N. B.– Sinhala and Tamil versions of this *Gazette* extraordinary will be published separately.

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The Gazette of the Democratic Socialist Republic of Sri Lanka

EXTRAORDINARY

අංක 1851/22 - 2014 පෙබරවාරි මස 26 වැනි බදාදා - 2014.02.26

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PART I : SECTION (I) — GENERAL

Government Notifications

SRI LANKA ACCOUNTING AND AUDITING STANDARDS ACT, No. 15 OF 1995

Publication under Section 4(2)

BY virtue of the powers vested in the Institute of Chartered Accountants of Sri Lanka (hereinafter referred to as the "Institute"), the Institute has adopted the Sri Lanka Accounting Standards – SLFRS 10 : Consolidated Financial Statements, SLFRS 11: Joint Arrangements, SLFRS 12: Disclosure of Interests in Other Entities and SLFRS 13: Fair Value Measurement, published herewith for the purpose of the Sri Lanka Accounting and Auditing Standards. Act, No. 15 of 1995. These Standards shall be effective for financial statements covering period commencing on or after the first day of January Two Thousand Fourteen.

By Order of the Council,

ARUNA ALWIS,
Secretary.

The Institute of Chartered Accountants of Sri Lanka,
No. 30A,
Malalasekera Mawatha,
Colombo 07,
26th February, 2014.

SRI LANKA ACCOUNTING STANDARDS
Effective for financial periods beginning on or after 1 January, 2014

SLFRS 10-13

Content

SRI LANKA ACCOUNTING STANDARD

SLFRS 10

Consolidated Financial Statements

CONTENTS *from paragraph*

Sri Lanka Accounting Standard-SLFRS 10
Consolidated Financial Statements

Sri Lanka Accounting Standard 10 *Consolidated Financial Statements* (SLFRS 10) isset out in paragraphs 1–33 and Appendices A–C. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the Standard. Definitions of other terms are given in the Glossary for Sri Lanka Accounting Standards. SLFRS 10 should be read in the context of its objective, the *Preface to Sri Lanka Accounting Standards* and the *Conceptual Framework for Financial Reporting*. LKAS8 *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 SLFRS is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.

Meeting the objective

2 To meet the objective in paragraph 1, this SLFRS:

(*a*) requires an entity (the *parent*) that controls one or more other entities(*subsidiaries*) 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 investor controls an investee and therefore must consolidate the investee;

(*d*) sets out the accounting requirements for the preparation of consolidatedfinancial statements; and

(*e*) defines an investment entity and sets out an exception to consolidating particular subsidiaries of an investment entity.

3 This SLFRS does not deal with the accounting requirements for business combinations and their effect on consolidation, including goodwill arising on abusiness combination (see SLFRS 3 *Business Combinations*).

Scope

4 An entity that is a parent shall present consolidated financial statements. This SLFRS applies to all entities, except as follows:

(*a*) a parent need not present consolidated financial statements if it meets all the following conditions:

(i) it is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;

(ii) 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);

(iii) it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and

(iv) its ultimate or any intermediate parent produces consolidated financial statements that are available for public use and comply with SLFRSs.

(*b*) Post-employment benefit plans or other long-term employee benefit plans to which LKAS 19 *Employee Benefits* applies.

(*c*) an investment entity need not present consolidated financial statements if it is required, in accordance with paragraph 31 of this SLFRS, to measure all of its subsidiaries at fair value through profit or loss.

Control

5 **An investor, regardless of the nature of its involvement with an entity (the investee), shall determine whether it is a parent by assessing whether it controls the investee.**

6 **An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.**

7 **Thus, an investor controls an investee if and only if the investor has all the following:**

(*a*) power over the investee (see paragraphs 10–14);

(b) exposure, or rights, to variable returns from its involvement with the investee (see paragraphs 15 and 16); and

(c) the ability to use its power over the investee to affect the amount of the investor's returns (see paragraphs 17 and 18).

8 An investor shall consider all facts and circumstances when assessing whether controls an investee. The investor shall reassess whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed in paragraph 7 (see paragraphs B80–B85).

9 Two or more investors collectively control an investee when they must act together to direct the relevant activities. In such cases, because no investor can direct the activities without the co-operation of the others, no investor individually controls the investee. Each investor would account for its interest in the investee in accordance with the relevant SLFRSs, such as SLFRS 11 *Joint Arrangements*, LKAS 28 *Investments in Associates and Joint Ventures* or SLFRS 9 *FinancialInstruments*.

Power

10 An investor has power over an investee when the investor has existing rights that give it the current ability to direct the *relevant activities*, ie the activities that significantly affect the investee's returns.

11 Power arises from rights. Sometimes assessing power is straightforward, such as when power over an investee 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. In other cases, the assessment will be more complex and require more than one factor to be considered, for example when power results from one or more contractual arrangements.

12 An investor 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 investor has been directing relevant activities can help determine whether the investor has power, but such evidence is not, in itself, conclusive in determining whether the investor has power over an investee.

13 If two or more investors each have existing rights that give them the unilateral ability to direct different relevant activities, the investor that has the current ability to direct the activities that most significantly affect the returns of the investee has power over the investee.

14 An investor can have power over an investee 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 investor that holds only protective rights does not have power overan investee (see paragraphs B26–B28), and consequently does not control the investee.

Returns

15 An investor is exposed, or has rights, to variable returns from its involvement with the investee when the investor's returns from its involvement have the potential to vary as a result of the investee's performance. The investor's returns can be only positive, only negative or both positive and negative.

16 Although only one investor can control an investee, more than one party can share in the returns of an investee. For example, holders of non-controlling interests can share in the profits or distributions of an investee.

Link between power and returns

17 An investor controls an investee if the investor not only has power over the investee and exposure or rights to variable returns from its involvement with the investee, but also has the ability to use its power to affect the investor's returns from its involvement with the investee.

