the base layers and RM110 related to construction of the surface layers. The fair value of the surface layers is used to estimate the fair value of the resurfacing (which is treated as a replacement component in accordance with MPSAS 17, *Property, Plant and Equipment*). The estimated life of surface layers (i.e., six years) is also used to estimate the depreciation of the replacement component in years 9 and 10. The total initial fair value of the road is lower than the present value of the series of predetermined payments pertaining to the asset, where applicable.
- IE9. The road base has an economic life of 25 years. Annual depreciation is taken by the grantor on a straight-line basis. It is therefore RM38 (940/25) for the base layers. The surface layers are depreciated over 6 years (years 3–8 for the original component, and starting in year 9 for the replacement component). Annual depreciation related to the surface layers is RM18 (RM110/6). There is no impairment in the value of the road over the term of the service concession arrangement.
- IE10. The operator's cost of capital is not practicable to determine. The rate implicit in the service concession arrangement specific to the asset is 6.18%.
- IE11. It is assumed that all cash flows take place at the end of the year.
- IE12. It is assumed that the time value of money is not significant. Paragraph AG59 provides guidance on methods that may be appropriate where the time value of money is significant.
- IE13. At the end of year 10, the arrangement will end. At the end of the arrangement, the operator will transfer the operation of the road to the grantor.
- IE14. The total compensation to the operator under each of the three examples is inclusive of each of the components of the service concession arrangement and reflects the fair values for each of the services, which are set out in Exhibit 1.
- IE15. The grantor's accounting policy for property, plant, and equipment is to recognize such assets using the cost model specified in MPSAS 17, *Property, Plant and Equipment*.

Exhibit 1: Fair Values of the Components of the Arrangement (RM)

Contact Component	Fair Value
Road – base layers	940
Road – original surface layers	110
Total FV of road	1,050
Annual service component	12
Effective interest rate	6.18%

Example 1: The Grantor makes a Predetermined Series of Payments to the Operator*Additional Terms*

IE16. The terms of the arrangement require the grantor to pay the operator RM200 per year in years 3–10 for making the road available to the public. The total consideration (payment of RM200 in each of years 3–10) reflects the fair values for each of the services indicated in Exhibit 1. These payments are intended to cover the cost of constructing the road, annual operating costs of RM12 and reimbursement to the operator for the cost of resurfacing the road in year 8 of RM110.

Financial Statement Impact

- IE17. The grantor initially recognizes the service concession asset as property, plant, and equipment at its fair value (total RM1,050, comprised of RM940 related to construction of the base layers and RM110 related to construction of the original surface layers). The asset is recognized as it is constructed (RM525 in year 1 and RM525 in year 2). Depreciation is taken annually (RM56, comprised of RM38 for the base layers and RM18 for the surface layers), starting from year 3.
- IE18. The grantor initially recognizes a financial liability at fair value equal to the fair value of the asset under construction at the end of year 1 (RM525). The liability is increased at the end of year 2 to reflect both the fair value of the additional construction (RM525) and the finance charge on the outstanding financial liability. Because the amount of the predetermined payment related to the service component of the service concession arrangement is known, the grantor is able to determine the amount of the payment that reduces the liability. A finance charge at the implicit rate of 6.18% is recognized annually. The liability is subsequently measured at amortized cost, i.e., the amount initially recognized plus the finance charge on that amount calculated using the effective interest method minus repayments.
- IE19. The compensation for the road resurfacing is included in the predetermined series of payments. There is no direct cash flow impact related to the road resurfacing; however, the grantor recognizes the resurfacing as an asset when the work is undertaken and recognizes depreciation expense of $RM110/6 = RM18$, beginning in year 9.
- IE20. The compensation for maintenance and operating the road (RM12) is included in the predetermined series of payments. There is no cash flow impact related to this service expense; however, the grantor recognizes an expense annually.
- IE21. The costs of services are accounted for in accordance with MPSAS 1, *Presentation of Financial Statements*.

Overview of Cash Flows, Statement of Financial Performance, and Statement of Financial Position

IE22. The grantor’s cash flows, statement of financial performance, and statement of financial position over the duration of the arrangement will be as illustrated in Tables 1.1 to 1.3. In addition, Table 1.4 shows the changes in the financial liability.

Table 1.1 Cash Flows (RM)

Year	1	2	3	4	5	6	7	8	9	10	Total
Predetermined series of payments	–	–	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(1,600)
Net inflow/ (outflow)	–	–	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(1,600)

Table 1.2 Statement of Financial Performance (RM)

Year	1	2	3	4	5	6	7	8	9	10	Total
Service expense	–	–	(12)	(12)	(12)	(12)	(12)	(12)	(12)	(12)	(96)
Finance charge	–	(32)	(67)	(59)	(51)	(43)	(34)	(25)	(22)	(11)	(344)
Depreciation – base layers	–	–	(38)	(38)	(38)	(38)	(38)	(38)	(38)	(38)	(304)
Depreciation – original surface layer	–	–	(18)	(19)	(18)	(18)	(19)	(18)	–	–	(110)
Depreciation-replacement surface layer	–	–	–	–	–	–	–	–	(18)	(19)	(37)
Total depreciation	–	–	(56)	(57)	(56)	(56)	(57)	(56)	(56)	(57)	(451)
Annual surplus/ (deficit)	–	(32)	(135)	(128)	(119)	(111)	(103)	(93)	(90)	(80)	(891)

NOTES:

1. Depreciation in years 3–8 reflects the depreciation on the initially-constructed road surface. It is fully depreciated over that period. Depreciation in years 9–10 reflects the depreciation on the new service concession asset component (surface) recognized in year 8.
2. Although these Illustrative Examples use a straight-line depreciation method, it is not intended that this method be used in all cases. Paragraph 76 of MPSAS 17, *Property, Plant and Equipment*, requires that, “The depreciation method shall reflect the pattern in which the asset’s future economic benefits or service potential is expected to be consumed by the entity.” Likewise, for intangible assets, paragraph 96 of MPSAS 31, *Intangible Assets*, requires that, “The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life.”

Table 1.3 Statement of Financial Position (RM)

Year	1	2	3	4	5	6	7	8	9	10
Service concession asset – base layers	525	940	902	864	826	788	750	712	674	636
Service concession asset – original surface layer	–	110	92	73	55	37	18	–	–	–
Service concession asset – replacement surface layer	–	–	–	–	–	–	–	110	92	73
Total Service concession asset	525	1,050	994	937	881	825	768	822	766	709
Cash	–	–	(200)	(400)	(600)	(800)	(1,000)	(1,200)	(1,400)	(1,600)
Financial liability	(525)	(1,082)	(961)	(832)	(695)	(550)	(396)	(343)	(177)	–
Cumulative surplus/deficit	–	32	167	295	414	525	628	721	811	891
NOTES: 1. In this example, the resurfacing occurs as expected in year 8, when the initially-constructed road surface is fully depreciated. If the resurfacing occurred earlier, the initially-constructed road surface would not be fully depreciated, and would need to be derecognized in accordance with MPSAS 17, <i>Property, Plant and Equipment</i>, before the new component of the service concession asset related to the resurfacing is recognized. 2. The new component of the service concession asset related to the resurfacing is recognized in year 8. Years 9–10 reflect depreciation on this additional component (Table 1.2). 3. The financial liability is increased in year 8 for the recognition of the new component of the service concession asset.										

Table 1.4 Changes in Financial Liability (RM)

Year	1	2	3	4	5	6	7	8	9	10
Balance brought forward	–	525	1,082	961	832	695	550	396	343	177
Liability recognized along with initial service concession asset	525	525	–	–	–	–	–	–	–	–
Finance charge added to liability prior to payments being made	–	32	–	–	–	–	–	–	–	–
Portion of predetermined series of payments that reduces the liability	–	–	(121)	(129)	(137)	(145)	(154)	(163)	(166)	(177)
Liability recognized along with replacement surface layers	–	–	–	–	–	–	–	110	–	–
Balance carried forward	525	1,082	961	832	695	550	396	343	177	–

Example 2: The Grantor Gives the Operator the Right to Charge Users a Toll for Use of the Road

Additional Arrangement Terms

IE23. The terms of the arrangement allow the operator to collect tolls from drivers using the road. The operator forecasts that vehicle numbers will remain constant over the duration of the arrangement and that it will receive tolls of RM200 in each of years 3–10. The total consideration (tolls of RM200 in each of years 3–10) reflects the fair values for each of the services indicated in Exhibit 1, and is intended to cover the cost of constructing the road, annual operating costs of RM12 and reimbursement to the operator for the cost of resurfacing the road in year 8 of RM110.

Financial Statement Impact

IE24. The grantor initially recognizes the service concession asset as property, plant, and equipment at its fair value (total RM1,050, comprised of RM940 related to construction of the base layers and RM110 related to construction of the original surface layers). The asset is recognized as it is constructed (RM525 in year 1 and RM525 in year 2). Depreciation is taken annually (RM56, comprised of RM38 for the base layers and RM18 for the surface layers, starting in year 3).

IE25. As consideration for the service concession asset, the grantor recognizes a liability under the grant of a right to the operator model for granting the operator the right to collect tolls of RM200 in years 3–10. The liability is recognized as the asset is recognized.

- IE26. The liability is reduced over years 3–10, and the grantor recognizes revenue on that basis because access to the service concession asset is expected to be provided evenly over the term of the service concession arrangement from the point at which the asset is capable of providing economic benefits.
- IE27. The compensation for the road resurfacing is included in the tolls the operator expects to earn over the term of the service concession arrangement. There is no direct cash flow impact related to the road resurfacing; however, the grantor recognizes the resurfacing as an asset when the work is undertaken and recognizes depreciation expense of $RM110/6 = RM18$, beginning in year 9.
- IE28. The compensation for maintenance and operating the road (RM12) is included in the tolls the operator expects to earn over the term of the service concession arrangement. There is no financial statement impact related to this service expense. It does not affect cash flow because the grantor has no cash outflow. It is not recognized as an operating expense because the fair value of the asset and liability initially recognized do not include any service costs the operator may incur.

Overview of Cash Flows, Statement of Financial Performance, and Statement of Financial Position

- IE29. The grantor's cash flows, statement of financial performance, and statement of financial position over the duration of the arrangement will be as illustrated in Tables 2.1 to 2.3. In addition, Table 2.4 shows the changes in the liability.

Cash Flows

- IE30. Because there are no payments made to the operator, there are no cash flow impacts for this example.

Table 2.2 Statement of Financial Performance (RM)

Year	1	2	3	4	5	6	7	8	9	10	Total
Revenue (reduction of liability)	–	–	145	145	145	145	145	145	145	145	1,160
Depreciation – base layers	–	–	(38)	(38)	(38)	(38)	(38)	(38)	(38)	(38)	(304)
Depreciation – original surface layer	–	–	(18)	(19)	(18)	(18)	(19)	(18)	–	–	(110)
Depreciation – replacement surface layer	–	–	–	–	–	–	–	–	(18)	(19)	(37)
Total depreciation	–	–	(56)	(57)	(56)	(56)	(57)	(56)	(56)	(57)	(451)
Annual surplus/(deficit)	–	–	89	88	89	89	88	89	89	88	709

NOTES:

1. Depreciation in years 3–8 reflects the depreciation on the initially-constructed road surface. It is fully depreciated over that period.
2. Depreciation in years 9–10 reflects the depreciation on the new service concession asset component (surface) recognized in year 8.
3. The revenue (reduction of the liability) includes revenue from the additional liability (Table 2.3).
4. All revenue is recognized evenly over the term of the arrangement.

Table 2.3 Statement of Financial Position (RM)

Year	1	2	3	4	5	6	7	8	9	10
Service concession asset – base layers	525	940	902	864	826	788	750	712	674	636
Service concession asset – original surface layer	–	110	92	73	55	37	18	–	–	–
Service concession asset – replacement surface layer	–	–	–	–	–	–	–	110	92	73
Total Service concession asset	525	1,050	994	937	881	825	768	822	766	709
Cash	–	–	–	–	–	–	–	–	–	–
Liability	(525)	(1,050)	(905)	(760)	(615)	(470)	(325)	(290)	(145)	–
Cumulative surplus/deficit	–	–	(89)	(177)	(266)	(355)	(443)	(532)	(621)	(709)

NOTES:

1. In this example, the resurfacing occurs as expected in year 8, when the initially-constructed road surface is fully depreciated. If the resurfacing occurred earlier, the initially-constructed road surface would not be fully depreciated, and would need to be derecognized in accordance with MPSAS 17, *Property, Plant and Equipment*, before the new component of the service concession asset related to the resurfacing is recognized.
2. The new component of the service concession asset related to the resurfacing is recognized in year 8. Years 9–10 reflect depreciation on this additional component (Table 2.2).
3. The liability is increased in year 8 for the recognition of the new component of the service concession asset.

Table 2.4 Changes in Liability (RM)

Year	1	2	3	4	5	6	7	8	9	10
Balance brought forward	–	525	1,050	905	760	615	470	325	290	145
Liability recognized along with initial service concession asset	525	525	–	–	–	–	–	–	–	–
Revenue (reduction of liability)	–	–	(145)	(145)	(145)	(145)	(145)	(145)	(145)	(145)
Liability recognized along with replacement surface layers	–	–	–	–	–	–	–	110	–	–
Balance carried forward	525	1,050	905	760	615	470	325	290	145	–

Example 3: The Grantor Makes a Predetermined Series of Payments to the Operator and Also Grants the Operator the Right to Charge Users a Toll for Use of the Road

Additional Arrangement Terms

IE31. The terms of the arrangement allow the operator to collect tolls from drivers using the road. The operator forecasts that vehicle numbers will remain constant over the duration of the arrangement and that it will receive tolls of RM100 in each of years 3–10. The arrangement also requires the grantor to make a predetermined series of payments to the operator of RM100 annually. The fair value of the right to collect tolls and the predetermined series of payments are considered to compensate the operator equally (i.e., 50% from each form of compensation to the operator).

Financial Statement Impact

IE32. The grantor initially recognizes the service concession asset as property, plant, and equipment at its fair value (total RM1,050, comprised of RM940 related to construction of the base layers and RM110 related to construction of the original surface layers). The asset is recognized as it is constructed (RM525 in year 1 and RM525 in year 2). Depreciation is taken annually (RM56, comprised of RM38 for the base layers and RM18 for the surface layers).

IE33. As consideration for the service concession asset, the grantor recognizes both a liability under the grant of a right to the operator model by granting the operator the right to collect tolls of RM100 in years 3–10, and a financial liability to make payments of RM100 in years 3–10. A liability and a financial liability are recognized as the asset is recognized at the end of year 1 (RM525). The liability and financial liability are increased at the end of year 2 to reflect both the fair value of the additional construction (RM525) and the finance charge on the outstanding financial liability.

IE34. The grantor's obligation related to the right granted to the operator to charge tolls and the predetermined payments are regarded as two separate items. Therefore in this arrangement it is necessary to divide the grantor's consideration to the operator into two parts—a liability and a financial liability.

- IE35. The liability of RM525 (recognized evenly at the end of years 1 and 2) is reduced over years 3–10, and the grantor recognizes revenue on the same basis because the tolls are expected to be earned evenly over the term of the service concession arrangement from the point at which the asset is capable of providing service benefits.
- IE36. The grantor initially recognizes a financial liability at fair value equal to half of the fair value of the asset (RM525), recognized evenly at the end of years 1 and 2; a liability under the grant of a right to the operator model is recognized in an amount equal to the other half of the fair value of the asset. The financial liability is also increased at the end of year 2 by the finance charge on the outstanding financial liability. Because the amount of the predetermined payments related to the service component of the service concession arrangement is known, the grantor is able to determine the amount of the payments that reduces the liability. A finance charge at the implicit rate of 6.18% is recognized annually. The liability is subsequently measured at amortized cost, i.e., the amount initially recognized plus the finance charge on that amount calculated using the effective interest method minus repayments.
- IE37. The operator is compensated for the road resurfacing (RM110) equally through the tolls the operator expects to earn over the term of the service concession arrangement and the series of predetermined payments (i.e., 50% from each). There is no direct cash flow impact related to the road resurfacing; however, the grantor recognizes the resurfacing as an asset when the work is undertaken and recognizes depreciation expense of $RM110/6 = RM18$, beginning in year 9.
- IE38. The operator is compensated for maintenance and operating the road (RM12) equally through the tolls the operator expects to earn over the term of the service concession arrangement and the predetermined payment (i.e., 50% from each). There is no direct cash flow impact related to this service expense because the grantor has no cash outflow. However, the grantor recognizes an expense annually for the portion of the compensation related to the series of predetermined payments (RM6). There is no financial statement impact for the remaining RM6 of this service expense. It is not recognized as an operating expense because the fair value of the asset and liability initially recognized do not include any service costs the operator may incur.
- IE39. The grantor's cash flows, statement of financial performance, and statement of financial position over the duration of the arrangement will be as illustrated in Tables 3.1 to 3.3. In addition, Table 3.4 shows the changes in the liability and Table 3.5 shows the changes in the financial liability.

Overview of Cash Flows, Statement of Financial Performance, and Statement of Financial Position

Table 3.1 Cash Flows (RM)

Year	1	2	3	4	5	6	7	8	9	10	Total
Predetermined series of payments	–	–	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(800)
Net inflow/(outflow)	–	–	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(800)

Table 3.2 Statement of Financial Performance (RM)

Year	1	2	3	4	5	6	7	8	9	10	Total
Revenue (reduction of liability)	–	–	73	72	73	72	73	72	73	72	580
Service expense	–	–	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(48)
Finance charge	–	(16)	(33)	(30)	(26)	(22)	(17)	(12)	(11)	(5)	(172)
Depreciation – base layers	–	–	(38)	(38)	(38)	(38)	(38)	(38)	(38)	(38)	(304)
Depreciation – original surface layer	–	–	(18)	(19)	(18)	(18)	(19)	(18)	–	–	(110)
Depreciation – replacement surface layer	–	–	–	–	–	–	–	–	(18)	(19)	(37)
Total depreciation	–	–	(56)	(57)	(56)	(56)	(57)	(56)	(56)	(57)	(451)
Annual surplus/(deficit)	–	(16)	(22)	(21)	(15)	(12)	(7)	(2)	–	4	(91)

NOTES:

1. Depreciation in years 3–8 reflects the depreciation on the initially-constructed road surface. It is fully depreciated over that period.
2. Depreciation in years 9–10 reflects the depreciation on the new service concession asset component (surface) recognized in year 8.
3. The revenue (reduction of the liability) includes revenue from the additional liability (Table 3.3).
4. All revenue is recognized evenly over the term of the arrangement.

Table 3.3 Statement of Financial Position (RM)

Year	1	2	3	4	5	6	7	8	9	10
Service concession asset – base layers	525	940	902	864	826	788	750	712	674	636
Service concession asset – surface layer	–	110	92	73	55	37	18	–	–	–
Service concession asset – replacement surface layer	–	–	–	–	–	–	–	110	92	73
Total service concession asset	525	1,050	994	937	881	825	768	822	766	709
Cash	–	–	(100)	(200)	(300)	(400)	(500)	(600)	(700)	(800)
Liability	(262)	(525)	(452)	(380)	(307)	(235)	(162)	(145)	(72)	–
Financial liability	(263)	(541)	(480)	(416)	(348)	(276)	(199)	(172)	(89)	–
Cumulative surplus/deficit	–	16	38	59	74	86	93	95	95	91

NOTES:

1. In this example, the resurfacing occurs as expected in year 8, when the initially-constructed road surface is fully depreciated. If the resurfacing occurred earlier, the initially-constructed road surface would not be fully depreciated, and would need to be derecognized in accordance with MPSAS 17 before the new component of the service concession asset related to the resurfacing is recognized.
2. The new component of the service concession asset related to the resurfacing is recognized in year 8. Years 9–10 reflect depreciation on this additional component (Table 3.2).
3. The liability is increased in year 8 for the recognition of 50% of the new component of the service concession asset.
4. The financial liability is increased in year 8 for the recognition of 50% of the new component of the service concession asset.

Table 3.4 Changes in Liability (RM)

Year	1	2	3	4	5	6	7	8	9	10
Balance brought forward	–	262	525	452	380	307	235	162	145	72
Liability recognized along with initial service concession asset	262	263	–	–	–	–	–	–	–	–
Revenue (reduction of liability)	–	–	(73)	(72)	(73)	(72)	(73)	(72)	(73)	(72)
Liability recognized along with replacement surface layers	–	–	–	–	–	–	–	55	–	–
Balance carried forward	262	525	452	380	307	235	162	145	72	–

Table 3.5 Changes in Financial Liability (RM)

Year	1	2	3	4	5	6	7	8	9	10
Balance brought forward	–	263	541	480	416	348	276	199	172	89
Liability recognized along with initial service concession asset	263	262	–	–	–	–	–	–	–	–
Finance charge added to liability prior to payments being made	–	16	–	–	–	–	–	–	–	–
Portion of predetermined series of payments that reduces the liability	–	–	(61)	(64)	(68)	(72)	(77)	(82)	(83)	(89)
Liability recognized along with replacement surface layers	–	–	–	–	–	–	–	55	–	–
Balance carried forward	263	541	480	416	348	276	199	172	89	–

Comparison with IPSAS 32

MPSAS 32, *Service Concession Arrangements: Grantor*, is drawn primarily from IPSAS 32 (2018). There is no significant difference between MPSAS 32 and IPSAS 32.

**MPSAS 33 - FIRST-TIME ADOPTION OF ACCRUAL BASIS
MALAYSIAN PUBLIC SECTOR ACCOUNTING STANDARDS
(MPSASs)**

Acknowledgement

The Malaysian Public Sector Accounting Standard (MPSAS) 33 is based on International Public Sector Accounting Standard (IPSAS) 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)*, from the *Handbook of International Public Sector Accounting Pronouncements* of the International Public Sector Accounting Standards Board, published by the International Federation of Accountants (IFAC) in 2018 and is used with permission of IFAC.

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**MPSAS 33—FIRST-TIME ADOPTION OF ACCRUAL BASIS
MALAYSIAN PUBLIC SECTOR ACCOUNTING
STANDARDS (MPSASs)**

History of MPSAS

This version includes amendments resulting from MPSASs issued up to December 2022.

MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)* was issued in November 2015.

Since then, MPSAS 33 has been amended by the following MPSASs:

- *Improvements to MPSASs 2023* (issued December 2022)
- MPSAS 40, *Public Sector Combinations* (issued October 2021)

Table of Amended Paragraphs in MPSAS 33

Paragraph Affected	How Affected	Affected By
7	Deleted	Improvements to MPSASs 2023 December 2022
8	Deleted	Improvements to MPSASs 2023 December 2022
39	Amended	Improvements to MPSASs 2023 December 2022
62A	New	MPSAS 40 October 2021
62B	New	MPSAS 40 October 2021
62C	New	MPSAS 40 October 2021
86	Amended	MPSAS 40 October 2021
129	Amended	MPSAS 40 October 2021
130	Amended	MPSAS 40 October 2021
132	Amended	MPSAS 40 October 2021
154A	New	MPSAS 40 October 2021
154B	New	Improvements to MPSASs 2023 December 2022

MPSAS 33 —FIRST-TIME ADOPTION OF ACCRUAL BASIS MALAYSIAN PUBLIC SECTOR ACCOUNTING STANDARDS

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MPSAS 33 - First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)

Malaysian Public Sector Accounting Standard 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)* is set out in paragraphs 1–154. All the paragraphs have equal authority. MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, should be read in the context of its objective and the *Preface to Malaysian Public Sector Accounting Standards*. MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to provide guidance to a first-time adopter that prepares and presents financial statements following the adoption of accrual basis MPSASs, in order to present high quality information:
 - (a) That provides transparent reporting about a first-time adopter's transition MPSASs;
 - (b) That provides a suitable starting point for accounting in accordance with accrual basis MPSASs irrespective of the basis of accounting the first-time adopter has used prior to the date of adoption; and
 - (c) Where the benefits are expected to exceed the costs.

Scope

2. **An entity shall apply this MPSAS when it prepares and presents its annual financial statements on the adoption of, and during the transition to, accrual basis MPSASs.**
3. This MPSAS applies when an entity first adopts accrual basis MPSASs and during the transitional period allowed in this MPSAS. It does not apply when, for example, a first-time adopter:
 - (a) Stops presenting financial statements in accordance with prescribed requirements, having previously presented them as well as another set of financial statements that contained an explicit and unreserved statement of compliance with accrual basis MPSASs;
 - (b) Presented financial statements in the previous reporting period in accordance with prescribed requirements and those financial statements contained an explicit and unreserved statement of compliance with accrual basis MPSASs; or
 - (c) Presented financial statements in the previous reporting period that contained an explicit and unreserved statement of compliance with accrual basis MPSASs, even if the auditors modified their audit report on those financial statements.
4. This Standard shall be applied from the date on which a first-time adopter adopts accrual basis MPSASs and during the period of transition. This Standard permits a first-time adopter to apply transitional exemptions and provisions that may impact fair presentation. Where these transitional exemptions and provisions are applied, a first-time adopter is required to disclose information about the transitional exemptions and provisions adopted, and progress towards fair presentation and compliance with accrual basis MPSASs.
5. At the end of the transitional period a first-time adopter must comply with the recognition, measurement, presentation and disclosure requirements in the other accrual basis MPSAS in order to assert compliance with accrual basis MPSASs as required in MPSAS 1, *Presentation of Financial Statements*.
6. This MPSAS does not apply to changes in accounting policies made by an entity that already applies MPSASs. Such changes are the subject of:
 - (a) Requirements on changes in accounting policies in MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*; and

- (b) Specific transitional requirements in other MPSASs. The transitional provisions in other MPSASs apply only to changes in accounting policies made by an entity that already applies accrual basis MPSASs; they do not apply to a first-time adopter's transition to MPSASs, except as specified in this MPSAS.

7. [Deleted]

8. [Deleted]

Definitions

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

Date of adoption of MPSASs is the date an entity adopts accrual basis MPSASs for the first time, and is the start of the reporting period in which the first-time adopter adopts accrual basis MPSASs and for which the entity presents its first transitional MPSAS financial statements or its first MPSAS financial statements.

Deemed cost is an amount used as a surrogate for acquisition cost or depreciated cost at a given date.

First MPSAS financial statements are the first annual financial statements in which an entity complies with the accrual basis MPSASs and can make an explicit and unreserved statement of compliance with those MPSASs because it adopted one or more of the transitional exemptions in this MPSAS that do not affect the fair presentation of the financial statements and its ability to assert compliance with accrual basis MPSASs.

First-time adopter is an entity that adopts accrual basis MPSASs for the first time and presents its first transitional MPSAS financial statements or its first MPSAS financial statements.

Opening statement of financial position is a first-time adopter's statement of financial position at the date of adoption of MPSASs.

Period of transition is the period during which a first-time adopter applies one or more of the exemptions in this MPSAS before it complies with the accrual basis MPSASs, and before it is able to make an explicit and unreserved statement of such compliance with MPSASs.

Previous basis of accounting is the basis of accounting that a first-time adopter used immediately before adopting accrual basis MPSASs.

Transitional MPSAS financial statements are the financial statements prepared in accordance with this MPSAS where a first-time adopter cannot make an explicit and unreserved statement of compliance with other MPSASs because it adopted one or more of the transitional exemptions in this MPSAS that affect the fair presentation of the financial statements and its ability to assert compliance with accrual basis MPSASs.

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

Date of Adoption of MPSASs

10. The date of adoption of MPSASs is the date that an entity adopts accrual basis MPSASs for the first time. It is the start of the reporting period in which the first-time adopter adopts accrual basis

MPSASs and for which it presents its first transitional MPSAS financial statements or its first MPSAS financial statements. If a first-time adopter takes advantage of the exemptions in this MPSASs that affect fair presentation and compliance with accrual basis MPSASs (see paragraphs 36–62) in producing its first transitional MPSAS financial statements, it can only make an explicit and unreserved statement of compliance with accrual basis MPSASs when the exemptions that provided the relief have expired, and/or when the relevant items are recognized, measured and/or the relevant information is presented and/or disclosed in the financial statements in accordance with the applicable MPSASs (whichever is earlier). Financial statements shall not be described as complying with MPSASs unless they comply with all the requirements of all the applicable MPSASs.

First MPSAS Financial Statements

11. An entity's first MPSAS financial statements are the first annual financial statements in which the first-time adopter can make an explicit and unreserved statement in those financial statements of compliance with accrual basis MPSASs. If a first-time adopter does not adopt the exemptions in this MPSAS that affect fair presentation and compliance with accrual basis MPSASs (see paragraphs 36– 62), its first financial statements following the adoption of accrual basis MPSASs will also be its first MPSAS financial statements.

Previous Basis of Accounting

12. The previous basis of accounting is the basis of accounting that a first-time adopter used immediately before adopting accrual basis MPSASs. This might be a cash basis of accounting, an accrual basis of accounting, a modified version of either a cash basis or an accrual basis of accounting, or another prescribed basis.

Transitional MPSAS Financial Statements

13. An entity's transitional MPSAS financial statements are the annual financial statements in which an entity transitions to accrual basis MPSASs and adopts certain exemptions in this MPSAS that affect the fair presentation of the financial statements and its ability to assert compliance with accrual basis MPSASs. If a first-time adopter adopts the exemptions in this MPSASs that affect fair presentation and compliance with accrual basis MPSASs (see paragraphs 36–62), it will not be able to make an explicit and unreserved statement of compliance with other accrual basis MPSASs until the exemptions that provided the relief in this MPSAS have expired and/or when the relevant items are recognized, measured and/or the relevant information has been presented and/or disclosed in accordance with the applicable MPSASs (whichever is earlier). Financial statements shall not be described as complying with MPSASs unless they comply with all the requirements of all the applicable MPSASs.
14. An entity's transitional MPSAS financial statements are those financial statements, where the entity transitions from another accounting basis such as when it:
 - (a) Prepared its most recent previous financial statements in accordance with the MPSAS, *Financial Reporting Under the Cash Basis of Accounting*;
 - (b) Presented its most recent previous financial statements:
 - (i) In accordance with prescribed requirements that are not consistent with MPSASs in all respects;

- (ii) In conformity with MPSASs in all respects, except that the financial statements did not contain an explicit and unreserved statement that they complied with MPSASs;
 - (iii) Containing an explicit statement of compliance with some, but not all, MPSASs, including the adoption of the exemptions provided in this MPSAS that affect fair presentation and compliance with accrual basis MPSASs (see paragraphs 36–62);
 - (iv) In accordance with prescribed requirements inconsistent with MPSASs, using some individual MPSASs to account for items for which prescribed requirements did not exist; or
 - (v) In accordance with prescribed requirements, with a reconciliation of some amounts to the amounts determined in accordance with MPSASs;
- (c) Prepared financial statements in accordance with MPSASs for internal use only, without making them available to external users;
- (d) Prepared a reporting package in accordance with MPSASs for consolidation purposes without preparing a complete set of financial statements as defined in MPSAS 1, *Presentation of Financial Statements*; or
- (e) Did not present financial statements for previous periods.

Recognition and Measurement

Opening Statement of Financial Position on Adoption of MPSASs

15. **A first-time adopter shall prepare and present an opening statement of financial position at the date of adoption of MPSASs. This is the starting point for its accounting in accordance with accrual basis MPSASs.**

Accounting Policies

16. **On the date of adoption of accrual basis MPSASs, a first-time adopter shall apply the requirements of the MPSASs retrospectively except if required, or otherwise permitted, in this MPSAS.**
17. **A first-time adopter shall use the same accounting policies in its opening statement of financial position and throughout all periods presented, except as specified in paragraphs 36–134. The accounting policies shall comply with each MPSAS effective at the date of adoption of MPSASs, except as specified in paragraphs 36–134.**
18. A first-time adopter that takes advantage of the exemptions in paragraph 36–134 will be required to amend its accounting policies after the exemptions that provided the relief have expired and/or when the relevant items are recognized, measured and/or the relevant information is presented and/or disclosed in the financial statements in accordance with the applicable MPSASs (whichever is earlier).

19. A first-time adopter shall apply the versions of accrual basis MPSASs effective at the date of adoption of MPSASs. A first-time adopter may apply a new MPSAS that is not yet mandatory if that MPSAS permits early application. Any new MPSASs that become effective during the period of transition shall be applied by the first-time adopter from the date it becomes effective.
20. Except as described in paragraphs 36–134, a first-time adopter shall, in its opening statement of financial position:
 - (a) Recognize all assets and liabilities whose recognition is required by MPSASs;
 - (b) Not recognize items as assets or liabilities if MPSASs do not permit such recognition;
 - (c) Reclassify items that it recognized in accordance with the previous basis of accounting as one type of asset, liability or component of net assets/equity, but are a different type of asset, liability or component of net assets/equity in accordance with MPSASs; and
 - (d) Apply MPSASs in measuring all recognized assets and liabilities.
21. The accounting policies that a first-time adopter uses in financial statements may differ from those that it used at the end of its comparative period under its previous basis of accounting. The resulting adjustments arise from transactions, other events or conditions before the date of adoption of MPSASs. Therefore, a first-time adopter shall recognize those adjustments to the opening balance of accumulated surplus or deficit in the period in which the items are recognized and/or measured (or, if appropriate, another category of net assets/equity). The first-time adopter shall recognize these adjustments in the earliest period presented.
22. The transitional exemptions and provisions in other MPSAS apply to changes in accounting policies made by an entity that already applies accrual basis MPSASs. The transitional exemptions and provisions in this MPSAS applies to a first-time adopter that prepares and presents its annual financial statements on the adoption of, and during the transition to accrual basis MPSASs.

Exceptions to the Retrospective Application of MPSASs

23. **A first-time adopter's estimates in accordance with MPSASs at the date of adoption of MPSASs, shall be consistent with estimates made in accordance with the previous basis of accounting (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were inconsistent with the requirements in MPSASs.**
24. This MPSAS prohibits retrospective application of some aspects of accrual basis MPSASs. A first-time adopter may receive information after the date of adoption of MPSASs about estimates that it had made under its previous basis of accounting. In accordance with paragraph 23, a first-time adopter shall treat the receipt of that information in the same way as non-adjusting events after the reporting period in accordance with MPSAS 14, *Events After the Reporting Period*.
25. A first-time adopter may need to make estimates in accordance with MPSASs at the date of adoption of MPSASs or during the period of transition that were not required at that date under the previous basis of accounting. To achieve consistency with MPSAS 14, *Events After the Reporting Period*, those estimates in accordance with MPSASs shall reflect conditions that

existed at the date of adoption of MPSASs or at the date during the period of transition. In particular, estimates determined at the date of adoption of MPSASs or during the period of transition of market prices, interest rates or foreign exchange rates shall reflect market conditions at that date. For non-financial assets, such as property, plant and equipment, estimates about the asset's useful life, residual value or condition reflect management's expectations and judgment at the date of adoption of MPSASs or the date during the period of transition.

26. Paragraphs 23–25 apply to the opening statement of financial position. They also apply to a comparative period where an entity elects to present comparative information in accordance with paragraph 78, in which case the references to the date of adoption of MPSASs are replaced by references to the end of that comparative period.

Fair Presentation and Compliance with MPSASs

27. **A first-time adopter's first MPSAS financial statements shall fairly present the financial position, financial performance, and cash flows of the entity. Fair presentation requires the faithful representation of the effects of transactions, other events, and conditions in accordance with the definitions and recognition criteria for assets, liabilities, revenue, and expenses set out in MPSASs. If a first-time adopter takes advantage of the exemptions in paragraphs 36–62, these exemptions will affect the fair presentation of the financial statements and the first-time adopter's ability to assert compliance with accrual basis MPSASs, until the exemptions that provided the relief have expired and/or when the relevant items are recognized and/or measured in accordance with the applicable MPSAS (whichever is earlier).**
28. **A first-time adopter shall claim full compliance with MPSASs only when it has complied with all the requirements of the applicable MPSASs effective at that date, subject to paragraph 11. If a first-time adopter adopts one or more of the exemptions in paragraph 36–62, the fair presentation of the financial statements and its ability to assert compliance with accrual basis MPSASs will be affected. An entity's whose financial MPSASs statements shall make an explicit and unreserved statement of such compliance in the notes. Financial statements shall not be described as complying with MPSASs unless they comply with all the requirements of MPSASs, and shall be qualified as accrual basis MPSAS complaint financial statements.**
29. In accordance with paragraph 29 of MPSAS 1, *Presentation of Financial Statements*, fair presentation is achieved in virtually all circumstances by compliance with applicable MPSASs. For a first-time adopter to claim full compliance with MPSASs, all the requirements of the applicable MPSASs needs to be complied with to ensure that information is presented in a manner that meets the qualitative characteristics, subject to paragraph 11.
30. The exemptions in paragraphs 36–62 provide relief from the recognition, measurement, presentation and/or disclosure requirements in MPSASs on the date of adoption of MPSASs and during the period of transition. A first-time adopter may elect to adopt these exemptions, but shall consider that applying these exemptions will affect the fair presentation of its financial statements and its ability to assert compliance with accrual basis MPSASs in accordance with paragraphs 27 and 28 until the exemptions that provided the relief have expired and/or when the relevant items

are recognized, measured, and/or the relevant information is presented and/or disclosed in the financial statements in accordance with the applicable MPSASs (whichever is earlier). Before making use of such exemptions, a first-time adopter shall consider all the relevant facts and circumstances and the potential effect on its financial statements.

31. **A first-time adopter shall assess whether the transitional exemptions adopted affect the fair presentation of the financial statements and the first-time adopter's ability to a compliance with accrual basis MPSASs.**
32. For example, a first-time adopter adopts the three year transitional relief period for the recognition and measurement of traffic fines because insufficient data is available about the value of fines issued, fines written off, the compromises reached with offenders etc. The relief period is not applied to any other class of non-exchange revenue. The revenue received from fines is not material in relation to the financial statements as a whole. The entity concludes that, by adopting the transitional exemption and provisions, fair presentation and compliance with MPSASs will not be affected. As a result, the first-time adopter will still be able to achieve fair presentation and assert compliance with accrual basis MPSASs at the date of adoption of accrual basis MPSASs or during the period of transition.

Exemptions that Affect Fair Presentation and Compliance with Accrual Basis MPSASs during the Period of Transition

33. **A first-time adopter may adopt the exemptions in paragraphs 36–62. These exemptions will affect the fair presentation of a first-time adopter's financial and its ability to assert compliance with accrual basis MPSASs during the period of transition in accordance with paragraphs 27 and 28 while they are applied. A first-time adopter shall not apply these exemptions by analogy to other items.**
34. **Notwithstanding the exemptions provided in paragraphs 36–62 a first-time adopter is encouraged to comply in full with all the requirements of the applicable MPSASs as soon as possible.**
35. **To the extent that a first-time adopter applies the exemptions in paragraph 36–62, it is not required to apply any associated presentation and/or disclosure requirements in the applicable MPSASs until the exemptions that provided the relief have expired or the relevant items are recognized and/or measured in the financial statements in accordance with the applicable MPSASs (whichever is earlier).**

Three Year Transitional Relief for the Recognition and/or Measurement of Assets and/or Liabilities

Recognition and/or Measurement of Assets and/or Liabilities

36. **Where a first-time adopter has not recognized assets and/or liabilities under its previous basis of accounting, it is not required to recognize and/or measure the following assets and/or liabilities for reporting periods beginning on a date within three years following the date of adoption of MPSASs:**
- (a) **Inventories (see MPSAS 12, *Inventories*);**

- (b) **Investment property** (see MPSAS 16, *Investment Property*);
 - (c) **Property, plant and equipment** (see MPSAS 17, *Property, Plant and Equipment*);
 - (d) **Defined benefit plans and other long-term employee benefits** (see MPSAS 25, *Employee Benefits*);
 - (e) **Biological assets and agricultural produce** (see MPSAS 27, *Agriculture*);
 - (f) **Intangible assets** (see MPSAS 31, *Intangible Assets*);
 - (g) **Service concession assets and the related liabilities, either under the financial liability model or the grant of a right to the operator model** (see MPSAS 32, *Service Concession Arrangements: Grantor*); and
 - (h) **Financial instruments** (see MPSAS 29, *Financial Instruments; Recognition and Measurement*).
37. **Where a first-time adopter applies the exemption in paragraph 36(d), it shall recognize the obligation and any related plan assets at the same time.**
38. **Where a first-time adopter has recognized the assets and/or liabilities included in paragraph 36 under its previous basis of accounting, it is not required to change its accounting policy(ies) in respect of the measurement of these assets and/or liabilities for reporting periods beginning on a date within three years following the date of adoption of MPSASs.**
39. Subject to paragraphs 36 and 38, a first-time adopter is not required to change its accounting policy(ies) in respect of the recognition and/or measurement of assets and/or liabilities for reporting periods beginning on a date within three years following the date of adoption of MPSASs. The transitional exemptions in paragraphs 36 and 38 are intended to allow a first-time adopter a period to develop reliable¹ models for recognizing and/or measuring its assets and/or liabilities during the period of transition. The first-time adopter may apply accounting policies for the recognition and/or measurement of such assets and/or liabilities that do not comply with the provisions of other MPSASs.
40. **Subject to the provisions of paragraphs 36 and 38, a first-time adopter shall only change its accounting policies during the period of transition to better conform to the accounting policies in accrual basis MPSASs, and may retain its existing accounting policies until the exemptions that provided the relief have expired or when the relevant items are recognized and/or measured in the financial statements in accordance with the applicable MPSASs (whichever is earlier). A first-time adopter may change its accounting policy in respect of the recognition and/or measurement of assets and/or liabilities on a class-by-class or category-by-category basis where the use of classes or categories is permitted in the applicable MPSAS.**

¹ Information that is reliable is free from material error and bias, and can be depended on by users to faithfully represent that which it purports to represent or could reasonably be expected to represent.

41. **To the extent that a first-time adopter applies the exemptions in paragraphs 36 and 38 which allows a three year transitional relief period to not recognize and/or measure financial assets, it is not required to recognize and/or measure any related revenue in terms of MPSAS 9, *Revenue from Exchange Transactions*, or other receivables settled in cash or another financial asset in terms of MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*.**

Recognition and/or Measurement of Non-Exchange Revenue

42. **A first-time adopter is not required to change its accounting policy in respect of the recognition and measurement of non-exchange revenue for reporting periods beginning on a date within three years following the date of adoption of MPSASs. A first-time adopter may change its accounting policy in respect of revenue from non-exchange transactions on a class-by-class basis.**
43. The transitional provision in paragraph 42 is intended to allow a first-time adopter a period to develop reliable models for recognizing and measuring revenue from non-exchange transactions in accordance with MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*, during the period of transition. The first-time adopter may apply accounting policies for the recognition and/or measurement of revenue from non-exchange transactions that do not comply with the provisions of MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. The transitional provision in paragraph 42 allows a first-time adopter to apply MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*, incrementally to different classes of revenue from non-exchange transactions. For example, a first-time adopter may be able to recognize and measure property taxes and some other classes of transfers in accordance with MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*, from the date of adoption of MPSASs, but may require three years to fully develop a reliable model for recognizing and measuring income tax revenue.

Other Exemptions

MPSAS 5, Borrowing Costs

44. **Where a first-time adopter applies the exemption in paragraph 36 which allows a three year transitional relief period to not recognize and/or measure assets, and elects to account for borrowing costs in terms of the allowed alternative treatment, it is not required to capitalize any borrowing costs on qualifying assets for which the commencement date for capitalization is prior to the date of adoption of accrual basis MPSASs, until the exemption that provided the relief has expired and/or when the relevant assets are recognized and/or measured in accordance with the applicable MPSASs (whichever is earlier).**
45. Paragraph 36 allows a first-time adopter to not, recognize and/or measure assets in accordance with MPSAS 16, *Investment Property*, MPSAS 17, *Property, Plant and Equipment*, MPSAS 27, *Agriculture*, MPSAS 31, *Intangible Assets*, and MPSAS 32, *Service Concession Arrangements: Grantor*, for a period of up to three years from the date of adoption of MPSASs. During this period, a first-time adopter may need to consider the requirements of those MPSASs at the same time as the capitalization of borrowing costs where it applies the allowed alternative method. Where a first-time adopter takes advantage of the transitional exemption period for the recognition and/or measurement of assets in accordance with MPSAS 16, *Investment Property*,

MPSAS 17, *Property, Plant and Equipment*, MPSAS 27, *Agriculture*, MPSAS 31, *Intangible Assets*, and MPSAS 32, *Service Concession Arrangements: Grantor*, it is not required to capitalize borrowing costs incurred on qualifying assets prior, or during the period of transition. Only when the exemptions that provided the relief have expired, and/or when the relevant assets are recognized and/or measured in accordance with the applicable MPSASs (whichever is earlier) will a first-time adopter be allowed to capitalize borrowing costs incurred on the qualifying assets in accordance with the allowed alternative treatment.

MPSAS 13, Leases

46. **Where a first-time adopter takes advantage of the exemption in paragraph 36 which allows a three year transitional relief period to not recognize assets, it is not required to apply the requirements related to finance leases until the exemption that provided the relief has expired, and/or when the relevant assets are recognized in accordance with the applicable MPSASs (whichever is earlier).**
47. This MPSAS allows a first-time adopter a period of up to three years from the date of adoption of MPSASs to not recognize assets in accordance with MPSAS 16, *Investment Property*, MPSAS 17, *Property, Plant and Equipment*, MPSAS 27, *Agriculture*, MPSAS 31, *Intangible Assets*, and MPSAS 32, *Service Concession Arrangements: Grantor*. During this period, a first-time adopter may need to consider the recognition requirements of those MPSASs at the same time as considering the recognition of finance leases in this MPSAS. Where a first-time adopter takes advantage of the exemption in accordance with MPSAS 16, *Investment Property*, MPSAS 17, *Property, Plant and Equipment*, MPSAS 27, *Agriculture*, MPSAS 31, *Intangible Assets*, and MPSAS 32, *Service Concession Arrangements: Grantor*, it is not required to recognize finance lease assets and/or liabilities until the exemptions that provided the relief have expired, and/or when the relevant assets are recognized in accordance with the applicable MPSASs (whichever is earlier).

MPSAS 19, Provisions, Contingent Liabilities and Contingent Assets

48. **Where a first-time adopter takes advantage of the exemption in paragraph 36 which allows a three year transitional relief period to not recognize and/or measure property, plant and equipment, it is not required to recognize and/or measure the liability relating to the initial estimate of costs of dismantling and removing the item and restoring the site on which it is located until the exemption for MPSAS 17, *Property, Plant and Equipment*, has expired, and/or the relevant asset is recognized and/or measured in accordance with MPSAS 17, *Property, Plant and Equipment*, (whichever is earlier).**
49. This MPSAS allows a first-time adopter a period of up to three years from the date of adoption of MPSASs to not recognize and/or measure property, plant and equipment. MPSAS 17, *Property, Plant and Equipment*, requires an entity to include as part of the cost of an item of property, plant and equipment, the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located. Where a first-time adopter takes advantage of the exemption that allows a three year transitional relief period for the recognition and/or measurement of property, plant and equipment, a first-time adopter is not required to apply the requirements related to the initial estimate of costs of dismantling and removing the item and restoring the site on which it is located until the exemption that provided the relief has expired,

and/or when the relevant asset is recognized and/or measured in accordance with MPSAS 17, *Property, Plant and Equipment*, (whichever is earlier). The liability shall be measured as at the date of adoption of MPSASs, or where a first-time adopter has taken advantage of the exemption that allows a three year transitional relief period for the recognition and/or measurement of an asset, the date on which the exemption that provides the relief has expired and/or the asset has been recognized and/or measured in accordance with the applicable MPSASs.

50. **Where a first-time adopter takes advantage of the exemption in paragraph 48, it shall recognize and/or measure the obligation and any related asset at the same time.**

MPSAS 20, Related Party Disclosures

51. **A first-time adopter is not required to disclose related party relationships, related party transactions and information about key management personnel for reporting periods beginning on a date within three years following the date of adoption of MPSASs.**
52. **Notwithstanding the transitional provision in paragraph 51, a first-time adopter is encouraged to disclose information about related party relationships, related party transactions and information about key management personnel that is known at the date of adoption of MPSAS.**

MPSAS 34, Separate Financial Statements, MPSAS 35, Consolidated Financial Statements and MPSAS 36, Investments in Associates and Joint Ventures

53. **Where a first-time adopter has not recognized its interests in controlled entities, associates or joint ventures under its previous basis of accounting, it is not required to recognize and/or measure its interests in other entities as a controlled entity, associate or joint venture for reporting periods beginning on a date within three years following the date of adoption of accrual basis MPSAS.**
54. Subject to paragraph 53, a first-time adopter is not required to change its accounting policy in respect of the recognition and/or measurement of its interests in controlled entities, associates or joint ventures for reporting periods beginning on a date within three years following the date of adoption of MPSASs. The transitional exemption in paragraph 53 is intended to allow a first-time adopter a period to identify and appropriately classify its interests in other entities as either controlled entities, associates or joint ventures during the period of transition. The first-time adopter may apply accounting policies for the recognition and/or measurement of its interests in controlled entities, associates or joint ventures that do not comply with the provisions of other MPSASs.

MPSAS 35, Consolidated Financial Statements

55. **Subject to paragraph 53, a first-time adopter shall present consolidated financial statements following the adoption of accrual basis MPSASs. A first-time adopter presenting consolidated financial statements is, however, not required to eliminate all balances, transactions, revenue and expenses between entities within the economic entity for reporting periods beginning on a date within three years following the date of adoption of MPSASs.**

56. On adoption of MPSASs, an entity may have controlled entities with a significant number of transactions between controlled entities. Accordingly, it may be difficult to identify some transactions and balances that need to be eliminated for the purpose of preparing the consolidated financial statements of the economic entity. For this reason, paragraph 55 provides relief for a period of up to three years to fully eliminate balances, transactions, revenue and expenses between entities within the economic entity.
57. **Notwithstanding the transitional exemption in paragraph 55, a first-time adopter is encouraged to eliminate those balances, transactions, revenue and expenses that are known on the date of adoption of MPSASs to comply in full with the provisions of MPSAS 35, *Consolidated Financial Statements*, as soon as possible.**
58. **Where a first-time adopter has taken advantage of the transitional exemption in paragraph 53 and/or paragraph 55, it shall not present financial statements as consolidated financial statements until:**
- (a) **The exemptions that provided the relief have expired; and**
 - (b) **Its interests in other entities have been appropriately recognized and/or measured as controlled entities, associates or joint ventures; or**
 - (c) **Inter-entity balances, transactions, revenue and expenses between entities within the economic entity are eliminated (whichever is earlier).**

MPSAS 36, Investments in Associates and Joint Ventures

59. **When a first-time adopter applies the equity method on adoption of MPSAS 36, *Investments in Associates and Joint Ventures*, the investor is not required to eliminate its share in the surplus and deficit resulting from upstream and downstream transactions between the investor and its associate or joint venture for reporting periods beginning on a date within three years following the date of adoption of MPSASs.**
60. On adoption of MPSASs, a first-time adopter may be an investor in one or more associates or joint ventures with a significant number of upstream and downstream transactions between the investor and the investee. Accordingly, it may be difficult to identify some upstream and/or downstream transactions in which the investor's share in the associate's or joint venture's surplus or deficit needs to be eliminated in applying the equity method. For this reason, paragraph 59 provides the investor relief with a period of up to three years to fully eliminate its share in the associate's or joint venture's surplus or deficit resulting from upstream and/or downstream transactions.
61. **Notwithstanding the transitional exemption in paragraph 59, a first-time adopter is encouraged to eliminate its share in the associate's and joint venture's surplus or deficit resulting from upstream and downstream transactions that are known on the date of adoption of MPSASs, to comply in full with the provisions of MPSAS 36, *Investments in Associates and Joint Ventures*, as soon as possible.**
62. **Where a first-time adopter has taken advantage of the transitional exemption in paragraph 53 and/or paragraph 59, it shall not present financial statements in which investments in associates or joint ventures are accounted for using the equity method until:**

- (a) The exemptions that provided the relief have expired; and
- (b) The interest in other entities have been appropriately recognized and/or measured as an associate or joint venture; or
- (c) Its share in the associate's surplus and deficit resulting from upstream and downstream transactions between the investor and the investee are eliminated (whichever is earlier).

MPSAS 40, Public Sector Combinations

- 62A. Where a first-time adopter applies the exemption in paragraph 36 which allows a three year transitional relief period to not recognize and/or measure assets and/or liabilities, the first-time adopter may be a party to a public sector combination during that three year transitional relief period. The first-time adopter is not required to recognize and/or measure the assets and/or liabilities associated with the public sector combination, until the exemption that provided the relief has expired and/or when the relevant assets and/or liabilities are recognized and/or measured in accordance with the applicable MPSASs (whichever is earlier).
- 62B. Where a first-time adopter applies the exemption in paragraph 62A it shall not recognize goodwill in respect of an acquisition. The first-time adopter shall recognize the difference between (a) and (b) below in net assets/equity:
- (a) The aggregate of:
 - (i) Any consideration transferred;
 - (ii) Any non-controlling interests in an acquired operation; and
 - (iii) Any previously held equity interests in an acquired operation.
 - (b) The net amounts of any identifiable assets acquired and the liabilities assumed.
- 62C. *MPSAS 40, Public Sector Combinations*, is applied prospectively. Consequently, a first-time adopter does not adjust any amounts of goodwill recognized as a result of a public sector combination that occurred prior to the application of *MPSAS 40, Public Sector Combinations*.

Exemptions that Do Not Affect Fair Presentation and Compliance with Accrual Basis MPSASs during the Period of Adoption

63. A first-time adopter is required, or may elect, to adopt the exemptions in paragraphs 64–134. These exemptions will not affect the fair presentation of a first-time adopter's financial statements and its ability to assert compliance with accrual basis MPSASs during the period of transition in accordance with paragraphs 27 and 28 while they are applied. A first-time adopter shall not apply these exemptions by analogy to other items.

Using Deemed Cost to Measure Assets and/or Liabilities

64. A first-time adopter may elect to measure the following assets and/or liabilities at their fair value when reliable cost information about the assets and liabilities is not available, and use that fair value as the deemed cost for:

- (a) **Inventory (see MPSAS 12, *Inventories*);**
 - (b) **Investment property, if the first-time adopter elects to use the cost model in MPSAS 16, *Investment Property*;**
 - (c) **Property, plant and equipment (see MPSAS 17, *Property, Plant and Equipment*);**
 - (d) **Intangible Assets, other than internally generated intangible assets (see MPSAS 31, *Intangible Assets*) that meets:**
 - (i) **The recognition criteria in MPSAS 31, *Intangible Assets*, (excluding the reliable measurement criterion); and**
 - (ii) **The criteria in MPSAS 31, *Intangible Assets*, for revaluation (including the existence of an active market);**
 - (e) **Financial Instruments (see MPSAS 29, *Financial Instruments: Recognition and Measurement*); or**
 - (f) **Service concession assets (see MPSAS 32, *Service Concession Arrangements: Grantor*).**
65. Deemed cost can only be determined where the acquisition cost of the asset and/or the liability is not available. Deemed cost assumes that the entity had initially recognized the asset and/ or the liability at the given date. Subsequent depreciation or amortization is based on that deemed cost on the premise that the acquisition cost is equal to the deemed cost. For example, a first-time adopter may elect to measure property, plant and equipment at deemed cost at the date of adoption of MPSASs because cost information about the item of property, plant and equipment was not available on that date, and use fair value as its deemed cost at that date. Any subsequent depreciation is based on the fair value determined at that date and starts from the date that the deemed cost has been determined.
66. The use of deemed cost is not considered a revaluation or the application of the fair value model for subsequent measurement in accordance with other MPSASs.
67. **A first-time adopter may elect to use the revaluation amount of property, plant and equipment under its previous basis of accounting as deemed cost if the revaluation was, at the date of the revaluation, broadly comparable to:**
- (a) **Fair value; or**
 - (b) **Cost or depreciated cost, where appropriate, in accordance with MPSASs adjusted to reflect, for example, changes in a general or specific price index.**
68. A first-time adopter may have established a deemed cost in accordance with its previous basis of accounting for property, plant and equipment by measuring it at fair value at one particular date because of a specific event:
- (a) If the measurement date is at or before the date of adoption of MPSASs, a first-time adopter may use such event-driven fair value measurements as deemed cost for MPSASs at the date of that measurement.

- (b) If the measurement date is after the date of adoption of MPSASs, but during the period of transition where the first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure certain assets, the event-driven fair value measurements may be used as deemed cost when the event occurs. A first-time adopter shall recognize the resulting adjustments directly in accumulated surplus or deficit when the asset is recognized and/or measured.
69. In determining the fair value in accordance with paragraph 67, the first-time adopter shall apply the definition of fair value and guidance in other applicable MPSASs in determining the fair value of the asset in question. The fair value shall reflect conditions that existed at the date on which it was determined.
70. **If reliable market-based evidence of fair value is not available for inventory, or investment property that is of a specialized nature, a first-time adopter may consider the following measurement alternatives in determining a deemed cost:**
- (a) **For inventory, current replacement cost; and**
 - (b) **For investment property of a specialized nature, depreciated replacement cost.**

Using Deemed Cost to Measure Assets Acquired Through a Non-Exchange Transaction

71. **A first-time adopter may elect to measure an asset acquired through a non-exchange transaction at its fair value when reliable cost information about the asset is not available, and use that fair value as its deemed cost.**

Using Deemed Cost for Investments in Controlled Entities, Joint Ventures and Associates (MPSAS 34, Separate Financial Statements)

72. **Where a first-time adopter measures an investment in a controlled entity, joint venture or associate at cost in its separate financial statements, it may, on the date of adoption of MPSASs, elect to measure that investment at one of the following amounts in its separate opening statement of financial position:**
- (a) **Cost; or**
 - (b) **Deemed cost. The deemed cost of such an investment shall be its fair value (determined in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*) at the first-time adopter's date of MPSASs in its separate financial statements.**
73. A first-time adopter may have established a deemed cost in accordance with its previous basis of accounting for an investment in a controlled entity, joint venture or associate by measuring it at its fair value at one particular date because of a specific event. In such instances, a first-time adopter applies paragraph 72(a) and (b).

Date at which Deemed Cost can be Determined

74. **The date at which deemed cost is determined may vary depending on whether the first-time adopter takes advantage of the exemptions that provides a three year transitional relief period to not recognize and/or measure certain assets and/or liabilities. When the first-time**

adopter takes advantage of the exemption, deemed cost can be determined at any date during this period, or on the date that the exemption expires (whichever is earlier), and shall be recognized in accordance with paragraph 76. If a first-time adopter does not adopt the exemption, deemed cost shall be determined at the beginning of the earliest period for which the first-time adopter presents MPSAS financial statements.

75. Where a first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure certain assets and/or liabilities, it may determine a deemed cost for that asset and/or liability at any point of time within the three year transitional relief period.
76. **When a deemed cost is determined during the period in which a first-time adopter takes advantage of the exemption that provides a three year transitional exemption not to recognize and/or measure an asset and/or liability, a first-time adopter shall recognize the adjustment against the opening accumulated surplus or deficit in the year in which the deemed cost of the asset and/or liability is recognized and/or measured.**

MPSAS 1, Presentation of Financial Statements

Comparative Information

77. **A first-time adopter is encouraged, but not required, to present comparative information in its first transitional MPSAS financial statements or its first MPSAS financial statements presented in accordance with this MPSAS. When a first-time adopter presents comparative information, it shall be presented in accordance with the requirements of MPSAS 1, *Presentation of Financial Statements*.**
78. **Where a first-time adopter elects to present comparative information, the transitional MPSAS financial statements or the first MPSAS financial statements presented in accordance with this MPSAS shall include:**
- (a) **One statement of financial position with comparative information for the preceding period, and an opening statement of financial position as at the beginning of the reporting period prior to the date of adoption of accrual basis MPSAS;**
 - (b) **One statement of financial performance with comparative information for the preceding period;**
 - (c) **One statement of changes in net assets/equity with comparative information for the preceding period;**
 - (d) **One cash flow statement with comparative information for the preceding period;**
 - (e) **A comparison of budget and actual amounts for the current year as a separate additional financial statement or as a budget column in the financial statements if the first-time adopter makes its approved budget publicly available; and**
 - (f) **Related notes including comparative information, and the disclosure of narrative information about material adjustments as required by paragraph 142.**

79. **Where a first-time adopter elects to not present comparative information, its transitional MPSAS financial statements following the adoption of accrual basis MPSASs or its first MPSAS financial statements presented in accordance with this MPSASs shall include:**
- (a) **One statement of financial position, and an opening statement of financial position at the date of adoption of accrual basis MPSASs;**
 - (b) **One statement of financial performance;**
 - (c) **One statement of changes in net assets/equity;**
 - (d) **One cash flow statement;**
 - (e) **A comparison of budget and actual amounts for the current year as a separate additional financial statement or as a budget column in the financial statements if the first-time adopter makes its approved budget publicly available; and**
 - (f) **Related notes and the disclosure of narrative information about material adjustments as required by paragraph 142.**
80. **Where a first-time adopter takes advantage of the exemptions in paragraphs 36–62 which allow a three year transitional relief period to not recognize and/or measure an item, comparative information for the year following the date of adoption of MPSASs shall be adjusted only when information is available about the items following their recognition and/or measurement during the relief period.**
81. MPSAS 1, *Presentation of Financial Statements*, requires an entity to present comparative information in respect of the previous period for all amounts reported in the financial statements. Where a first-time adopter takes advantage of the exemption that provides a three year transitional exemption to not recognize and/or measure an item, it shall, during the period of transition present comparative information for an item recognized and/or measured during that period only, if information is available about the item for the comparative period. The first-time adopter shall apply the requirements in MPSAS 1, *Presentation of Financial Statements*, after it has adjusted its first MPSAS financial statements.

Non-MPSAS Comparative Information

82. A first-time adopter may present comparative information in accordance with its previous basis of accounting. In any financial statements containing comparative information in accordance with the previous basis of accounting, the first-time adopter shall label the information prepared using the previous basis of accounting information as not being prepared in accordance with MPSASs, and disclose the nature of the main adjustments that would be required to comply with MPSASs.
83. Where a first-time adopter presents non-MPSAS comparative information in its first MPSAS or first transitional MPSAS financial statements following its adoption of accrual basis MPSASs, the transitional exemptions and provisions provided in this Standard shall not be applied to the non-MPSAS comparative information presented in the first MPSAS financial statements or first transitional MPSAS financial statements.

Non-MPSAS Historical Summaries

84. A first-time adopter may elect to present historical summaries of selected data for periods before the first period for which it presents financial statements in accordance with MPSASs. This MPSAS does not require such summaries to comply with the recognition and measurement requirements of MPSASs. In any financial statements containing historical summaries in accordance with the previous basis of accounting, the first-time adopter shall label the previous basis of accounting information prominently as not being prepared in accordance with MPSASs, and disclose the nature of the main adjustments that would be required to comply with MPSASs. The first-time adopter need not quantify those adjustments.

MPSAS 4, The Effects of Changes in Foreign Exchange Rates

85. **On the date of adoption of MPSASs a first-time adopter need not comply with the requirements for cumulative translation differences that exist at that date. If a first-time adopter uses this exemption:**
- (a) **The cumulative translation differences for all foreign operations are deemed to be zero at the date of adoption of MPSASs; and**
 - (b) **The gain or loss on a subsequent disposal of any foreign operation shall exclude translation differences that arose before the date of adoption of MPSASs and shall include later translation differences.**
86. **A first-time adopter shall apply the requirement to treat any goodwill (see MPSAS 40, *Public Sector Combinations*) arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation, as assets and liabilities of the foreign operation, prospectively on the date of adoption of MPSASs.**
87. In applying the transitional exemption in paragraph 85, a first-time adopter shall not restate prior years for the acquisition of a foreign operation acquired prior to the date of adoption of MPSASs, and accordingly shall, where appropriate, treat goodwill and fair value adjustments arising on acquisition as assets and liabilities of the entity rather than as assets and liabilities of the foreign operation. Therefore, those goodwill and fair value adjustment functional currency or are non-monetary foreign currency items, which are reported using the exchange rate at the date of the acquisition.

MPSAS 5, Borrowing Costs

88. **A first-time adopter is encouraged, but not required, to apply the requirements of MPSAS 5, *Borrowing Costs*, retrospectively where it adopts or changes its accounting policy to the benchmark treatment.**
89. **Where a first-time adopter adopts or changes its accounting policy to the benchmark treatment it is allowed to designate any date before the date of adoption of MPSASs and apply MPSAS 5, *Borrowing Costs*, prospectively on or after that designated date.**

90. Where a first-time adopter changes its accounting policy to the allowed alternative treatment, any borrowing costs incurred both before and after date of adoption of MPSASs on qualifying assets for which the commencement date for the capitalization is prior to the date of adoption of MPSASs, shall be recognized retrospectively in accordance with the allowed alternative treatment.

IPSAS 10, Financial Reporting in Hyperinflationary Economies

Severe Hyperinflation

91. [Deleted]
92. [Deleted]
93. [Deleted]
94. [Deleted]

MPSAS 13, Leases

95. A first-time adopter shall on the date of adoption of MPSAS, classify all existing leases as operating or finance leases on the basis of circumstances existing at the inception of the lease, to the extent that these are known on the date of adoption of MPSASs.
96. If, however, the lessee and the lessor have agreed to change the provisions of the lease between the date of inception of the lease and the date of adoption of accrual basis MPSASs in a manner that would have resulted in a different classification of the lease at the date of adoption, the revised agreement shall be regarded as a new agreement. A first-time adopter shall consider the provisions of the new agreement at the date of adoption of accrual basis MPSASs in classifying the lease as an operating or finance lease.

IPSAS 18, Segment Reporting

97. [Deleted]

MPSAS 21, Impairment of Non-Cash-Generating Assets

98. A first-time adopter shall apply the requirements in MPSAS 21, *Impairment of Non-Cash-Generating Assets*, prospectively from the date of adoption of MPSASs, except in relation to those assets where a first-time adopter takes advantage of the exemption in paragraph 36 which allows a three year transitional relief period to not recognize and/or measure assets. When a first-time adopter takes advantage of the exemption that provides a three year transitional relief period in MPSAS 16, *Investment Property*, MPSAS 17, *Property, Plant and Equipment*, MPSAS 27, *Agriculture*, MPSAS 31, *Intangible Assets*, and MPSAS 32, *Service Concession Arrangements: Grantor*, it applies MPSAS 21, *Impairment of Non-Cash-Generating Assets*, when the exemption that provided the relief has expired, and/or the relevant assets are recognized and/or measured in accordance with the applicable MPSASs (whichever is earlier).
99. On the date that the transitional exemption that provided the relief has expired, and/or when the relevant assets are recognized and/or measured in the financial statements (whichever is earlier), a first-time adopter shall assess whether there is any indication that

the non-cash-generating assets recognized and/or measured are impaired. Any impairment loss shall be recognized in opening accumulated surplus or deficit on the date of adoption of MPSASs, or in opening accumulated surplus or deficit in the reporting period in which the transitional exemption expires, and/or the relevant assets are recognized and/or measured (whichever is earlier).

100. A first-time adopter shall apply the requirements of MPSAS 21, *Impairment of Non-Cash-Generating Assets*, prospectively. This means that on the date of adoption of accrual basis MPSASs, or if the first-time adopter has adopted transitional relief relating to the recognition and/or measurement of assets, only when the three year transitional exemption expires, and/or when the relevant assets are recognized and/or measured in the financial statements (whichever is earlier), will a first-time adopter be required to assess whether there is an indication that any non-cash-generating assets included in the opening statement of financial position, are impaired.

MPSAS 25, Employee Benefits

101. **A first-time adopter shall recognize and/or measure all employee benefits on the date of adoption of MPSASs, except for defined benefit plans and other long-term employee benefits where it takes advantage of the exemption in paragraph 36.**

Defined Benefit Plans and Other Long-Term Employee Benefits

102. **On the date of adoption of MPSASs, or where a first-time adopter takes advantage of the three year transitional exemption, the date on which the exemption expires, or when the relevant liabilities are recognized and/or measured in the financial statements (whichever is earlier), a first-time adopter shall determine its initial liability for defined benefit plans and other long-term employee benefits at that date as:**
- (a) **The present value of the obligation at the date of adoption of MPSASs, or where a first-time adopter takes advantage of the three year transitional relief period, the date on which the exemption expires, or when the relevant liabilities are recognized and/or measured in the financial statements (whichever is earlier), by using the Projected Unit Credit Method;**
 - (b) **Minus the fair value, at the date of adoption of MPSASs, or where a first-time adopter takes advantage of the three year transitional relief period, the date on which the exemption expires, or when the relevant liabilities are recognized and/or measured in the financial statements (whichever is earlier) of plan assets (if any) out of which the obligations are to be settled directly; and**
 - (c) **Minus any past service cost that shall be recognized in later periods as an expense on a straight-line basis over the average period until the benefits become vested.**
103. **If the initial liability in accordance with paragraph 102 is more or less than the liability that was recognized and/or measured at the end of the comparative period under the first-time adopter's previous basis of accounting, the first-time adopter shall recognize that increase/decrease in opening accumulated surplus or deficit in the period in which the items are recognized and/or measured.**

104. The effect of the change in the accounting policy to MPSAS 25, *Employee Benefits*, includes any actuarial gains and losses that arose, if any, in earlier periods, even if they fall outside the corridor specified in MPSAS 25, *Employee Benefits*. Under its previous basis of accounting, a first-time adopter may not have recognized and/or measured any liability, in which case the increase in the liability will represent the full amount of the liability minus the fair value, at the date of adoption of MPSASs or where a first-time adopter takes advantage of the three year transitional relief period, the date on which the exemption expires, or when the relevant liabilities are recognized and/or measured in the financial statements (whichever is earlier), of any plan assets in accordance with paragraph 102(b) and any past service cost to be recognized in later periods in accordance with paragraph 102(c). This increased liability is recognized in opening accumulated surplus or deficit in the period in which the items are recognized and/or measured.
105. **A first-time adopter shall not separate the cumulative actuarial gains and losses from the inception of the defined benefit plan(s), until the date of adoption of MPSASs into a recognized and unrecognized portion. All cumulative actuarial gains and losses shall be recognized in opening accumulated surplus or deficit in the period in which the items are recognized and/or measured.**
106. A first-time adopter is not permitted to separate cumulative actuarial gains and losses into recognized and unrecognized portions on adoption of MPSAS 25, *Employee Benefits*. All cumulative actuarial gains and losses shall be recognized in opening accumulated surplus or deficit in the period in which the items are recognized and/or measured. This requirement does however not preclude a first-time adopter electing to recognize only parts of its actuarial gains and losses in accordance with paragraphs 105–107 of MPSAS 25, *Employee Benefits*, in subsequent reporting periods.
107. A first-time adopter shall disclose information on experience adjustments in accordance with paragraph 141(p) of MPSAS 25, *Employee Benefits*, prospectively on the date of adoption of MPSASs.

MPSAS 26, Impairment of Cash-Generating Assets

108. **A first-time adopter shall apply the requirements in MPSAS 26, *Impairment of Cash-Generating Assets*, prospectively from the date of adoption of MPSASs, except in relation to those assets where a first-time adopter takes advantage of the exemption in paragraph 36 which allows a three year transitional relief period to not recognize and/or measure assets. When a first-time adopter takes advantage of the exemption that provides a three year transitional relief period in MPSAS 16, *Investment Property*, MPSAS 17, *Property, Plant and Equipment*, MPSAS 27, *Agriculture*, MPSAS 31, *Intangible Assets*, and MPSAS 32, *Service Concession Arrangements: Grantor*, it applies MPSAS 26, *Impairment of Cash-Generating Assets*, when the exemption that provided the relief has expired, and/or the relevant assets are recognized and/or measured in accordance with the applicable MPSASs (whichever is earlier).**
109. **On the date that the transitional exemption that provided the relief has expired, and/or when the relevant assets are recognized and/or measured in the financial statements (whichever is earlier), a first-time adopter shall assess whether there is any indication that the cash-generating assets recognized and/or measured are impaired. Any impairment loss shall be recognized in opening accumulated surplus or deficit on the date of adoption of**

MPSASs, or in opening accumulated surplus or deficit in the reporting period in which the transitional exemption expires, and/or the relevant assets are recognized and/or measured (whichever is earlier).

110. A first-time adopter shall apply the requirements of MPSAS 26, *Impairment of Cash-Generating Assets*, prospectively. This means that on the date of adoption of accrual basis MPSASs, or if the first-time adopter has adopted the transitional relief relating to the recognition and/or measurement of assets, only when the three year transitional exemption expires, and/or when the relevant assets are recognized and/or measured in the financial statements (whichever is earlier), will a first-time adopter be required to assess whether there is an indication that any cash-generating assets included in the opening statement of financial position, are impaired.

MPSAS 28, Financial Instruments: Presentation

111. **On the date of adoption of MPSASs, a first-time adopter shall evaluate the terms of the financial instrument to determine whether it contains both a liability component and a net asset/equity component. If the liability component is no longer outstanding on the date of adoption of MPSASs, the first-time adopter need not separate the compound financial instrument into a liability component and a net asset/equity component.**
112. MPSAS 28, *Financial Instruments: Presentation*, requires an entity to split a compound financial instrument at inception into separate liability and net asset/equity components. If the liability component is no longer outstanding, retrospective application of MPSAS 28, *Financial Instruments: Presentation*, involves separating two portions of net assets/equity. The first portion is in accumulated surplus and deficit and represents the cumulative interest accreted on the liability component. The other portion represents the original net asset/equity component. However, this MPSASs allows a first-time adopter to not separate these two portions if the liability component is no longer outstanding at the date of adoption of MPSASs.

MPSAS 29, Financial Instruments: Recognition and Measurement

Designation of Financial Instruments on the Date of adoption of MPSASs during The Period of Transition

113. **A first-time adopter may designate a financial asset or financial liability as a financial asset or financial liability at fair value through surplus or deficit that meet the criteria for designation in MPSAS 29, *Financial Instruments: Recognition and Measurement*, in accordance with paragraph 114. A first-time adopter shall disclose the fair value of financial assets and financial liabilities designated into each category at the date of designation, their classification and carrying amount.**
114. **MPSAS 29, *Financial Instruments: Recognition and Measurement*, permits a financial asset to be designated on initial recognition as available for sale or a financial instrument (provide it meets certain criteria) to be designated as a financial asset or financial liability at fair value through surplus or deficit. Despite this requirement, exceptions apply in the following circumstances:**
- (a) **A first-time adopter is permitted to make an available-for-sale designation at the date of adoption of MPSASs.**

- (b) A first-time adopter is permitted to designate, at the date of adoption of MPSASs, any financial asset or financial liability as at fair value through surplus or deficit provided the asset or liability meets the criteria in paragraph 10(b)(i), 10(b)(ii) or 13 of MPSAS 29, *Financial Instruments: Recognition and Measurement*, at that date.

Derecognition of Financial Assets and Financial Liabilities

- 115. Except as permitted by paragraph 116 a first-time adopter shall apply the derecognition requirements in MPSAS 29, *Financial Instruments: Recognition and Measurement*, prospectively for transactions occurring on or after the date of adoption of MPSASs, or where a first-time adopter takes advantage of the exemptions not to recognize financial instruments, the date on which the exemptions that provided the relief have expired and/or the financial instruments are recognized (whichever is earlier). For example, if a first-time adopter derecognized non-derivative financial assets or non-derivative financial liabilities in accordance with its previous basis of accounting as a result of a transaction that occurred before the date of adoption of MPSASs, it shall not recognize those assets and liabilities in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, unless they qualify for recognition as a result of a later transaction or event.
- 116. Notwithstanding the provision in paragraph 115, a first-time adopter may apply the derecognition requirements in MPSAS 29, *Financial Instruments: Recognition and Measurement*, retrospectively from a date of the first-time adopter choosing, provided that the information needed to apply MPSAS 29, *Financial Instruments: Recognition and Measurement*, to financial assets and financial liabilities derecognized as a result of past transactions was obtained at the time of initially accounting for these transactions.

Hedge Accounting

- 117. As required by MPSAS 29, *Financial Instruments: Recognition and Measurement*, a first-time adopter shall at the date of adoption of MPSASs, or where a first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure financial instruments, the date when the exemption that provided the relief has expired and/or the relevant financial instruments are recognized and/or measured in accordance with the applicable MPSASs (whichever is earlier):
 - (a) Measure all derivatives at fair value; and
 - (b) Eliminate all deferred losses and gains arising on derivatives that were reported in accordance with its previous basis of accounting as if they were assets or liabilities.
- 118. A first-time adopter shall not reflect in its opening statement of financial position a hedging relationship of a type that does not qualify for hedge accounting in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, (for example, many hedging relationships where the hedging instrument is a cash instrument or written option; or where the hedged item is a net position). However, if a first-time adopter designated a net position as a hedged item in accordance with its previous basis of accounting, it may designate an individual item within that net position as a hedged item in accordance with MPSASs, provided that it does so no later than the date of adoption of MPSASs or where it takes advantage of the exemption that provides a three year transitional relief period to

not recognize and/or measure financial instruments, the date when the exemption that provided the relief has expired, and/or the relevant financial instruments are recognized and/or measured in accordance with the applicable MPSASs (whichever is earlier).

119. If, before the date of adoption of MPSASs, or where a first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure financial instruments the date on which the exemption that provided the relief has expired, and/or the relevant financial instruments are recognized and/or measured in accordance with the applicable MPSASs (whichever is earlier), a first-time adopter had designated a transaction as a hedge but the hedge does not meet the conditions for hedge accounting in MPSAS 29, *Financial Instruments: Recognition and Measurement*, the first-time adopter shall apply paragraphs 102 and 112 of MPSAS 29, *Financial Instruments: Recognition and Measurement*, to discontinue hedge accounting. Transactions entered into before the date of adoption of MPSASs, or where a first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure financial instruments, the date when the transitional exemption expires and/or the relevant financial instruments are recognized and/or measured in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, (whichever is earlier), shall not be retrospectively designated as hedges.

Impairment of Financial Assets

120. A first-time adopter shall apply the impairment requirements prospectively from the date of adoption of MPSASs, except in relation to those financial assets where it takes advantage of the exemptions in paragraphs 36, 38 and 42 which allow a three year transitional relief period to not recognize and/or measure financial instruments. When a first-time adopter adopts the three year transitional relief period provided, it applies the impairment provisions when exemption that provided the relief has expired, and/or the relevant financial instruments are recognized and/or measured in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, (whichever is earlier).
121. A first-time adopter shall on the date of adoption of MPSASs, or when the exemptions that provided the relief have expired, and/or when the relevant financial instruments are recognized and/or measured and relevant information has been presented and/or disclosed in the financial statements in accordance with the applicable MPSAS (whichever is earlier), assess at that date whether there is any indication that the financial instrument recognized and/or measured in the statement of financial position, is impaired. Any impairment loss incurred shall be recognized in opening accumulated surplus or deficit in the period in which the financial instrument is recognized and/or measured.
122. A first-time adopter shall apply the impairment requirements prospectively. This means that on the date of adoption of MPSAS 29, *Financial Instruments: Recognition and Measurement*, when the exemptions that provided the relief have expired, and/ or when the relevant financial instruments are recognized and/or measured, a first-time adopter shall be required to assess whether there is an indication that the financial instrument is impaired. Any impairment loss shall be recognized in opening accumulated surplus or deficit on the date of adoption of MPSASs, or in the opening accumulated surplus or deficit of the reporting period in which the exemptions that

provided the relief have expired, and/or the relevant financial instruments are recognized and/or measured (whichever is earlier).