18 Thus, an investor with decision-making rights shall determine whether it is a principal or an agent. An investor that is an agent in accordance with paragraphs B58–B72 does not control an investee when it exercises decision-making rights delegated to it.

Accounting requirements

19 A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.

20 Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee.

21 Paragraphs B86–B93 set out guidance for the preparation of consolidated financial statements.

Non-controlling interests

22 A parent shall present non-controlling interests in the consolidated statement of financial position within equity, separately from the equity of the owners of the parent.

23 Changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (ie transactions with owners in their capacity as owners).

24 Paragraphs B94–B96 set out guidance for the accounting for non-controlling interests in consolidated financial statements.

Loss of control

25 If a parent loses control of a subsidiary, the parent:

(*a*) derecognises the assets and liabilities of the former subsidiary from the consolidated statement of financial position.

(*b*) recognises any investment retained in the former subsidiary at its fair value when control is lost and subsequently accounts for it and for any amounts owed by or to the former subsidiary in accordance with relevant SLFRSs. That fair value shall be regarded as the fair value on initial recognition of a financial asset in accordance with SLFRS 9 or, when appropriate, the cost on initial recognition of an investment in anassociate or joint venture.

(*c*) recognises the gain or loss associated with the loss of control attributable to the former controlling interest.

26 Paragraphs B97–B99 set out guidance for the accounting for the loss of control.

Determining whether an entity is an investment entity

27 A parent shall determine whether it is an investment entity. 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*) commits to its investor(s) that its business purpose is to investfunds solely for returns from capital appreciation, investment income, or both; and

(*c*) measures and evaluates the performance of substantially all of its investments on a fair value basis.

Paragraphs B85A–B85M provide related application guidance.

28 In assessing whether it meets the definition described in paragraph 27, an entity shall consider whether it has the following typical characteristics of an investment entity:

(*a*) it has more than one investment (see paragraphs B85O–B85P);

(*b*) it has more than one investor (see paragraphs B85Q–B85S);

(*c*) it has investors that are not related parties of the entity (see paragraphsB85T–B85U); and

(*d*) it has ownership interests in the form of equity or similar interests (see paragraphs B85V–B85W).

The absence of any of these typical characteristics does not necessarily disqualify an entity from being classified as an investment entity. An investment entity that does not have all of these typical characteristics provides additional disclosure required by paragraph 9A of SLFRS 12 *Disclosure of Interests in OtherEntities*.

29 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, as described in paragraph 27, or the typical characteristics of an investment entity, as described in paragraph 28, a parent shall reassess whether it is an investment entity.

30 A parent 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 B100–B101).

Investment entities: exception to consolidation

31 Except as described in paragraph 32, an investment entity shall not consolidate its subsidiaries or apply SLFRS 3 when it obtains control of another entity. Instead, an investment entity shall measure an investment in a subsidiary at fair value through profit or loss in accordance with SLFRS 9.[1]

32 Notwithstanding the requirement in paragraph 31, if an investment entity has a subsidiary that provides services that relate to the investment entity's investment activities (see paragraphs B85C–B85E), it shall consolidate that subsidiary in accordance with paragraphs 19–26 of this SLFRS and apply the requirements of SLFRS 3 to the acquisition of any such subsidiary.

33 A parent of an investment entity shall consolidate all entities that it controls,including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity.

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[1] Paragraph C7 of SLFRS 10 *Consolidated Financial Statements* states "If an entity applies this SLFRS but does not yet apply SLFRS 9, any reference in this SLFRS to SLFRS 9 shall be read as a reference to LKAS 39 *Financial Instruments: Recognition and Measurement*."

Appendix A

Defined terms

This appendix is an integral part of the SLFRS.

consolidated financial statements	The financial statements of a **group** in which the assets, liabilities, equity, income, expenses and cash flows of the **parent** and its **subsidiaries** are presented as those of a single economic entity.
control of an investee	An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.
decision maker	An entity with decision-making rights that is either a principal or an agent for other parties.
group	A **parent** and its **subsidiaries**.
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*) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and (*c*) measures and evaluates the performance of substantially all of its investments on a fair value basis.
non-controlling interest	Equity in a **subsidiary** not attributable, directly or indirectly, to a **parent.**
parent	An entity that **controls** one or more entities.
power	Existing rights that give the current ability to direct the **relevant activities.**
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.
relevant activities	For the purpose of this SLFRS relevant activities are activities of the investee that significantly affect the investee's returns.
removal rights	Rights to deprive the decision maker of its decision-making authority
subsidiary	An entity that is controlled by another entity.

The following terms are defined in SLFRS 11, SLFRS 12 *Disclosure of Interests in Other Entities*, LKAS 28 or LKAS 24 *Related Party Disclosures* and are used in this SLFRS with the meanings specified in those SLFRSs:

- associate
- interest in another entity
- joint venture
- key management personnel
- related party
- significant influence.

Appendix B

Application guidance

This appendix is an integral part of the SLFRS. It describes the application of paragraphs 1–26 and has the same authority as the other parts of the SLFRS.

B1 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 SLFRS 10.

Assessing control

B2 To determine whether it controls an investee an investor shall assess whether it has all the following:

(*a*) power over the investee;

(*b*) exposure, or rights, to variable returns from its involvement with the investee; and

(*c*) the ability to use its power over the investee to affect the amount of the investor's returns.

B3 Consideration of the following factors may assist in making that determination:

(*a*) the purpose and design of the investee (see paragraphs B5–B8);

(*b*) what the relevant activities are and how decisions about those activities are made (see paragraphs B11–B13);

(*c*) whether the rights of the investor give it the current ability to direct the relevant activities (see paragraphs B14–B54);

(*d*) whether the investor is exposed, or has rights, to variable returns from its involvement with the investee (see paragraphs B55–B57); and

(*e*) whether the investor has the ability to use its power over the investee to affect the amount of the investor's returns (see paragraphs B58–B72).

B4 When assessing control of an investee, an investor shall consider the nature of its relationship with other parties (see paragraphs B73–B75).

Purpose and design of an investee

B5 When assessing control of an investee, an investor shall consider the purpose and design of the investee 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 receives returns from those activities.

B6 When an investee's purpose and design are considered, it may be clear that aninvestee is controlled by means of equity instruments that give the holder proportionate voting rights, such as ordinary shares in the investee. 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 investee's operating and financing policies (see paragraphs B34–B50). In the most straightforward case, the investor that holds amajority of those voting rights, in the absence of any other factors, controls the investee.

B7 To determine whether an investor controls an investee in more complex cases, it may be necessary to consider some or all of the other factors in paragraph B3.

B8 An investee may be designed so that voting rights are not the dominant factor in deciding who controls the investee, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. In such cases, an investor's consideration of the purpose and design of the investee shall also include consideration of the risks to which the investee was designed to be exposed, the risks it was designed to pass on to the parties involved with the investee and whether the investor 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

B9 To have power over an investee, an investor 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 B22–B28).

B10 The determination about whether an investor has power depends on the relevant activities, the way decisions about the relevant activities are made and the rights the investor and other parties have in relation to the investee.

Relevant activities and direction of relevant activities

B11 For many investees, a range of operating and financing activities significantly affect their returns. Examples of activities that, depending on the circumstances, can be relevant activities include, but are not limited to:

(*a*) selling and purchasing of goods or services;

(*b*) managing financial assets during their life (including upon default);

(*c*) selecting, acquiring or disposing of assets;

(*d*) researching and developing new products or processes; *and*

(*e*) determining a funding structure or obtaining funding.

B12 Examples of decisions about relevant activities include but are not limited to:

(*a*) establishing operating and capital decisions of the investee, including budgets; *and*

(*b*) appointing and remunerating an investee's key management personnelor service providers and terminating their services or employment.

B13 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 investors have the current ability to direct relevant activities and those activities occur at different times, the investors shall determine which investor is able to direct the activities that most significantly affect those returns consistently with the treatment of concurrent decision-making rights (see paragraph 13). The investors shall reconsider this assessment over time if relevant facts or circumstances change.

Application examples

Example 1

Two investors form an investee to develop and market a medical product.One investor 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, the other investor will manufacture and market it-this investor 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, each investor needs to determine whether it is able to direct the activities that most significantly affect the investee's returns. Accordingly, each investor needs 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 investee's returns and whether it is able to direct that activity. In determining which investor has power, the investors would consider:

(*a*) the purpose and design of the investee;

(*b*) the factors that determine the profit margin, revenue and value of the investee as well as the value of the medical product;

(*c*) the effect on the investee's returns resulting from each investor's decision-making authority with respect to the factors in (b); *and*

(*d*) the investors' exposure to variability of returns.

In this particular example, the investors would also consider:

(*e*) the uncertainty of, and effort required in, obtaining regulatory approval (considering the investor's record of successfully developing and obtaining regulatory approval of medical products); and

(*f*) which investor controls the medical product once the development phase is successful.

Application examples

Example 2

An investment vehicle (the investee) is created and financed with a debtinstrument held by an investor (the debt investor) and equity instrumentsheld by a number of other investors. The equity tranche is designed to absorb the first losses and to receive any residual return from the investee. One of the equity investors who holds 30 percent of the equity is also the asset manager. The investee uses its proceeds to purchase a portfolio of financial assets, exposing the investee 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 investee. The returns of the investee are significantly affected by the management of the investee'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 (ie when the value of the portfolio is such that the equity tranche of the investee has been consumed). From that time, a third-party trustee manages the assets according to the instructions of the debt investor. Managing the investee's asset portfolio is the relevant activity of the investee. 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 investee's returns, including considering the purpose and design of the investee as well as each party's exposure to variability of returns.

Rights that give an investor power over an investee

B14 Power arises from rights. To have power over an investee, an investor must have existing rights that give the investor the current ability to direct the relevant activities. The rights that may give an investor power can differ between investees.

B15 Examples of rights that, either individually or in combination, can give an investor power include but are not limited to:

(*a*) rights in the form of voting rights (or potential voting rights) of an investee (see paragraphs B34-B50);

(*b*) rights to appoint, reassign or remove members of an investee's key management personnel who have the ability to direct the relevant activities;

(*c*) rights to appoint or remove another entity that directs the relevant activities;

(*d*) rights to direct the investee to enter into, or veto any changes to, transactions for the benefit of the investor; *and*

(*e*) other rights (such as decision-making rights specified in a management contract) that give the holder the ability to direct the relevant activities.

B16 Generally, when an investee has a range of operating and financing activities that significantly affect the investee's returns and when substantive decision-making with respect to these activities is required continuously, it will be voting or similar rights that give an investor power, either individually or incombination with other arrangements.

B17 When voting rights cannot have a significant effect on an investee's returns,such as when voting rights relate to administrative tasks only and contractual arrangements determine the direction of the relevant activities, the investor needs to assess those contractual arrangements in order to determine whether it has rights sufficient to give it power over the investee. To determine whether an investor has rights sufficient to give it power, the investor shall consider the purpose and design of the investee (see paragraphs B5-B8) and the requirements in paragraphs B51-B54 together with paragraphs B18-B20.

B18 In some circumstances it may be difficult to determine whether an investor's rights are sufficient to give it power over an investee. In such cases, to enable the assessment of power to be made, the investor 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 B19 and may provide evidence that the investor's rights are sufficient to give it power over the investee:

(*a*) The investor can, without having the contractual right to do so, appoint or approve the investee's key management personnel who have the ability to direct the relevant activities.

(*b*) The investor can, without having the contractual right to do so, direct the investee to enter into, or can veto any changes to, significant transactions for the benefit of the investor.