MPSAS 30, Financial Instruments: Disclosure

123. **Where the first-time adopter elects to present comparative information in accordance with paragraph 78, it is not required to present information about the nature and extent of risks arising from financial instruments for the comparative period in its transitional MPSAS financial statements or its first MPSAS financial statements.**
124. **A first-time adopter shall apply the requirements in MPSAS 30, *Financial Instruments: Disclosure*, prospectively from the date of adoption of MPSASs, or when the exemptions that provided the relief have expired, and/or when the relevant financial instrument is recognized and/or measured in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, (whichever is earlier).**

MPSAS 31, Intangible Assets

125. **A first-time adopter shall recognize and/or measure an internally generated intangible asset if it meets the definition of an intangible asset and the recognition criteria in MPSAS 31, *Intangible Assets*, even if the first-time adopter has, under its previous basis of accounting, expensed such costs. A deemed cost may not be determined for internally generated intangible assets.**
126. As required by paragraph 20, a first-time adopter is required to recognize all assets for which recognition is required by MPSASs. A first-time adopter shall therefore recognize any internally generated intangible asset if it meets the definition of an intangible asset and the recognition criteria in MPSAS 31, *Intangible Assets*, irrespective of whether such costs were expensed under its previous basis of accounting.

MPSAS 32, Service Concession Arrangements

Initial Measurement of Related Liability

127. **Where a first-time adopter elects to measure service concession assets using deemed cost, the related liabilities shall be measured as follows:**
- (a) **For the liability under the financial liability model, the remaining contractual cash flows specified in the binding arrangement and the rate prescribed in MPSAS 32, *Service Concession Arrangements*; or**
 - (b) **For the liability under the grant of a right to the operator model, the fair value of the asset less any financial liabilities, adjusted to reflect the remaining period of the service concession arrangement.**
128. **A first-time adopter shall recognize and/or measure any difference between the value of the service concession asset and the financial liability under the financial liability model in paragraph 127 in opening accumulated surplus or deficit in the period in which the items are recognized and/or measured.**

MPSAS 34, Separate Financial Statements, MPSAS 35, Consolidated Financial Statements and MPSAS 36, Investments in Associates and Joint Ventures

129. If a controlled entity becomes a first-time adopter later than its controlling entity, except for the controlled entity of an investment entity, the controlled entity shall, in its financial statements, measure its assets and liabilities at either:
- (a) The carrying amounts determined in accordance with this MPSAS that would be included in the controlling entity's consolidated financial statements, based on the controlled entity's date of adoption of MPSASs, if no adjustments were made for consolidation procedures and for the effects of the public sector combination in which the controlling entity acquired the controlled entity; or
 - (b) The carrying amounts required by the rest of this MPSAS, based on the controlled entity's date of adoption of MPSASs. These carrying amounts could differ from described in (a):
 - (i) When the exemptions in this MPSAS result in measurements that depend on the date of adoption of MPSASs.
 - (ii) When the accounting policies used in the controlled entity's financial statements differ from those in the consolidated financial statements. For example, the controlled entity may use as its accounting policy the cost model in MPSAS 17, *Property, Plant and Equipment*, whereas the economic entity may use the revaluation model.

A similar election is available to an associate or joint venture that becomes a first-time adopter later than an entity that has significant influence or joint control over it.

130. However, if a controlling entity becomes a first-time adopter later than its controlled entity (or associate or joint venture) the controlling 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 public sector combination in which the controlling entity acquired the controlled entity (or associate or joint venture), subject to the exemptions that may be adopted in terms of this MPSAS. Similarly, if a controlled 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, subject to the exemptions that may be adopted in this MPSAS, except for consolidation adjustments.

MPSAS 35, Consolidated Financial Statements

131. A first-time adopter that is a controlled entity shall assess whether it is an investment entity on the basis of the facts and circumstances that exist at the date of adoption of accrual basis MPSASs, and measure its investment in each controlled entity at fair value through surplus or deficit at the date of adoption of accrual basis MPSASs.

MPSAS 37, Joint Arrangements

132. Where a first-time adopter accounted for its investment in a joint venture under its previous basis of accounting basis using proportionate consolidation, the investment in the joint venture shall be measured on the date of adoption as the aggregate of the carrying amount of the assets and liabilities that the entity previously proportionately consolidated, including any purchased goodwill arising from acquisition transactions (see MPSAS 40, *Public Sector Combinations*).
133. The opening balance of the investment determined in accordance with paragraph 132 is regarded as the deemed cost of the investment at initial recognition. A first-time adopter shall test the investment for impairment as at the date of adoption, regardless of whether there is any indication that the investment may be impaired. Any impairment loss shall be adjusted to the accumulated surplus or deficit at the date of adoption.
134. If aggregating all previously proportionately consolidated assets and liabilities results in negative net assets, the first-time adopter shall assess whether it has legal or constructive obligations in relation to the negative net assets and, if so, the first-time adopter shall recognize a corresponding liability. If the first-time adopter concludes that it does not have legal or constructive obligations in relation to the negative net assets, it shall not recognize the corresponding liability but it shall adjust accumulated surplus or deficit at the date of adoption. The first-time adopter shall disclose this fact, along with its cumulative unrecognized share of losses of its joint ventures as at the date of adoption of accrual basis MPSASs.

Disclosures

135. A first-time adopter with financial statements that comply with the requirements of this MPSAS while taking advantage of the transitional exemptions and provisions that affect fair presentation and its ability to assert compliance with accrual basis MPSASs, shall make an explicit and unreserved statement of compliance with this MPSAS in the notes to the financial statements. This statement shall be accompanied by a statement that the financial statements do not fully comply with accrual basis MPSASs.
136. Where a first-time adopter takes advantage of the transitional exemptions in this MPSAS, the first-time adopter shall disclose:
- (a) The extent to which it has taken advantage of the transitional exemptions that affect the fair presentation of the financial statements and its ability to assert compliance with accrual basis MPSASs; and/or
 - (b) The extent to which it has taken advantage of the transitional exemptions that do not affect the fair presentation of the financial statements and its ability to assert compliance with accrual basis MPSASs.
137. To the extent that a first-time adopter has taken advantage of the transitional exemptions and provisions in this MPSAS that affect fair presentation and compliance with accrual basis MPSASs in relation to assets, liabilities, revenue and/or expenses, it shall disclose:

- (a) **Progress made towards recognizing, measuring, presenting and/or disclosing assets, liabilities revenue and/or expenses in accordance with the requirements of the applicable MPSAS;**
 - (b) **The assets, liabilities, revenue and/or expenses that have been recognized and measured under an accounting policy that is not consistent with the requirements of applicable MPSAS;**
 - (c) **The assets, liabilities, revenue and/or expenses that have not been measured, presented and/or disclosed in the previous reporting period, but which are now recognized and/or measured, and/or presented and/or disclosed;**
 - (d) **The nature and amount of any adjustments recognized during the reporting period; and**
 - (e) **An indication of how and by when it intends to comply in full with the requirements of the applicable MPSAS.**
138. **Where a first-time adopter takes advantage of the transitional exemption to not eliminate some balances, transactions, revenue and expenses, and/or where it applies the three year transitional relief for the recognition and/or measurement of its interest in controlled entities, associates or joint ventures in paragraph 55, it shall disclose the nature of the balances, transactions, revenue and expenses and/or upstream or downstream transactions that have been eliminated during the reporting period.**
139. **Where a first-time adopter is not able to present consolidated financial statements because of the transitional exemptions and provisions adopted in paragraphs 58 or 62, it shall disclose:**
- (a) **The reason why the financial statements, investments in associates or interests in joint ventures could not be presented as consolidated financial statements; and**
 - (b) **An indication by when the first-time adopter will be able to present consolidated financial statements.**
140. **The disclosure requirements of paragraphs 135 and 139 will assist users to track the progress of the first-time adopter in conforming its accounting policies to the requirements in the applicable MPSASs during the period of transition.**

Explanation of Transition to MPSASs

141. **A first-time adopter shall disclose:**
- (a) **The date of adoption of MPSASs; and**
 - (b) **Information and explanations about how the transition from the previous basis of accounting to MPSASs affected its reported financial position, and, where appropriate, its reported financial performance and cash flows.**

Reconciliations

142. A first-time adopter shall present in the notes to its transitional MPSAS financial statements or its first MPSAS financial statements:

- (a) A reconciliation of its net assets/equity reported in accordance with its previous basis of accounting to its opening balance of net assets/equity at the date of adoption of MPSASs; and**
- (b) A reconciliation of its surplus or deficit in accordance with its previous basis of accounting to its opening balance of surplus or deficit at the date of adoption of MPSASs.**

A first-time adopter that has applied a cash basis of accounting in its previous financial statements is not required to present such reconciliations.

- 143. The reconciliation presented in accordance with paragraph 142 shall provide sufficient detail, both quantitative and qualitative, to enable users to understand the material adjustments to the opening statement of financial position and, where applicable, the opening statement of financial performance presented in accordance with accrual basis MPSAS. Where narrative explanations are included in other public documents issued in conjunction with the financial statements, a cross reference to those documents shall be included in the notes.**
- 144. If an entity becomes aware of errors made under its previous basis of accounting, the reconciliations required by paragraph 142 shall distinguish the correction of those errors from changes in accounting policies.**
- 145. If an entity did not present financial statements for previous periods, its transitional MPSAS financial statements or its first MPSAS financial statements shall disclose that fact.**
- 146. Where a first-time adopter takes advantage of the exemptions in paragraph 36–43 which allow a three year transitional relief period to not recognize and/or measure items, it shall present as part of the notes, a reconciliation of items that have been recognized and/or measured during the reporting period when these items were not included in the previous reported financial statements. The reconciliation shall be presented in each period when new items are recognized and/or measured in accordance with this MPSAS.**
- 147. The reconciliation presented in accordance with paragraph 146 provides sufficient detail to enable users to understand which items have been recognized and/or measured during the reporting period where the first-time adopter adopts one of more of the exemptions that provide a three year transitional relief period to not recognize and/or measure an item. The reconciliation explains the adjustments to the previously reported statement of financial position and, where applicable, the previously reported statement of financial performance in each period when new items are recognized and/or measured in accordance with this MPSAS.**

Disclosure where Deemed Cost is used for Inventory, Investment Property, Property, plant and Equipment, Intangible Asset, Financial Instruments or Service Concession Asset

148. If a first-time adopter uses fair value, or the alternative in paragraphs 64, 67 or 70, as deemed cost for inventory, investment property, property, plant and equipment, Intangible assets, financial instruments, or service concession assets, its financial statements shall disclose:
- (a) The aggregate of those fair values or other measurement alternatives that were considered in determining deemed cost;
 - (b) The aggregate adjustment to the carrying amounts recognized under the previous basis of accounting; and
 - (c) Whether the deemed cost was determined on the date of adoption of MPSASs or during the period of transition.

Disclosures Where Deemed Cost is Used for Investments in Controlled Entities, Joint Ventures and Associates

149. If a first-time adopter uses fair value as deemed cost in its opening statement of financial position for an investment in a controlled entity, joint venture or associate in its separate financial statements, its separate financial statements shall disclose:
- (a) The aggregate deemed cost of those investments for which deemed cost is fair value; and
 - (b) The aggregate adjustment to the carrying amounts reported under the previous basis of accounting.
150. The disclosure requirements required in paragraph 148 and 149 shall be disclosed in each period when new items are recognized and/or measured until the exemptions that provided the relief have expired and/or when the relevant assets are recognized and/or measured in accordance with the applicable MPSASs (whichever is earlier).

Exemptions from Disclosure Requirements in MPSASs during the Period of Transition

151. To the extent that a first-time adopter takes advantage of the exemption that provides a three year relief period to not recognize and/or measure items, it is not required to apply any associated presentation and/or disclosure requirements related to such items as required in MPSAS 1, *Presentation of Financial Statements*, and/or the applicable MPSASs until such time as the exemptions that provided the relief have expired and/or when the relevant items have been recognized and/or measured in accordance with the applicable MPSASs (whichever is earlier).
152. Notwithstanding the transitional provision in paragraph 151, a first-time adopter is encouraged to disclose the information required by MPSAS 1, *Presentation of Financial Statements*, and/or the applicable MPSAS as soon as possible.

Transitional Provisions

153. Where a first-time adopter has adopted the existing transitional provisions in other accrual basis MPSASs, it shall continue to apply those transitional provisions until they expire and/or the relevant items are recognized and/or measured in accordance with the applicable MPSAS (whichever is earlier). If the first-time adopter elects to adopt the transitional exemptions in this MPSAS, the relief period applied in adopting accrual basis MPSASs, may not be longer than the relief period provided in this MPSAS.

Effective Date

154. A first-time adopter shall apply this Standard if its first MPSAS financial statements are for a period beginning on or after January 1, 2017. Earlier application is permitted.
- 154A. Paragraphs 86, 129, 130 and 132 were amended and paragraphs 62A–62C were added by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2023 it shall disclose that fact and apply MPSAS 40, *Public Sector Combinations*, at the same time
- 154B. Paragraphs 7 and 8 were deleted by *Improvements to MPSASs 2023, (The Applicability of MPSASs)*, issued in December 2022. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2024. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2024, it shall disclose that fact.

Appendix A

Amendments to Other MPSASs

[Deleted]

Implementation Guidance

This guidance accompanies, but is not part of, MPSAS 33, First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs).

- IG1. The purpose of this Implementation Guidance is to illustrate certain aspects of the requirements of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*.

Date of Adoption of MPSASs

- IG2. The date of adoption of MPSASs is the date an entity adopts accrual basis MPSAS for the first time in preparing its financial statements.
- IG3. Prior to the adoption of this MPSAS, a first-time adopter shall have adequately prepared for its transition to accrual basis MPSASs. The guidance provided in Study 14, *Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities* issued by the Accountant General's Department may assist a first-time adopter with planning the conversion to accrual basis MPSASs. The relief provided in this MPSAS shall therefore not be seen as a complete roadmap for the adoption of accrual basis MPSASs, but rather the end stage of the adoption process.
- IG4. A first-time adopters' date of adoption will therefore to be the start of the reporting period in which it elects to adopt accrual basis MPSASs for which it presents its transitional MPSAS financial statements or its first MPSAS financial statements. For example, an entity elects to adopt accrual basis MPSASs from January 1, 20X1 for its reporting period ending December 31, 20X1. The date of adoption of MPSASs will be January 1, 20X1.

Transitional MPSAS Financial Statements

- IG5. On the date of adoption of MPSASs, a first-time adopter may elect to adopt one of more of the exemptions included in MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*. Some of the exemptions included in MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, affect the fair presentation of a first-time adopter's financial statements and its ability to assert compliance with accrual basis MPSASs (Appendix A lists the transitional exemptions and provisions that a first-time adopter is required to apply and/or can illustrate whether fair presentation and the first-time adopter's ability to as elect to apply on adoption of accrual basis MPSASs and accrual basis MPSASs will be affected).
- IG6. As a first-time adopter is not able to make an explicit and unreserved statement of compliance with accrual basis MPSASs following the adoption of the exemptions provided in MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, the financial statements presented for the first reporting period following the adoption of accrual basis MPSASs, will be referred to as the "transitional MPSAS financial statements".
- IG7. For example, if the first-time adopter adopts the transitional exemption that provides relief for the recognition of certain items of property, plant and equipment when adopting accrual basis MPSASs on January 1, 20X1, it would not be able to make an explicit and unreserved statement

of compliance with accrual basis MPSASs at the end of its first reporting period, i.e. December 31, 20X1. The financial statements prepared for the first reporting period, will therefore be referred to as the “first transitional MPSAS financial statements”.

- IG8. The financial statements presented during the period of transition until the exemptions that provided the relief have expired, and/or when the relevant items are recognized and/or measured in the financial statements in accordance with the applicable MPSASs, will be referred to as the “transitional MPSAS financial statements”.

Basis of Preparation When Preparing Transitional MPSAS Financial Statements

- IG9. As stated in paragraph 27 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, a first-time adopter that elects to adopt one or more of the exemptions included in MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, may not be able to make an explicit and unreserved statement of compliance with accrual basis MPSASs as required by MPSAS 1, *Presentation of Financial Statements*. During the period of transition, this fact shall be highlighted to the users of financial statements in presenting the “basis of preparation” in the financial statements.
- IG10. As an illustration, if a first-time adopter elected to adopt the transitional exemption that allows it three years in which to recognize and/or measure investment property, the following explanation may be provided in the “basis of preparation” paragraph in the period of transition:

Basis of preparation

The financial statements have been prepared in accordance with accrual basis Malaysian Public Sector Accounting Standards (MPSASs). MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, allows a first-time adopter a period of up to three years to recognize and/or measure certain assets and/or liabilities.

In its transition to accrual basis MPSASs, Public Sector Entity X took advantage of this transitional exemption for investment property. As a result, it is unable to make an explicit and unreserved statement of compliance with accrual basis MPSASs in preparing its transitional MPSAS financial statements for this reporting period. Public Sector Entity X intends to recognize and/or measure its investment property by 20X3.

First MPSAS Financial Statements

- IG11. A first-time adopter’s first MPSAS financial statements will be the first set of financial statements that it presents in which it makes an explicit and unreserved statement of compliance with accrual basis MPSASs.
- IG12. A first-time adopter will not be able to prepare its first MPSAS financial statements until the exemptions in MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, that provided relief which affected fair presentation and compliance with MPSAS, have expired, or when the relevant items are recognized, measured and/or the relevant information has been presented and/or disclosed in accordance with the applicable MPSASs (whichever is earlier).

- IG13. Following from the example in IG5, the transitional exemptions that provided the relief for the recognition of certain items of property, plant and equipment expire after three years, i.e. December 31, 20X3. If it is assumed that the entity has not adopted any other transitional exemptions in MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, that affect fair presentation and compliance with MPSASs, and that it recognizes and/or measures the items of property, plant and equipment during the transitional period, a first-time adopter will present its first MPSAS financial statements for the period ending December 31, 20X3.
- IG14. If a first-time adopter has not adopted any of the exemptions in MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, that affect fair presentation and its ability to claim compliance with accrual basis MPSASs, its first accrual financial statements will also be its first MPSAS financial statements.

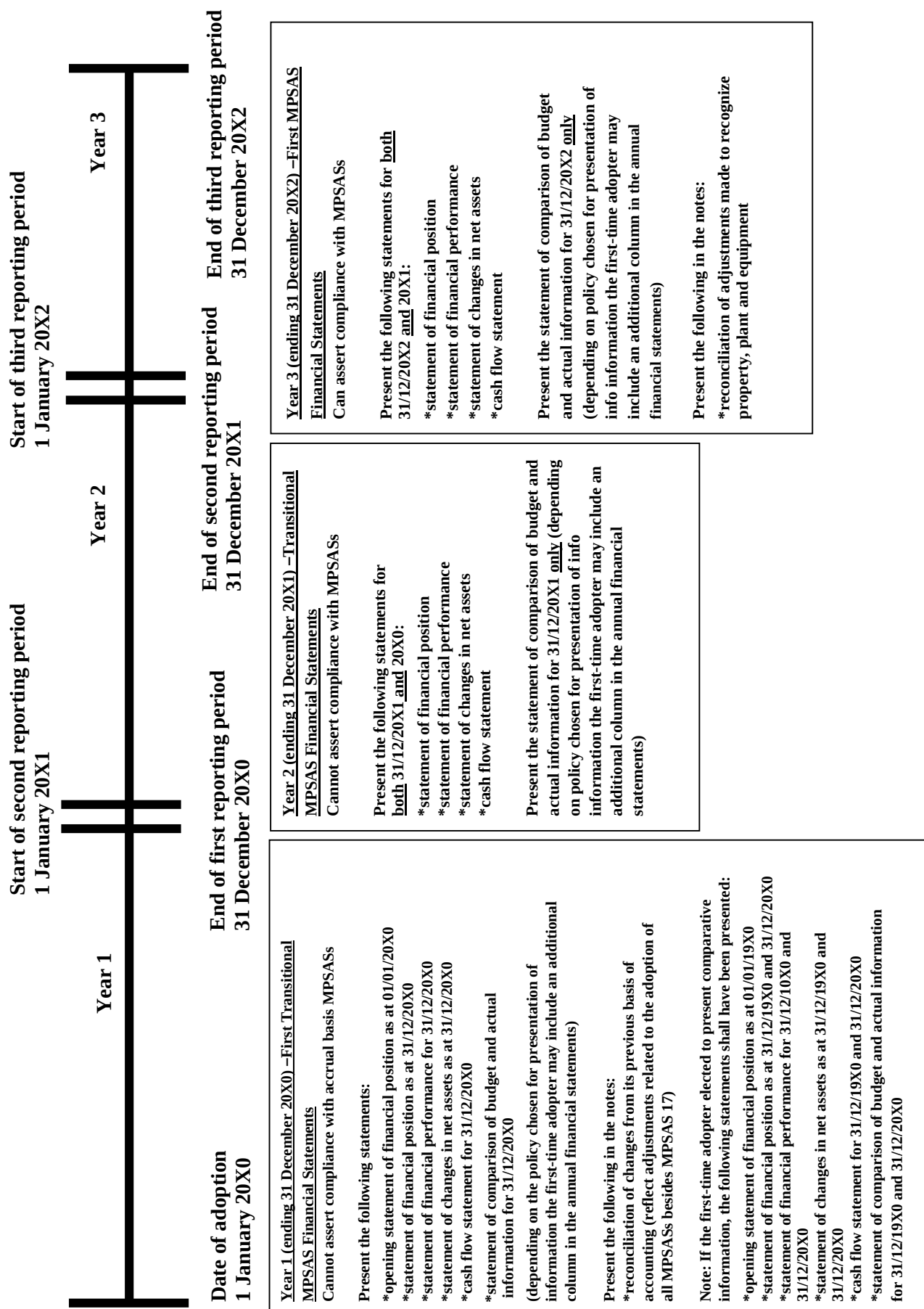
To illustrate:

Timeline –First Time Adoption MPSAS (assuming that entity elects to apply the three year transitional relief for the recognition and/or measurement of certain assets)

An entity adopts accrual basis MPSASs on 1 January 20X0 by applying MPSAS 33, *First-time Adoption of Accrual Basis MPSASs*

The first-time adopter elects to apply the three year relief for the recognition of property, plant and equipment. Assume that it does not adopt of any other relief periods. It also elects not to present comparative information.

The first-time adopter recognizes all property, plant and equipment by 31 December 20X2.



Estimates

- IG15. Paragraph 23 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, requires that a first-time adopter's estimates in accordance with MPSASs at the date of adoption of MPSASs shall be consistent with estimates made at the end of its comparative period in accordance with the previous basis of accounting (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error. An entity may receive information after the date of adoption of MPSASs about estimates that it had made under the previous basis of accounting. In accordance with paragraph 24, a first-time adopter shall treat the receipt of that information in the same way as non-adjusting events after the reporting period in accordance with MPSAS 14, *Events After the Reporting Period*.
- IG16. For example, assume that a first-time adopter's date of adoption of MPSASs is January 1, 20X4 and new information on July 15, 20X4 requires the revision of an estimate made in accordance with the previous basis of accounting at December 31, 20X3. The first-time adopter shall not reflect that new information in its opening statement of financial position (unless the estimates require adjustment for any differences in accounting policies or there is objective evidence that the estimates were in error). Instead, the first-time adopter shall reflect that new information in surplus or deficit for the year ended December 31, 20X4.

Transitional Exemptions that Provide Three Year Relief for the Recognition and/or Measurement of Assets and/or Liabilities

- IG17. MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, provides a first-time adopter a period of up to three years relief in which it is allowed to not recognize and/or measure certain assets and liabilities. Where a first-time adopter takes advantage of this exemption, it will have to consider and analyse title deeds, contracts and other similar arrangements in accounting for, and classifying these assets in accordance with the applicable MPSAS.
- IG18. For example, assume that a first-time adopter controls a wide range of property, plant and equipment when it adopts accrual basis MPSASs on January 1, 20X1. If the first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure the property, plant and equipment, it may recognize and/or measure the property, plant and equipment during the period of transition from January 1, 20X1 until December 31, 20X3. If the property, plant and equipment is recognized for example, on April 1, 20X2, the first-time adopter shall adjust the opening accumulated surplus or deficit on January 1, 20X2. As required by paragraph 142 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, the first-time adopter shall, as part of the notes to the financial statements, provide a reconciliation to the accumulated surplus or deficit as at December 31, 20X1 (i.e. the opening balance as at January 1, 20X2) for the property, plant and equipment that was recognized on April 1, 20X2.
- IG19. Where a first-time adopter has taken advantage of the three year relief period, it shall not derecognise any of the assets and/or liabilities that were recognized under its previous basis of accounting unless it is to comply with an MPSAS requirement. Any adjustments to the assets and/or liabilities recognized under its previous basis of accounting shall be adjusted during the

period of transition against the opening accumulated surplus of deficit in the period in which the adjustment is made.

Accounting for Finance Leases Assets and Finance Lease Liabilities

- IG20. Where a first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize its finance lease assets, it will also not be able to comply with the recognition requirements relating to the finance lease liabilities, until the transitional exemptions related to the finance leased assets have expired, or the finance leased assets have been recognized in accordance with MPSAS 13, *Leases*.
- IG21. For example, assume that a first-time has a motor vehicle that is subject to a finance lease agreement on the date of adoption of accrual basis MPSASs on January 1, 20X1. The first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize the motor vehicle. The motor vehicle is recognized on December 31, 20X3 when the exemption expires. MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, requires the first-time adopter to only recognize the corresponding finance lease liability for the motor vehicle on December 31, 20X3, i.e. on the date that the finance lease asset (the motor vehicle) is recognized.

Recognition of Provisions Included in the Initial Cost of an Item of Property, Plant and Equipment

- IG22. MPSAS 17, *Property, Plant and Equipment*, recognizes that in some cases, the construction or commissioning of an item of property, plant and equipment will result in an obligation for an entity to dismantle or remove the item of property, plant and equipment and restore the site on which the asset is located. An entity is required to apply MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, in recognising and measuring the resulting provision to be included in the initial cost of the item of property, plant and equipment.
- IG23. MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, provides an exemption for the recognition of this liability. A first-time adopter is allowed to not recognize and/or measure the liability relating to the initial estimate of costs of dismantling and removing the item and restoring the site on which it is located, until such time as the exemption for MPSAS 17, *Property, Plant and Equipment*, expires and/or the relevant asset is recognized and/or measured and relevant information has been presented and/or disclosed in the financial statements in accordance with MPSAS 17, *Property, Plant and Equipment*, (whichever is earlier).
- IG24. For example, an entity adopts accrual basis MPSASs on January 1, 20X1 and takes advantage of the exemption in MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, that provides a three year transitional relief period to not recognize a government owned nuclear power station. The first-time adopter determines a deemed cost for the asset on June 30, 20X3 and recognizes the asset on that date at RM1,000,000. The first-time adopter determines that it has a decommissioning obligation under MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, of RM500,000 at the date of adoption of MPSASs. The obligation amounts to RM550,000 on June 30, 20X3 when the asset is recognized.

- IG25. MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, requires the first-time adopter to only recognize and/or measure its obligation relating to the dismantling and restoring of the site on June 30, 20X3, i.e. the date on which the asset is recognized. The liability will be measured at RM550,000 which reflects the first-time adopter's obligation on the date that the asset is recognized. The first-time adopter shall, as part of the notes to the financial statements, provide a reconciliation to the accumulated surplus or deficit as at December 31, 20X2 (i.e. the opening balance as at January 1, 20X3) for the recognition of the obligation and the related asset that was recognized on June 30, 20X2.

Borrowing Costs Incurred on Qualifying Assets

- IG26. Paragraph 90 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, requires that, where a first-time adopter elects to account for borrowing costs in accordance with the allowed alternative treatment, it is required to apply the requirements in MPSAS 5, *Borrowing Costs* retrospectively, for any borrowing costs incurred on qualifying assets before the date for adoption of MPSASs.
- IG27. Paragraph 44 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, provides an exemption to this requirement by allowing a first-time adopter to commence capitalization of borrowings costs incurred on qualifying assets after the recognition of an asset where the first-time adopter takes advantage of the exemption that provides a three year transitional relief period for the recognition of assets.
- IG28. For example, a first-time adopter adopts the allowed alternative treatment in accounting for borrowing costs incurred on qualifying assets. The date of adoption of MPSASs is January 1, 20X1. The first-time adopter determines that the borrowing cost incurred prior to the adoption of MPSASs on January 1, 20X1 amounts to RM500,000 and that borrowing costs incurred at the end following two reporting periods amounted to RM20,000 and RM30,000. In addition, the first-time adopter adopts the exemption that provides three year transitional relief from the recognition of property, plant and equipment and as a result, recognizes the item of property, plant and equipment at the end of the second reporting period at RM1,000,000.

At the end of 20X2, the item of property, plant and equipment recognized on the statement of financial position will be RM1,030,000 (RM1,000,000 + RM30,000). Borrowing costs incurred prior to the recognition of the item of property, plant and equipment, i.e. RM500,000 and RM20,000 shall not be included as part of the cost of the qualifying asset.

Presenting Comparative Information

- IG29. Paragraph 78 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, encourages, but does not require an entity to present comparative information in its transitional MPSAS financial statements or its first MPSAS financial statements in accordance with this MPSAS. The decision to present comparative information affects not only the extent of the information presented, but also the date of adoption of MPSASs.

Date of Adoption of MPSASs

IG30. To illustrate: The end of a first-time adopter's first accrual basis reporting period is December 31, 20X5. The first-time adopter decides to present comparative information in those financial statements for one year only (see paragraph 78 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*). Therefore, its date of adoption of MPSASs is the beginning of the comparative period i.e. January 1, 20X4 (or equivalently December 31, 20X3).

Information Presented when a First-Time Adopter Elects to Prepare Comparative Information

IG31. Where the first-time adopter elects to prepare comparative information, it is required to apply the accrual basis MPSASs effective for periods ending on December 31, 20X5 in:

- (a) Preparing and presenting its opening accrual basis statement of financial position at January 1, 20X4; and
- (b) Preparing and presenting its:
 - (i) Statement of financial position for December 31, 20X5 (including comparative amounts for 20X4);
 - (ii) Statement of financial performance (including comparative amounts for 20X4);
 - (iii) Statement of changes in net assets/equity for December 31, 20X5 (including comparative amounts for 20X4);
 - (iv) Statement of cash flows for the year to December 31, 20X5 (including comparative amounts for 20X4);
 - (v) Disclosures (including comparative information for 20X4);
 - (vi) A comparison of budget and actual amounts for the year to December 31, 20X5; and
 - (vii) Reconciliations in accordance with paragraph 142.

First-Time Adopter Elects to Not Prepare Comparative Information

IG32. Where a first-time adopter elects to not prepare comparative information, it is required to apply the accrual basis effective for periods ending on December 31, 20X5:

- (a) Preparing and presenting its opening accrual basis statement of financial position at 1 January 20X5; and
- (b) Preparing and presenting its:
 - (i) Statement of financial position for December 31, 20X5;
 - (ii) Statement of financial performance for December 31, 20X5;
 - (iii) Statement of changes in net assets/equity for December 31, 20X5;
 - (iv) Statement of cash flows for the year to December 31, 20X5;
 - (v) Disclosures;

- (vi) A comparison of budget and actual amounts for the year to December 31, 20X5; and
- (vii) Reconciliations in accordance with paragraph 142.

Adoption of Three Year Transitional Relief Period

- IG33. Where the first-time adopter takes advantage of the exemptions that provide relief from the recognition and/or measurement of assets and/or liabilities, MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, requires it to only adjust comparative information for reporting periods following the date of adoption of MPSASs to the extent that reliable and relevant information is available about the items that have been recognized and/or measured.
- IG34. To illustrate: The end of a first-time adopter's first accrual basis reporting period is December 31, 20X2. The first-time adopter on the date of adoption of MPSASs on January 1, 20X1, adopts the transitional exemption providing a three year relief period for the recognition of investment property. At the end of 20X3 the first-time adopter has recognized the investment property, which is included in the statement of financial position as at December 31, 20X3. Only if reliable and relevant information is available about the value of the investment property recognized during 20X3, will the first-time adopter adjust the comparative information presented (i.e., for the period ending December 31, 20X2).

Presenting Reconciliations

- IG35. Paragraph 142 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, requires a first-time adopter to present a reconciliation of its closing balances reported under its previous basis of accounting, to its net assets/equity in accordance with MPSASs for the transitional MPSAS financial statements or its first MPSAS financial statements. A reconciliation is presented of its surplus or deficit in accordance with its previous basis of accounting to its opening balance of surplus or deficit at the date of adoption of MPSASs.
- IG36. For example, a first-time adopter, which previously applied a modified-accrual basis of accounting, adopts accrual basis MPSASs on January 1, 20X4 and elects to not present comparative information as permitted in MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*. The first-time adopter shall, in accordance with paragraph 142 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, present a reconciliation in the notes to its transitional MPSAS financial statements that provides sufficient detail to enable users to understand the material adjustments to the opening statement of financial position, and where applicable, the opening statement of financial performance as at January 1, 20X4.
- IG37. Paragraph 146 further requires a first-time adopter that takes advantage of the exemptions that provide a three year transitional relief period to not recognize and/or measure items, to present a reconciliation of items that have been recognized and/or measured during the reporting period which were not recognized and/or measured in the previous financial statements.

IG38. Following from the example in IG29, a first-time adopter adopts the exemption in MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, that allows it to not recognize investment property for a period of three years. The first-time adopter applies this exemption and only recognizes the investment property at the end of year three, i.e. December 31, 20X4. As an adjustment is made to the opening balance of accumulated surplus or deficit as on January 1, 20X4 in recognizing the investment property, paragraph 146 requires the first-time adopter to present a reconciliation in its notes to the financial statements for the year ending December 31, 20X4 to allow users to understand the adjustment that was made following the recognition of the investment property.

Deemed Cost

IG39. MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, allows a first-time adopter to determine a deemed cost as a substitute for acquisition cost or depreciated cost at the date of adoption of MPSASs, where a first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure certain assets and/or liabilities. A deemed cost may however only be determined if no cost information is available about the historical cost of the asset and/or liability. When a first-time adopter initially measures these assets on the date of adoption of MPSASs, or when the transitional exemptions that provided the first-time adopter with a three year relief period to not recognize and/or measure certain assets have expired, it recognizes the effect:

- (a) As an adjustment to the opening balance of accumulated surplus or deficit in the opening statement of financial position in the period in which the deemed is determined; or
- (b) In the revaluation surplus if the first-time adopter adopts the revaluation model in MPSAS 17, *Property, Plant and Equipment*, or in MPSAS 31, *Intangible Assets*.

To illustrate:

Public Sector Entity X adopted accrual basis MPSAS on January 1, 20X4 and applied deemed cost to measure investment property. In applying deemed cost, investment property was valued at RM 1,800,000 on the date of adoption. Public Sector Entity X elected to not present comparative information.

MPSAS 33 – First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)

Statement of Changes in Net Assets/Equity for the Year ended December 31, 20X4

	Attributable to owners of the controlling entity		Total net assets/equity
	Accumulated surplus/deficit	Other Reserves	
	RM	RM	RM
Opening balance as at January 1, 20X4	210,000	10,000	220,000
Measurement of investment property at deemed cost in accordance with MPSAS 33 (see note 34)	1,500,000		1,500,000
Restated opening balance as at January 1, 20X4	1,710,000	10,000	1,720,000
Surplus for the period	5,000		5,000
Balance as at December 31, 20X4	1,715,000	10,000	1,725,000

Notes to the financial statements of Public Sector Entity X as at December 31, 20X4:

Note 34 – Investment Property

	<i>December 31, 20X4</i>
	<i>RM</i>
Opening balance of investment property recognized under previous basis of accounting	300,000
Investment property measured at deemed cost as provided in MPSAS 33 on January 1, 20X4	1,500,000
Restated opening balance of investment property at January 1, 20X4	1,800,000
Additions	

Transitional exemptions adopted in MPSAS 33, First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs), on adoption of accrual basis MPSASs

Public Sector Entity X adopted accrual basis MPSAS on January 1, 20X4 and applied deemed cost in measuring investment property as reliable cost information about some investment properties was not available. As a result, Public Sector Entity X restated its opening balance of investment property with an additional value of RM1,500,000 on January 1, 20X4.

MPSAS 33 – First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)

Note 54 –Reconciliation of net assets/equity and surplus or deficit on January 1, 20X4

Reconciliation of net assets/equity as on January 1, 20X4

	Net assets/equity as on January 1, 20X4
	RM
<i>Opening balance of net assets/equity as on January 1, 20X4 reported under previous basis of accounting</i>	<i>220,000</i>
<i>Recognition of investment property at deemed cost (see note 34)</i>	<i>1,500,000</i>
<i>Restated opening balance of net assets/equity as on January 1, 20X4</i>	<i>1,720,000</i>

Reconciliation of surplus or deficit on January 1, 20X4

	Surplus or deficit on January 1, 20X4
	RM
<i>Surplus or deficit as at 31, December 20X3 as reported under previous basis of accounting</i>	<i>210,000</i>
<i>Recognition of investment property at deemed cost (see note 34)</i>	<i>1,500,000</i>
<i>Restated surplus or deficit as on January 1, 20X4</i>	<i>1,710,000</i>

Determining a Deemed Cost During the Period of Transition

- IG40. If a first-time adopter takes advantage of the exemption in MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, that provides a three year transitional relief period to not recognize and/or measure an asset, the MPSAS requires that it may determine a deemed cost for that asset during any point of time within the three year transitional relief period.
- IG41. Subsequent depreciation and amortization, if applicable, is based on that deemed cost and starts from the date of adoption of MPSASs, or when the transitional exemptions that provided the relief have expired, or when the relevant items are recognized and/or measured in accordance with the applicable MPSASs (whichever is earlier).
- IG42. For example, a first-time adopter adopts MPSASs on January 1, 20X1 and adopts the exemption that provides a three year transitional relief period for the recognition of an investment property. Because the first-time adopter does not have reliable cost information about the historical cost of the investment property on the date of adoption of MPSASs it decides to determine a deemed cost for the investment property. The deemed cost for the investment property is determined during the second reporting period (i.e. 20X2) in which the first-time adopter applies the exemption. MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, allows the first-time adopter to use the deemed cost determined during 20X2 in recognizing the investment property by adjusting the opening accumulated surplus and deficit on January 1, 20X2. The deemed cost as determined on January 1, 20X2 will be used in determining subsequent depreciation and in assessing impairment where the first-time adopter elects to apply the cost model as its subsequent measurement basis in applying MPSAS 16, *Investment Property*.

MPSAS 5, Borrowing Costs

- IG43. An entity adopts the accrual basis MPSASs on January 1, 20X3 and adopts the allowed alternative treatment in accounting for borrowing costs. Borrowing costs directly attributable to the acquisition of the asset amounts to RM525,000, of which RM500,000 was incurred prior to the adoption of accrual basis MPSASs, while RM25,000 was incurred in the first reporting period ending December 31, 20X3. Paragraph 90 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, requires the first-time adopter to retrospectively recognize any borrowing costs incurred prior to the adoption of accrual basis MPSASs when it adopts the allowed alternative method. Therefore, RM500,000 shall be capitalized to the cost of the asset recognized in the opening statement of financial position as at January 1, 20X3.
- IG44. If the entity has elected to apply the benchmark treatment, paragraph 88 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, encourages, but does not require, the first-time adopter to apply the accounting policy retrospectively. If the first-time adopter elects to apply its accounting policy prospectively, it will only expense RM25,000 in the statement of financial performance for the period ending December 31, 20X3.

MPSAS 9, Revenue from Exchange Transactions

- IG45. If a first-time adopter has received amounts that do not yet qualify for recognition as revenue in accordance with MPSAS 9, *Revenue from Exchange Transactions*, (for example, the proceeds of a sale that does not qualify for recognition as revenue), the first-time adopter recognizes the amounts received as a liability in its opening statement of financial position and measures that liability at the amount received. It shall derecognize the liability and recognize the revenue in its statement of financial performance when the recognition criteria in MPSAS 9, *Revenue from Exchange Transactions*, are met.

IPSAS 10, Financial Reporting in Hyperinflationary Economies

IG46. [Deleted]

IG47. [Deleted]

MPSAS 14, Events After the Reporting Date

- IG48. Except as described in paragraph IG49, a first-time adopter applies MPSAS 14, *Events After the Reporting Date*, in determining whether:
- (a) Its opening statement of financial position reflects an event that occurred after the date of transition; and
 - (b) Comparative amounts in its transitional MPSAS financial statements or its first MPSAS financial statements, where applicable, reflect an event that occurred after the end of that comparative period.
- IG49. Paragraphs 23–26 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, require some modifications to the principles in MPSAS 14, *Events After the Reporting Date*, when a first-time adopter determines whether changes in estimates are adjusting or non-adjusting events at the date of adoption of MPSASs (or, when applicable, the end of the comparative period). Cases 1 and 2 below illustrate those

modifications. In case 3 below, paragraphs 23–26 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, do not require modifications to the principles in MPSAS 14, *Events After the Reporting Date*.

- (a) Case 1—If a first-time adopter's previous basis of accounting similar items for the date of adoption of MPSASs, using an accounting policy that is consistent with MPSASs. In this case, the estimates in accordance with MPSASs need to be consistent with estimates made for that date in accordance with previous basis of accounting, unless there is objective evidence that those estimates were in error (see MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*). The first-time adopter reports later revisions to those estimates as events of the period in which it makes the revisions, rather than as adjusting events resulting from the receipt of further evidence about conditions that existed at the date of adoption of MPSASs.
- (b) Case 2—Previous basis of accounting required estimates of similar items for the date of adoption of MPSASs, but the first-time adopter made those estimates using accounting policies that are not consistent with its accounting policies in accordance with MPSASs. In this case, the estimates in accordance with MPSASs need to be consistent with the estimates required in accordance with the previous basis of accounting for that date (unless there is objective evidence that those estimates were in error), after adjusting for the difference in accounting policies. The opening statement of financial position reflects those adjustments for the difference in accounting policies. As in case 1, the first-time adopter reports later revisions to those estimates as events of the period in which it makes the revisions.

For example, the previous basis of accounting may have required a first-time adopter to recognize and measure provisions on a basis consistent with MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, except that the previous measurement was on an undiscounted basis. In this example, the first-time adopter uses the estimates in accordance with its previous basis of accounting as inputs in making the discounted measurement required by MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*.

- (c) Case 3- Previous basis of accounting did not require estimates of similar items for the date of adoption of MPSASs. Estimates in accordance with MPSASs for that date reflect conditions existing at that date. In particular, estimates of market prices, interest rates or foreign exchange rates at the date of adoption of MPSASs reflect market conditions at that date. This is consistent with the distinction in MPSAS 14, *Events After the Reporting Date*, between adjusting events after the reporting period and non-adjusting events after the reporting period.

IG50. To illustrate: Entity A's first transitional MPSAS financial statements are for the period ending December 31, 20X5 with the first-time adopter electing to present comparative information. In terms of its previous basis of accounting the following transactions and events are noted in entity A's financial statements for December 31, 20X3 and 20X4:

- (a) Estimates of accrued expenses and provisions were made at those dates;
- (b) The entity accounted on a cash basis for a defined benefit pension plan; and

- (c) No provision was recognized for a court case arising from events that occurred in September 20X4. When the court case was concluded on June 30, 20X5, entity A was required to pay RM1 000 and paid this on July 10, 20X5.

In preparing its transitional MPSAS financial statements, entity A concludes that its estimates in accordance with its previous basis of accounting of accrued expenses and provisions at December 31, 20X3 and 20X4 were made on a basis consistent with its accounting policies in accordance with MPSASs. Although some of the accruals and provisions turned out to be overestimates and others to be underestimates, entity A concludes that its estimates were reasonable and that, therefore, no error had occurred. As a result, accounting for those overestimates and underestimates involves the routine adjustment of estimates in accordance with MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.

Application of Requirements

In preparing its opening statement of financial position at January 1, 20X4 and in its comparative statement of financial position at December 31, 20X4, entity A:

- (a) Does not adjust the previous estimates for accrued expenses and provisions; and
- (b) Makes estimates (in the form of actuarial assumptions) necessary to account for the pension plan in accordance with MPSAS 25, *Employee Benefits*. Entity A's actuarial assumptions at January 1, 20X4 and December 31, 20X4 do not reflect conditions that arose after those dates. For example, entity A's:
- (i) Discount rates at January 1, 20X4 and December 31, 20X4 for the pension plan and for provisions reflect market conditions at those dates; and
- (ii) Actuarial assumptions at January 1, 20X4 and December 31, 20X4 about future employee turnover rates do not reflect conditions that arose after those dates—such as a significant increase in estimated employee turnover rates as a result of a curtailment of the pension plan in 20X5.

The treatment of the court case at December 31, 20X4 depends on the reason why entity A did not recognize a provision in accordance with its previous basis of accounting at that date.

Assumption 1 –The previous basis of accounting was consistent with MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*. Entity A concluded that the recognition criteria were not met. In this case, entity A's assumptions in a assumptions in accordance with its previous basis of accounting. Therefore, entity A does not recognize a provision at December 31, 20X4.

Assumption 2 –Entity A's previous basis of accounting was not consistent with MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*. Therefore, entity A develops estimates in accordance with MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*. Under MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, an entity determines whether an obligation exists at the end of the reporting period by taking account of all available evidence, including any additional evidence provided by events after the reporting period. Similarly, in accordance with MPSAS 14, *Events After the Reporting Period*, the resolution of a court case after the reporting period is an adjusting event after the reporting period if it confirms that the entity had a present obligation at that date. In this instance, the resolution of the court case confirms that entity A had a liability in September 20X4 (when the events occurred that gave rise to the court case). Therefore, entity A recognizes a provision at

December 31, 20X4. Entity A measures that provision by discounting the RM1 000 paid on July 10, 20X5 to its present value, using a discount rate that complies with MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, and reflects market conditions at December 31, 20X4.

IG51. Paragraphs 23–26 of the MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, do not override requirements in other MPSASs that base classifications or measurements on circumstances existing at a particular date. Examples include:

- (a) The distinction between finance leases and operating leases (see MPSAS 13, *Leases*); and
- (b) The distinction between financial liabilities and equity instruments (see MPSAS 28, *Financial Instruments: Presentation*).

MPSAS 13, Leases

IG52. In accordance with paragraph 95 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, and paragraph 18 of MPSAS 13, *Leases*, a lessee or lessor classifies leases as operating leases or finance leases on the basis of circumstances existing at the inception of the lease, on the date of adoption of accrual basis MPSASs. In some cases, the lessee and the lessor may agree to change the provisions of the lease, other than by renewing the lease, in a manner that would have resulted in a different classification in accordance with MPSAS 13, *Leases*, had the changed terms been in effect at the inception of the lease. If so, the revised agreement is considered as a new agreement over its term from the date of adoption of accrual basis MPSASs. However, changes in estimates (for example, changes in estimates of the economic life or of the residual value of the leased property) or changes in circumstances (for example, default by the lessee) do not give rise to a new classification of a lease.

MPSAS 17, Property, Plant and Equipment

IG53. If a first-time adopter's depreciation methods and rates in accordance with its previous basis of accounting are acceptable in accordance with MPSASs, it accounts for any change in estimated useful life or depreciation pattern prospectively from when it makes that change in estimate (paragraphs 22 and 26 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, and paragraph 76 of MPSAS 17, *Property, Plant and Equipment*). However, in some cases, a first-time adopter's depreciation methods and rates in accordance with its previous basis of accounting may differ from those that would be acceptable in accordance with MPSASs (for example, if they do not reflect a reasonable estimate of the asset's useful life). If those differences have a material effect on the financial statements, the entity adjusts accumulated depreciation in its opening statement of financial position retrospectively so that it complies with MPSASs.

IG54. A first-time adopter may elect to use one of the following amounts as the deemed cost of property, plant and equipment:

- (a) Fair value at the date of adoption of MPSASs (paragraph 67 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*), in which case the first-time adopter provides the disclosures required by paragraph 148

of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*; or

- (b) A revaluation in accordance with its previous basis of accounting that meets the criteria in paragraph 67 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*.

- IG55. Subsequent depreciation is based on that deemed cost and starts from the date for which the first-time adopter determined the deemed cost, or where the first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize certain assets, when the exemptions providing the relief have expired, or the asset has been recognized in accordance with MPSAS 17, *Property, Plant and Equipment*, (whichever is earlier).
- IG56. If a first-time adopter chooses as its accounting policy the revaluation model in MPSAS 17, *Property, Plant and Equipment*, for some or all classes of property, plant and equipment, it presents the cumulative revaluation surplus as a separate component of net assets/equity. The revaluation surplus at the date of adoption of MPSASs is based on a comparison of the carrying amount of the asset at that date with its cost or deemed cost. If the deemed cost is the fair value at the date of adoption of MPSASs or where the first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure certain assets, when the exemptions providing the relief have expired, or the asset has been recognized and/or measured in accordance with MPSAS 17, *Property, Plant and Equipment*, (whichever is earlier), the first-time adopter provides the disclosures required by paragraph 148 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*.
- IG57. If revaluations in accordance with the first-time adopter's previous basis of accounting did not satisfy the criteria in paragraphs 67 or 69 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, the first-time adopter measures the revalued assets in its opening statement of financial position on one of the following bases:
- (a) Cost (or deemed cost) less any accumulated depreciation and any accumulated impairment losses under the cost model in MPSAS 17, *Property, Plant and Equipment*;
 - (b) Deemed cost, being the fair value or an alternative when market-based evidence of fair value is not available, at the date of adoption of MPSASs, or where a first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure certain assets, the date at which the asset is recognized and/or measured during the period of transition, or when the transitional exemptions expire (whichever is earlier); or
 - (c) A revalued amount, if the entity adopts the revaluation model in MPSAS 17, *Property, Plant and Equipment*, as its accounting policy in accordance with MPSASs for all items of property, plant and equipment in the same class.

- IG58. MPSAS 17, *Property, Plant and Equipment*, requires each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item to be depreciated separately. However, MPSAS 17, *Property, Plant and Equipment*, does not prescribe the unit of measurement for recognition of an asset, i.e. what constitutes an item of property, plant and equipment. Thus, judgment is required in applying the recognition criteria to an entity's specific circumstances (paragraphs 18 and 59).

MPSAS 25, Employee Benefits

- IG59. At the date of adoption of MPSASs, a first-time adopter applies MPSAS 25, *Employee Benefits*, in measuring defined benefits plans and other long-term employee benefits, and recognizes all cumulative actuarial gains or losses from the inception of the plan until the date of adoption of MPSASs, or where the first-time adopter takes advantage of the exemption that provides a three year transitional relief period from the recognition of defined benefit plans and other long-term employee benefits, the date on which the exemptions expire or when the defined benefits plans and other long-term employee benefits are recognized and/or measured in accordance with MPSAS 25, *Employee Benefits*, (whichever is earlier), even if its accounting policy in accordance with MPSAS 25, *Employee Benefits*, will involve leaving some later actuarial gains and losses unrecognized (see paragraph 105 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*).
- IG60. A first-time adopter's actuarial assumptions at the date of adoption of MPSASs, or where the first-time adopter takes advantage of the exemptions that provide relief from the recognition of defined benefit plans and other long-term employee benefits, the date on which the exemptions expire or when the defined benefits plans and other long-term employee benefits are recognized and/or measured in accordance with MPSAS 25 *Employee Benefits*, (whichever is earlier), are consistent with actuarial assumptions made at the end of its comparative period (if the first-time adopter elects to present comparative information in accordance with paragraph 78 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*) in accordance with its previous basis of accounting (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those assumptions were in error (paragraph 23 of the MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*). Any later revisions to those assumptions are an actuarial gain or loss of the period in which the first-time adopter makes the revisions.
- IG61. A first-time adopter may need to make actuarial assumptions at the date of adoption of MPSASs, or where the first-time adopter takes advantage of the exemptions that provide relief from the recognition of defined benefit plans and other long-term employee benefits, the date on which the exemptions expire or when the defined benefits plans and other long-term employee benefits are recognized and/or measured in accordance with MPSAS 25, *Employee Benefits*, (whichever is earlier), that were not necessary in accordance with its basis of accounting. Such actuarial assumptions do not reflect conditions that arose after the date of adoption of MPSASs, or where the first-time adopter takes advantage of the exemptions that provide relief from the recognition of defined benefit plans and other long-term employee benefits, the date on which the exemptions expire or when the defined benefits plans and other long-term employee benefits are recognized and/or measured in accordance with MPSAS 25, *Employee Benefits*, (whichever is earlier). In particular, discount rates and the fair value of plan assets at the date of adoption

of MPSASs, or where the first-time adopter takes advantage of the exemptions that provide relief from the recognition of defined benefit plans and other long-term employee benefits, the date on which the exemptions expire or when the liabilities are recognized and/or measured in accordance with MPSAS 25, *Employee Benefits*, (whichever is earlier), reflect market conditions at that date. Similarly, the first-time adopter's actuarial assumptions adoption of MPSASs, or where the first-time adopter takes advantage of the exemptions that provide relief from the recognition of defined benefit plans and other long-term employee benefits, the date on which the exemptions expire or when the defined benefits plans and other long-term employee benefits are recognized and/or measured in accordance with MPSAS 25, *Employee Benefits*, (whichever is earlier), about future employee turnover rates do not reflect a significant increase in estimated employee turnover rates as a result of a curtailment of the pension plan that occurred after the date of adoption of MPSASs, or where the first-time adopter takes advantage of the exemptions that provide relief from the recognition of defined benefit plans and other long-term employee benefits, the date on which the exemptions expire or when the defined benefits plans and other long-term employee benefits are recognized and/or measured in accordance with MPSAS 25, *Employee Benefits*, (whichever is earlier) (paragraph 23 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*).

- IG62. In many cases, a first-time adopter's transitional MPSAS financial statements or its first MPSAS financial statements will reflect measurements of employee benefit obligations at three dates (where a first-time adopter elects to present comparative information in accordance with paragraph 78 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*), the end of the first reporting period, the date of the comparative statement of financial position (where the first-time adopter elects to present comparative information) and the date of adoption of MPSASs, or where the first-time adopter takes advantages of the exemptions that provide relief from the recognition of defined benefit plans and other long-term employee benefits, the date on which the exemptions expire or when the defined benefits plans and other long-term employee benefits are recognized and/or measured in accordance with MPSAS 25, *Employee Benefits*, (whichever is earlier). MPSAS 25, *Employee Benefits*, encourages the first-time adopter to involve a qualified actuary in the measurement of all material post-employment benefit obligations. To minimize costs, a first-time adopter may request a qualified actuary to carry out a detailed actuarial valuation at one or two of these dates and roll the valuation(s) forward or back to the other date(s). Any such roll forward or roll back reflects any material transactions and other material events (including changes in market prices and interest rates) between those dates (paragraph 68 of MPSAS 25 *Employee Benefits*).

MPSAS 21, Impairment of Non-Cash-Generating Assets and MPSAS 26, Impairment of Cash-Generating Assets

- IG63. Paragraph 98 and 108 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, requires a first-time adopter to apply the requirements in MPSAS 21, *Impairment of Non-Cash-Generating Assets*, and MPSAS 26, *Impairment of Cash-Generating Assets*, prospectively from the date of adoption of accrual basis MPSASs, or where a first-time adopter takes advantage of the exemptions that provide a three year transitional relief period to not recognize and/or measure an asset, the date when the exemptions that provided the relief expire and/or the asset is recognized and/or measured. For example, if

an entity adopts accrual basis MPSASs on January 1, 20X1 and takes advantage of the three year transitional relief period to not recognize and/or measure an item or property, plant and equipment, if would not be required to assess the item of property, plant and equipment for impairment until (a) December 31, 20X3 (i.e. the date on which the transitional exemption expire) or (b) the date following the recognition of the item of property, plant and equipment if it was recognized and/or measured during the period of transition (whichever is earlier).

- IG64. The estimates used to determine whether a first-time adopter recognizes an impairment loss (and to measure any such impairment loss) at the date of adoption of MPSASs, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition of assets, the date on which the exemptions expire or when the assets are recognized and/or measured in accordance with the applicable MPSAS (whichever is earlier) are consistent with estimates made for at the end of its comparative period (if the first-time adopter elects to present comparative information in accordance with paragraph 78 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*) the first-time adopter's previous basis of accounting (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error (paragraphs 23 and 24 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*). The first-time adopter reports any later revisions to those estimates as an event of the period in which it makes the revisions.
- IG65. In assessing whether it needs to recognize an impairment loss (and in measuring any such impairment loss) at the date of adoption of MPSASs, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition of assets, the date on which the exemptions expire or when the assets are recognized and/or measured in accordance with the applicable MPSAS (whichever is earlier), the first-time adopter may need to make estimates for that date that were not necessary in accordance with its previous basis of accounting. Such estimates and assumptions do not reflect conditions that arose after the date of transition, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition of assets, the date on which the exemptions expire or when the assets are recognized and/or measured in accordance with the applicable MPSAS (whichever is earlier) (paragraph 25 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*).

MPSAS 28, Financial Instruments: Presentation

- IG66. In its opening statement of financial position, a first-time adopter applies the criteria in MPSAS 28, *Financial Instruments: Presentation*, to classify financial instruments issued (or components of compound instruments issued) as either financial liabilities or net asset/equity instruments in accordance with the substance of the contractual arrangement when the instrument first satisfied the recognition criteria in MPSAS 28, *Financial Instruments: Presentation*, (paragraphs 13 and 35), without considering events after that date (other than changes to the terms of the instruments).

MPSAS 29, Financial Instruments: Recognition and Measurement

Recognition

- IG67. A first-time adopter recognizes all financial assets and financial liabilities (including all derivatives) that qualify for recognition in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, and have not yet qualified for derecognition in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, except non-derivative financial assets and non-derivative financial liabilities derecognized in accordance with its previous basis of accounting before the date of adoption of MPSASs, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition of financial instruments, the date on which the exemptions expire or when the financial instruments are recognized and/or measured in accordance with the applicable MPSAS (whichever is earlier), to which the first-time adopter does not choose to apply paragraph 116 of MPSAS 33 (see paragraphs 115 and 116 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*).
- IG68. For example, a first-time adopter that does not apply paragraph 116 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, does not recognize assets transferred in a securitization, transfer or other derecognition transaction that occurred before the date of adoption of MPSASs if those transactions qualified for derecognition in accordance with its previous basis of accounting. However, if the first-time adopter uses the same securitization arrangement or other derecognition arrangement for further transfers after the date of transition to MPSASs, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition and/or measurement of financial instruments, the date on which the exemptions expire or when the financial instruments are recognized and/or measured in accordance with the applicable MPSAS (whichever is earlier), those further transfers qualify for derecognition only if they meet the derecognition criteria of MPSAS 29, *Financial Instruments: Recognition and Measurement*.

Embedded Derivatives

- IG69. When MPSAS 29, *Financial Instruments: Recognition and Measurement*, requires a first-time adopter to separate an embedded derivative from a host contract, the initial carrying amounts of the components at the date when the instrument first satisfies the recognition criteria in MPSAS 29, *Financial Instruments: Recognition and Measurement*, reflect circumstances at that date (MPSAS 29, *Financial Instruments: Recognition and Measurement*, paragraph 12). If the first-time adopter cannot determine the initial carrying amounts of the embedded derivative and host contract reliably, it measures the entire combined contract as at fair value through surplus or deficit (MPSAS 29, *Financial Instruments: Recognition and Measurement*, paragraph 14).

Measurement

- IG70. In preparing its opening statement of financial position, a first-time adopter applies the criteria in MPSAS 29, *Financial Instruments: Recognition and Measurement*, to identify those financial assets and financial liabilities that are measured at fair value and those that are measured at amortised cost.

Adjusting the Carrying Amount of Financial Instruments on the Date of Adoption of Accrual Basis MPSASs or During the Period of Transition

IG71. A first-time adopter shall treat an adjustment to the carrying amount of a financial asset or financial liability as an adjustment to be recognized in the opening balance of accumulated surplus or deficit at the date of adoption of MPSASs, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition and/or measurement of financial instruments, the date on which the exemptions expire or when the financial instruments are recognized and/or measured in accordance with the applicable MPSAS (whichever is earlier), only to the extent that it results from adopting MPSAS 29, *Financial Instruments: Recognition and Measurement*. Because all derivatives, other than those that are financial guarantee contracts or are designated and effective hedging instruments, are classified as held for trading, the differences between the previous carrying amount (which may have been zero) and the fair value of the derivatives are recognized as an adjustment of the balance of accumulated surplus or deficit at the beginning of the financial year in which MPSAS 29, *Financial Instruments: Recognition and Measurement*, is initially applied, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition and/or measurement of financial instruments, the date on which the exemptions expire or when the financial instruments are recognized and/or measured in accordance with the applicable MPSAS (whichever is earlier).

Hedge Accounting

IG72. Paragraphs 117 to 119 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, deal with hedge accounting. The designation and documentation of a hedge relationship must be completed on or before the date of adoption of MPSASs, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition and/or measurement of financial instruments, the date on which the exemptions expire or when the financial instruments are recognized and/or measured in accordance with the applicable MPSAS (whichever is earlier) if the hedge relationship is to qualify for hedge accounting from that date. Hedge accounting can be applied prospectively only from the date that the hedge relationship is fully designated and documented.

IG73. A first-time adopter may, in accordance with its previous basis of accounting, have deferred or not recognized gains and losses on a fair value hedge of a hedged item that is not measured at fair value. For such a fair value hedge, a first-time adopter adjusts the carrying amount of the hedged item at the date of adoption of MPSASs, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition of financial instruments, the date on which the exemptions expire or when the financial instruments are recognized and/or measured in accordance with the applicable MPSAS (whichever is earlier). The adjustment is the lower of:

- (a) That portion of the cumulative change in the fair value of the hedged item that reflects the designated hedged risk and was not recognized in accordance with its previous basis of accounting; and
- (b) That portion of the cumulative change in the fair value of the hedging instrument that reflects the designated hedged risk and, in accordance with its previous basis of accounting, was either (i) not recognized or (ii) deferred in the statement of financial position as an asset or liability.

IG74. A first-time adopter may, in accordance with its previous basis of accounting, have deferred gains and losses on a cash flow hedge of a forecast transaction. If, at the date of adoption of MPSAS, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition and/or measurement of financial instruments, the date on which the exemptions expire or when the financial instruments are recognized and/or measured in accordance with the applicable MPSAS (whichever is earlier), the hedged forecast transaction is not highly probable, but is expected to occur, the entire deferred gain or loss is recognized in net assets/equity. Any net cumulative gain or loss that has been reclassified to net assets/equity on initial application of MPSAS 29, *Financial Instruments: Recognition and Measurement*, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition and/or measurement of financial instruments, the date on which the exemptions expire or when the financial instruments are recognized and/or measured in accordance with the applicable MPSAS (whichever is earlier) remains in net assets/equity until:

- (a) The forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability;
- (b) The forecast transaction affects surplus or deficit; or
- (c) Subsequently circumstances change and the forecast transaction is no longer expected to occur, in which case any related net cumulative gain or loss is reclassified from net assets/equity to surplus or deficit.

If the hedging instrument is still held, but the hedge does not qualify as a cash flow hedge in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, hedge accounting is no longer appropriate starting from the date of adoption of MPSASs, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition and/or measurement of financial instruments, the date on which the exemptions expire or when the financial instruments are recognized and/or measured in accordance with the applicable MPSAS (whichever is earlier).

MPSAS 31, Intangible Assets

IG75. A first-time adopter's opening statement of financial position excludes all intangible assets and other intangible items that do not meet the criteria for recognition in accordance with MPSAS 31, *Intangible Assets*, at the date of adoption of MPSAS, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition of intangible assets, the date on which the exemptions expire and/or when the intangible assets are recognized and/or measured in accordance with the applicable MPSAS (whichever is earlier) and includes all intangible assets that meet the recognition criteria in MPSAS 31, *Intangible Assets*, at that date.

IG76. The criteria in MPSAS 31, *Intangible Assets*, require an entity to recognize an intangible asset if, and only if:

- (a) It is probable that the future economic benefits that are attributable to the asset will flow to the entity; and
- (b) The cost of the asset can be measured reliably.

MPSAS 31, *Intangible Assets*, supplements these two criteria with further, more specific, criteria for internally generated intangible assets.

- IG77. In accordance with paragraphs 63 and 66 of MPSAS 31, *Intangible Assets*, an entity capitalises the costs of internally generated intangible assets prospectively from the date when the recognition criteria are met. MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, allows an entity to recognize previously expensed intangible assets to the extent that the item meets the definition of an intangible asset, and the recognition criteria in MPSAS 31, *Intangible Assets*. Thus, if an internally generated intangible asset qualifies for recognition at the date of adoption of MPSASs, or where the first-time adopter takes advantage of the exemption that provides relief from the recognition of intangible assets, the date on which the exemptions expire and/or when the intangible assets are recognized and/or measured in accordance with the MPSAS 31, *Intangible Assets*, (whichever is earlier) the first-time adopter recognizes and/or measures the asset in its opening statement of financial position even if it had recognized the related expenditure as an expense in accordance with its previous basis of accounting.
- IG78. If the asset does not qualify for recognition in accordance with MPSAS 31, *Intangible Assets*, until a later date, its cost is the sum of the expenditure incurred from that later date.
- IG79. The criteria in paragraph IG76 also apply to intangible assets acquired separately. In many cases, contemporaneous documentation prepared to support the decision to acquire the asset will contain an assessment of the future economic benefits or service potential. Furthermore, as explained in paragraph 33 of MPSAS 31, *Intangible Assets*, the cost of a separately acquired intangible asset can usually be measured reliably.
- IG80. A first-time adopter may elect to use one of the following amounts as the deemed cost of intangible assets (except for internally generated intangible assets):
- (a) Fair value at the date of transition at the date of adoption of MPSASs, or where a first-time adopter takes advantage of the exemption that provides a three year transitional relief period to not recognize and/or measure certain assets, the date at which the asset is recognized and/or measured during the period of transition, or the date on which the exemptions expire (whichever is earlier) (paragraph 67 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*), in which case the entity gives the disclosures required by paragraph 148 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*; or
 - (b) A revaluation in accordance with its previous basis of accounting that meets the criteria in paragraph 67 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*.
- IG81. If a first-time adopter's amortization methods and rates in accordance with its previous basis of accounting are acceptable MPSAS, its account for any change in estimated useful life or amortization pattern prospectively from when it makes that change in estimate (paragraphs 23 and 24 MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, and paragraph 103 of MPSAS 31, *Intangible Assets*). However, in some cases, the first-time adopter's amortization methods and rates in accounting may differ from those that would be acceptable in accordance with MPSASs (for example, if they do not reflect a reasonable estimate of the asset's useful life). If those differences have a material effect on

the financial statements, the first-time adopter adjusts accumulated amortization on in its opening statement of financial position retrospectively so that it complies with MPSASs.

MPSAS 35, Consolidated Financial Statements

IG82. If a first-time adopter did not consolidate a controlled entity in accordance with its previous basis of accounting, then, in its consolidated financial statements, the first-time adopter measures the controlled entity's assets and liabilities at the same carrying amounts as in the accrual basis financial statements of the controlled entity following its adoption of MPSASs, after adjusting for consolidation procedures and for the effects of the entity combination in which it acquired the controlled entity (paragraph 130 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*). If the controlled entity has not adopted accrual basis MPSASs in its financial statements, the carrying amounts described in the previous sentence are those that MPSASs would require in those financial statements.

Controlling Entity Adopts Accrual Basis MPSASs Before the Controlled Entity

Background

IG83. Controlling entity A presents its (consolidated) first MPSAS financial statements in 20X5. Its controlled entity B, wholly owned by controlling entity A since formation, prepares information in accordance with accrual basis MPSASs for internal consolidation purposes from that date, but controlled entity B does not present its first MPSAS financial statements until 20X7.

Application of Requirements

IG84. If controlled entity B applies paragraph 129(a) of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, the carrying amounts of its assets and liabilities are the same in both its opening MPSAS statement of financial position at January 1, 20X6 and controlling entity's A consolidated financial position (except for adjustments for consolidation procedures) and are based on controlling entity B's date adoption of MPSASs.

IG85. Alternatively, controlled entity B, in accordance with paragraph 129(b) of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, measure all its assets or liabilities based on its own date of adoption of MPSASs (January 20X6). However, the fact that controlled entity B becomes a first-time adopter in 20X7 does not change the carrying amounts of its assets and liabilities in controlling entity A's consolidated financial statements.

Controlled Entity Adopts Accrual Basis MPSASs Before the Controlling Entity

Background

IG86. Controlling entity C presents its (consolidated) transitional MPSAS financial statements MPSASs in 20X7. Its controlled entity D, wholly owned by controlling entity C since formation, presented its transitional MPSAS financial statements in 20X5. Until 20X7, controlled entity D prepared information for internal consolidation purposes in basis of accounting.

Application of Requirements

- IG87. The carrying amounts of controlled entity D's assets and liabilities at January 1, 20X6 are the same in both controlling entity's C (consolidated) opening accrual basis statements of financial position and controlled entity D's financial statements (except for adjustments for consolidation procedures) and are based on controlled entity D' date of adoption of MPSASs. The fact that controlling entity C becomes a first-time adopter in 20X7 does not change those carrying amounts (paragraph 129 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*).
- IG88. Paragraphs 129 and 130 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, do not override the following requirements:
- (a) The rest of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, in measuring all assets and liabilities for which paragraphs 129 and 130 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, are not relevant.
 - (b) To give all disclosures required by this MPSAS as of the first-time adopter's own transition to MPSASs.
- IG89. Paragraph 129 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, applies if a controlled entity becomes a first-time adopter later than its controlling entity, for example if the controlling entity previously prepared a reporting package in accordance with accrual basis MPSASs for consolidation purposes but did not present a full set of financial statements in accordance with MPSASs. This may be relevant not only when a controlling entity reporting package complies fully with the recognition and measurement requirements of MPSASs, but also when it is adjusted centrally for matters such as review of events after the reporting date and central allocation of pension costs. However, paragraph 129 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, does not permit a controlled entity to ignore misstatements that are immaterial to the consolidated financial statements of its controlling entity but material to its own financial statements.

Presentation and Disclosure

- IG90. Paragraphs 135 to 140 in MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, require a first-time adopter to disclose certain information when it has taken advantage of the transitional exemptions and provisions in its adoption of accrual basis MPSASs.

To illustrate:

Notes to the financial statements for the year ending December 31, 20X2

Note 48 –Adoption of transitional exemptions and provisions in MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*.

Public Sector Entity X adopted accrual basis MPSAS on January 1, 20X1 and elected to adopt the transitional exemption in MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, that allows it to apply a deemed cost and a period of up to three years in which to measure land and buildings and investment property.

Public Sector Entity X took advantage of these exemptions in determining a deemed cost, and to measure its land and buildings and investment property. As a result of adopting these transitional exemptions and provisions the entity is not able to make an explicit and unreserved statement about its compliance with accrual basis MPSASs, as the adoption of these transitional exemptions affect the fair presentation of Public Sector Entity X's financial statements and its ability to assert compliance with accrual basis MPSASs.

No other transitional exemptions that affect fair presentation and compliance with accrual basis MPSASs during the period of transition were adopted or applied to any other assets and/or liabilities.

During the period under review, Public Sector Entity X restated its opening balance of investment property with an additional value of RM 1,200,000 after determining the deemed cost on June 30, 20X2 for the investment property under its control.

As at year end, Public Sector Entity X has not yet determined a deemed cost for land and buildings and has not yet measured these assets in its financial statements. Land and buildings reflect a closing balance of RM2,500,000 as at December 31, 20X2. This value was determined under Public Sector Entity X's previous basis of accounting.

Public Sector Entity X plans to apply a three year transitional exemption for measuring its land and buildings and in determining a deemed cost for these asset.

Public Sector Entity X has appointed an appraiser to value the land and has developed a model for the measurement of buildings. The progress in determining the valuations for land and buildings is in accordance with its implementation plan.

Summary of Transitional Exemptions and Provisions Included in MPSAS 33 *First-time Adoption of Accrual Basis MPSASs*

IG91. The diagram below summarizes the transitional exemptions and provisions included in other accrual basis MPSASs

MPSAS	Transitional exemption provided							
	NO	YES						
		Deemed cost	3 year transitional relief for recognition	3 year transitional relief for measurement	3 year transitional relief for recognition and/or measurement	3 year transitional relief for disclosure	Elimination of transactions, balances, revenue and expenses	Other
MPSAS 1, <i>Presentation of Financial Statements</i>						√ To extent that 3 year relief period was adopted		Presenting comparative info encouraged
MPSAS 2, <i>Cash Flow Statements</i>	√							
MPSAS 3, <i>Accounting Policies, Changes in Accounting Estimates and Errors</i>	√							
MPSAS 4, <i>The Effects of Changes in Foreign Exchange Rates</i>								Exemption to comply with requirements for cumulative translation
MPSAS 5, <i>Borrowing Costs</i>			√ When allowed alternative is elected as accounting policy					- Encouraged to apply benchmark treatment retrospectively - Allowed alternative must be applied retrospectively

MPSAS	Transitional exemption provided							
	NO	YES						
		Deemed cost	3 year transitional relief for recognition	3 year transitional relief for measurement	3 year transitional relief for recognition and/or measurement	3 year transitional relief for disclosure	Elimination of transactions, balances, revenue and expenses	Other
MPSAS 9, <i>Revenue from Exchange Transactions</i>	√				√ To extent that 3 year relief period was adopted for assets and/or liabilities			
MPSAS 11, <i>Construction Contracts</i>	√							
MPSAS 12, <i>Inventories</i>		√	√ Inventory not recognized under previous basis of accounting	√ Inventory recognized under previous basis of accounting				
MPSAS 13, <i>Leases</i>			√ Leased assets and/or liabilities not recognized under previous basis of accounting	√ Leased assets and/or liabilities recognized under previous basis of accounting				

MPSAS	Transitional exemption provided							
	NO	YES						
		Deemed cost	3 year transitional relief for recognition	3 year transitional relief for measurement	3 year transitional relief for recognition and/or measurement	3 year transitional relief for disclosure	Elimination of transactions, balances, revenue and expenses	Other
MPSAS 14, <i>Events After the Reporting Date</i>	√							
MPSAS, 16 <i>Investment Property</i>		√	√ Investment property not recognized under previous basis of accounting	√ Investment property recognized under previous basis of accounting				
MPSAS 17, <i>Property, Plant and Equipment</i>		√	√ Property, plant and equipment not recognized under previous basis of accounting	√ Property, plant and equipment recognized under previous basis of accounting				

MPSAS	Transitional exemption provided							
	NO	YES						
		Deemed cost	3 year transitional relief for recognition	3 year transitional relief for measurement	3 year transitional relief for recognition and/or measurement	3 year transitional relief for disclosure	Elimination of transactions, balances, revenue and expenses	Other
MPSAS 19, <i>Provisions, Contingent Liabilities and Contingent Assets</i>			√ Only liabilities related to assets not recognized under previous basis of accounting to be included initial estimate of cost of dismantling/ removing item/ restoring site	√ Only liabilities related to assets recognized under previous basis of accounting to be included initial estimate of cost of dismantling/ removing item/ restoring site				
MPSAS 20, <i>Related Party Disclosures</i>						√		
MPSAS 21, <i>Impairment of Non - Cash-Generating Assets</i>								• Prospective application
MPSAS 22, <i>Disclosure of Financial Information About the General Government Sector</i>	√							

MPSAS	Transitional exemption provided							
	NO	YES						
		Deemed cost	3 year transitional relief for recognition	3 year transitional relief for measurement	3 year transitional relief for recognition and/or measurement	3 year transitional relief for disclosure	Elimination of transactions, balances, revenue and expenses	Other
MPSAS 23, <i>Revenue from Non-Exchange Transactions</i>			√ All non-exchange revenue not recognized under previous basis of accounting	√ All non-exchange revenue recognized under previous basis of accounting	√ To extent that 3 year relief period was adopted for assets and/or liabilities			
MPSAS 24, <i>Presentation of Budget Information in Financial Statements</i>	√							

MPSAS	Transitional exemption provided							
	NO	YES						
		Deemed cost	3 year transitional relief for recognition	3 year transitional relief for measurement	3 year transitional relief for recognition and/or measurement	3 year transitional relief for disclosure	Elimination of transactions, balances, revenue and expenses	Other
MPSAS 25, <i>Employee Benefits</i>			√ defined benefit plans and other long-term employee benefits not recognized under previous basis of accounting	√ for defined benefit and other long-term employee benefits recognized under previous basis of accounting				- Provisions on how to determine initial liability - Provision to not separate cumulative actuarial gains and losses - Prospective disclosure on experience adjustments
MPSAS 26, <i>Impairment of Cash-Generating Assets</i>			√					Prospective application
MPSAS 27, <i>Agriculture</i>			√ Biological and agricultural activities not recognized under previous basis of accounting	√ Biological and agricultural activities recognized under previous basis of accounting				

MPSAS	Transitional exemption provided							
	NO	YES						
		Deemed cost	3 year transitional relief for recognition	3 year transitional relief for measurement	3 year transitional relief for recognition and/or measurement	3 year transitional relief for disclosure	Elimination of transactions, balances, revenue and expenses	Other
MPSAS 28, <i>Financial Instruments: Presentation</i>								Provisions not to separate liability and net asset/equity component under specific circumstances
MPSAS 29, <i>Financial Instruments: Recognition and Measurement</i>		√	√ For financial instruments not recognized under previous basis of accounting	√ For financial instruments recognized under previous basis of accounting				- Provisions around designation/ derecognition /hedge accounting - Apply impairment principles prospectively
MPSAS 30, <i>Financial Instruments: Disclosure</i>								No comparative info about nature and extent of risks
MPSAS 31, <i>Intangible Assets</i>		√ Intangible assets other than internally generated I/A	√ Intangible assets not recognized under previous basis of accounting	√ Intangible assets recognized under previous basis of accounting				Provision to recognise previously expensed internally generated intangible assets

MPSAS	Transitional exemption provided							
	NO	YES						
		Deemed cost	3 year transitional relief for recognition	3 year transitional relief for measurement	3 year transitional relief for recognition and/or measurement	3 year transitional relief for disclosure	Elimination of transactions, balances, revenue and expenses	Other
MPSAS 32, <i>Service Concession Arrangements: Grantor</i>		✓ Service concession asset	✓ Service concession asset and not recognized under related liability previous basis of accounting	✓ Service concession asset and related liability recognized under previous basis of accounting				Provision on how to recognize related liability
MPSAS 35, <i>Consolidated Financial Statements</i>		✓			✓ To appropriately classify and identify interests in other entities		✓	- Provisions when controlling and/or controlled entity adopts MPSAS at different time - Exemption to not prepare financial statements as consolidated financial statements (Assess if investment entity on date of adoption and measure at fair value at that date)

MPSAS	Transitional exemption provided							
	NO	YES						
		Deemed cost	3 year transitional relief for recognition	3 year transitional relief for measurement	3 year transitional relief for recognition and/or measurement	3 year transitional relief for disclosure	Elimination of transactions, balances, revenue and expenses	Other
MPSAS 36, Investments in Associates and Joint Ventures		√			√ To appropriately classify and identify interests in other entities		√	- Provisions when controlling entity and associate adopts MPSAS at different time - Exemption to not include investment in associate in consolidated financial statements
		√			√ To appropriately classify and identify interests in other entities		√	- Provisions when controlling entity and associate and jointly controlled entities adopt MPSAS at different time - Exemption to not include interests in joint venture in consolidated financial statements
MPSAS 37, Joint Arrangements								Provisions on how to measure investment in joint venture previously accounted for using proportionate consolidation

Appendix

Differentiation between transitional exemptions and provisions that a first-time adopter is required to apply and/or can elect to apply on adoption of accrual basis MPSASs

This Appendix summarises how the transitional exemptions and provisions that a first-time adopter is required to apply in terms of this MPSAS, and those that a first-time adopter may elect to apply on adoption of accrual basis MPSASs.

As the transitional exemptions and provisions that may be elected can also affect the fair presentation and the first-time adopter's ability to assert compliance with accrual basis MPSASs as explained in paragraphs 27 to 32 of MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, the Appendix makes a distinction between those transitional exemptions and provisions that affect fair presentation and the ability to assert compliance with accrual basis MPSASs, and those that do not.

Transitional exemption or provision	Transitional exemptions or provisions that have to be applied	Transitional exemptions or provisions that may be applied or elected	
		Do not affect fair presentation and compliance with accrual basis MPSAS	Affect fair presentation and compliance with accrual basis MPSAS
MPSAS 1 • Present comparative information		√	
MPSAS 4 • Cumulative transitional differences at the date of adoption		√	
MPSAS 5 • Allowed alternative treatment and has taken advantage of relief period • Adopt allowed alternative treatment on date of adoption – retrospective application • Adopt bench mark treatment on the date of adoption – retrospective application of costs incurred before and after date of adoption	√	√	√

Transitional exemption or provision	Transitional exemptions or provisions that have to be applied	Transitional exemptions or provisions that may be applied or elected	
		Do not affect fair presentation and compliance with accrual basis MPSAS	Affect fair presentation and compliance with accrual basis MPSAS
MPSAS 9 Relief for recognition and/measurement of the revenue related to adoption of three year relief period for recognition and/or measurement of financial instruments.			√
MPSAS 12 Three year relief for recognition and/or measurement of assets and changing the accounting policy to measure assets			√
MPSAS 13 - No recognition and/or measurement of finance lease liability and finance lease asset if relief period for recognition and/or measurement of assets is adopted - Classification of lease based on circumstances at adoption of accrual basis MPSAS	√		√

MPSAS 33	Transitional exemption or provision	Transitional exemptions or provisions that have to be applied	Transitional exemptions or provisions that may be applied or elected	
		Do not affect fair presentation and compliance with accrual basis MPSAS	Do not affect fair presentation and compliance with accrual basis MPSAS	Affect fair presentation and compliance with accrual basis MPSAS
1110	MPSAS 28 - Determine if financial instrument has liability and net asset/equity component on date of adoption - Do not separate compound financial instrument if no liability exists on date of adoption	√ √		
	MPSAS 29 - Three year relief for recognition and/or measurement of assets and/or liabilities and changing the accounting policy to measure assets and/or liabilities <i>Designation</i> - Designate financial asset or liability at fair value through surplus or deficit on date of adoption <i>Impairment</i> - Apply impairment provisions prospectively on date of adoption	√ √		√

Transitional exemption or provision	Transitional exemptions or provisions that have to be applied	Transitional exemptions or provisions that may be applied or elected	
	Do not affect fair presentation and compliance with accrual basis MPSAS	Do not affect fair presentation and compliance with accrual basis MPSAS	Affect fair presentation and compliance with accrual basis MPSAS
MPSAS 29 <i>Derecognition</i> • Apply derecognition provisions prospectively on date of adoption • Apply derecognition provisions retrospectively if information is available as at the date of initial accounting	√	√	
<i>Hedge accounting</i> • Measure derivatives at fair value • Eliminate all deferred losses and gains • Only reflect hedges that qualify for hedge accounting on date of adoption • Discontinue hedge transaction if conditions of hedge accounting on date of adoption are not met	√ √ √ √		
MPSAS 30 • No disclosure of information about nature and extent of risks		√	

Transitional exemption or provision	Transitional exemptions or provisions that have to be applied	Transitional exemptions or provisions that may be applied or elected	
		Do not affect fair presentation and compliance with accrual basis MPSAS	Affect fair presentation and compliance with accrual basis MPSAS
MPSAS 31 • Three year relief for recognition and/or measurement of assets and changing the accounting policy to measure assets • Recognize all internally generated intangible assets	√		√
MPSAS 32 • Three year relief for recognition and/or measurement of assets and/or liabilities and changing the accounting policy to measure assets and/or liabilities • Measure liability either under financial liability model or grant of a right to the operator model on date of adoption or when asset is recognised if relief period is adopted	√		√
Applying deemed cost to assets and/or liabilities		√	
Applying deemed cost to assets acquired in a non-exchange transaction		√	
Using deemed cost for investments in controlled entities, jointly controlled entities and associates		√	
Preparing reconciliations during transitional period	√		

Transitional exemption or provision	Transitional exemptions or provisions that have to be applied	Transitional exemptions or provisions that may be applied or elected	
		Do not affect fair presentation and compliance with accrual basis MPSAS	Affect fair presentation and compliance with accrual basis MPSAS
MPSAS 35 • Relief to recognize and/or measure interests in controlled entity • Elect to not eliminate inter-entity balances, transactions, revenue and expenses • Controlled entity becomes first-time adopter later or earlier than its controlling entity	√		√
• Not present financial statements as consolidated financial statements if three year relief for recognition and/or measurement and/or elimination option was adopted • <i>Assess if investment entity on date of adoption and determine fair value at that date</i>	√		√

Transitional exemption or provision	Transitional exemptions or provisions that have to be applied	Transitional exemptions or provisions that may be applied or elected	
	Do not affect fair presentation and compliance with accrual basis MPSAS	Do not affect fair presentation and compliance with accrual basis MPSAS	Affect fair presentation and compliance with accrual basis MPSAS
MPSAS 36 • Relief to recognize and/or measure interests in controlled entity • Elect to not eliminate share in associate's surplus or deficit • Associate becomes first-time adopter later or earlier than its controlling entity • Not present investment in associates in consolidated financial statements if three year relief for recognition and/or measurement and/or elimination option was adopted	√		√ √ √
MPSAS 37 • <i>Measure investment in joint venture previously accounted for using proportionate consolidation</i>	√		

Comparison with IPSAS 33

MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSAS)*, is drawn primarily from IPSAS 33 (2018). Main difference between MPSAS 33 and IPSAS 33 is as follows:

- Paragraph 91 to 94 are deleted because IPSAS 10, *Financial Reporting in Hyperinflationary Economies* is not adopted in Malaysia.
- Paragraph 97 is deleted because IPSAS 18, *Segment Reporting* is not adopted in Malaysia.
- In paragraph 36, 102, 104, 105, 106 and 107, IPSAS 33 refers to IPSAS 39, *Employee Benefits*, whereas MPSAS 33 refers to MPSAS 25, *Employee Benefits*, in which drawn from IPSAS 25 that has been superseded by IPSAS 39. The MPSAS is yet to adopt IPSAS 39.

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MPSAS 34 - SEPARATE FINANCIAL STATEMENTS

Acknowledgement

The Malaysian Public Sector Accounting Standard (MPSAS) 34 is based on International Public Sector Accounting Standard (IPSAS) 34, *Separate Financial Statements*, from the *Handbook of International Public Sector Accounting Pronouncements* of the International Public Sector Accounting Standards Board, published by the International Federation of Accountants (IFAC) in 2018 and is used with permission of IFAC.

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MPSAS 34—SEPARATE FINANCIAL STATEMENTS**History of MPSAS**

This version includes amendments resulting from MPSASs issued up to December 2022.

MPSAS 34, *Separate Financial Statements* was issued in January 2016.

Since then, MPSAS 34, *Separate Financial Statements* has been amended by the following MPSASs:

- *Improvements to MPSASs 2023* (issued December 2022)

Table of Amended Paragraphs in MPSAS 34

Paragraph Affected	How Affected	Affected By
4	Deleted	Improvements to MPSASs 2023 December 2022
5	Deleted	Improvements to MPSASs 2023 December 2022
32A	New	Improvements to MPSASs 2023 December 2022

MPSAS 34—SEPARATE FINANCIAL STATEMENTS
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Malaysian Public Sector Accounting Standard (MPSAS) 34, *Separate Financial Statements*, is set out in paragraphs 1–34. All the paragraphs have equal authority. MPSAS 34, *Separate Financial Statements*, should be read in the context of its objective and the Preface to *Malaysian Public Sector Accounting Standards*. MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe the accounting and disclosure requirements for investments in controlled entities, joint ventures and associates when an entity prepares separate financial statements.

Scope

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for investments in controlled entities, joint ventures and associates when it elects, or is required by regulations, to present separate financial statements.**
3. This Standard does not mandate which entities produce separate financial statements. It applies when an entity prepares separate financial statements that comply with Malaysian Public Sector Accounting Standards (MPSASs).
4. [Deleted]
5. [Deleted]

Definitions

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

Consolidated financial statements are the financial statements of an economic entity in which the assets, liabilities, net assets/equity, revenue, expenses and cash flows of the controlling entity and its controlled entities are presented as those of a single economic entity.

Separate financial statements are those presented by an entity, in which the entity could elect, subject to the requirements in this Standard, to account for its investments in controlled entities, joint ventures and associates either at cost, in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, or using the equity method as described in MPSAS 36, *Investments in Associates and Joint Ventures*.

Terms defined in other MPSASs 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 MPSAS 35, *Consolidated Financial Statements*, MPSAS 36, *Investments in Associates and Joint Ventures*, or MPSAS 37, *Joint Arrangements*: associate, control, controlled entity, controlling entity, economic entity, equity method, investment entity, joint control, joint operation, joint venture, joint venturer and significant influence.

7. Separate financial statements are those presented in addition to consolidated financial statements or in addition to the financial statements of an investor that does not have controlled entities but has investments in associates or joint ventures in which the investments in associates or joint ventures are required by MPSAS 36, *Investment in Associates and Joint Ventures*, to be accounted for using the equity method, other than in the circumstances set out in paragraphs 9–10.
8. The financial statements of an entity that does not have a controlled entity, associate or joint venturer's interest in a joint venture are not separate financial statements.

9. An entity that is exempted in accordance with paragraph 5 of MPSAS 35, *Consolidated Financial Statements*, from consolidation or paragraph 23 of MPSAS 36, *Investment in Associates and Joint Ventures*, from applying the equity method may present separate financial statements as its only financial statements.
10. An investment entity that is required, throughout the current period and all comparative periods presented, to measure its investment in all its controlled entities at fair value through surplus or deficit in accordance with paragraph 56 of MPSAS 35, *Consolidated Financial Statements*, presents separate financial statements as its only financial statements.

Preparation of Separate Financial Statements

11. **Separate financial statements shall be prepared in accordance with all applicable MPSASs, except as provided in paragraph 12.**
12. **When an entity prepares separate financial statements, it shall account for similar investments in controlled entities, joint ventures and associates either:**
 - (a) **At cost;**
 - (b) **In accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*;**
or
 - (c) **Using the equity method as described in MPSAS 36, *Investments in Associates and Joint Ventures*.**
13. **If an entity elects, in accordance with paragraph 24 of MPSAS 36, *Investments in Associates and Joint Ventures*, to measure its investments in associates or joint ventures at fair value through surplus or deficit in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, it shall also account for those investments in the same way in its separate financial statements.**
14. **If a controlling entity is required, in accordance with paragraph 56 of MPSAS 35, *Consolidated Financial Statements*, to measure its investment in a controlled entity at fair value through surplus or deficit in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, it shall also account for that investment in the same way in its separate financial statements. If a controlling entity that is not itself an investment entity is required, in accordance with paragraph 58 of MPSAS 35, *Consolidated Financial Statements*, to measure the investments of a controlled investment entity at fair value through surplus or deficit in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, and consolidate the other assets and liabilities and revenue and expenses of the controlled investment entity, it shall also account for that investment in the controlled investment entity in the same way in its separate financial statements.**
15. **When a controlling entity ceases to be an investment entity, or becomes an investment entity, it shall account for the change from the date when the change in status occurred, as follows:**
 - (a) **When an entity ceases to be an investment entity, the entity shall account for an investment in a controlled entity in accordance with paragraph 12. The date of the change of status shall be the deemed acquisition date. The fair value of the controlled entity at the deemed acquisition date shall represent the transferred**

deemed consideration when accounting for the investment in accordance with paragraph 12.

- (b) When an entity becomes an investment entity, it shall account for an investment in a controlled entity at fair value through surplus or deficit in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*. The difference between the previous carrying amount of the controlled entity and its fair value at the date of the change of status of the investor shall be recognized as a gain or loss in surplus or deficit. The cumulative amount of any gain or loss previously recognized directly in net assets/equity in respect of those controlled entities shall be treated as if the investment entity had disposed of those controlled entities at the date of change in status.
16. Dividends or similar distributions from a controlled entity, a joint venture or an associate are recognized in the separate financial statements of an entity when the entity's right to receive the dividend or similar distribution is established. The dividend or similar distribution is recognized in surplus or deficit unless the entity elects to use the equity method, in which case the dividend or similar distribution is recognized as a reduction from the carrying amount of the investment.
17. When a controlling entity reorganizes the structure of its economic entity by establishing a new entity as its controlling entity in a manner that satisfies the following criteria:
- (a) The new controlling entity obtains control of the original controlling entity either (i) by issuing equity instruments in exchange for existing equity instruments of the original controlling entity or (ii) by some other mechanism which results in the new controlling entity having a controlling ownership interest in the original controlling entity;
 - (b) The assets and liabilities of the new economic entity and the original economic entity are the same immediately before and after the reorganization; and
 - (c) The owners of the original controlling entity before the reorganization have the same absolute and relative interests in the net assets of the original economic entity and the new economic entity immediately before and after the reorganization;
- and the new controlling entity accounts for its investment in the original controlling entity in accordance with paragraph 12(a) in its separate financial statements, the new controlling entity shall measure cost at the carrying amount of its share of the net assets/equity items shown in the separate financial statements of the original controlling entity at the date of the reorganization.
18. Similarly, an entity that is not a controlling entity might establish a new entity as its controlling entity in a manner that satisfies the criteria in paragraph 17. The requirements in paragraph 17 apply equally to such reorganizations. In such cases, references to "original controlling entity" and "original economic entity" are to the "original entity".

Disclosure

19. An entity shall apply all applicable MPSASs when providing disclosures in its separate financial statements, including the requirements in paragraphs 20–23.
20. When a controlling entity, in accordance with paragraph 5 of MPSAS 35, *Consolidated Financial Statements*, elects not to prepare consolidated financial statements and instead prepares separate financial statements, it shall disclose in those separate financial statements:
 - (a) The fact that the financial statements are separate financial statements; that the exemption from consolidation has been used; the name of the entity whose consolidated financial statements that comply with MPSASs have been produced for public use; and the address where those consolidated financial statements are obtainable.
 - (b) A list of significant investments in controlled entities, joint ventures and associates, including:
 - (i) The name of those controlled entities, joint ventures and associates.
 - (ii) The jurisdiction in which those controlled entities, joint ventures and associates operate (if it is different from that of the controlling entity).
 - (iii) Its proportion of the ownership interest held in those entities and a description of how that ownership interest has been determined.
 - (c) A description of the method used to account for the controlled entities, joint ventures and associates listed under (b).
21. When an investment entity that is a controlling entity (other than a controlling entity covered by paragraph 20) prepares, in accordance with paragraph 10, separate financial statements as its only financial statements, it shall disclose that fact. The investment entity shall also present the disclosures relating to investment entities required by MPSAS 38, *Disclosure of Interests in Other Entities*.
22. If a controlling entity that is not itself an investment entity is required, in accordance with paragraph 56 of MPSAS 35, *Consolidated Financial Statements*, to measure the investments of a controlled investment entity at fair value through surplus or deficit in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, and consolidate the other assets and liabilities and revenue and expenses of the controlled investment entity, it shall disclose that fact. The entity shall also present the disclosures relating to investment entities required by MPSAS 38, *Disclosure of Interests in Other Entities*.
23. When a controlling entity (other than a controlling entity covered by paragraphs 20–21) or an investor with joint control of, or significant influence over, an investee prepares separate financial statements, the controlling entity or investor shall identify the financial statements prepared in accordance with MPSAS 35, *Consolidated Financial Statements*, MPSAS 36, *Investments in Associates and Joint Ventures* or MPSAS 37, *Joint Arrangements*, to which they relate. The controlling entity or investor shall also disclose in its separate financial statements:

- (a) The fact that the statements are separate financial statements and the reasons why those statements are prepared, if not required by legislation or other authority.
- (b) A list of significant controlled entities, joint ventures and associates, including:
 - (i) The name of those controlled entities, joint ventures and associates.
 - (ii) The jurisdiction in which those controlled entities, joint ventures and associates operate (if different from that of the controlling entity).
 - (iii) Its proportion of the ownership interest held in those entities and a description of how that ownership interest has been determined.
- (c) A description of the method used to account for the controlled entities, joint ventures and associates listed under (b).

Transitional Provisions

- 24. At the date of initial application, an investment entity that previously measured its investment in a controlled entity at cost shall instead measure that investment at fair value through surplus or deficit as if the requirements of this Standard had always been effective. The investment entity shall adjust retrospectively the annual period immediately preceding the date of initial application and shall adjust accumulated surplus/deficit at the beginning of the immediately preceding period for any difference between:
 - (a) The previous carrying amount of the investment; and
 - (b) The fair value of the investor's investment in the controlled entity.
- 25. At the date of initial application, an investment entity that previously measured its investment in a controlled entity at fair value directly to net assets/equity shall continue to measure that investment at fair value. The cumulative amount of any fair value adjustment previously recognized in net assets/equity shall be transferred to accumulated surplus/deficit at the beginning of the annual period immediately preceding the date of initial application.
- 26. At the date of initial application, an investment entity shall not make adjustments to the previous accounting for an interest in a controlled entity that it had previously elected to measure at fair value through surplus or deficit in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, as permitted in paragraph 12.
- 27. An investment entity shall use the fair value amounts previously reported to investors or to management.
- 28. If measuring the investment in the controlled entity in accordance with paragraphs 24–27 is impracticable (as defined in MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*), an investment entity shall apply the requirements of this Standard at the beginning of the earliest period for which application of paragraphs 24–27 is practicable, which may be the current period. The investor shall adjust retrospectively the annual period immediately preceding the date of initial application, unless the beginning of the earliest period for which application of this paragraph is practicable is the current

period. When the date that it is practicable for the investment entity to measure the fair value of the controlled entity is earlier than the beginning of the immediately preceding period, the investor shall adjust net assets/equity at the beginning of the immediately preceding period for any difference between:

- (a) The previous carrying amount of the investment; and
- (b) The fair value of the investor's investment in the controlled entity.

If the earliest period for which application of this paragraph is practicable is the current period, the adjustment to net assets/equity shall be recognized at the beginning of the current period.

- 29. If an investment entity has disposed of, or lost control of, an investment in a controlled entity before the date of initial application of this Standard, the investment entity is not required to make adjustments to the previous accounting for that investment.
- 30. At the date of initial application, a controlling entity that is not itself an investment entity but which is required, in accordance with paragraph 56 of MPSAS 35, *Consolidated Financial Statements*, to measure the investments of a controlled investment entity at fair value through surplus or deficit in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement* and consolidate the other assets and liabilities and revenue and expenses of the controlled investment entity, shall use the transitional provisions in paragraphs 24–29 in accounting for its investment in the controlled investment entity in its separate financial statements.
- 31. The transitional provisions for changes in the accounting, in an entity's separate financial statements, for its interest in a joint operation are set out in MPSAS 37, *Joint Arrangements*.

Effective Date

- 32. An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2017, it shall disclose that fact and apply MPSAS 35, *Consolidated Financial Statements*, MPSAS 36, *Investments in Associates and Joint Ventures*, MPSAS 37, *Joint Arrangement*, and MPSAS 38, *Disclosure of Interests in Other Entities*, at the same time.
- 32A. Paragraphs 4 and 5 were deleted by *Improvements to MPSASs 2023, (The Applicability of MPSASs)*, issued in December 2022. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2024. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2024, it shall disclose that fact.
- 33. When an entity adopts the accrual basis MPSASs as defined in MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of MPSASs.

Withdrawal and Replacement of MPSAS 6 (November 2014)

34. This Standard is issued concurrently with MPSAS 35, *Consolidated Financial Statements*. Together, the two Standards supersede MPSAS 6, *Consolidated and Separate Financial Statements*. MPSAS 6 remains applicable until MPSAS 34, *Separate Financial Statements*, and MPSAS 35, *Consolidated Financial Statements*, are applied or become effective, whichever is earlier.

Comparison with IPSAS 34

MPSAS 34, *Separate Financial Statements*, is drawn primarily from IPSAS 34 (2018). There is no significant difference between MPSAS 34 and IPSAS 34.

MPSAS 35 - CONSOLIDATED FINANCIAL STATEMENTS

Acknowledgement

The Malaysian Public Sector Accounting Standard (MPSAS) 35 is based on International Public Sector Accounting Standard (IPSAS) 35, *Consolidated Financial Statements*, from the *Handbook of International Public Sector Accounting Pronouncements* of the International Public Sector Accounting Standards Board, published by the International Federation of Accountants (IFAC) in 2018 and is used with permission of IFAC.

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MPSAS 35—CONSOLIDATED FINANCIAL STATEMENTS

History of MPSAS

This version includes amendments resulting from MPSASs issued up to December 2022.

MPSAS 35, *Consolidated Financial Statements* was issued in March 2016.

Since then, MPSAS 35 has been amended by the following MPSASs:

- *Improvements to MPSASs 2023* (issued December 2022)
- MPSAS 40, *Public Sector Combinations* (issued October 2021)

Table of Amended Paragraphs in MPSAS 35

Paragraph Affected	How Affected	Affected By
4	Amended	MPSAS 40 October 2021
8	Amended	Improvements to MPSASs 2023 December 2022
11	Deleted	Improvements to MPSASs 2023 December 2022
12	Deleted	Improvements to MPSASs 2023 December 2022
13	Deleted	Improvements to MPSASs 2023 December 2022
40	Amended	MPSAS 40 October 2021
52	Amended	MPSAS 40 October 2021
55A	New	MPSAS 40 October 2021
56	Amended	MPSAS 40 October 2021
57	Amended	MPSAS 40 October 2021
63	Amended	MPSAS 40 October 2021
79A	New	MPSAS 40 October 2021
79B	New	MPSAS 40 October 2021
79C	New	Improvements to MPSASs 2023 December 2022

MPSAS 35—CONSOLIDATED FINANCIAL STATEMENTS

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Malaysian Public Sector Accounting Standard (MPSAS) 35, *Consolidated Financial Statements*, is set out in paragraphs 1–81. All the paragraphs have equal authority. MPSAS 35, *Consolidated Financial Statements*, should be read in the context of its objective and the *Preface to Malaysian Public Sector Accounting Standards*. MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.
2. To meet the objective in paragraph 1, this Standard:
 - (a) Requires an entity (the controlling entity) that controls one or more other entities (controlled entities) to present consolidated financial statements;
 - (b) Defines the principle of control, and establishes control as the basis for consolidation;
 - (c) Sets out how to apply the principle of control to identify whether an entity controls another entity and therefore must consolidate that entity;
 - (d) Sets out the accounting requirements for the preparation of consolidated financial statements; and
 - (e) Defines an investment entity and sets out an exception to consolidating particular controlled entities of an investment entity.

Scope

3. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in the preparation and presentation of consolidated financial statements for the economic entity.**

Public Sector Combinations

4. This Standard does not deal with the accounting requirements for public sector combinations and their effect on consolidation, including goodwill arising on a public sector combination (see MPSAS 40, *Public Sector Combinations*).

Presentation of Consolidated Financial Statements

5. **An entity that is a controlling entity other than Federal Government and State Governments shall present consolidated financial statements. This Standard applies to all entities, except that a controlling entity need not present consolidated financial statements if it meets all the following conditions:**
 - (a) **It is itself a controlled entity and the information needs of users are met by its controlling entity's consolidated financial statements, and, in the case of a partially owned controlled entity, all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the entity not presenting consolidated financial statements;**
 - (b) **Its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);**
 - (c) **It did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organization for the purpose of issuing any class of instruments in a public market; and**

- (d) **Its ultimate or any intermediate controlling entity produces financial statements that are available for public use and comply with Malaysian Public Sector Accounting Standards (MPSASs), in which controlled entities are consolidated or are measured at fair value through surplus or deficit in accordance with this Standard.**
6. This Standard does not apply to post-employment benefit plans or other long-term employee benefit plans to which MPSAS 25, *Employee Benefits* applies.
7. **A controlling entity that is an investment entity shall not present consolidated financial statements if it is required, in accordance with paragraph 56 of this Standard, to measure all of its controlled entities at fair value through surplus or deficit.**
8. A controlled entity is not excluded from consolidation because its activities are dissimilar to those of the other entities within the economic entity, for example, the consolidation of commercial public sector entities with entities in the budget sector. Relevant information is provided by consolidating such controlled entities and disclosing additional information in the consolidated financial statements about the different activities of controlled entities.
9. The exemption from preparing consolidated financial statements in paragraph 5 does not apply where the information needs of a controlled entity's users would not be met by the consolidated financial statements of its controlling entity. For example, consolidated financial statements at a whole-of-government level may not meet the information needs of users in respect of key sectors or activities of a government. In many jurisdictions there are legislated financial reporting requirements intended to address the information needs of such users.
10. An entity may be required, (for example, by legislation, or by external users) to prepare aggregated financial statements which are for a different economic entity than that required by this Standard. Although such financial statements fall outside the scope of this Standard and would not comply with the requirements in this Standard, an entity could use the guidance in this Standard in the preparation of such aggregated financial statements.

Government Business Enterprises

11. [Deleted]
12. [Deleted]
13. [Deleted]

Definitions

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

Benefits are the advantages an entity obtains from its involvement with other entities. **Benefits may be financial or non-financial. The actual impact of an entity's involvement with another entity can have positive or negative aspects.**

Binding arrangement: For the purposes of this Standard, a binding arrangement is an arrangement that confers enforceable rights and obligations on the parties to it as if it were in the form of a contract. It includes rights from contracts or other legal rights.

Consolidated financial statements are the financial statements of an economic entity in which the assets, liabilities, net assets/equity, revenue, expenses and cash flows of the controlling entity and its controlled entities are presented as those of a single economic entity.

Control: An entity controls another entity when the entity is exposed, or has rights, to variable benefits from its involvement with the other entity and has the ability to affect the nature or amount of those benefits through its power over the other entity.

A **controlled entity** is an entity that is controlled by another entity.

A **controlling entity** is an entity that controls one or more entities.

A **decision-maker** is an entity with decision-making rights that is either a principal or an agent for other parties.

An **economic entity** is a controlling entity and its controlled entities.

An **investment entity** is an entity that:

- (a) Obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;
- (b) Has the purpose of investing funds solely for returns from capital appreciation, investment revenue, or both; and
- (c) Measures and evaluates the performance of substantially all of its investments on a fair value basis.

A **non-controlling interest** is the net assets/equity in a controlled entity not attributable, directly or indirectly, to a controlling entity.

Power consists of existing rights that give the current ability to direct the relevant activities of another entity.

Protective rights are rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate.

Relevant activities: For the purpose of this Standard, relevant activities are activities of the potentially controlled entity that significantly affect the nature or amount of the benefits that an entity receives from its involvement with that other entity.

Removal rights are rights to deprive the decision maker of its decision-making authority.

Terms defined in other MPSASs are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately. The following terms are defined in either MPSAS 36, *Investments in Associates and Joint Ventures*, MPSAS 37, *Joint Arrangements*, or MPSAS 38, *Disclosure of Interests in Other Entities*: associate, interest in another entity, joint venture and significant influence.

Binding Arrangement

15. Binding arrangements can be evidenced in several ways. A binding arrangement is often, but not always, in writing, in the form of a contract or documented discussions between the parties. Statutory mechanisms such as legislative or executive authority can also create enforceable arrangements, similar to contractual arrangements, either on their own or in conjunction with contracts between the parties.

Economic Entity

16. The term economic entity is used in this Standard to define, for financial reporting purposes, a group of entities comprising the controlling entity and any controlled entities. Other terms

sometimes used to refer to an economic entity include administrative entity, financial entity, consolidated entity, and group. An economic entity may include entities with both social policy and commercial objectives.

17. The determination of the economic entity will need to be made having regard to the constitutional arrangements in a jurisdiction, in particular the ways in which government power is limited and allocated, and how the government system is set up and operates. For example, in jurisdictions with an executive, legislature and judiciary, these may collectively form an economic entity in respect of which there is a user need for consolidated financial statements. Such consolidated financial statements are commonly referred to as whole-of-government financial statements.

Control (see paragraphs AG2–AG87)

18. **An entity, regardless of the nature of its involvement with another entity, shall determine whether it is a controlling entity by assessing whether it controls the other entity.**
19. **An entity controls another entity when it is exposed, or has rights, to variable benefits from its involvement with the other entity and has the ability to affect the nature and amount of those benefits through its power over the other entity.**
20. **Thus, an entity controls another entity if and only if the entity has all the following:**
 - (a) **Power over the other entity (see paragraphs 23–29);**
 - (b) **Exposure, or rights, to variable benefits from its involvement with the other entity (see paragraphs 30–34); and**
 - (c) **The ability to use its power over the other entity to affect the nature or amount of the benefits from its involvement with the other entity (see paragraphs 35–37).**
21. **An entity shall consider all facts and circumstances when assessing whether it controls another entity. The entity shall reassess whether it controls another entity if facts and circumstances indicate that there are changes to one or more of the three elements of control listed in paragraph 20 (see paragraphs AG82–AG87).**
22. Two or more entities collectively control another entity when they must act together to direct the relevant activities. In such cases, because no single entity can direct the activities without the co-operation of the others, no single entity controls the other entity. Each entity would account for its interest in the other entity in accordance with the relevant MPSASs, such as MPSAS 36, *Investments in Associates and Joint Ventures*, MPSAS 37, *Joint Arrangements*, or the MPSASs dealing with financial instruments (MPSAS 28, *Financial Instruments: Presentation*, MPSAS 29, *Financial Instruments: Recognition and Measurement*, and MPSAS 30, *Financial Instruments: Disclosures*).

Power

23. An entity has power over another entity when the entity has existing rights that give it the current ability to direct the relevant activities, i.e., the activities that significantly affect the nature or amount of the benefits from its involvement with the other entity. The right to direct the financial and operating policies of another entity indicates that an entity has the ability to direct the relevant activities of another entity and is frequently the way in which power is demonstrated in the public sector.

24. Power arises from rights. In some cases assessing power is straightforward, such as when power over another entity is obtained directly and solely from the voting rights granted by equity instruments such as shares, and can be assessed by considering the voting rights from those shareholdings. However, public sector entities often obtain power over another entity from rights other than voting rights. They may also obtain power over another entity without having an equity instrument providing evidence of a financial investment. An entity may have rights conferred by binding arrangements. These rights may give an entity power to require the other entity to deploy assets or incur liabilities in a way that affects the nature or amount of benefits received by the first-mentioned entity. The assessment of whether such rights give rise to power over another entity may be complex and require more than one factor to be considered.
25. An entity can have power over another entity even if it does not have responsibility for the day-to-day operation of the other entity or the manner in which prescribed functions are performed by that other entity. Legislation may give statutory bodies or statutory officers powers to carry out their functions independently of government. For example, the Auditor-General and Government Statistician usually have statutory powers to obtain information and publish reports without recourse to government and the judiciary often has special powers to give effect to the concept of judicial independence. Legislation may also set out the broad parameters within which the statutory body is required to operate, and result in the statutory body operating in a manner consistent with the objectives set by Parliament or a similar body. The existence of statutory powers to operate independently does not, of itself, preclude an entity having the ability to direct the operating and financial policies of another entity with statutory powers so as to obtain benefits. For example, the independence of a central bank in relation to monetary policy does not preclude the possibility of the central bank being controlled. All facts and circumstances would still need to be considered.
26. The existence of rights over another entity does not necessarily give rise to power for the purposes of this Standard. An entity does not have power over another entity solely due to the existence of:
- (a) Regulatory control (see paragraph AG12); or
 - (b) Economic dependence (see paragraphs AG41–AG42).
27. An entity with the current ability to direct the relevant activities has power even if its rights to direct have yet to be exercised. Evidence that the entity has been directing the relevant activities of the entity being assessed for control can help determine whether the entity has power, but such evidence is not, in itself, conclusive in determining whether the entity has power over the entity being assessed for control. In the case of an entity established with predetermined activities, the right to direct the relevant activities may have been exercised at the time that the entity was established.
28. If two or more entities each have existing rights that give them the unilateral ability to direct different relevant activities, the entity that has the current ability to direct the activities that most significantly affect the nature or amount of benefits from that entity has power over that other entity.
29. An entity can have power over an entity being assessed for control even if other entities have existing rights that give them the current ability to participate in the direction of the relevant activities, for example when another entity has significant influence. However, an entity that holds only protective rights does not have power over another entity (see paragraphs AG29–AG31), and consequently does not control the other entity.

Benefits

30. An entity is exposed, or has rights, to variable benefits from its involvement with an entity being assessed for control when the benefits that it seeks from its involvement have the potential to vary as a result of the other entity's performance. Entities become involved with other entities with the expectation of positive financial or non-financial benefits over time. However, in a particular reporting period, the actual impact of an entity's involvement with the entity being assessed for control can be only positive, only negative or a mix of both positive and negative.
31. The entity's benefits from its involvement with the entity being assessed for control can be only financial, only non-financial or both financial and non-financial. Financial benefits include returns on investment such as dividends or similar distributions and are sometimes referred to as "returns". Non-financial benefits include advantages arising from scarce resources that are not measured in financial terms and economic benefits received directly by service recipients of the entity. Non-financial benefits can occur when the activities of another entity are congruent with, (that is, they are in agreement with), the objectives of the entity and support the entity in achieving its objectives. For example, an entity may obtain benefits when another entity with congruent activities provides services that the first entity would have otherwise been obliged to provide. Congruent activities may be undertaken voluntarily or the entity may have the power to direct the other entity to undertake those activities. Non-financial benefits can also occur when two entities have complementary objectives (that is, the objectives of one entity add to, and make more complete, the objectives of the other entity).
32. The following examples illustrate financial benefits that an entity may receive from its involvement with another entity:
- (a) Dividends, variable interest on debt securities, other distributions of economic benefits;
 - (b) Exposure to increases or decreases in the value of an investment in another entity;
 - (c) Exposure to loss from agreements to provide financial support, including financial support for major projects;
 - (d) Cost savings (for example, if an entity would achieve economies of scale or synergies by combining the operations or assets of the other entity with its own operations or assets);
 - (e) Residual interests in the other entity's assets and liabilities on liquidation of that other entity; and
 - (f) Other exposures to variable benefits that are not available to other entities.
33. Examples of non-financial benefits include:
- (a) The ability to benefit from the specialized knowledge of another entity;
 - (b) The value to the entity of the other entity undertaking activities that assist the entity in achieving its objectives;
 - (c) Improved outcomes;
 - (d) More efficient delivery of outcomes;
 - (e) More efficient or effective production and delivery of goods and services;
 - (f) Having an asset and related services available earlier than otherwise would be the case; and

- (g) Having a higher level of service quality than would otherwise be the case.
- 34. Although only one entity can control another entity, more than one party can share in the benefits of that other entity. For example, holders of non-controlling interests can share in the financial benefits such as surpluses or distributions from an entity or the non-financial benefits such as congruence of activities with desired outcomes.

Link between Power and Benefits

- 35. An entity controls another entity if the entity not only has power over the entity being assessed for control and exposure or rights to variable benefits from its involvement with the other entity, but also has the ability to use its power to affect the nature or amount of the benefits from its involvement with the entity being assessed for control.
- 36. The existence of congruent objectives alone is insufficient for an entity to conclude that it controls another entity. In order to have control the entity would also need to have the ability to use its power over the entity being assessed for control to direct that other entity to work with it to further its objectives.
- 37. **An entity with decision-making rights shall determine whether it is a principal or an agent. An entity shall also determine whether another entity with decision-making rights is acting as an agent for the entity. An agent is a party primarily engaged to act on behalf and for the benefit of another party or parties (the principal(s)) and therefore does not control the other entity when it exercises its decision-making authority. Thus, sometimes a principal's power may be held and exercisable by an agent, but on behalf of the principal.**

Accounting Requirements

- 38. **A controlling entity shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.**
- 39. **Consolidation of a controlled entity shall begin from the date the entity obtains control of the other entity and cease when the entity loses control of the other entity.**

Consolidation Procedures

- 40. Consolidated financial statements:
 - (a) Combine like items of assets, liabilities, net assets/equity, revenue, expenses and cash flows of the controlling entity with those of its controlled entities.
 - (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 (MPSAS 40, *Public Sector Combinations*, explains how to account for any related goodwill).
 - (c) Eliminate in full intra-economic entity assets, liabilities, net assets/equity, revenue, expenses and cash flows relating to transactions between entities of the economic entity (surpluses or deficits resulting from intra-economic entity transactions that are recognized in assets, such as inventory and fixed assets, are eliminated in full). Intra-economic entity losses may indicate an impairment that requires recognition in the consolidated financial statements.

Uniform Accounting Policies

41. If a member of the economic entity uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to that member's financial statements in preparing the consolidated financial statements to ensure conformity with the economic entity's accounting policies.

Measurement

42. An entity includes the revenue and expenses of a controlled entity in the consolidated financial statements from the date it gains control until the date when the entity ceases to control the controlled entity. Revenue and expenses of the controlled entity are based on the amounts of the assets and liabilities recognized in the consolidated financial statements at the acquisition date. For example, depreciation expense recognized in the consolidated statement of financial performance after the acquisition date is based on the values of the related depreciable assets recognized in the consolidated financial statements at the acquisition date.

Potential Voting Rights

43. When potential voting rights, or other derivatives containing potential voting rights, exist, the proportion of surplus or deficit and changes in net assets/equity allocated to the controlling entity and non-controlling interests in preparing consolidated financial statements is determined solely on the basis of existing ownership interests and does not reflect the possible exercise or conversion of potential voting rights and other derivatives, unless paragraph 44 applies.
44. In some circumstances an entity has, in substance, an existing ownership interest as a result of a transaction that currently gives the entity access to the benefits associated with an ownership interest. In such circumstances, the proportion allocated to the controlling entity and non-controlling interests in preparing consolidated financial statements is determined by taking into account the eventual exercise of those potential voting rights and other derivatives that currently give the entity access to the benefits.
45. MPSAS 28, *Financial Instruments: Presentation*, and MPSAS 29, *Financial Instruments: Recognition and Measurement*, do not apply to interests in controlled entities that are consolidated. When instruments containing potential voting rights in substance currently give access to the benefits associated with an ownership interest in a controlled entity, the instruments are not subject to the requirements of MPSAS 28, *Financial Instruments: Presentation*, and MPSAS 29, *Financial Instruments: Recognition and Measurement*. In all other cases, instruments containing potential voting rights in a controlled entity are accounted for in accordance with MPSAS 28, *Financial Instruments: Presentation*, and MPSAS 29, *Financial Instruments: Recognition and Measurement*.

Reporting Dates

46. **The financial statements of the controlling entity and its controlled entities used in the preparation of the consolidated financial statements shall be prepared as at the same reporting date. When the end of the reporting period of the controlling entity is different from that of a controlled entity, the controlling entity either:**
- (a) **Obtains, for consolidation purposes, additional financial information as of the same date as the financial statements of the controlling entity; or**

- (b) Uses the most recent financial statements of the controlled entity adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the consolidated financial statements.

Non-Controlling Interests

- 47. A controlling entity shall present non-controlling interests in the consolidated statement of financial position within net assets/equity, separately from the net assets/equity of the owners of the controlling entity.
- 48. Changes in a controlling entity's interest in a controlled entity that do not result in the controlling entity losing control of the controlled entity are transactions with owners in their capacity as owners.
- 49. An entity shall attribute the surplus or deficit and each gain or loss recognized directly in net assets/equity to the owners of the controlling entity and to the non-controlling interests. The entity shall also attribute the total amount recognized in the statement of changes in net assets/equity 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.
- 50. If a controlled entity has outstanding cumulative preference shares that are classified as equity instruments and are held by non-controlling interests, the entity shall compute its share of surplus or deficit after adjusting for the dividends on such shares, whether or not such dividends have been declared.

Changes in the Proportion held by Non-Controlling Interests

- 51. When the proportion of the net assets/equity held by non-controlling interests changes, an entity shall adjust the carrying amounts of the controlling and non-controlling interests to reflect the changes in their relative interests in the controlled entity. The entity shall recognize directly in net assets/equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the controlling entity.

Loss of Control

- 52. If a controlling entity loses control of a controlled entity, the controlling entity:
 - (a) Derecognizes the assets and liabilities of the former controlled entity from the consolidated statement of financial position;
 - (b) Recognizes any investment retained in the former controlled entity when control is lost and subsequently accounts for it and for any amounts owed by or to the former controlled entity in accordance with relevant MPSASs. That retained interest is remeasured, as described in paragraphs 54(b)(iii) and 55A. The remeasured value at the date that control is lost shall be regarded as the fair value on initial recognition of a financial asset in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, or the cost on initial recognition of an investment in an associate or joint venture, if applicable; and
 - (c) Recognizes the gain or loss associated with the loss of control attributable to the former controlling interest, as specified in paragraphs 54–55A.

53. A controlling entity might lose control of a controlled entity in two or more arrangements (transactions). However, sometimes circumstances indicate that the multiple arrangements should be accounted for as a single transaction. In determining whether to account for the arrangements as a single transaction, a controlling entity shall consider all the terms and conditions of the arrangements and their economic effects. One or more of the following indicate that the controlling entity should account for the multiple arrangements as a single transaction:
- (a) They are entered into at the same time or in contemplation of each other.
 - (b) They form a single transaction designed to achieve an overall commercial effect.
 - (c) The occurrence of one arrangement is dependent on the occurrence of at least one other arrangement.
 - (d) One arrangement considered on its own is not economically justified, but it is economically justified when considered together with other arrangements. An example is when a disposal of an investment is priced below market and is compensated for by a subsequent disposal priced above market.
54. If a controlling entity loses control of a controlled entity, it shall:
- (a) **Derecognize:**
 - (i) The assets (including any goodwill) and liabilities of the controlled entity at their carrying amounts at the date when control is lost; and
 - (ii) The carrying amount of any non-controlling interests in the former controlled entity at the date when control is lost (including any gain or loss recognized directly in net assets/equity attributable to them).
 - (b) **Recognize:**
 - (i) The fair value of the consideration received, if any, from the transaction, event or circumstances that resulted in the loss of control;
 - (ii) If the transaction, event or circumstances that resulted in the loss of control involves a distribution of shares of the controlled entity to owners in their capacity as owners, that distribution; and
 - (iii) Any investment retained in the former controlled entity at its fair value at the date when control is lost.
 - (c) Transfer directly to accumulated surplus/deficit, if required by other MPSASs, the amounts recognized directly in net assets/equity in relation to the controlled entity on the basis described in paragraph 55.
 - (d) Recognize any resulting difference as a gain or loss in surplus or deficit attributable to the controlling entity.
55. If a controlling entity loses control of a controlled entity, the controlling entity shall account for all amounts previously recognized directly in net assets/equity in relation to that controlled entity on the same basis as would be required if the controlling entity had directly disposed of the related assets or liabilities. If a revaluation surplus previously recognized

directly in net assets/equity would be transferred directly to accumulated surplus/deficit on the disposal of the asset, the controlling entity shall transfer the revaluation surplus directly to accumulated surplus/deficit when it loses control of the controlled entity.

- 55A. If a controlling entity loses control of a controlled entity that does not contain an operation, as defined in MPSAS 40, *Public Sector Combinations*, as a result of a transaction involving an associate or a joint venture that is accounted for using the equity method, the controlling entity determines the gain or loss in accordance with paragraphs 54–55. The gain or loss resulting from the transaction is recognized in the controlling entity’s surplus or deficit only to the extent of the unrelated investors’ interests in that associate or joint venture. The remaining part of the gain is eliminated against the carrying amount of the investment in that associate or joint venture. In addition, if the controlling entity retains an investment in the former controlled entity and the former controlled entity is now an associate or a joint venture that is accounted for using the equity method, the controlling entity recognizes the part of the gain or loss resulting from the remeasurement at fair value of the investment retained in that former controlled entity in its surplus or deficit only to the extent of the unrelated investors’ interests in the new associate or joint venture. The remaining part of that gain is eliminated against the carrying amount of the investment retained in the former controlled entity. If the controlling entity retains an investment in the former controlled entity that is now accounted for in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, the part of the gain or loss resulting from the remeasurement at fair value of the investment retained in the former controlled entity is recognized in full in the controlling entity’s surplus or deficit.

Investment Entities: Fair Value Requirement

56. Except as described in paragraph 57, an investment entity shall not consolidate its controlled entities or apply MPSAS 40, *Public Sector Combinations*, 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 MPSAS 29, *Financial Instruments: Recognition and Measurement*.
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 MPSAS 40, *Public Sector Combinations*, to the acquisition of any such controlled entity.
58. A controlling entity of an investment entity that is not itself an investment entity shall present consolidated financial statements in which it:
- (i) Measures the investments of a controlled investment entity at fair value through surplus or deficit in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*; and
 - (ii) Consolidates the other assets and liabilities and revenue and expenses of the controlled investment entity in accordance with paragraphs 38–55 of this Standard.

Determining Whether an Entity is an Investment Entity

59. An entity shall consider all facts and circumstances when assessing whether it is an investment entity, including its purpose and design. Paragraphs AG89–AG106 describe aspects of the definition of an investment entity in more detail. If facts and circumstances indicate that there are changes to one or more of the three elements that make up the definition of an investment entity, a controlling entity shall reassess whether it is an investment entity.
60. A controlling entity that either ceases to be an investment entity or becomes an investment entity shall account for the change in its status prospectively from the date at which the change in status occurred (see paragraphs 63–64).

Judgments and Assumptions

61. An investment entity shall disclose the information required by paragraph 15 of MPSAS 38, *Disclosure of Interest in Other Entities*, about significant judgments and assumptions made in determining that it is an investment entity unless it has all of the following characteristics:
- (a) It has obtained funds from more than one investor (see paragraphs AG89–AG90);
 - (b) It has ownership interests in the form of equity or similar interests (see paragraphs AG91–AG92); and
 - (c) It has more than one investment (see paragraphs AG96–AG97).
62. The absence of any of these characteristics does not necessarily disqualify an entity from being classified as an investment entity. However, the absence of any of these characteristics means that an entity is required to disclose information about the significant judgments and assumptions made in determining that it is an investment entity.

Accounting for a Change in Investment Entity Status

63. When an entity ceases to be an investment entity, it shall apply MPSAS 40, *Public Sector Combinations*, 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.
64. When an entity becomes an investment entity, it shall cease to consolidate its controlled entities at the date of the change in status, except for any controlled entity that shall continue to be consolidated in accordance with paragraph 57. The investment entity shall apply the requirements of paragraphs 52 and 53 to those controlled entities that it ceases to consolidate as though the investment entity had lost control of those controlled entities at that date.

Transitional Provisions

65. An entity shall apply this Standard retrospectively, in accordance with MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, except as specified in paragraphs 66–78.

66. **Notwithstanding the requirements of paragraph 33 of MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, when this Standard is first applied an entity need only present the quantitative information required by paragraph 33(f) of MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, for the annual period immediately preceding the date of initial application of this Standard (the “immediately preceding period”). An entity may also present this information for the current period or for earlier comparative periods, but is not required to do so.**
67. For the purposes of this Standard, the date of initial application is the beginning of the annual reporting period for which this Standard is applied for the first time.
68. At the date of initial application, an entity is not required to make adjustments to the previous accounting for its involvement with either:
- (a) Entities that would be consolidated at that date in accordance with MPSAS 6, *Consolidated and Separate Financial Statements*, and are still consolidated in accordance with this Standard; or
 - (b) Entities that would not be consolidated at that date in accordance with MPSAS 6, *Consolidated and Separate Financial Statements*, and are not consolidated in accordance with this Standard.
69. **At the date of initial application, an entity shall assess whether it is an investment entity on the basis of the facts and circumstances that exist at that date. If, at the date of initial application, an entity concludes that it is an investment entity, it shall apply the requirements of paragraphs 70–73 instead of paragraphs 77–78.**
70. **Except for any controlled entity that is consolidated in accordance with paragraph 57 (to which paragraph 68 or paragraphs 77–78, whichever is relevant, apply), an investment entity shall measure its investment in each controlled entity at fair value through surplus or deficit as if the requirements of this Standard had always been effective. The investment entity shall retrospectively adjust both the annual period that immediately precedes the date of initial application and net assets/equity at the beginning of the immediately preceding period for any difference between:**
- (a) The previous carrying amount of the controlled entity; and
 - (b) The fair value of the investment entity’s investment in the controlled entity.
- The cumulative amount of any fair value adjustments previously recognized directly in net assets/equity shall be transferred to accumulated surplus/deficit at the beginning of the annual period immediately preceding the date of initial application.**
71. **An investment entity shall use the fair value amounts that were previously reported to investors or to management.**
72. **If measuring an investment in a controlled entity in accordance with paragraph 70 is impracticable (as defined in MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*), an investment entity shall apply the requirements of this Standard at the beginning of the earliest period for which application of paragraph 70 is practicable, which may be the current period. The investor shall retrospectively adjust the annual period that immediately precedes the date of initial application, unless the beginning of the earliest**

period for which application of this paragraph is practicable is the current period. If this is the case, the adjustment to net assets/equity shall be recognized at the beginning of the current period.

73. If an investment entity has disposed of, or has lost control of, an investment in a controlled entity before the date of initial application of this Standard, the investment entity is not required to make adjustments to the previous accounting for that controlled entity.
74. **If, at the date of initial application, an entity concludes that it shall consolidate another entity that was not consolidated in accordance with MPSAS 6, *Consolidated and Separate Financial Statements*, the entity shall measure the assets, liabilities and non-controlling interests in that previously unconsolidated entity as if that other entity had been consolidated 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 recognize, as an adjustment to net assets/equity at the beginning of the immediately preceding period, any difference between:**
 - (a) The amount of assets, liabilities and non-controlling interests recognized; and
 - (b) The previous carrying amount of the entity's involvement with the other entity.
75. **If measuring a controlled entity's assets, liabilities and non-controlling interests in accordance with paragraph 74(a) or (b) is impracticable (as defined in MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*), an entity shall measure the assets, liabilities and non-controlling interests in that previously unconsolidated entity as if that entity had been consolidated from the deemed acquisition date. The deemed acquisition date shall be the beginning of the earliest period for which the application of this paragraph is practicable, which may be the current period.**
76. **The entity shall adjust retrospectively the annual period immediately preceding the date of initial application, unless the beginning of the earliest period for which application of this paragraph is practicable is the current period. When the deemed acquisition date is earlier than the beginning of the immediately preceding period, the entity shall recognize, as an adjustment to net assets/equity at the beginning of the immediately preceding period, any difference between:**
 - (a) The amount of assets, liabilities and non-controlling interests recognized; and
 - (b) The previous carrying amounts of the entity's involvement with the other entity.

If the earliest period for which application of this paragraph is practicable is the current period, the adjustment to net assets/equity shall be recognized at the beginning of the current period.

77. **If, at the date of initial application, an entity concludes that it will no longer consolidate an entity that was consolidated in accordance with MPSAS 6, *Consolidated and Separate Financial Statements*, the entity shall measure its interest in the other entity at the amount at which it would have been measured if the requirements of this Standard had been effective when the entity became involved with, or lost control of, the other entity. The entity shall adjust retrospectively the annual period immediately preceding the date of initial**

application. When the date that the entity became involved with (but did not obtain control in accordance with this Standard), or lost control of, the other entity is earlier than the beginning of the immediately preceding period, the entity shall recognize, as an adjustment to net assets/equity at the beginning of the immediately preceding period, any difference between:

- (a) The previous carrying amount of the assets, liabilities and non-controlling interests; and
 - (b) The recognized amount of the entity's interest in the other entity.
78. If measuring the interest in the other entity in accordance with paragraph 77 is impracticable (as defined in MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*), an entity shall apply the requirements of this Standard at the beginning of the earliest period for which application of paragraph 77 is practicable, which may be the current period. The entity shall adjust retrospectively the annual period immediately preceding the date of initial application, unless the beginning of the earliest period for which application of this paragraph is practicable is the current period. When the date that the entity became involved with (but did not obtain control in accordance with this Standard), or lost control of, the other entity is earlier than the beginning of the immediately preceding period, the entity shall recognize, as an adjustment to net assets/equity at the beginning of the immediately preceding period, any difference between:
- (a) The previous carrying amount of the assets, liabilities and non-controlling interests; and
 - (b) The recognized amount of the entity's interest in the other entity.

If the earliest period for which application of this paragraph is practicable is the current period, the adjustment to net assets/equity shall be recognized at the beginning of the current period.

Effective Date

79. An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2017, it shall disclose that fact and apply MPSAS 34, *Separate Financial Statements*, MPSAS 36, *Investment in Associates and Joint Ventures*, MPSAS 37, *Joint Arrangements*, and MPSAS 38, *Disclosure of Interest in Other Entities*, at the same time.
- 79A. Paragraphs 4, 40, 56, 57 and 63 were amended by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2023 it shall disclose that fact and apply MPSAS 40, *Public Sector Combinations*, at the same time.
- 79B. Paragraph 52 was amended and paragraph 55A added by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply these amendments prospectively for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is permitted. If an entity applies the amendments earlier, it shall disclose that fact and, if it has not already done so, apply MPSAS 40, *Public Sector Combinations*, at the same time.

- 79C. Paragraphs 11, 12 and 13 were deleted and paragraph 8 was amended by *Improvements to MPSASs 2023 (The Applicability of MPSASs)*, issued in December 2022. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2024. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2024, it shall disclose that fact.
80. When an entity adopts the accrual basis MPSASs as defined in MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of MPSASs.

Withdrawal and Replacement of MPSAS 6

81. This Standard is issued concurrently with MPSAS 34, *Separate Financial Statements*. Together, the two Standards supersede MPSAS 6, *Consolidated and Separate Financial Statements*. MPSAS 6, *Consolidated and Separate Financial Statements* remains applicable until MPSAS 34, *Separate Financial Statements* and MPSAS 35, *Consolidated Financial Statements*, are applied or become effective, whichever is earlier.

Application Guidance

This Appendix is an integral part of MPSAS 35, Consolidated Financial Statements.

- AG1. The examples in this appendix portray hypothetical situations. Although some aspects of the examples may be present in actual fact patterns, all facts and circumstances of a particular fact pattern would need to be evaluated when applying MPSAS 35, *Consolidated Financial Statements*.

Assessing Control

- AG2. To determine whether it controls another entity an entity shall assess whether it has all the following:
- (a) Power over the other entity;
 - (b) Exposure, or rights, to variable benefits from its involvement with the other entity; and
 - (c) The ability to use its power over the other entity to affect the nature or amount of the benefits from its involvement with the other entity.
- AG3. Consideration of the following factors may assist in making that determination:
- (a) The purpose and design of the other entity (see paragraphs AG5–AG8);
 - (b) What the relevant activities are and how decisions about those activities are made (see paragraphs AG13–AG15);
 - (c) Whether the rights of the entity give it the current ability to direct the relevant activities of the other entity (see paragraphs AG16–AG56);
 - (d) Whether the entity is exposed, or has rights, to variable benefits from its involvement with the other entity (see paragraph AG57–AG58); and
 - (e) Whether the entity has the ability to use its power over the other entity to affect the nature or amount of the benefits from its involvement with the other entity (see paragraphs AG60–AG74).
- AG4. When assessing whether it controls another entity, an entity shall consider the nature of its relationship with other parties (see paragraphs AG75–AG77).

Purpose and Design of another Entity

- AG5. An entity shall consider the purpose and design of the entity being assessed for control in order to identify the relevant activities, how decisions about the relevant activities are made, who has the current ability to direct those activities and who benefits from those activities.
- AG6. When the purpose and design of the entity being assessed for control are considered, it may be clear that the entity being assessed for control is controlled by means of equity instruments that give the holder proportionate voting rights, such as ordinary shares. In this case, in the absence of any additional arrangements that alter decision-making, the assessment of control focuses on which party, if any, is able to exercise voting rights sufficient to determine the operating and financing policies of the entity being assessed for control (see paragraphs AG32–AG52). In the most straightforward case, the entity that

holds a majority of those voting rights, in the absence of any other factors, controls the other entity.

AG7. To determine whether an entity controls another entity in more complex cases, it may be necessary to consider some or all of the other factors in paragraph AG3.

AG8. Voting rights may not be the dominant factor in deciding who controls the entity being assessed for control. If there are voting rights they may be limited in scope. The relevant activities of the entity being assessed for control may be directed by means of binding arrangements or provisions in founding documents such as articles of association or a constitution. In such cases, an entity's consideration of the purpose and design of the entity being assessed for control shall also include consideration of the risks to which the other entity was designed to be exposed, the risks it was designed to pass on to the parties involved and whether the entity is exposed to some or all of those risks. Consideration of the risks includes not only the downside risk, but also the potential for upside.

Power

AG9. To have power over another entity, an entity must have existing rights that give it the current ability to direct the relevant activities. For the purpose of assessing power, only substantive rights and rights that are not protective shall be considered (see paragraphs AG25–AG31).

AG10. The determination about whether an entity has power depends on the relevant activities, the way decisions about the relevant activities are made and the rights of the entity and other entities in relation to the potentially controlled entity.

AG11. An entity normally will have power over an entity that it has established when the constituting document or enabling legislation specifies the operating and financing activities that are to be carried out by that entity. However, the impact of the constituting document or legislation is evaluated in the light of other prevailing circumstances, as all facts and circumstances need to be considered in assessing whether an entity has power over another entity. For example, a government may not have power over a research and development corporation that operates under a mandate created, and limited, by legislation if that or other legislation assigns power to direct the relevant activities to other entities that are not controlled by the government.

Regulatory Control

AG12. Regulatory control does not usually give rise to power over an entity for the purposes of this Standard. Governments and other public sector bodies, including supranational bodies, may have wide ranging powers to establish the regulatory framework within which entities operate, to impose conditions or sanctions on their operations and to enforce those conditions or sanctions. For example, governments and other public sector bodies may enact regulations to protect the health and safety of the community, restrict the sale or use of dangerous goods or specify the pricing policies of monopolies. However, when regulation is so tight as to effectively dictate how the entity performs its business, then it may be necessary to consider whether the purpose and design of the entity is such that it is controlled by the regulating entity.

Relevant Activities and Direction of Relevant Activities

AG13. For many entities, a range of operating and financing activities significantly affect the benefits they generate. Any activity that assists in achieving or furthering the objectives of a controlled entity may affect the benefits to the controlling entity. Examples of activities

that, depending on the circumstances, can be relevant activities include, but are not limited to:

- (a) Using assets and incurring liabilities to provide services to service recipients;
- (b) Distributing funds to specified individuals or groups;
- (c) Collecting revenue through non-exchange transactions;
- (d) Selling and purchasing of goods or services;
- (e) Managing physical assets;
- (f) Managing financial assets during their life (including upon default);
- (g) Selecting, acquiring or disposing of assets;
- (h) Managing a portfolio of liabilities;
- (i) Researching and developing new products or processes; and
- (j) Determining a funding structure or obtaining funding.

AG14. Examples of decisions about relevant activities include but are not limited to:

- (a) Establishing operating and capital decisions of an entity, including budgets; and
- (b) Appointing and remunerating an entity's key management personnel or service providers and terminating their services or employment.

AG15. In some situations, activities both before and after a particular set of circumstances arises or event occurs, may be relevant activities. When two or more entities have the current ability to direct relevant activities and those activities occur at different times, those entities shall determine which entity is able to direct the activities that most significantly affect those benefits consistently with the treatment of concurrent decision-making rights (see paragraph 28). The entities concerned shall reconsider this assessment over time if relevant facts or circumstances change.

Rights that Give an Entity Power over another Entity

AG16. Power arises from rights. To have power over another entity, an entity must have existing rights that give the entity the current ability to direct the relevant activities of the other entity. The rights that may give an entity power can differ.

AG17. Examples of rights that, either individually or in combination, can give an entity power include but are not limited to:

- (a) Rights to give policy directions to the governing body of another entity that give the holder the ability to direct the relevant activities of the other entity;
- (b) Rights in the form of voting rights (or potential voting rights) of another entity (see paragraphs AG32–AG52);
- (c) Rights to appoint, reassign or remove members of another entity's key management personnel who have the ability to direct the relevant activities;
- (d) Rights to appoint or remove another entity that directs the relevant activities;

- (e) Rights to approve or veto operating and capital budgets relating to the relevant activities of another entity;
- (f) Rights to direct the other entity to enter into, or veto any changes to, transactions for the benefit of the entity;
- (g) Rights to veto key changes to the other entity, such as the sale of a major asset or of the other entity as a whole; and
- (h) Other rights (such as decision-making rights specified in a management contract) that give the holder the ability to direct the relevant activities.

AG18. In considering whether it has power, an entity will need to consider the binding arrangements that are in place and the mechanism(s) by which it has obtained power. Ways in which an entity may have obtained power, either individually or in combination with other arrangements, include:

- (a) Legislative or executive authority;
- (b) Administrative arrangements;
- (c) Contractual arrangements;
- (d) Founding documents (for example, articles of association); and
- (e) Voting or similar rights.

AG19. To determine whether an entity has rights sufficient to give it power, the entity shall also consider the purpose and design of the other entity (see paragraphs AG5–AG8) and the requirements in paragraphs AG53–AG56 together with paragraphs AG20–AG22.

AG20. In some circumstances it may be difficult to determine whether an entity's rights are sufficient to give it power over another entity. In such cases, to enable the assessment of power to be made, the entity shall consider evidence of whether it has the practical ability to direct the relevant activities unilaterally. Consideration is given, but is not limited, to the following, which, when considered together with its rights and the indicators in paragraphs AG21 and AG22, may provide evidence that the entity's rights are sufficient to give it power over the other entity:

- (a) The entity can, without having the contractual right to do so, appoint or approve the other entity's key management personnel who have the ability to direct the relevant activities;
- (b) The entity can, without having the contractual right to do so, direct the other entity to enter into, or can veto any changes to, significant transactions for the benefit of the entity;
- (c) The entity can dominate either the nominations process for electing members of the other entity's governing body or the obtaining of proxies from other holders of voting rights;
- (d) The other entity's key management personnel are related parties of the entity (for example, the chief executive officer of the other entity and the chief executive officer of the entity are the same person); or
- (e) The majority of the members of the other entity's governing body are related parties of the entity.

- AG21. Sometimes there will be indications that the entity has a special relationship with the other entity, which suggests that the entity has more than a passive interest in the other entity. The existence of any individual indicator, or a particular combination of indicators, does not necessarily mean that the power criterion is met. However, if an entity has more than a passive interest in another entity this may indicate that the entity has other related rights sufficient to give it power or provide evidence of existing power over another entity. For example, the following suggests that the entity has more than a passive interest in the other entity and, in combination with other rights, may indicate power:
- (a) The relationship between the entity and the other entity's operations is one of dependence, such as in the following situations:
 - (i) The entity funds a significant portion of the other entity's operations and the other entity depends on this.
 - (ii) The entity guarantees a significant portion of the other entity's obligations, and the other entity depends on this.
 - (iii) The entity provides critical services, technology, supplies or raw materials to the other entity, and the other entity depends on this.
 - (iv) The entity controls assets such as licenses or trademarks that are critical to the other entity's operations and the other entity depends on this.
 - (v) The entity provides key management personnel to the other entity (for example, when the entity's personnel have specialized knowledge of the other entity's operations) and the other entity depends on this.
 - (b) A significant portion of the other entity's activities either involve or are conducted on behalf of the entity.
 - (c) The entity's exposure, or rights, to benefits from its involvement with the other entity is disproportionately greater than its voting or other similar rights. For example, there may be a situation in which an entity is entitled, or exposed, to more than half of the benefits of the other entity but holds less than half of the voting rights of the other entity.
- AG22. Public sector entities often have special relationships with other parties as a result of the indicators listed in paragraph AG21. Public sector entities often fund the activities of other entities. Economic dependence is discussed in paragraphs AG41 to AG42.
- AG23. The greater an entity's exposure, or rights, to variability of benefits from its involvement with another entity, the greater is the incentive for the entity to obtain rights sufficient to give it power. Therefore, having a large exposure to variability of benefits is an indicator that the entity may have power. However, the extent of the entity's exposure does not, in itself, determine whether an entity has power over the other entity.
- AG24. When the factors set out in paragraph AG20 and the indicators set out in paragraphs AG21–AG23 are considered together with an entity's rights, greater weight shall be given to the evidence of power described in paragraph AG20.

Substantive Rights

- AG25. An entity, in assessing whether it has power, considers only substantive rights relating to another entity (held by the entity and others). For a right to be substantive, the holder must have the practical ability to exercise that right.

- AG26. Determining whether rights are substantive requires judgment, taking into account all facts and circumstances. Factors to consider in making that determination include but are not limited to:
- (a) Whether there are any barriers (economic or otherwise) that prevent the holder (or holders) from exercising the rights. Examples of such barriers include but are not limited to:
 - (i) Financial penalties and incentives that would prevent (or deter) the holder from exercising its rights.
 - (ii) An exercise or conversion price that creates a financial barrier that would prevent (or deter) the holder from exercising its rights.
 - (iii) Terms and conditions that make it unlikely that the rights would be exercised, for example, conditions that narrowly limit the timing of their exercise.
 - (iv) The absence of an explicit, reasonable mechanism in the founding documents of another entity or in applicable laws or regulations that would allow the holder to exercise its rights.
 - (v) The inability of the holder of the rights to obtain the information necessary to exercise its rights.
 - (vi) Operational barriers or incentives that would prevent (or deter) the holder from exercising its rights (e.g., the absence of other managers willing or able to provide specialized services or provide the services and take on other interests held by the incumbent manager).
 - (vii) Legal or regulatory requirements that limit the manner in which rights may be exercised or that prevent the holder from exercising its rights (e.g., where another entity has statutory powers which permit it to operate independently of the government or where a foreign entity is prohibited from exercising its rights).
 - (b) When the exercise of rights requires the agreement of more than one party, or when the rights are held by more than one party, whether a mechanism is in place that provides those parties with the practical ability to exercise their rights collectively if they choose to do so. The lack of such a mechanism is an indicator that the rights may not be substantive. The more parties that are required to agree to exercise the rights, the less likely it is that those rights are substantive. However, a board of directors (or other governing body) whose members are independent of the decision maker may serve as a mechanism for numerous entities (or other parties) to act collectively in exercising their rights. Therefore, removal rights exercisable by an independent board of directors (or other governing body) are more likely to be substantive than if the same rights were exercisable individually by a large number of entities (or other parties).
 - (c) Whether the party or parties that hold the rights would benefit from the exercise of those rights. For example, the holder of potential voting rights in another entity (see paragraphs AG49–AG52) shall consider the exercise or conversion price of the instrument. The terms and conditions of potential voting rights are more likely to be substantive when the instrument is in the money or the entity would benefit for other

reasons (e.g., by realizing synergies between the entity and the other entity) from the exercise or conversion of the instrument.

- AG27. To be substantive, rights also need to be exercisable when decisions about the direction of the relevant activities need to be made. Usually, to be substantive, the rights need to be currently exercisable. However, sometimes rights can be substantive, even though the rights are not currently exercisable.
- AG28. Substantive rights exercisable by other parties can prevent an entity from controlling the entity being assessed for control, to which those rights relate. Such substantive rights do not require the holders to have the ability to initiate decisions. As long as the rights are not merely protective (see paragraphs AG29–AG31), substantive rights held by other parties may prevent the entity from controlling the entity being assessed for control even if the rights give the holders only the current ability to approve or block decisions that relate to the relevant activities.

Protective Rights

- AG29. In evaluating whether rights give an entity power over another entity, the entity shall assess whether its rights, and rights held by others, are protective rights. Protective rights relate to fundamental changes to the activities of another entity or apply in exceptional circumstances. However, not all rights that apply in exceptional circumstances or are contingent on events are protective (see paragraphs AG15 and AG55).
- AG30. Because protective rights are designed to protect the interests of their holder without giving that party power over the entity to which those rights relate, an entity that holds only protective rights cannot have power or prevent another party from having power over the entity to which those rights relate (see paragraph 29).
- AG31. Examples of protective rights include but are not limited to:
- (a) A lender's right to restrict a borrower from undertaking activities that could significantly change the credit risk of the borrower to the detriment of the lender.
 - (b) The right of a party holding a non-controlling interest in an entity to approve capital expenditure greater than that required in the ordinary course of business, or to approve the issue of equity or debt instruments.
 - (c) The right of a lender to seize the assets of a borrower if the borrower fails to meet specified loan repayment conditions.
 - (d) The right of a regulator to curtail or close the operations of entities that are not complying with regulations or other requirements. For example, a pollution control authority may be able to close down activities of an entity that breaches environmental regulations.
 - (e) The right to remove members of the governing body of another entity under certain restricted circumstances. For example, a state government may be able to remove or suspend the chairman of a municipality and appoint an administrator if the municipality is unable to make timely decisions about key policies.
 - (f) The right of the government to remove tax deductibility for contributions to a not-for-profit entity if the entity significantly changes its objectives or activities.

- (g) The right of an entity providing resources to a charity to demand that, if the charity were to be liquidated, the net assets of the charity would be distributed to an organization undertaking similar activities. (However, if the entity had the power to determine specifically to where the charity's net assets would be distributed upon liquidation, the entity would have substantive rights in relation to the charity).

Voting Rights

AG32. Where an entity has voting or similar rights in respect of another entity, an entity should consider whether those rights give it the current ability to direct the relevant activities of the other entity. An entity considers the requirements in this section (paragraphs AG33–AG52) in making that assessment.

Power with a Majority of the Voting Rights

AG33. An entity that holds more than half of the voting rights of another entity has power in the following situations, unless paragraph AG34 or paragraph AG35 applies:

- (a) The relevant activities are directed by a vote of the holder of the majority of the voting rights; or
- (b) A majority of the members of the governing body that directs the relevant activities are appointed by a vote of the holder of the majority of the voting rights.

Majority of the Voting Rights but no Power

AG34. For an entity that holds more than half of the voting rights of another entity, to have power over that other entity, the entity's voting rights must be substantive, in accordance with paragraphs AG25–AG28, and must provide the entity with the current ability to direct the relevant activities, which often will be through determining operating and financing policies. If another entity has existing rights that provide that entity with the right to direct the relevant activities and that entity is not an agent of the entity making the assessment of control, the entity making the assessment of control does not have power over the other entity.

AG35. An entity does not have power over another entity, even though the entity holds the majority of the voting rights in the other entity, when those voting rights are not substantive. For example, an entity that has more than half of the voting rights in another entity cannot have power if the relevant activities are subject to direction by a government, court, administrator, receiver, liquidator or regulator.

Power without a Majority of the Voting Rights

AG36. An entity can have power even if it holds less than a majority of the voting rights of another entity. An entity can have power with less than a majority of the voting rights of another entity, for example, through:

- (a) The power to appoint or remove a majority of the members of the board of directors (or other governing body), and control of the other entity is by that board or by that body (see paragraph AG38);
- (b) A binding arrangement between the entity and other vote holders (see paragraph AG39);
- (c) Rights arising from other binding arrangements (see paragraph AG40);
- (d) The entity's voting rights (see paragraphs AG37 and AG43–AG48);

- (e) Potential voting rights (see paragraphs AG49–AG52); or
- (f) A combination of (a)–(e).

Special Voting Rights Attaching to Ownership Interests (Golden Shares)

AG37. An entity may have the right of decisive vote, thus to veto all other voting rights of another entity. This type of right is sometimes referred to as a “golden share”. Such special voting rights may give rise to power. Usually these rights are documented in the founding documents of the other entity (such as articles of association), and are designed to restrict the level of voting or other rights that may be held by certain parties. They may also give an entity veto powers over any major change in the other entity, such as the sale of a major asset or the sale of the other entity as a whole.

Control of the Board or Other Governing Body

AG38. An entity may have the power to appoint or remove a majority of the members of the board of directors (or other governing body) as a result of binding arrangements (including existing legislation, executive authority, regulation, contractual, or other arrangements).

Binding Arrangement with Other Vote Holders

AG39. A binding arrangement between an entity and other vote holders can give the entity the right to exercise voting rights sufficient to give the entity power, even if the entity does not have voting rights sufficient to give it power without the binding arrangement. However, a binding arrangement might ensure that the entity can direct enough other vote holders on how to vote to enable the entity to make decisions about the relevant activities.

Rights from Other Binding Arrangements

AG40. Other decision-making rights, in combination with voting rights, can give an entity the current ability to direct the relevant activities. For example, the rights specified in a binding arrangement in combination with voting rights may give an entity the current ability to direct the operating or financing policies or other key activities of another entity that significantly affect the benefits received by the entity. However, an entity would not control another entity if that other entity were able to determine its policy or program to a significant extent, (for example, by failing to comply with the binding arrangement and accepting the consequences, or by changing its constitution or dissolving itself).

Economic Dependence

AG41. Economic dependence, alone, does not give rise to power over an entity for the purposes of this Standard. Economic dependence may occur when:

- (a) An entity has a single major client and the loss of that client could affect the existence of the entity’s operations; or
- (b) An entity’s activities are predominantly funded by grants and donations and it receives the majority of its funding from a single entity.

AG42. An entity may be able to influence the financial and operating policies of another entity that is dependent on it for funding. However, a combination of factors will need to be considered to determine whether the economic dependence is such that the economically dependent entity no longer has the ultimate power to govern its own financial or operating policies. If an economically dependent entity retains discretion as to whether it will take funding from an entity, or do business with an entity, the economically dependent entity still has the ultimate power to govern its own financial or operating policies. For example,

a private school that accepts funding from a government but whose governing body has retained discretion with respect to accepting funds or the manner in which those funds are to be used, would still have the ultimate power to govern its own financial or operating policies. This may be so even if government grants provided to such an entity requires it to comply with specified conditions. Although the entity might receive government grants for the construction of capital assets and operating costs subject to specified service standards or restrictions on user fees, its governing bodies may have ultimate discretion about how assets are used; the entity would therefore control its financial and operating policies. It is also important to distinguish between the operations of an entity and an entity itself. The loss of a major client might affect the viability of the operations of an entity but not the existence of the entity itself.

The Entity's Voting Rights

- AG43. An entity with less than a majority of the voting rights has rights that are sufficient to give it power when the entity has the practical ability to direct the relevant activities unilaterally.
- AG44. When assessing whether an entity's voting rights are sufficient to give it power, an entity considers all facts and circumstances, including:
- (a) The size of the entity's holding of voting rights relative to the size and dispersion of holdings of the other vote holders, noting that:
 - (i) The more voting rights an entity holds, the more likely the entity is to have existing rights that give it the current ability to direct the relevant activities;
 - (ii) The more voting rights an entity holds relative to other vote holders, the more likely the entity is to have existing rights that give it the current ability to direct the relevant activities;
 - (iii) The more parties that would need to act together to outvote the entity, the more likely the entity is to have existing rights that give it the current ability to direct the relevant activities;
 - (b) Potential voting rights held by the entity, other vote holders or other parties (see paragraphs AG49–AG52);
 - (c) Rights arising from other binding arrangements (see paragraph AG40); and
 - (d) Any additional facts and circumstances that indicate the entity has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings.
- AG45. When the direction of relevant activities is determined by majority vote and an entity holds significantly more voting rights than any other vote holder or organized group of vote holders, and the other shareholdings are widely dispersed, it may be clear, after considering the factors listed in paragraph AG44(a)–(c) alone, that the entity has power over the other entity.
- AG46. In other situations, it may be clear after considering the factors listed in paragraph AG44(a)–(c) alone that an entity does not have power.
- AG47. However, the factors listed in paragraph AG44(a)–(c) alone may not be conclusive. If an entity, having considered those factors, is unclear whether it has power, it shall consider additional facts and circumstances, such as whether other shareholders are passive in nature as demonstrated by voting patterns at previous shareholders' meetings. This includes the

assessment of the factors set out in paragraph AG20 and the indicators in paragraphs AG21–AG23. The fewer voting rights the entity holds, and the fewer parties that would need to act together to outvote the entity, the more reliance would be placed on the additional facts and circumstances to assess whether the entity's rights are sufficient to give it power. When the facts and circumstances in paragraphs AG20–AG23 are considered together with the entity's rights, greater weight shall be given to the evidence of power in paragraph AG20 than to the indicators of power in paragraphs AG21–AG23.

- AG48. If it is not clear, having considered the factors listed in paragraph AG44(a)–(d), that the entity has power, the entity does not control the other entity.

Potential Voting Rights

- AG49. When assessing control, an entity considers its potential voting rights as well as potential voting rights held by other parties, to determine whether it has power. Potential voting rights are rights to obtain voting rights of another entity, such as those arising from convertible instruments or options, including forward contracts. Those potential voting rights are considered only if the rights are substantive (see paragraphs AG25–AG28).
- AG50. When considering potential voting rights, an entity shall consider the purpose and design of the instrument, as well as the purpose and design of any other involvement the entity has with the other entity. This includes an assessment of the various terms and conditions of the instrument as well as the entity's apparent expectations, motives and reasons for agreeing to those terms and conditions.
- AG51. If the entity also has voting or other decision-making rights relating to the other entity's activities, the entity assesses whether those rights, in combination with potential voting rights, give the entity power.
- AG52. Substantive potential voting rights alone, or in combination with other rights, can give an entity the current ability to direct the relevant activities. For example, this is likely to be the case when an entity holds 40 per cent of the voting rights of another entity and, in accordance with paragraph AG26, holds substantive rights arising from options to acquire a further 20 per cent of the voting rights.