(*c*) The investor can dominate either the nominations process for electing members of the investee's governing body or the obtaining of proxies from other holders of voting rights.

(*d*) The investee's key management personnel are related parties of the investor (for example, the chief executive officer of the investee and the chief executive officer of the investor are the same person).

(*e*) The majority of the members of the investee's governing body are related parties of the investor.

B19 Sometimes there will be indications that the investor has a special relationship with the investee, which suggests that the investor has more than a passive interest in the investee. The existence of any individual indicator, or a particular combination of indicators, does not necessarily mean that the power criterion is met. However, having more than a passive interest in the investee may indicate that the investor has other related rights sufficient to give it power or provide evidence of existing power over an investee. For example, the following suggests that the investor has more than a passive interest in the investee and, in combination with other rights, may indicate power:

(*a*) The investee's key management personnel who have the ability to direct the relevant activities are current or previous employees of the investor.

(*b*) The investee's operations are dependent on the investor, such as in the following situations:

(i) The investee depends on the investor to fund a significant portion of its operations.

(ii) The investor guarantees a significant portion of the investee's obligations.

(iii) The investee depends on the investor for critical services, technology, supplies or raw materials.

(iv) The investor controls assets such as licensees or trademarks that are critical to the investee's operations.

(v) The investee depends on the investor for key management personnel, such as when the investor's personnel have specialised knowledge of the investee's operations.

(*c*) A significant portion of the investee's activities either involve or are conducted on behalf of the investor.

(*d*) The investor's exposure, or rights, to returns from its involvement with the investee is disproportionately greater than its voting or other similar rights. For example, there may be a situation in which an investor is entitled, or exposed, to more than half of the returns of the investee but holds less than half of the voting rights of the investee.

B20 The greater an investor's exposure, or rights, to variability of returns from its involvement with an investee; the greater is the incentive for the investor to obtain rights sufficient to give it power. Therefore, having a large exposure to variability of returns is an indicator that the investor may have power. However,the extent of the investor's exposure does not, in itself, determine whether an investor has power over the investee.

B21 When the factors set out in paragraph B18 and the indicators set out in paragraphs B19 and B20 are considered together with an investor's rights,greater weight shall be given to the evidence of power described inparagraph B18.

Substantive rights

B22 An investor, in assessing whether it has power, considers only substantive rights relating to an investee (held by the investor and others). For a right to be substantive, the holder must have the practical ability to exercise that right.

B23 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 an investee 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 (*eg*: the absence of othermanagers willing or able to provide specialised services or provide the services and take on other interests held by the incumbent manager).

(vii) legal or regulatory requirements that prevent the holder from exercising its rights (*eg*: where a foreign investor 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 whose members are independent of the decision maker may serve as a mechanism for numerous investors to act collectively in exercising their rights. Therefore, removal rights exercisable by an independent board of directors are more likely to be substantive than if the same rights were exercisable individually by a large number of investors.

(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 an investee (see paragraphs B47-B50) 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 investor would benefit for other reasons (*eg*: by realising synergies between the investor and the investee)from the exercise or conversion of the instrument.

B24 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.

Application examples

Example 3

The investee 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 togive 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 3A-3D described below. Each example is considered in isolation.

Example 3A

An investor holds a majority of the voting rights in the investee. The investor's voting rights are substantive because the investor is able to makedecisions about the direction of the relevant activities when they need to bemade. The fact that it takes 30 days before the investor can exercise its voting rights does not stop the investor from having the current ability to direct the relevant activities from the moment the investor acquires the share holding.

Example 3B

An investor is party to a forward contract to acquire the majority of shares in the investee. The forward contract's settlement date is in 25 days. The existing shareholders are unable to change the existing policies over the relevant

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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 investor has rights that are essentially equivalent to the majority shareholder in example 3A above (ie. the investor holding the forward contract can make decisions about the direction of the relevant activities when they need to be made). The investor's forward contract is a substantive right that gives the investor the current ability to direct the relevant activities even before the forward contract is settled.

Example 3C

An investor holds a substantive option to acquire the majority of shares in the investee that is exercisable in 25 days and is deeply in the money. The same conclusion would be reached as in example 3B.

Example 3D

An investor is party to a forward contract to acquire the majority of shares inthe investee, with no other related rights over the investee. The forward contract's settlement date is in six months. In contrast to the examples above, the investor 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.

B25 Substantive rights exercisable by other parties can prevent an investor from controlling the investee 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 B26-B28), substantive rights held by other parties may prevent the investor from controlling the investee even if the rights give the holders only the current ability to approve or block decisions that relate to the relevant activities.

Protective rights

B26 In evaluating whether rights give an investor power over an investee, the investor shall assess whether its rights, and rights held by others, are protective rights. Protective rights relate to fundamental changes to the activities of an investee or apply in exceptional circumstances. However, not all rights that apply in exceptional circumstances or are contingent on events are protective(see paragraphs B13 and B53).

B27 Because protective rights are designed to protect the interests of their holder without giving that party power over the investee to which those rights relate,an investor that holds only protective rights cannot have power or prevent another party from having power over an investee (see paragraph 14).

B28 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 investee 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.

Franchises

B29 A franchise agreement for which the investee is the franchisee often gives the franchisor rights that are designed to protect the franchise brand. Franchise agreements typically give franchisors some decision-making rights with respect to the operations of the franchisee.

B30 Generally, franchisors' rights do not restrict the ability of parties other than the franchisor to make decisions that have a significant effect on the franchisee's returns. Nor do the rights of the franchisor in franchise agreements necessarily give the franchisor the current ability to direct the activities that significantly affect the franchisee's returns.

B31 It is necessary to distinguish between having the current ability to make decisions that significantly affect the franchisee's returns and having the ability to make decisions that protect the franchise brand. The franchisor does not have power over the franchisee if other parties have existing rights that give them the current ability to direct the relevant activities of the franchisee.