Power when Voting or Similar Rights do not have a Significant Effect on Benefits

- AG53. In assessing the purpose and design of another entity (see paragraphs AG5–AG8), an entity shall consider the involvement and decisions made at the inception of the other entity as part of its design and evaluate whether the transaction terms and features of the involvement provide the entity with rights that are sufficient to give it power. Being involved in the design of another entity alone is not sufficient to give an entity control of that other entity. However, involvement in the design of the other entity may indicate that the entity had the opportunity to obtain rights that are sufficient to give it power over the other entity and hence the ability to determine the purpose and design of an entity may give rise to power. In the case of an entity established with most (or all) of its relevant activities predetermined at inception, having the ability to determine the purpose and design of an entity may be more relevant to the control assessment than any on-going decision-making rights.
- AG54. In addition, an entity shall consider rights arising from binding arrangements such as call rights, put rights, liquidation rights and rights arising from legislative or executive authority established at the inception of the other entity. When binding arrangements involve activities that are closely related to the other entity, then these activities are, in substance, an integral part of the other entity's overall activities, even though they may occur outside the legal boundaries of the other entity. Therefore, explicit or implicit decision-making

rights embedded in binding arrangements that are closely related to the other entity need to be considered as relevant activities when determining power over the other entity.

- AG55. For some other entities, relevant activities occur only when particular circumstances arise or events occur. The other entity may be designed so that the direction of its activities and the benefits from those activities are predetermined unless and until those particular circumstances arise or events occur. In this case, only the decisions about the other entity's activities when those circumstances or events occur can significantly affect its benefits and thus be relevant activities. The circumstances or events need not have occurred for an entity with the ability to make those decisions to have power. The fact that the right to make decisions is contingent on circumstances arising or an event occurring does not, in itself, make those rights protective.
- AG56. An entity may have an explicit or implicit commitment to ensure that another entity continues to operate as designed. Such a commitment may increase the entity's exposure to variability of benefits and thus increase the incentive for the entity to obtain rights sufficient to give it power. Therefore a commitment to ensure that another entity operates as designed may be an indicator that the entity has power, but does not, by itself, give an entity power, nor does it prevent another party from having power.

Exposure, or Rights, to Variable Benefits from another Entity

- AG57. When assessing whether an entity has control of another entity, the entity determines whether it is exposed, or has rights, to variable benefits from its involvement with the other entity.
- AG58. Variable benefits are benefits that are not fixed and have the potential to vary as a result of the performance of another entity. Variable benefits can be only positive, only negative or both positive and negative (see paragraph 30). An entity assesses whether benefits from another entity are variable and how variable those benefits are on the basis of the substance of the arrangement and regardless of the legal form of the benefits. For example:
- (a) In the context of non-financial benefits an entity may receive benefits as a result of the activities of another entity furthering its objectives. The benefits may be variable benefits for the purpose of this Standard because they may expose the entity to the performance risk of the other entity. If the other entity were unable to perform those activities then the entity might incur additional costs, either from undertaking the activities itself or by providing additional funds or other forms of assistance to enable the other entity to continue providing those activities.
 - (b) In the context of financial benefits an entity can hold a bond with fixed interest payments. The fixed interest payments are variable benefits for the purpose of this Standard because they are subject to default risk and they expose the entity to the credit risk of the issuer of the bond. The amount of variability (i.e., how variable those benefits are) depends on the credit risk of the bond. Similarly, fixed performance fees for managing another entity's assets are variable benefits because they expose the entity to the performance risk of the other entity. The amount of variability depends on the other entity's ability to generate sufficient revenue to pay the fee.
- AG59. A liquidator would not normally have rights to variable benefits from its involvement with the entity being liquidated.

Link between Power and Benefits

Delegated Power

- AG60. It is common for public sector entities to be responsible for carrying out government policy. In some cases they may have the authority to act in their own right, in other cases they may act as an agent for a Minister or another entity. For example:
- (a) A government department, which is authorized by a Minister to act on the Minister's behalf, might act solely as an agent of the responsible Minister in relation to another entity. In such cases the department would not control the other entity and would not consolidate it.
 - (b) A government department may operate under a delegation of power from a Minister. The department uses its own discretion in making decisions and taking actions and is not subject to direction from the Minister. In such cases the department is acting in its own right and would need to apply the other requirements of this Standard to determine whether it controlled another entity. The scope of the department's decision-making authority over another entity would be a significant factor in distinguishing whether it is acting as an agent or as a principal.
 - (c) An entity may establish a trust to carry out specified activities and appoints the trustee. The trustee is responsible for making decisions about the financing and operating activities of the trust in accordance with the trust deed. If the entity can replace the trustee at its discretion, the entity would need to assess whether it controls the trust given that, for example, it would be exposed, or have rights, to variable benefits in terms of the extent to which its objectives are achieved or furthered through the activities of the trust.
- AG61. An entity may delegate its decision-making authority to an agent on some specific issues or on all relevant activities. When assessing whether it controls another entity, the entity shall treat the decision-making rights delegated to its agent as held by the entity directly. In situations where there is more than one principal, each of the principals shall assess whether it has power over the other entity by considering the requirements in paragraphs AG5– AG56. Paragraphs AG62–AG74 provide guidance on determining whether a decision maker is an agent or a principal.
- AG62. A decision maker shall consider the overall relationship between itself, the other entity being managed (and assessed for control) and other parties involved with that entity. In particular, a decision maker shall consider all the factors below, in determining whether it is an agent:
- (a) The scope of its decision-making authority over the other entity (paragraphs AG64 and AG65);
 - (b) The rights held by other parties (paragraphs AG66–AG69);
 - (c) The remuneration to which it is entitled in accordance with the remuneration agreement(s) (paragraphs AG70–AG72); and
 - (d) The decision maker's exposure to variability of benefits from other interests that it holds in the other entity (paragraphs AG73 and AG74).

Different weightings shall be applied to each of the factors on the basis of particular facts and circumstances.

- AG63. Determining whether a decision maker is an agent requires an evaluation of all the factors listed in paragraph AG62 unless a single party holds substantive rights to remove the decision maker (removal rights) and can remove the decision maker without cause (see paragraph AG67).

The Scope of the Decision-Making Authority

- AG64. The scope of a decision maker's decision-making authority is evaluated by considering:
- (a) The activities that are permitted according to the decision-making agreement(s) and specified by law, and
 - (b) The discretion that the decision maker has when making decisions about those activities.
- AG65. A decision maker shall consider the purpose and design of the other entity, the risks to which the other entity was designed to be exposed, the risks it was designed to pass on to the parties involved and the level of involvement the decision maker had in the design of another entity. For example, if a decision maker is significantly involved in the design of the other entity (including in determining the scope of decision-making authority), that involvement may indicate that the decision maker had the opportunity and incentive to obtain rights that result in the decision maker having the ability to direct the relevant activities.

Rights held by Other Parties

- AG66. Substantive rights held by other parties may affect the decision maker's ability to direct the relevant activities of another entity. Substantive removal or other rights may indicate that the decision maker is an agent.
- AG67. When a single party holds substantive removal rights and can remove the decision maker without cause, this, in isolation, is sufficient to conclude that the decision maker is an agent. If more than one party holds such rights (and no individual party can remove the decision maker without the agreement of other parties) those rights are not, in isolation, conclusive in determining that a decision maker acts primarily on behalf and for the benefit of others. In addition, the greater the number of parties required to act together to exercise rights to remove a decision maker and the greater the magnitude of, and variability associated with, the decision maker's other economic interests (i.e., remuneration and other interests), the less the weighting that shall be placed on this factor.
- AG68. Substantive rights held by other parties that restrict a decision maker's discretion shall be considered in a similar manner to removal rights when evaluating whether the decision maker is an agent. For example, a decision maker that is required to obtain approval from a small number of other parties for its actions is generally an agent. (See paragraphs AG25–AG28 for additional guidance on rights and whether they are substantive).
- AG69. Consideration of the rights held by other parties shall include an assessment of any rights exercisable by another entity's board of directors (or other governing body) and their effect on the decision-making authority (see paragraph AG26(b)).

Remuneration

- AG70. The greater the magnitude of, and variability associated with, the decision maker's remuneration relative to the benefits expected from the activities of the other entity, the more likely the decision maker is a principal.
- AG71. In determining whether it is a principal or an agent the decision maker shall also consider whether the remuneration agreement includes only terms, conditions or amounts that are customarily present in arrangements for similar services and level of skills negotiated on an arm's length basis.
- AG72. A decision maker cannot be an agent unless the conditions set out in paragraph AG74(a) and (b) are present. However, meeting those conditions in isolation is not sufficient to conclude that a decision maker is an agent.

Exposure to Variability of Benefits from Other Interests

- AG73. A decision maker that holds other interests in another entity (e.g., investments in the other entity or provides guarantees with respect to the performance of the other entity), shall consider its exposure to variability of benefits from those interests in assessing whether it is an agent. Holding other interests in another entity indicates that the decision maker may be a principal.
- AG74. In evaluating its exposure to variability of benefits from other interests in the other entity a decision maker shall consider the following:
- (a) The greater the magnitude of, and variability associated with, its economic interests, considering its remuneration and other interests in aggregate, the more likely the decision maker is a principal.
 - (b) Whether its exposure to variability of benefits is different from that of the other entities that receive benefits from the entity being assessed for control and, if so, whether this might influence its actions. For example, this might be the case when a decision maker holds subordinated interests in, or provides other forms of credit enhancement to, another entity.

The decision maker shall evaluate its exposure relative to the total variability of benefits of the other entity. This evaluation is made primarily on the basis of benefits expected from the activities of the other entity but shall not ignore the decision maker's maximum exposure to variability of benefits of the other entity through other interests that the decision maker holds.

Relationship with Other Parties

- AG75. When assessing control, an entity shall consider the nature of its relationship with other parties and whether those other parties are acting on the entity's behalf (i.e., they are "de facto agents"). The determination of whether other parties are acting as de facto agents requires judgment, considering not only the nature of the relationship but also how those parties interact with each other and the entity.
- AG76. Such a relationship need not involve a binding arrangement. Such relationships could also arise from legislative or executive authority that does not meet the definition of a binding arrangement. A party is a de facto agent when the entity has, or those that direct the activities of the entity have, the ability to direct that party to act on the entity's behalf. In these circumstances, the entity shall consider its de facto agent's decision-making rights

and its indirect exposure, or rights, to variable benefits through the de facto agent together with its own when assessing control of another entity.

AG77. The following are examples of such other parties that, by the nature of their relationship, might act as de facto agents for the entity:

- (a) The entity's related parties.
- (b) A party that received its interest in the other entity as a contribution or loan from the entity making the assessment of control.
- (c) A party that has agreed not to sell, transfer or encumber its interests in the other entity without the entity's prior approval (except for situations in which the entity and the other party have the right of prior approval and the rights are based on mutually agreed terms by willing independent parties).
- (d) A party that cannot finance its operations without subordinated financial support from the entity.
- (e) Another entity for which the majority of the members of its governing body or for which its key management personnel are the same as those of the entity.
- (f) A party that has a close business relationship with the entity, such as the relationship between a professional service provider and one of its significant clients.

Control of Specified Assets

AG78. An entity shall consider whether it treats a portion of another entity as a deemed separate entity and, if so, whether it controls the deemed separate entity.

AG79. An entity shall treat a portion of another entity as a deemed separate entity if and only if the following condition is satisfied:

Specified assets of the other entity (and related credit enhancements, if any) are the only source of payment for specified liabilities of, or specified other interests in, the other entity. Parties other than those with the specified liability do not have rights or obligations related to the specified assets or to residual cash flows from those assets. In substance, none of the benefits from the specified assets can be used by the remaining portion of the other entity and none of the liabilities of the deemed separate entity are payable from the assets of the remainder of the other entity. Thus, in substance, all the assets, liabilities and equity instruments of that deemed separate entity are ring-fenced from the overall other entity. Such a deemed separate entity is often called a "silo".

AG80. When the condition in paragraph AG79 is satisfied, an entity shall identify the activities that significantly affect the benefits of the deemed separate entity and how those activities are directed in order to assess whether it has power over that portion of the other entity. When assessing control of the deemed separate entity, the entity shall also consider whether it has exposure or rights to variable benefits from its involvement with that deemed separate entity and the ability to use its power over that portion of the other entity to affect the amount of the benefits from that entity.

AG81. If the entity controls the deemed separate entity, the entity shall consolidate that portion of the other entity. In that case, other parties exclude that portion of the other entity when assessing control of, and in consolidating, the other entity.

Continuous Assessment

- AG82. An entity shall reassess whether it controls another entity if facts and circumstances indicate that there are changes to one or more of the three elements of control listed in paragraph 20.
- AG83. If there is a change in how power over another entity can be exercised, that change must be reflected in how an entity assesses its power over another entity. For example, changes to decision-making rights can mean that the relevant activities are no longer directed through voting rights, but instead other agreements, such as contracts, give another party or parties the current ability to direct the relevant activities.
- AG84. An event can cause an entity to gain or lose power over another entity without the entity being involved in that event. For example, an entity can gain power over another entity because decision-making rights held by another party or parties that previously prevented the entity from controlling another entity have lapsed.
- AG85. An entity also considers changes affecting its exposure, or rights, to variable benefits from its involvement with another entity. For example, an entity that has power over another entity can lose control of that other entity if the entity ceases to be entitled or have the ability to receive benefits or to be exposed to obligations, because the entity would fail to satisfy paragraph 20(b) (e.g., if a contract to receive performance-related fees is terminated).
- AG86. An entity shall consider whether its assessment that it acts as an agent or a principal has changed. Changes in the overall relationship between the entity and other parties can mean that an entity no longer acts as an agent, even though it has previously acted as an agent, and vice versa. For example, if changes to the rights of the entity, or of other parties, occur, the entity shall reconsider its status as a principal or an agent.
- AG87. An entity's initial assessment of control or its status as a principal or an agent would not change simply because of a change in market conditions (e.g., a change in the other entity's benefits driven by market conditions), unless the change in market conditions changes one or more of the three elements of control listed in paragraph 20 or changes the overall relationship between a principal and an agent.

Determining Whether an Entity is an Investment Entity

- AG88. An entity shall consider all facts and circumstances when assessing whether it is an investment entity, including its purpose and design. Paragraphs AG89–AG106 describe aspects of the definition of an investment entity in more detail.

Number of Investors

- AG89. The definition of an investment entity requires that the entity have one or more investors. An investment entity may have several investors who pool their funds to gain access to investment management services and investment opportunities that they might not have had access to individually. Having several investors would make it less likely that the entity, or other members of the economic entity containing the entity, would obtain benefits other than capital appreciation or investment revenue.
- AG90. However, in the public sector it is also common for an investment entity to be formed by, or for, a single controlling entity that represents or supports the interests of a wider group of investors (e.g., a pension fund, government investment fund or trust).

Ownership Interests

- AG91. An investment entity is typically, but is not required to be, a separate legal entity. The investors in an investment entity will often, but not always, have ownership interests in the form of equity or similar interests (e.g., partnership interests), to which proportionate shares of the net assets of the investment entity are attributed. The definition of an investment entity does not specify that all investors must have the same rights. Having different classes of investors, some of which have rights only to a specific investment or groups of investments or which have different proportionate shares of the net assets, does not preclude an entity from being an investment entity.
- AG92. The definition of an investment entity does not specify that the investors must have an ownership interest that meets the definition of net assets/equity in accordance with other applicable MPSASs. An entity that has significant ownership interests in the form of debt that does not meet the definition of net assets/equity may still qualify as an investment entity, provided that the debt holders are exposed to variable returns from changes in the fair value of the entity's net assets.

Purpose

- AG93. The definition of an investment entity requires that the purpose of the entity is to invest solely for returns from capital appreciation, investment revenue (such as dividends or similar distributions, interest or rental revenue), or both. Documents that indicate what the entity's investment objectives are, such as the entity's mandate, constitution, offering memorandum, publications distributed by the entity and other corporate or partnership documents, will typically provide evidence of an investment entity's purpose. Further evidence may include the manner in which the entity presents itself to other parties; for example, an entity may present its objective as providing medium-term investment for capital appreciation.
- AG94. An entity that has additional objectives that are inconsistent with the purpose of an investment entity would not meet the definition of an investment entity. Examples of when this may occur are as follows:
- (a) An investor whose objective is to jointly develop, produce or market products with its investees. The entity will earn returns from the development, production or marketing activity as well as from its investments;
 - (b) An investor whose objectives require it to be aligned with the economic, social or environmental policies of another entity. For example, if an entity is required to align its investment policies with other objectives such as owning certain businesses or improving employment outcomes in a jurisdiction; and
 - (c) An investor whose individual investment decisions have to be ratified or approved by a controlling entity or which is required to follow the direction of a controlling entity. Such ratifications, approvals or decisions are likely to be inconsistent with the purpose of an investment entity.
- AG95. An entity's purpose may change over time. In assessing whether it continues to meet the definition of an investment entity, an entity would need to have regard to any changes in the environment in which it operates and the impact of such changes on its investment strategy.

Demonstrating Purpose through Holding More than One Investment

- AG96. An investment entity may have a number of ways in which it can demonstrate that its purpose is to invest funds for capital appreciation, investment revenue or both. One way is by holding several investments to diversify its risk and maximize its returns. An entity may hold a portfolio of investments directly or indirectly, for example by holding a single investment in another investment entity that itself holds several investments.
- AG97. There may be times when the entity holds a single investment. However, holding a single investment does not necessarily prevent an entity from meeting the definition of an investment entity. For example, an investment entity may hold only a single investment when the entity:
- (a) Is in its start-up period and has not yet identified suitable investments and, therefore, has not yet executed its investment plan to acquire several investments;
 - (b) Has not yet made other investments to replace those it has disposed of;
 - (c) Is established to pool investors' funds to invest in a single investment when that investment is unobtainable by individual investors (e.g., when the required minimum investment is too high for an individual investor); or
 - (d) Is in the process of being disestablished.

Investment-Related Services and Activities

- AG98. An investment entity may provide investment-related services (e.g., investment advisory services, investment management, investment support and administrative services), either directly or through a controlled entity, to third parties as well as to its controlling entity or other investors, even if those activities are substantial to the entity, subject to the entity continuing to meet the definition of an investment entity.
- AG99. An investment entity may also participate in the following investment-related activities, either directly or through a controlled entity, if these activities are undertaken to maximize the investment return (capital appreciation or investment revenue) from its investees and do not represent a separate substantial activity or a separate substantial source of revenue to the investment entity:
- (a) Providing management services and strategic advice to an investee; and
 - (b) Providing financial support to an investee, such as a loan, capital commitment or guarantee.
- AG100. If an investment entity has a controlled entity that is not itself an investment entity and whose main purpose and activities are providing investment-related services or activities that relate to the investment entity's investment activities, such as those described in paragraphs AG98–AG99, to the entity or other parties, it shall consolidate that controlled entity in accordance with paragraph 57. If the controlled entity that provides the investment-related services or activities is itself an investment entity, the controlling investment entity shall measure that controlled entity at fair value through surplus or deficit in accordance with paragraph 56.

Exit Strategies

- AG101. An entity's investment plans also provide evidence of its purpose. One feature that differentiates an investment entity from other entities is that an investment entity does not plan to hold its investments indefinitely; it holds them for a limited period. Because equity investments and non-financial asset investments have the potential to be held indefinitely, an investment entity shall have an exit strategy documenting how the entity plans to realize capital appreciation from substantially all of its equity investments and non-financial asset investments. An investment entity shall also have an exit strategy for any debt instruments that have the potential to be held indefinitely, for example perpetual debt investments. The entity need not document specific exit strategies for each individual investment but shall identify different potential strategies for different types or portfolios of investments, including a substantive time frame for exiting the investments. Exit mechanisms that are only put in place for default events, such as a breach of contract or non-performance, are not considered exit strategies for the purpose of this assessment.
- AG102. Exit strategies can vary by type of investment. For investments in private equity securities, examples of exit strategies include an initial public offering, a private placement, a trade sale of a business, distributions (to investors) of ownership interests in investees and sales of assets (including the sale of an investee's assets followed by a liquidation of the investee). For equity investments that are traded in a public market, examples of exit strategies include selling the investment in a private placement or in a public market. For real estate investments, an example of an exit strategy includes the sale of the real estate through specialized property dealers or the open market.
- AG103. An investment entity may have an investment in another investment entity that is formed in connection with the entity for legal, regulatory, tax or similar business reasons. In this case, the investment entity investor need not have an exit strategy for that investment, provided that the investment entity investee has appropriate exit strategies for its investments.

Fair Value Measurement

- AG104. An essential element of the definition of an investment entity is that it measures and evaluates the performance of substantially all of its investments on a fair value basis, because using fair value results in more relevant information than, for example, consolidating its controlled entities or using the equity method for its interests in associates or joint ventures. In order to demonstrate that it meets this element of the definition, an investment entity:
- (a) Provides investors with fair value information and measures substantially all of its investments at fair value in its financial statements whenever fair value is required or permitted in accordance with MPSASs; and
 - (b) Reports fair value information internally to the entity's key management personnel (as defined in MPSAS 20, *Related Party Disclosures*), who use fair value as the primary measurement attribute to evaluate the performance of substantially all of its investments and to make investment decisions.
- AG105. In order to meet the requirement in AG104(a), an investment entity would:
- (a) Elect to account for any investment property using the fair value model in MPSAS 16, *Investment Property*;

- (b) Elect the exemption from applying the equity method in MPSAS 36, *Investment in Associates and Joint Ventures*, for its investments in associates and joint ventures; and
- (c) Measure its financial assets at fair value using the requirements in MPSAS 29, *Financial Instruments: Recognition and Measurement*.

AG106. An investment entity may have some non-investment assets, such as a head office property and related equipment, and may also have financial liabilities. The fair value measurement element of the definition of an investment entity applies to an investment entity's investments. Accordingly, an investment entity need not measure its non-investment assets or its liabilities at fair value.

Amendments to Other MPSASs

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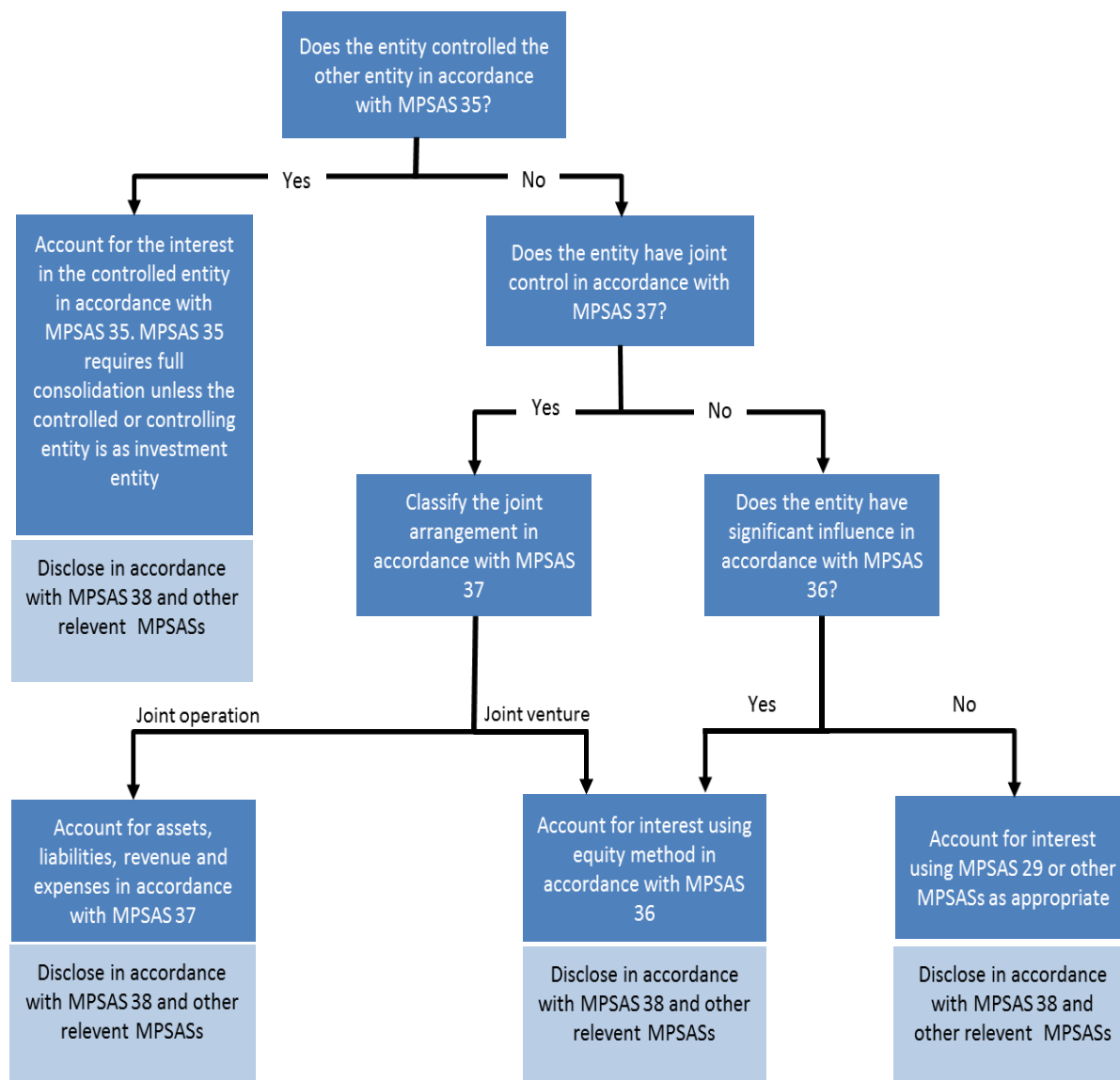
Implementation Guidance

This guidance accompanies, but is not part of, MPSAS 35, Consolidated Financial Statements.

Nature of Relationship with Another Entity

IG1. The diagram below summarizes the accounting for various types of involvement with another entity.

Flowchart 1: Forms of Involvement with Other Parties



Illustrative Examples

These examples accompany, but are not part of, MPSAS 35, Consolidated Financial Statements.

- IE1. The examples in this appendix portray hypothetical situations. Although some aspects of the examples may be present in actual fact patterns, all facts and circumstances of a particular fact pattern would need to be evaluated when applying MPSAS 35, *Consolidated Financial Statements*.

Power (paragraphs AG9–AG56)

- IE2. The following example illustrates an assessment of whether power exists for the purposes of this Standard.

Example 1

A state government partially funds the activities of a local government. Some of this funding is required to be spent on specified activities. The local government has a council that is elected every four years by the local community. The council decides how to use the local government's resources for the benefit of the local community. The activities of the local government are diverse and include library services, provision of leisure facilities, management of refuse and wastewater, and enforcement of building and health and safety regulations. These activities are the relevant activities of the local government. Many of these activities also coincide with the interests of the state government.

Despite its partial funding of the local government's activities, the state government does not have the power to direct the relevant activities of the local government. The rights of the local government over the relevant activities preclude the state government from having control.

Regulatory Control (paragraph AG12)

- IE3. The following examples illustrate various forms of regulatory control. None of these forms of regulatory control give rise to power over the relevant activities for the purposes of this Standard. However, those examples do not rule out that there may be instances where power over the relevant activities for the purposes of this Standard may derive from regulatory control.

Example 2

A pollution control authority has the power to close down the operations of entities that are not complying with environmental regulations.

The existence of this power does not constitute power over the relevant activities.

Example 3

A city has the power to pass zoning laws to limit the location of fast food outlets or to ban them altogether.

The existence of this power does not constitute power over the relevant activities of the fast food outlets.

Example 4

A central government has the power to impose regulatory control on monopolies. A wholly owned government agency has the power to regulate monopolies that are subject to such regulatory control and has established price ceilings for entities that distribute electricity. The central government does not have an ownership interest in the electricity distributors and does not receive financial benefits from the electricity distributors. Neither the central government, nor the government agency, has control as a result of the power to impose regulatory control. Any other powers would need to be separately assessed.

Example 5

A gaming control board (GCB) is a government agency that regulates casinos and other types of gaming in a state, and enforces state gaming legislation. The GCB is responsible for promulgating rules and regulations that govern the conduct of gaming activities in the state. The rules and regulations stem from legislation. The legislation was passed by the legislature and sets forth the broad policy of the state with regard to gaming; while the rules and regulations provide detailed requirements that must be satisfied by a gaming establishment, its owners, employees, and vendors. The rules and regulations cover a broad range of activity, including licensing, accounting systems, rules of casino games, and auditing.

The GCB also has authority to grant or deny licenses to gaming establishments, their ownership, employees, and vendors. In order to obtain a license, an applicant must demonstrate that they possess good character, honesty and integrity. License application forms typically require detailed personal information. Based upon the type of license being sought, an applicant may also be required to disclose details regarding previous business relationships, employment history, criminal records, and financial stability.

Although the rules and regulations have an impact on how gaming establishments operate, the GCB does not have power over the relevant activities (as defined in this Standard) of the gaming establishments. The regulations apply to all gaming establishments and each establishment has a choice as to whether it wishes to engage in gaming or not. The purpose of the gaming legislation and regulations is to protect the public, rather than to establish a controlling interest in the gaming establishment.

Relevant Activities and Direction of Relevant Activities (paragraphs AG13–AG15)

- IE4. The following examples illustrate assessments of whether an entity has the power to direct the relevant activities of another entity for the purposes of this Standard.

Example 6

Entities A and B, form another entity, entity C, to develop and market a medical product. Entity A is responsible for developing and obtaining regulatory approval of the medical product—that responsibility includes having the unilateral ability to make all decisions relating to the development of the product and to obtaining regulatory approval. Once the regulator has approved the product, entity B will manufacture and market it—entity B has the unilateral ability to make all decisions about the manufacture and marketing of the product. If all the activities—developing and obtaining regulatory approval as well as manufacturing and marketing of the medical product—are relevant activities, entity A and entity B, each needs to determine whether they are able to direct the activities that *most* significantly affect the benefits from entity C. Accordingly, entity A and B each need to consider whether developing and obtaining regulatory approval or the manufacturing and marketing of the medical product is the activity that most significantly affects the benefits from entity C and whether they are able to direct that activity. In determining which entity has power, entities A and B would consider:

- (a) The purpose and design of entity C;
- (b) The factors that determine the surplus, revenue and value of entity C as well as the value of the medical product;
- (c) The effect of their decision-making authority on entity C's performance with respect to the factors in (b); and
- (d) Their exposure to variability of benefits from entity C.

In this particular example, the entities would also consider:

- (a) The uncertainty of, and effort required in, obtaining regulatory approval (considering their record of successfully developing and obtaining regulatory approval of medical products); and
- (b) Which entity controls the medical product once the development phase is successful.

Example 7

An investment vehicle is created and financed with a debt instrument held by an entity (the debt investor) and equity instruments held by a number of other investors. The equity tranche is designed to absorb the first losses and to receive any residual benefit from the investment vehicle. One of the equity investors who holds 30 per cent of the equity instruments is also the asset manager. The investment vehicle uses its proceeds to purchase a portfolio of financial assets, exposing the investment vehicle to the credit risk associated with the possible default of principal and interest payments of the assets. The transaction is marketed to the debt investor as an investment with minimal exposure to the credit risk associated with the possible default of the assets in the portfolio because of the nature of these assets and because the equity tranche is designed to absorb the first losses of the investment vehicle. The benefits from the investment vehicle are significantly affected by the management of the investment vehicle's asset portfolio, which includes decisions about the selection, acquisition and disposal of the assets within portfolio guidelines and the management upon default of any portfolio assets. All those activities are managed by the asset manager until defaults reach a specified proportion of the portfolio value (i.e., when the value of the portfolio is such that the equity tranche of the investment vehicle has been consumed). From that time, a third-party trustee manages the assets according to the instructions of the debt investor. Managing the investment vehicle's asset portfolio is the relevant activity of the investment vehicle. The asset manager has the ability to direct the relevant activities until defaulted assets reach the specified proportion of the portfolio value; the debt investor has the ability to direct the relevant activities when the value of defaulted assets surpasses that specified proportion of the portfolio value. The asset manager and the debt investor each need to determine whether they are able to direct the activities that most significantly affect the benefits from the investment vehicle, including considering the purpose and design of the investment vehicle as well as each party's exposure to variability of benefits.

Rights that Give an Entity Power over another Entity (paragraphs AG16–AG28)

IE5. The following examples illustrate assessments of whether an entity has the power to direct the relevant activities of another entity for the purposes of this Standard.

Example 8

A government housing agency establishes a community housing program that provides low-cost housing. The program is operated under an agreement with an incorporated association. The association's only activity is to manage the community housing facility. The association has no ownership instruments.

The relevant activities of the association comprise:

- Reviewing and selecting applicants for housing;
- The day-to-day operation of the housing program;
- Maintaining the houses and common facilities; and
- Improving and extending the housing facilities.

The board of governors of the association has 16 members, with eight appointed by (and subject to removal by) the government housing agency. The chair is appointed by the board from amongst the appointees of the government housing agency, and has a casting vote that is rarely exercised. The board meets regularly and reviews reports received from the association's management. Based on these reports, the board may confirm or override management decisions. In addition, the board makes decisions on major issues such as significant maintenance and investing further capital to build additional housing, after reviewing vacancy levels and the demand for housing.

The government housing agency owns the land on which the housing facilities stand and has contributed capital and operating funds to the association since it was established. The association owns the housing facilities.

The association retains any surplus resulting from the operation of the facilities and under its constitution is unable to provide a direct financial return to the government housing agency. The above fact pattern applies to examples 8A and 8B described below. Each example is considered in isolation.

Example 8A

Based on the facts and circumstances outlined above, the government housing agency controls the association.

The government housing agency has rights that give it the current ability to direct the relevant activities of the association, regardless of whether it chooses to exercise those rights.

The government housing agency appoints eight members of the board of governors, one of whom will become the chair, who has a casting vote. As a result, the government housing agency has power over the association through substantive rights that give it the current ability to direct the relevant activities of the association, regardless of whether the government housing agency chooses to exercise those substantive rights.

The government housing agency also has exposure or rights to variable benefits from its involvement with the association. The government housing agency obtains non-financial benefits through the association furthering its social objective of meeting the need for low-cost community housing. Although not able to receive direct financial benefits, the government housing agency obtains indirect benefits through its ability to direct how the financial returns are to be employed in the community housing program.

The government housing agency also satisfies the final control criterion. Through its appointees on the board, the government housing agency has the ability to use its power to affect the nature and amount of its benefits from the association.

The government housing agency satisfies all three criteria for control and therefore the government housing agency controls the association.

Example 8B

In this example, the facts of Example 8A apply, except that:

- (a) The association's board of governors is elected through a public nomination and voting process that does not give rights to the government housing agency to appoint board members; and
- (b) Decisions made by the association's board are reviewed by the government housing agency, which may offer advice to the association.

Based on the revised facts and circumstances outlined above, the government housing agency does not have substantive rights relating to the association and therefore does not have power over the association.

The government housing agency's social objectives in relation to low-cost community housing are still being achieved and therefore it will still obtain direct non-financial benefits. However, congruence of objectives alone is insufficient to conclude that one entity controls another entity (refer paragraph 36).

The government housing agency does not have power and consequently does not have the ability to use power to affect the nature or amount of the agency's benefits. The government housing agency is unable to satisfy two of the three control criteria and therefore the government housing agency does not control the association.

Example 9

A government has the right to appoint and remove the majority of members of a statutory body. This power has been used by previous governments. The current government has not done so because it does not wish, for political reasons, to be regarded as interfering in the activities of the statutory body. In this case the government still has substantive rights, even though it has chosen not to use them.

Example 10

A local government has a policy that, where it holds land that is surplus to its requirements, consideration should be given to making the land available for affordable housing. The local government establishes terms and conditions to ensure that the housing provided remains affordable and available to meet local housing needs.

In accordance with this policy, the local government sold part of a site to a housing association for RM1 to provide 20 affordable homes. The remainder of the site was sold at open market value to a private developer.

The contract between the local government and the housing association specifies what the land can be used for, the quality of housing developments, ongoing reporting and performance management requirements, the process for return of unused land and dispute resolution. The land must be used in a manner consistent with the local government's policy for affordable housing.

The agreement also has requirements regarding the housing association's quality assurance and financial management processes. The housing association must demonstrate that it has the capacity and authority to undertake the development. It must also demonstrate the added value that can be achieved by joining the local government's resources with that of the housing association to address a need within a particular client group in a sustainable way.

The Board of the housing association is appointed by the members of the housing association. The local government does not have a representative on the Board.

Based on the facts and circumstances outlined above, the government housing agency does not hold sufficient power over the association to direct its relevant activities and therefore does not control the association. The local government may receive indirect, non-financial benefits from the association in that the local government's social objectives in relation to low-cost community housing are being furthered by the activities of the housing association. However, congruence of objectives alone is insufficient to conclude that one entity controls another (see paragraph 36). In order to have power over the housing association the local government would need to have the ability to direct the housing association to work with the local government to further the local governments' objectives.

Example 11

An entity being assessed for control has annual shareholder meetings at which decisions to direct the relevant activities are made. The next scheduled shareholders' meeting is in eight months. However, shareholders that individually or collectively hold at least 5 per cent of the voting rights can call a special meeting to change the existing policies over the relevant activities, but a requirement to give notice to the other shareholders means that such a meeting cannot be held for at least 30 days. Policies over the relevant activities can be changed only at special or scheduled shareholders' meetings. This includes the approval of material sales of assets as well as the making or disposing of significant investments.

The above fact pattern applies to examples 11A–11D described below. Each example is considered in isolation.

Example 11A

An entity holds a majority of the voting rights in the other entity. The entity's voting rights are substantive because the entity is able to make decisions about the direction of the relevant activities when they need to be made. The fact that it takes 30 days before the entity can exercise its voting rights does not stop the entity from having the current ability to direct the relevant activities from the moment the entity acquires the shareholding.

Example 11B

An entity is party to a forward contract to acquire the majority of shares in the other entity. The forward contract's settlement date is in 25 days. The existing shareholders are unable to change the existing policies over the relevant activities because a special meeting cannot be held for at least 30 days, at which point the forward contract will have been settled. Thus, the entity has rights that are essentially equivalent to the majority shareholder in example 11A above (i.e., the entity holding the forward contract can make decisions about the direction of the relevant activities when they need to be made). The entity's forward contract is a substantive right that gives the entity the current ability to direct the relevant activities even before the forward contract is settled.

Example 11C

An entity holds a substantive option to acquire the majority of shares in the other entity that is exercisable in 25 days and is deeply in the money. The same conclusion would be reached as in example 11B.

Example 11D

An entity is party to a forward contract to acquire the majority of shares in the other entity, with no other related rights over the other entity. The forward contract's settlement date is in six months. In contrast to the examples above, the entity does not have the current ability to direct the relevant activities. The existing shareholders have the current ability to direct the relevant activities because they can change the existing policies over the relevant activities before the forward contract is settled.

Power without a Majority of the Voting Rights and Special Voting Rights Attaching to Ownership Interests (paragraphs AG36–AG37)

IE6. The following examples illustrate assessments of whether special voting rights attaching to ownership interests in another entity give rise to power for the purposes of this Standard.

Example 12

A central government has privatized a company and, in order to protect its national interests, it has used a “golden share” mechanism. The “golden share” does not have any value or give any percentage rights to the capital of the company. The golden share states that control of the company, or a 24 percent stake in the company cannot be sold without the permission of the central government.

The central government has protective rights, not substantive rights.

Example 13

A central government sold all of its shares in a company, but kept a golden share (with a nominal value of one currency unit). The golden share granted the Secretary of State (as the holder of the share) a 15 percent shareholding in the company, and consequently the ability to block any potential takeover of the business. It also required that the chairman of the board and the chief executive be citizens of the country. The rationale for the golden share was to protect the company from an overseas acquisition, principally on the grounds of national security.

The central government has protective rights, not substantive rights.

Example 14

A central government does not own any shares in defense companies. However it has passed legislation which specifies that, with respect to companies carrying out strategic activities for the defense and national security system, in the event that fundamental interests of national defense or security could be materially affected, the government may:

- (a) Impose specific conditions on the purchase of an interest in any such company – by any person – relating to the security of procurement and of information, the transfer of technologies and export controls;
- (b) Veto the purchase by any person – other than the state (whether directly or indirectly, individually or jointly) – of an interest in the voting share capital in any such company that, given its size, may jeopardize defense or national security; and
- (c) Veto the adoption of resolutions by the shareholders or the board of directors of any such company relating to certain extraordinary transactions (such as mergers, demergers, assets disposals, winding up, and bylaws amendments concerning the corporate purpose or equity ownership caps in certain state-controlled companies).

The central government has protective rights, not substantive rights, in respect of these companies.

Control of the Board or Other Governing Body (paragraph AG38)

- IE7. The following example illustrates assessments of whether an entity has control of the board or governing body of another entity for the purposes of this Standard. The existence of such control may provide evidence that an entity has sufficient rights to have power over another entity.

Example 15

A national museum is governed by a board of trustees who are chosen by the government department responsible for funding the museum. The trustees have freedom to make decisions about the operation of the museum.

The department has the power to appoint the majority of the museum's trustees. The department has the potential to exercise power over the museum.

Economic Dependence (paragraphs AG41–AG42)

- IE8. The following examples illustrate assessments of whether dependence on funding from another entity gives rise to power in the context of this Standard.

Example 16

A research institution is one of many institutions that receive the majority of their funding from a central government. The institutions submit proposals and the funding is allocated through a tendering process. The research institution retains the right to accept or decline funding.

The central government does not control the research institution because the research institution can choose to decline funding from the government, seek alternative sources of funding or cease to operate.

Example 17

A catering entity has a binding arrangement to supply food to a government-owned school. The arrangement is between the company and the school. The school contracts generate the majority of the revenue of the catering entity. There are general requirements, set out in regulations, which are applicable to all such arrangements including nutritional standards and policies on procurement. For example, the arrangements specify how much produce must be purchased locally.

Current arrangements are for a period of five years. At the end of this period, if the catering entity wishes to continue supplying school meals it is required to go through a tendering process and compete with other entities for the business.

The school does not control the catering entity because the catering entity can choose to stop supplying school meals, seek other work, or cease to operate.

Example 18

An international donor funds a project in a developing country. The donor uses a small, local agency in the country to run the project. The local agency has its own management board but is highly dependent on the donor for funding. The agency retains the power to turn down funding from the donor.

The international donor does not control the local agency because the agency can choose not to accept funding from the donor and seek alternative sources of funding, or cease to operate.

Voting Rights (paragraphs AG43–AG48)

- IE9. The following examples illustrate assessments of whether an entity with less than a majority of the voting rights in another entity has the practical ability to direct the relevant activities unilaterally, and whether its rights are sufficient to give it power over that other entity for the purposes of this Standard.

Example 19

An entity acquires 48 per cent of the voting rights of another entity. The remaining voting rights are held by thousands of shareholders, none individually holding more than 1 percent of the voting rights. None of the shareholders have any arrangements to consult any of the others or make collective decisions. When assessing the proportion of voting rights to acquire, on the basis of the relative size of the other shareholdings, the entity determined that a 48 per cent interest would be sufficient to give it control. In this case, on the basis of the absolute size of its holding and the relative size of the other shareholdings, the entity concludes that it has a sufficiently dominant voting interest to meet the power criterion without the need to consider any other evidence of power.

Example 20

Entity A holds 40 per cent of the voting rights of another entity and twelve other investors each hold 5 per cent of the voting rights of the other entity. A shareholder agreement grants Entity A the right to appoint, remove and set the remuneration of management responsible for directing the relevant activities. To change the agreement, a two-thirds majority vote of the shareholders is required. In this case, Entity A concludes that the absolute size of its holding and the relative size of the other shareholdings alone are not conclusive in determining whether it has rights sufficient to give it power. However, Entity A determines that its contractual right to appoint, remove and set the remuneration of management is sufficient to conclude that it has power over the other entity. The fact that Entity A might not have exercised this right or the likelihood of Entity A exercising its right to select, appoint or remove management shall not be considered when assessing whether Entity A has power.

Example 21

Entity A holds 45 per cent of the voting rights of another entity. Two other investors each hold 26 per cent of the voting rights of the other entity. The remaining voting rights are held by three other shareholders, each holding 1 per cent. There are no other arrangements that affect decision-making. In this case, the size of Entity A's voting interest and its size relative to the other shareholdings are sufficient to conclude that Entity A does not have power. Only two other investors would need to co-operate to be able to prevent Entity A from directing the relevant activities of the other entity.

Example 22

An entity holds 35 per cent of the voting rights of another entity. Three other shareholders each hold 5 per cent of the voting rights of the other entity. The remaining voting rights are held by numerous other shareholders, none individually holding more than 1 per cent of the voting rights. None of the shareholders has arrangements to consult any of the others or make collective decisions. Decisions about the relevant activities of the other entity require the approval of a majority of votes cast at relevant shareholders' meetings—75 per cent of the voting rights of the other entity have been cast at recent relevant shareholders' meetings. In this case, the active participation of the other shareholders at recent shareholders' meetings indicates that the entity would not have the practical ability to direct the relevant activities unilaterally, regardless of whether the entity has directed the relevant activities because a sufficient number of other shareholders voted in the same way as the entity.

Potential Voting Rights (paragraphs AG49–AG52)

- IE10. The following examples illustrate assessments of whether potential voting rights are substantive for the purposes of this Standard.

Example 23

Entity A holds 70 per cent of the voting rights of another entity. Entity B has 30 per cent of the voting rights of the other entity as well as an option to acquire half of Entity A's voting rights. The option is exercisable for the next two years at a fixed price that is deeply out of the money (and is expected to remain so for that two-year period). Entity A has been exercising its votes and is actively directing the relevant activities of the other entity. In such a case, Entity A is likely to meet the power criterion because it appears to have the current ability to direct the relevant activities. Although Entity B has currently exercisable options to purchase additional voting rights (that, if exercised, would give it a majority of the voting rights in the other entity), the terms and conditions associated with those options are such that the options are not considered substantive.

Example 24

Entity A and two other investors each hold a third of the voting rights of another entity. The other entity's business activity is closely related to Entity A. In addition to its equity instruments, Entity A also holds debt instruments that are convertible into ordinary shares of the other entity at any time for a fixed price that is out of the money (but not deeply out of the money). If the debt were converted, Entity A would hold 60 per cent of the voting rights of the other entity. Entity A would benefit from realizing synergies if the debt instruments were converted into ordinary shares. Entity A has power over the other entity because it holds voting rights of the other entity together with substantive potential voting rights that give it the current ability to direct the relevant activities.

Power when Voting or Similar Rights do not have a Significant Effect on Benefits (paragraphs AG53–AG56)

- IE11. The following examples illustrate assessments of whether an entity has power in the absence of voting rights or similar rights for the purposes of this Standard.

Example 25

A central government has legislation that governs the establishment of cultural and heritage boards. These boards have a separate legal status and have limited liability. The powers and objectives of the boards, along with their reporting requirements are specified by legislation. The main function of each board is to administer the board's assets, mainly property, for the general benefit of beneficiaries. Boards are permitted to spend money on the promotion of health, education, vocational training, and the social and economic welfare of the beneficiaries. They have limited authority to spend money unless it is for a purpose specifically mentioned in the legislation. Each board must deliver an annual financial report to the government. The beneficiaries (as defined by each board and comprising people from a specified area) elect the members of the board. Trustees are appointed for a three-year term by way of voting by beneficiaries at the annual general meeting. Each board determines its own operating and financial policies and strategy. The activities that have the biggest impact on the achievement of the boards' objectives are the management of property and the distribution of funds to the beneficiaries.

The central government does not control the boards. The government was involved in establishing the legislation that governs the activities of the boards, but does not have rights over the relevant activities of the boards.

Example 26

Five local authorities create a separate company to deliver shared services to participating authorities. The company operates under contract to these local authorities. The company's major objective is the provision of services to these local authorities.

The company is owned by all of the participating local authorities with each owning one share and allowed one vote. The chief executive of each local government is permitted to be a board member of the company. The board of the company is responsible for strategic direction, approval of business cases and monitoring of performance.

For each shared activity there is an advisory group that is responsible for operational management and decision-making in relation to that activity. Each advisory group consists of one representative from each local government.

The benefits of the shared services arrangement are:

- Improved levels and quality of service;
- A co-ordinated and consistent approach to the provision of services;
- Reductions in the cost of support and administrative services;
- Opportunities to develop new initiatives; and
- Economies of scale resulting from a single entity representing many councils in procurement.

If further shared service activities are established that lead to the need for further capital, the company will either issue a new class of equity instrument or will form a controlled entity to hold the interest in the new assets.

The company covers its costs in two ways. It retains a percentage of savings from its bulk purchasing activities and it charges an administrative transaction cost of services provided to the local authorities.

None of the local authorities individually controls the company. In deciding how to account for its interest in the company each local authority would also need to consider whether it is a party to a joint arrangement as defined in MPSAS 37, *Joint Arrangements*.

Example 27

A leisure trust was established as a charity, limited by guarantee, to operate and manage sport and leisure facilities on behalf of a local government. Under the terms of the agreement with the local government, the leisure trust is responsible for the operational management, delivery and development of the city's sports and leisure facilities. The trust is required to operate the existing leisure facilities of the local government. The level of service required, including hours of operation and staffing levels, are specified by the local government. The leisure trust's activities must be consistent with the long-term plan of the local government and a significant portion of the trusts activities are funded by the local government. The leisure trust may not create new facilities nor may it engage in any other activities without the approval of the local government.

If the leisure trust ceases to operate the proceeds must be distributed to another charity with similar purposes. The local government is not responsible for the debts of the leisure trust (its liability is limited to one currency unit).

The local government controls the leisure trust. By specifying in detail the way in which the leisure trust must operate the local government has predetermined the leisure trust's activities and the nature of benefits to the local government.

Example 28

A local government transfers its leisure centers, libraries and theatres into a charitable trust.

In creating the trust the local government expects to benefit from cost savings, increased use of facilities by the public, a more favorable taxation treatment, and better access to funding restricted to charities. The trust can decide the nature and extent of facilities to be provided and can engage in any other charitable purpose. The board of the trust is elected by the community. The local government is entitled to have one representative on the board. The trust is required to retain any surplus and use it for the objectives of the trust.

The local government benefits from the trust's activities but it does not control the trust. The local government cannot direct how the trust uses its resources.

Example 29

Trust A promotes, supports and undertakes programs, actions and initiatives to beautify City A. It receives funding from the local government for various services, including graffiti removal, beautification projects and running environmental events. It reports back to the local government on its performance in delivering these services. If the trust did not exist the local government would need to find some other way to deliver these services. The trust also receives assistance through donations and volunteer work by the local community including local businesses, schools, community groups and individuals.

The trust was originally established by an elected official of the local government.

The governing body of the local government appoints all the trustees (having regard to certain requirements such as balance in gender and location of trustees). There are between five and 12 trustees. The trustees appoint the officers.

Changes to the trust deed must be approved by the trustees and the governing body of the local authority.

If the trust is wound up, surplus assets must be transferred to a similar charitable body in the same geographical area. This transfer of assets is subject to the approval of the local government.

The local government has a mix of rights over the trust including rights to:

- (a) Appoint, reassign or remove members of the trust's key management personnel who have the ability to direct the relevant activities;
- (b) Approve or veto operating and capital budgets relating to the relevant activities of the trust; and
- (c) Veto key changes to the trust, such as the sale of a major asset or of the trust as a whole.

The local government is able to direct the relevant activities (the services) of the trust through its arrangements in such a way that it is able to affect the costs and quality of the services being provided. The local government is exposed to variable returns (both the economic effects of the service and the quality of the service). As it uses its power to affect these returns, the local government controls the trust.

Example 30

Entity A is a public sector body that promotes the construction of new houses, the repair and modernization of existing houses, and the improvement of housing and living conditions. It also facilitates access to housing finance and promotes competition and efficiency in the provision of housing finance.

Entity A established a separate trust which has narrowly defined objectives. The trust's functions are to acquire interests in eligible housing loans and issue mortgage bonds. Entity A guarantees the bonds issued by the trust but does not provide on-going funding – the trust finances its activities through the revenue from its investments. If the trust is wound up the trust's assets are to be distributed to one or more charitable organizations. Entity A does not have on-going decision-making rights over the trust's activities.

Entity A has power over the relevant activities of the trust because it determined the relevant activities of the trust when it established the trust. Entity A is also exposed to variable benefits both through its exposure to the guaranteed bonds and because the trust's activities, determined by Entity A in establishing the trust, help Entity A to achieve its objectives.

Example 31

A funding agency was established by legislation. It is owned by ten local authorities and the central government. It operates on a for-profit basis. The funding agency will raise debt funding and provide that funding to the participating local authorities. Its primary purpose is to provide more efficient funding costs and diversified funding sources for the local authorities. It may undertake any other activities considered by the board to be reasonably related or incidental to, or in connection with, that business.

The main benefits to the participating local authorities are the reduced borrowing costs. The board of the funding agency may decide to pay dividends but dividend payments are expected to be low.

The board is responsible for the strategic direction and control of the funding agency's activities. The board will comprise between four and seven directors with a majority of independent directors.

There is also a shareholders' council which is made up of ten appointees of the shareholders (including an appointee from the central government). The role of the shareholders' council is to:

- Review the performance of the funding agency and the Board, and report to shareholders on that performance;
- Make recommendations to shareholders as to the appointment, removal, replacement and remuneration of directors; and
- Coordinate shareholders' governance decisions.

The funding agency purchases debt securities in accordance with its lending and/or investment policies, as approved by the board and/or shareholders.

To participate in the funding agency as a principal shareholding authority, each local government made an initial capital investment of RM100,000, provided security against future property taxes and agreed to borrow a set portion of its borrowing needs from the funding agency for a period of three years.

Neither the central government nor the participating local authorities control the funding agency. In deciding how to account for their interest in the funding agency the central government and participating local authorities would also need to consider whether they are parties to a joint arrangement as defined in MPSAS 37, *Joint Arrangement*.

Example 32

Entity A's only business activity, as specified in its founding documents, is to purchase receivables and service them on a day-to-day basis for Entity B. The servicing on a day-to-day basis includes the collection and passing on of principal and interest payments as they fall due. Upon default of a receivable Entity A automatically puts the receivable to Entity B as agreed separately in a put agreement between Entity A and Entity B. The only relevant activity is managing the receivables upon default because it is the only activity that can significantly affect Entity A's financial performance. Managing the receivables before default is not a relevant activity because it does not require substantive decisions to be made that could significantly affect Entity A's financial performance—the activities before default are predetermined and amount only to collecting cash flows as they fall due and passing them on to Entity B. Therefore, only Entity B's right to manage the assets upon default should be considered when assessing the overall activities of Entity A that significantly affect Entity A's financial performance. In this example, the design of Entity A ensures that Entity B has decision-making authority over the activities that significantly affect the financial performance at the only time that such decision-making authority is required. The terms of the put agreement are integral to the overall transaction and the establishment of Entity A. Therefore, the terms of the put agreement together with the founding documents of Entity A lead to the conclusion that Entity B has power over Entity A, even though Entity B takes ownership of the receivables only upon default and manages the defaulted receivables outside the legal boundaries of Entity A.

Exposure, or Rights, to Variable Benefits from another Entity (paragraph AG57)

- IE12. The following examples illustrate assessments of whether an entity receives variable benefits from another entity for the purposes of this Standard.

Example 33

Research has shown that family friendly policies at universities, which include the provision of quality early childhood education services, are critical in attracting and retaining students and staff. This is particularly important for attracting high-level staff and post-graduate students, which in turn help uphold the reputation of the University and its ability to obtain research funding.

The above background information is relevant to examples 33A and 33B described below. Each example is considered in isolation.

Example 33A

University A has established seven childcare centers (although University A receives government funding for its educational programs, the childcare centers have been established by the university, not by the government). The centers operate in University owned buildings. Each center has its own manager, staff and budget. The centers are able to be used by university staff and students only. The University is the licensed provider of childcare services. The University has the right to close centers or relocate them to other properties. Because the childcare center is on university property the staff and parents are required to comply with University health and safety policies. The management team of the childcare center has the ability to determine all other operating policies.

University A receives non-financial benefits from having childcare services available on campus. Although University A is not involved in the day-to-day running of the centers, it has the ability to close the centers or change their hours of operation.

University A controls the childcare centers.

Example 33B

University B has made a building available free of charge for the provision of childcare services on the grounds of the University. The childcare services are provided by an incorporated society. All parents using the childcare center are members of the society. The members appoint the Board of the incorporated society and are in charge of the childcare center's operating and financial policies. The childcare center is able to be used by staff, students and the general public, with students having priority. Because the childcare center is on University property the staff and parents are required to comply with University health and safety policies. The incorporated society is the licensed provider of childcare services. If the incorporated society ceases to operate, its resources must be distributed to a similar non-profit organization. The incorporated society could choose not to use the University's buildings in providing its services.

Although the University receives non-financial benefits from having childcare services available on campus it does not have power to direct the relevant activities of the incorporated society. The members of the incorporated society, being the parents of the children, have the power to direct the relevant activities of the incorporated society. The University does not control the incorporated society.

Link between Power and Benefits

Delegated Power (paragraphs AG60–AG63)

- IE13. The following examples illustrate assessments of whether an entity is acting as a principal or an agent for the purposes of this Standard.

Example 34

A government department may be responsible for monitoring the performance of another public sector entity. The role of the monitoring department is to make sure the other entity's approach is consistent with the government's goals, provide Ministers with quality assurance about delivery and results and assess and notify the Minister of any risks. The department has an explicit agreement with the Minister which sets out its monitoring responsibilities. The department has the authority to request information from the other entity and provides advice to the Minister on any funding requests from that entity. The department also advises the Minister as to whether the other entity should be permitted to undertake certain activities. The department is acting as an agent of the Minister.

Example 35

A provincial government establishes a trust to co-ordinate fundraising efforts for the benefit of health programs and other health initiatives in the region. The trust also invests and manages designated endowment funds. The funds raised are applied to the government-owned hospitals and aged care facilities in the region.

The provincial government appoints all the trustees on the board of the trust and funds the trust's operating costs. The trust is a registered charity and is exempt from income tax.

Based on the following analysis, the provincial government controls the trust:

- (a) The provincial government can give directions to the trustees, and the trustees have the current ability to direct the relevant activities of the trust. The trustees have power over the trust and the provincial government can replace the trustees at its discretion. The trustees' fiduciary obligation to act in the best interest of the beneficiaries does not prevent the provincial government from having power over the trust;
- (b) The provincial government has exposure and rights to variable benefits from involvement with the trust;
- (c) The provincial government can use its power over the trust to affect the nature and amount of the trust's benefits; and
- (d) The activities of the trust are complementary to the activities of the provincial government.

Example 36

A statutory body is established under legislation to deliver services to the community. The statutory body has a governing council that oversees the body's operations and is responsible for its day-to-day operations. The Minister of Health for the provincial government appoints the statutory body's governing council and, subject to the Minister's approval, the statutory body's governing council appoints the chief executive of the body.

The provincial government's Health Department acts as the "system manager" for the provincial public health system. This role includes:

- (a) Strategic leadership, such as the development of provincial-wide health service plans;
- (b) Directions for the delivery of health services, such as entering into service agreements, capital works approval and management of provincial-wide industrial relations, including employment terms and conditions for the statutory body's employees; and
- (c) Monitoring of performance (e.g., quality of health services and financial data) of the authority and taking remedial action when performance does not meet specified performance measures.

The Minister's approval is specifically required for the following major decisions:

- (a) Entering into service agreements with the body;
- (b) Issuing binding health service directives;
- (c) Finalization of health service plans and capital works planning; and
- (d) Employment and remuneration of the statutory body's executive staff.

The Health Department receives all its operating and capital funding from the provincial government.

Based on the facts and circumstances outlined above, the Health Department generally acts as an agent of the Minister in relation to the statutory body. This is evident from the restricted decision-making authority held by the Department. The Health Department does not control the statutory body.

As the Minister appoints the statutory body's governing council and approves the major decisions affecting the body's activities, the Minister has the power to direct the relevant activities of the body. Assuming that the other control criteria (variable returns and link between power and benefits) are satisfied, as would be expected, then the Minister would control the statutory body. As a result, the statutory body would be consolidated in the provincial government's whole of government general purpose financial statements.

Example 37

The facts are the same as in Example 36 except that:

- (a) The Minister has delegated the power to appoint members of the statutory body's governing council to the Health Department's head;
- (b) The appointment of the statutory body's chief executive by the governing council does not require the Minister's approval;
- (c) The Minister has delegated the power to approve the major decisions to the Health Department's head; and
- (d) Assessments of the Health Department's performance encompass the performance of the statutory body.

The Minister could still exercise the powers that have been delegated to the Health Department's head, but in practice, is unlikely to do so.

In this example, the scope of the decision-making authority held by the Health Department has increased significantly as a result of the delegations by the Minister to the Health Department head. As the Health Department acts as a principal under the delegations, the Department has the current ability to direct the relevant activities of the statutory body so as to achieve the health service objectives of the Health Department. As the Health Department also has the ability to use its power over the authority to affect the nature and amount of the Department's benefits, the Department controls the statutory body.

Example 38

The head of the government department related to finance and taxation (the Treasury) is designated by law as the managing trustee for a number of investment funds. The investment funds are funded by designated taxes and are used to deliver federal welfare programs. The Treasury collects most of the designated tax revenue that relates to these funds. Other agencies also collect some of the revenues and forward these to the Treasury.

The Treasury is delegated the responsibility for administering the funds. For each of the funds, the Treasury immediately invests all receipts credited to the fund, and maintains the invested assets in a designated trust fund until money is needed by the relevant agency.

When the relevant agencies determine that monies are needed, the Treasury redeems securities from the funds' investment balances, and transfers the cash proceeds, including interest earned on the investments, to the program accounts for disbursement by the agency. The Treasury provides monthly and other periodic reporting to each agency. The Treasury charges a management fee for its services.

The Treasury does not control the funds.

Example 39

A local government administers ten funds, each relating to a specific district. The funds hold specified assets (such as land, property and investments) that belonged to districts that previously had their own local government but which have since been amalgamated with other districts. The funds receive the revenue associated with the assets and certain taxes such as the property taxes for that district. The rights of the funds to hold these specified assets and receive the specified revenue are set out in legislation. The assets and revenue of the fund may be applied solely for the benefit of the inhabitants of the former districts.

The local government has wide discretion over spending by the funds. Funds must be applied for the benefit of the community in such a manner as using reasonable judgment the local government thinks proper and having regard to the interests of the inhabitants of the former district. The local government may apply the fund to spending which is not covered by council taxation. Expenditure charged to the fund must be for purposes permitted by law.

The funds are controlled by the local government.

Example 40

A sovereign wealth fund (the fund) is a constitutionally established permanent fund, managed by a government corporation. Legislation specifies that the fund is entitled to receive at least 25% of proceeds from oil sales. The fund sets aside a certain share of these revenues to benefit current and future generations of citizens.

The corporation manages the assets of both the fund and certain other state investments and is remunerated for doing so. The corporation may not spend the fund revenue. Decisions on spending fund revenue are made by the Parliament. Each year, the fund's revenue is split between operating expenses and an annual payment to residents that meet certain criteria specified in legislation.

The corporation does not control the sovereign wealth fund. It acts solely as an agent.

Example 41

A decision maker (fund manager) establishes, markets and manages a publicly traded, regulated fund according to narrowly defined parameters set out in the investment mandate as required by its local laws and regulations. The fund was marketed to investors as an investment in a diversified portfolio of equity securities of publicly traded entities. Within the defined parameters, the fund manager has discretion about the assets in which to invest. The fund manager has made a 10 per cent pro rata investment in the fund and receives a market-based fee for its services equal to 1 per cent of the net asset value of the fund. The fees are commensurate with the services provided. The fund manager does not have any obligation to fund losses beyond its 10 per cent investment. The fund is not required to establish, and has not established, an independent board of directors. The investors do not hold any substantive rights that would affect the decision-making authority of the fund manager, but can redeem their interests within particular limits set by the fund.

Although operating within the parameters set out in the investment mandate and in accordance with the regulatory requirements, the fund manager has decision-making rights that give it the current ability to direct the relevant activities of the fund—the investors do not hold substantive rights that could affect the fund manager’s decision-making authority. The fund manager receives a market-based fee for its services that is commensurate with the services provided and has also made a pro rata investment in the fund. The remuneration and its investment expose the fund manager to variability of benefits from the activities of the fund without creating exposure that is of such significance that it indicates that the fund manager is a principal.

In this example, consideration of the fund manager’s exposure to variability of benefits from the fund together with its decision-making authority within restricted parameters indicates that the fund manager is an agent. Thus, the fund manager concludes that it does not control the fund.

Example 42

A decision maker establishes, markets and manages a fund that provides investment opportunities to a number of investors. The decision maker (fund manager) must make decisions in the best interests of all investors and in accordance with the fund's governing agreements. Nonetheless, the fund manager has wide decision-making discretion. The fund manager receives a market-based fee for its services equal to 1 per cent of assets under management and 20 per cent of all the fund's surplus if a specified level of surplus is achieved. The fees are commensurate with the services provided.

Although it must make decisions in the best interests of all investors, the fund manager has extensive decision-making authority to direct the relevant activities of the fund. The fund manager is paid fixed and performance-related fees that are commensurate with the services provided. In addition, the remuneration aligns the interests of the fund manager with those of the other investors to increase the value of the fund, without creating exposure to variability of benefits from the activities of the fund that is of such significance that the remuneration, when considered in isolation, indicates that the fund manager is a principal.

The above fact pattern and analysis applies to examples 42A-42C described below. Each example is considered in isolation.

Example 42A

The fund manager also has a 2 per cent investment in the fund that aligns its interests with those of the other investors. The fund manager does not have any obligation to fund losses beyond its 2 per cent investment. The investors can remove the fund manager by a simple majority vote, but only for breach of contract.

The fund manager's 2 per cent investment increases its exposure to variability of benefits from the activities of the fund without creating exposure that is of such significance that it indicates that the fund manager is a principal. The other investors' rights to remove the fund manager are considered to be protective rights because they are exercisable only for breach of contract. In this example, although the fund manager has extensive decision-making authority and is exposed to variability of benefits from its interest and remuneration, the fund manager's exposure indicates that the fund manager is an agent. Thus, the fund manager concludes that it does not control the fund.

Example 42B

The fund manager has a more substantial pro rata investment in the fund, but does not have any obligation to fund losses beyond that investment. The investors can remove the fund manager by a simple majority vote, but only for breach of contract.

In this example, the other investors' rights to remove the fund manager are considered to be protective rights because they are exercisable only for breach of contract. Although the fund manager is paid fixed and performance-related fees that are commensurate with the services provided, the combination of the fund manager's investment together with its remuneration could create exposure to variability of benefits from the activities of the fund that is of such significance that it indicates that the fund manager is a principal. The greater the magnitude of, and variability associated with, the fund manager's economic interests (considering its remuneration and other interests in aggregate), the more emphasis the fund manager would place on those economic interests in the analysis, and the more likely the fund manager is a principal.

For example, having considered its remuneration and the other factors, the fund manager might consider a 20 per cent investment to be sufficient to conclude that it controls the fund. However, in different circumstances (i.e., if the remuneration or other factors are different), control may arise when the level of investment is different.

Example 42C

The fund manager has a 20 per cent pro rata investment in the fund, but does not have any obligation to fund losses beyond its 20 per cent investment. The fund has a board of directors, all of whose members are independent of the fund manager and are appointed by the other investors. The board appoints the fund manager annually. If the board decided not to renew the fund manager's contract, the services performed by the fund manager could be performed by other managers in the industry.

Although the fund manager is paid fixed and performance-related fees that are commensurate with the services provided, the combination of the fund manager's 20 per cent investment together with its remuneration creates exposure to variability of benefits from the activities of the fund that is of such significance that it indicates that the fund manager is a principal. However, the investors have substantive rights to remove the fund manager—the board of directors provides a mechanism to ensure that the investors can remove the fund manager if they decide to do so.

In this example, the fund manager places greater emphasis on the substantive removal rights in the analysis. Thus, although the fund manager has extensive decision-making authority and is exposed to variability of benefits of the fund from its remuneration and investment, the substantive rights held by the other investors indicate that the fund manager is an agent. Thus, the fund manager concludes that it does not control the fund

Example 43

Entity A is created to purchase a portfolio of fixed rate asset-backed securities, funded by fixed rate debt instruments and equity instruments. The equity instruments are designed to provide first loss protection to the debt investors and receive any residual benefits from Entity A. The transaction was marketed to potential debt investors as an investment in a portfolio of asset-backed securities with exposure to the credit risk associated with the possible default of the issuers of the asset-backed securities in the portfolio and to the interest rate risk associated with the management of the portfolio. On formation, the equity instruments represent 10 per cent of the value of the assets purchased. A decision maker (the asset manager) manages the active asset portfolio by making investment decisions within the parameters set out in Entity A's prospectus. For those services, the asset manager receives a market-based fixed fee (i.e., 1 per cent of assets under management) and performance-related fees (i.e., 10 per cent of surplus) if Entity A's surpluses exceed a specified level. The fees are commensurate with the services provided. The asset manager holds 35 per cent of the equity instruments of Entity A. The remaining 65 per cent of the equity instruments, and all the debt instruments of Entity A, are held by a large number of widely dispersed unrelated third party investors. The asset manager can be removed, without cause, by a simple majority decision of the other investors.

The asset manager is paid fixed and performance-related fees that are commensurate with the services provided. The remuneration aligns the interests of the fund manager with those of the other investors to increase the value of the fund. The asset manager has exposure to variability of returns from the activities of the fund because it holds 35 per cent of the equity instruments and from its remuneration.

Although operating within the parameters set out in Entity A's prospectus, the asset manager has the current ability to make investment decisions that significantly affect Entity A's benefits in the form of returns—the removal rights held by the other investors receive little weighting in the analysis because those rights are held by a large number of widely dispersed investors. In this example, the asset manager places greater emphasis on its exposure to variability of returns of the fund from its net asset/equity interest, which is subordinate to the debt instruments. Holding 35 per cent of the equity instruments creates subordinated exposure to losses and rights to returns of Entity A, which are of such significance that it indicates that the asset manager is a principal. Thus, the asset manager concludes that it controls Entity A.

Example 44

A decision maker (the sponsor) sponsors a multi-seller conduit, which issues short-term debt instruments to unrelated third party investors. The transaction was marketed to potential investors as an investment in a portfolio of highly rated medium-term assets with minimal exposure to the credit risk associated with the possible default by the issuers of the assets in the portfolio. Various transferors sell high quality medium-term asset portfolios to the conduit. Each transferor services the portfolio of assets that it sells to the conduit and manages receivables on default for a market-based servicing fee. Each transferor also provides first loss protection against credit losses from its asset portfolio through over-collateralization of the assets transferred to the conduit. The sponsor establishes the terms of the conduit and manages the operations of the conduit for a market-based fee. The fee is commensurate with the services provided. The sponsor approves the sellers permitted to sell to the conduit, approves the assets to be purchased by the conduit and makes decisions about the funding of the conduit. The sponsor must act in the best interests of all investors.

The sponsor is entitled to any residual benefit from the conduit and also provides credit enhancement and liquidity facilities to the conduit. The credit enhancement provided by the sponsor absorbs losses of up to 5 per cent of all of the conduit's assets, after losses are absorbed by the transferors. The liquidity facilities are not advanced against defaulted assets. The investors do not hold substantive rights that could affect the decision-making authority of the sponsor.

Even though the sponsor is paid a market-based fee for its services that is commensurate with the services provided, the sponsor has exposure to variability of benefits from the activities of the conduit because of its rights to any residual benefits from the conduit and the provision of credit enhancement and liquidity facilities (i.e., the conduit is exposed to liquidity risk by using short-term debt instruments to fund medium-term assets). Even though each of the transferors has decision-making rights that affect the value of the assets of the conduit, the sponsor has extensive decision-making authority that gives it the current ability to direct the activities that most significantly affect the benefits from the conduit (i.e., the sponsor established the terms of the conduit, has the right to make decisions about the assets (approving the assets purchased and the transferors of those assets) and the funding of the conduit (for which new investment must be found on a regular basis)). The right to residual benefits from the conduit and the provision of credit enhancement and liquidity facilities expose the sponsor to variability of benefits from the activities of the conduit that is different from that of the other investors. Accordingly, that exposure indicates that the sponsor is a principal and thus the sponsor concludes that it controls the conduit. The sponsor's obligation to act in the best interest of all investors does not prevent the sponsor from being a principal.

Accounting requirements: loss of control (paragraphs 52–55A)

IE13A. The following example illustrates the treatment of a sale of an interest in a controlled entity that does not contain an operation.

Example 44A

A controlling entity has a 100 per cent interest in a controlled entity that does not contain an operation. The controlling entity sells 70 per cent of its interest in the controlled entity to an associate in which it has a 20 per cent interest. As a consequence of this transaction, the controlling entity loses control of the controlled entity. The carrying amount of the net assets of the subsidiary is RM100 and the carrying amount of the interest sold is RM70 ($\text{RM}70 = \text{RM}100 \times 70\%$). The fair value of the consideration received is RM210, which is also the fair value of the interest sold. The investment retained in the former controlled entity is an associate accounted for using the equity method and its fair value is RM90. The gain determined in accordance with paragraphs 54–55, before the elimination required by paragraph 55A, is RM200 ($\text{RM}200 = \text{RM}210 + \text{RM}90 - \text{RM}100$). This gain comprises two parts:

- (a) The gain (RM140) resulting from the sale of the 70 per cent interest in the controlled entity to the associate. This gain is the difference between the fair value of the consideration received (RM210) and the carrying amount of the interest sold (RM70). According to paragraph 55A, the controlling entity recognizes in its surplus or deficit the amount of the gain attributable to the unrelated investors' interests in the existing associate. This is 80 per cent of this gain, that is RM112 ($\text{RM}112 = \text{RM}140 \times 80\%$). The remaining 20 per cent of the gain ($\text{RM}28 = \text{RM}140 \times 20\%$) is eliminated against the carrying amount of the investment in the existing associate.
- (b) The gain (RM60) resulting from the remeasurement at fair value of the investment directly retained in the former controlled entity. This gain is the difference between the fair value of the investment retained in the former controlled entity (RM90) and 30 per cent of the carrying amount of the net assets of the controlled entity ($\text{RM}30 = \text{RM}100 \times 30\%$). According to paragraph 55A, the controlling entity recognizes in its surplus or deficit the amount of the gain attributable to the unrelated investors' interests in the new associate. This is 56 per cent ($70\% \times 80\%$) of the gain, that is RM34 ($\text{RM}34 = \text{RM}60 \times 56\%$). The remaining 44 per cent of the gain RM26 ($\text{RM}26 = \text{RM}60 \times 44\%$) is eliminated against the carrying amount of the investment retained in the former controlled entity.

Investment Entities (paragraphs AG88–AG106)

- IE14. The following examples illustrate assessments of whether an entity is an investment entity for the purposes of this Standard.

Example 45

An entity, Limited Partnership, is formed in 20X1 as a limited partnership with a 10-year life. The offering memorandum states that Limited Partnership's purpose is to invest in entities with rapid growth potential, with the objective of realizing capital appreciation over their life. Entity GP (the general partner of Limited Partnership) provides 1 per cent of the capital to Limited Partnership and has the responsibility of identifying suitable investments for the partnership. Approximately 75 limited partners, who are unrelated to Entity GP, provide 99 per cent of the capital to the partnership.

Limited Partnership begins its investment activities in 20X1. However, no suitable investments are identified by the end of 20X1. In 20X2 Limited Partnership acquires a controlling interest in one entity, ABC Corporation. Limited Partnership is unable to close another investment transaction until 20X3, at which time it acquires equity interests in five additional operating companies. Other than acquiring these equity interests, Limited Partnership conducts no other activities. Limited Partnership measures and evaluates its investments on a fair value basis and this information is provided to Entity GP and the external investors.

Limited Partnership has plans to dispose of its interests in each of its investees during the 10-year stated life of the partnership. Such disposals include the outright sale for cash, the distribution of marketable equity securities to investors following the successful public offering of the investees' securities and the disposal of investments to the public or other unrelated entities.

From the information provided, Limited Partnership meets the definition of an investment entity from formation in 20X1 to 31 December 20X3 because the following conditions exist:

- (a) Limited Partnership has obtained funds from the limited partners and is providing those limited partners with investment management services;
- (b) Limited Partnership's only activity is acquiring equity interests in operating companies with the purpose of realizing capital appreciation over the life of the investments. Limited Partnership has identified and documented exit strategies for its investments, all of which are equity investments; and
- (c) Limited Partnership measures and evaluates its investments on a fair value basis and reports this financial information to its investors.

In addition, Limited Partnership displays the following characteristics that are relevant in assessing whether it meets the definition of an investment entity:

- (a) Limited Partnership is funded by many investors; and
- (b) Ownership in Limited Partnership is represented by units of partnership interests acquired through a capital contribution.

Limited Partnership does not hold more than one investment throughout the period. However, this is because it was still in its start-up period and had not identified suitable investment opportunities.

Example 46

High Technology Fund was formed by Technology Corporation to invest in technology start-up companies for capital appreciation. Technology Corporation holds a 70 per cent interest in High Technology Fund and controls High Technology Fund; the other 30 per cent ownership interest in High Technology Fund is owned by 10 investors. Technology Corporation holds options to acquire investments held by High Technology Fund, at their fair value, which would be exercised if the technology developed by the investees would benefit the operations of Technology Corporation. No plans for exiting the investments have been identified by High Technology Fund. High Technology Fund is managed by an investment adviser that acts as agent for the investors in High Technology Fund.

Even though High Technology Fund's purpose is investing for capital appreciation and it provides investment management services to its investors, High Technology Fund is not an investment entity because of the following arrangements and circumstances:

- (a) Technology Corporation, the controlling entity of High Technology Fund, holds options to acquire investments in investments held by High Technology Fund if the assets developed by those entities would benefit the operations of Technology Corporation. This provides a benefit in addition to capital appreciation or investment revenue; and
- (b) The investment plans of High Technology Fund do not include exit strategies for its investments, which are equity investments. The options held by Technology Corporation are not controlled by High Technology Fund and do not constitute an exit strategy.

Example 47

Real Estate Entity was formed to develop, own and operate retail, office and other commercial properties. Real Estate Entity typically holds its property in separate wholly-owned controlled entities, which have no other substantial assets or liabilities other than borrowings used to finance the related investment property. Real Estate Entity and each of its controlled entities report their investment properties at fair value in accordance with MPSAS 16, *Investment Property*. Real Estate Entity does not have a set time frame for disposing of its property investments, but uses fair value to help identify the optimal time for disposal. Although fair value is one performance indicator, Real Estate Entity and its investors use other measures, including information about expected cash flows, rental revenues and expenses, to assess performance and to make investment decisions. The key management personnel of Real Estate Entity do not consider fair value information to be the primary measurement attribute to evaluate the performance of its investments but rather a part of a group of equally relevant key performance indicators.

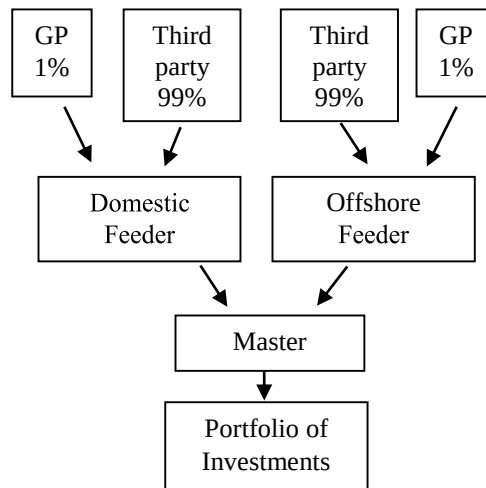
Real Estate Entity undertakes extensive property and asset management activities, including property maintenance, capital expenditure, redevelopment, marketing and tenant selection, some of which it outsources to third parties. This includes the selection of properties for refurbishment, development and the negotiation with suppliers for the design and construction work to be done to develop such properties. This development activity forms a separate substantial part of Real Estate Entity's activities.

Real Estate Entity does not meet the definition of an investment entity because:

- (a) Real Estate Entity has a separate substantial activity that involves the active management of its property portfolio, including lease negotiations, refurbishments and development activities, and marketing of properties to provide benefits other than capital appreciation, investment revenue, or both;
- (b) The investment plans of Real Estate Entity do not include specified exit strategies for its investments. As a result, Real Estate Entity plans to hold those property investments indefinitely; and
- (c) Although Real Estate Entity reports its investment properties at fair value in accordance with MPSAS 16, *Investment Property*, fair value is not the primary measurement attribute used by management to evaluate the performance of its investments. Other performance indicators are used to evaluate performance and make investment decisions.

Example 48

An entity, Master Fund, is formed in 20X1 with a 10-year life. The equity of Master Fund is held by two related feeder funds. The feeder funds are established in connection with each other to meet legal, regulatory, tax or similar requirements. The feeder funds are capitalized with a 1 per cent investment from the general partner and 99 per cent from equity investors that are unrelated to the general partner (with no party holding a controlling financial interest).



The purpose of Master Fund is to hold a portfolio of investments in order to generate capital appreciation and investment revenue (such as dividends, interest or rental revenue). The investment objective communicated to investors is that the sole purpose of the Master-Feeder structure is to provide investment opportunities for investors in separate market niches to invest in a large pool of assets. Master Fund has identified and documented exit strategies for the equity and non-financial investments that it holds. Master Fund holds a portfolio of short and medium term debt investments, some of which will be held until maturity and some of which will be traded but Master Fund has not specifically identified which investments will be held and which will be traded. Master Fund measures and evaluates substantially all of its investments, including its debt investments, on a fair value basis. In addition, investors receive periodic financial information, on a fair value basis, from the feeder funds. Ownership in both Master Fund and the feeder funds is represented through units of equity.

Master Fund and the feeder funds each meet the definition of an investment entity. The following conditions exist:

- (a) Both Master Fund and the feeder funds have obtained funds for the purpose of providing investors with investment management services;
- (b) The Master-Feeder structure's purpose, which was communicated directly to investors of the feeder funds, is investing solely for capital appreciation and investment revenue and Master Fund has identified and documented potential exit strategies for its equity and non-financial investments;

- (c) Although the feeder funds do not have an exit strategy for their interests in Master Fund, the feeder funds can nevertheless be considered to have an exit strategy for their investments because Master Fund was formed in connection with the feeder funds and holds investments on behalf of the feeder funds; and
- (d) The investments held by Master Fund are measured and evaluated on a fair value basis and information about the investments made by Master Fund is provided to investors on a fair value basis through the feeder funds.

Master Fund and the feeder funds were formed in connection with each other for legal, regulatory, tax or similar requirements. When considered together, they display the following characteristics:

- (a) The feeder funds indirectly hold more than one investment because Master Fund holds a portfolio of investments;
- (b) Although Master Fund is wholly capitalized by the feeder funds, the feeder funds are funded by many investors who are unrelated to the feeder funds (and to the general partner); and
- (c) Ownership in the feeder funds is represented by units of equity interests acquired through a capital contribution.

Example 49

Government Corporation A was established with the principal activity of providing equity finance to both existing and new enterprises. Its investment objective is to seek capital appreciation and returns. All acquisitions are made on that basis. The strategy of the Corporation is to increase the fair value of investments in order to realize a gain on disposal. Management assesses and monitors fair value of the investments on a regular basis. The Corporation regularly disposes of investments when they reach a certain stage of maturity so as to provide funds for ongoing investment opportunities. Any surplus is distributed to the government in the form of dividends.

The Corporation also provides investment related services to the government regarding the government's policies for assisting entities in financial distress. It acts as an agent in managing and implementing some of the government's business incentive schemes. The Corporation is not exposed to any losses or risks as a result of its involvement with these schemes.

The Corporation is an investment entity. It meets all three aspects of the definition of an investment entity.

Comparison with IPSAS 35

MPSAS 35, Consolidated *Financial Statements*, is drawn primarily from IPSAS 35 (2018). Main difference between MPSAS 35 and IPSAS 35 are as follows:

- In paragraph 5, MPSAS 35 exempts Federal Government and State Government from presenting Consolidated Financial Statement.
- In paragraph 6, IPSAS 35 refers to IPSAS 39, *Employee Benefits*, whereas MPSAS 35 refers to MPSAS 25, *Employee Benefits*, in which drawn from IPSAS 25 that has been superseded by IPSAS 39. The MPSAS is yet to adopt IPSAS 39.

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MPSAS 36 - INVESTMENTS IN ASSOCIATES AND JOINT VENTURES

Acknowledgement

The Malaysian Public Sector Accounting Standard (MPSAS) 36 is based on International Public Sector Accounting Standard (IPSAS) 36, *Investments in Associates and Joint Ventures*, from the *Handbook of International Public Sector Accounting Pronouncements* of the International Public Sector Accounting Standards Board, published by the International Federation of Accountants (IFAC) in 2018 and is used with permission of IFAC.

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MPSAS 36 - INVESTMENTS IN ASSOCIATES AND JOINT VENTURES

History of MPSAS

This version includes amendments resulting from MPSASs issued up to December 2022.

MPSAS 36, *Investments in Associates and Joint Ventures* was issued in June 2016.

Since the first issuance, MPSAS 36 has been amended by the following MPSASs:

- *Improvements to MPSASs 2023* (issued December 2022)
- MPSAS 40, *Public Sector Combinations* (issued October 2021)

Table of Amended Paragraphs in MPSAS 36

Paragraph Affected	How Affected	Affected By
4	Amended	Improvements to MPSASs 2023 December 2022
6	Deleted	Improvements to MPSASs 2023 December 2022
7	Deleted	Improvements to MPSASs 2023 December 2022
26	Amended	MPSAS 40 October 2021
31	Amended	MPSAS 40 October 2021
33	Amended	MPSAS 40 October 2021
34A	New	MPSAS 40 October 2021
34B	New	MPSAS 40 October 2021
51A	New	MPSAS 40 October 2021
51B	New	MPSAS 40 October 2021
51C	New	Improvements to MPSASs 2023 December 2022

MPSAS 36 - INVESTMENTS IN ASSOCIATES AND JOINT VENTURES

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Malaysian Public Sector Accounting Standard (MPSAS) 36, *Investments in Associates and Joint Ventures*, is set out in paragraphs 1–53. All the paragraphs have equal authority. MPSAS 36, *Investments in Associates and Joint Ventures*, should be read in the context of its objective and the Preface to Malaysian Public Sector Accounting Standards. MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe the accounting for investments in associates and joint ventures and to set out the requirements for the application of the equity method when accounting for investments in associates and joint ventures.

Scope

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for investments in associates and joint ventures.**
3. **This Standard shall be applied by all entities that are investors with significant influence over, or joint control of, an investee where the investment leads to the holding of a quantifiable ownership interest.**
4. This Standard provides the basis for accounting for ownership interests in associates and joint ventures. That is, the investment in the other entity confers on the entity the risks and rewards incidental to an ownership interest. This Standard applies only to quantifiable ownership interests. This includes ownership interests arising from investments in the formal equity structure of another entity. A formal equity structure means share capital or an equivalent form of capital, such as units in a property trust. Quantifiable ownership interests may also include ownership interests arising from other investments in which the entity's ownership interest can be measured reliably (for example, interests in a partnership). Where the equity structure of the other entity is poorly defined, it may not be possible to obtain a reliable measure of the ownership interest.
5. Some contributions made by public sector entities may be referred to as an "investment," but may not give rise to an ownership interest. For example, a public sector entity may make a substantial investment in the development of a hospital that is owned and operated by a charity. While such contributions are non-exchange in nature, they allow the public sector entity to participate in the operation of the hospital, and the charity is accountable to the public sector entity for its use of public monies. However, the contributions made by the public sector entity do not constitute an ownership interest, as the charity could seek alternative funding and thereby prevent the public sector entity from participating in the operation of the hospital. Accordingly, the public sector entity is not exposed to the risks, nor does it enjoy the rewards, that are incidental to an ownership interest.
6. [Deleted]
7. [Deleted]

Definitions

8. **The following terms are used in this Standard with the meanings specified:**
An associate is an entity over which the investor has significant influence.

Binding arrangement: For the purposes of this Standard, a binding arrangement is an arrangement that confers enforceable rights and obligations on the parties to it as if it were in the form of a contract. It includes rights from contracts or other legal rights.

Consolidated financial statements are the financial statements of an economic entity in which assets, liabilities, net assets/equity, revenue, expenses and cash flows of the controlling entity and its controlled entities are presented as those of a single economic entity.

The **equity method** is a method of accounting whereby the investment is initially recognized at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets/equity of the associate or joint venture. The investor's surplus or deficit includes its share of the investee's surplus or deficit and the investor's net assets/equity includes its share of changes in the investee's net assets/equity that have not been recognized in the investee's surplus or deficit.

A **joint arrangement** is an arrangement of which two or more parties have joint control.

Joint control is the agreed sharing of control of an arrangement by way of a binding arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

A **joint venture** is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

A **joint venturer** is a party to a joint venture that has joint control of that joint venture.

Significant influence is the power to participate in the financial and operating policy decisions of another entity but is not control or joint control of those policies.

Terms defined in other MPSASs are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately. The following terms are defined in either MPSAS 34, *Separate Financial Statements*, MPSAS 35, *Consolidated Financial Statements*, or MPSAS 37, *Joint Arrangements*: benefits, control, controlled entity, controlling entity, economic entity, investment entity, joint operation, power and separate financial statements.

Binding Arrangement

9. Binding arrangements can be evidenced in several ways. A binding arrangement is often, but not always, in writing, in the form of a contract or documented discussions between the parties. Statutory mechanisms such as legislative or executive authority can also create enforceable arrangements, similar to contractual arrangements, either on their own, or in conjunction with contracts between the parties.

Significant Influence

10. Whether an investor has significant influence over the investee is a matter of judgment based on the nature of the relationship between the investor and the investee, and on the definition of

significant influence in this Standard. This Standard applies only to those associates in which an entity holds a quantifiable ownership interest either in the form of a shareholding or other formal equity structure or in another form in which the entity's interest can be measured reliably.

11. If an entity holds a quantifiable ownership interest and it holds, directly or indirectly (e.g., through controlled entities), 20 per cent or more of the voting power of the investee, it is presumed that the entity has significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the entity holds, directly or indirectly (e.g., through controlled entities), less than 20 per cent of the voting power of the investee, it is presumed that the entity does not have significant influence, unless such influence can be clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an entity from having significant influence.
12. The existence of significant influence by an entity is usually evidenced in one or more of the following ways:
 - (a) Representation on the board of directors or equivalent governing body of the investee;
 - (b) Participation in policy-making processes, including participation in decisions about dividends or similar distributions;
 - (c) Material transactions between the entity and its investee;
 - (d) Interchange of managerial personnel; or
 - (e) Provision of essential technical information.
13. An entity may own share warrants, share call options, debt or equity instruments that are convertible into ordinary shares, or other similar instruments that have the potential, if exercised or converted, to give the entity additional voting power or to reduce another party's voting power over the financial and operating policies of another entity (i.e., potential voting rights). The existence and effect of potential voting rights that are currently exercisable or convertible, including potential voting rights held by other entities, are considered when assessing whether an entity has significant influence. Potential voting rights are not currently exercisable or convertible when, for example, they cannot be exercised or converted until a future date or until the occurrence of a future event.
14. In assessing whether potential voting rights contribute to significant influence, the entity examines all facts and circumstances (including the terms of exercise of the potential voting rights and any other binding arrangements whether considered individually or in combination) that affect potential rights, except the intentions of management and the financial ability to exercise or convert those potential rights.
15. An entity loses significant influence over an investee when it loses the power to participate in the financial and operating policy decisions of that investee. The loss of significant influence can occur with or without a change in absolute or relative ownership levels. It could occur, for example, when an associate becomes subject to the control of another government, a court or an administrator. It could also occur as a result of a binding arrangement.

Equity Method

16. Under the equity method, on initial recognition the investment in an associate or a joint venture is recognized at cost and the carrying amount is increased or decreased to recognize the investor's share of the surplus or deficit of the investee after the date of acquisition. The investor's share of the investee's surplus or deficit is recognized in the investor's surplus or deficit. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's equity that have not been recognized in the investee's surplus or deficit. Such changes include those arising from the revaluation of property, plant and equipment and from foreign exchange translation differences. The investor's share of those changes is recognized in net assets/equity of the investor.
17. The recognition of revenue on the basis of distributions received may not be an adequate measure of the revenue earned by an investor on an investment in an associate or a joint venture because the distributions received may bear little relation to the performance of the associate or joint venture. Because the investor has joint control of, or significant influence over, the investee, the investor has an interest in the associate's or joint venture's performance and, as a result, the return on its investment. The investor accounts for this interest by extending the scope of its financial statements to include its share of the surplus or deficit of such an investee. As a result, application of the equity method provides more informative reporting of the investor's net assets/equity and surplus or deficit.
18. When potential voting rights or other derivatives containing potential voting rights exist, an entity's interest in an associate or a joint venture is determined solely on the basis of existing ownership interests and does not reflect the possible exercise or conversion of potential voting rights and other derivative instruments, unless paragraph 19 applies.
19. In some circumstances, an entity has, in substance, an existing ownership interest as a result of a transaction that currently gives it access to the benefits associated with an ownership interest. In such circumstances, the proportion allocated to the entity is determined by taking into account the eventual exercise of those potential voting rights and other derivative instruments that currently give the entity access to the benefits.
20. MPSAS 29, *Financial Instruments: Recognition and Measurement*, does not apply to interests in associates and joint ventures that are accounted for using the equity method. When instruments containing potential voting rights in substance currently give access to the benefits associated with an ownership interest in an associate or a joint venture, the instruments are not subject to MPSAS 29, *Financial Instruments: Recognition and Measurement*. In all other cases, instruments containing potential voting rights in an associate or a joint venture are accounted for in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*.
21. **An investment in an associate or a joint venture accounted for using the equity method shall be classified as a non-current asset.**

Application of the Equity Method

22. **An entity with joint control of, or significant influence over, an investee shall account for its investment in an associate or a joint venture using the equity method except when that investment qualifies for exemption in accordance with paragraphs 23–25.**

Exemptions from Applying the Equity Method

23. An entity need not apply the equity method to its investment in an associate or a joint venture if the entity is a controlling entity that is exempt from preparing consolidated financial statements by the scope exception in paragraph 5 of MPSAS 35, *Consolidated Financial Statements*, or if all of the following apply:
- (a) The entity itself is a controlled entity and the information needs of users are met by its controlling entity's consolidated financial statements, and, in the case of a partially owned entity, all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the entity not applying the equity method.
 - (b) The entity's debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets).
 - (c) The entity did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organization, for the purpose of issuing any class of instruments in a public market.
 - (d) The ultimate or any intermediate controlling entity of the entity produces financial statements available for public use that comply with MPSASs, in which controlled entities are consolidated or are measured at fair value in accordance with MPSAS 35, *Consolidated Financial Statements*.
24. When an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organization, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure investments in those associates and joint ventures at fair value through surplus or deficit in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*. An investment entity will, by definition, have made this election.
25. When an entity has an investment in an associate, a portion of which is held indirectly through a venture capital organization, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure that portion of the investment in the associate at fair value through surplus or deficit in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, regardless of whether the venture capital organization, or the mutual fund, unit trust and similar entities including investment-linked insurance funds, has significant influence over that portion of the investment. If the entity makes that election, the entity shall apply the equity method to any remaining portion of its investment in an associate that is not held through a venture capital organization, or a mutual fund, unit trust and similar entities including investment-linked insurance funds. When an entity has an investment in an associate, a portion of which is held indirectly through an investment

entity, the entity shall measure that portion of the investment at fair value through surplus or deficit in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*.

Discontinuing the Use of the Equity Method

26. **An entity shall discontinue the use of the equity method from the date when its investment ceases to be an associate or a joint venture as follows:**
- (a) **If the investment becomes a controlled entity, the entity shall account for its investment in accordance with MPSAS 40, *Public Sector Combinations*, and MPSAS 35, *Consolidated Financial Statements*.**
 - (b) **If the retained interest in the former associate or joint venture is a financial asset, the entity shall measure the retained interest at fair value. The fair value of the retained interest shall be regarded as its fair value on initial recognition as a financial asset in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*. If an entity is precluded by MPSAS 29, *Financial Instruments: Recognition and Measurement*, paragraphs AG113 and AG114 from measuring the retained interest at fair value, the entity shall measure the retained interest at the carrying amount of the investment at the date that it ceases to be an associate or joint venture and that carrying amount shall be regarded as its cost on initial recognition as a financial asset in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*. The entity shall recognize in surplus or deficit any difference between:**
 - (i) **The fair value (or, where relevant, the carrying amount) of any retained interest and any proceeds from disposing of a part interest in the associate or joint venture; and**
 - (ii) **The carrying amount of the investment at the date the equity method was discontinued.**
 - (c) **When an entity discontinues the use of the equity method, the entity shall account for all amounts previously recognized directly in the entity's net assets/equity in relation to that investment on the same basis as would have been required if the investee had directly disposed of the related assets or liabilities.**
27. **If an investment in an associate becomes an investment in a joint venture or an investment in a joint venture becomes an investment in an associate, the entity continues to apply the equity method and does not remeasure the retained interest.**

Changes in Ownership Interest

28. **If an entity's ownership interest in an associate or a joint venture is reduced, but the investment continues to be classified either as an associate or a joint venture respectively, the entity shall transfer directly to accumulated surpluses or deficits the proportion of the gain or loss that had previously been recognized in net assets/equity relating to that reduction in ownership interest if that gain or loss would be required to be transferred directly to accumulated surpluses or deficits on the disposal of the related assets or liabilities.**

Equity Method Procedures

29. Many of the procedures that are appropriate for the application of the equity method are similar to the consolidation procedures described in MPSAS 35, *Consolidated Financial Statements*. Furthermore, the concepts underlying the procedures used in accounting for the acquisition of a controlled entity are also adopted in accounting for the acquisition of an investment in an associate or a joint venture.
30. An economic entity's share in an associate or a joint venture is the aggregate of the holdings in that associate or joint venture by the controlling entity and its controlled entities. The holdings of the economic entity's other associates or joint ventures are ignored for this purpose. When an associate or a joint venture has controlled entities, associates or joint ventures, the surplus or deficit and net assets taken into account in applying the equity method are those recognized in the associate's or joint venture's financial statements (including the associate's or joint venture's share of the surpluses or deficits and net assets of its associates and joint ventures), after any adjustments necessary to give effect to uniform accounting policies (see paragraphs 37–39).
31. Gains and losses resulting from “upstream” and “downstream” transactions involving assets that do not constitute an operation, as defined in MPSAS 40, *Public Sector Combinations*, between an entity (including its consolidated controlled entities) and its associate or joint venture are recognized in the entity's financial statements only to the extent of unrelated investors' interests in the associate or joint venture. “Upstream” transactions are, for example, sales of assets from an associate or a joint venture to the investor. The entity's share in the associate's or the joint venture's gains or losses resulting from these transactions is eliminated. “Downstream” transactions are, for example, sales or contributions of assets from the investor to its associate or its joint venture.
32. When downstream transactions provide evidence of a reduction in the net realizable value of the assets to be sold or contributed, or of an impairment loss of those assets, those losses shall be recognized in full by the investor. When upstream transactions provide evidence of a reduction in the net realizable value of the assets to be purchased or of an impairment loss of those assets, the investor shall recognize its share in those losses.
33. The gain or loss resulting from the contribution of a non-monetary asset that do not constitute an operation, as defined in MPSAS 40, *Public Sector Combinations*, to an associate or a joint venture in exchange for an equity interest in that associate or joint venture shall be accounted for in accordance with paragraph 31, except when the contribution lacks commercial substance, as that term is described in MPSAS 17, *Property, Plant and Equipment*. If such a contribution lacks commercial substance, the gain or loss is regarded as unrealized and is not recognized unless paragraph 34 also applies. Such unrealized gains and losses shall be eliminated against the investment accounted for using the equity method and shall not be presented as deferred gains or losses in the entity's consolidated statement of financial position or in the entity's statement of financial position in which investments are accounted for using the equity method.
34. If, in addition to receiving an equity interest in an associate or a joint venture, an entity receives monetary or non-monetary assets, the entity recognizes in full in surplus or deficit the portion of the gain or loss on the contribution relating to the monetary or non-monetary assets received.

- 34A. The gain or loss resulting from a downstream transaction involving assets that constitute an operation, as defined in MPSAS 40, *Public Sector Combinations*, between an entity (including its consolidated controlled entities) and its associate or joint venture is recognized in full in the investor's financial statements.
- 34B. An entity might sell or contribute assets in two or more arrangements (transactions). When determining whether assets that are sold or contributed constitute an operation, as defined in MPSAS 40, *Public Sector Combinations*, an entity shall consider whether the sale or contribution of those assets is part of multiple arrangements that should be accounted for as a single transaction in accordance with the requirements in paragraph 53 of MPSAS 35, *Consolidated Financial Statements*.
35. An investment is accounted for using the equity method from the date on which it becomes an associate or a joint venture. On acquisition of the investment, any difference between the cost of the investment and the entity's share of the net fair value of the investee's identifiable assets and liabilities is accounted for as follows:
- (a) When an entity has included goodwill relating to an associate or a joint venture in the carrying amount of the investment, amortization of that goodwill is not permitted.
 - (b) Any excess of the entity's share of the net fair value of the investee's identifiable assets and liabilities over the cost of the investment is included as revenue in the determination of the entity's share of the associate or joint venture's surplus or deficit in the period in which the investment is acquired.

Appropriate adjustments to the entity's share of the associate's or joint venture's surplus or deficit after acquisition are made in order to account, for example, for depreciation of the depreciable assets based on their fair values at the acquisition date. Similarly, appropriate adjustments to the entity's share of the associate's or joint venture's surplus or deficit after acquisition are made for impairment losses such as for property, plant and equipment or, where relevant, goodwill.

36. **The most recent available financial statements of the associate or joint venture are used by the entity in applying the equity method. When the end of the reporting period of the entity is different from that of an associate or a joint venture the entity either:**
- (a) **Obtains, for the purpose of applying the equity method, additional financial information as of the same date as the financial statements of the entity; or**
 - (b) **Uses the most recent financial statements of the associate or joint venture adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the entity's financial statements.**
37. **The entity's financial statements shall be prepared using uniform accounting policies for like transactions and events in similar circumstances.**
38. Except as described in paragraph 39, if an associate or a joint venture uses accounting policies other than those of the entity for like transactions and events in similar circumstances, adjustments shall be made to make the associate's or joint venture's accounting policies conform

to those of the entity when the associate's or joint venture's financial statements are used by the entity in applying the equity method.

39. **Notwithstanding the requirements in paragraph 38, if an entity has an interest in an associate or a joint venture that is an investment entity, the entity shall, when applying the equity method, retain the fair value measurement applied by that investment entity associate or joint venture to its interest in controlled entities.**
40. If an associate or a joint venture has outstanding cumulative preference shares that are held by parties other than the entity and are classified as equity, the entity computes its share of surplus or deficit after adjusting for the dividends on such shares, whether or not the dividends have been declared.
41. If an entity's share of the deficit of an associate or a joint venture equals or exceeds its interest in the associate or joint venture, the entity discontinues recognizing its share of further deficits. The interest in an associate or a joint venture is the carrying amount of the investment in the associate or joint venture determined using the equity method together with any long-term interests that, in substance, form part of the entity's net investment in the associate or joint venture. For example, an item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, an extension of the entity's investment in that associate or joint venture. Such items may include preference shares and long-term receivables or loans, but do not include trade receivables, trade payables or any long-term receivables for which adequate collateral exists, such as secured loans. Deficits recognized using the equity method in excess of the entity's investment in ordinary shares are applied to the other components of the entity's interest in an associate or a joint venture in the reverse order of their seniority (i.e. priority in liquidation).
42. After the entity's interest is reduced to zero, additional deficits are provided for, and a liability is recognized, only to the extent that the entity has incurred legal or constructive obligations or made payments on behalf of the associate or joint venture. If the associate or joint venture subsequently reports surpluses, the entity resumes recognizing its share of those surpluses only after its share of the surpluses equals the share of deficits not recognized.

Impairment Losses

43. After application of the equity method, including recognizing the associate's or joint venture's deficits in accordance with paragraph 41, the entity applies MPSAS 29, *Financial Instruments: Recognition and Measurement*, to determine whether it is necessary to recognize any additional impairment loss with respect to its net investment in the associate or joint venture.
44. The entity also applies MPSAS 29, *Financial Instruments: Recognition and Measurement*, to determine whether any additional impairment loss is recognized with respect to its interest in the associate or joint venture that does not constitute part of the net investment and the amount of that impairment loss.
45. Whenever application of MPSAS 29, *Financial Instruments: Recognition and Measurement*, indicates that the investment in an associate or a joint venture may be impaired, an entity applies MPSAS 26, *Impairment of Cash-Generating Assets*, and possibly, MPSAS 21, *Impairment of Non-Cash-Generating Assets*.

46. MPSAS 26, *Impairment of Cash-Generating Assets*, directs an entity to determine the value in use of the cash-generating investment. In determining the value in use of the cash-generating investment in accordance with MPSAS 26, *Impairment of Cash-Generating Assets*, an entity estimates:
- (a) Its share of the present value of the estimated future cash flows expected to be generated by the associate or joint venture, including the cash flows from the operations of the associate or joint venture and the proceeds from the ultimate disposal of the investment; or
 - (b) The present value of the estimated future cash flows expected to arise from dividends or similar distributions to be received from the investment, and from its ultimate disposal.

Using appropriate assumptions, both methods give the same result.

47. MPSAS 21, *Impairment of Non-Cash-Generating Assets*, requires that, if the recoverable service amount of an asset is less than its carrying amount, the carrying amount shall be reduced to its recoverable service amount. Recoverable service amount is the higher of an asset's fair value, less costs to sell and its value in use. Value in use of a non-cash-generating asset is defined as the present value of the asset's remaining service potential. The present value of the remaining service potential may be assessed using the depreciated replacement cost approach, the restoration cost approach or the service units approach, as appropriate.
48. **The recoverable amount of an investment in an associate or a joint venture shall be assessed for each associate or joint venture, unless the associate or joint venture does not generate cash inflows from continuing use that are largely independent of those from other assets of the entity.**

Separate Financial Statements

49. **An investment in an associate or a joint venture shall be accounted for in the entity's separate financial statements in accordance with paragraph 12 of MPSAS 34, *Separate Financial Statements*.**

Transitional Provisions

50. The transitional provisions for changing from proportionate consolidation to the equity method, or from the equity method to accounting for assets and liabilities in respect of a joint operation are set out in MPSAS 37, *Joint Arrangements*.

Effective Date

51. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2017, it shall disclose that fact and apply MPSAS 34, *Separate Financial Statements*, MPSAS 35, *Consolidated Financial Statements*, MPSAS 37, *Joint Arrangements*, and MPSAS 38, *Disclosure of Interests in Other Entities*, at the same time.**

- 51A. Paragraph 26 was amended by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2023 it shall disclose that fact and apply MPSAS 40, *Public Sector Combinations*, at the same time.
- 51B. Paragraphs 31 and 33 were amended and paragraphs 34A and 34B added by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply these amendments prospectively for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is permitted. If an entity applies the amendments for a period earlier, it shall disclose that fact and, if it has not already done so, apply MPSAS 40, *Public Sector Combinations*, at the same time.
- 51C. Paragraphs 6 and 7 were deleted by *Improvements to MPSASs 2023, (The Applicability of MPSASs)*, issued in December 2022. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2024. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2024, it shall disclose that fact.
52. When an entity adopts the accrual basis MPSASs as defined in MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of MPSASs.

Withdrawal and Replacement of MPSAS 7

53. This Standard supersedes MPSAS 7, *Investment in Associates*. MPSAS 7, *Investment in Associates*, remains applicable until MPSAS 36, *Investments in Associates and Joint Ventures*, is applied or becomes effective, whichever is earlier.

Comparison with IPSAS 36

MPSAS 36, *Investments in Associates and Joint Ventures*, is drawn primarily from IPSAS 36 (2018). There is no significant difference between MPSAS 36 and IPSAS 36.

MPSAS 37 - JOINT ARRANGEMENTS

Acknowledgement

The Malaysian Public Sector Accounting Standard (MPSAS) 37 is based on International Public Sector Accounting Standard (IPSAS) 37, *Joint Arrangements*, from the *Handbook of International Public Sector Accounting Pronouncements* of the International Public Sector Accounting Standards Board, published by the International Federation of Accountants (IFAC) in 2018 and is used with permission of IFAC.

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MPSAS 37 - JOINT ARRANGEMENTS

History of MPSAS

This version includes amendments resulting from MPSASs issued up to December 2022.

MPSAS 37, *Joint Arrangements* was issued in August 2016.

Since the first issuance, MPSAS 37 has been amended by the following MPSASs:

- *Improvements to MPSASs 2023* (issued December 2022)
- MPSAS 40, *Public Sector Combinations* (issued October 2021)

Table of Amended Paragraphs in MPSAS 37

Paragraph Affected	How Affected	Affected By
5	Deleted	Improvements to MPSASs 2023 December 2022
6	Deleted	Improvements to MPSASs 2023 December 2022
24A	New	MPSAS 40 October 2021
32	Amended	MPSAS 40 October 2021
41A	New	MPSAS 40 October 2021
42A	New	MPSAS 40 October 2021
42B	New	MPSAS 40 October 2021
42C	New	Improvements to MPSASs 2023 December 2022
AG33A	New	MPSAS 40 October 2021
AG33B	New	MPSAS 40 October 2021
AG33C	New	MPSAS 40 October 2021
AG33D	New	MPSAS 40 October 2021
IE60 - IE80	New	MPSAS 40 October 2021

MPSAS 37- JOINT ARRANGEMENTS

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Malaysian Public Sector Accounting Standard (MPSAS) 37, *Joint Arrangements*, is set out in paragraphs 1–44. All the paragraphs have equal authority. MPSAS 37, *Joint Arrangements*, should be read in the context of its objective and the Preface to Malaysian Public Sector Accounting Standards. MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to establish principles for financial reporting by entities that have an interest in arrangements that are controlled jointly (i.e., joint arrangements).
2. To meet the objective in paragraph 1, this Standard defines joint control and requires an entity that is a party to a joint arrangement to determine the type of joint arrangement in which it is involved by assessing its rights and obligations and to account for those rights and obligations in accordance with that type of joint arrangement.

Scope

3. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in determining the type of joint arrangement in which it is involved and in accounting for the rights and obligations of the joint arrangement.**
4. **This Standard shall be applied by all entities that are a party to a joint arrangement.**
5. [Deleted]
6. [Deleted]

Definitions

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

Binding arrangement: For the purposes of this Standard, a binding arrangement is an arrangement that confers enforceable rights and obligations on the parties to it as if it were in the form of a contract. It includes rights from contracts or other legal rights.

A joint arrangement is an arrangement of which two or more parties have joint control.

Joint control is the agreed sharing of control of an arrangement by way of a binding arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement.

A joint operator is a party to a joint operation that has joint control of that joint operation.

A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

A joint venturer is a party to a joint venture that has joint control of that joint venture.

A party to a joint arrangement is an entity that participates in a joint arrangement, regardless of whether that entity has joint control of the arrangement.

A **separate vehicle** is a separately identifiable financial structure, including separate legal entities or entities recognized by statute, regardless of whether those entities have a legal personality.

Terms defined in other MPSASs 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 MPSAS 34, *Separate Financial Statements*, MPSAS 35, *Consolidated Financial Statements*, or MPSAS 36, *Investments in Associates and Joint Ventures*: benefits, control, equity method, power, protective rights, relevant activities, separate financial statements and significant influence.

Binding Arrangement

8. Binding arrangements can be evidenced in several ways. A binding arrangement is often, but not always, in writing, in the form of a contract or documented discussions between the parties. Statutory mechanisms such as legislative or executive authority can also create enforceable arrangements, similar to contractual arrangements, either on their own, or in conjunction with contracts between the parties.

Joint Arrangements (see paragraphs AG2–AG33)

9. A joint arrangement is an arrangement of which two or more parties have joint control.
10. A joint arrangement has the following characteristics:
 - (a) The parties are bound by a binding arrangement (see paragraphs AG2–AG4).
 - (b) The binding arrangement gives two or more of those parties joint control of the arrangement (see paragraphs 12–18).
11. A joint arrangement is either a joint operation or a joint venture.

Joint Control

12. Joint control is the sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control. The sharing of control may have been agreed by way of a binding arrangement.
13. An entity that is a party to an arrangement shall assess whether the binding arrangement gives all the parties, or a group of the parties, control of the arrangement collectively. All the parties, or a group of the parties, control the arrangement collectively when they must act together to direct the activities that significantly affect the benefits from the arrangement (i.e., the relevant activities).
14. Once it has been determined that all the parties, or a group of the parties, control the arrangement collectively, joint control exists only when decisions about the relevant activities require the unanimous consent of the parties that control the arrangement collectively.
15. In a joint arrangement, no single party controls the arrangement on its own. A party with joint control of an arrangement can prevent any of the other parties, or a group of the parties, from controlling the arrangement.

16. An arrangement can be a joint arrangement even though not all of its parties have joint control of the arrangement. This Standard distinguishes between parties that have joint control of a joint arrangement (joint operators or joint venturers) and parties that participate in, but do not have joint control of, a joint arrangement.
17. **An entity will need to apply judgment when assessing whether all the parties, or a group of the parties, have joint control of an arrangement. An entity shall make this assessment by considering all facts and circumstances (see paragraphs AG5–AG11).**
18. **If facts and circumstances change, an entity shall reassess whether it still has joint control of the arrangement.**

Types of Joint Arrangement

19. **An entity shall determine the type of joint arrangement in which it is involved. The classification of a joint arrangement as a joint operation or a joint venture depends upon the rights and obligations of the parties to the arrangement.**
20. **An entity applies judgment when assessing whether a joint arrangement is a joint operation or a joint venture. An entity shall determine the type of joint arrangement in which it is involved by considering its rights and obligations arising from the arrangement. An entity assesses its rights and obligations by considering the structure and legal form of the arrangement, the terms agreed by the parties or established by legislative or executive authority and, when relevant, other facts and circumstances (see paragraphs AG12–AG33).**
21. Sometimes the parties are bound by a framework agreement that sets up the general terms for undertaking one or more activities. The framework agreement might set out that the parties establish different joint arrangements to deal with specific activities that form part of the agreement. Even though those joint arrangements are related to the same framework agreement, their type might be different if the parties' rights and obligations differ when undertaking the different activities dealt with in the framework agreement. Consequently, joint operations and joint ventures can coexist when the parties undertake different activities that form part of the same framework agreement.
22. **If facts and circumstances change, an entity shall reassess whether the type of joint arrangement in which it is involved has changed.**

Financial Statements of Parties to a Joint Arrangement (see paragraphs AG34–AG37)

Joint Operations

23. **A joint operator shall recognize in relation to its interest in a joint operation:**
 - (a) **Its assets, including its share of any assets held jointly;**
 - (b) **Its liabilities, including its share of any liabilities incurred jointly;**
 - (c) **Its revenue from the sale of its share of the output arising from the joint operation;**

- (d) Its share of the revenue from the sale of the output by the joint operation; and
 - (e) Its expenses, including its share of any expenses incurred jointly.
24. A joint operator shall account for the assets, liabilities, revenues and expenses relating to its interest in a joint operation in accordance with the MPSASs applicable to the particular assets, liabilities, revenues and expenses.
- 24A. When an entity acquires an interest in a joint operation in which the activity of the joint operation constitutes an operation, as defined in MPSAS 40, *Public Sector Combinations*, it shall apply, to the extent of its share in accordance with paragraph 23, all of the principles on acquisition accounting in MPSAS 40, *Public Sector Combinations*, and other MPSASs, that do not conflict with the guidance in this Standard, and disclose the information that is required in those MPSASs in relation to acquisitions. 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. The accounting for the acquisition of an interest in such a joint operation is specified in paragraphs AG33A–AG33D.
25. The accounting for transactions such as the sale, contribution or purchase of assets between an entity and a joint operation in which it is a joint operator is specified in paragraphs AG34–AG37.
26. A party that participates in, but does not have joint control of, a joint operation shall also account for its interest in the arrangement in accordance with paragraphs 23–25 if that party has rights to the assets, and obligations for the liabilities, relating to the joint operation. If a party that participates in, but does not have joint control of, a joint operation does not have rights to the assets, and obligations for the liabilities, relating to that joint operation, it shall account for its interest in the joint operation in accordance with the MPSASs applicable to that interest.

Joint Ventures

27. A joint venturer shall recognize its interest in a joint venture as an investment and shall account for that investment using the equity method in accordance with MPSAS 36, *Investments in Associates and Joint Ventures*, unless the entity is exempted from applying the equity method as specified in that Standard.
28. A party that participates in, but does not have joint control of, a joint venture shall account for its interest in the arrangement in accordance with the MPSASs dealing with financial instruments, being MPSAS 28, *Financial Instruments: Presentation*, MPSAS 29, *Financial Instruments: Recognition and Measurement*, and MPSAS 30, *Financial Instruments: Disclosures*, unless it has significant influence over the joint venture, in which case it shall account for it in accordance with MPSAS 36, *Investments in Associates and Joint Ventures*.

Separate Financial Statements

29. In its separate financial statements, a joint operator or joint venturer shall account for its interest in:
- (a) A joint operation in accordance with paragraphs 23–25; and

- (b) A joint venture in accordance with paragraph 12 of MPSAS 34, *Separate Financial Statements*.
30. In its separate financial statements, a party that participates in, but does not have joint control of, a joint arrangement shall account for its interest in:
- (a) A joint operation in accordance with paragraph 26; and
 - (b) A joint venture in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, unless the entity has significant influence over the joint venture, in which case it shall apply paragraph 12 of MPSAS 34, *Separate Financial Statements*.

Transitional Provisions

31. Notwithstanding the requirements of paragraph 33 of MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, when this Standard is first applied, an entity need only present the quantitative information required by paragraph 33(f) of MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, for the annual period immediately preceding the first annual period for which this Standard is applied (the ‘immediately preceding period’). An entity may also present this information for the current period or for earlier comparative periods, but is not required to do so.

Joint Ventures - Transition from Proportionate Consolidation to the Equity Method

32. When changing from proportionate consolidation to the equity method, an entity shall recognize its investment in the joint venture as at the beginning of the immediately preceding period. That initial investment shall be measured as the aggregate of the carrying amounts of the assets and liabilities that the entity had previously proportionately consolidated, including any purchased goodwill arising from acquisition transactions. If the goodwill previously belonged to a larger cash-generating unit, or to a group of cash-generating units, the entity shall allocate goodwill to the joint venture on the basis of the relative carrying amounts of the joint venture and the cash-generating unit or group of cash-generating units to which it belonged.
33. The opening balance of the investment determined in accordance with paragraph 32 is regarded as the deemed cost of the investment at initial recognition. An entity shall apply paragraphs 43-48 of MPSAS 36, *Investments in Associates and Joint Ventures*, to the opening balance of the investment to assess whether the investment is impaired and shall recognize any impairment loss as an adjustment to accumulated surplus or deficit at the beginning of the immediately preceding period.
34. If aggregating all previously proportionately consolidated assets and liabilities results in negative net assets, an entity shall assess whether it has legal or constructive obligations in relation to the negative net assets and, if so, the entity shall recognize the corresponding liability. If the entity concludes that it does not have legal or constructive obligations in relation to the negative net assets, it shall not recognize the corresponding liability but it shall adjust accumulated surplus or deficit at the beginning of the immediately preceding period. The entity shall disclose this fact, along with its cumulative unrecognized share of

losses of its joint ventures as at the beginning of the immediately preceding period and at the date at which this Standard is first applied.

35. An entity shall disclose a breakdown of the assets and liabilities that have been aggregated into the single line investment balance as at the beginning of the immediately preceding period. That disclosure shall be prepared in an aggregated manner for all joint ventures for which an entity applies the transition requirements referred to in paragraphs 32–36.
36. After initial recognition, an entity shall account for its investment in the joint venture using the equity method in accordance with MPSAS 36, *Investments in Associates and Joint Ventures*.

Joint Operations - Transition from the Equity Method to Accounting for Assets and Liabilities

37. When changing from the equity method to accounting for assets and liabilities in respect of its interest in a joint operation, an entity shall, at the beginning of the immediately preceding period, derecognize the investment that was previously accounted for using the equity method and any other items that formed part of the entity's net investment in the arrangement in accordance with paragraph 41 of MPSAS 36, *Investments in Associates and Joint Ventures*, and recognize its share of each of the assets and the liabilities in respect of its interest in the joint operation, including any goodwill that might have formed part of the carrying amount of the investment.
38. An entity shall determine its interest in the assets and liabilities relating to the joint operation on the basis of its rights and obligations in a specified proportion in accordance with the binding arrangement. An entity measures the initial carrying amounts of the assets and liabilities by disaggregating them from the carrying amount of the investment at the beginning of the immediately preceding period on the basis of the information used by the entity in applying the equity method.
39. Any difference arising from the investment previously accounted for using the equity method together with any other items that formed part of the entity's net investment in the arrangement in accordance with paragraph 41 of MPSAS 36, *Investments in Associates and Joint Ventures*, and the net amount of the assets and liabilities, including any goodwill, recognized shall be:
 - (a) Offset against any goodwill relating to the investment with any remaining difference adjusted against accumulated surplus or deficit at the beginning of the immediately preceding period, if the net amount of the assets and liabilities, including any goodwill, recognized is higher than the investment (and any other items that formed part of the entity's net investment) derecognized.
 - (b) Adjusted against accumulated surplus or deficit at the beginning of the immediately preceding period, if the net amount of the assets and liabilities, including any goodwill, recognized is lower than the investment (and any other items that formed part of the entity's net investment) derecognized.

40. An entity changing from the equity method to accounting for assets and liabilities shall provide a reconciliation between the investment derecognized, and the assets and liabilities recognized, together with any remaining difference adjusted against accumulated surplus or deficit, at the beginning of the immediately preceding period.

Transitional Provisions in an Entity's Separate Financial Statements

41. An entity that, in accordance with paragraph 58 of MPSAS 6, *Consolidated and Separate Financial Statements*, was previously accounting in its separate financial statements for its interest in a joint operation as an investment using the equity method, at cost or in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, shall:
- (a) Derecognize the investment and recognize the assets and the liabilities in respect of its interest in the joint operation at the amounts determined in accordance with paragraphs 37-39.
 - (b) Provide a reconciliation between the investment derecognized, and the assets and liabilities recognized, together with any remaining difference adjusted in accumulated surplus or deficit, at the beginning of the immediately preceding period.

Accounting for acquisitions of interests in joint operations

- 41A. MPSAS 40, *Public Sector Combinations*, issued in October 2021, added paragraphs 24A, 42B, and AG33A–AG33D. An entity shall apply those amendments prospectively for acquisitions of interests in joint operations in which the activities of the joint operations constitute operations, as defined in MPSAS 40, *Public Sector Combinations*, for those acquisitions occurring from the beginning of the first period in which it applies those amendments. Consequently, amounts recognized for acquisitions of interests in joint operations occurring in prior periods shall not be adjusted.

Effective Date

42. An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2017, it shall disclose that fact and apply MPSAS 34, *Separate Financial Statements*, MPSAS 35, *Consolidated Financial Statements*, MPSAS 36, *Investments in Associates and Joint Ventures*, and MPSAS 38, *Disclosure of Interests in Other Entities*, at the same time.
- 42A. Paragraphs 24A, 41A and AG33A–AG33D were added by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply these amendments prospectively for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2023 it shall disclose that fact and apply MPSAS 40, *Public Sector Combinations*, at the same time.

- 42B. Paragraph 32 was amended by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2023 it shall disclose that fact and apply MPSAS 40, *Public Sector Combinations*, at the same time.
- 42C. Paragraphs 5 and 6 were deleted by *Improvements to MPSASs 2023 (The Applicability of MPSASs)*, issued in December 2022. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2024. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2024, it shall disclose that fact.
43. When an entity adopts the accrual basis MPSASs as defined in MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of MPSASs.

Withdrawal and Replacement of MPSAS 8

44. This Standard supersedes MPSAS 8, *Interests in Joint Ventures*. MPSAS 8, *Interests in Joint Ventures*, remains applicable until MPSAS 37, *Joint Arrangements*, is applied or becomes effective, whichever is earlier.

Appendix A

Application Guidance

This Appendix is an integral part of MPSAS 37, Joint Arrangements.

- AG1. The examples in this appendix portray hypothetical situations. Although some aspects of the examples may be present in actual fact patterns, all relevant facts and circumstances of a particular fact pattern would need to be evaluated when applying MPSAS 37, *Joint Arrangements*.

Joint Arrangements

Binding Arrangement (paragraph 8)

- AG2. Consistent with the definition of binding arrangements in this Standard, this discussion of binding arrangements is also relevant to enforceable arrangements created by legislative or executive authority.
- AG3. When joint arrangements are structured through a separate vehicle (see paragraphs AG19–AG33), the binding arrangement, or some aspects of the binding arrangement, will in some cases be incorporated in the articles, charter or by-laws of the separate vehicle.
- AG4. The binding arrangement sets out the terms upon which the parties participate in the activity that is the subject of the arrangement. The binding arrangement generally deals with such matters as:
- (a) The purpose, activity and duration of the joint arrangement.
 - (b) How the members of the board of directors, or equivalent governing body, of the joint arrangement, are appointed.
 - (c) The decision-making process: the matters requiring decisions from the parties, the voting rights of the parties and the required level of support for those matters. The decision-making process reflected in the binding arrangement establishes joint control of the arrangement (see paragraphs AG5–AG11).
 - (d) The capital or other contributions required of the parties.
 - (e) How the parties share assets, liabilities, revenues, expenses or surplus or deficit relating to the joint arrangement.

Joint Control (paragraphs 12–18)

- AG5. In assessing whether an entity has joint control of an arrangement, an entity shall assess first whether all the parties, or a group of the parties, control the arrangement. MPSAS 35, *Consolidated Financial Statements*, defines control and shall be used to determine whether all the parties, or a group of the parties, are exposed, or have rights, to variable benefits from their involvement with the arrangement and have the ability to affect those benefits through their power over the arrangement. When all the parties, or a group of the parties, considered

collectively, are able to direct the activities that significantly affect the benefits from the arrangement (i.e., the relevant activities), the parties control the arrangement collectively.

- AG6. After concluding that all the parties, or a group of the parties, control the arrangement collectively, an entity shall assess whether it has joint control of the arrangement. Joint control exists only when decisions about the relevant activities require the unanimous consent of the parties that collectively control the arrangement. Assessing whether the arrangement is jointly controlled by all of its parties or by a group of the parties, or controlled by one of its parties alone, can require judgment.
- AG7. Sometimes the decision-making process that is agreed upon by the parties in their binding arrangement implicitly leads to joint control. For example, assume two parties establish an arrangement in which each has 50 per cent of the voting rights and the binding arrangement between them specifies that at least 51 per cent of the voting rights are required to make decisions about the relevant activities. In this case, the parties have implicitly agreed that they have joint control of the arrangement because decisions about the relevant activities cannot be made without both parties agreeing.
- AG8. In other circumstances, the binding arrangement requires a minimum proportion of the voting rights to make decisions about the relevant activities. When that minimum required proportion of the voting rights can be achieved by more than one combination of the parties agreeing together, that arrangement is not a joint arrangement unless the binding arrangement specifies which parties (or combination of parties) are required to agree unanimously to decisions about the relevant activities of the arrangement.

Application Examples

Example 1

Assume that three parties establish an arrangement: A has 50 per cent of the voting rights in the arrangement, B has 30 per cent and C has 20 per cent. The binding arrangement between A, B and C specifies that at least 75 per cent of the voting rights are required to make decisions about the relevant activities of the arrangement. Even though A can block any decision, it does not control the arrangement because it needs the agreement of B. The terms of their binding arrangement requiring at least 75 per cent of the voting rights to make decisions about the relevant activities imply that A and B have joint control of the arrangement because decisions about the relevant activities of the arrangement cannot be made without both A and B agreeing.

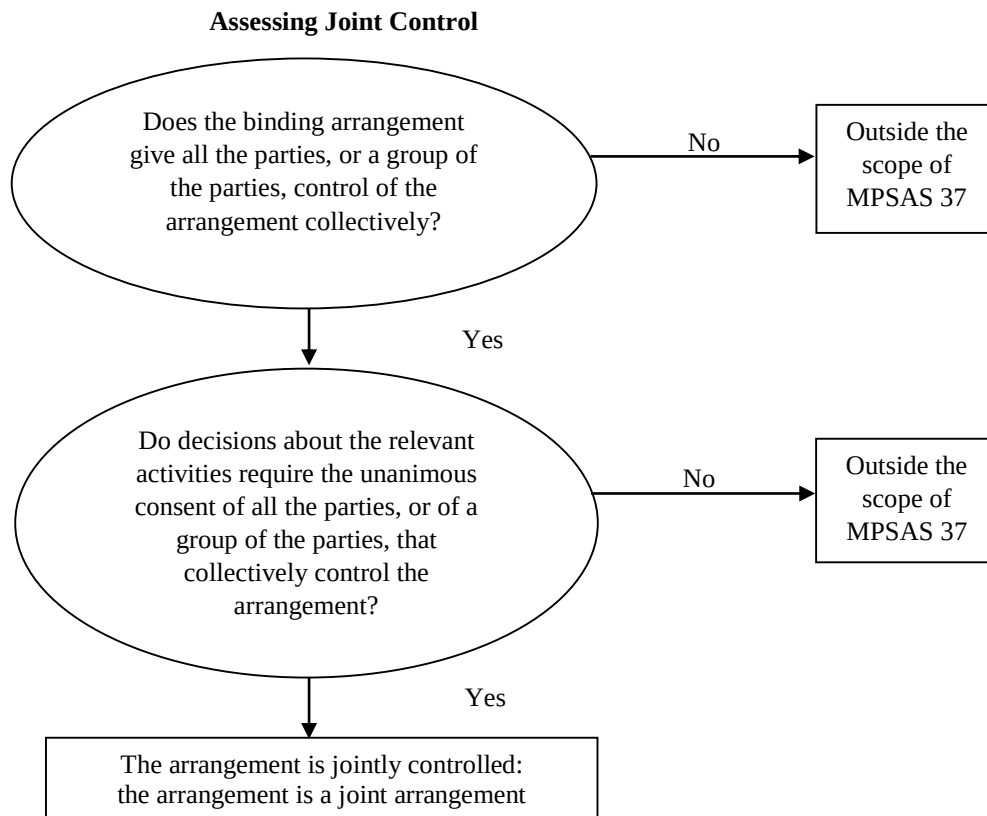
Example 2

Assume an arrangement has three parties: A has 50 per cent of the voting rights in the arrangement and B and C each have 25 per cent. The binding arrangement between A, B and C specifies that at least 75 per cent of the voting rights are required to make decisions about the relevant activities of the arrangement. Even though A can block any decision, it does not control the arrangement because it needs the agreement of either B or C. In this example, A, B and C collectively control the arrangement. However, there is more than one combination of parties that can agree to reach 75 per cent of the voting rights (i.e., either A and B or A and C). In such a situation, to be a joint arrangement the binding arrangement between the parties would need to specify which combination of the parties is required to agree unanimously to decisions about the relevant activities of the arrangement.

Example 3

Assume an arrangement in which A and B each have 35 per cent of the voting rights in the arrangement with the remaining 30 per cent being widely dispersed. Decisions about the relevant activities require approval by a majority of the voting rights. A and B have joint control of the arrangement only if the binding arrangement specifies that decisions about the relevant activities of the arrangement require both A and B agreeing.

- AG9. The requirement for unanimous consent means that any party with joint control of the arrangement can prevent any of the other parties, or a group of the parties, from making unilateral decisions (about the relevant activities) without its consent. If the requirement for unanimous consent relates only to decisions that give a party protective rights and not to decisions about the relevant activities of an arrangement, that party is not a party with joint control of the arrangement.
- AG10. A binding arrangement might include clauses on the resolution of disputes, such as arbitration. These provisions may allow for decisions to be made in the absence of unanimous consent among the parties that have joint control. The existence of such provisions does not prevent the arrangement from being jointly controlled and, consequently, from being a joint arrangement.



AG11. When an arrangement is outside the scope of MPSAS 37, *Joint Arrangements*, an entity accounts for its interest in the arrangement in accordance with relevant MPSASs, such as MPSAS 35, *Consolidated Financial Statements*, MPSAS 36, *Investments in Associates and Joint Ventures*, or MPSAS 29, *Financial Instruments: Recognition and Measurement*.

Types of Joint Arrangement (paragraphs 19–22)

AG12. Joint arrangements are established for a variety of purposes (e.g., as a way for parties to share costs and risks, or as a way to provide the parties with access to new technology or new markets), and can be established using different structures and legal forms.

AG13. Some arrangements do not require the activity that is the subject of the arrangement to be undertaken in a separate vehicle. However, other arrangements involve the establishment of a separate vehicle.

AG14. The classification of joint arrangements required by this Standard depends upon the parties' rights and obligations arising from the arrangement in the normal course of operations. This Standard classifies joint arrangements as either joint operations or joint ventures. When an entity has rights to the assets, and obligations for the liabilities, relating to the arrangement, the arrangement is a joint operation. When an entity has rights to the net assets of the arrangement, the arrangement is a joint venture. Paragraphs AG16–AG33 set out the assessment an entity carries out to determine whether it has an interest in a joint operation or an interest in a joint venture.

Classification of a Joint Arrangement

AG15. As stated in paragraph AG14, the classification of joint arrangements requires the parties to assess their rights and obligations arising from the arrangement. When making that assessment, an entity shall consider the following:

- (a) The structure of the joint arrangement (see paragraphs AG16–AG21).
- (b) When the joint arrangement is structured through a separate vehicle:
 - (i) The legal form of the separate vehicle (see paragraphs AG22–AG24);
 - (ii) The terms of the binding arrangement (see paragraphs AG25–AG28); and
 - (iii) When relevant, other facts and circumstances (see paragraphs AG29–AG33).

Structure of the Joint Arrangement

Joint Arrangements not Structured Through a Separate Vehicle

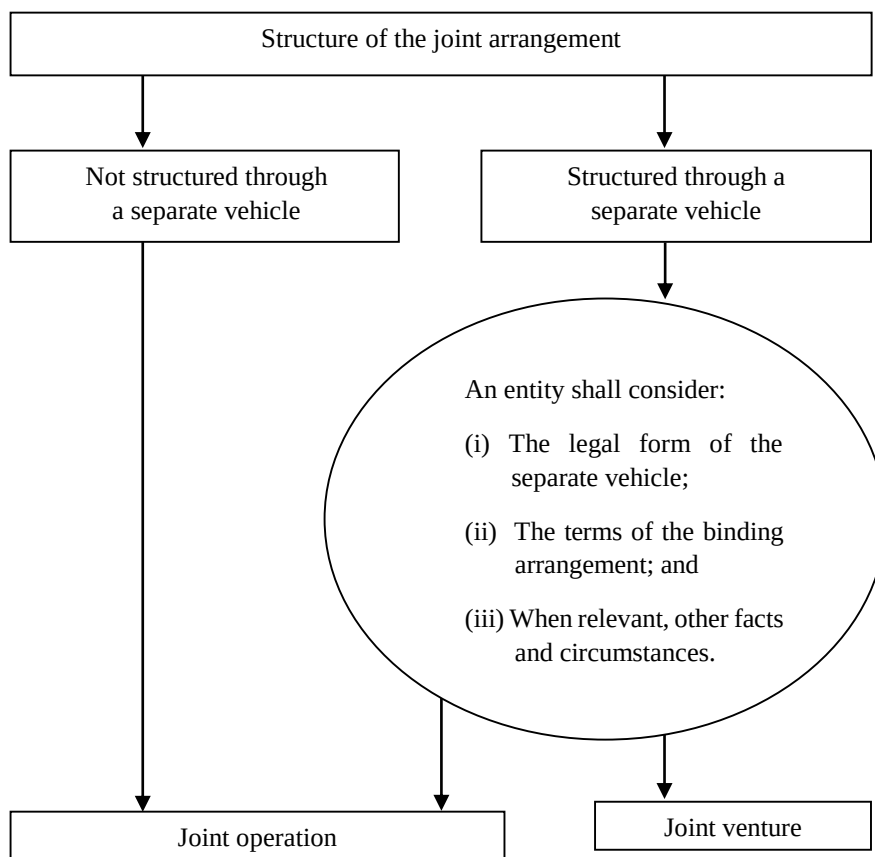
AG16. A joint arrangement that is not structured through a separate vehicle is a joint operation. In such cases, the binding arrangement establishes the parties' rights to the assets, and obligations for the liabilities, relating to the arrangement, and the parties' rights to the corresponding revenues and obligations for the corresponding expenses.

- AG17. The binding arrangement often describes the nature of the activities that are the subject of the arrangement and how the parties intend to undertake those activities together. For example, the parties to a joint arrangement could agree to deliver services or manufacture a product together, with each party being responsible for specific areas and each using its own assets and incurring its own liabilities. The binding arrangement could also specify how the revenues and expenses that are common to the parties are to be shared among them. In such a case, each joint operator recognizes in its financial statements the assets and liabilities used for the specific task, and recognizes its share of the revenues and expenses in accordance with the binding arrangement.
- AG18. In other cases, the parties to a joint arrangement might agree, for example, to share and operate an asset together. In such a case, the binding arrangement establishes the parties' rights to the asset that is operated jointly, and how output or revenue from the asset and operating costs are shared among the parties. Each joint operator accounts for its share of the joint asset and its agreed share of any liabilities, and recognizes its share of the output, revenues and expenses in accordance with the binding arrangement.

Joint Arrangements Structured through a Separate Vehicle

- AG19. A joint arrangement in which the assets and liabilities relating to the arrangement are held in a separate vehicle can be either a joint venture or a joint operation.
- AG20. Whether a party is a joint operator or a joint venturer depends on the party's rights to the assets, and obligations for the liabilities, relating to the arrangement, that are held in the separate vehicle.
- AG21. As stated in paragraph AG15, when the parties have structured a joint arrangement in a separate vehicle, the parties need to assess whether the legal form of the separate vehicle, the terms of the binding arrangement and, when relevant, any other facts and circumstances give them:
- (a) Rights to the assets, and obligations for the liabilities, relating to the arrangement (i.e., the arrangement is a joint operation); or
 - (b) Rights to the net assets of the arrangement (i.e., the arrangement is a joint venture.

Classification of a Joint Arrangement: Assessment of the Parties' Rights and Obligations Arising from the Arrangement



The Legal Form of the Separate Vehicle

- AG22. The legal form of the separate vehicle is relevant when assessing the type of joint arrangement. The legal form assists in the initial assessment of the parties' rights to the assets and obligations for the liabilities held in the separate vehicle, such as whether the parties have interests in the assets held in the separate vehicle and whether they are liable for the liabilities held in the separate vehicle.
- AG23. For example, the parties might conduct the joint arrangement through a separate vehicle, whose legal form causes the separate vehicle to be considered in its own right (i.e., the assets and liabilities held in the separate vehicle are the assets and liabilities of the separate vehicle and not the assets and liabilities of the parties). In such a case, the assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle indicates that the arrangement is a joint venture. However, the terms agreed by the parties in their binding arrangement (see paragraphs AG25–AG28) and, when relevant, other facts and circumstances (see paragraphs AG29–AG33) can override the assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle.
- AG24. The assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle is sufficient to conclude that the arrangement is a joint operation only if the parties conduct the joint arrangement in a separate vehicle whose legal form does not confer separation between the parties and the separate vehicle (i.e., the assets and liabilities held in the separate vehicle are the parties' assets and liabilities).

Assessing the Terms of the Binding Arrangement

- AG25. In many cases, the rights and obligations agreed to by the parties in their binding arrangements are consistent, or do not conflict, with the rights and obligations conferred on the parties by the legal form of the separate vehicle in which the arrangement has been structured.
- AG26. In other cases, the parties use the binding arrangement to reverse or modify the rights and obligations conferred by the legal form of the separate vehicle in which the arrangement has been structured.

Application Example

Example 4

Assume that two parties structure a joint arrangement in an incorporated entity. Each party has a 50 per cent ownership interest in the incorporated entity. The incorporation enables the separation of the entity from its owners and as a consequence the assets and liabilities held in the entity are the assets and liabilities of the incorporated entity. In such a case, the assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle indicates that the parties have rights to the net assets of the arrangement.

However, the parties modify the features of the corporation through their binding arrangement so that each has an interest in the assets of the incorporated entity and each is liable for the liabilities of the incorporated entity in a specified proportion. Such binding modifications to the features of a corporation can cause an arrangement to be a joint operation.

- AG27. The following table compares common terms in binding arrangements of parties to a joint operation and common terms in binding arrangements of parties to a joint venture. The examples of the binding terms provided in the following table are not exhaustive.

Assessing the Terms of the Binding Arrangement		
	Joint Operation	Joint Venture
The terms of the binding arrangement	The binding arrangement provides the parties to the joint arrangement with rights to the assets, and obligations for the liabilities, relating to the arrangement.	The binding arrangement provides the parties to the joint arrangement with rights to the net assets of the arrangement (i.e., it is the separate vehicle, not the parties, that has rights to the assets, and obligations for the liabilities, relating to the arrangement).
Rights to assets	The binding arrangement establishes that the parties to the joint arrangement share all interests (e.g., rights, title or ownership) in the assets relating to the arrangement in a specified proportion (e.g., in proportion to the parties' ownership interest in the arrangement or in proportion to the activity carried out through the arrangement that is directly attributed to them).	The binding arrangement establishes that the assets brought into the arrangement or subsequently acquired by the joint arrangement are the arrangement's assets. The parties have no interests (i.e., no rights, title or ownership) in the assets of the arrangement.
Obligations for liabilities	The binding arrangement establishes that the parties to the joint arrangement share all liabilities, obligations, costs and expenses in a specified proportion (e.g., in proportion to the parties' ownership interest in the arrangement or in proportion to the activity carried out through the arrangement that is directly attributed to them).	The binding arrangement establishes that the joint arrangement is liable for the debts and obligations of the arrangement.
		The binding arrangement establishes that the parties to the joint arrangement are liable to the arrangement only to the extent of their respective investments in the arrangement or to their respective obligations to contribute any unpaid or additional capital to the arrangement, or both.
	The binding arrangement establishes that the parties to the joint arrangement are liable for claims raised by third parties.	The binding arrangement states that creditors of the joint arrangement do not have rights of recourse against any party with respect to debts or obligations of the arrangement.

Assessing the Terms of the Binding Arrangement		
	Joint Operation	Joint Venture
Revenues, expenses, surplus or deficit	The binding arrangement establishes the allocation of revenues and expenses on the basis of the relative performance of each party to the joint arrangement. For example, the binding arrangement might establish that revenues and expenses are allocated on the basis of the capacity that each party uses in a plant operated jointly, which could differ from their ownership interest in the joint arrangement. In other instances, the parties might have agreed to share the surplus or deficit relating to the arrangement on the basis of a specified proportion such as the parties' ownership interest in the arrangement. This would not prevent the arrangement from being a joint operation if the parties have rights to the assets, and obligations for the liabilities, relating to the	The binding arrangement establishes each party's share in the surplus or deficit relating to the activities of the arrangement.
Guarantees	The parties to joint arrangements are often required to provide guarantees to third parties that, for example, receive a service from, or provide financing to, the joint arrangement. The provision of such guarantees, or the commitment by the parties to provide them, does not, by itself, determine that the joint arrangement is a joint operation. The feature that determines whether the joint arrangement is a joint operation or a joint venture is whether the parties have obligations for the liabilities relating to the arrangement (for some of which the parties might or might not have provided a guarantee).	

AG28. When the binding arrangement specifies that the parties have rights to the assets, and obligations for the liabilities, relating to the arrangement, they are parties to a joint operation and do not need to consider other facts and circumstances (paragraphs AG29–AG33) for the purposes of classifying the joint arrangement.

Assessing Other Facts and Circumstances

AG29. When the terms of the binding arrangement do not specify that the parties have rights to the assets, and obligations for the liabilities, relating to the arrangement, the parties shall consider other facts and circumstances to assess whether the arrangement is a joint operation or a joint venture.

AG30. A joint arrangement might be structured in a separate vehicle whose legal form confers separation between the parties and the separate vehicle. The binding terms agreed among the parties might not specify the parties' rights to the assets and obligations for the liabilities, yet consideration of other facts and circumstances can lead to such an arrangement being classified as a joint operation. This will be the case when other facts and circumstances give the parties rights to the assets, and obligations for the liabilities, relating to the arrangement.

- AG31. When the activities of an arrangement are primarily designed for the provision of output to the parties, this indicates that the parties have rights to substantially all the service potential or economic benefits of the assets of the arrangement. The parties to such arrangements often ensure their access to the outputs provided by the arrangement by preventing the arrangement from selling output to third parties.
- AG32. The effect of an arrangement with such a design and purpose is that the liabilities incurred by the arrangement are, in substance, satisfied by the cash flows received from the parties through their purchases of the output. When the parties are substantially the only source of cash flows contributing to the continuity of the operations of the arrangement, this indicates that the parties have an obligation for the liabilities relating to the arrangement.

Application Example
Example 5 Assume that two parties structure a joint arrangement in an incorporated entity (entity C) in which each party has a 50 per cent ownership interest. The purpose of the arrangement is to manufacture materials required by the parties for their own, individual manufacturing processes. The arrangement ensures that the parties operate the facility that produces the materials to the quantity and quality specifications of the parties. The legal form of entity C (an incorporated entity) through which the activities are conducted initially indicates that the assets and liabilities held in entity C are the assets and liabilities of entity C. The binding arrangement between the parties does not specify that the parties have rights to the assets or obligations for the liabilities of entity C. Accordingly, the legal form of entity C and the terms of the binding arrangement indicate that the arrangement is a joint venture. However, the parties also consider the following aspects of the arrangement: • The parties agreed to purchase all the output produced by entity C in a ratio of 50:50. Entity C cannot sell any of the output to third parties, unless this is approved by the two parties to the arrangement. Because the purpose of the arrangement is to provide the parties with output they require, such sales to third parties are expected to be uncommon and not material. • The price of the output sold to the parties is set by both parties at a level that is designed to cover the costs of production and administrative expenses incurred by entity C. On the basis of this operating model, the arrangement is intended to operate at a break-even level. From the fact pattern above, the following facts and circumstances are relevant: • The obligation of the parties to purchase all the output produced by entity C reflects the exclusive dependence of entity C upon the parties for the generation of cash flows and, thus, the parties have an obligation to fund the settlement of the liabilities of entity C.

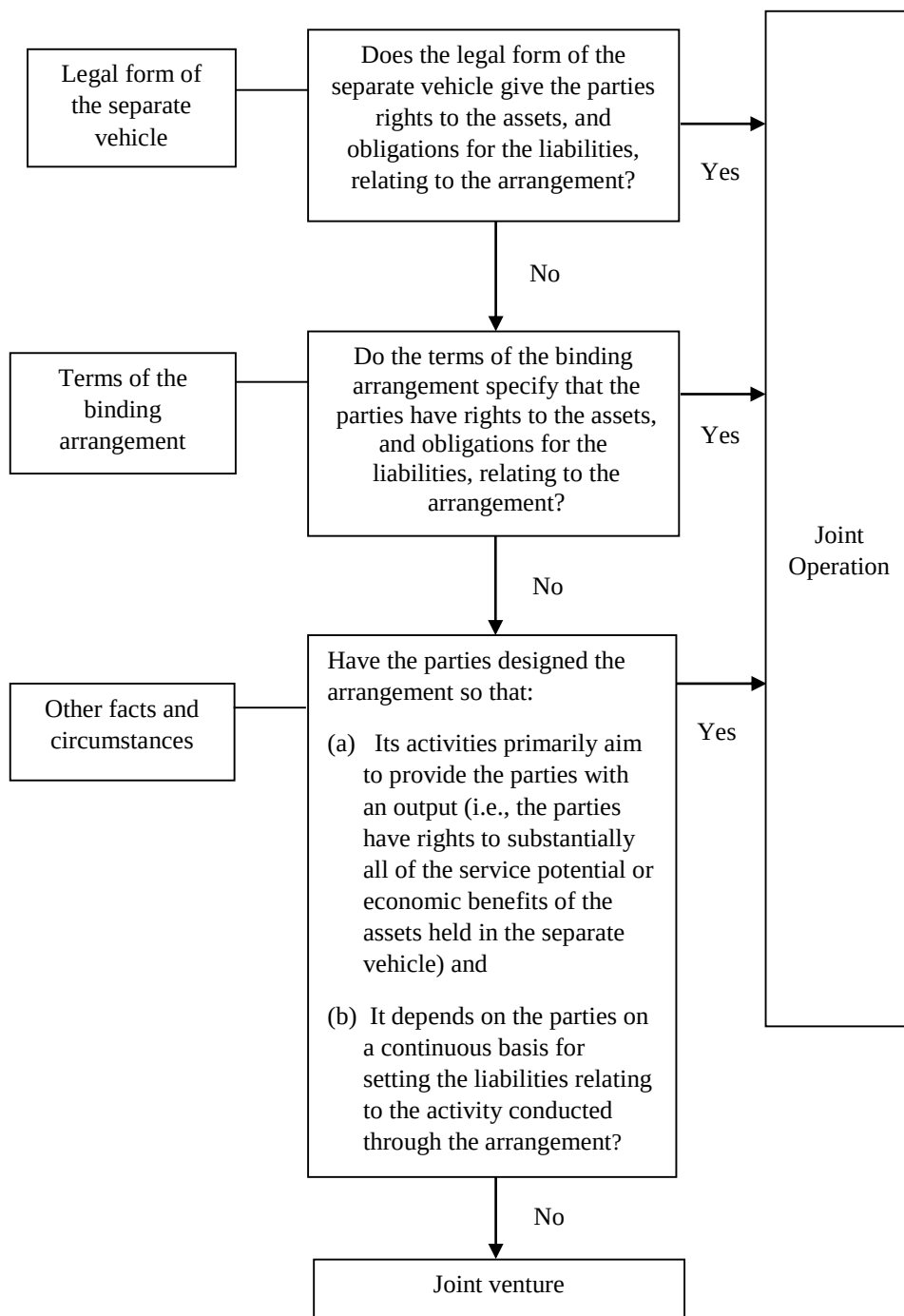
- The fact that the parties have rights to all the output produced by entity C means that the parties are consuming, and therefore have rights to, all the service potential or economic benefits of the assets of entity C.

These facts and circumstances indicate that the arrangement is a joint operation. The conclusion about the classification of the joint arrangement in these circumstances would not change if, instead of the parties using their share of the output themselves in a subsequent manufacturing process, the parties sold their share of the output to third parties.

If the parties changed the terms of the binding arrangement so that the arrangement was able to sell output to third parties, this would result in entity C assuming demand, inventory and credit risks. In that scenario, such a change in the facts and circumstances would require reassessment of the classification of the joint arrangement. Such facts and circumstances would indicate that the arrangement is a joint venture.

AG33. The following flow chart reflects the assessment an entity follows to classify an arrangement when the joint arrangement is structured through a separate vehicle:

Classification of a Joint Arrangement Structured Through a Separate Vehicle



Financial Statements of Parties to a Joint Arrangement (paragraphs 23–28)

Accounting for acquisitions of interests in joint operations

AG33A. When an entity acquires an interest in a joint operation in which the activity of the joint operation constitutes an operation, as defined in MPSAS 40, *Public Sector Combinations*, it shall apply, to the extent of its share in accordance with paragraph 23, all of the principles on acquisition accounting in MPSAS 40, *Public Sector Combinations*, and other MPSASs, that do not conflict with the guidance in this Standard and disclose the information required by those MPSASs in relation to acquisitions. The principles on acquisition accounting that do not conflict with the guidance in this Standard include but are not limited to:

- (a) Measuring identifiable assets and liabilities at fair value, other than items for which exceptions are given in MPSAS 40, *Public Sector Combinations*, and other MPSASs;
- (b) Recognizing acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with the exception that the costs to issue debt or equity securities are recognized in accordance with MPSAS 28 *Financial Instruments: Presentation*, and MPSAS 29, *Financial Instruments: Recognition and Measurement*;
- (c) Recognizing the excess of the consideration transferred over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed, if any, as goodwill; and
- (d) Testing for impairment a cash-generating unit to which goodwill has been allocated at least annually, and whenever there is an indication that the unit may be impaired, as required by MPSAS 26, *Impairment of Cash-Generating Assets*, for goodwill acquired in an acquisition.

AG33B. Paragraphs 24A and AG33A also apply to the formation of a joint operation if, and only if, an existing operation, as defined in MPSAS 40, *Public Sector Combinations*, 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 to the joint operation on its formation.

AG33C. A joint operator might increase its interest in a joint operation in which the activity of the joint operation constitutes an operation, as defined in MPSAS 40, *Public Sector Combinations*, 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.

AG33D. Paragraphs 24A and AG33A–AG33C do not apply on the acquisition of an interest in a joint operation when the parties sharing joint control, including the entity acquiring the interest in the joint operation, are under the common control of the same ultimate controlling party or parties both before and after the acquisition, and that control is not transitory.

Accounting for Sales or Contributions of Assets to a Joint Operation

- AG34. When an entity enters into a transaction with a joint operation in which it is a joint operator, such as a sale or contribution of assets, it is conducting the transaction with the other parties to the joint operation and, as such, the joint operator shall recognize gains and losses resulting from such a transaction only to the extent of the other parties' interests in the joint operation.
- AG35. When such transactions provide evidence of a reduction in the net realizable value of the assets to be sold or contributed to the joint operation, or of an impairment loss of those assets, those losses shall be recognized fully by the joint operator.

Accounting for Purchases of Assets from a Joint Operation

- AG36. When an entity enters into a transaction with a joint operation in which it is a joint operator, such as a purchase of assets, it shall not recognize its share of the gains and losses until it resells those assets to a third party.
- AG37. When such transactions provide evidence of a reduction in the net realizable value of the assets to be purchased or of an impairment loss of those assets, a joint operator shall recognize its share of those losses.

Appendix B

Amendments to Other MPSASs

[Deleted]

ILLUSTRATIVE EXAMPLES

CONTENTS

	<i>Paragraph</i>
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Oil and Gas Exploration, Development and Production Activities	IE41–IE50
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Illustrative Examples

These examples accompany, but are not part of, MPSAS 37, Joint Arrangements.

IE1. These examples portray hypothetical situations illustrating the judgments that might be used when applying MPSAS 37, *Joint Arrangements*, in different situations. Although some aspects of the examples may be present in actual fact patterns, all relevant facts and circumstances of a particular fact pattern would need to be evaluated when applying MPSAS 37, *Joint Arrangements*.

Example 1 – Construction Services

IE2. A and B (the parties) are two entities whose activities include the provision of many types of public and private construction services. Entity A is a private sector entity. Entity B is government owned. They set up a binding arrangement to work together for the purpose of fulfilling a contract with a government for the design and construction of a road between two cities. The binding arrangement determines the participation shares of A and B and establishes joint control of the arrangement, the subject matter of which is the delivery of the road. The joint arrangement will have no further involvement once the road has been completed. The road will be transferred to the government at that point.

IE3. The parties set up a separate vehicle (entity Z) through which to conduct the arrangement. Entity Z, on behalf of A and B, enters into the contract with the government. In addition, the assets and liabilities relating to the arrangement are held in entity Z. The main feature of entity Z's legal form is that the parties, not entity Z, have rights to the assets, and obligations for the liabilities, of the entity.

IE4. The binding arrangement between A and B additionally establishes that:

- (a) The rights to all the assets needed to undertake the activities of the arrangement are shared by the parties on the basis of their participation shares in the arrangement;
- (b) The parties have several and joint responsibility for all operating and financial obligations relating to the activities of the arrangement on the basis of their participation shares in the arrangement; and
- (c) The surplus or deficit resulting from the activities of the arrangement is shared by A and B on the basis of their participation shares in the arrangement.

IE5. For the purposes of coordinating and overseeing the activities, A and B appoint a project manager, who will be an employee of one of the parties. After a specified time, the role of the project manager will rotate to an employee of the other party. A and B agree that the activities will be executed by the employees on a "no gain or loss" basis.

IE6. In accordance with the terms specified in the contract with the government, entity Z invoices the construction services to the government on behalf of the parties.

Analysis

- IE7. The joint arrangement is carried out through a separate vehicle whose legal form does not confer separation between the parties and the separate vehicle (i.e., the assets and liabilities held in entity Z are the parties' assets and liabilities). This is reinforced by the terms agreed by the parties in their binding arrangement, which state that A and B have rights to the assets, and obligations for the liabilities, relating to the arrangement that is conducted through entity Z. The joint arrangement is a joint operation. It is not a service concession arrangement.
- IE8. A and B each recognize in their financial statements their share of the assets (e.g., property, plant, and equipment, accounts receivable) and their share of any liabilities resulting from the arrangement (e.g., accounts payable to third parties) on the basis of their agreed participation share. Each also recognizes its share of the revenue and expenses resulting from the construction services provided to the government through entity Z.

Example 2 – Service Centre Operated Jointly

- IE9. Two entities (the parties) set up a separate vehicle (entity X) for the purpose of establishing and operating a joint service center. The binding arrangement between the parties establishes joint control of the activities that are conducted in entity X. The main feature of entity X's legal form is that the entity, not the parties, has rights to the assets, and obligations for the liabilities, relating to the arrangement. These activities include the allocation of office space to services, managing the car park, maintaining the center and its equipment, such as lifts, building the reputation of the center and managing the client base for the center.
- IE10. The terms of the binding arrangement are such that:
- (a) Entity X owns the service center. The binding arrangement does not specify that the parties have rights to the service center.
 - (b) The parties are not liable in respect of the debts, liabilities or obligations of entity X. If entity X is unable to pay any of its debts or other liabilities or to discharge its obligations to third parties, the liability of each party to any third party will be limited to the unpaid amount of that party's capital contribution.
 - (c) The parties have the right to sell or pledge their interests in entity X.
 - (d) Each party pays for its share of expenses for operating the service in accordance with its interest in entity X.