B32 By entering into the franchise agreement the franchisee has made a unilateral decision to operate its business in accordance with the terms of the franchise agreement, but for its own account.

B33 Control over such fundamental decisions as the legal form of the franchisee and its funding structure may be determined by parties other than the franchisor and may significantly affect the returns of the franchisee. The lower the level of financial support provided by the franchisor and the lower the franchisor's exposure to variability of returns from the franchisee the more likely it is that the franchisor has only protective rights.

Voting rights

B34 Often an investor has the current ability, through voting or similar rights, to direct the relevant activities. An investor considers the requirements in this section (paragraphs B35-B50) if the relevant activities of an investee are directed through voting rights.

Power with a Majority of the Voting Rights

B35 An investor that holds more than half of the voting rights of an investee haspower in the following situations, unless paragraph B36 or paragraph B37applies:

(*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

B36 For an investor that holds more than half of the voting rights of an investee, to have power over an investee, the investor's voting rights must be substantive, in accordance with paragraphs B22-B25, and must provide the investor 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 investor, the investor does not have power over the investee.

B37 An investor does not have power over an investee, even though the investor holds the majority of the voting rights in the investee, when those voting rights are not substantive. For example, an investor that has more than half of the voting rights in an investee cannot have power if the relevant activities aresubject to direction by a government, court, administrator, receiver, liquidator or regulator.

Power Without a Majority of the Voting Rights

B38 An investor can have power even if it holds less than a majority of the voting rights of an investee. An investor can have power with less than a majority of the voting rights of an investee, for example, through:

(*a*) a contractual arrangement between the investor and other vote holders(see paragraph B39);

(*b*) rights arising from other contractual arrangements (see paragraph B40);

(*c*) the investor's voting rights (see paragraphs B41-B45);

(d) potential voting rights (see paragraphs B47-B50); or

(e) a combination of (a)-(d).

Contractual Arrangement with other Vote Holders

B39 A contractual arrangement between an investor and other vote holders can give the investor the right to exercise voting rights sufficient to give the investor power, even if the investor does not have voting rights sufficient to give it power without the contractual arrangement. However, a contractual arrangement might ensure that the investor can direct enough other vote holders on how to vote to enable the investor to make decisions about the relevant activities.

Rights from Other Contractual Arrangements

B40 Other decision-making rights, in combination with voting rights, can give aninvestor the current ability to direct the relevant activities. For example, the rights specified in a contractual arrangement in combination with voting rights may be sufficient to give an investor the current ability to direct the manufacturing processes of an investee or to direct other operating or financing activities of an investee that significantly affect the investee's returns. However,in the absence of any other rights, economic dependence of an investee on theinvestor (such as relations of a supplier with its main customer) does not lead to the investor having power over the investee.

The Investor's Voting Rights

B41 An investor with less than a majority of the voting rights has rights that are sufficient to give it power when the investor has the practical ability to direct the relevant activities unilaterally.

B42 When assessing whether an investor's voting rights are sufficient to give it power, an investor considers all facts and circumstances, including:

(*a*) the size of the investor'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 investor holds, the more likely the investor is to have existing rights that give it the current ability to direct the relevant activities;

(ii) the more voting rights an investor holds relative to other vote holders, the more likely the investor 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 investor, the more likely the investor is to have existing rights that give it the current ability to direct the relevant activities;

(*b*) potential voting rights held by the investor, other vote holders or other parties (see paragraphs B47-B50);

(*c*) rights arising from other contractual arrangements (see paragraph B40);and

(*d*) any additional facts and circumstances that indicate the investor 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.

B43 When the direction of relevant activities is determined by majority vote and an investor holds significantly more voting rights than any other vote holder or organised group of vote holders, and the other share holdings are widely dispersed, it may be clear, after considering the factors listed in paragraph B42(a)-(c) alone, that the investor has power over the investee.

Application examples

Example 4

An investor acquires 48 per cent of the voting rights of an investee. The remaining voting rights are held by thousands of share holders, none individually holding more than 1 percent of the voting rights. None of the shareholders has 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 investor 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 investor concludes that it has a sufficiently dominant voting interest to meet the power criterion with out the need to consider any other evidence of power.

Application examples

Example 5

Investor A holds 40 per cent of the voting rights of an investee and twelve other investors each hold 5 per cent of the voting rights of the investee. A shareholder agreement grants investor 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 share holders is required. In this case, investor A concludes that the absolute size of the investor's holding and the relative size of the other share holdingsalone are not conclusive in determining whether the investor has rights sufficient to give it power. However, investor 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 investee.The fact that investor A might not have exercised this right or the Likelihood of investor A exercising its right to select, appoint or remove management shall not be considered when assessing whether investor A has power.

B44 In other situations, it may be clear after considering the factors listed in paragraph B42(a)-(c) alone that an investor does not have power.

Application example

Example 6

Investor A holds 45 per cent of the voting rights of an investee. Two other investors each hold 26 percent of the voting rights of the investee. The remaining voting rights are held by three other shareholders, each holding1 per cent. There are no other arrangements that affect decision-making. In this case, the size of investor A's voting interest and its size relative to the other shareholdings are sufficient to conclude that investor A does not have power. Only two other investors would need to co-operate to be able to prevent investor A from directing the relevant activities of the investee.

B45 However, the factors listed in paragraph B42(a)-(c) alone may not be conclusive.If an investor, 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 setout in paragraph B18 and the indicators in paragraphs B19 and B20. The fewer voting rights the investor holds, and the fewer parties that would need to act together to outvote the investor, the more reliance would be placed on the additional facts and circumstances to assess whether the investor's rights are sufficient to give it power. When the facts and circumstances in paragraphs B18-B20 are considered together with the investor's rights, greater weight shall be given to the evidence of power in paragraph B18 than to the indicators of power in paragraphs B19 and B20.