Analysis

- IE11. The joint arrangement is carried out through a separate vehicle whose legal form causes the separate vehicle to be considered in its own right (i.e., the assets and liabilities held in the separate vehicle are the assets and liabilities of the separate vehicle and not the assets and liabilities of the parties). In addition, the terms of the binding arrangement do not specify that the parties have rights to the assets, or obligations for the liabilities, relating to the

arrangement. Instead, the terms of the binding arrangement establish that the parties have rights to the net assets of entity X.

- IE12. On the basis of the description above, there are no other facts and circumstances that indicate that the parties have rights to substantially all the service potential or economic benefits of the assets relating to the arrangement, and that the parties have an obligation for the liabilities relating to the arrangement. The joint arrangement is a joint venture.
- IE13. The parties recognize their rights to the net assets of entity X as investments and account for them using the equity method.

Example 3 – Joint Provision of Assisted Living Services

- IE14. A public sector health care provider (entity X) and a large property developer (entity Y) enter into an agreement to work together to provide assisted living services for the elderly. Entity X and entity Y establish a separate company (entity Z). The legal form of the company confers the rights to the assets and obligations for liabilities to the company itself. The agreement between entity X and entity Y requires all decisions be made jointly. The agreement also confirms:
- (a) Entity X will provide the assisted living services. Entity Y will construct the premises.
 - (b) The assets of the arrangement are owned by entity Z, the company. Neither party will be able to sell, pledge, transfer or otherwise mortgage the assets of entity Z.
 - (c) The liability of the parties is limited to any unpaid capital of entity Z.
 - (d) Each party pays for its share of expenses for operating the service in accordance with its interest in entity Z.
 - (e) Profits of entity Z will be distributed to entity X and entity Y 40:60, being the parties' respective interests in the arrangement.

Analysis

- IE15. The joint arrangement is carried out through a separate vehicle whose legal form causes the separate vehicle to be considered in its own right (i.e., the assets and liabilities held in the separate vehicle are the assets and liabilities of the separate vehicle and not the assets and liabilities of the parties). In addition, the terms of the binding arrangement do not specify that the parties have rights to the assets, or obligations for the liabilities, relating to the arrangement. Instead, the terms of the binding arrangement establish that the parties have rights to the net assets of entity Z.
- IE16. On the basis of the description above, there are no other facts and circumstances that indicate that the parties have rights to substantially all the service potential or economic benefits of the assets relating to the arrangement, or that the parties have an obligation for the liabilities relating to the arrangement. The joint arrangement is a joint venture.
- IE17. The parties recognize their rights to the net assets of entity Z as investments and account for them using the equity method.

Variation

- IE18. A public sector health care provider (entity X) and a large property developer (entity Y) enter into an agreement to work together to provide assisted living services for the elderly. The agreement between entity X and entity Y requires all decisions to be made jointly. The agreement confirms:
- (a) Entity X will supply operational assets including office equipment, motor vehicles and furniture and fittings for the assisted living premises.
 - (b) Entity Y will construct the premises and will continue to own the premises. Entity Y will be responsible for the ongoing maintenance of the premises. Entity Y cannot sell the premises without first offering entity X the right to purchase the premises. Entity Y is entitled to 100% of any gain on eventual sale of the premises.
 - (c) The services will be delivered through a new entity, entity Z, established for this purpose.
 - (d) Each party will pay for 50% of the expenses for operating the services.
 - (e) Any profits from providing the assisted living services will be shared equally between entity X and entity Y.
 - (f) Entity X will be responsible for managing staff and for any liabilities arising from personal grievance claims and health and safety issues.
 - (g) Entity Y will be responsible for any liabilities to make good any defects in the premises or alterations to the premises required to meet health and safety codes and changes in those codes.

Analysis of Variation

- IE19. Although the services are delivered through a separate vehicle, entity X and entity Y continue to own the assets used to provide the services. The joint arrangement is a joint operation.
- IE20. Entity X and entity Y each recognize in their financial statements their own assets and liabilities. They also recognize their share of the revenue and expenses resulting from the provision of assisted living services through entity Z.

Example 4 – Joint Manufacturing and Distribution of a Product

- IE21. Entities A and B (the parties) have set up a strategic and operating agreement (the framework agreement) in which they have agreed the terms according to which they will conduct the manufacturing and distribution of a product (product P) in different markets.
- IE22. The parties have agreed to conduct manufacturing and distribution activities by establishing joint arrangements, as described below:
- (a) Manufacturing activity: the parties have agreed to undertake the manufacturing activity through a joint arrangement (the manufacturing arrangement). The manufacturing

arrangement is structured in a separate vehicle (entity M) whose legal form causes it to be considered in its own right (i.e., the assets and liabilities held in entity M are the assets and liabilities of entity M and not the assets and liabilities of the parties). In accordance with the framework agreement, the parties have committed themselves to purchasing the whole production of product P manufactured by the manufacturing arrangement in accordance with their ownership interests in entity M. The parties subsequently sell product P to another arrangement, jointly controlled by the two parties themselves, that has been established exclusively for the distribution of product P as described below. Neither the framework agreement nor the binding arrangement between A and B dealing with the manufacturing activity specifies that the parties have rights to the assets, and obligations for the liabilities, relating to the manufacturing activity.

- (b) Distribution activity: the parties have agreed to undertake the distribution activity through a joint arrangement (the distribution arrangement). The parties have structured the distribution arrangement in a separate vehicle (entity D) whose legal form causes it to be considered in its own right (i.e., the assets and liabilities held in entity D are the assets and liabilities of entity D and not the assets and liabilities of the parties). In accordance with the framework agreement, the distribution arrangement orders its requirements for product P from the parties according to the needs of the different markets where the distribution arrangement sells the product. Neither the framework agreement nor the binding arrangement between A and B dealing with the distribution activity specifies that the parties have rights to the assets, and obligations for the liabilities, relating to the distribution activity.

IE23. In addition, the framework agreement establishes:

- (a) That the manufacturing arrangement will produce product P to meet the requirements for product P that the distribution arrangement places on the parties;
- (b) The commercial terms relating to the sale of product P by the manufacturing arrangement to the parties. The manufacturing arrangement will sell product P to the parties at a price agreed by A and B that covers all production costs incurred. Subsequently, the parties sell the product to the distribution arrangement at a price agreed by A and B.
- (c) That any cash shortages that the manufacturing arrangement may incur will be financed by the parties in accordance with their ownership interests in entity M.

Analysis

- IE24. The framework agreement sets up the terms under which parties A and B conduct the manufacturing and distribution of product P. These activities are undertaken through joint arrangements whose purpose is either the manufacturing or the distribution of product P.
- IE25. The parties carry out the manufacturing arrangement through entity M whose legal form confers separation between the parties and the entity. In addition, neither the framework agreement nor the binding arrangement dealing with the manufacturing activity specifies that the parties have rights to the assets, and obligations for the liabilities, relating to the manufacturing activity. However, when considering the following facts and circumstances the parties have concluded that the manufacturing arrangement is a joint operation:

- (a) The parties have committed themselves to purchasing the whole production of product P manufactured by the manufacturing arrangement. Consequently, A and B have rights to substantially all the service potential or economic benefits of the assets of the manufacturing arrangement.
 - (b) The manufacturing arrangement manufactures product P to meet the quantity and quality needs of the parties so that they can fulfill the demand for product P of the distribution arrangement. The exclusive dependence of the manufacturing arrangement upon the parties for the generation of cash flows and the parties' commitments to provide funds when the manufacturing arrangement incurs any cash shortages indicate that the parties have an obligation for the liabilities of the manufacturing arrangement, because those liabilities will be settled through the parties' purchases of product P or by the parties' direct provision of funds.
- IE26 The parties carry out the distribution activities through entity D, whose legal form confers separation between the parties and the entity. In addition, neither the framework agreement nor the binding arrangement dealing with the distribution activity specifies that the parties have rights to the assets, and obligations for the liabilities, relating to the distribution activity.
- IE27. There are no other facts and circumstances that indicate that the parties have rights to substantially all the service potential or economic benefits of the assets relating to the distribution arrangement or that the parties have an obligation for the liabilities relating to that arrangement. The distribution arrangement is a joint venture.
- IE28. A and B each recognize in their financial statements their share of the assets (e.g., property, plant and equipment, cash) and their share of any liabilities resulting from the manufacturing arrangement (e.g., accounts payable to third parties) on the basis of their ownership interest in entity M. Each party also recognizes its share of the expenses resulting from the manufacture of product P incurred by the manufacturing arrangement and its share of the revenues relating to the sales of product P to the distribution arrangement.
- IE29. The parties recognize their rights to the net assets of the distribution arrangement as investments and account for them using the equity method.

Variation

- IE30. Assume that the parties agree that the manufacturing arrangement described above is responsible not only for manufacturing product P, but also for its distribution to third-party customers.
- IE31. The parties also agree to set up a distribution arrangement like the one described above to distribute product P exclusively to assist in widening the distribution of product P in additional specific markets.
- IE32. The manufacturing arrangement also sells product P directly to the distribution arrangement. No fixed proportion of the production of the manufacturing arrangement is committed to be purchased by, or to be reserved to, the distribution arrangement.

Analysis of Variation

- IE33. The variation has affected neither the legal form of the separate vehicle in which the manufacturing activity is conducted nor the binding terms relating to the parties' rights to the assets, and obligations for the liabilities, relating to the manufacturing activity. However, it causes the manufacturing arrangement to be a self-financed arrangement because it is able to undertake trade on its own behalf, distributing product P to third-party customers and, consequently, assuming demand, inventory and credit risks. Even though the manufacturing arrangement might also sell product P to the distribution arrangement, in this scenario the manufacturing arrangement is not dependent on the parties to be able to carry out its activities on a continuous basis. In this case, the manufacturing arrangement is a joint venture.
- IE34. The variation has no effect on the classification of the distribution arrangement as a joint venture.
- IE35. The parties recognize their rights to the net assets of the manufacturing arrangement and their rights to the net assets of the distribution arrangement as investments and account for them using the equity method.

Example 5 – Bank Operated Jointly

- IE36. Bank A, a government owned bank, and bank B, a privately owned bank, (the parties) agreed to combine certain corporate, investment banking, asset management and service activities by establishing a separate vehicle (bank C). Both parties expect the arrangement to benefit them in different ways. Bank A believes that the arrangement could enable it to achieve its strategic plans to improve its profitability through an enlarged offering of products and services. Bank B expects the arrangement to reinforce its offering in financial savings and market products.
- IE37. The main feature of bank C's legal form is that it causes the separate vehicle to be considered in its own right (i.e., the assets and liabilities held in the separate vehicle are the assets and liabilities of the separate vehicle and not the assets and liabilities of the parties). Banks A and B each have a 40 per cent ownership interest in bank C, with the remaining 20 per cent being listed and widely held. The agreement between bank A and bank B establishes joint control of the activities of bank C.
- IE38. In addition, bank A and bank B entered into an irrevocable agreement under which, even in the event of a dispute, both banks agree to provide the necessary funds in equal amount and, if required, jointly and severally, to ensure that bank C complies with the applicable legislation and banking regulations, and honors any commitments made to the banking authorities. This commitment represents the assumption by each party of 50 per cent of any funds needed to ensure that bank C complies with legislation and banking regulations.

Analysis

- IE39. The joint arrangement is carried out through a separate vehicle whose legal form confers separation between the parties and the separate vehicle. The terms of the binding arrangement do not specify that the parties have rights to the assets, or obligations for

the liabilities, of bank C, but it establishes that the parties have rights to the net assets of bank C. The commitment by the parties to provide support if bank C is not able to comply with the applicable legislation and banking regulations is not by itself a determinant that the parties have an obligation for the liabilities of bank C. There are no other facts and circumstances that indicate that the parties have rights to substantially all the economic benefits of the assets of bank C and that the parties have an obligation for the liabilities of bank C. The joint arrangement is a joint venture.

- IE40. Both banks A and B recognize their rights to the net assets of bank C as investments and account for them using the equity method.

Example 6 – Oil and Gas Exploration, Development and Production Activities

- IE41. Entities A and B (the parties) set up a separate vehicle (entity H) and a Joint Operating Agreement (JOA) to undertake oil and gas exploration, development and production activities in country O. The main feature of entity H's legal form is that it causes the separate vehicle to be considered in its own right (i.e., the assets and liabilities held in the separate vehicle are the assets and liabilities of the separate vehicle and not the assets and liabilities of the parties).
- IE42. Country O has granted entity H permits for the oil and gas exploration, development and production activities to be undertaken in a specific assigned block of land (fields).
- IE43. The agreement and JOA agreed by the parties establish their rights and obligations relating to those activities. The main terms of those agreements are summarized below.

Agreement

- IE44. The board of entity H consists of a director from each party. Each party has a 50 per cent holding in entity H. The unanimous consent of the directors is required for any resolution to be passed.

Joint Operating Agreement (JOA)

- IE45. The JOA establishes an Operating Committee. This Committee consists of one representative from each party. Each party has a 50 per cent participating interest in the Operating Committee.
- IE46. The Operating Committee approves the budgets and work programs relating to the activities, which also require the unanimous consent of the representatives of each party. One of the parties is appointed as operator and is responsible for managing and conducting the approved work programs.
- IE47. The JOA specifies that the rights and obligations arising from the exploration, development and production activities shall be shared among the parties in proportion to each party's holding in entity H. In particular, the JOA establishes that the parties share:
- (a) The rights and the obligations arising from the exploration and development permits granted to entity H (e.g., the permits, rehabilitation liabilities, any royalties and taxes payable);

- (b) The production obtained; and
- (c) All costs associated with all work programs.

IE48. The costs incurred in relation to all the work programs are covered by cash calls on the parties. If either party fails to satisfy its monetary obligations, the other is required to contribute to entity H the amount in default. The amount in default is regarded as a debt owed by the defaulting party to the other party.

Analysis

- IE49. The parties carry out the joint arrangement through a separate vehicle whose legal form confers separation between the parties and the separate vehicle. The parties have been able to reverse the initial assessment of their rights and obligations arising from the legal form of the separate vehicle in which the arrangement is conducted. They have done this by agreeing terms in the JOA that entitle them to rights to the assets (e.g., exploration and development permits, production, and any other assets arising from the activities) and obligations for the liabilities (e.g., all costs and obligations arising from the work programs) that are held in entity H. The joint arrangement is a joint operation.
- IE50. Both entity A and entity B recognize in their financial statements their own share of the assets and of any liabilities resulting from the arrangement on the basis of their agreed participating interest. On that basis, each party also recognizes its share of the revenue (from the sale of their share of the production) and its share of the expenses.

Example 7 – Liquefied Natural Gas Arrangement

- IE51. Entity A owns an undeveloped gas field that contains substantial gas resources. Entity A determines that the gas field will be economically viable only if the gas is sold to customers in overseas markets. To do so, a liquefied natural gas (LNG) facility must be built to liquefy the gas so that it can be transported by ship to the overseas markets.
- IE52. Entity A enters into a joint arrangement with entity B in order to develop and operate the gas field and the LNG facility. Under that arrangement, entities A and B (the parties) agree to contribute the gas field and cash, respectively, to a new separate vehicle, entity C. In exchange for those contributions, the parties each take a 50 per cent ownership interest in entity C. The main feature of entity C's legal form is that it causes the separate vehicle to be considered in its own right (i.e., the assets and liabilities held in the separate vehicle are the assets and liabilities of the separate vehicle and not the assets and liabilities of the parties).
- IE53. The binding arrangement between the parties specifies that:
- (a) Entities A and B must each appoint two members to the board of entity C. The board of directors must unanimously agree the strategy and investments made by entity C.
 - (b) Day-to-day management of the gas field and LNG facility, including development and construction activities, will be undertaken by the staff of entity B in accordance

with the directions jointly agreed by the parties. Entity C will reimburse B for the costs it incurs in managing the gas field and LNG facility.

- (c) Entity C is liable for taxes and royalties on the production and sale of LNG as well as for other liabilities incurred in the ordinary course of business, such as accounts payable, site restoration and decommissioning liabilities.
 - (d) Entities A and B have equal shares in the surplus from the activities carried out in the arrangement and, as such, are entitled to equal shares of any dividends or similar distributions made by entity C.
- IE54. The binding arrangement does not specify that either party has rights to the assets, or obligations for the liabilities, of entity C.
- IE55. The board of entity C decides to enter into a financing arrangement with a syndicate of lenders to help fund the development of the gas field and construction of the LNG facility. The estimated total cost of the development and construction is RM1,000 million¹.
- IE56. The lending syndicate provides entity C with a RM700 million loan. The arrangement specifies that the syndicate has recourse to entities A and B only if entity C defaults on the loan arrangement during the development of the field and construction of the LNG facility. The lending syndicate agrees that it will not have recourse to entities A and B once the LNG facility is in production because it has assessed that the cash inflows that entity C should generate from LNG sales will be sufficient to meet the loan repayments. Although at this time the lenders have no recourse to entities A and B, the syndicate maintains protection against default by entity C by taking a lien on the LNG facility.

Analysis

- IE57. The joint arrangement is carried out through a separate vehicle whose legal form confers separation between the parties and the separate vehicle. The terms of the binding arrangement do not specify that the parties have rights to the assets, or obligations for the liabilities, of entity C, but they establish that the parties have rights to the net assets of entity C. The recourse nature of the financing arrangement during the development of the gas field and construction of the LNG facility (i.e., entities A and B providing separate guarantees during this phase) does not, by itself, impose on the parties an obligation for the liabilities of entity C (i.e., the loan is a liability of entity C). Entities A and B have separate liabilities, which are their guarantees to repay that loan if entity C defaults during the development and construction phase.
- IE58. There are no other facts and circumstances that indicate that the parties have rights to substantially all the service potential or economic benefits of the assets of entity C and that the parties have an obligation for the liabilities of entity C. The joint arrangement is a joint venture.

¹ In this example monetary amounts are denominated in ‘currency units (RM)’

- IE59. The parties recognize their rights to the net assets of entity C as investments and account for them using the equity method.

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 MPSAS 40, *Public Sector Combinations*.
- IE61. Municipality E acquires municipality A's 40 per cent ownership interest in Joint Operation D at a cost of RM300 and incurs acquisition-related costs of RM50.
- 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:

<i>Municipality E's share in the assets and liabilities related to Joint Operation D</i>	
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 recognizes 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 MPSAS 40, *Public Sector Combinations*, and other MPSASs for identifying, recognizing, 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 24A).
- IE65. However, Municipality E does not apply the principles on acquisition accounting in MPSAS 40, *Public Sector Combinations*, and other MPSASs that conflict with the guidance in this Standard. Consequently, in accordance with paragraph 23, Municipality E recognizes, 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. MPSAS 40, *Public Sector Combinations*, 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 recognized 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 MPSAS 40, *Public Sector Combinations*, 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 MPSAS 40, *Public Sector Combinations*, of Municipality E's shares in the identifiable assets and liabilities related to Joint Operation D:

	<i>Fair value or other measure specified by MPSAS 40 for Municipality E's shares in the identifiable assets and liabilities of Joint Operation D (RM)</i>
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 the international or national standard dealing with income taxes)	(24)
Net assets	228

- IE68. In accordance with MPSAS 40, *Public Sector Combinations*, the excess of the consideration transferred over the amount allocated to Municipality E's shares in the net identifiable assets is recognized as goodwill:

Consideration transferred	RM 300
Municipality E's shares in the identifiable assets and liabilities relating to its interest in the joint operation	RM 228
Goodwill	RM 72

- IE69. Acquisition-related costs of RM50 are not considered to be part of the consideration transferred for the interest in the joint operation. They are recognized as expenses in surplus or deficit in the period that the costs are incurred and the services are received (see paragraph 111 of MPSAS 40, *Public Sector Combinations*).

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 MPSAS 40, *Public Sector Combinations*.
- 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 seconded 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 RM1,000. Immediately before the acquisition, the carrying amount of the know-how in the financial statements of Entity C was RM300.

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 MPSAS 40, *Public Sector Combinations*.
- IE78. In accounting for the acquisition of its interest in the joint operation, Entity C applies all the principles on acquisition accounting in MPSAS 40, *Public Sector Combinations*, and other MPSASs that do not conflict with the guidance in this Standard (see paragraph 24A). Entity C therefore recognizes 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 recognize 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 recognize the know-how based on its carrying amount of RM300. 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 recognize a gain or loss on the grant of the right to use it.

Comparison with IPSAS 37

MPSAS 37, *Joint Arrangements*, is drawn primarily from IPSAS 37 (2018). There is no significant difference between MPSAS 37 and IPSAS 37.

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MPSAS 38 - DISCLOSURE OF INTERESTS IN OTHER ENTITIES

Acknowledgement

The Malaysian Public Sector Accounting Standard (MPSAS) 38 is based on International Public Sector Accounting Standard (IPSAS) 38, *Disclosure of Interests in Other Entities*, from the *Handbook of International Public Sector Accounting Pronouncements* of the International Public Sector Accounting Standards Board, published by the International Federation of Accountants (IFAC) in 2018 and is used with permission of IFAC.

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MPSAS 38—DISCLOSURE OF INTERESTS IN OTHER ENTITIES**History of MPSAS**

This version includes amendments resulting from MPSASs issued up to December 2022.

MPSAS 38, *Disclosure of Interests in Other Entities* was issued in December 2016.

Since the first issuance, MPSAS 38 has been amended by the following MPSASs:

- *Improvements to MPSASs 2023* (issued December 2022)

Table of Amended Paragraphs in MPSAS 38

Paragraph Affected	How Affected	Affected By
5	Deleted	Improvements to MPSASs 2023 December 2022
6	Deleted	Improvements to MPSASs 2023 December 2022
61A	New	Improvements to MPSASs 2023 December 2022

MPSAS 38 - DISCLOSURE OF INTERESTS IN OTHER ENTITIES

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Malaysian Public Sector Accounting Standard (MPSAS) 38, *Disclosure of Interests in Other Entities*, is set out in paragraphs 1–62. All the paragraphs have equal authority. MPSAS 38, *Disclosure of Interest in Other Entities*, should be read in the context of its objective and the *Preface to Malaysian Public Sector Accounting Standards*. MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to require an entity to disclose information that enables users of its financial statements to evaluate:
 - (a) The nature of, and risks associated with, its interests in controlled entities, unconsolidated controlled entities, joint arrangements and associates, and structured entities that are not consolidated; and
 - (b) The effects of those interests on its financial position, financial performance and cash flows.

Scope

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in disclosing information about its interests in controlled entities, unconsolidated controlled entities, joint arrangements and associates, and structured entities that are not consolidated.**
3. **This Standard shall be applied by an entity that has an interest in any of the following:**
 - (a) **Controlled entities;**
 - (b) **Joint arrangements (i.e., joint operations or joint ventures);**
 - (c) **Associates; or**
 - (d) **Structured entities that are not consolidated.**
4. **This Standard does not apply to:**
 - (a) **Post-employment benefit plans or other long-term employee benefit plans to which MPSAS 25, *Employee Benefits*, applies.**
 - (b) **An entity's separate financial statements to which MPSAS 34, *Separate Financial Statements*, applies. However:**
 - (i) **If an entity has interests in structured entities that are not consolidated and prepares separate financial statements as its only financial statements, it shall apply the requirements in paragraphs 40–48 when preparing those separate financial statements.**
 - (ii) **An investment entity that prepares financial statements in which all of its controlled entities are measured at fair value through surplus or deficit in accordance with paragraph 56 of MPSAS 35, *Consolidated Financial Statements*, shall present the disclosures relating to investment entities required by this Standard.**

- (c) An interest held by an entity that participates in, but does not have joint control of, a joint arrangement unless that interest results in significant influence over the arrangement or is an interest in a structured entity.
 - (d) An interest in another entity that is accounted for in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*. However, an entity shall apply this Standard:
 - (i) When that interest is an interest in an associate or a joint venture that, in accordance with MPSAS 36, *Investments in Associates and Joint Ventures*, is measured at fair value through surplus or deficit; or
 - (ii) When that interest is an interest in a structured entity that is not consolidated.
5. [Deleted]
6. [Deleted]

Definitions

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

Binding arrangement: For the purposes of this Standard, a binding arrangement is an arrangement that confers enforceable rights and obligations on the parties to it as if it were in the form of a contract. It includes rights from contracts or other legal rights.

An **interest in another entity**, for the purpose of this Standard, refers to involvement by way of binding arrangements or otherwise that exposes an entity to variability of benefits from the performance of the other entity. An interest in another entity can be evidenced by, but is not limited to, the holding of equity or debt instruments as well as other forms of involvement such as the provision of funding, liquidity support, credit enhancement and guarantees. It includes the means by which an entity has control or joint control of, or significant influence over, another entity. An entity does not necessarily have an interest in another entity solely because of a typical funder/recipient or customer/supplier relationship.

Paragraphs AG7–AG9 provide further information about interests in other entities.

Paragraphs AG57–AG59 of MPSAS 35, *Consolidated Financial Statements*, explain variability of benefits.

Revenue from a structured entity, for the purpose of this Standard, includes, but is not limited to, recurring and non-recurring fees, interest, dividends or similar distributions, gains or losses on the remeasurement or derecognition of interests in structured entities and gains or losses from the transfer of assets and liabilities to the structured entity.

A **structured entity** is:

- (a) In the case of entities where administrative arrangements or legislation are normally the dominant factors in deciding who has control of an entity, an entity that has been designed so that administrative arrangements or legislation are not the dominant factors in deciding who controls the entity, such as when binding arrangements are significant to determining control of the entity and relevant activities are directed by means of binding arrangements; or
- (b) In the case of entities where voting or similar rights are normally the dominant factor in deciding who has control of an entity, an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of binding arrangements.

Paragraphs AG20–AG23 provide further information about structured entities.

Terms defined in other MPSASs are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately. The following terms are defined in either MPSAS 34, *Separate Financial Statements*, MPSAS 35, *Consolidated Financial Statements*, MPSAS 36, *Investments in Associates and Joint Ventures*, or MPSAS 37, *Joint Arrangements*: associate, consolidated financial statements, control, controlled entity, controlling entity, economic entity, equity method, investment entity, joint arrangement, joint control, joint operation, joint venture, non-controlling interest, relevant activities, separate financial statements, separate vehicle and significant influence.

Binding Arrangement

- 8. Binding arrangements can be evidenced in several ways. A binding arrangement is often, but not always, in writing, in the form of a contract or documented discussions between the parties. Statutory mechanisms such as legislative or executive authority can also create enforceable arrangements, similar to contractual arrangements, either on their own or in conjunction with contracts between the parties.

Disclosing Information about Interests in Other Entities

- 9. To meet the objective in paragraph 1, an entity shall disclose:
 - (a) The significant judgments and assumptions it has made in determining:
 - (i) The nature of its interest in another entity or arrangement;
 - (ii) The type of joint arrangement in which it has an interest (paragraphs 12–14); and
 - (iii) That it meets the definition of an investment entity, if applicable (paragraph 15); and

- (b) **Information about its interests in:**
 - (i) **Controlled entities (paragraphs 17–26);**
 - (ii) **Joint arrangements and associates (paragraphs 35–39);**
 - (iii) **Structured entities that are not consolidated (paragraphs 40–48);**
 - (iv) **Non-quantifiable ownership interests (paragraphs 49–50); and**
 - (v) **Controlling interests acquired with the intention of disposal (paragraphs 51–57).**
- 10. **If the disclosures required by this Standard, together with disclosures required by other MPSASs, do not meet the objective in paragraph 1, an entity shall disclose whatever additional information is necessary to meet that objective.**
- 11. **An entity shall consider the level of detail necessary to satisfy the disclosure objective in paragraph 1 and how much emphasis to place on each of the requirements in this Standard. It shall aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics (see paragraphs AG2–AG6).**

Significant Judgments and Assumptions

- 12. **An entity shall disclose the methodology used to determine:**
 - (a) **That it has control of another entity as described in paragraphs 18 and 20 of MPSAS 35, *Consolidated Financial Statements*.**
 - (b) **That it has joint control of an arrangement or significant influence over another entity; and**
 - (c) **The type of joint arrangement (i.e., joint operation or joint venture) when the arrangement has been structured through a separate vehicle.**
- 13. **The disclosures required by paragraph 12 shall be either given in the financial statements or incorporated by cross-reference from the financial statements to some other statement that is available to users of the financial statements on the same terms as the financial statements and at the same time. Without the information incorporated by cross-reference, the financial statements are incomplete. The use of such cross-referencing may be subject to jurisdictional restrictions.**
- 14. **To comply with paragraph 12, an entity shall disclose, for example, the factors considered in determining that:**
 - (a) **It controls a specific entity (or similar category of entities) where the interest in the other entity is not evidenced by the holding of equity or debt instruments;**

- (b) It does not control another entity (or category of entities) even though it holds more than half of the voting rights of the other entity (or entities);
- (c) It controls another entity (or category of entities) even though it holds less than half of the voting rights of the other entity (or entities);
- (d) It is an agent or a principal (see paragraphs AG60–AG74 of MPSAS 35, *Consolidated Financial Statements*);
- (e) It does not have significant influence even though it holds 20 per cent or more of the voting rights of another entity; and
- (f) It has significant influence even though it holds less than 20 per cent of the voting rights of another entity.

Investment Entity Status

15. When a controlling entity determines that it is an investment entity in accordance with MPSAS 35, *Consolidated Financial Statements*, the investment entity shall disclose information about significant judgments and assumptions it has made in determining that it is an investment entity. An investment entity is not required to disclose this information if it has all of the characteristics in paragraph 61 of MPSAS 35, *Consolidated Financial Statements*.
16. When an entity becomes, or ceases to be, an investment entity, it shall disclose the change of investment entity status and the reasons for the change. In addition, an entity that becomes an investment entity shall disclose the effect of the change of status on the financial statements for the period presented, including:
 - (a) The total fair value, as of the date of change of status, of the controlled entities that cease to be consolidated;
 - (b) The total gain or loss, if any, calculated in accordance with paragraph 63 of MPSAS 35, *Consolidated Financial Statements*; and
 - (c) The line item(s) in surplus or deficit in which the gain or loss is recognized (if not presented separately).

Interests in Controlled Entities

17. An entity shall disclose information that enables users of its consolidated financial statements:
 - (a) To understand:
 - (i) The composition of the economic entity; and
 - (ii) The interest that non-controlling interests have in the economic entity's activities and cash flows (paragraph 19); and

- (b) **To evaluate:**
 - (i) **The nature and extent of significant restrictions on its ability to access or use assets, and settle liabilities, of the economic entity (paragraph 20);**
 - (ii) **The nature of, and changes in, the risks associated with its interests in consolidated structured entities (paragraphs 21–24);**
 - (iii) **The consequences of changes in its ownership interest in a controlled entity that do not result in a loss of control (paragraph 25); and**
 - (iv) **The consequences of losing control of a controlled entity during the reporting period (paragraph 26).**
18. **When the financial statements of a controlled entity used in the preparation of consolidated financial statements are as of a date or for a period that is different from that of the consolidated financial statements (see paragraph 46 of MPSAS 35, *Consolidated Financial Statements*) an entity shall disclose:**
- (a) **The date of the end of the reporting period of the financial statements of that controlled entity; and**
 - (b) **The reason for using a different date or period.**

The Interest that Non-controlling Interests have in the Economic Entity’s Activities and Cash Flows

19. **An entity shall disclose for each of its controlled entities that have non-controlling interests that are material to the reporting entity:**
- (a) **The name of the controlled entity;**
 - (b) **The domicile and legal form of the controlled entity and the jurisdiction in which it operates;**
 - (c) **The proportion of ownership interests held by non-controlling interests;**
 - (d) **The proportion of voting rights held by non-controlling interests, if different from the proportion of ownership interests held;**
 - (e) **The surplus or deficit allocated to non-controlling interests of the controlled entity during the reporting period;**
 - (f) **Accumulated non-controlling interests of the controlled entity at the end of the reporting period; and**
 - (g) **Summarized financial information about the controlled entity (see paragraph AG10).**

The Nature and Extent of Significant Restrictions

20. An entity shall disclose:

- (a) Significant restrictions in binding arrangements (e.g., statutory, contractual and regulatory restrictions) on its ability to access or use the assets and settle the liabilities of the economic entity, such as:
 - (i) Those that restrict the ability of a controlling entity or its controlled entities to transfer cash or other assets to (or from) other entities within the economic entity.
 - (ii) Guarantees or other requirements that may restrict dividends and other capital distributions being paid, or loans and advances being made or repaid, to (or from) other entities within the economic entity.
- (b) The nature and extent to which protective rights of non-controlling interests can significantly restrict the entity's ability to access or use the assets and settle the liabilities of the economic entity (such as when a controlling entity is obliged to settle liabilities of a controlled entity before settling its own liabilities, or approval of non-controlling interests is required either to access the assets or to settle the liabilities of a controlled entity).
- (c) The carrying amounts in the consolidated financial statements of the assets and liabilities to which those restrictions apply.

Nature of the Risks Associated with an Entity's Interests in Consolidated Structured Entities

- 21. An entity shall disclose the terms of any binding arrangements that could require the controlling entity or its controlled entities to provide financial support to a consolidated structured entity, including events or circumstances that could expose the reporting entity to a loss (e.g., liquidity arrangements or credit rating triggers associated with obligations to purchase assets of the structured entity or provide financial support).
- 22. If during the reporting period a controlling entity or any of its controlled entities has, without having an obligation under a binding arrangement to do so, provided financial or other support to a consolidated structured entity (e.g., purchasing assets of, or instruments issued by, the structured entity), the entity shall disclose:
 - (a) The type and amount of support provided, including situations in which the controlling entity or its controlled entities assisted the structured entity in obtaining financial support; and
 - (b) The reasons for providing the support.
- 23. If during the reporting period a controlling entity or any of its controlled entities has, without having an obligation under a binding arrangement to do so, provided financial or other support to a previously unconsolidated structured entity and that provision of

support resulted in the entity controlling the structured entity, the entity shall disclose an explanation of the relevant factors in reaching that decision.

24. An entity shall disclose any current intentions to provide financial or other support to a consolidated structured entity, including intentions to assist the structured entity in obtaining financial support.

Consequences of Changes in a Controlling Entity's Ownership Interest in a Controlled Entity that do not Result in a Loss of Control

25. An entity shall present a schedule that shows the effects on the net assets/equity attributable to owners of the controlling entity of any changes in its ownership interest in a controlled entity that do not result in a loss of control.

Consequences of Losing Control of a Controlled Entity During the Reporting Period

26. An entity shall disclose the gain or loss, if any, calculated in accordance with paragraph 52 of MPSAS 35, *Consolidated Financial Statements*, and:
- (a) The portion of that gain or loss attributable to measuring any investment retained in the former controlled entity at its fair value at the date when control is lost; and
 - (b) The line item(s) in surplus or deficit in which the gain or loss is recognized (if not presented separately).

Interests in Unconsolidated Controlled Entities (Investment Entities)

27. An investment entity that, in accordance with MPSAS 35, *Consolidated Financial Statements*, is required to apply the exception to consolidation and instead account for its investment in a controlled entity at fair value through surplus or deficit shall disclose that fact.
28. For each unconsolidated controlled entity, an investment entity shall disclose:
- (a) The controlled entity's name;
 - (b) The domicile and legal form of the controlled entity and the jurisdiction in which it operates; and
 - (c) The proportion of ownership interest held by the investment entity and, if different, the proportion of voting rights held.
29. If an investment entity is the controlling entity of another investment entity, the controlling entity shall also provide the disclosures in paragraph 28(a)–(c) for investments that are controlled by its controlled investment entity. The disclosure may be provided by including, in the financial statements of the controlling entity, the financial statements of the controlled entity (or controlled entities) that contain the above information.

30. **An investment entity shall disclose:**
- (a) **The nature and extent of any significant restrictions arising from binding arrangements (e.g., resulting from borrowing arrangements, regulatory requirements or contractual arrangements) on the ability of an unconsolidated controlled entity to transfer funds to the investment entity in the form of cash dividends, or similar distributions, or to repay loans or advances made to the unconsolidated controlled entity by the investment entity; and**
 - (b) **Any current commitments or intentions to provide financial or other support to an unconsolidated controlled entity, including commitments or intentions to assist the controlled entity in obtaining financial support.**
31. **If, during the reporting period, an investment entity or any of its controlled entities has, without having an obligation arising from a binding arrangement to do so, provided financial or other support to an unconsolidated controlled entity (e.g., purchasing assets of, or instruments issued by, the controlled entity or assisting the controlled entity in obtaining financial support), the entity shall disclose:**
- (a) **The type and amount of support provided to each unconsolidated controlled entity; and**
 - (b) **The reasons for providing the support.**
32. **An investment entity shall disclose the terms of any binding arrangements that could require the entity or its unconsolidated controlled entities to provide financial support to an unconsolidated, controlled, structured entity, including events or circumstances that could expose the reporting entity to a loss (e.g., liquidity arrangements or credit rating triggers associated with obligations to purchase assets of the structured entity or to provide financial support).**
33. **If during the reporting period an investment entity or any of its unconsolidated controlled entities has, without having an obligation arising from a binding arrangement to do so, provided financial or other support to an unconsolidated, structured entity that the investment entity did not control, and if that provision of support resulted in the investment entity controlling the structured entity, the investment entity shall disclose an explanation of the relevant factors in reaching the decision to provide that support.**
34. **A controlling entity that controls an investment entity and is not itself an investment entity, shall disclose in its consolidated financial statements, the information required by paragraphs 27 to 33 in respect of such unconsolidated controlled entities.**

Interests in Joint Arrangements and Associates

35. **An entity shall disclose information that enables users of its financial statements to evaluate:**
- (a) **The nature, extent and financial effects of its interests in joint arrangements and associates, including the nature and effects of its relationship with the other investors**

with joint control of, or significant influence over, joint arrangements and associates (paragraphs 36 and 38); and

- (b) The nature of, and changes in, the risks associated with its interests in joint ventures and associates (paragraph 39).

Nature, Extent and Financial Effects of an Entity's Interests in Joint Arrangements and Associates

36. An entity shall disclose:

- (a) For each joint arrangement and associate that is material to the reporting entity:
 - (i) The name of the joint arrangement or associate;
 - (ii) The nature of the entity's relationship with the joint arrangement or associate (by, for example, describing the nature of the activities of the joint arrangement or associate and whether they are strategic to the entity's activities);
 - (iii) The domicile and legal form of the joint arrangement or associate and the jurisdiction in which it operates; and
 - (iv) The proportion of ownership interest or participating share held by the entity and, if different, the proportion of voting rights held (if applicable).
- (b) For each joint venture and associate that is material to the reporting entity:
 - (i) Whether the investment in the joint venture or associate is measured using the equity method or at fair value;
 - (ii) Summarized financial information about the joint venture or associate as specified in paragraphs AG12 and AG13; and
 - (iii) If the joint venture or associate is accounted for using the equity method, the fair value of its investment in the joint venture or associate, if there is a quoted market price for the investment.
- (c) Financial information as specified in paragraph AG16 about the entity's investments in joint ventures and associates that are not individually material:
 - (i) In aggregate for all individually immaterial joint ventures; and
 - (ii) In aggregate for all individually immaterial associates. This aggregated information is to be disclosed separately from the aggregated information on joint ventures.

37. An investment entity need not provide the disclosures required by paragraphs 36(b)–36(c).

38. An entity shall also disclose:

- (a) The nature and extent of any significant restrictions (e.g., resulting from borrowing arrangements, regulatory requirements or binding arrangements between investors with joint control of, or significant influence over, a joint venture or an associate) on the ability of joint ventures or associates to transfer funds to the entity in the form of cash dividends or similar distributions, or to repay loans or advances made by the entity.
- (b) When the financial statements of a joint venture or associate used in applying the equity method are as of a date or for a period that is different from that of the entity:
 - (i) The date of the end of the reporting period of the financial statements of that joint venture or associate; and
 - (ii) The reason for using a different date or period.
- (c) The unrecognized share of losses of a joint venture or associate, both for the reporting period and cumulatively, if the entity has stopped recognizing its share of losses of the joint venture or associate when applying the equity method.

Risks Associated with an Entity's Interests in Joint Ventures and Associates**39. An entity shall disclose:**

- (a) Commitments that it has relating to its joint ventures separately from the amount of other commitments as specified in paragraphs AG17–AG19; and
- (b) In accordance with MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, unless the probability of loss is remote, contingent liabilities incurred relating to its interests in joint ventures or associates (including its share of contingent liabilities incurred jointly with other investors with joint control of, or significant influence over, the joint ventures or associates), separately from the amount of other contingent liabilities.

Interests in Structured Entities that are not Consolidated**40. An entity shall disclose information that enables users of its financial statements:**

- (a) To understand the nature and extent of its interests in structured entities that are not consolidated (paragraphs 43–45); and
- (b) To evaluate the nature of, and changes in, the risks associated with its interests in structured entities that are not consolidated (paragraphs 46–48).

41. The information required by paragraph 40(b) includes information about an entity's exposure to risk from involvement that it had with structured entities that are not consolidated in previous periods (e.g., sponsoring the structured entity), even if the entity no longer has any involvement by way of binding arrangement with the structured entity at the reporting date.

42. An investment entity need not provide the disclosures required by paragraph 40 for a structured entity that it controls but which is not consolidated, and for which it presents the disclosures required by paragraphs 27–33.

Nature of Interests

43. An entity shall disclose qualitative and quantitative information about its interests in structured entities that are not consolidated, including, but not limited to, the nature, purpose, size and activities of the structured entity and how the structured entity is financed.
44. If an entity has sponsored a structured entity that is not consolidated for which it does not provide information required by paragraph 46 (e.g., because it does not have an interest in the entity at the reporting date), the entity shall disclose:
- (a) How it has determined which structured entities it has sponsored;
 - (b) Revenue from those structured entities during the reporting period, including a description of the types of revenue presented; and
 - (c) The carrying amount (at the time of transfer) of all assets transferred to those structured entities during the reporting period.
45. An entity shall present the information in paragraph 44(b) and (c) in tabular format, unless another format is more appropriate, and classify its sponsoring activities into relevant categories (see paragraphs AG2–AG6).

Nature of Risks

46. An entity shall disclose in tabular format, unless another format is more appropriate, a summary of:
- (a) The carrying amounts of the assets and liabilities recognized in its financial statements relating to its interests in structured entities that are not consolidated;
 - (b) The line items in the statement of financial position in which those assets and liabilities are recognized;
 - (c) The amount that best represents the entity's maximum exposure to loss from its interests in structured entities that are not consolidated, including how the maximum exposure to loss is determined. If an entity cannot quantify its maximum exposure to loss from its interests in structured entities that are not consolidated it shall disclose that fact and the reasons; and
 - (d) A comparison of the carrying amounts of the assets and liabilities of the entity that relate to its interests in structured entities that are not consolidated and the entity's maximum exposure to loss from those entities.

47. **If during the reporting period an entity has, without having an obligation under a binding arrangement to do so, provided financial or other support to a structured entity that is not consolidated in which it previously had or currently has an interest (for example, purchasing assets of, or instruments issued by, the structured entity), the entity shall disclose:**
 - (a) **The type and amount of support provided, including situations in which the entity assisted the structured entity in obtaining financial support; and**
 - (b) **The reasons for providing the support.**
48. **An entity shall disclose any current intentions to provide financial or other support to a structured entity that is not consolidated, including intentions to assist the structured entity in obtaining financial support. Such current intentions include intentions to provide support as a result of obligations under binding arrangements and intentions to provide support where the entity has no obligation under a binding arrangement.**

Non-quantifiable Ownership Interests

49. **An entity shall disclose information that enables users of its financial statements to understand the nature and extent of any non-quantifiable ownership interests in other entities.**
50. **To the extent that this information has not already been provided in accordance with this Standard, an entity shall disclose, in respect of each non-quantifiable ownership interest that is material to the reporting entity:**
 - (a) **The name of the entity in which it has an ownership interest; and**
 - (b) **The nature of its ownership interest in the entity.**

Controlling Interests Acquired with the Intention of Disposal

51. **An entity, other than an investment entity, shall disclose information regarding its interest in a controlled entity when, at the point at which control arose, the entity had the intention of disposing of that interest and, at the reporting date, it has an active intention to dispose of that interest.**
52. **There are a number of situations in which a public sector entity may obtain control of another entity, but where the entity has an active intention to dispose of all or part of its controlling interest in the near future.**
53. **Because of a government's broad responsibility for the economic well-being of a jurisdiction it may intervene to prevent the consequences of failure of an entity, such as a financial institution. Such interventions may lead to a government obtaining control of another entity, although it has no intention of maintaining control over that entity. Rather, its intention may be to sell, or otherwise dispose of, its interest in the controlled entity. If the other entity needs to be restructured to facilitate disposal the restructuring can occur over a period of one or more years and the government may retain some residual assets or liabilities at the end of the process. The**

consolidation of such controlled entities for the reporting periods in which control is present, can have a significant impact on the consolidated financial statements. The obtaining of control as a result of interventions to prevent failure is most likely to occur in the context of governments, but could also occur in the case of individual public sector entities.

54. A public sector entity may also acquire a controlling interest in another entity, with the intention of disposing of all or part of that interest, in implementing a government's policy objectives. For example, a government may direct an entity to acquire certain interests in other entities for the purpose of redistribution.
55. **An entity shall disclose the following information in the notes in respect of each controlled entity referred to in paragraph 51:**
 - (a) **The name of the controlled entity and a description of its key activities;**
 - (b) **The rationale for the acquisition of the controlling interest and the factors considered in determining that control exists;**
 - (c) **The impact on the consolidated financial statements of consolidating the controlled entity including the effect on assets, liabilities, revenue, expenses and net assets/equity; and**
 - (d) **The current status of the approach to disposal, including the expected method and timing of disposal.**
56. **The disclosures required by paragraph 55 shall be provided at each reporting date until the entity disposes of the controlling interest or ceases to have the intention to dispose of that interest. In the period in which the entity disposes of the controlling interest or ceases to have the intention to dispose of the controlling interest it shall disclose:**
 - (a) **The fact that there has been a disposal or change of intention; and**
 - (b) **The effect of the disposal or change of intention on the consolidated financial statements.**
57. **Where other disclosures required by this Standard or other MPSASs would provide information relevant to paragraphs 55 or 56 a cross-reference to those other disclosures shall be provided.**

Transitional Provisions

58. An entity is encouraged to provide information required by this Standard earlier than annual periods beginning on or after January 1, 2017. Providing some of the disclosures required by this Standard does not compel the entity to comply with all the requirements of this Standard or to apply MPSAS 34, *Separate Financial Statements*, MPSAS 35, *Consolidated Financial Statements*, MPSAS 36, *Investments in Associates and Joint Ventures*, and MPSAS 37, *Joint Arrangements*, early.

59. The disclosure requirements of this Standard need not be applied for any period presented that begins before the annual period immediately preceding the first annual period for which this Standard is applied.
60. The disclosure requirements of paragraphs 40–56 and the corresponding guidance in paragraphs AG20–AG25 of this Standard need not be applied for any period presented that begins before the first annual period for which this Standard is applied.

Effective Date

61. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is encouraged.**
- 61A. **Paragraphs 5 and 6 were deleted by *Improvements to MPSASs 2023, (The Applicability of MPSASs)*, issued in December 2022. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2024. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2024, it shall disclose that fact.**
62. When an entity adopts the accrual basis MPSASs as defined in MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*, for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of MPSASs.

Appendix A

Application Guidance

This Appendix is an integral part of MPSAS 38, Disclosure of Interest in Other Entities.

- AG1. The examples in this appendix portray hypothetical situations. Although some aspects of the examples may be present in actual fact patterns, all relevant facts and circumstances of a particular fact pattern would need to be evaluated when applying this Standard.

Aggregation (paragraph 11)

- AG2. An entity shall decide, in the light of its circumstances, how much detail it provides to satisfy the information needs of users, how much emphasis it places on different aspects of the requirements and how it aggregates the information. It is necessary to strike a balance between burdening financial statements with excessive detail that may not assist users of financial statements and obscuring information as a result of too much aggregation.
- AG3. An entity may aggregate the disclosures required by this Standard for interests in similar entities if aggregation is consistent with the disclosure objective and the requirement in paragraph AG4, and does not obscure the information provided. An entity shall disclose how it has aggregated its interests in similar entities.
- AG4. An entity shall present information separately for interests in:
- (a) Controlled entities;
 - (b) Joint ventures;
 - (c) Joint operations;
 - (d) Associates; and
 - (e) Structured entities that are not consolidated.
- AG5. In determining whether to aggregate information, an entity shall consider quantitative and qualitative information about the different risk and benefit characteristics of each entity it is considering for aggregation and the significance of each such entity to the reporting entity. The entity shall present the disclosures in a manner that clearly explains to users of financial statements the nature and extent of its interests in those other entities.
- AG6. Examples of aggregation levels within the classes of entities set out in paragraph AG4 that might be appropriate are:
- (a) Nature of activities (e.g., a research and development entity, a revolving credit card securitization entity).
 - (b) Industry classification.
 - (c) Geography (e.g., country or region).

Interests in Other Entities

- AG7. An interest in another entity refers to involvement by way of binding arrangements or otherwise that exposes the reporting entity to variability of benefits from the performance of the other entity. Consideration of the purpose and design of the other entity may help the reporting entity when assessing whether it has an interest in that entity and, therefore, whether it is required to provide the disclosures in this Standard. That assessment shall include consideration of the risks that the other entity was designed to create and the risks the other entity was designed to pass on to the reporting entity and other parties.
- AG8. A reporting entity is typically exposed to variability of benefits from the performance of another entity by holding instruments (such as equity or debt instruments issued by the other entity) or having another involvement that absorbs variability. For example, assume a structured entity holds a loan portfolio. The structured entity obtains a credit default swap from another entity (the reporting entity) to protect itself from the default of interest and principal payments on the loans. The reporting entity has involvement that exposes it to variability of benefits from the performance of the structured entity because the credit default swap absorbs variability of benefits, in the form of returns, of the structured entity.
- AG9. Some instruments are designed to transfer risk from a reporting entity to another entity. Such instruments create variability of benefits for the other entity but do not typically expose the reporting entity to variability of benefits from the performance of the other entity. For example, assume a structured entity is established to provide investment opportunities for investors who wish to have exposure to entity Z's credit risk (entity Z is unrelated to any party involved in the arrangement). The structured entity obtains funding by issuing to those investors notes that are linked to entity Z's credit risk (credit-linked notes) and uses the proceeds to invest in a portfolio of risk-free financial assets. The structured entity obtains exposure to entity Z's credit risk by entering into a credit default swap (CDS) with a swap counterparty. The CDS passes entity Z's credit risk to the structured entity in return for a fee paid by the swap counterparty. The investors in the structured entity receive higher benefits that reflect both the structured entity's return from its asset portfolio and the CDS fee. The swap counterparty does not have involvement with the structured entity that exposes it to variability of benefits from the performance of the structured entity because the CDS transfers variability to the structured entity, rather than absorbing variability of benefits of the structured entity.

Summarized Financial Information for Controlled Entities, Joint Ventures and Associates (paragraphs 19 and 36)

- AG10. For each controlled entity that has non-controlling interests that are material to the reporting entity, an entity shall disclose:
- (a) Dividends or similar distributions paid to non-controlling interests; and
 - (b) Summarized financial information about the assets, liabilities, surplus or deficit and cash flows of the controlled entity that enables users to understand the interest that non-controlling interests have in the economic entity's activities and cash flows. That information might include but is not limited to, for example, current assets, non-current assets, current liabilities, non-current liabilities, revenue and surplus or deficit.

- AG11. The summarized financial information required by paragraph AG10(b) shall be the amounts before inter-entity eliminations.
- AG12. For each joint venture and associate that is material to the reporting entity, an entity shall disclose:
- (a) Dividends or similar distributions received from the joint venture or associate; and
 - (b) Summarized financial information for the joint venture or associate (see paragraphs AG14 and AG15) including, but not necessarily limited to:
 - (i) Current assets;
 - (ii) Non-current assets;
 - (iii) Current liabilities;
 - (iv) Non-current liabilities;
 - (v) Revenue;
 - (vi) Tax expense;
 - (vii) Pre-tax gain or loss recognized on the disposal of assets or settlement of liabilities attributable to discontinuing operations; and
 - (viii) Surplus or deficit.
- AG13. In addition to the summarized financial information required by paragraph AG12, an entity shall disclose for each joint venture that is material to the reporting entity the amount of:
- (a) Cash and cash equivalents included in paragraph AG12(b)(i);
 - (b) Current financial liabilities (excluding taxes and transfers payable, payables under exchange transactions and provisions) included in paragraph AG12(b)(iii);
 - (c) Non-current financial liabilities (excluding taxes and transfers payable, payables under exchange transactions and provisions) included in paragraph AG12(b)(iv);
 - (d) Depreciation and amortization;
 - (e) Interest revenue;
 - (f) Interest expense; and
 - (g) Income tax expense.
- AG14. The summarized financial information presented in accordance with paragraphs AG12 and AG13 shall be the amounts included in the MPSAS financial statements of the joint venture or associate (and not the entity's share of those amounts). If the entity accounts for its interest in the joint venture or associate using the equity method:

- (a) The amounts included in the MPSAS financial statements of the joint venture or associate shall be adjusted to reflect adjustments made by the entity when using the equity method, such as fair value adjustments made at the time of acquisition and adjustments for differences in accounting policies.
 - (b) The entity shall provide a reconciliation of the summarized financial information presented to the carrying amount of its interest in the joint venture or associate.
- AG15. An entity may present the summarized financial information required by paragraphs AG12 and AG13 on the basis of the joint venture's or associate's financial statements if:
- (a) The entity measures its interest in the joint venture or associate at fair value in accordance with MPSAS 36, *Investments in Associates and Joint Ventures*; and
 - (b) The joint venture or associate does not prepare MPSAS financial statements and preparation on that basis would be impracticable or cause undue cost.

In that case, the entity shall disclose the basis on which the summarized financial information has been prepared.

- AG16. An entity shall disclose, in aggregate, the carrying amount of its interests in all individually immaterial joint ventures or associates that are accounted for using the equity method. An entity shall also disclose separately the aggregate amount of its share of those joint ventures' or associates'
- (a) Revenue.
 - (b) Tax expense.
 - (c) Pre-tax gain or loss recognized on the disposal of assets or settlement of liabilities attributable to discontinuing operations.
 - (d) Surplus or deficit.
 - (e) An entity provides the disclosures separately for joint ventures and associates.

Commitments for Joint Ventures (paragraph 39(a))

- AG17. An entity shall disclose total commitments it has made but not recognized at the reporting date (including its share of commitments made jointly with other investors with joint control of a joint venture) relating to its interests in joint ventures. Commitments are those that may give rise to a future outflow of cash or other resources.
- AG18. Unrecognized commitments that may give rise to a future outflow of cash or other resources include:
- (a) Unrecognized commitments to contribute funding or resources as a result of, for example:

- (i) The constitution or acquisition agreements of a joint venture (that, for example, require an entity to contribute funds over a specific period).
 - (ii) Capital-intensive projects undertaken by a joint venture.
 - (iii) Unconditional purchase obligations, comprising procurement of equipment, inventory or services that an entity is committed to purchasing from, or on behalf of, a joint venture.
 - (iv) Unrecognized commitments to provide loans or other financial support to a joint venture.
 - (v) Unrecognized commitments to contribute resources to a joint venture, such as assets or services.
 - (vi) Other non-cancellable unrecognized commitments relating to a joint venture.
- (b) Unrecognized commitments to acquire another party's ownership interest (or a portion of that ownership interest) in a joint venture if a particular event occurs or does not occur in the future.

AG19. The requirements and examples in paragraphs AG17 and AG18 illustrate some of the types of disclosure required by paragraph 27 of MPSAS 20, *Related Party Disclosures*.

Interests in Structured Entities that are not Consolidated (paragraphs 40–48)

Structured Entities

AG20. A structured entity is an entity that has been designed so that the conventional ways in which an entity is controlled are not the dominant factors in deciding who controls the entity. In the case of entities such as departments or ministries where administrative arrangements or legislation are often the dominant factors in deciding who has control of an entity, a structured entity is an entity that has been designed so that administrative arrangements or legislation are not the dominant factor in deciding who controls the entity. In the case of entities where voting or similar rights are normally the dominant factor in deciding who has control of an entity (which may be the case for some entities with profit objectives), a structured entity is an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity. Although binding arrangements frequently occur between public sector entities, binding arrangements are not normally the dominant factor in determining who controls an entity. Therefore the use of binding arrangements to determine the relevant activities of an entity may indicate the existence of a structured entity. Depending on the context a structured entity could be:

- (i) An entity for which most of the activities are predetermined, with the relevant activities limited in scope but directed through binding arrangements; or
- (ii) An entity for which any voting rights relate to administrative tasks only and the relevant activities are directed by means of binding arrangements.

AG21. A structured entity often has some or all of the following features or attributes:

- (a) Restricted activities.
- (b) A narrow and well-defined objective, such as to carry out research and development activities, provide a source of capital or funding to an entity or provide investment opportunities for investors by passing on risks and rewards associated with the assets of the structured entity to investors.
- (c) Insufficient net assets/equity to permit the structured entity to finance its activities without subordinated financial support.
- (d) Financing in the form of multiple contractually linked instruments to investors that create concentrations of credit or other risks (tranches).

AG22. Examples of entities that are regarded as structured entities include, but are not limited to:

- (a) A partnership between a government and a private sector entity that is not a joint venture, being a partnership established and directed by binding arrangements.
- (b) Securitization vehicles.
- (c) Asset-backed financings.
- (d) Some investment funds.

AG23. The mere fact that a government provides funding to another entity does not make that entity a structured entity. Nor is an entity that is controlled by voting rights a structured entity simply because, for example, it receives funding from third parties following a restructuring.

Nature of Risks from Interests in Structured Entities that are not Consolidated (paragraphs 46–48)

AG24. In addition to the information required by paragraphs 46–48, an entity shall disclose additional information that is necessary to meet the disclosure objective in paragraph 40(b).

AG25. Examples of additional information that, depending on the circumstances, might be relevant to an assessment of the risks to which an entity is exposed when it has an interest in a structured entity that is not consolidated are:

- (a) The terms of an arrangement that could require the entity to provide financial support to a structured entity that is not consolidated (e.g., liquidity arrangements or credit rating triggers associated with obligations to purchase assets of the structured entity or provide financial support), including:
 - (i) A description of events or circumstances that could expose the reporting entity to a loss.
 - (ii) Whether there are any terms that would limit the obligation.

- (iii) Whether there are any other parties that provide financial support and, if so, how the reporting entity's obligation ranks with those of other parties.
- (b) Losses incurred by the entity during the reporting period relating to its interests in structured entities that are not consolidated.
- (c) The types of revenue the entity received during the reporting period from its interests in structured entities that are not consolidated.
- (d) Whether the entity is required to absorb losses of a structured entity that is not consolidated before other parties, the maximum limit of such losses for the entity, and (if relevant) the ranking and amounts of potential losses borne by parties whose interests rank lower than the entity's interest in the structured entity that is not consolidated.
- (e) Information about any liquidity arrangements, guarantees or other commitments with third parties that may affect the fair value or risk of the entity's interests in structured entities that are not consolidated.
- (f) Any difficulties a structured entity that is not consolidated has experienced in financing its activities during the reporting period.
- (g) In relation to the funding of a structured entity that is not consolidated, the forms of funding (e.g., commercial paper or medium-term notes) and their weighted-average life. That information might include maturity analyses of the assets and funding of a structured entity if the structured entity has longer-term assets funded by shorter-term funding.

Appendix B

Amendments to Other MPSASs

[Deleted]

Comparison with IPSAS 38

MPSAS 38, *Disclosure of Interests in Other Entities*, is drawn primarily from IPSAS 38 (2018). Main difference between MPSAS 38 and IPSAS 38 is as follows:

- In paragraph 4(a), IPSAS 38 refers to IPSAS 39, *Employee Benefits*, whereas MPSAS 38 refers to MPSAS 25, *Employee Benefits*, in which drawn from IPSAS 25 that has been superseded by IPSAS 39. The MPSAS is yet to adopt IPSAS 39.

MPSAS 40 - PUBLIC SECTOR COMBINATIONS

Acknowledgement

The Malaysian Public Sector Accounting Standard (MPSAS) 40 is based on International Public Sector Accounting Standard (IPSAS) 40, *Public Sector Combinations*, from the *Handbook of International Public Sector Accounting Pronouncements* of the International Public Sector Accounting Standards Board, published by the International Federation of Accountants (IFAC) in 2018 and is used with permission of IFAC.

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MPSAS 40 - PUBLIC SECTOR COMBINATIONS

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Malaysian Public Sector Accounting Standard 40, *Public Sector Combinations*, is set out in paragraphs 1–134. All the paragraphs have equal authority. MPSAS 40, *Public Sector Combinations* should be read in the context of its objective, the *Preface to Malaysian Public Sector Accounting Standards* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

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 sector combination and its effects. To accomplish that, this Standard establishes principles and requirements for how:
 - (a) A reporting entity classifies a public sector combination as an amalgamation or an acquisition;
 - (b) A resulting entity recognizes 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 recognizes and measures components of net assets/equity and other adjustments recognized in an amalgamation;
 - (d) An acquirer recognizes 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 recognizes 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 public sector combination.

Scope

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for public sector combinations.**
3. **This Standard applies to a transaction or other event that meets the definition of a 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 recognize the individual identifiable assets acquired or received (including those assets that meet the definition of, and recognition criteria for, intangible assets in MPSAS 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 recognize the individual liabilities assumed.**
4. **The requirements of this Standard do not apply to the acquisition by an investment entity, as defined in MPSAS 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:

A **public sector combination** is the bringing together of separate operations into one public sector entity.

General Definitions Related to All Public Sector Combinations

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

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

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

Definitions Related to Amalgamations

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

- (a) A public sector combination in which no party to the combination gains control of one or more operations; or
- (b) A public sector combination in which one party to the combination gains control of one or more operations, and in which there is evidence that the combination has the economic substance of an amalgamation.

(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 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 recognized.

Terms defined in other MPSASs 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 Public Sector Combination

6. An entity shall determine whether a transaction or other event is a 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 MPSASs. Paragraphs AG2–AG9 provide guidance on identifying a public sector combination.

Classification of Public Sector Combinations

7. If no party to a 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 public sector combination gains control of one or more operations as a result of that combination.
8. If one party to a 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 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 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 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

Indicators Relating to Consideration

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).

Indicators Relating to the Decision-Making Process

13. The following indicators may provide evidence that the combination is an amalgamation:
- (a) A 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 public sector combination is subject to approval by each party's citizens through referenda (paragraph AG36 provides additional guidance); or
 - (c) A 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 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) Recognizing and measuring the identifiable assets received, the liabilities assumed and any non-controlling interest in the combining operations, consistent with the requirements in MPSASs; and
 - (d) Recognizing 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.” 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.

Recognizing and Measuring the Identifiable Assets, Liabilities Assumed and Any Non-Controlling Interests in the Combining Operations

Recognition Principle

21. **As of the amalgamation date, the resulting entity shall recognize the identifiable assets, liabilities and any non-controlling interests that are recognized in the financial statements of the combining operations as of the amalgamation date. Recognition of identifiable assets and liabilities received is subject to the conditions specified in paragraphs 22–23.**

Recognition Conditions

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. 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 *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* 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 recognize those costs as part of applying the modified pooling of interests method. Instead, the resulting entity recognizes those costs in its post-combination financial statements in accordance with other MPSASs.

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, even if this is permitted by other MPSASs.**
25. In some situations, MPSASs 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 amortized cost, in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*;
 - (b) Designation of a derivative instrument as a hedging instrument in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*; and

- (c) Assessment of whether an embedded derivative should be separated from a host contract in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, (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 (paragraphs AG53–AG54 provide related application guidance).**
- 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 MPSASs, 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.
- 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) Recognized either by applying recognition conditions in addition to those in paragraphs 22–23 or by applying the requirements of other MPSASs, 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

Licenses and similar rights previously granted by one combining operation to another combining operation

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

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 amount of tax due as part of the terms of the amalgamation. The resulting entity shall not recognize any taxation items that are forgiven as a result of the terms of the amalgamation (paragraphs AG57–AG58 provide related application guidance).
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 MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*.

Employee Benefits

35. The resulting entity shall recognize and measure a liability (or asset, if any) related to the combining operation's employee benefit arrangements in accordance with MPSAS 25, *Employee Benefits*.

Recognizing 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 recognize within net assets/equity amounts equal and opposite to the following items:**
 - (a) **The carrying amounts of the combining operations' assets;**
 - (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 recognize within net assets/equity the corresponding adjustments in respect of:**
 - (a) **The elimination of transactions between combining operations 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 recognized within net assets/equity in accordance with paragraphs 37 and 38 as either:**
 - (a) **A single opening balance; or**
 - (b) **As separate components of net assets/equity.**

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 recognized 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 recognized as of that date. During the measurement period, the resulting entity shall also recognize additional assets or liabilities if new information is obtained about facts and circumstances that 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 recognized 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 recognizes an increase (decrease) in the provisional amount recognized for an identifiable asset (liability) by adjusting components of net assets/equity recognized 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 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 recognized 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 recognized for the claim receivable from the insurer.
43. During the measurement period, the resulting entity shall recognize 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 amortization recognized 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 MPSAS 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 recognized in accordance with MPSAS 28, *Financial Instruments: Presentation*, and MPSAS 29, *Financial Instruments: Recognition and Measurement*.

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 MPSASs 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;
 - (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).

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

47. A license or similar right, previously granted by one combining operation to another combining operation and recognized as an intangible asset shall be amortized 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 license 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 MPSASs (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 the relevant international or national accounting standard dealing with income taxes.

Presentation of Financial Statements

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:**
- (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 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; and**
 - (g) **Notes, comprising a summary of significant accounting policies and other explanatory notes.**
51. **Where a resulting entity is not a new entity following a public sector combination, the resulting entity shall disclose:**
- (a) **The amounts recognized 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.**
52. Subject to the requirements in paragraphs 54 and 56, the resulting entity is permitted but not required to present financial statements for periods prior to the amalgamation date (paragraphs AG64–AG65 provide related application guidance). Where a resulting entity elects to present financial statements for periods prior to the amalgamation date, it shall disclose the information required by paragraph 54(g).

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.**
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 recognized 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, recognized in accordance with paragraphs 37–38.
- (g) If a resulting entity elects to present financial statements for periods prior to the amalgamation date in accordance with paragraph 52, the resulting entity shall disclose the following information for each combining operation:
 - (i) A statement of financial position as at the end of the prior period(s);
 - (ii) A statement of financial performance 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 used in the combining operations' financial statements. The resulting entity shall disclose the basis on which this information is presented.

- (h) If, at the time the financial statements of the resulting entity are authorized 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 analyzed in a manner appropriate to the entity's operations, in accordance with paragraph 108 of MPSAS 1, *Presentation of Financial Statements*. The amounts of expense shall be analyzed 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 MPSAS 1, *Presentation of Financial Statements*.
 - (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 for periods 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 recognized 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 recognized 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 recognized 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 paragraphs 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.
57. If the specific disclosures required by this and other MPSASs 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) Recognizing and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquired operation; and
 - (d) Recognizing 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 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.

Recognizing 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 recognize, separately from any goodwill recognized, 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 *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* 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 recognize those costs as part of applying the acquisition method. Instead, the acquirer recognizes those costs in its post-combination financial statements in accordance with other MPSASs.
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 MPSASs.
67. The acquirer's application of the recognition principle and conditions may result in recognizing some assets and liabilities that the acquired operation had not previously recognized as assets and liabilities in its financial statements. For example, the acquirer recognizes the acquired identifiable intangible assets, such as a patent or a customer relationship that the acquired

operation did not recognize 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 recognizing 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 MPSASs. 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, MPSASs 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 amortized cost, in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*;
 - (b) Designation of a derivative instrument as a hedging instrument in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*; and
 - (c) Assessment of whether an embedded derivative should be separated from a host contract in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement* (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 MPSAS 13, *Leases*; and
 - (b) Classification of a contract as an insurance contract in accordance with the relevant international or national accounting standard dealing with insurance contracts.

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:
- (a) Fair value; or

- (b) The present ownership instruments' proportionate share in the recognized 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 MPSAS.

- 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) Recognized either by applying recognition conditions in addition to those in paragraphs 65–66 or by applying the requirements of other MPSASs, 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. MPSAS 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 recognized because:
 - (i) It is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; or
 - (ii) The amount of the obligation cannot be measured with sufficient reliability.
- 77. The requirements in MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, do not apply in determining which contingent liabilities to recognize as of the acquisition date. Instead, the acquirer shall recognize 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 reliably¹. Therefore, contrary to MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, the acquirer recognizes 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.

¹ Information that is reliable is free from material error and bias, and can be depended on by users to faithfully represent that which it purports to represent or could reasonably be expected to represent.

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 recognize any taxation items that are forgiven as a result of the terms of the acquisition (paragraphs AG85–AG87 provide related application guidance).
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 MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*.

Employee Benefits

80. The acquirer shall recognize and measure a liability (or asset, if any) related to the acquired operation's employee benefit arrangements in accordance with MPSAS 25, *Employee Benefits*.

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 recognize an indemnification asset at the same time that it recognizes 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 recognized at the acquisition date and measured at its acquisition-date fair value, the acquirer shall recognize 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 collectability 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 recognized 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 recognized and measured using assumptions consistent with those used to measure the indemnified item, subject to management's assessment of the collectability 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 recognized 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.

Recognizing and Measuring Goodwill or a Gain from A Bargain Purchase

85. **The acquirer shall recognize 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 recognize goodwill only to the extent that the acquisition will result in:**
- (a) The generation of cash inflows (such as the acquisition of a cash-generating operation); and/or**
 - (b) A reduction in the net cash outflows of the acquirer.**

An acquirer shall recognize 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, 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)). Paragraph AG94 provides related application guidance.

Bargain Purchases

88. Occasionally in a 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 recognize 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 recognizing a gain (or change the amount of a recognized gain) on a bargain purchase.
90. Before recognizing 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 recognize 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 recognized 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 sector, 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 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 sector, 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 nationalizations).
 - (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 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 recognize goodwill. The acquirer recognizes 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 recognize 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 recognize 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 recognize 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 MPSAS 28, *Financial Instruments: Presentation*. 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 recognize the resulting gain or loss, if any, in surplus or deficit or in net assets/equity, as appropriate. In prior reporting periods, the acquirer may have recognized changes in the value of its equity interest in the acquired operation in net assets/equity. If so, the amount that was recognized in net assets/equity shall be recognized on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest.

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 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 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 recognized in accordance with this Standard. In other words, the 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 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 recognized at the acquisition date 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 recognized as of that date. During the measurement period, the acquirer shall also recognize 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 recognized 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 recognized 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 recognizes an increase (decrease) in the provisional amount recognized for an identifiable asset (liability) by means of a decrease (increase) in goodwill. 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 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 recognized 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 recognized for the claim receivable from the insurer.
107. During the measurement period, the acquirer shall recognize 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, amortization or other income effects recognized 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 MPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors*.

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 recognize 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 MPSASs.**
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 recognized in accordance with MPSAS 28, *Financial Instruments: Presentation*, and MPSAS 29, *Financial Instruments: Recognition and Measurement*.

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 MPSASs 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 recognized 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 recognized as an intangible asset shall be amortized 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 MPSAS (paragraphs AG109–AG111 provide related application guidance).

Contingent Liabilities

115. After initial recognition and until the liability is settled, cancelled or expires, the acquirer shall measure a contingent liability recognized in an acquisition at the higher of:
- (a) The amount that would be recognized in accordance with MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*; and
 - (b) The amount initially recognized less, if appropriate, cumulative amortization recognized in accordance with MPSAS 9, *Revenue from Exchange Transactions*.

This requirement does not apply to contracts accounted for in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*.

Indemnification Assets

116. At the end of each subsequent reporting period, the acquirer shall measure an indemnification asset that was recognized 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 collectability of the indemnification asset. The acquirer shall derecognize 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 recognizes after the acquisition date may be the result of additional information that the acquirer obtained after that date about facts and circumstances that existed at the acquisition date. Such changes are measurement period adjustments in accordance with paragraphs 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 MPSAS 29, *Financial Instruments: Recognition and Measurement*, shall be measured at fair value at each reporting date and changes in fair value shall be recognized in surplus or deficit in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*.
 - (ii) Is not within the scope of MPSAS 29, *Financial Instruments: Recognition and Measurement*, shall be measured at fair value at each reporting date and changes in fair value shall be recognized 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 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 authorized for issue.**
- 120. To meet the objective in paragraph 119, the acquirer shall disclose the following information for each acquisition that occurs during the reporting period:
 - (a) The name and a description of the acquired operation.
 - (b) The acquisition date.
 - (c) The percentage of voting equity interests or equivalent acquired.
 - (d) The primary reasons for the acquisition and a description of how the acquirer obtained control of the acquired operation including, where applicable, the legal basis for the acquisition.
 - (e) A qualitative description of the factors that make up the goodwill recognized, such as expected synergies from combining the operations of the acquired operation and the acquirer, intangible assets that do not qualify for separate recognition or other factors.
 - (f) The acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration, such as:
 - (i) Cash;
 - (ii) Other tangible or intangible assets, including an operation or controlled entity of the acquirer;

- (iii) Liabilities incurred, for example, a liability for contingent consideration; and
 - (iv) Equity interests of the acquirer, including the number of instruments or interests issued or issuable and the method of measuring the fair value of those instruments or interests.
- (g) For contingent consideration arrangements and indemnification assets:
 - (i) The amount recognized as of the acquisition date;
 - (ii) A description of the arrangement and the basis for determining the amount of the payment; and
 - (iii) An estimate of the range of outcomes (undiscounted) or, if a range cannot be estimated, that fact and the reasons why a range cannot be estimated. If the maximum amount of the payment is unlimited, the acquirer shall disclose that fact.
- (h) For acquired receivables:
 - (i) The fair value of the receivables;
 - (ii) The gross amounts receivable in accordance with a binding arrangement; and
 - (iii) The best estimate at the acquisition date of the cash flows in accordance with a binding arrangement not expected to be collected.

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

- (i) The amounts recognized as of the acquisition date for each major class of assets acquired and liabilities assumed.
- (j) For each contingent liability recognized in accordance with paragraph 77, the information required in paragraph 98 of MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*. If a contingent liability is not recognized because its fair value cannot be measured reliably, the acquirer shall disclose:
 - (i) The information required by paragraph 100 of MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*; 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 recognized 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 recognized for each transaction and the line item in the financial statements in which each amount is recognized; 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 recognized transactions required by (l) shall include the amount of acquisition-related costs and, separately, the amount of those costs recognized as an expense and the line item or items in the statement of financial performance in

which those expenses are recognized. The amount of any issue costs not recognized as an expense and how they were recognized shall also be disclosed.

- (n) In an acquisition in which a loss is recognized in surplus or deficit (see paragraph 86):
 - (i) The amount of the loss recognized in accordance with paragraph 86 and the line item in the statement of financial performance in which the loss is recognized; 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 recognized in accordance with paragraph 88 and the line item in the statement of financial performance in which the gain is recognized; 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 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 recognized 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 recognized 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 in which that gain or loss is recognized.
- (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 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 MPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.

- 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).
- 122. If the acquisition date of an acquisition is after the end of the reporting period but before the financial statements are authorized 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 authorized 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 recognized 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 recognized 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, 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 recognized 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 recognized 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 recognized in an acquisition, the acquirer shall disclose the information required by paragraphs 97 and 98 of MPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, for each class of provision.
 - (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 recognized during the reporting period.
 - (iii) Adjustments resulting from the subsequent recognition of amounts during the reporting period in accordance with the relevant international or national accounting standard dealing with income taxes.
 - (iv) Goodwill derecognized during the reporting period.
 - (v) Impairment losses recognized during the reporting period in accordance with MPSAS 26, *Impairment of Cash-Generating Assets*. (MPSAS 26, *Impairment of*

Cash-Generating Assets, 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 MPSAS 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.
- (e) The amount and an explanation of any gain or loss recognized 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.

125. If the specific disclosures required by this and other MPSASs 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.

Effective Date and Transition

Effective date

126. **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, 2023. Earlier application is encouraged. If an entity applies this Standard before January 1, 2023, it shall disclose that fact.**

Transition

127. 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 recognized. 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 amortization 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 recognize 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).

Application Guidance

This Appendix is an integral part of MPSAS 40, Public Sector Combinations.

Definitions (see paragraph 5)

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.

Identifying a Public Sector Combination (see paragraph 6)

AG2. Paragraph 5 of this Standard defines a public sector combination as “the bringing together of separate operations into one public sector entity.” The reference to one public sector entity may be to a single entity or to an economic entity. Some public sector reorganizations may involve more than one public sector combination. The circumstances in which a 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.
- (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.
- (c) **Output:** The result of inputs and processes applied to those inputs that provide, or have the ability to provide, goods and/or services.

The definitions of an input and an output differ from those in RPG 3, *Reporting Service Performance Information*. This is because RPG 3 focuses on recipients who are external to the entity; an operation may have recipients who are internal to an entity.

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 their 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 Public Sector Combinations (see paragraphs 7–14)

Assessment of Control (see paragraphs 7–8)

- AG10. Where a party to a 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 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 public sector combination, it differs from the assessment of control made in accordance with MPSAS 35, *Consolidated Financial Statements*, where the assessment of control is made by reference to the entities that exist after a public sector combination has taken place.
- AG11. In determining whether one party to a public sector combination gains control of one or more operations as a result of the combination, an entity applies the principles and guidance in MPSAS 35, *Consolidated Financial Statements*. 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 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 MPSAS 35, *Consolidated Financial Statements*, 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).

AG12. In applying the principles and guidance in MPSAS 35, *Consolidated Financial Statements*, an entity has regard to paragraphs AG13–AG18.

AG13. A 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 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 organized group of owners has a significant voting interest.

AG15. A 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 public sector combination gains control of operations.

AG16. In a public sector combination involving more than two entities, the party to the 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 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.

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 Public Sector Combination (see paragraphs 9–14)

AG19. If one party to a 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 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. 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 public sector combination. 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.

AG24. An acquisition is usually a mutual agreement between two or more parties, and usually has commercial substance. However, 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. 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.

Indicators Relating to Consideration (see paragraph 12)

AG26. Amalgamations usually do not involve the payment of consideration to compensate a seller for giving up 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. 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 that is not intended to compensate the seller for giving up their entitlement to the net assets of an operation, but is, for example, intended to reimburse them for costs incurred in effecting the public sector combination, 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, the absence of consideration does not in itself provide evidence of the economic substance of the public sector combination. 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. 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. 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 organizations.