Application examples

Example 7

An investor holds 45 per cent of the voting rights of an investee. Eleven other shareholders each hold 5 per cent of the voting rights of the investee.None of the shareholders has contractual arrangements to consult any of the others or make collective decisions. In this case, the absolute size of the investor's holding and the relative size of the other shareholdings alone are not conclusive in determining whether the investor has rights sufficient to give it power over the investee. Additional facts and circumstances that may provide evidence that the investor has, or does not have, power shall be considered.

Example 8

An investor holds 35 per cent of the voting rights of an investee. Three other shareholders each hold 5 per cent of the voting rights of the investee. 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 investee require the approval of a majority of votes cast at relevant shareholders'meetings-75 per cent of the voting rights of the investee have been cast at recent relevant shareholders' meetings. In this case, the active participationof the other shareholders at recent shareholders' meetings indicates that the investor would not have the practical ability to direct the relevant activitie sunilaterally, regardless of whether the investor has directed the relevant activities because a sufficient number of other shareholders voted in the same way as the investor.

B46 If it is not clear, having considered the factors listed in paragraph B42(a)-(d), that the investor has power, the investor does not control the investee.

Potential Voting Rights

B47 When assessing control, an investor 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 an investee,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 B22-B25).

B48 When considering potential voting rights, an investor shall consider the purpose and design of the instrument, as well as the purpose and design of any other involvement the investor has with the investee. This includes an assessment of the various terms and conditions of the instrument as well as the investor's apparent expectations, motives and reasons for agreeing to those terms and conditions.

B49 If the investor also has voting or other decision-making rights relating to the investee's activities, the investor assesses whether those rights, in combination with potential voting rights, give the investor power.

B50 Substantive potential voting rights alone, or in combination with other rights,can give an investor the current ability to direct the relevant activities. For example, this is likely to be the case when an investor holds 40 per cent of the voting rights of an investee and, in accordance with paragraph B23, holds substantive rights arising from options to acquire a further 20 per cent of the voting rights.

Application examples

Example 9

Investor A holds 70 per cent of the voting rights of an investee. Investor Bhas 30 per cent of the voting rights of the investee as well as an option to acquire half of investor A's voting rights. The option is exercisable for the next two years

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at a fixed price that is deeply out of the money (and is expected to remain so for that two-year period). Investor A has been exercising its votes and is actively directing the relevant activities of the investee. In such a case, investor A is likely to meet the power criterion because it appears to have the current ability to direct the relevant activities. Although investor B has currently exercisable options to purchase additional voting rights (that, if exercised, would give it a majority of the voting rightsin the investee), the terms and conditions associated with those options are such that the options are not considered substantive.

Example 10

Investor A and two other investors each hold a third of the voting rights of an investee. The investee's business activity is closely related to investor A.In addition to its equity instruments, investor A also holds debt instruments that are convertible into ordinary shares of the investee at any time for afixed price that is out of the money (but not deeply out of the money). If thedebt were converted, investor A would hold 60 per cent of the voting rights of the investee. Investor A would benefit from realising synergies if the debt instruments were converted into ordinary shares. Investor A has power over the investee because it holds voting rights of the investee together with substantive potential voting rights that give it the current ability to directthe relevant activities.

Power when voting or similar rights do not have a significant effect on the investee's returns

B51 In assessing the purpose and design of an investee (see paragraphs B5-B8), an investor shall consider the involvement and decisions made at the investee's inception as part of its design and evaluate whether the transaction terms and features of the involvement provide the investor with rights that are sufficient to give it power. Being involved in the design of an investee alone is not sufficient to give an investor control. However, involvement in the design may indicate that the investor had the opportunity to obtain rights that are sufficient to give it power over the investee.

B52 In addition, an investor shall consider contractual arrangements such as call rights, put rights and liquidation rights established at the investee's inception.When these contractual arrangements involve activities that are closely related to the investee, then these activities are, in substance, an integral part of the investee's overall activities, even though they may occur outside the legal boundaries of the investee. Therefore, explicit or implicit decision-making rights embedded in contractual arrangements that are closely related to the investee need to be considered as relevant activities when determining power over the investee.

B53 For some investees, relevant activities occur only when particular circumstances arise or events occur. The investee may be designed so that the direction of its activities and its returns are predetermined unless and until those particular circumstances arise or events occur. In this case, only the decisions about the investee's activities when those circumstances or events occur can significantly affect its returns and thus be relevant activities. The circumstances or events need not have occurred for an investor 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.

Application examples

Example 11

An investee's only business activity, as specified in its founding documents is to purchase receivables and service them on a day-to-day basis for its investors.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 the investee automatically puts the receivable to an investor as agreed separately in a put agreement between the investor and the investee. The only relevant

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activity is managing the receivables upon default because it is the only activity that can significantly affect the investee's returns. Managing the receivables before default is not a relevant activity because it does not require substantive decisions to be made that could significantly affect the investee's returns-the activities before default are predetermined and amount only to collecting cash flows as they fall due and passing them on to investors.

Therefore, only the investor's right to manage the assets upon default should be considered when assessing the overall activities of the investee that significantly affect the investee's returns. In this example,the design of the investee ensures that the investor has decision-making authority over the activities that significantly affect the returns 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 the investee.Therefore, the terms of the put agreement together with the founding documents of the investee lead to the conclusion that the investor has power over the investee even though the investor takes ownership of the receivables only upon default and manages the defaulted receivables outside the legal boundaries of the investee.

Example 12

The only assets of an investee are receivables. When the purpose and designof the investee are considered, it is determined that the only relevant activityis managing the receivables upon default. The partythat has the ability tomanage the defaulting receivables has powerover the investee, irrespectiveof whether any of the borrowers have defaulted.

B54 An investor may have an explicit or implicit commitment to ensure that an investee continues to operate as designed. Such a commitment may increase the investor's exposure to variability of returns and thus increase the incentive for the investor to obtain rights sufficient to give it power. Therefore a commitment to ensure that an investee operates as designed may be an indicator that theinvestor has power, but does not, by itself, give an investor power, nor does itprevent another party from having power.

Exposure, or rights, to variable returns from an investee

B55 When assessing whether an investor has control of an investee, the invest or determines whether it is exposed, or has rights, to variable returns from its involvement with the investee.

B56 Variable returns are returns that are not fixed and have the potential to vary asa result of the performance of an investee. Variable returns can be only positive,only negative or both positive and negative (see paragraph 15). An investor assesses whether returns from an investee are variable and how variable those returns are on the basis of the substance of the arrangement and regardless of the legal form of the returns. For example, an investor can hold a bond withfixed interest payments. The fixed interest payments are variable returns for the purpose of this SLFRS because they are subject to default risk and they expose the investor to the credit risk of the issuer of the bond. The amount of variability (ie how variable those returns are) depends on the credit risk of the bond.Similarly, fixed performance fees for managing an investee's assets are variable returns because they expose the investor to the performance risk of the investee.The amount of variability depends on the investee's ability to generate sufficient income to pay the fee.

B57 Examples of returns include:

(*a*) dividends, other distributions of economic benefits from an investee (eg interest from debt securities issued by the investee) and changes in the value of the investor's investment in that investee.

(*b*) remuneration for servicing an investee's assets or liabilities, fees and exposure to loss from providing credit or liquidity support, residual interests in the investee's assets and liabilities on liquidation of that investee, tax benefits, and access to future liquidity that an investor has from its involvement with an investee.

(*c*) returns that are not available to other interest holders. For example, an investor might use its assets in combination with the assets of the investee, such as combining operating functions to achieve economies of scale, cost savings, sourcing scarce products, gaining access to proprietary knowledge or limiting some operations or assets, to enhance the value of the investor's other assets.

Link between power and returns

Delegated power

B58 When an investor with decision-making rights (a decision maker) assesses whether it controls an investee, it shall determine whether it is a principal or anagent. An investor shall also determine whether another entity with decision-making rights is acting as an agent for the investor. 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 investee when it exercises its decision-making authority (see paragraphs 17 and 18). Thus, sometimes a principal's power may be held and exercisable by an agent, but on behalf of the principal. A decision maker is not an agent simply because other parties can benefit from the decisions that it makes.

B59 An investor may delegate its decision-making authority to an agent on some specific issues or on all relevant activities. When assessing whether it controls an investee, the investor shall treat the decision-making rights delegated to its agent as held by the investor directly. In situations where there is more than one principal, each of the principals shall assess whether it has power over the investee by considering the requirements in paragraphs B5-B54. Paragraphs B60-B72 provide guidance on determining whether a decision maker is an agent or a principal.

B60 A decision maker shall consider the overall relationship between itself, the investee being managed and other parties involved with the investee, in particular all the factors below, in determining whether it is an agent:

(*a*) the scope of its decision-making authority over the investee (paragraphs B62 and B63).

(*b*) the rights held by other parties (paragraphs B64-B67).

(*c*) the remuneration to which it is entitled in accordance with the remuneration agreement(s) (paragraphs B68-B70).

(*d*) the decision maker's exposure to variability of returns from otherinterests that it holds in the investee (paragraphs B71 and B72).

Different weightings shall be applied to each of the factors on the basis of particular facts and circumstances.

B61 Determining whether a decision maker is an agent requires an evaluation of all the factors listed in paragraph B60 unless a single party holds substantive rights to remove the decision maker (removal rights) and can remove the decision maker without cause (see paragraph B65).

The scope of the decision-making authority

B62 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.

B63 A decision maker shall consider the purpose and design of the investee, the risks to which the investee 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 an investee. For example, if a decision maker is significantlyinvolved in the design of the investee (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

B64 Substantive rights held by other parties may affect the decision maker's ability to direct the relevant activities of an investee. Substantive removal or other rights may indicate that the decision maker is an agent.

B65 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 otherparties) those rights are not, in isolation, conclusive in determining that adecision maker acts primarily on behalf and for the benefit of others. In addition, the greater the number of parties required to act together to exerciserights to remove a decision maker and the greater the magnitude of, and variability associated with, the decision maker's other economic interests (ie remuneration and other interests), the less the weighting that shall be placed on this factor.

B66 Substantive rights held by other parties that restrict a decision maker'sdiscretion 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 B22-B25 for additional guidance on rights and whether they are substantive.)

B67 Consideration of the rights held by other parties shall include an assessment of any rights exercisable by an investee's board of directors (or other governing body) and their effect on the decision-making authority (see paragraph B23(b)).

Remuneration

B68 The greater the magnitude of, and variability associated with, the decision maker's remuneration relative to the returns expected from the activities of the investee, the more likely the decision maker is a principal.

B69 In determining whether it is a principal or an agent the decision maker shallalso consider whether the following conditions exist:

(*a*) The remuneration of the decision maker is commensurate with the services provided;

(*b*) 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.

B70 A decision maker cannot be an agent unless the conditions set out in paragraph B69(a) and (b) are present. However, meeting those conditions in isolation is notsufficient to conclude that a decision maker is an agent.

Exposure to variability of returns from other interests

B71 A decision maker that holds other interests in an investee (eg investments in theinvestee or provides guarantees with respect to the performance of the investee),shall consider its exposure to variability of returns from those interests inassessing whether it is an agent. Holding other interests in an investee indicatesthat the decision maker may be a principal.

B72 In evaluating its exposure to variability of returns from other interests in the investee a decision maker shall consider the following:

(*a*) the greater the magnitude of, and variability associated with, itseconomic 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 returns is different from that of theother investors 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, an investee.