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 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 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 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 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 nationalize 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 nationalization, 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 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 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. 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 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 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 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 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 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 recognizes in its financial statements the assets acquired and liabilities assumed, including those not previously recognized by the acquired operation. Such information assists users of the financial statements in assessing the initial investments made 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 summarized 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 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 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 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 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 public sector combination? For example, in an amalgamation, any difference between the total recognized assets and total recognized liabilities is recognized in net assets/equity, whereas in an acquisition, the acquirer recognizes 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 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 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

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 at the amalgamation date. The expense of the combining operation receiving the services is reflected in that combining operation's accumulated surplus or deficit at the amalgamation date. The resulting entity will recognize both amounts in net assets/equity.

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

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

- AG53. 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.

Licenses 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 license 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 recognized or unrecognized assets. Examples of such rights include a right to use the acquirer's technology under a technology licensing agreement. The resulting entity recognizes this license 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 license or similar right has previously been part of a binding arrangement, the license satisfies both the separability and binding arrangement criteria in MPSAS 31, *Intangible Assets*. Paragraph 47 provides guidance on the subsequent accounting for a license or similar right previously granted by one combining operation to another combining operation.
- AG56. The resulting entity assesses both the license or similar right previously granted by one combining operation to another combining operation, and the underlying asset (where the underlying asset is a recognized asset) for impairment in accordance with MPSAS 21, *Impairment of Non-Cash-Generating Assets*, and MPSAS 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 paragraphs 33–34)

- AG57. The resulting entity shall not recognize 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 derecognized 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 the relevant international or national accounting standard dealing with income taxes.

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 MPSAS 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 recognize 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 recognized goodwill as a result of a previous acquisition, the resulting entity recognizes 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 MPSASs.

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 MPSASs.

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 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 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:

- (a) Where 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) Where 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. 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 a public sector entity wants to become a listed entity but does not want to register its equity shares. To accomplish that, the 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 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 public sector entity as the acquirer for accounting purposes (the accounting acquirer)—i.e., the 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 recognize 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) recognized and measured at their pre-combination carrying amounts.
- (b) The assets and liabilities of the legal controlling entity (the accounting acquired operation) recognized and measured in accordance with this Standard.
- (c) The accumulated surplus or deficit and other equity balances of the legal controlled entity (accounting acquirer) before the acquisition.
- (d) The amount recognized 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 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 recognized 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.

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

Operating Leases

- AG72. The acquirer shall recognize no assets or liabilities related to an operating lease in which the acquired operation is the lessee except as required by paragraphs AG73–AG74.
- AG73. The acquirer shall determine whether the terms of each operating lease in which the acquired operation is the lessee are favorable or unfavorable. The acquirer shall recognize an intangible asset if the terms of an operating lease are favorable relative to market terms and a liability if the terms are unfavorable relative to market terms. Paragraph AG89 provides guidance on measuring the acquisition-date fair value of assets subject to operating leases in which the acquired operation is the lessor.
- AG74. An identifiable intangible asset may be associated with an operating lease, which may be evidenced by market participants' willingness to pay a price for the lease even if it is at market terms. For example, a lease of gates at an airport or of retail space in a prime shopping area might provide entry into a market or other future economic benefits or service potential that qualify as identifiable intangible assets, for example, as a relationship with users of a service. In that situation, the acquirer shall recognize the associated identifiable intangible asset(s) in accordance with paragraph AG75.

Intangible Assets

- AG75. The acquirer shall recognize, 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 favorable relative to market terms. The lease terms explicitly prohibit transfer of the lease (through either sale or sublease). The amount by which the lease terms are favorable compared with the terms of current market transactions for the same or similar items is an intangible asset that meets the binding arrangement criterion for recognition separately from goodwill, even though the acquirer cannot sell or otherwise transfer the lease arrangement.
 - (b) An acquired operation owns and operates a nuclear power plant. The license to operate that power plant is an intangible asset that meets the binding arrangement criterion for recognition separately from goodwill, even if the acquirer cannot sell or transfer it separately from the acquired power plant. An acquirer may recognize the fair value of the operating license and the fair value of the power plant as a single asset for financial reporting purposes if the useful lives of those assets are similar.
 - (c) An acquired operation owns a technology patent. It has licensed that patent to others for their exclusive use outside the domestic market, receiving a specified percentage of future foreign revenue in exchange. Both the technology patent and the related license agreement meet the binding arrangement criterion for recognition separately from goodwill even if selling or exchanging the patent and the related license agreement separately from one another would not be practical.

- 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 recognized or unrecognized assets. Examples of such rights include a right to use the acquirer's technology under a technology licensing agreement. A reacquired right is an identifiable intangible asset that the acquirer recognizes 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 favorable or unfavorable relative to the terms of current market transactions for the same or similar items, the acquirer shall recognize 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 specialized) knowledge and experience that employees of an acquired operation bring to their jobs. Because the assembled workforce is not an identifiable asset to be recognized

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 recognize 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 recognizable 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 MPSAS 31, *Intangible Assets*. However, as described in paragraph 6 of MPSAS 31, *Intangible Assets*, the accounting for some acquired intangible assets after initial recognition is prescribed by other MPSASs.
- AG84. The identifiability criteria determine whether an intangible asset is recognized 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 recognized in an acquisition.) Paragraphs 39D and 39E of MPSAS 31, *Intangible Assets*, 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)

- AG85. The acquirer shall not recognize 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 the relevant international or national accounting standard dealing with income taxes.
- 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 MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes & Transfers)*.
- 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 derecognize those amounts in accordance with 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 recognize a separate valuation allowance as of the acquisition date for assets acquired in an acquisition that are measured at their acquisition-date fair values because the effects of uncertainty about future cash flows are included in the fair value measure. For example, because this 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 recognize a separate valuation allowance for the cash flows of the binding arrangement that are deemed to be uncollectible at that date.

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

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

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.

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 recognize goodwill only to the extent that the acquirer estimates there will be favorable changes to its net cash flows, either from increased cash inflows or decreased cash outflows. An acquirer shall not recognize goodwill related to service potential other than cash flows.

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 recognize 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, 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 recognizes 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 favorable or unfavorable from the perspective of the acquirer when compared with terms for current market transactions for the same or similar items. (An unfavorable binding arrangement is a binding arrangement that is unfavorable 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 unfavorable.

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

The amount of gain or loss recognized may depend in part on whether the acquirer had previously recognized 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 recognizes as a reacquired right. If the binding arrangement includes terms that are favorable or unfavorable when compared with pricing for current market transactions for the same or similar items, the acquirer recognizes, 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 recognize 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 recognize 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 MPSASs that provide guidance on subsequently measuring and accounting for assets acquired and liabilities assumed or incurred in an acquisition include:

- (a) MPSAS 31, *Intangible Assets*, prescribes the accounting for identifiable intangible assets acquired in an acquisition. The acquirer measures goodwill at the amount recognized at the acquisition date less any accumulated impairment losses. MPSAS 26, *Impairment of Cash-Generating Assets*, prescribes the accounting for impairment losses.
- (b) MPSAS 35, *Consolidated Financial Statements*, provides guidance on accounting for changes in a controlling entity's ownership interest in a controlled entity after control is obtained.

AG108. An acquirer should refer to the relevant international or national accounting standards 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 MPSASs.

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 MPSASs.

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. 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 Public Sector Combinations Involving Only Mutual Entities or by Contract Alone (see paragraph 133)

- AG114. 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 January 1, 2023. 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 recognized 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 amortization of that goodwill and the corresponding decrease in goodwill. No other adjustments shall be made to the carrying amount of goodwill.
 - (c) Goodwill previously recognized as a deduction from equity. The entity's previous accounting policies may have resulted in goodwill arising from the prior public sector combination being recognized as a deduction from equity. In that situation the entity shall not recognize that goodwill as an asset at the beginning of the first annual period in which this Standard is applied. Furthermore, the entity shall not recognize 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 amortizing goodwill arising from the prior public sector combination and shall test goodwill for impairment in accordance with MPSAS 26, *Impairment of Cash-Generating Assets*.
 - (e) Previously recognized negative goodwill. An entity that accounted for the prior public sector combination by applying the purchase method may have recognized 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 derecognize 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.

Amendments to Other MPSASs

Amendments to MPSAS 1, *Presentation of Financial Statements*

Paragraph 135 is amended and paragraph 153J is added. New text is underlined and deleted text is struck through.

Notes

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Disclosure of Accounting Policies

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135. Each entity considers the nature of its operations and the policies that the users of its financial statements would expect to be disclosed for that type of entity. For example, public sector entities would be expected to disclose an accounting policy for recognition of taxes, donations, and other forms of non-exchange revenue. When an entity has significant foreign operations or transactions in foreign currencies, disclosure of accounting policies for the recognition of foreign exchange gains and losses would be expected. When ~~entity combinations~~ public sector combinations have occurred, the policies used for measuring goodwill and non-controlling interest are disclosed.

...

Effective Date

...

- 153J. Paragraph 135 was amended by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2023 it shall disclose that fact and apply MPSAS 40, *Public Sector Combinations* at the same time.

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

Paragraph 31 is amended and paragraph 32E is added. New text is underlined and deleted text is struck through.

Disclosure

...

Disclosure of Non-adjusting Events after the Reporting Date

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31. The following are examples of non-adjusting events after the reporting date that would generally result in disclosure:
- (a) An unusually large decline in the value of property carried at fair value, where that decline is unrelated to the condition of the property at reporting date, but is due to circumstances that have arisen since the reporting date;

- (b) The entity decides after the reporting date, to provide/distribute substantial additional benefits in the future directly or indirectly to participants in community service programs that it operates, and those additional benefits have a major impact on the entity;
- (c) A major public sector combination (MPSAS 40, *Public Sector 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;~~

Effective Date

...

32E. Paragraph 31 was amended by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2023 it shall disclose that fact and apply MPSAS 40, *Public Sector Combinations* at the same time.

Amendments to MPSAS 16, *Investment Property*

Paragraphs 87 and 90 are amended and paragraphs 18A and 101E are added. New text is underlined and deleted text is struck through.

Definitions

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Investment Property

...

18A. Judgment is also needed to determine whether the acquisition of investment property is the acquisition of an asset or a group of assets or a public sector combination within the scope of MPSAS 40, *Public Sector Combinations*. Reference should be made to MPSAS 40, *Public Sector Combinations*, to determine whether it is a public sector 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 public sector combination as defined in MPSAS 40, *Public Sector Combinations*. Determining whether a specific transaction meets the definition of a public sector combination as defined in MPSAS 40, *Public Sector Combinations*, and includes an investment property as defined in this Standard requires the separate application of both Standards.

...

Disclosure

Fair Value Model and Cost Model

...

Fair Value Model

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:

- (a) Additions, disclosing separately those additions resulting from acquisitions and those resulting from subsequent expenditure recognized in the carrying amount of an asset;
- (b) Additions resulting from acquisitions through ~~entity combinations~~ public sector combinations;

...

Cost Model

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

- (a) The depreciation methods used;

...

- (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 recognized as an asset;
- (ii) Additions resulting from acquisitions through ~~entity combinations~~ public sector combinations;
- (iii) Disposals;

...

Effective Date

...

101E. Paragraph 18A was added and paragraphs 87 and 90 amended by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2023 it shall disclose that fact and apply MPSAS 40, *Public Sector Combinations*, at the same time.

Amendments to MPSAS 17, *Property, Plant, and Equipment*

Paragraphs 60 and 88 are amended and paragraph 107M is added. New text is underlined and deleted text is struck through.

Depreciation

...

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

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

(a) The measurement bases used for determining the gross carrying amount;

...

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

(i) Additions;

(ii) Disposals;

(iii) Acquisitions through ~~entity combinations~~ public sector combinations;

...

Effective Date

...

107M. Paragraphs 60 and 88 were amended by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies these amendments for a period beginning before January 1, 2023 it shall disclose that fact and apply MPSAS 40, *Public Sector Combinations*, at the same time.

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

Paragraphs 4A and 111F are added. New text is underlined.

Scope

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4A. This Standard does not apply to the contingent consideration of an acquirer in a public sector combination which is within the scope of MPSAS 40, *Public Sector Combinations*.

...

Effective Date

...

111F. Paragraph 4A was added by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2023 it shall disclose that fact and apply MPSAS 40, *Public Sector Combinations*, at the same time.

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

Paragraph 14 is amended and paragraphs 20A and 82G are added. New text is underlined and deleted text is struck through.

Definitions

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.

...

Cash-Generating Assets

...

- 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 only recognized where it gives rise to cash inflows or reductions in an acquirer's net cash outflows. No goodwill is recognized in respect of service potential that does not give rise to related cash flows. The recoverable service amount used to assess impairment in this Standard includes service potential. Consequently, an entity applies MPSAS 26, *Impairment of Cash-Generating Assets*, rather than this Standard to determine whether to impair goodwill.

...

Effective Date

...

- 82G. Paragraph 14 was amended and paragraph 20A added by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2023 it shall disclose that fact and apply MPSAS 40, *Public Sector Combinations*, at the same time.

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

Paragraphs 1, 2 and 6 are amended and paragraph 124E is added. New text is underlined and deleted text is struck through.

Objective

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

Scope

2. An entity 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 public sector combination ~~an entity combination~~ that is a non-exchange transaction.

...

6. Governments may reorganize the public sector, merging some public sector entities, and dividing other entities into two or more separate entities. A public sector combination ~~An entity combination~~ occurs when two or more operations reporting entities are brought together to form one reporting entity. These restructurings do not ordinarily involve one entity purchasing another operation or entity, but may result in a new or existing entity acquiring all the assets and liabilities of another operation or entity. ~~The IPSASB has not addressed entity combinations, and has excluded them from the scope of this Standard. Therefore, this Standard does not specify whether an entity combination, which is a non-exchange transaction, will give rise to revenue or not.~~ Public sector combinations shall be accounted for in accordance with MPSAS 40, *Public Sector Combinations*.

...

Effective Date

...

- 124E. Paragraphs 1, 2 and 6 were amended by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2023 it shall disclose that fact and apply MPSAS 40, *Public Sector Combinations*, at the same time.

Amendments to MPSAS 25, *Employee Benefits*

Paragraph 128 is deleted, and 141(c)(viii), 141(e)(vii), IE7 are amended and paragraph 177B is added . New text is underlined and deleted text is struck through.

Post-employment Benefits—Defined Benefit Plans

~~Entity Combinations~~

128. ~~In determining the assets and liabilities to be recognized related to post-employment benefits in an entity combination, an entity considers the international or national accounting standard dealing with entity combinations.~~

Disclosure

...

141. An entity shall disclose the following information about defined benefit plans:

...

- (c) A reconciliation of opening and closing balances of the present value of the defined benefit obligation showing separately, if applicable, the effects during the period attributable to each of the following:

...

(viii) ~~Entity combinations~~ Public Sector Combinations;

...

...

- (e) A reconciliation of the opening and closing balances of the fair value of plan assets, and of the opening and closing balances of any reimbursement right recognized as an asset in accordance with paragraph 121 showing separately, if applicable, the effects during the period attributable to each of the following:

...

(vii) ~~Entity combinations~~; Public Sector Combinations; and

...

...

Illustrative Examples (IE)

...

IE7. Illustrative disclosures are as follows.

...

Changes in the present value of the defined benefit obligation are as follows:

	Defined benefit pension plans		Post-employment medical benefits	
	20X8	20X7	20X8	20X7
Service cost	850	750	479	411
Interest cost	950	1,000	803	705
Actuarial losses (gains)	2,350	950	250	400
Losses (gains) on curtailments	(500)	–		
Liabilities extinguished on settlements	–	(350)		
Liabilities assumed in an ~~entity combination~~ public sector combination	–	5,000		
Exchange differences on foreign plans	900	(150)		
Benefits paid	(650)	(400)	(600)	(550)
Closing defined benefit obligation	22,300	18,400	7,337	6,405

Changes in the fair value of plan assets are as follows:

	Defined benefit pension	
	20X8	20X7
Opening fair value of plan assets	17,280	9,200
Expected return	900	650
Actuarial gains (losses)	(300)	1,600
Assets distributed on settlements	(400)	–
Contributions by employer	700	350
Assets acquired in an ~~entity combination~~ public sector combination	–	6,000
Exchange differences on foreign plans	890	(120)
Benefits paid	(650)	(400)
	<u>18,420</u>	<u>17,280</u>

...

Effective Date

...

177B. Paragraph 128 is deleted, and 141(c)(viii), 141(e)(vii) and IE7 are amended by MPSAS 40, Public Sector Combinations, issued in October 2021. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2023 it shall disclose that fact and apply MPSAS 40, Public Sector Combinations, at the same time.

...

Amendments to MPSAS 26, *Impairment of Cash-Generating Assets*

Paragraphs 2, 23, 71, 76, 88, 91, 92, 98–100, 102, 103, 106–108, 110, 111, 120, 122 and 123–125, and headings before paragraphs 71 and 76 are amended. Paragraphs 18A, 20A, 90A–90O, 97A–97H, 111A, 111B, 122A and 126I, and headings after paragraphs 90, 97 and 111 are added. Paragraphs 7 and 96 are deleted. New text is underlined and deleted text is struck through.

Scope

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

...

- (i) ~~Goodwill;~~

...

7. ~~This Standard excludes goodwill from its scope. Entities apply the requirements of the relevant international or national accounting standards dealing with the impairment of goodwill, the allocation of goodwill to cash-generating units, and the testing for impairment of cash-generating units with goodwill.~~

...

Definitions

...

Cash-Generating Assets

...

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. MPSAS 21, *Impairment of Cash-Generating Assets*, deals with the assessment of individual assets. Goodwill is only recognized where it gives rise to cash inflows or reductions in an acquirer's net cash outflows. No goodwill is recognized in respect of service potential that does not give rise to related cash flows. The recoverable service amount used to assess impairment in MPSAS 21, *Impairment of Cash-Generating Assets*, includes service potential. Consequently, an entity applies this Standard to determine whether to impair goodwill.

...

Identifying an Asset that may be Impaired

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 recognizing 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 recognized 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–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.

...

23. 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 the reporting period, provided it is performed at the same time every year. Different intangible assets may be tested for impairment at different times. However, if such an intangible asset was initially recognized during the current reporting period, that intangible asset shall be tested for impairment before the end of the current reporting period.
 - (b) Test goodwill acquired in an acquisition for impairment annually in accordance with paragraphs 90A–90O.

...

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

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

...

Cash-Generating Units and Goodwill

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 recognizing impairment losses for, cash-generating units and goodwill.

...

Recoverable Amount and Carrying Amount of a Cash-Generating Unit

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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–90O explain how to deal with these assets in testing a cash-generating unit for impairment.

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Goodwill

Allocating goodwill to cash-generating units

- 90A. For the purpose of impairment testing, goodwill acquired in an acquisition shall, from the acquisition date, be allocated to each of the acquirer's cash-generating units, or groups of cash-generating units, that is expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquired operation are assigned to those units or groups of units. Where goodwill is acquired in an acquisition of a non-cash-

generating operation that results in a reduction in the net cash outflows of the acquirer, the acquirer shall be considered as the cash-generating unit. Except where goodwill relates to the acquisition of a non-cash-generating operation, 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; and
- (b) Not be larger than a segment as defined by paragraph 9 of IPSAS 18, *Segment Reporting*.

90B. Goodwill recognized 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 recognized. Goodwill does not generate cash flows, or reductions in net cash outflows, 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–90O and 97A–97H 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. Where goodwill is acquired in an acquisition of a non-cash-generating operation that results in a reduction in the net cash outflows of the acquirer, references in paragraphs 90D–90O and 97A–97H to a cash-generating unit to which goodwill is allocated should be read as references also to the acquirer.

90C. Applying the requirements in paragraph 90A results 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. A cash-generating unit to which goodwill is allocated for the purpose of impairment testing may not coincide with the level at which goodwill is allocated in accordance with MPSAS 4, *The Effects of Changes in Foreign Exchange Rates*, for the purpose of measuring foreign currency gains and losses. For example, if an entity is required by MPSAS 4, *The Effects of Changes in Foreign Exchange Rates*, to allocate goodwill to relatively low levels for the purpose of measuring foreign currency gains and losses, it is not required to test the goodwill for impairment at that same level unless it also monitors the goodwill at that level for internal management purposes.

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

90F. In accordance with MPSAS 40, *Public Sector Combinations*, if the initial accounting for an acquisition can be determined only provisionally by the end of the period in which the combination is effected, the acquirer:

- (a) Accounts for the acquisition using those provisional values; and
- (b) Recognizes any adjustments to those provisional values as a result of completing the initial accounting within the measurement period, which will 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 recognized in the acquisition 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.

90G. If goodwill has been allocated to a cash-generating unit and the entity disposes of an operation within that unit, the goodwill associated with the operation disposed of shall be:

- (a) Included in the carrying amount of the operation when determining the gain or loss on disposal; and**
- (b) Measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit retained, unless the entity can demonstrate that some other method better reflects the goodwill associated with the operation disposed of.**

90H. If an entity reorganizes its reporting structure in a way that changes the composition of one or more cash-generating units to which goodwill has been allocated, the goodwill shall be reallocated to the units affected. This reallocation shall be performed using a relative value approach similar to that used when an entity disposes of an operation within a cash-generating unit, unless the entity can demonstrate that some other method better reflects the goodwill associated with the reorganized units.

Testing cash-generating units with goodwill for impairment

90I. When, as described in paragraph 90B, 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 recognized in accordance with paragraph 91.

90J. If a cash-generating unit described in paragraph 90I 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 requires the unit also to be tested for impairment annually.

90K. 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 recognize the impairment loss in accordance with paragraph 91.

Timing of impairment tests

90L. 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 during the current annual period, that unit shall be tested for impairment before the end of the current annual period.

- 90M. If the assets constituting the cash-generating unit to which goodwill has been allocated are tested for impairment at the same time as the unit containing the goodwill, they shall be tested for impairment before the unit containing the goodwill. Similarly, if the cash-generating units constituting a group of cash-generating units to which goodwill has been allocated are tested for impairment at the same time as the group of units containing the goodwill, the individual units shall be tested for impairment before the group of units containing the goodwill.
- 90N. At the time of impairment testing a cash-generating unit to which goodwill has been allocated, there may be an indication of an impairment of an asset within the unit containing the goodwill. In such circumstances, the entity tests the asset for impairment first, and recognizes any impairment loss for that asset before testing for impairment the cash-generating unit containing the goodwill. Similarly, there may be an indication of an impairment of a cash-generating unit within a group of units containing the goodwill. In such circumstances, the entity tests the cash-generating unit for impairment first, and recognizes any impairment loss for that unit, before testing for impairment the group of units to which the goodwill is allocated.
- 90O. The most recent detailed calculation made in a preceding period of the recoverable amount of a cash-generating unit to which goodwill has been allocated may be used in the impairment test of that unit in the current period provided all of the following criteria are met:
- (a) The assets and liabilities making up the unit have not changed significantly since the most recent recoverable amount calculation;
 - (b) The most recent recoverable amount calculation resulted in an amount that exceeded the carrying amount of the unit by a substantial margin; and
 - (c) Based on an analysis of events that have occurred and circumstances that have changed since the most recent recoverable amount calculation, the likelihood that a current recoverable amount determination would be less than the current carrying amount of the unit is remote.

Impairment Loss for a Cash-Generating Unit

91. An impairment loss shall be recognized 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 cash-generating 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) on a pro rata basis, based on the carrying amount of each asset in the unit.
- These reductions in carrying amounts shall be treated as impairment losses on individual assets and recognized in accordance with paragraph 73.
92. In allocating an impairment loss in accordance with paragraph 91, an entity shall not reduce the carrying amount of an asset below the highest of:
- (a) Its fair value less costs to sell (if determinable);
 - (b) Its value in use (if determinable); and

(c) **Zero.**

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

...

96. ~~Where an asset releases service potential to one or more cash-generating activities, but not to non-cash-generating activities, entities refer to the relevant international and national accounting standard dealing with such circumstances.~~

...

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

97A. In accordance with MPSAS 40, *Public Sector Combinations*, the acquirer measures and recognizes 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 MPSAS 40, *Public Sector Combinations*, which generally requires acquisition-date fair value;
- (ii) The amount of any non-controlling interest in the acquired operation measured in accordance with MPSAS 40, *Public Sector Combinations*; 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.

(b) The net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed measured in accordance with MPSAS 40, *Public Sector Combinations*.

Allocation of Goodwill

97B. Paragraph 90A of this Standard requires goodwill acquired in an acquisition 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 are assigned to those units, or groups of units. It is possible that some of the synergies resulting from an acquisition will be allocated to a cash-generating unit in which the non-controlling interest does not have an interest.

Testing for Impairment

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

97D. 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 recognized 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. Paragraph 91 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. 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. 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. If an impairment loss attributable to a non-controlling interest relates to goodwill that is not recognized in the controlling entity's consolidated financial statements (see paragraph 97D), that impairment is not recognized as a goodwill impairment loss. In such cases, only the impairment loss relating to the goodwill that is allocated to the controlling entity is recognized as a goodwill impairment loss.

Reversing an Impairment Loss

98. Paragraphs 99–105 set out the requirements for reversing an impairment loss recognized for an asset or a cash-generating unit in prior periods. These requirements use the term “an asset,” but apply equally to an individual asset or a cash-generating unit. Additional requirements for an individual asset are set out in paragraphs 106–109 and, for a cash-generating unit, in paragraphs 110 and 111 and for goodwill in paragraphs 111A and 111B.
99. **An entity shall assess at each reporting date whether there is any indication that an impairment loss recognized in prior periods for an asset other than goodwill may no longer exist or may have decreased. If any such indication exists, the entity shall estimate the recoverable amount of that asset.**
100. **In assessing whether there is any indication that an impairment loss recognized in prior periods for an asset other than goodwill may no longer exist or may have decreased, an entity shall consider, as a minimum, the following indications:**
- ...
102. If there is an indication that an impairment loss recognized for an asset other than goodwill may no longer exist or may have decreased, this may indicate that (a) the remaining useful life, (b) the depreciation (amortization) method, or (c) the residual value may need to be reviewed and

adjusted in accordance with the standard applicable to the asset, even if no impairment loss is reversed for the asset.

103. **An impairment loss recognized in prior periods for an asset 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 recognized. 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 an Individual Asset

106. **The increased carrying amount of an asset other than goodwill attributable to a reversal of an impairment loss shall not exceed the carrying amount that would have been determined (net of amortization or depreciation) had no impairment loss been recognized for the asset in prior years.**
107. Any increase in the carrying amount of an asset other than goodwill above the carrying amount that would have been determined (net of amortization or depreciation) had no impairment loss been recognized for the asset in prior years is a revaluation. In accounting for such a revaluation, an entity applies the standard applicable to the asset.
108. **A reversal of an impairment loss for an asset other than goodwill shall be recognized immediately in surplus or deficit, unless the asset is carried at revalued amount in accordance with another Standard (for example, the revaluation model in MPSAS 17, *Property, Plant and Equipment*, and MPSAS 31, *Intangible Assets*). Any reversal of an impairment loss of a revalued asset shall be treated as a revaluation increase in accordance with that other Standard.**

...

Reversing an Impairment Loss for a Cash-Generating Unit

110. **A reversal of an impairment loss for a cash-generating unit shall be allocated to the cash-generating assets of the unit, except for goodwill, pro rata with the carrying amounts of those assets. These increases in carrying amounts shall be treated as reversals of impairment losses for individual assets and recognized in accordance with paragraph 108. No part of the amount of such a reversal shall be allocated to a non-cash-generating asset contributing service potential to a cash-generating unit.**
111. **In allocating a reversal of an impairment loss for a cash-generating unit in accordance with paragraph 110, the carrying amount of an asset shall not be increased above the lower of:**
- (a) **Its recoverable amount (if determinable); and**
 - (b) **The carrying amount that would have been determined (net of amortization or depreciation) if no impairment loss had been recognized for the asset in prior periods.**

The amount of the reversal of the impairment loss that would otherwise have been allocated to the asset shall be allocated pro rata to the other assets of the unit, except for goodwill.

Reversing an Impairment Loss for Goodwill

111A. An impairment loss recognized for goodwill shall not be reversed in a subsequent period.

111B. MPSAS 31, *Intangible Assets*, prohibits the recognition of internally generated goodwill. Any increase in the recoverable amount of goodwill in the periods following the recognition of an impairment loss for that goodwill is likely to be an increase in internally generated goodwill, rather than a reversal of the impairment loss recognized for the acquired goodwill.

...

Disclosure

...

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

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

...

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

...

122. An entity is encouraged to disclose assumptions used to determine the recoverable amount of assets during the period. However, paragraph 123 requires an entity to disclose information about the estimates used to measure the recoverable amount of a cash-generating unit when goodwill or an intangible asset with an indefinite useful life is included in the carrying amount of that unit.

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

Disclosure of Estimates Used to Measure Recoverable Amounts of Cash-Generating Units Containing Intangible Assets with Indefinite Useful Lives

123. An entity shall disclose the information required by (a)–(e)(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);

(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:

- (i) A description of each key assumption on which management has based its cash flow projections for the period covered by the most recent budgets/forecasts. Key assumptions are those to which the unit's (group of units') recoverable amount is most sensitive;
 - (ii) A description of management's approach to determining the value(s) assigned to each key assumption, whether those value(s) reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information;
 - (iii) The period over which management has projected cash flows based on financial budgets/forecasts approved by management and, when a period greater than five years is used for a cash-generating unit (group of units), an explanation of why that longer period is justified;
 - (iv) The growth rate used to extrapolate cash flow projections beyond the period covered by the most recent budgets/forecasts, and the justification for using any growth rate that exceeds the long-term average growth rate for the products, industries, or country or countries in which the entity operates, or for the market to which the unit (group of units) is dedicated; and
 - (v) The discount rate(s) applied to the cash flow projections.
- ~~(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:
- (i) A description of each key assumption on which management has based its determination of fair value less costs to sell. Key assumptions are those to which the unit's (group of units') recoverable amount is most sensitive; and
 - (ii) A description of management's approach to determining the value (or values) assigned to each key assumption, whether those values 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.
- If fair value less costs to sell is determined using discounted cash flow projections, the following information shall also be disclosed:
- (iii) The period over which management has projected cash flows;
 - (iv) The growth rate used to extrapolate cash flow projections; and
 - (v) The discount rate(s) applied to the cash flow projections.
- ~~(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:
- (i) The amount by which the unit's (group of units') recoverable amount would exceed its carrying amount;
 - (ii) The value assigned to the key assumption; and

- (iii) The amount by which the value assigned to the key assumption must change, after incorporating any consequential effects of that change on the other variables used to measure recoverable amount, in order for the unit's (group of units) recoverable amount to be equal to its carrying 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);
 - ~~(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:
 - (i) The amount by which the aggregate of the units' (group of units) recoverable amounts would exceed the aggregate of their carrying amounts;
 - (ii) The value(s) assigned to the key assumption(s); and
 - (iii) The amount by which the value(s) assigned to the key assumption(s) must change, after incorporating any consequential effects of the change on the other variables used to measure recoverable amount, in order for the aggregate of the units' (group of units) recoverable amounts to be equal to the aggregate of their carrying amounts.
125. The most recent detailed calculation made in a preceding period of the recoverable amount of a cash-generating unit (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.

Effective Date

...

126I. Paragraphs 2, 23, 71, 76, 88, 91, 92, 98–100, 102, 103, 106–108, 110, 111, 120, 122 and 123–125 were amended, paragraphs 18A, 20A, 90A–90O, 97A–97H, 111A, 111B and 122A added and paragraphs 7 and 96 deleted by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2023 it shall disclose that fact and apply MPSAS 40, *Public Sector Combinations*, at the same time.

Implementation Guidance

This guidance accompanies, but is not part of, MPSAS 26, Impairment of Cash-Generating Assets.

...

Including Goodwill in the Carrying Amount of an Operation on Disposal

Background

IG24A. A municipality sells for RM100 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 RM300.

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.

Amendments to MPSAS 27, *Agriculture*

Paragraph 48 is amended and paragraph 56F is added. New text is underlined and deleted text is struck through.

Disclosure

General

...

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 ~~entity combinations~~ public sector combinations;

...

Effective Date

...

- 56F. Paragraph 48 was amended by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2023 it shall apply MPSAS 40, *Public Sector Combinations*, at the same time.

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

Paragraphs 2, AG35, AG131 and B4 are amended and paragraph 125F is added. New text is underlined and deleted text is struck through.

Scope

2. This Standard shall be applied by all entities to all types of financial instruments, except:

...

- (f) Any forward contracts between an acquirer and seller to buy or sell an acquired operation ~~acquiree~~ that will result in a public sector combination ~~an 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.

...

Effective Date

...

- 125F. Paragraphs 2, AG35, AG131 and B4 were amended by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2023 it shall disclose that fact and apply MPSAS 40, *Public Sector Combinations*, at the same time.

Application Guidance

*This Appendix is an integral part of MPSAS 29, *Financial Instruments: Recognition and Measurement*.*

...

Definitions (paragraphs 9 and 10)

...

Held-to-Maturity Investments

...

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 public sector combination ~~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 public sector combination ~~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).

...

Hedging (paragraphs 80–113)

...

Hedged Items (paragraphs 87–94)

Qualifying Items (paragraphs 87–89)

AG131. A firm commitment to acquire an entity or an integrated set of activities in a public sector combination ~~an 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.

Appendix B

Reassessment of Embedded Derivatives

This Appendix is an integral part of MPSAS 29, Financial Instruments: Recognition and Measurement.

Introduction

...

- B4. This appendix applies to all embedded derivatives within the scope of MPSAS 29, *Financial Instruments: Recognition and Measurement*, except the acquisition of contracts with embedded derivatives in a public sector combination ~~an entity combination~~ or their possible reassessment at the date of acquisition.

Implementation Guidance

This guidance accompanies, but is not part of, MPSAS 29, Financial Instruments: Recognition and Measurement.

...

Section F: Hedging

...

F.2 Hedged Items

...

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 public sector combination ~~an entity combination~~).

...

Amendments to MPSAS 31, *Intangible Assets*

Paragraphs 3, 6, 18, 24, 40, 41, 66, 67, and 117 are amended, paragraphs 18A, 26A, 39A–39E, 93A, 114A and 132H are added, and additional headings are inserted after paragraphs 17 and 39. New text is underlined and deleted text is struck through.

Scope

...

3. This Standard shall be applied in accounting for intangible assets, except:

- (a) **Intangible assets that are within the scope of another Standard;**

...

- (e) ~~Intangible assets acquired in a business combination (see the relevant international or national accounting standard dealing with business combinations);~~

- (f) ~~Goodwill acquired in a business combination (see the relevant international or national accounting standard dealing with business combinations);~~

...

6. If another MPSAS prescribes the accounting for a specific type of intangible asset, an entity applies that MPSAS instead of this Standard. For example, this Standard does not apply to:

...

- (d) Financial assets as defined in MPSAS 28, *Financial Instruments: Presentation*. The recognition and measurement of some financial assets are covered by MPSAS 34, *Separate Financial Statements*, MPSAS 35, *Consolidated Financial Statements*, and MPSAS 36, *Investments in Associates and Joint Ventures*; ~~and~~

- (e) Recognition and initial measurement of service concession assets that are within the scope of MPSAS 32, *Service Concession Assets: Grantor*. However, this Standard applies to the subsequent measurement and disclosure of such assets; and

- (f) Goodwill (see MPSAS 40, *Public Sector Combinations*).

...

Definitions

...

Intangible Assets

...

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 recognized as an expense when it is incurred. However, if the item is acquired in an acquisition, it forms part of the goodwill recognized at the acquisition date (see paragraph 66).
- 18A. The definition of an intangible asset requires an intangible asset to be identifiable to distinguish it from goodwill. Goodwill recognized 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 recognized. 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.

...

Control of an Asset

...

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.

...

Recognition and Measurement

...

- 26A. Paragraphs 32–39 deal with the application of the recognition criteria to separately acquired intangible assets, and paragraphs 39A–41 deal with their application to intangible assets acquired in a public sector 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 (Public Sector Combination)

39A. In accordance with MPSAS 40, *Public Sector Combinations*, if an intangible asset is acquired in an acquisition, the cost of that intangible asset is its fair value at the acquisition date. The fair value of an intangible asset will reflect market participants' expectations at the acquisition date about the probability that the expected 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. If an asset acquired in an acquisition is separable or arises from binding arrangements (including rights from contracts 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.

39B. In accordance with this Standard and MPSAS 40, *Public Sector Combinations*, an acquirer recognizes at the acquisition date, separately from goodwill, an intangible asset of the acquired operation, irrespective of whether the asset had been recognized by the acquired operation before the acquisition. This means that the acquirer recognizes as an asset separately from goodwill an in-process research and development project of the acquired operation if the project meets the definition of an intangible asset. An acquired operation'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 or other legal rights).

Intangible Asset Acquired in an Acquisition (Public Sector Combination)

39C. If an intangible asset acquired in an acquisition is separable or arises from a binding arrangement (including rights from contracts 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. An intangible asset acquired in an acquisition might be separable, but only together with a related binding arrangement, identifiable asset or liability. In such cases, the acquirer recognizes the intangible asset separately from goodwill, but together with the related item.

39E. The acquirer may recognize a group of complementary intangible assets as a single asset provided the individual assets have similar useful lives. For example, the terms 'brand' and 'brand name' are often used as synonyms for trademarks and other marks. However, the former are general marketing terms that are typically used to refer to a group of complementary assets such as a trademark (or service mark) and its related trade name, formulas, recipes and technological expertise.

Subsequent Expenditure on an Acquired In-process Research and Development Project

40. **Research or development expenditure that:**

- (a) **Relates to an in-process research or development project acquired separately or in an acquisition and recognized as an intangible asset; and**

- (b) **Is incurred after the acquisition of that project;**
shall be accounted for in accordance with paragraphs 52–60.

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 recognized as an intangible asset is:
- (a) Recognized as an expense when incurred if it is research expenditure;
 - (b) Recognized as an expense when incurred if it is development expenditure that does not satisfy the criteria for recognition as an intangible asset in paragraph 55; and
 - (c) Added to the carrying amount of the acquired in-process research or development project if it is development expenditure that satisfies the recognition criteria in paragraph 55.

...

Recognition of an Expense

66. **Expenditure on an intangible item shall be recognized 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 and cannot be recognized as an intangible asset. If this is the case, it forms part of the amount recognized as goodwill at the acquisition date (see MPSAS 40, *Public Sector Combinations*).
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 recognized. In the case of the supply of goods, the entity recognizes such expenditure as an expense when it has a right to access those goods. In the case of the supply of services, the entity recognizes the expenditure as an expense when it receives the services. For example, expenditure on research is recognized as an expense when it is incurred (see paragraph 52), except when it is acquired as part of an acquisition. Other examples of expenditure that is recognized as an expense when it is incurred include:
- (a) Expenditure on start-up activities (i.e., start-up costs), unless this expenditure is included in the cost of an item of property, plant, and equipment in accordance with MPSAS 17, *Property, Plant and Equipment*. Start-up costs may consist of establishment costs such as legal and secretarial costs incurred in establishing a legal entity, expenditure to open a new facility or operation (i.e., pre-opening costs), or expenditures for starting new operations or launching new products or processes (i.e., pre-operating costs);
 - (b) Expenditure on training activities;
 - (c) Expenditure on advertising and promotional activities (including mail order catalogues and information pamphlets); and
 - (d) Expenditure on relocating or reorganizing part or all of an entity.

...

Useful Life

...

93A. The useful life of:

- (a) A license or similar right previously granted by one combining operation to another combining operation that is recognized by the resulting entity in an amalgamation; or
- (b) A reacquired right recognized 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 granted and shall not include renewal periods.

...

Retirements and Disposals

...

114A. In the case of:

- (a) A license or similar right previously granted by one combining operation to another combining operation that is recognized by the resulting entity in an amalgamation; or
- (b) A reacquired right recognized 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.

...

Disclosure

General

117. An entity shall disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:
- (a) Whether the useful lives are indefinite or finite and, if finite, the useful lives or the amortization rates used;
 - ...
 - (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;
 - ...

Effective Date

...

- 132H. Paragraphs 3, 6, 18, 24, 40, 41, 66, 67, and 117 were amended and paragraphs 18A, 26A, 39A–39E, 93A and 114A were added by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply these amendments prospectively for annual financial statements covering periods beginning on or after January 1, 2023. Therefore, amounts recognized for intangible assets and goodwill in prior public sector combinations shall not be adjusted. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2023 it shall disclose that fact and apply MPSAS 40, *Public Sector Combinations*, at the same time.

Amendments to MPSAS 33, *First-time Adoption of Accrual Basis Malaysian Public Sector Accounting Standards (MPSASs)*

Paragraphs 86, 129, 130 and 132 are amended, paragraphs 62A–62C, and 156 are added, and an additional heading is inserted after paragraph 62. New text is underlined and deleted text is struck through.

Exemptions that Affect Fair Presentation and Compliance with Accrual Basis MPSASs During the Period of Transition

...

Three Year Transitional Relief Period for the Recognition and/or Measurement of Assets and/or Liabilities

...

Other Exemptions

...

MPSAS 40, Public Sector Combinations

62A. Where a first-time adopter applies the exemption in paragraph 36 which allows a three year transitional relief period to not recognize and/or measure assets and/or liabilities, the first-time adopter may be a party to a public sector combination during that three year transitional relief period. The first-time adopter is not required to recognize and/or measure the assets and/or liabilities associated with the public sector combination, until the exemption that provided the relief has expired and/or when the relevant assets and/or liabilities are recognized and/or measured in accordance with the applicable MPSASs (whichever is earlier).

62B. Where a first-time adopter applies the exemption in paragraph 62A it shall not recognize goodwill in respect of an acquisition. The first-time adopter shall recognize the difference between (a) and (b) below in net assets/equity:

(a) The aggregate of:

(i) Any consideration transferred;

(ii) Any non-controlling interests in an acquired operation; and

(iii) Any previously held equity interests in an acquired operation.

(b) The net amounts of any identifiable assets acquired and the liabilities assumed.

62C. MPSAS 40, *Public Sector Combinations* is applied prospectively. Consequently, a first-time adopter does not adjust any amounts of goodwill recognized as a result of a public sector combination that occurred prior to the application of MPSAS 40, *Public Sector Combinations*.

Exemptions that Do Not Affect Fair Presentation and Compliance with Accrual Basis MPSASs During the Period of Adoption

...

MPSAS 4, The Effects of Changes in Foreign Exchange Rates

86. A first-time adopter shall apply the requirement to treat any goodwill (see ~~the relevant international or national accounting standard dealing with entity combinations~~)

MPSAS 40, *Public Sector Combinations*) arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation, as assets and liabilities of the foreign operation, prospectively on the date of adoption of MPSASs.

...

MPSAS 34, *Separate Financial Statements*, MPSAS 35, *Consolidated Financial Statements* and MPSAS 36, *Investments in Associates and Joint Ventures*

129. If a controlled entity becomes a first-time adopter later than its controlling entity, except for the controlled entity of an investment entity, the controlled entity shall, in its financial statements, measure its assets and liabilities at either:

- (a) The carrying amounts determined in accordance with this MPSAS that would be included in the controlling entity's consolidated financial statements, based on the controlled entity's date of adoption of MPSASs, if no adjustments were made for consolidation procedures and for the effects of the ~~entity combination~~ public sector combination in which the controlling entity acquired the controlled entity; or

...

130. However, if a controlling entity becomes a first-time adopter later than its controlled entity (or associate or joint venture) the controlling 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 ~~entity combination~~ public sector combination in which the controlling entity acquired the controlled entity (or associate or joint venture), subject to the exemptions that may be adopted in terms of this MPSAS. Similarly, if a controlled 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, subject to the exemptions that may be adopted in this MPSAS, except for consolidation adjustments.

...

MPSAS 37, *Joint Arrangements*

132. Where a first-time adopter accounted for its investment in a joint venture under its previous basis of accounting basis using proportionate consolidation, the investment in the joint venture shall be measured on the date of adoption as the aggregate of the carrying amount of the assets and liabilities that the entity previously proportionately consolidated, including any purchased goodwill arising from acquisition transactions (see ~~the relevant international or national accounting standard dealing with entity combinations~~ MPSAS 40, *Public Sector Combinations*).

...

Effective Date

...

156. Paragraphs 86, 129, 130 and 132 were amended and paragraphs 62A–62C were added by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply

these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2023 it shall disclose that fact and apply MPSAS 40, Public Sector Combination, at the same time.

Implementation Guidance

This guidance accompanies, but is not part of, MPSAS 33, First-Time Adoption of Accrual Basis MPSASs.

...

MPSAS 35, Consolidated Financial Statements

IG82. If a first-time adopter did not consolidate a controlled entity in accordance with its previous basis of accounting, then, in its consolidated financial statements, the first-time adopter measures the controlled entity's assets and liabilities at the same carrying amounts as in the accrual basis financial statements of the controlled entity following its adoption of MPSASs, after adjusting for consolidation procedures and for the effects of the ~~entity combination~~ public sector combination in which it acquired the controlled entity (paragraph 130 of MPSAS 33, *First-Time Adoption of Accrual Basis MPSASs*). If the controlled entity has not adopted accrual basis MPSASs in its financial statements, the carrying amounts described in the previous sentence are those that MPSAS would require in those financial statements.

Amendments to MPSAS 35, Consolidated Financial Statements

Paragraphs 4, 40, 52, 56, 57 and 63 are amended and paragraphs 55A, 79B and 79C are added. New text is underlined and deleted text is struck through.

Scope

...

Public Sector Combinations

4. This Standard does not deal with the accounting requirements for public sector combinations and their effect on consolidation, including goodwill arising on a public sector combination (see ~~the relevant international or national accounting standard dealing with public sector combinations~~ MPSAS 40, Public Sector Combinations).

...

Accounting Requirements

...

Consolidation Procedures

40. Consolidated financial statements:

...

- (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 (~~the relevant international or national accounting standards~~ MPSAS 40, Public Sector Combinations, explains how to account for any related goodwill).

...

Loss of Control

52. If a controlling entity loses control of a controlled entity, the controlling entity:
- (a) Derecognizes the assets and liabilities of the former controlled entity from the consolidated statement of financial position;
 - (b) Recognizes any investment retained in the former controlled entity ~~at its fair value when control is lost~~ and subsequently accounts for it and for any amounts owed by or to the former controlled entity in accordance with relevant MPSASs. That fair value retained interest is remeasured, as described in paragraphs 54(b)(iii) and 55A. The remeasured value at the date that control is lost shall be regarded as the fair value on initial recognition of a financial asset in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, or the cost on initial recognition of an investment in an associate or joint venture, if applicable; and
 - (c) Recognizes the gain or loss associated with the loss of control attributable to the former controlling interest, as specified in paragraphs 54–55A.

- ...
- 55A. If a controlling entity loses control of a controlled entity that does not contain an operation, as defined in MPSAS 40, *Public Sector Combinations*, as a result of a transaction involving an associate or a joint venture that is accounted for using the equity method, the controlling entity determines the gain or loss in accordance with paragraphs 54–55. The gain or loss resulting from the transaction is recognized in the controlling entity's surplus or deficit only to the extent of the unrelated investors' interests in that associate or joint venture. The remaining part of the gain is eliminated against the carrying amount of the investment in that associate or joint venture. In addition, if the controlling entity retains an investment in the former controlled entity and the former controlled entity is now an associate or a joint venture that is accounted for using the equity method, the controlling entity recognizes the part of the gain or loss resulting from the remeasurement at fair value of the investment retained in that former controlled entity in its surplus or deficit only to the extent of the unrelated investors' interests in the new associate or joint venture. The remaining part of that gain is eliminated against the carrying amount of the investment retained in the former controlled entity. If the controlling entity retains an investment in the former controlled entity that is now accounted for in accordance with MPSAS 29, *Financial Instruments: Recognition and Measurement*, the part of the gain or loss resulting from the remeasurement at fair value of the investment retained in the former controlled entity is recognized in full in the controlling entity's surplus or deficit.

Investment Entities: Fair Value Requirement

56. Except as described in paragraph 57, an investment entity shall not consolidate its controlled entities or apply MPSAS 40, *Public Sector Combinations*, 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 MPSAS 29, *Financial Instruments: Recognition and Measurement*.

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 MPSAS 40, *Public Sector Combinations*, to the acquisition of any such controlled entity.

...

Accounting for a Change in Investment Entity Status

63. When an entity ceases to be an investment entity, it shall apply ~~the relevant international or national accounting standard dealing with public sector combinations~~ MPSAS 40, *Public Sector Combinations*, 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.

...

Effective Date

...

- 79B. Paragraphs 4, 40, 56, 57 and 63 were amended by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2023, it shall disclose that fact and apply MPSAS 40, *Public Sector Combinations*, at the same time.
- 79C. Paragraph 52 was amended and paragraph 55A added by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply these amendments prospectively for annual financial statements covering periods beginning on or after a date to be determined by the AGD. Earlier application is permitted. If an entity applies the amendments earlier, it shall disclose that fact and, if it has not already done so, apply MPSAS 40, *Public Sector Combinations*, at the same time.

Illustrative Examples

These examples accompany, but are not part of, MPSAS 35, Consolidated Financial Statements.

...

Accounting requirements: loss of control (paragraphs 52–55A)

- IE13A. The following example illustrates the treatment of a sale of an interest in a controlled entity that does not contain an operation.

Example 44A

A controlling entity has a 100 per cent interest in a controlled entity that does not contain an operation. The controlling entity sells 70 per cent of its interest in the controlled entity to an associate in which it has a 20 per cent interest. As a consequence of this transaction, the controlling entity loses control of the controlled entity. The carrying amount of the net assets of the subsidiary is RM100 and the carrying amount of the interest sold is RM70 ($\text{RM70} = \text{RM100} \times 70\%$). The fair value of the consideration received is RM210, which is also the fair value of the interest sold. The investment retained in the former controlled entity is an associate accounted for using the equity method and its fair value is RM90. The gain determined in accordance with paragraphs 54–55, before the elimination required by paragraph 55A, is RM200 ($\text{RM200} = \text{RM210} + \text{RM90} - \text{RM100}$). This gain comprises two parts:

- (a) The gain (RM140) resulting from the sale of the 70 per cent interest in the controlled entity to the associate. This gain is the difference between the fair value of the consideration received (RM210) and the carrying amount of the interest sold (RM70). According to paragraph 55A, the controlling entity recognizes in its surplus or deficit the amount of the gain attributable to the unrelated investors' interests in the existing associate. This is 80 per cent of this gain, that is RM112 ($\text{RM112} = \text{RM140} \times 80\%$). The remaining 20 per cent of the gain ($\text{RM28} = \text{RM140} \times 20\%$) is eliminated against the carrying amount of the investment in the existing associate.
- (b) The gain (RM60) resulting from the remeasurement at fair value of the investment directly retained in the former controlled entity. This gain is the difference between the fair value of the investment retained in the former controlled entity (RM90) and 30 per cent of the carrying amount of the net assets of the controlled entity ($\text{RM30} = \text{RM100} \times 30\%$). According to paragraph 55A, the controlling entity recognizes in its surplus or deficit the amount of the gain attributable to the unrelated investors' interests in the new associate. This is 56 per cent ($70\% \times 80\%$) of the gain, that is RM34 ($\text{RM34} = \text{RM60} \times 56\%$). The remaining 44 per cent of the gain RM26 ($\text{RM26} = \text{RM60} \times 44\%$) is eliminated against the carrying amount of the investment retained in the former controlled entity.

Amendments to MPSAS 36, Investments in Associates and Joint Ventures

Paragraphs 26, 31 and 33 are amended and paragraphs 34A, 34B, 51B and 51C are added. New text is underlined and deleted text is struck through.

Application of the Equity Method

...

Discontinuing the Use of the Equity Method

26. An entity shall discontinue the use of the equity method from the date when its investment ceases to be an associate or a joint venture as follows:

- (a) If the investment becomes a controlled entity, the entity shall account for its investment in accordance with ~~the relevant national or international pronouncement dealing with public sector combinations~~ MPSAS 40, Public Sector Combinations, and MPSAS 35, Consolidated Financial Statements.

Equity Method Procedures

...

31. Gains and losses resulting from “upstream” and “downstream” transactions involving assets that do not constitute an operation, as defined in MPSAS 40, *Public Sector Combinations*, between an entity (including its consolidated controlled entities) and its associate or joint venture are recognized in the entity’s financial statements only to the extent of unrelated investors’ interests in the associate or joint venture. “Upstream” transactions are, for example, sales of assets from an associate or a joint venture to the investor. The entity’s share in the associate’s or the joint venture’s gains or losses resulting from these transactions is eliminated. “Downstream” transactions are, for example, sales or contributions of assets from the investor to its associate or its joint venture. ~~The investor’s share in the associate’s or joint venture’s gains or losses resulting from these transactions is eliminated.~~

...

33. The gain or loss resulting from the contribution of a non-monetary assets that do not constitute an operation, as defined in MPSAS 40, *Public Sector Combinations*, to an associate or a joint venture in exchange for an equity interest in the that associate or joint venture shall be accounted for in accordance with paragraph 31, except when the contribution lacks commercial substance, as that term is described in MPSAS 17, *Property, Plant and Equipment*. If such a contribution lacks commercial substance, the gain or loss is regarded as unrealized and is not recognized unless paragraph 34 also applies. Such unrealized gains and losses shall be eliminated against the investment accounted for using the equity method and shall not be presented as deferred gains or losses in the entity’s consolidated statement of financial position or in the entity’s statement of financial position in which investments are accounted for using the equity method.

...

34A. The gain or loss resulting from a downstream transaction involving assets that constitute an operation, as defined in MPSAS 40, *Public Sector Combinations*, between an entity (including its consolidated controlled entities) and its associate or joint venture is recognized in full in the investor’s financial statements.

34B. An entity might sell or contribute assets in two or more arrangements (transactions). When determining whether assets that are sold or contributed constitute an operation, as defined in MPSAS 40, *Public Sector Combinations* an entity shall consider whether the sale or contribution of those assets is part of multiple arrangements that should be accounted for as a single transaction in accordance with the requirements in paragraph 53 of MPSAS 35, *Consolidated Financial Statements*.

Effective Date

...

51B. **Paragraph 26 was amended by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2023, it shall**

disclose that fact and apply MPSAS 40, *Public Sector Combinations*, at the same time.

- 51C. Paragraphs 31 and 33 were amended and paragraphs 34A and 34B added by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply these amendments prospectively for annual financial statements covering periods beginning on or after a date to be determined by the AGD. Earlier application is permitted. If an entity applies the amendments for a period earlier, it shall disclose that fact and, if it has not already done so, apply MPSAS 40, *Public Sector Combinations*, at the same time.

Amendments to MPSAS 37, *Joint Arrangements*

Paragraph 32 is amended and paragraphs 24A, 41A, 42B, 42C and AG33A–AG33D are added. The heading before paragraph 23 is amended and additional headings are added before paragraphs 41A and AG33A. New text is underlined and deleted text is struck through.

Financial Statements of Parties to a Joint Arrangement (see paragraphs ~~AG34~~ AG33A–AG37)

Joint Operations

...

- 24A. When an entity acquires an interest in a joint operation in which the activity of the joint operation constitutes an operation, as defined in MPSAS 40, *Public Sector Combinations*, it shall apply, to the extent of its share in accordance with paragraph 23, all of the principles on acquisition accounting in MPSAS 40, *Public Sector Combinations*, and other MPSASs, that do not conflict with the guidance in this Standard, and disclose the information that is required in those MPSASs in relation to acquisitions. 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. The accounting for the acquisition of an interest in such a joint operation is specified in paragraphs ~~AG33A–AG33D~~.

...

Transitional Provisions

...

Joint Ventures—Transition from Proportionate Consolidation to the Equity Method

...

32. When changing from proportionate consolidation to the equity method, an entity shall recognize its investment in the joint venture as at the beginning of the immediately preceding period. That initial investment shall be measured as the aggregate of the carrying amounts of the assets and liabilities that the entity had previously proportionately consolidated, including any purchased goodwill arising from acquisition transactions (~~guidance on accounting for the acquisition of an entity and the allocation of goodwill to joint ventures can be found in the relevant international or national standards on entity combinations and joint arrangements~~). If the goodwill previously belonged to a larger cash-generating unit, or to a group of cash-generating units, the entity shall allocate goodwill to the joint venture on the basis of the relative carrying amounts of the joint venture and the cash-generating unit or group of cash-generating units to which it belonged.

...

Accounting for Acquisitions of Interests in Joint Operations

41A. MPSAS 40, *Public Sector Combinations*, issued in January 2017, added paragraphs 24A, 42B, and AG33A–AG33D. An entity shall apply those amendments prospectively for acquisitions of interests in joint operations in which the activities of the joint operations constitute operations, as defined in MPSAS 40, *Public Sector Combinations*, for those acquisitions occurring from the beginning of the first period in which it applies those amendments. Consequently, amounts recognized for acquisitions of interests in joint operations occurring in prior periods shall not be adjusted.

Effective Date

...

42B. Paragraphs 24A, 41A and AG33A–AG33D were added by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply these amendments prospectively for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2023, it shall disclose that fact and apply MPSAS 40, *Public Sector Combinations*, at the same time.

42C. Paragraph 32 was amended by MPSAS 40, *Public Sector Combinations*, issued in October 2021. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2023. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2023, it shall disclose that fact and apply MPSAS 40, *Public Sector Combinations*, at the same time.

Application Guidance

This Appendix is an integral part of MPSAS 37, Joint Arrangements.

...

Financial Statements of Parties to a Joint Arrangement (paragraphs 23–28)**Accounting for Acquisitions of Interests in Joint Operations**

AG33A. When an entity acquires an interest in a joint operation in which the activity of the joint operation constitutes an operation, as defined in MPSAS 40, *Public Sector Combinations*, it shall apply, to the extent of its share in accordance with paragraph 23, all of the principles on acquisition accounting in MPSAS 40, *Public Sector Combinations* and other MPSASs, that do not conflict with the guidance in this Standard and disclose the information required by those MPSASs in relation to acquisitions. The principles on acquisition accounting that do not conflict with the guidance in this Standard include but are not limited to:

- (a) Measuring identifiable assets and liabilities at fair value, other than items for which exceptions are given in MPSAS 40, *Public Sector Combinations*, and other MPSASs;
- (b) Recognizing acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with the exception that the costs to issue debt or equity securities are recognized in accordance with MPSAS 28, *Financial Instruments: Presentation*, and MPSAS 29, *Financial Instruments: Recognition and Measurement*;

- (c) Recognizing the excess of the consideration transferred over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed, if any, as goodwill; and
- (d) Testing for impairment a cash-generating unit to which goodwill has been allocated at least annually, and whenever there is an indication that the unit may be impaired, as required by MPSAS 26, *Impairment of Cash-Generating Assets*, for goodwill acquired in an acquisition.

AG33B. Paragraphs 24A and AG33A also apply to the formation of a joint operation if, and only if, an existing operation, as defined in MPSAS 40, *Public Sector Combinations*, 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 to the joint operation on its formation.

AG33C. A joint operator might increase its interest in a joint operation in which the activity of the joint operation constitutes an operation, as defined in MPSAS 40, *Public Sector Combinations*, 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.

AG33D. Paragraphs 24A and AG33A–AG33C do not apply on the acquisition of an interest in a joint operation when the parties sharing joint control, including the entity acquiring the interest in the joint operation, are under the common control of the same ultimate controlling party or parties both before and after the acquisition, and that control is not transitory.

Illustrative Examples

These examples accompany, but are not part of, MPSAS 37, Joint Arrangements.

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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 MPSAS 40, *Public Sector Combinations*.

IE61. Municipality E acquires municipality A's 40 per cent ownership interest in Joint Operation D at a cost of RM300 and incurs acquisition-related costs of RM50.

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:

<u>Municipality E's share in the asset and liabilities related to Joint Operation D</u>	
<u>Property, plant and equipment</u>	<u>48%</u>
<u>Intangible assets (excluding goodwill)</u>	<u>90%</u>
<u>Accounts receivable</u>	<u>40%</u>
<u>Inventory</u>	<u>40%</u>
<u>Retirement benefit obligations</u>	<u>15%</u>
<u>Accounts payable</u>	<u>40%</u>
<u>Contingent liabilities</u>	<u>56%</u>

Analysis

- IE63. Municipality E recognizes 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 MPSAS 40, *Public Sector Combinations*, and other MPSASs for identifying, recognizing, 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 24A).
- IE65. However, Municipality E does not apply the principles on acquisition accounting in MPSAS 40, *Public Sector Combinations*, and other MPSASs that conflict with the guidance in this Standard. Consequently, in accordance with paragraph 23, Municipality E recognizes, 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. MPSAS 40, *Public Sector Combinations*, 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 recognized 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 MPSAS 40, *Public Sector Combinations*, 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 MPSAS 40, *Public Sector Combinations*, of Municipality E's shares in the identifiable assets and liabilities related to Joint Operation D:

<u><i>Fair value or other measure specified by MPSAS 40, Public Sector Combinations for Municipality E's shares in the identifiable assets and liabilities of Joint Operation D (RM)</i></u>	
<u>Property, plant and equipment</u>	138
<u>Intangible assets (excluding goodwill)</u>	72
<u>Accounts receivable</u>	84
<u>Inventory</u>	70
<u>Retirement benefit obligations</u>	(12)
<u>Accounts payable</u>	(48)
<u>Contingent liabilities</u>	(52)
<u>Deferred tax liability (see the international or national standard dealing with income taxes)</u>	(24)
<u>Net assets</u>	<u>228</u>

IE68. In accordance with MPSAS 40, *Public Sector Combinations*, the excess of the consideration transferred over the amount allocated to Municipality E's shares in the net identifiable assets is recognized as goodwill:

<u>Consideration transferred</u>	<u>RM300</u>
<u>Municipality E's shares in the identifiable assets and liabilities relating to its interest in the joint operation</u>	<u>RM228</u>
<u>Goodwill</u>	<u>RM72</u>

IE69. Acquisition-related costs of RM50 are not considered to be part of the consideration transferred for the interest in the joint operation. They are recognized as expenses in surplus or deficit in the period that the costs are incurred and the services are received (see paragraph 113 of MPSAS 40, *Public Sector Combinations*).

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 MPSAS 40, *Public Sector Combinations*.

- 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 seconded 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 RM1,000. Immediately before the acquisition, the carrying amount of the know-how in the financial statements of Entity C was RM300.

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 MPSAS 40, *Public Sector Combinations*.
- IE78. In accounting for the acquisition of its interest in the joint operation, Entity C applies all the principles on acquisition accounting in MPSAS 40, *Public Sector Combinations*, and other MPSAS that do not conflict with the guidance in this Standard (see paragraph 24A). Entity C therefore recognizes 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 recognize 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 recognize the know-how based on its carrying amount of RM300. 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 recognize a gain or loss on the grant of the right to use it.

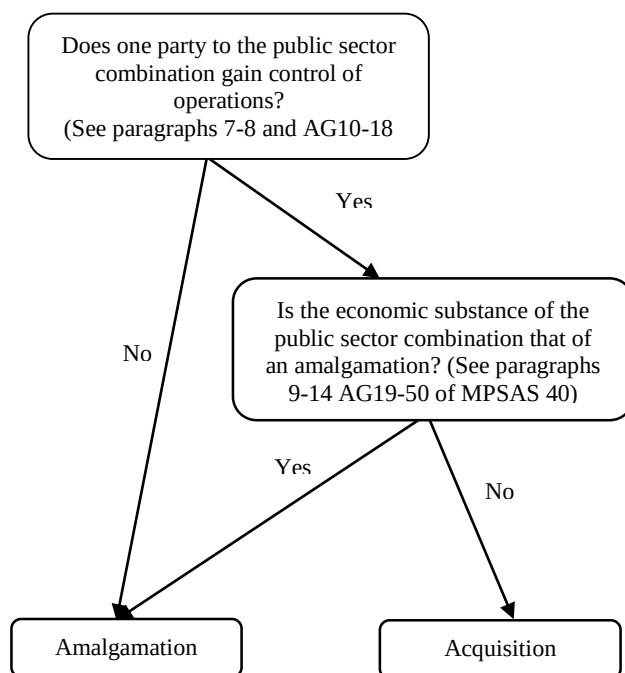
Implementation Guidance

This guidance accompanies, but is not part of, MPSAS 40, Public Sector Combinations.

IG1. The purpose of this Implementation Guidance is to illustrate certain aspects of the requirements of MPSAS 40, *Public Sector Combinations*.

Classification of Public Sector Combinations

IG2. The diagram below summarizes the process established by MPSAS 40, *Public Sector Combinations*, for classifying public sector combinations.



Illustrative Examples

These examples accompany, but are not part of, MPSAS 40, Public Sector Combinations.

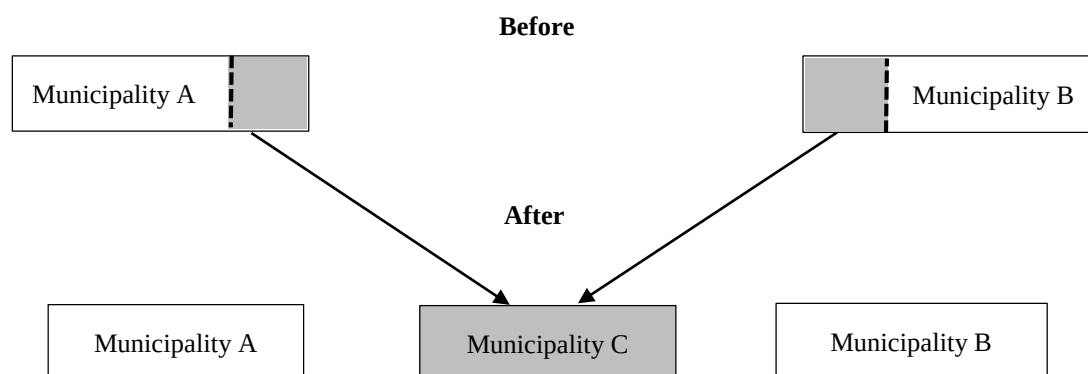
Classification of Public Sector Combinations

Illustrating the Consequences of Applying Paragraphs 7–14 and AG10–AG50 of MPSAS 40, *Public Sector Combinations*

- IE1. The following scenarios illustrate the process for classifying 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 MPSAS 40, *Public Sector Combinations*.
- IE2. Each scenario is illustrated by a diagram. Where a 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: Reorganization 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.

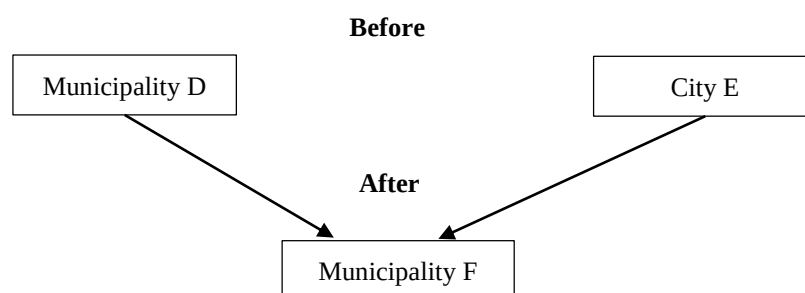


- IE4. In this scenario, the territorial boundaries of two existing municipalities, Municipality A and Municipality B, are redrawn by Parliament through legislation; neither Parliament nor Central Government controls Municipality A or Municipality B. Responsibility for part of each municipality's former territory is transferred to a new municipality, Municipality C. Operations in respect of the transferred territory are combined to form Municipality C. A 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 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 public sector combination. Consequently, the combination is classified as an amalgamation.

Scenario 2: Reorganization 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 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 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 public sector combination. Consequently, the combination is classified as an amalgamation.

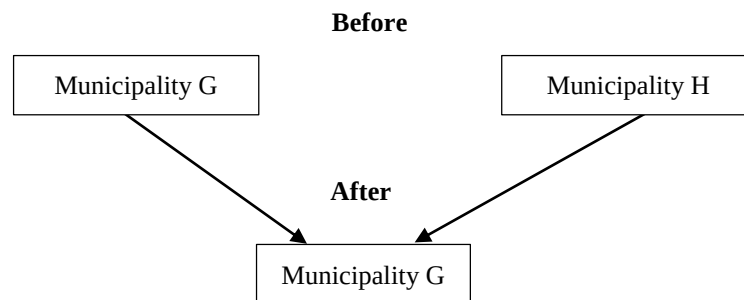
Scenario 2: Variation

- 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 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 MPSAS 40, *Public Sector Combinations*.
- 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 public sector combination, Municipality D has gained control of City E. Municipality F considers the guidance in paragraphs 9–14 and AG19–AG50 of MPSAS 40, *Public Sector Combinations*, in determining whether the economic substance of the combination is that of an amalgamation.
- IE19. 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 indicators relating to consideration, Municipality F notes that the public sector combination does not include the payment of consideration 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 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, Municipality F considers that the public sector 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: Reorganization 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 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 public sector combination, Municipality H ceases to exist.
- IE26. These facts suggest that as part of the 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 MPSAS 40, *Public Sector Combinations*, 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 public sector combination, it has gained control of Municipality H. Municipality G considers the guidance in paragraphs 9–14 and AG19–AG50 of MPSAS 40, *Public Sector Combinations*, in determining whether the economic substance of the combination is that of an amalgamation.
- IE29. 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.

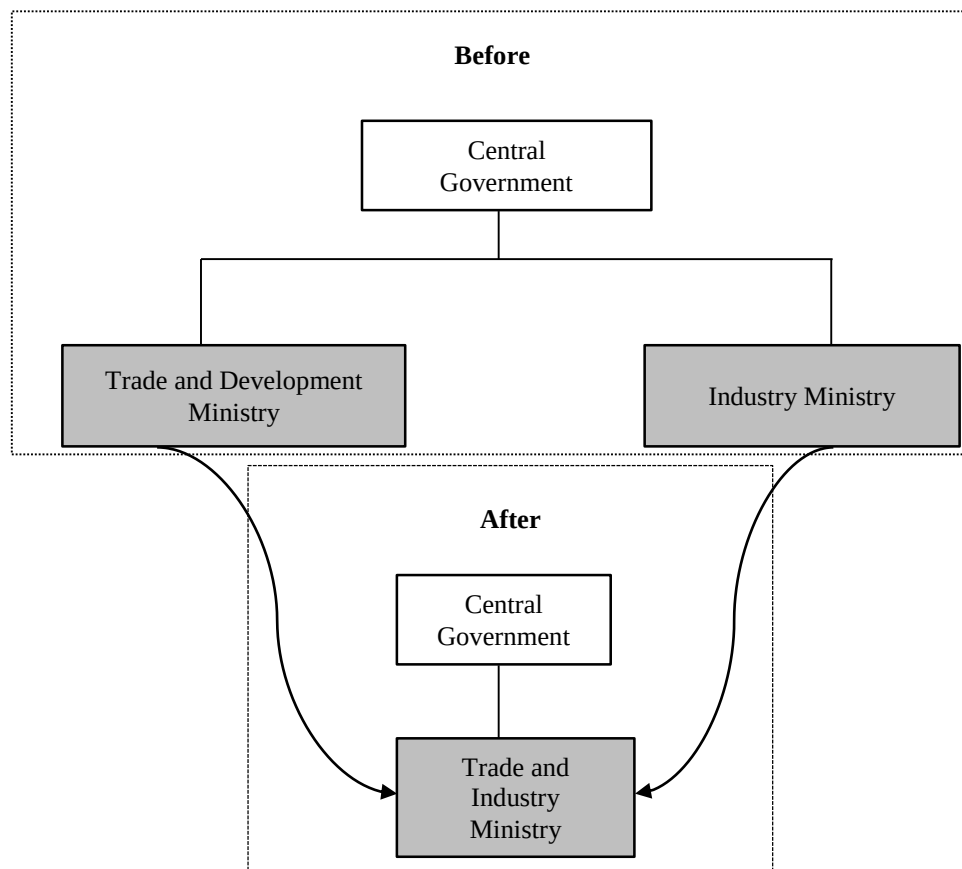
- IE30. In considering the indicators relating to consideration, Municipality G notes that the public sector combination does not include the payment of consideration because there is no party with an entitlement to the net assets of Municipality H (i.e., there are no former owners of Municipality H 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 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, Municipality G considers that the public sector 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 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 public sector combination. Consequently the combination is classified as an amalgamation.

Scenario 4: Restructuring of Central Government Ministries

- IE37. The following diagram illustrates the reorganization 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 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 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 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 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 MPSAS 40, *Public Sector Combinations*.

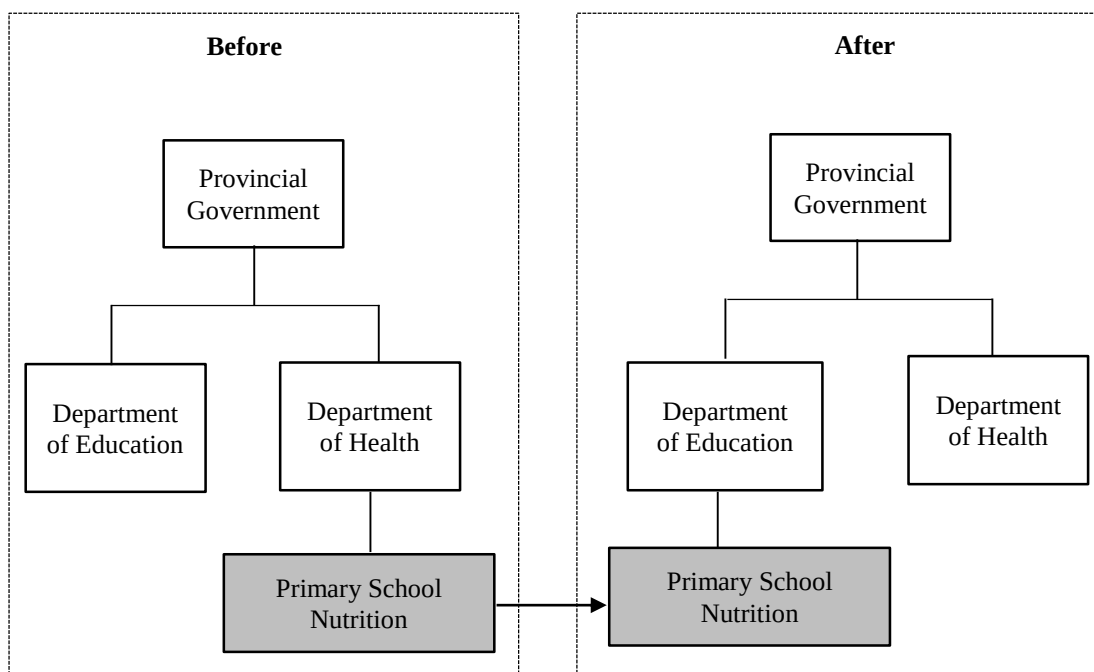
- IE43. In this scenario, it is assumed that the decision of Central Government to give responsibility for the new Trade and Industry Ministry to the Minister of Industry and the governing body of the Industry Ministry results in the Industry Ministry gaining:
- (a) Power over the operations of the Trade 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 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 MPSAS 40, *Public Sector Combinations*, in determining whether the economic substance of the combination is that of an amalgamation.
- IE45. 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 indicators relating to consideration, the Trade and Industry Ministry notes that the 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, although 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 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. Taking these factors together, the Trade and Industry Ministry considers that the public sector combination should be classified as an amalgamation. In coming to this decision, the fact that the 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 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 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.

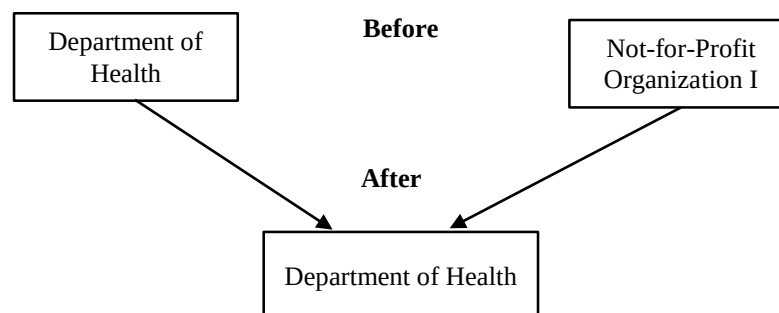


- IE54. In this scenario, a public sector combination occurs in which the Primary School Nutrition operation is transferred from the Provincial Government's Department of Health to its Department of Education. Both departments are controlled by the Provincial Government prior to and after the combination.
- IE55. As the Provincial Government controls the same operations both before and after the 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 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 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 MPSAS 40, *Public Sector Combinations*, in determining whether the economic substance of the combination is that of an amalgamation.
- IE59. 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 indicators relating to consideration, the Department of Education notes that the 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, although 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 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. Taking these factors together, the Department of Education considers that the public sector combination should be classified as an amalgamation. In coming to this decision, the fact that the 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 Organization

IE63. The following diagram illustrates the combination of a public sector entity with a not-for-profit organization providing similar services.



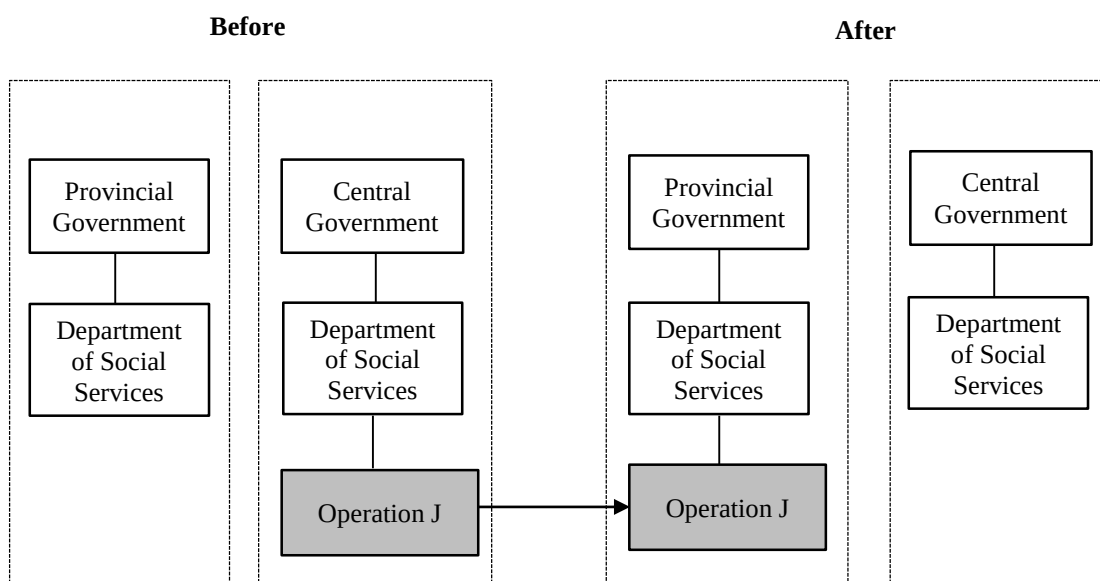
- IE64. In this scenario, a public sector combination occurs in which Not-for-Profit Organization I, a charity which provides paramedic services, voluntarily agrees to combine with the Department of Health in order to improve the delivery of services to the public. The operations of Not-for-Profit Organization 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 Organization I. The Department of Health meets the cost of transferring the title to the assets and liabilities of Not-for-Profit Organization I incurred by the trustees of the charity.
- IE65. The combination of the Department of Health and Not-for-Profit Organization I is a 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:
- Power over Not-for-Profit Organization I and its operations;
 - Exposure, or rights, to variable benefits from its involvement with those operations; and
 - 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 public sector combination, it has gained control of Not-for-Profit Organization I. The Department of Health considers the guidance in paragraphs 9–14 and AG19–AG50 of MPSAS 40, *Public Sector Combinations*, in determining whether the economic substance of the combination is that of an amalgamation.
- IE68. 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 Organization I. This is consistent with both an amalgamation and an acquisition.
- IE69. In considering the indicators relating to consideration, the Department of Health notes that the 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. Although the Department of Health makes a payment to the trustees, this is to compensate 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 Organization I. Although Not-for-Profit Organization 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 Organization I

(i.e., there are no former owners of Not-for-Profit Organization I with quantifiable ownership interests). This suggests that the economic substance of the combination is that of an 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 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, the Department of Health considers that the public sector combination should be classified as an 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 RM1,000². 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 shortfall. Following the transfer,

² In these examples monetary amounts are denominated in 'Ringgit Malaysia (RM)'

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 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 public sector combination, it has gained control of Operation J. The Provincial Government considers the guidance in paragraphs 9–14 and AG19–AG50 of MPSAS 40, *Public Sector Combinations*, in determining whether the economic substance of the combination is that of an amalgamation.
- IE78. In considering the economic substance of the 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 indicators relating to consideration, the Provincial Government notes that the 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, 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 the indicators relating to consideration do 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 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 public sector combination should, therefore, be classified as an acquisition.

Scenario 7: Variation

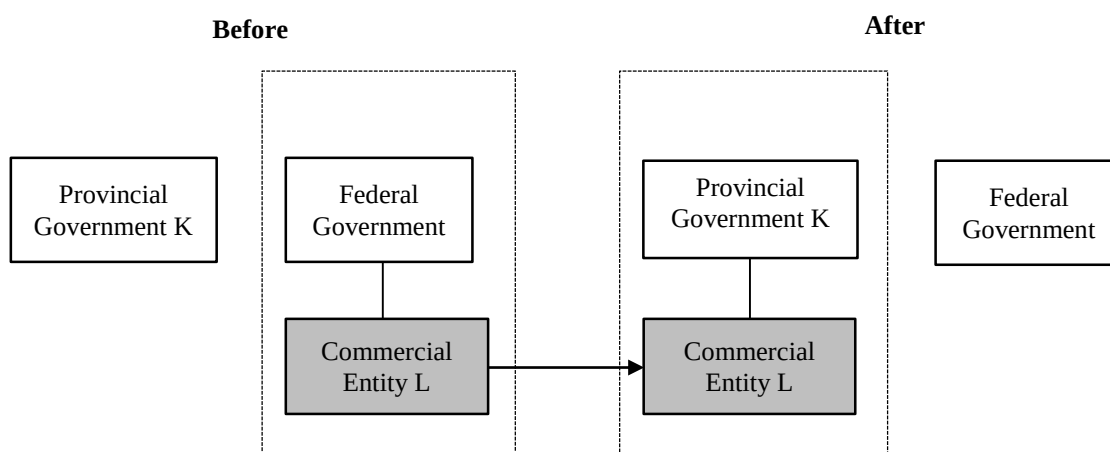
IE82. In scenario 7, the Provincial Government considers that a market participant would estimate the fair value of Operation J (with the obligation to provide services for 10 years) to be zero. This is the reason that no consideration is paid. In this variation, Operation J is assumed to cover its costs 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 the seller for giving up their entitlement to the net assets of an operation may provide evidence that the economic substance of the combination is that of an amalgamation.

IE84. In determining the classification of the 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 support this classification; 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.

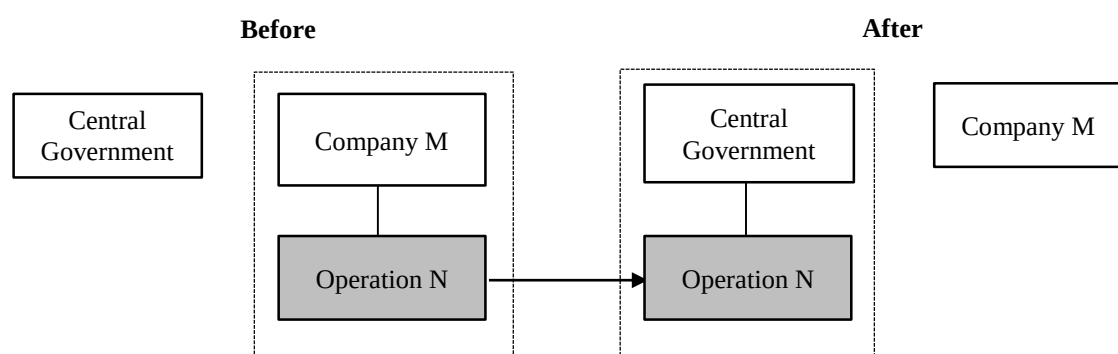


IE86. In this scenario, the Federal Government agrees to transfer Commercial Entity L to Provincial Government K. Provincial Government K pays consideration to the Federal Government in respect of the transfer. Following the combination, Provincial Government K operates Commercial Entity L as an arms-length, stand-alone entity.

- IE87. The transfer of Commercial Entity L is a 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 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 MPSAS 40, *Public Sector Combinations*, in determining whether the economic substance of the combination is that of an amalgamation.
- IE90. In considering the economic substance of the 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 indicators relating to consideration, Provincial Government K notes that the public sector combination includes the payment of consideration that is intended to compensate the seller for giving up their entitlement to the net assets of an operation. Provincial Government K concludes that the indicators relating to consideration do 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 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 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 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 public sector combination, it has gained control of Operation N. Central Government considers the guidance in paragraphs 9–14 and AG19–AG50 of MPSAS 40, *Public Sector Combinations*, in determining whether the economic substance of the combination is that of an amalgamation.
- IE99. In considering the economic substance of the 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 indicators relating to consideration, Central Government notes that the public sector combination includes the payment of consideration that is intended to compensate the seller for giving up their entitlement to the net assets of an operation. Central Government concludes that the indicators relating to consideration do 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 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 public sector combination should, therefore, be classified as an acquisition.

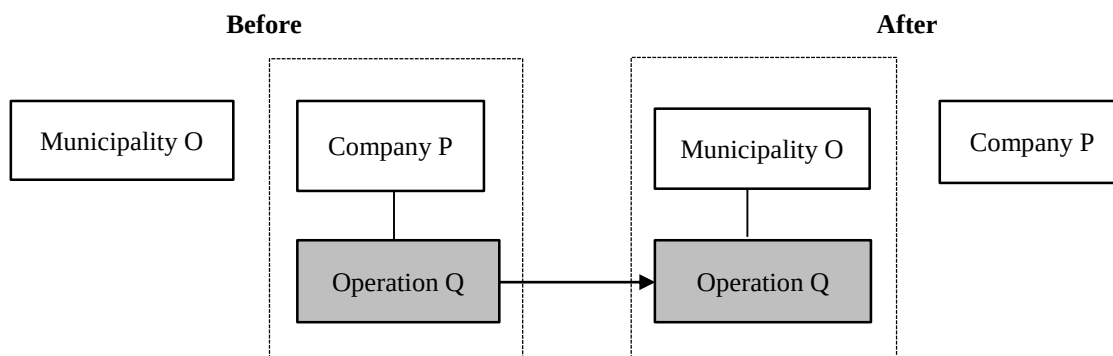
Scenario 9: Variation

- IE103. In scenario 9, Company M enters into the transaction voluntarily. In this variation, Central Government nationalizes 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 indicators 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 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 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 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:

- Power over Operation Q;
- Exposure, or rights, to variable benefits from its involvement with Operation Q; and
- 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 public sector combination, it has gained control of Operation Q. Municipality O considers the guidance in paragraphs 9–14 and AG19–AG50 of MPSAS 40, *Public Sector Combinations*, in determining whether the economic substance of the combination is that of an amalgamation.

IE112. In considering the economic substance of the 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 indicators relating to consideration, Municipality O notes that the public sector combination includes the payment of consideration that is intended to compensate the seller for giving up 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 indicators relating to consideration do 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 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 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.

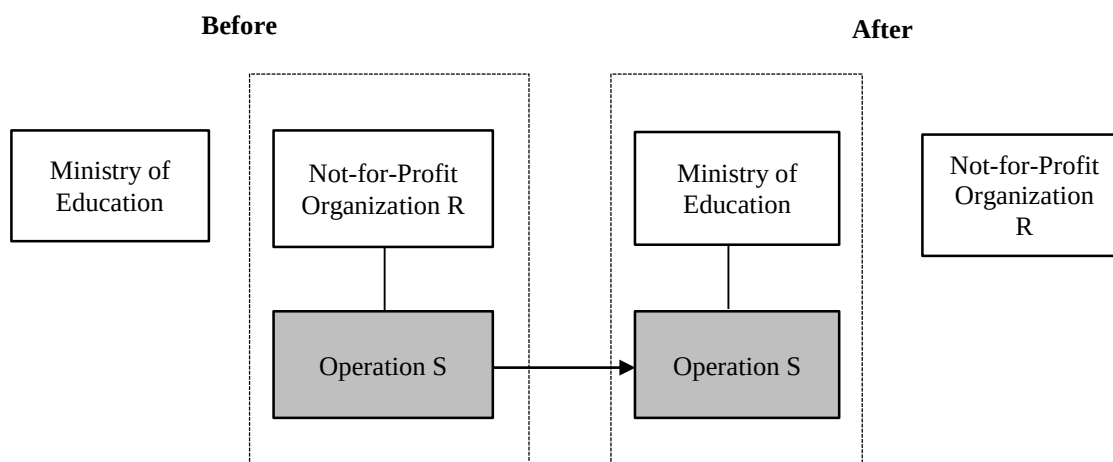
IE118. In considering the indicators relating to consideration, Municipality O notes that the public sector combination includes consideration that is intended to compensate the seller for giving up their entitlement to the net assets of an operation. However, the level of compensation is less than Company P would have accepted voluntarily. Consequently, these indicators provide 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 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 public sector combination as an acquisition.

Scenario 11: Donated Operations

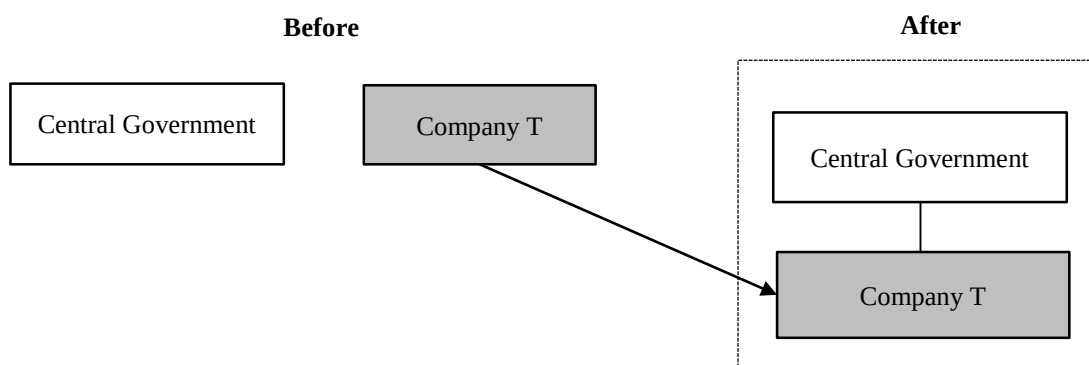
IE121. The following diagram illustrates the receipt of a donated operation by a public sector entity.



- IE122. In this scenario, Not-for-Profit Organization R, a charity providing education services, voluntarily transfers Operation S, a school, to the Ministry of Education at no cost. Not-for-Profit Organization 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 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 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 MPSAS 40, *Public Sector Combinations*, in determining whether the economic substance of the combination is that of an amalgamation.
- IE126. In considering the economic substance of the 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 indicators relating to consideration, the Ministry of Education notes that the 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, the reason for this is that Not-for-Profit Organization 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 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 their preferred counterparty. In this scenario, Not-for-Profit Organization 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 indicators of consideration do 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 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 public sector combination should, therefore, be classified as an acquisition.

Scenario 12: Nationalization of a Private Sector Entity–Forced Seizure

IE130. The following diagram illustrates the nationalization of a private sector entity by a public sector entity by means of a forced seizure.



IE131. In this scenario, Central Government nationalizes 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 nationalization of Company T is a 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 public sector combination, it has gained control of Company T. Central Government considers the guidance in paragraphs 9–14 and AG19–AG50 of MPSAS 40, *Public Sector Combinations*, in determining whether the economic substance of the combination is that of an amalgamation.

IE135. In considering the economic substance of the 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.

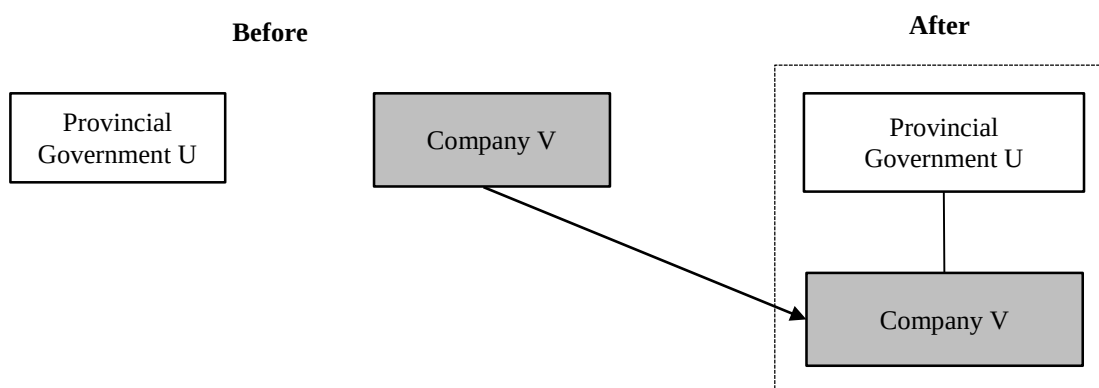
IE136. In considering the indicators relating to consideration, Central Government notes that the public sector combination does not include the payment of consideration that is intended to compensate the seller for giving up their entitlement to the net assets of an operation. However, the former shareholders 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 indicators relating to consideration do 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 public sector combination should, therefore, be classified as an acquisition.

Scenario 13: Nationalization of a Private Sector Entity–Bailout

IE139. The following diagram illustrates the nationalization of a private sector entity by a public sector entity by means of a bailout.



IE140. In this scenario, Provincial Government U nationalizes Company V through legislation as a result of a bailout. Prior to the nationalization, 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 nationalization of Company V is a 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:

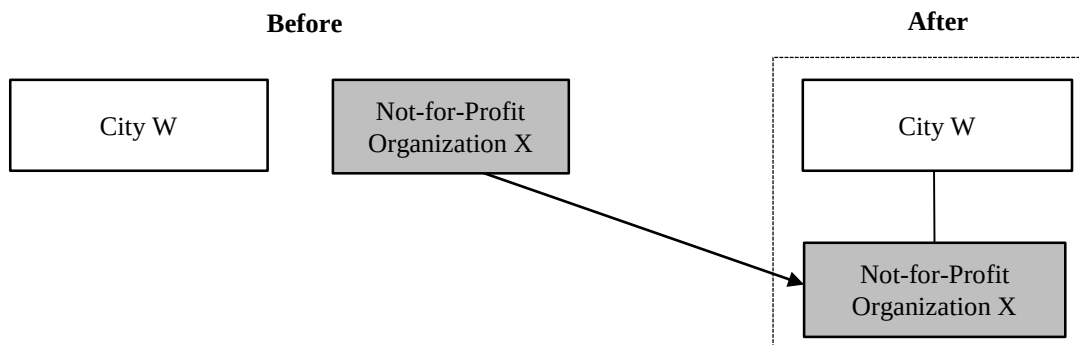
- (a) Power over Company V;
- (b) Exposure, or rights, to variable benefits from its involvement with Company V; and
- (c) The ability to use its power over Company V to affect the nature or amount of the benefits from its involvement with Company V.

IE143. Provincial Government U concludes that, as a result of the public sector combination, it has gained control of Company V. Provincial Government U considers the guidance in paragraphs 9–14 and AG19–AG50 of MPSAS 40, *Public Sector Combinations*, in determining whether the economic substance of the combination is that of an amalgamation.

- IE144. In considering the economic substance of the 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 indicators relating to consideration, Provincial Government U notes that the 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 indicators relating to consideration do 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 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 public sector combination should, therefore, be classified as an acquisition.

Scenario 14: Nationalization of a Not-For-Profit Organization–Bailout

- IE148. The following diagram illustrates the nationalization of a not-for-profit organization by a public sector entity by means of a bailout.



- IE149. In this scenario, City W nationalizes Not-for-Profit Organization X (a charity) as a result of a voluntary bailout. Prior to the nationalization, Not-for-Profit Organization X was in financial distress and approached City W for support. City W assumes Not-for-Profit Organization X's net liabilities. Following the purchase, Not-for-Profit Organization X is managed as an arms-length, stand-alone entity.
- IE150. The nationalization of Not-for-Profit Organization X is a 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 Organization X;
- (b) Exposure, or rights, to variable benefits from its involvement with Not-for-Profit Organization X; and
- (c) The ability to use its power over Not-for-Profit Organization X to affect the nature or amount of the benefits from its involvement with Not-for-Profit Organization X.

IE152. City W concludes that, as a result of the public sector combination, it has gained control of Not-for-Profit Organization X. City W considers the guidance in paragraphs 9–14 and AG19–AG50 of MPSAS 40, *Public Sector Combinations*, in determining whether the economic substance of the combination is that of an amalgamation.

IE153. In considering the economic substance of the public sector combination, City W notes that the combination results in a controlling entity/controlled entity relationship between City W and Not-for-Profit Organization 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 Organization X, the combination has commercial substance, which is suggestive of an acquisition.

IE154. In considering the indicators relating to consideration, City W notes that the 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 Organization 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 Organization 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 Organization X of the responsibility for settling the liabilities, which is analogous to paying consideration. City W concludes, therefore, that the indicators relating to consideration do 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 Organization 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 combination should, therefore, be classified as an acquisition.

Accounting for Amalgamations

Eliminating Transactions between the Combining Operations - Loans

Illustrating the Consequences of Applying Paragraphs 22 and AG51–AG52 of MPSAS 40, Public Sector Combinations

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 RM250. 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 amortized cost of the loan) in its financial statements at the amalgamation date is RM260.
- 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 RM200.
- 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 RM60, 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 MPSAS 40, Public Sector Combinations

- 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 RM700 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 recognized a liability of RM350 in respect of its performance obligation, in accordance with MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. 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 recognize an asset in respect of the grant, but accounted for the full RM700 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 recognize a liability for the RM350, but instead recognizes 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 MPSAS 40, Public Sector Combinations

- 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 MPSAS 17, *Property, Plant and Equipment*. COB has previously adopted an accounting policy of measuring property, plant and equipment using the revaluation model in MPSAS 17, *Property, Plant and Equipment*.
- 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 (RM)	Valuation (RM)	Adjustment (RM)
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 recognizes the items of property, plant and equipment previously controlled by COB at their carrying amounts. In accordance with paragraph 67 of MPSAS 17, *Property, Plant and Equipment*, 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 MPSAS 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 MPSAS 40, *Public Sector Combinations*

- 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 recognizes 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 (RM)	COB (RM)	RE (RM)
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 derecognize 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 (RM)
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 accounts for tax receivable in accordance with MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes & Transfers)*, and would recognize an adjustment for the tax forgiven.

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

Illustrating the Consequences of Applying Paragraphs 37–39 of MPSAS 40, *Public Sector Combinations*

- IE177. The following example illustrates the accounting for recognizing 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 RM750. 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 RM5,750 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 summarized 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.

MPSAS 40 – Public Sector Combinations

	COA (RM)	COB (RM)	Elimination Adjustments (RM)	Accounting Policy Adjustments (RM)	RE Opening Balance (RM)
Financial Assets	11,248	17,311	(750)		27,809
Inventory	1,072	532			1,604
Property, plant and equipment	5,663	12,171		5,750	23,584
Intangible assets	0	137			137
Financial liabilities	(18,798)	(20,553)	750		(38,601)
Total net assets/ (liabilities)	(815)	9,598		5,750	14,533
Revaluation surplus	0	6,939		5,750	12,689
Accumulated surpluses or deficits	(815)	2,659			1,844
Total net assets/equity	(815)	9,598	0	5,750	14,533

IE182. In accordance with paragraphs 37–39 of MPSAS 40, *Public Sector Combinations*, RE may present net assets/equity as either a single opening balance of RM14,533 or as the separate components shown above.

IE183. The other municipalities that, prior to the amalgamation, controlled COA and COB would derecognize the assets, liabilities and components of net assets/equity transferred to RE in accordance with other MPSASs.

Measurement Period in an Amalgamation

Illustrating the Consequences of Applying Paragraphs 40–44 of MPSAS 40, *Public Sector Combinations*

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 MPSAS 40, *Public Sector Combinations*, requires the resulting entity to recognize in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the resulting entity recognizes 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 recognized as of that date.

Paragraph 43 of MPSAS 40, *Public Sector Combinations*, requires the resulting entity to recognize 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 authorized for issue its financial statements for the year ended 31 December 20X3. In its 20X3 annual financial statements, RE recognized provisional values for the land and buildings of RM150,000 and RM275,000 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 RM160,000 and the amalgamation-date value of the buildings as RM365,000.

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 RM10,000. 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 RM89,500. That adjustment is measured as the valuation adjustment at the amalgamation date of RM90,000 less the additional depreciation that would have been recognized if the asset's value at the amalgamation date had been recognized from that date (RM500 for one months' depreciation).
- (c) An adjustment of RM100,000 is recognized in net assets/equity as of 31 December 20X3.
- (d) Depreciation expense for 20X3 is increased by RM500.

IE187. In accordance with paragraph 56 of MPSAS 40, *Public Sector Combinations*, 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 recognized 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 RM99,500 (RM100,000 at the amalgamation date), an increase in depreciation expense of RM500 and an increase in net assets/equity of RM100,000.

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 MPSAS 40, *Public Sector Combinations*

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 RM1,000, 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 (RM200) of the grant previously paid to COA. RE recognizes a liability and an expense of RM200 on 1 July 20X3.

Disclosure Requirements Relating to Amalgamations

Illustrating the Consequences of Applying the Disclosure Requirements in Paragraphs 53–57 of MPSAS 40, *Public Sector Combinations*

IE192. The following example illustrates some of the disclosure requirements relating to amalgamations of MPSAS 40, *Public Sector Combinations*; 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 recognized for each major class of assets and liabilities transferred as at 30 June 20X2**

	RM
Financial assets	1,701
Inventory	5
Property, plant and equipment	74,656
Intangible assets	42
Financial liabilities	(2,001)
Total net assets	<u>74,403</u>

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 (RM)	Adjustment (RM)	Revised Amount (RM)
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

54(f) Amounts recognized in Net assets/equity as at 30 June 20X2

	COA (RM)	COB (RM)	Adjustment (RM)	RE (RM)
Revaluation surplus	0	18,332	17,954	36,286
Accumulated surpluses or deficits	12,047	26,070	0	38,117
Total net assets/equity	12,047	44,402	17,954	74,403

**Paragraph
reference**

54(h) At the time these financial statements were authorized 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:

		COA (RM)	COB (RM)
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

Paragraph reference			
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		(1,093)
	Total liabilities		(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	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 MPSAS 1, *Presentation of Financial Statements*.

Accounting for Acquisitions

Reverse Acquisitions

Illustrating the Consequences of Recognizing a Reverse Acquisition by Applying Paragraphs AG66–AG71 of MPSAS 40, Public Sector Combinations

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)	Entity B (legal controlled entity, accounting acquirer)
	RM	RM
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	800	1,400
Issued equity		
100 ordinary shares	300	
60 ordinary shares		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 RM40. The quoted market price of Entity A's ordinary shares at that date is RM16.
- (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 RM1,500.

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 are 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 RM1,600 (40 shares with a fair value per share of RM40).

- 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 RM16.

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 recognized identifiable assets and liabilities, as follows:

	RM	RM
Consideration effectively transferred		1,600
Net recognized 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	<u> </u>	<u> </u> <u> </u> 300

Consolidated Statement of Financial Position at 30 September 20X6

IE199. The consolidated statement of financial position immediately after the acquisition is:

	RM
Current assets [RM700 + RM500]	1,200
Non-current assets [RM3,000 + RM1,500]	4,500
Goodwill	300
Total assets	<u>6,000</u>
Current liabilities [RM600 + RM300]	900
Non-current liabilities [RM1,100 + RM400]	1,500
Total liabilities	<u>2,400</u>
Shareholders' equity	
Accumulated surplus or deficit	1,400
Issued equity	
250 ordinary shares [RM600 + RM1,600]	2,200
Total shareholders' equity	<u>3,600</u>
Total liabilities and shareholders' equity	<u>6,000</u>

IE200. The amount recognized as issued equity interests in the consolidated financial statements (RM2,200) is determined by adding the issued equity of the legal controlled entity immediately before the acquisition (RM600) and the fair value of the consideration effectively transferred (RM1,600). 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 MPSAS 40, *Public Sector Combinations*, 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 RM1,600 (i.e., 40 shares, each with a fair value of RM40). That is the same amount

as when Entity B's sole shareholder tenders all 60 of its ordinary shares for exchange. The recognized 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., RM134 or 6.7 percent of RM2,000).
- IE204. The consolidated statement of financial position at 30 September 20X6, reflecting the non-controlling interest, is as follows:

	RM
Current assets [RM700 + RM500]	1,200
Non-current assets [RM3,000 + RM1,500]	4,500
Goodwill	300
Total assets	<u>6,000</u>
Current liabilities [RM600 + RM300]	900
Non-current liabilities [RM1,100 + RM400]	1,500
Total liabilities	<u>2,400</u>
Shareholders' equity	
Accumulated surplus or deficit [RM1,400 × 93.3 percent]	1,306
Issued equity	
240 ordinary shares [RM560 + RM1,600]	2,160
Non-controlling interest	134
Total shareholders' equity	<u>3,600</u>
Total liabilities and shareholders' equity	<u><u>6,000</u></u>

- IE205. The non-controlling interest of RM134 has two components. The first component is the reclassification of the non-controlling interest's share of the accounting acquirer's retained earnings immediately before the acquisition (RM1,400 × 6.7 percent or RM93.80). The second component represents the reclassification of the non-controlling interest's share of the accounting acquirer's issued equity (RM600 × 6.7 percent or RM40.20).

Identifiable Intangible Assets in an Acquisition

Illustrating the Consequences of Applying Paragraphs 64–68 and AG75–AG84 of MPSAS 40, Public Sector Combinations

- 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 color, 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 recognized 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. MPSAS 40, *Public Sector Combinations*, does not preclude an entity from

recognizing, 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. MPSAS 26, *Impairment of Cash-Generating Assets*, and MPSAS 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 programs	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 recognizing a copyright intangible asset and any related assignments or license 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 unfavorable relative to market terms), the acquirer recognizes it as a liability assumed in the acquisition. Examples of binding arrangement-based intangible assets are:

Class	Basis
Licensing, royalty and standstill agreements	Binding arrangement
Advertising, construction, management, service or supply binding arrangements	Binding arrangement
Lease agreements (whether the acquired operation is the lessee or the lessor)	Binding arrangement
Construction permits	Binding arrangement
Franchise agreements	Binding arrangement
Operating and broadcast rights	Binding arrangement
Servicing binding arrangements, such as mortgage servicing binding arrangements	Binding arrangement
Binding arrangements for employment	Binding arrangement
Use rights, such as drilling, water, air, timber cutting and route authorities	Binding arrangement

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:

- When separated in the binding arrangement from the underlying financial asset by sale or securitization of the assets with servicing retained;
- 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 favorable 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 program 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 specialized 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, program, 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.’³

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 MPSAS 40, Public Sector Combinations.

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 RM1 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 RM1 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 MPSAS 40, *Public Sector Combinations*, confirms the transaction is an acquisition. The acquisition-date fair value of the preference shares is RM120.

IE238. Paragraph 73 of MPSAS 40, *Public Sector Combinations*, 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 acquired operation’s recognized 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 MPSASs.

³ Melvin Simensky and Lanning Bryer, *The New Role of Intellectual Property in Commercial Transactions* (New York: John Wiley & Sons, 1998), page 293.

IE239. The non-controlling interests that relate to TE's preference shares do not qualify for the measurement choice in paragraph 73 of MPSAS 40, *Public Sector Combinations*, 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 RM120.

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 RM160 and that the proportionate share of TE's recognized amounts of the identifiable net assets that is attributable to the preference shares is RM140.

IE241. The preference shares qualify for the measurement choice in paragraph 73 of MPSAS 40, *Public Sector Combinations*. AE can choose to measure the preference shares either at their acquisition-date fair value of RM160 or at their proportionate share in the acquired operation's recognized amounts of the identifiable net assets of RM140.

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 RM200. The share options do not expire on the acquisition date and AE does not replace them.

IE243. Paragraph 73 of MPSAS 40, *Public Sector Combinations*, requires such share options to be measured at their acquisition-date fair value, unless another measurement basis is required by MPSAS. Paragraph 84 of MPSAS 40, *Public Sector Combinations*, 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 RM200.

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–AG87 of MPSAS 40, Public Sector Combinations

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 RM575. 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:	RM
Financial assets	265
Inventory	5
Property, plant and equipment	640
Identifiable intangible assets	12
Financial liabilities	(320)
Tax liabilities	(40)
Total net assets	<u>562</u>

IE247. AE recognizes goodwill of RM13, the difference between the price paid to acquire TE (RM575) and the net assets of TE (RM562).

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:	RM
Financial assets	265
Inventory	5
Property, plant and equipment	640
Identifiable intangible assets	12
Financial liabilities	(320)
Tax liabilities	(20)
Total net assets	<u>582</u>

IE249. AE recognizes a gain of RM7, the difference between the price paid to acquire TE (RM575) and the net assets of TE (RM582). AE would account for the remaining tax liability in accordance with the relevant international or national accounting standard dealing with income taxes.

IE250. MF accounts for tax receivable in accordance with MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes & Transfers)*, and would recognize an adjustment for the tax forgiven.

Gain on a Bargain Purchase in an Acquisition

Illustrating the Consequences of Recognizing and Measuring a Gain from a Bargain Purchase in an Acquisition by Applying Paragraphs 85–90 of MPSAS 40, Public Sector Combinations

IE251. The following example illustrates the accounting for an acquisition in which a gain on a bargain purchase is recognized.

IE252. On 1 January 20X5 AE acquires 80 percent of the equity interests of TE, a private entity, in exchange for cash of RM150. 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 recognizable

identifiable assets acquired and the liabilities assumed as of the acquisition date in accordance with the requirements of MPSAS 40, *Public Sector Combinations*. The identifiable assets are measured at RM250 and the liabilities assumed are measured at RM50. AE engages an independent consultant, who determines that the fair value of the 20 percent non-controlling interest in TE is RM42.

IE253. The amount of TE's identifiable net assets (RM200, calculated as RM250 – RM50) 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:

	RM
Amount of the identifiable net assets acquired (RM250 – RM50)	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
	<u>192</u>
Gain on bargain purchase of 80 percent interest	<u>8</u>

IE254. AE would record its acquisition of TE in its consolidated financial statements as follows:

	RM	RM
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 recognized amount of the non-controlling interest would be RM40 (RM200 × 0.20). The gain on the bargain purchase then would be RM10 (RM200 – (RM150 + RM40)).

Measurement Period in an Acquisition

Illustrating the Consequences of Applying Paragraphs 103–108 of MPSAS 40, Public Sector Combinations

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 MPSAS 40, *Public Sector Combinations*, requires the acquirer to recognize in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the

acquirer recognizes 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 recognized as of that date. Paragraph 107 of MPSAS 40, *Public Sector Combinations*, requires the acquirer to recognize 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 authorized for issue its financial statements for the year ended 31 December 20X7. In its 20X7 annual financial statements, AE recognized a provisional fair value for the asset of RM30,000. 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 RM40,000.

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 RM9,500. That adjustment is measured as the fair value adjustment at the acquisition date of RM10,000 less the additional depreciation that would have been recognized if the asset's fair value at the acquisition date had been recognized from that date (RM500 for three months' depreciation).
- (b) The carrying amount of goodwill as of 31 December 20X7 is decreased by RM10,000.
- (c) Depreciation expense for 20X7 is increased by RM500.

IE259. In accordance with paragraph 124 of MPSAS 40, *Public Sector Combinations*, 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 recognized 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 RM9,500, offset by a decrease to goodwill of RM10,000 and an increase in depreciation expense of RM500.

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 MPSAS 40, Public Sector Combinations

IE260. AE provides TE with a five year, fixed rate loan of RM100. 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 RM90 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 amortized cost of the loan) is RM100.
- IE262. In this example, AE calculates a loss of RM10. 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 recognized by AE. In its consolidated financial statements, AE will eliminate its financial asset (RM100) against the fair value of TE's financial liability (RM90), 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 MPSAS 40, Public Sector Combinations.

- IE263. On 1 January 20X7, AE acquires TE. Previously, on 1 October 20X6, AE provided TE with a grant of RM800 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 recognized a liability of RM600 in respect of its performance obligation, in accordance with MPSAS 23, *Revenue from Non-Exchange Transactions (Taxes & Transfers)*. 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 recognize an asset in respect of the grant but accounted for the full RM800 as an expense.
- IE265. In this example, AE calculates a gain of RM600. The gain is calculated as the liability assumed that is derecognized 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 recognized by AE; if AE had previously recognized a corresponding asset, this would be derecognized at the acquisition date, and the derecognized 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 MPSAS 40, Public Sector Combinations.

- 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 RM6 million penalty. With three years remaining under the supply contract, AE pays RM50 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 RM8 million related to the fair value of the supply contract with AE. The RM8 million represents a RM3 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 RM5 million component for pricing that is unfavorable 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 recognized any assets or liabilities related to the supply contract before the acquisition.

IE269. In this example, AE calculates a loss of RM5 million (the lesser of the RM6 million stated settlement amount and the amount by which the contract is unfavorable to the acquirer) separately from the acquisition. The RM3 million ‘at-market’ component of the contract is part of goodwill.

IE270. Whether AE had recognized previously an amount in its financial statements related to a pre-existing relationship will affect the amount recognized as a gain or loss for the effective settlement of the relationship. Suppose that MPSASs had required AE to recognize a RM6 million liability for the supply contract before the acquisition. In that situation, AE recognizes a RM1 million settlement gain on the contract in surplus or deficit at the acquisition date (the RM5 million measured loss on the contract less the RM6 million loss previously recognized). In other words, AE has in effect settled a recognized liability of RM6 million for RM5 million, resulting in a gain of RM1 million.

Contingent Payments to Employees in an Acquisition

Illustrating the Consequences of Applying Paragraphs 109–110, AG98 and AG102–AG103 of MPSAS 40, *Public Sector Combinations*.

IE271. TE appointed a candidate as its new CEO under a ten-year contract. The contract required TE to pay the candidate RM5 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 RM5 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 MPSAS 40, Public Sector Combinations.

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 RM500, 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 (RM100) of the grant previously received by AE. AE recognizes a liability and an expense of RM100 on 1 July 20X3.

Disclosure Requirements Relating to Acquisitions

Illustrating the Consequences of Applying the Disclosure Requirements in Paragraphs 119–125 of MPSAS 40, Public Sector Combinations.

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 RM2,500 arising from the acquisition consists largely of the synergies and economies of scale expected from combining the operations of AE and TE.
- 120(k) None of the goodwill recognized is expected to be deductible for income tax purposes. The following table summarizes the consideration paid for TE and the amounts of the assets acquired and liabilities assumed recognized at the acquisition date, as well as the fair value at the acquisition date of the non-controlling interest in TE.

At 30 June 20X2

	Consideration	RM
120(f)(i)	Cash	11,000
120(f)(iii); 120(g)(i)	Contingent consideration arrangement	1,000
120(f)	Total consideration transferred	12,000

**Paragraph
reference**

120(m)	Acquisition-related costs (included in selling, general and administrative expenses in AE's statement of comprehensive income for the year ended 31 December 20X2)	1,250
120(i)	Recognized 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 RM7,500 for 20X3, up to a maximum amount of RM2,500 (undiscounted). The potential undiscounted amount of all future payments that AE could be required to make under the contingent consideration arrangement is between RM0 and RM2,500. The fair value of the contingent consideration arrangement of RM1,000 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 RM10,000–20,000. As of 31 December 20X2, neither the amount recognized 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 RM2,375. The gross amount due under the contracts is RM3,100, of which RM450 is expected to be uncollectible.	
124(a)	The fair value of the acquired identifiable intangible assets of RM3,300 is provisional pending receipt of the final valuations for those assets.	

**Paragraph
reference**

120(j) 124(c) MPSAS 19.97, 98	A contingent liability of RM1,000 has been recognized 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 RM500 and RM1,500. As of 31 December 20X2, there has been no change since 30 June 20X2 in the amount recognized 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 income since 30 June 20X2 contributed by TE was RM4,090. TE also contributed profit of RM1,710 over the same period.
120(r)(ii)	Had TE been consolidated from 1 January 20X2 the consolidated statement of comprehensive income would have included revenue of RM27,670 and profit of RM12,870.

In considering the disclosures related to an acquisition, an entity may find it helpful to refer to the discussion of materiality in MPSAS 1, *Presentation of Financial Statements*.

Comparison with IPSAS 40

MPSAS 40, *Public Sector Combinations* are drawn primarily from IPSAS 40, *Public Sector Combinations* (issued in 2017, including amendments up to January 31, 2020). The main differences between MPSAS 40 and IPSAS 40 are as follows:

- In paragraph 35 and 80, IPSAS 40 refers to IPSAS 39, *Employee Benefits* whereas MPSAS 40 refers to MPSAS 25, *Employee Benefits* in which drawn from IPSAS 25 that has been superseded by IPSAS 39. The MPSAS is yet to adopt IPSAS 39.

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GLOSSARY OF DEFINED TERMS

This Glossary contains all terms defined in the 33 accrual basis Malaysian Public Sector Accounting Standards (MPSASs) approved up to December 2022. A list of these MPSASs is located on the outside back cover of the handbook.

Definitions

References to accrual basis MPSASs are by Standard number and paragraph number. For example, 1.7 refers users to MPSAS 1, *Presentation of Financial Statements*, paragraph 7. References set out in brackets indicate a minor variation in wording.

Term	Definition	Location
accounting basis	The accrual or cash basis of accounting as defined in the accrual basis MPSASs and the Cash Basis IPSAS.	24.7
accounting policies	The specific principles, bases, conventions, rules, and practices applied by an entity in preparing and presenting financial statements.	3.7
accrual basis	A basis of accounting under which transactions and other events are recognized when they occur (and not only when cash or its equivalent is received or paid). Therefore, the transactions and events are recorded in the accounting records and recognized in the financial statements of the periods to which they relate. The elements recognized under accrual accounting are assets, liabilities, net assets/equity, revenue, and expenses.	1.7
acquired operation	The operation that the acquirer gains control of in an acquisition.	40.5
acquirer	The entity that gains control of one or more operations in an acquisition.	40.5
acquisition	A public sector combination in which one party to the combination gains control of one or more operations, and there is evidence that the combination is not an amalgamation.	40.5
acquisition date	The date on which the acquirer gains control of the acquired operation.	40.5
active market	A market in which all the following conditions exist: (a) The items traded within the market are homogeneous; (b) Willing buyers and sellers can normally be found at any time; and (c) Prices are available to the public.	21.14
actuarial gains and losses	Comprise: (a) Experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred); and (b) The effects of changes in actuarial assumptions.	25.10

Glossary

Term	Definition	Location
agricultural activity	The management by an entity of the biological transformation and harvest of biological assets for: • Sale; • Distribution at no charge or for a nominal charge; or • Conversion into agricultural produce or into additional biological assets for sale or for distribution at no charge or for a nominal charge.	27.9
agricultural produce	The harvest procedure of entity's biological assets.	27.9
amalgamation	Gives rise to a resulting entity and is either: - A public sector combination in which no party to the combination gains control of one or more operations; or - A public sector combination in which one party to the combination gains control of one or more operations, and in which there is evidence that the combination has the economic substance of an amalgamation.	40.5
amalgamation date	The date on which the resulting entity obtains control of the combining operations.	40.5
amortization	The systematic allocation of the depreciable amount of an intangible asset over its useful life.	31.16
amortized cost of a financial asset or financial liability	The amount at which the financial asset or financial liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between that initial amount and the maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectibility.	29.10
annual budget	An approved budget for one year. It does not include published forward estimates or projections for periods beyond the budget period.	24.7
appropriation	An authorization granted by a legislative body to allocate funds for purposes specified by the legislature or similar authority.	24.7
approved budget	The expenditure authority derived from laws, appropriation bills, government ordinances, and other decisions related to the anticipated revenue or receipts for the budgetary period.	24.7
assets	Resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity.	1.7

Term	Definition	Location
assets held by a long-term employee benefit fund	Assets (other than non-transferable financial instruments issued by the reporting entity) that: (a) Are held by an entity (a fund) that is legally separate from the reporting entity and exists solely to pay or fund employee benefits; and (b) Are available to be used only to pay or fund employee benefits, are not available to the reporting entity's own creditors (even in bankruptcy), and cannot be returned to the reporting entity, unless either: (i) The remaining assets of the fund are sufficient to meet all the related employee benefit obligations of the plan or the reporting entity; or (ii) The assets are returned to the reporting entity to reimburse it for employee benefits already paid.	25.10
available-for-sale financial assets	Those non-derivative financial assets that are designated as available for sale or are not classified as: (a) Loans and receivables; (b) Held-to-maturity investments; or (c) Financial assets at fair value through surplus or deficit.	29.10
bearer plant	A living plant that: (a) Is used in the production or supply of agricultural produce; (b) Is expected to bear produce for more than one period; and (c) Has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales.	17.13, 27.9
benefits	The advantages an entity obtains from its involvement with other entities. Benefits may be financial or non-financial. The actual impact of an entity's involvement with another entity can have positive or negative aspects.	35.14
binding arrangement (for a service concession arrangement)	Describes contracts and other arrangements that confer similar rights and obligations on the parties to it as if they were in the form of a contract.	32.8
binding arrangement (for a joint arrangement)	An arrangement that confers enforceable rights and obligations on the parties to it as if it were in the form of a contract. It includes rights from contracts or other legal rights.	35.14
biological asset	A living animal or plant.	27.9
biological transformation	Comprises the processes of growth, degeneration, production, and procreation that cause qualitative or quantitative changes in a biological asset.	27.9
borrowing costs	Interest and other expenses incurred by an entity in connection with the borrowing of funds.	5.5
budgetary basis	The accrual, cash, or other basis of accounting adopted in the budget that has been approved by the legislative body.	24.7

Term	Definition	Location
carrying amount (of an intangible asset)	The amount at which an asset is recognized after deducting any accumulated amortization and accumulated impairment losses.	31.16
carrying amount (of investment property)	The amount at which an asset is recognized in the statement of financial position.	16.7
carrying amount (of property, plant, and equipment)	The amount at which an asset is recognized after deducting any accumulated depreciation and accumulated impairment losses.	17.13
cash	Comprises cash on hand and demand deposits.	2.8
cash equivalents	Short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.	2.8
cash flows	Inflows and outflows of cash and cash equivalents.	2.8
cash-generating assets	Assets held with the primary objective of generating a commercial return.	21.14
cash-generating unit	The smallest identifiable group of assets held with the primary objective of generating a commercial return that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets.	26.13
change in accounting estimate	An adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not correction of errors.	3.7
class of property, plant, and equipment	A grouping of assets of a similar nature or function in an entity's operations that is shown as a single item for the purpose of disclosure in the financial statements.	17.13
close members of the family of an individual	Close relatives of the individual or members of the individual's immediate family who can be expected to influence, or be influenced by, that individual in their dealings with the entity.	20.4
closing rate	The spot exchange rate at the reporting date.	4.10
combining operation	An operation that combines with one or more other operations to form the resulting entity in an amalgamation.	40.5
commencement of the lease term	The date from which the lessee is entitled to exercise its right to use the leased asset. It is the date of initial recognition of the lease (i.e., the recognition of the assets, liabilities, revenue, or expenses resulting from the lease, as appropriate).	13.8

Glossary

Term	Definition	Location
comparable basis	The actual amounts presented on the same accounting basis, same classification basis, for the same entities, and for the same period as the approved budget.	24.7
composite social security programs	Programs established by legislation, and (a) Operate as multi-employer plans to provide post-employment benefits; as well as to (b) Provide benefits that are not consideration in exchange for service rendered by employees.	25.10
conditions on transferred assets	Stipulations that specify that the future economic benefits or service potential embodied in the asset is required to be consumed by the recipient as specified or future economic benefits or service potential must be returned to the transferor.	23.7
consolidated financial statements	The financial statements of an economic entity in which the assets, liabilities, net assets/equity, revenue, expenses and cash flows of the controlling entity and its controlled entities are presented as those of a single economic entity.	34.6
construction contract	A contract, or a similar binding arrangement, specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology, and function or their ultimate purpose or use.	11.4
constructive obligation	An obligation that derives from an entity's actions where: (a) By an established pattern of past practice, published policies, or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and (b) As a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.	19.18
contingent asset	A possible asset that arises from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.	19.18
contingent consideration	Usually an obligation of the acquirer to transfer additional assets or equity interests to the former owners of an acquired operation as part of the exchange for control of the acquired operation if specified future events occur or conditions are met. However, contingent consideration also may give the acquirer the right to the return of previously transferred consideration if specified conditions are met.	40.5

Glossary

Term	Definition	Location
contingent liability	(a) A possible obligation that arises from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or (b) A present obligation that arises from past events, but is not recognized because: (i) It is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; or (ii) The amount of the obligation cannot be measured with sufficient reliability.	19.18
contingent rent	That portion of the lease payments that is not fixed in amount, but is based on the future amount of a factor that changes other than with the passage of time (e.g., percentage of future sales, amount of future use, future price indices, future market rates of interest).	13.8
contractor	An entity that performs construction work pursuant to a construction contract.	11.4
contributions from owners	Future economic benefits or service potential that has been contributed to the entity by parties external to the entity, other than those that result in liabilities of the entity, that establish a financial interest in the net assets/equity of the entity, which: (a) Conveys entitlement both to: (i) Distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives; and to (ii) Distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or (b) Can be sold, exchanged, transferred, or redeemed.	1.7
control	An entity controls another entity when the entity is exposed, or has rights, to variable benefits from its involvement with the other entity and has the ability to affect the nature or amount of those benefits through its power over the other entity.	2.8
control of an asset	Arises when the entity can use or otherwise benefit from the asset in pursuit of its objectives, and can exclude or otherwise regulate the access of others to that benefit.	23.7
controlled entity	An entity that is controlled by another entity.	35.14
controlling entity	An entity that controls one or more entities.	35.14
cost	The amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction.	16.7

Glossary

Term	Definition	Location
cost plus or cost-based contract	A construction contract in which the contractor is reimbursed for allowable or otherwise defined costs and, in the case of a commercially based contract, an additional percentage of these costs or a fixed fee, if any.	11.4
costs of disposal	Incremental costs directly attributable to the disposal of an asset, excluding finance costs and income tax expense.	21.14
costs to sell	The incremental costs directly attributable to the disposal of an asset, excluding finance costs and income taxes. Disposal may occur through sale or through distribution at no charge or for a nominal charge.	27.9
credit risk	The risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.	30.8
currency risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.	30.8
current replacement cost	The cost the entity would incur to acquire the asset on the reporting date.	12.9
current service cost	The increase in the present value of the defined benefit obligation resulting from employee service in the current period.	25.10
date of adoption of MPSASs	The date an entity adopts accrual basis MPSASs for the first time, and is the start of the reporting period in which the first-time adopter adopts accrual basis MPSASs and for which the entity presents its first transitional MPSAS financial statements or its first MPSAS financial statements.	33.9
decision maker	An entity with decision-making rights that is either a principal or an agent for other parties.	35.14
deemed cost	An amount used as a surrogate for acquisition cost or depreciated cost at a given date.	33.9
defined benefit plans	Post-employment benefit plans other than defined contribution plans.	25.10
defined contribution plans	Post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund), and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.	25.10
depreciable amount	The cost of an asset, or other amount substituted for cost, less its residual value.	17.13
depreciation	The systematic allocation of the depreciable amount of an asset over its useful life.	17.13

Term	Definition	Location
derecognition	The removal of a previously recognized financial asset or financial liability from an entity's statement of financial position.	29.10
derivative	A financial instrument or other contract within the scope of [MPSAS 29] (see paragraphs 2–6) with all three of the following characteristics: (a) Its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the “underlying”); (b) It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and (c) It is settled at a future date.	29.10
development	The application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.	31.16
distributions to owners	Future economic benefits or service potential distributed by the entity to all or some of its owners, either as a return on investment or as a return of investment.	1.7
economic entity	A controlling entity and its controlled entities.	1.7, 35.14
economic life	Either: (a) The period over which an asset is expected to yield economic benefits or service potential to one or more users; or (b) The number of production or similar units expected to be obtained from the asset by one or more users.	13.8

Term	Definition	Location
effective interest method	A method of calculating the amortized cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest revenue or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, an entity shall estimate cash flows considering all contractual terms of the financial instrument (e.g., prepayment, call and similar options) but shall not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate (see MPSAS 9, <i>Revenue from Exchange Transactions</i>), transaction costs, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to estimate reliably the cash flows or the expected life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments).	29.10
employee benefits	All forms of consideration given by an entity in exchange for service rendered by employees.	25.10
entity-specific value	The present value of the cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.	17.13
equity interests	For the purposes of this Standard, is used broadly to mean ownership interests of investor-owned entities and owner, member or participant interests of mutual entities.	40.5
equity instrument	Any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.	28.9
equity method (relating to interests in other entities)	Method of accounting whereby the investment is initially recognized at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets/equity of the associate or joint venture. The investor's surplus or deficit includes its share of the investee's surplus or deficit and the investor's net assets/equity includes its share of changes in the investee's net assets/equity that have not been recognized in the investee's surplus or deficit.	36.8

Term	Definition	Location
events after the reporting date	Those events, both favorable and unfavorable, that occur between the reporting date and the date when the financial statements are authorized for issue. Two types of events can be identified: (a) Those that provide evidence of conditions that existed at the reporting date (adjusting events after the reporting date); and (b) Those that are indicative of conditions that arose after the reporting date (non-adjusting events after the reporting date).	14.5
exchange difference	The difference resulting from translating a given number of units of one currency into another currency at different exchange rates.	4.10
exchange rate	The ratio of exchange for two currencies.	4.10
exchange transactions	Transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.	9.11
executory contracts	Contracts under which neither party has performed any of its obligations, or both parties have partially performed their obligations to an equal extent.	19.18
expenses	Decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrences of liabilities that result in decreases in net assets/equity, other than those relating to distributions to owners.	1.7
expenses paid through the tax system	Amounts that are available to beneficiaries regardless of whether or not they pay taxes.	23.7
fair value	The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.	9.11
fair value less costs to sell	The amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.	21.14
final budget	The original budget, adjusted for all reserves, carry-over amounts, transfers, allocations, supplemental appropriations, and other authorized legislative or similar authority changes applicable to the budget period.	24.7
finance lease	A lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred.	13.8

Term	Definition	Location
financial asset	Any asset that is: (a) Cash; (b) An equity instrument of another entity; (c) A contractual right: (i) To receive cash or another financial asset from another entity; or (ii) To exchange financial assets or financial liabilities with another entity under conditions that are potentially favorable to the entity; or (d) A contract that will or may be settled in the entity's own equity instruments and is: (i) A non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or (ii) A derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include puttable financial instruments classified as equity instruments in accordance with paragraphs 15 and 16, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 17 and 18, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.	28.9

Term	Definition	Location
financial asset or financial liability at fair value through surplus or deficit	A financial asset or financial liability that meets either of the following conditions. (a) It is classified as held for trading. A financial asset or financial liability is classified as held for trading if: (i) It is acquired or incurred principally for the purpose of selling or repurchasing it in the near term; (ii) On initial recognition it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or (iii) It is a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument). (b) Upon initial recognition it is designated by the entity as at fair value through surplus or deficit. An entity may use this designation only when permitted by paragraph 13 or when doing so results in more relevant information, because either: (i) It eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as “an accounting mismatch”) that would otherwise arise from measuring assets or liabilities or recognizing the gains and losses on them on different bases; or (ii) A group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity’s key management personnel (as defined in MPSAS 20, <i>Related Party Disclosures</i>), for example the entity’s governing body and chief executive officer.	29.10
financial guarantee contract	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.	29.10
financial instrument	Any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity.	28.9

Glossary

Term	Definition	Location
financial liability	Any liability that is: (a) A contractual obligation: (i) To deliver cash or another financial asset to another entity; or (ii) To exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the entity; or (b) A contract that will or may be settled in the entity's own equity instruments and is: (i) A non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or (ii) A derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include puttable financial instruments classified as equity instruments in accordance with paragraphs 15 and 16, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 17 and 18, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments. As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraph 15 and 16 or paragraphs 17 and 18.	28.9
financing activities	Activities that result in changes in the size and composition of the contributed capital and borrowings of the entity.	2.8
fines	Economic benefits or service potential received or receivable by public sector entities, as determined by a court or other law enforcement body, as a consequence of the breach of laws or regulations.	23.7
firm commitment	A binding agreement for the exchange of a specified quantity of resources at a specified price on a specified future date or dates.	29.10
first MPSAS financial statements	The first annual financial statements in which an entity complies with the accrual basis MPSASs and can make an explicit and unreserved statement of compliance with those MPSASs because it adopted one or more of the transitional exemptions in this MPSAS that do not affect the fair presentation of the financial statements and its ability to assert compliance with accrual basis MPSASs.	33.9

Glossary

Term	Definition	Location
first-time adopter	An entity that adopts accrual basis MPSASs for the first time and presents its first transitional MPSAS financial statements or its first MPSAS financial statements.	33.9
fixed price contract	A construction contract in which the contractor agrees to a fixed contract price, or a fixed rate per unit of output, which in some cases is subject to cost escalation clauses.	11.4
forecast transaction	An uncommitted but anticipated future transaction.	29.10
foreign currency	A currency other than the functional currency of the entity.	4.10
foreign operation	An entity that is a controlled entity, associate, joint venture, or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity.	4.10
functional currency	The currency of the primary economic environment in which the entity operates.	4.10
general government sector	Comprises all organizational entities of the general government as defined in statistical bases of financial reporting	22.15
goodwill	An asset representing the future economic benefits arising from other assets acquired in an acquisition that are not individually identified and separately recognized.	40.5
grantor (in a service concession arrangement)	Is the entity that grants the right to use the service concession asset to the operator.	32.8
gross investment in the lease	The aggregate of: (a) The minimum lease payments receivable by the lessor under a finance lease; and (b) Any unguaranteed residual value accruing to the lessor.	13.8
group of biological assets	An aggregation of similar living animals or plants.	27.9
guaranteed residual value	(a) For a lessee, that part of the residual value that is guaranteed by the lessee or by a party related to the lessee (the amount of the guarantee being the maximum amount that could, in any event, become payable); and (b) For a lessor, that part of the residual value that is guaranteed by the lessee, or by a third party unrelated to the lessor, that is financially capable of discharging the obligations under the guarantee.	13.8
harvest	The detachment of produce from a biological asset or the cessation of a biological asset's life processes.	27.9

Term	Definition	Location
hedged item	An asset, liability, firm commitment, highly probable forecast transaction or net investment in a foreign operation that: (a) Exposes the entity to risk of changes in fair value or future cash flows; and (b) Is designated as being hedged ([MPSAS 29] paragraphs 87–94 and Appendix A paragraphs AG131–AG141 elaborate on the definition of hedged items).	29.10
hedge effectiveness	The degree to which changes in the fair value or cash flows of the hedged item that are attributable to a hedged risk are offset by changes in the fair value or cash flows of the hedging instrument (see [MPSAS 29] Appendix A paragraphs AG145–AG156).	29.10
hedging instrument	A designated derivative or (for a hedge of the risk of changes in foreign currency exchange rates only) a designated non-derivative financial asset or non-derivative financial liability whose fair value or cash flows are expected to offset changes in the fair value or cash flows of a designated hedged item ([MPSAS 29] paragraphs 81–86 and Appendix A paragraphs AG127–AG130 elaborate on the definition of a hedging instrument).	29.10
held-to-maturity investments	Non-derivative financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity (see [MPSAS 29] Appendix A paragraphs AG29–AG38) other than: (a) Those that the entity upon initial recognition designates as at fair value through surplus or deficit; (b) Those that the entity designates as available for sale; and (c) Those that meet the definition of loans and receivables. An entity shall not classify any financial assets as held to maturity if the entity has, during the current financial year or during the two preceding financial years, sold or reclassified more than an insignificant amount of held-to-maturity investments before maturity (more than insignificant in relation to the total amount of held-to-maturity investments) other than sales or reclassifications that: (a) Are so close to maturity or the financial asset’s call date (e.g., less than three months before maturity) that changes in the market rate of interest would not have a significant effect on the financial asset’s fair value; (b) Occur after the entity has collected substantially all of the financial asset’s original principal through scheduled payments or prepayments; or (c) Are attributable to an isolated event that is beyond the entity’s control, is non-recurring and could not have been reasonably anticipated by the entity.	29.10

Term	Definition	Location
identifiable	An asset is identifiable if it either: (a) Is separable, i.e., is capable of being separated or divided from the entity and sold, transferred, licensed, rented, or exchanged, either individually or together with a related binding arrangement, identifiable asset or liability, regardless of whether the entity intends to do so; or (b) Arises from binding arrangements (including rights from contracts or other legal rights), regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.	40.5
impairment	A loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of the asset's future economic benefits or service potential through depreciation.	21.14
impairment loss of a cash-generating asset	The amount by which the carrying amount of an asset exceeds its recoverable amount.	17.13
impairment loss of a non-cash-generating asset	The amount by which the carrying amount of an asset exceeds its recoverable service amount.	17.13
impracticable (1)	Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.	1.7
impracticable (2)	Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so. For a particular prior period, it is impracticable to apply a change in an accounting policy retrospectively or to make a retrospective restatement to correct an error if: (a) The effects of the retrospective application or retrospective restatement are not determinable; (b) The retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period; or (c) The retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that: (i) Provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognized, measured, or disclosed; and (ii) Would have been available when the financial statements for that prior period were authorized for issue; from other information.	3.7

Glossary

Term	Definition	Location
inception of the lease	The earlier of the date of the lease agreement and the date of commitment by the parties to the principal provisions of the lease. As at this date: (a) A lease is classified as either an operating or a finance lease; and (b) In the case of a finance lease, the amounts to be recognized at the commencement of the lease term are determined.	13.8
initial direct costs	Incremental costs that are directly attributable to negotiating and arranging a lease, except for such costs incurred by manufacturer or trader lessors.	13.8
intangible asset	An identifiable non-monetary asset without physical substance.	31.16
interest cost	The increase during a period in the present value of a defined benefit obligation that arises because the benefits are one period closer to settlement.	25.10
interest in another entity	Refers to involvement by way of binding arrangements or otherwise that exposes an entity to variability of benefits from the performance of the other entity. An interest in another entity can be evidenced by, but is not limited to, the holding of equity or debt instruments as well as other forms of involvement such as the provision of funding, liquidity support, credit enhancement and guarantees. It includes the means by which an entity has control or joint control of, or significant influence over, another entity. An entity does not necessarily have an interest in another entity solely because of a typical funder/recipient or customer/supplier relationship.	37.7
interest rate implicit in the lease	The discount rate that, at the inception of the lease, causes the aggregate present value of: (a) The minimum lease payments; and (b) The unguaranteed residual value to be equal to the sum of (i) the fair value of the leased asset, and (ii) any initial direct costs of the lessor.	13.8
interest rate risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.	30.8
inventories	Assets: (a) In the form of materials or supplies to be consumed in the production process; (b) In the form of materials or supplies to be consumed or distributed in the rendering of services; (c) Held for sale or distribution in the ordinary course of operations; or (d) In the process of production for sale or distribution.	12.9

Glossary

Term	Definition	Location
investing activities	The acquisition and disposal of long-term assets and other investments not included in cash equivalents.	2.8
investment entity	An entity that: (a) Obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services; (b) Has the purpose of investing funds solely for returns from capital appreciation, investment revenue, or both; and (c) Measures and evaluates the performance of substantially all of its investments on a fair value basis.	35.14
investment property	Property (land or a building – or part of a building – or both) held to earn rentals or for capital appreciation, or both, rather than for: (a) Use in the production or supply of goods or services, or for administrative purposes; or (b) Sale in the ordinary course of operations.	16.7
joint arrangement	An arrangement of which two or more parties have joint control.	36.8
joint control	The agreed sharing of control of an arrangement by way of a binding arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.	36.8
joint operation	A joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement.	37.7
joint operator	A party to a joint operation that has joint control of that joint operation.	37.7
joint venture	A joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.	36.8
joint venturer	A party to a joint venture that has joint control of that joint venture.	36.8

Glossary

Term	Definition	Location
key management personnel	(a) All directors or members of the governing body of the entity; and (b) Other persons having the authority and responsibility for planning, directing and controlling the activities of the reporting entity. Where they meet this requirement, key management personnel include: (i) Where there is a member of the governing body of a whole-of-government entity who has the authority and responsibility for planning, directing, and controlling the activities of the reporting entity, that member; (ii) Any key advisors of that member; and (iii) Unless already included in (a), the senior management group of the reporting entity, including the chief executive or permanent head of the reporting entity.	20.4
lease	An agreement whereby the lessor conveys to the lessee, in return for a payment or series of payments, the right to use an asset for an agreed period of time.	13.8
lease term	The non-cancelable period for which the lessee has contracted to lease the asset, together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.	13.8
legal obligation	An obligation that derives from: (a) A contract (through its explicit or implicit terms); (b) Legislation; or (c) Other operation of law.	19.18
lessee's incremental borrowing rate of interest	The rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.	13.8
liabilities	Present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.	1.7
liquidity risk	The risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.	30.8

Term	Definition	Location
loans and receivables	Non-derivative financial assets with fixed or determinable payments that are not quoted in an active market other than: (a) Those that the entity intends to sell immediately or in the near term, which shall be classified as held for trading, and those that the entity upon initial recognition designates as at fair value through surplus or deficit; (b) Those that the entity upon initial recognition designates as available for sale; or (c) Those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, which shall be classified as available for sale.	29.10
loans payable	Financial liabilities, other than short-term trade payables on normal credit terms.	30.8
market risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk, and other price risk.	30.8
material	Omissions or misstatements of items are material if they could, individually or collectively, influence the decisions or assessments of users made on the basis of the financial statements. Materiality depends on the nature and size of the omission or misstatement judged in the surrounding circumstances. The nature or size of the item, or a combination of both, could be the determining factor.	1.7
minimum lease payments	The payments over the lease term that the lessee is, or can be, required to make, excluding contingent rent, costs for services and, where appropriate, taxes to be paid by and reimbursed to the lessor, together with: (a) For a lessee, any amounts guaranteed by the lessee or by a party related to the lessee; or (b) For a lessor, any residual value guaranteed to the lessor by: (i) The lessee; (ii) A party related to the lessee; or (iii) An independent third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee. However, if the lessee has an option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised, the minimum lease payments comprise the minimum payments payable over the lease term to the expected date of exercise of this purchase option and the payment required to exercise it.	13.8

Glossary

Term	Definition	Location
monetary items	Units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency.	4.10
multi-employer plans	Defined contribution plans (other than state plans and composite social security programs) or defined benefit plans (other than state plans) that: (a) Pool the assets contributed by various entities that are not under common control; and (b) Use those assets to provide benefits to employees of more than one entity, on the basis that contribution and benefit levels are determined without regard to the identity of the entity that employs the employees concerned.	25.10
multi-year budget	An approved budget for more than one year. It does not include published forward estimates or projections for periods beyond the budget period.	24.7
mutual entity	An entity, other than an investor-owned entity, that provides dividends, lower costs or other economic benefits directly to its owners, members or participants. For example, a mutual insurance company, a credit union and a cooperative entity are all mutual entities.	40.5
net assets/equity	The residual interest in the assets of the entity after deducting all its liabilities.	1.7
net investment in a foreign operation	The amount of the reporting entity's interest in the net assets/equity of that operation.	4.10
net investment in the lease	The gross investment in the lease discounted at the interest rate implicit in the lease.	13.8
net realizable value	The estimated selling price in the ordinary course of operations, less the estimated costs of completion and the estimated costs necessary to make the sale, exchange or distribution.	12.9
non-cancelable lease	A lease that is cancelable only: (a) Upon the occurrence of some remote contingency; (b) With the permission of the lessor; (c) If the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or (d) Upon payment by the lessee of such an additional amount that, at inception of the lease, continuation of the lease is reasonably certain.	13.8
non-cash-generating assets	Assets other than cash-generating assets.	21.14
non-controlling interest	The net assets/equity in a controlled entity not attributable, directly or indirectly, to a controlling entity.	35.14

Glossary

Term	Definition	Location
non-exchange transactions	Transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.	9.11
non-monetary items	Items that are not monetary items.	10.7
notes	Contain information in addition to that presented in the statement of financial position, statement of financial performance, statement of changes in net assets/equity and cash flow statement. Notes provide narrative descriptions or disaggregations of items disclosed in those statements and information about items that do not qualify for recognition in those statements.	1.7
obligating event	An event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.	19.18
onerous contract	A contract for the exchange of assets or services in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits or service potential expected to be received under it.	19.18
operating activities	The activities of the entity that are not investing or financing activities.	2.8
operating lease	A lease other than a finance lease.	13.8
operation	An integrated set of activities and related assets and/or liabilities that is capable of being conducted and managed for the purpose of achieving an entity's objectives, by providing goods and/or services.	40.5
operator (in a service concession arrangement)	Is the entity that uses the service concession asset to provide public services subject to the grantor's control of the asset.	32.8
original budget	The initial approved budget for the budget period.	24.7
other long-term employee benefits	Employee benefits (other than post-employment benefits and termination benefits) that are not due to be settled within twelve months after the end of the period in which the employees render the related service.	25.10
other price risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.	30.8

Glossary

Term	Definition	Location
oversight	The supervision of the activities of an entity, with the authority and responsibility to control, or exercise significant influence over, the financial and operating decisions of the entity.	20.4
owner-occupied property	Property held (by the owner or by the lessee under a finance lease) for use in the production or supply of goods or services, or for administrative purposes.	16.7
owners	For the purposes of this Standard, is used broadly to include any party with quantifiable ownership interests in an operation. This includes, but is not limited to, holders of equity interests of investor-owned entities and owners or members of, or participants in, mutual entities.	40.5
party to a joint arrangement	An entity that participates in a joint arrangement, regardless of whether that entity has joint control of the arrangement.	37.7
past due	A financial asset is past due when a counterparty has failed to make a payment when contractually due.	30.8
past service cost	The change in the present value of the defined benefit obligation for employee service in prior periods, resulting in the current period from the introduction of, or changes to, post-employment benefits or other long-term employee benefits. Past service cost may be either positive (when benefits are introduced or changed so that the present value of the defined benefit obligation increases) or negative (when existing benefits are changed so that the present value of the defined benefit obligation decreases).	25.10
plan assets	Comprise: (a) Assets held by a long-term employee benefit fund; and (b) Qualifying insurance policies.	25.10
post-employment benefit plans	Formal or informal arrangements under which an entity provides post-employment benefits for one or more employees.	25.10
post-employment benefits	Employee benefits (other than termination benefits) which are payable after the completion of employment.	25.10
power	Consists of existing rights that give the current ability to direct the relevant activities of another entity.	35.14
present value of a defined benefit obligation	The present value, without deducting any plan assets, of expected future payments required to settle the obligation resulting from employee service in the current and prior periods.	25.10
presentation currency	The currency in which the financial statements are presented.	4.10

Term	Definition	Location
prior period errors	Omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, faithfully representative information that: (a) Was available when financial statements for those periods were authorized for issue; and (b) Could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements. Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.	3.7
property, plant and equipment	Tangible items that: (a) Are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and (b) Are expected to be used during more than one reporting period.	17.13
prospective application	Prospective application of a change in accounting policy and of recognizing the effect of a change in an accounting estimate, respectively, are: (a) Applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the policy is changed; and (b) Recognizing the effect of the change in the accounting estimate in the current and future periods affected by the change.	3.7
protective rights	Rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate.	35.14
provision	A liability of uncertain timing or amount.	19.18
public sector combination	The bringing together of separate operations into one public sector entity.	40.5
public sector combination under common control	Is a public sector combination in which all of the entities or operations involved are ultimately controlled by the same entity both before and after the public sector combination.	40.5
puttable instrument	A financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset or is automatically put back to the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder.	28.9
qualifying asset	An asset that necessarily takes a substantial period of time to get ready for its intended use or sale.	5.5

Glossary

Term	Definition	Location
qualifying insurance policy	An insurance policy¹ issued by an insurer that is not a related party (as defined in MPSAS 20) of the reporting entity, if the proceeds of the policy: (a) Can be used only to pay or fund employee benefits under a defined benefit plan; and (b) Are not available to the reporting entity's own creditors (even in bankruptcy) and cannot be paid to the reporting entity, unless either: (i) The proceeds represent surplus assets that are not needed for the policy to meet all the related employee benefit obligations; or (ii) The proceeds are returned to the reporting entity to reimburse it for employee benefits already paid.	25.10
recoverable amount (of an asset or a cash-generating unit)	The higher of an asset's or a cash-generating unit's fair value less costs to sell and its value in use.	26.13
recoverable amount (of property, plant and equipment)	The higher of a cash-generating asset's fair value less costs to sell and its value in use.	17.13
recoverable service amount	The higher of a non-cash-generating asset's fair value less costs to sell and its value in use.	21.14
regular way purchase or sale	A purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned.	29.10

¹ A qualifying insurance policy is not necessarily an insurance contracts (see the relevant international or national standard dealing with insurance contracts)

Term	Definition	Location
related party	Parties are considered to be related if one party has the ability to (a) control the other party, or (b) exercise significant influence over the other party in making financial and operating decisions, or if the related party entity and another entity are subject to common control. Related parties include: (a) Entities that directly, or indirectly through one or more intermediaries, control, or are controlled by, the reporting entity; (b) Associates (see MPSAS 36, <i>Investments in Associates and Joint Ventures</i>); (c) Individuals owning, directly or indirectly, an interest in the reporting entity that gives them significant influence over the entity, and close members of the family of any such individual; (d) Key management personnel, and close members of the family of key management personnel; and (e) Entities in which a substantial ownership interest is held, directly or indirectly, by any person described in (c) or (d), or over which such a person is able to exercise significant influence.	20.4
related party transaction	A transfer of resources or obligations between related parties, regardless of whether a price is charged. Related party transactions exclude transactions with any other entity that is a related party solely because of its economic dependence on the reporting entity or the government of which it forms part.	20.4
relevant rights	Activities of the potentially controlled entity that significantly affect the nature or amount of the benefits that an entity receives from its involvement with that other entity.	35.14
removal rights	Rights to deprive the decision maker of its decision-making authority.	35.14
remuneration of key management personnel	Any consideration or benefit derived directly or indirectly by key management personnel from the reporting entity for services provided in their capacity as members of the governing body, or otherwise as employees of the reporting entity.	20.4
reporting date	The date of the last day of the reporting period to which the financial statements relate.	2.8
research	Original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.	31.16
residual value (of property, plant and equipment or an intangible asset)	The estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.	17.13

Glossary

Term	Definition	Location
restrictions on transferred assets	Stipulations that limit or direct the purposes for which a transferred asset may be used, but do not specify that future economic benefits or service potential is required to be returned to the transferor if not deployed as specified.	23.7
restructuring	A program that is planned and controlled by management, and materially changes either: (a) The scope of an entity's activities; or (b) The manner in which those activities are carried out.	19.18
resulting entity	The entity that is the result of two or more operations combining in an amalgamation.	40.5
retrospective application	Applying a new accounting policy to transactions, other events, and conditions as if that policy had always been applied.	3.7
retrospective restatement	Correcting the recognition, measurement and disclosure of amounts of elements of financial statements as if a prior period error had never occurred.	3.7
return on plan assets	The interest, dividends or similar distributions and other revenue derived from the plan assets, together with realized and unrealized gains or losses on the plan assets, less any costs of administering the plan (other than those included in the actuarial assumptions used to measure the defined benefit obligation) and less any tax payable by the plan itself.	25.10
revenue	The gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets/equity, other than increases relating to contributions from owners.	1.7
revenue from a structured entity	Includes, but is not limited to, recurring and non-recurring fees, interest, dividends or similar distributions, gains or losses on the remeasurement or derecognition of interests in structured entities and gains or losses from the transfer of assets and liabilities to the structured entity.	38.7
separate financial statements	Those presented by an entity, in which the entity could elect, subject to the requirements in this Standard, to account for its investments in controlled entities, joint ventures and associates either at cost, in accordance with MPSAS 29, <i>Financial Instruments: Recognition and Measurement</i> or using the equity method as described in MPSAS 36, <i>Investments in Associates and Joint Ventures</i> .	34.6
separate vehicle	A separately identifiable financial structure, including separate legal entities or entities recognized by statute, regardless of whether those entities have a legal personality.	37.7

Glossary

Term	Definition	Location
service concession arrangement	Is a binding arrangement between a grantor and an operator in which: (a) The operator uses the service concession asset to provide a public service on behalf of the grantor for a specified period of time; and (b) The operator is compensated for its services over the period of the service concession arrangement.	32.8
service concession asset	It is an asset used to provide public services in a service concession arrangement that: (a) Is provided by the operator which: (i) The operator constructs, develops, or acquires from a third party; or (ii) Is an existing asset of the operator; or (b) Is provided by the grantor which: (i) Is an existing asset of the grantor; or (ii) Is an upgrade to an existing asset of the grantor.	32.8
short-term employee benefits	Employee benefits (other than termination benefits) that are due to be settled within twelve months after the end of the period in which the employees render the related service.	25.10
significant influence (relating to related party transactions)	The power to participate in the financial and operating policy decisions of an entity, but not control those policies. Significant influence may be exercised in several ways, usually by representation on the board of directors or equivalent governing body but also by, for example, participation in: (a) The policy making process; (b) Material transactions between entities within an economic entity; (c) Interchange of managerial personnel; or (d) Dependence on technical information. Significant influence may be gained by an ownership interest, statute, or agreement. With regard to an ownership interest, significant influence is presumed in accordance with the definition contained in MPSAS 36.	20.4
significant influence (relating to interests in other entities)	The power to participate in the financial and operating policy decisions of another entity but is not control or joint control of those policies.	36.8
spot exchange rate	The exchange rate for immediate delivery.	4.10
state plans	Plans other than composite social security programs established by legislation that operate as if they are multi-employer plans for all entities in economic categories laid down in legislation.	25.10
stipulations on transferred assets	Terms in laws or regulation, or a binding arrangement, imposed upon the use of a transferred asset by entities external to the reporting entity.	23.7

Term	Definition	Location
structured entity	Is: (a) In the case of entities where administrative arrangements or legislation are normally the dominant factors in deciding who has control of an entity, an entity that has been designed so that administrative arrangements or legislation are not the dominant factors in deciding who controls the entity, such as when binding arrangements are significant to determining control of the entity and relevant activities are directed by means of binding arrangements; or (b) In the case of entities where voting or similar rights are normally the dominant factor in deciding who has control of an entity, an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of binding arrangements.	38.7
tax expenditures	Preferential provisions of the tax law that provide certain taxpayers with concessions that are not available to others.	23.7
taxable event	The event that the government, legislature, or other authority has determined will be subject to taxation.	23.7
taxes	Economic benefits or service potential compulsorily paid or payable to public sector entities, in accordance with laws and/or regulations, established to provide revenue to the government. Taxes do not include fines or other penalties imposed for breaches of the law.	23.7
termination benefits	Employee benefits payable as a result of either: (a) An entity's decision to terminate an employee's employment before the normal retirement date; or (b) An employee's decision to accept voluntary redundancy in exchange for those benefits.	25.10
transaction costs	Incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability (see [MPSAS 29] Appendix A paragraph AG26). An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.	29.10
transfers	Inflows of future economic benefits or service potential from non-exchange transactions, other than taxes.	23.7
unearned finance revenue	The difference between: (a) The gross investment in the lease; and (b) The net investment in the lease.	13.8
unguaranteed residual value	That portion of the residual value of the leased asset, the realization of which by the lessor is not assured or is guaranteed solely by a party related to the lessor.	13.8

Glossary

Term	Definition	Location
useful life (of a lease)	The estimated remaining period, from the commencement of the lease term, without limitation by the lease term, over which the economic benefits or service potential embodied in the asset are expected to be consumed by the entity.	13.8
useful life (of a non-cash-generating asset)	Either: (a) The period of time over which an asset is expected to be used by the entity; or (b) The number of production or similar units expected to be obtained from the asset by the entity.	21.14
useful life (of property, plant and equipment or an intangible asset)	Either: (a) The period over which an asset is expected to be available for use by an entity; or (b) The number of production or similar units expected to be obtained from the asset by an entity.	17.13
value in use of a cash-generating asset	The present value of the estimated future cash flows expected to be derived from the continuing use of an asset and from its disposal at the end of its useful life.	26.13
value in use of a non-cash-generating asset	The present value of the asset's remaining service potential.	21.14
vested employee benefits	Employee benefits that are not conditional on future employment.	25.10

MALAYSIAN PUBLIC SECTOR ACCOUNTING PRONOUNCEMENTS HANDBOOK 2023

The Malaysian Public Sector Accounting Standards (MPSAS) is based on International Public Sector Accounting Standards (IPSAS) from the Handbook of International Public Sector Accounting Pronouncements of the International Public Sector Accounting Standards Board, published by the International Federation of Accountants (IFAC) in 2018 and is used with permission of IFAC.

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Volume 2 contains the following document and MPSASs:

MPSAS 29 Financial Instruments: Recognition and Measurement

MPSAS 30 Financial Instruments: Disclosure

MPSAS 31 Intangible Assets

MPSAS 32 Service Concession Arrangements: Grantor

MPSAS 33 First-Time Adoption of Accrual Basis MPSASs

MPSAS 34 Separate Financial Statements

MPSAS 35 Consolidated Financial Statements

MPSAS 36 Investments in Associates and Joint Ventures

MPSAS 37 Joint Arrangements

MPSAS 38 Disclosure of Interest in Other Entities

MPSAS 40 Public Sector Combinations

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