The decision maker shall evaluate its exposure relative to the total variability of returns of the investee. This evaluation is made primarily on the basis of returns expected from the activities of the investee but shall not ignore the decision maker's maximum exposure to variability of returns of the investee throughother interests that the decision maker holds.

Application examples

Example 13

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 toinvest. 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 establishand has not established, an independent board of directors. The investors do not hold any substantive rights that would affect the decision-making authorityof 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 returns 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 returns from the fund together with its decision-making authority with in restricted parameters indicates that the fund manager is an agent. Thus, the fund manager concludes that it does not control the fund.

Example 14

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 profits if a specified profitlevel 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 withthose of the other investors to increase the value of the fund, without creating exposure to variability of returns 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 14A-14C describedbelow. Each example is considered in isolation.

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Example 14A

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 percent 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 returns 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 returns 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 14B

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 returns 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, thefund manager might consider a 20 per cent investment to be sufficient to conclude that it controls the fund. However, in different circumstances (ie if the remuneration or other factors are different), control may arise when the level of investment is different.

Example 14C

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 pro rata 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 returns 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 returns 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.

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Example 15

An investee 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 returns of the investee. 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 the investee's prospectus. For those services, the asset manager receives a market-based fixed fee (*ie* 1 per cent of assets under management) and performance-related fees (*ie* 10 per cent of profits) if the investee's profits exceed a specified level. The fees are commensurate with the services provided. The asset manager holds 35 per cent of the equity in the investee. The remaining 65 per cent of the equity, and all the debt instruments, 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 and from its remuneration.

Although operating within the parameters set out in the investee's prospectus, the asset manager has the current ability to make investment decisions that significantly affect the investee's returns-the removal right sheld 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 equity interest, which is subordinate to the debt instruments.

Holding 35 per cent of the equitycreates subordinated exposure to losses and rights to returns of the investee,which are of such significance that it indicates that the asset manager is aprincipal. Thus, the asset manager concludes that it controls the investee.

Example 16

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 transfer or also provides first loss protection against credit losses from its asset portfolio through over-collateralisation 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 return of 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.

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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 returns from the activities of the conduit because of its rights to any residual returns of the conduit and the provision of credit enhancement and liquidity facilities (*ie* 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-makingauthority that gives it the current ability to direct the activities that most significantly affect the conduit's returns (ie 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 returns of the conduit and the provision of credit enhancement and liquidity facilities expose the sponsor to variability of returns 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.

Relationship with other parties

B73 When assessing control, an investor shall consider the nature of its relationship with other parties and whether those other parties are acting on the investor's behalf (*ie* 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 investor.

B74 Such a relationship need not involve a contractual arrangement. A party is a defacto agent when the investor has, or those that direct the activities of the investor have, the ability to direct that party to act on the investor's behalf. In these circumstances, the investor shall consider its de facto agent's decision-making rights and its indirect exposure, or rights, to variable returns through the de facto agent together with its own when assessing control of an investee.

B75 The following are examples of such other parties that, by the nature of their relationship, might act as de facto agents for the investor :–

(*a*) The investor's related parties.

(*b*) A party that received its interest in the investee as a contribution or loan from the investor.

(*c*) A party that has agreed not to sell, transfer or encumber its interests in the investee without the investor's prior approval (except for situations in which the investor 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 investor.

(*e*) An investee for which the majority of the members of its governing bodyor for which its key management personnel are the same as those of the investor.

(*f*) A party that has a close business relationship with the investor, such as the relationship between a professional service provider and one of its significant clients.

Control of specified assets

B76 An investor shall consider whether it treats a portion of an investee as a deemed separate entity and, if so, whether it controls the deemed separate entity.

B77 An investor shall treat a portion of an investee as a deemed separate entity if and only if the following condition is satisfied:

Specified assets of the investee (and related credit enhancements, if any) are the only source of payment for specified liabilities of, or specified other interests in, the investee. 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 returns from the specified assets can be used by the remaining investee and none of the liabilities of the deemed separate entity are payable from the assets of the remaining investee. Thus, in substance, all the assets, liabilities and equity of that deemed separate entities are ring-fenced from the overall investee. Such a deemed separate entity is often called a 'silo'.

B78 When the condition in paragraph B77 is satisfied, an investor shall identify the activities that significantly affect the returns of the deemed separate entity and how those activities are directed in order to assess whether it has power over that portion of the investee. When assessing control of the deemed separate entity, the investor shall also consider whether it has exposure or rights tovariable returns from its involvement with that deemed separate entity and the ability to use its power over that portion of the investee to affect the amount of the investor's returns.

B79 If the investor controls the deemed separate entity, the investor shall consolidate that portion of the investee. In that case, other parties exclude that portion of the investee when assessing control of, and in consolidating, the investee.

Continuous assessment

B80 An investor shall reassess whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed in paragraph 7.

B81 If there is a change in how power over an investee can be exercised, that change must be reflected in how an investor assesses its power over an investee. 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.

B82 An event can cause an investor to gain or lose power over an investee without the investor being involved in that event. For example, an investor can gain power over an investee because decision-making rights held by another party or parties that previously prevented the investor from controlling an investee have lapsed.

B83 An investor also considers changes affecting its exposure, or rights, to variable returns from its involvement with an investee. For example, an investor that has power over an investee can lose control of an investee if the investor ceases to be entitled to receive returns or to be exposed to obligations, because the investor would fail to satisfy paragraph 7(b) (*eg* if a contract to receive performance-related fees is terminated).

B84 An investor shall consider whether its assessment that it acts as an agent or a principal has changed. Changes in the overall relationship between the investor and other parties can mean that an investor 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 investor, or of other parties, occur, the investor shall reconsider its status as a principal or an agent.

B85 An investor'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 (*eg* a change in the investee's returns driven by market conditions), unless the change in market conditions changes one or more of the three elements of control listed inparagraph 7 or changes the overall relationship between a principal and an agent.

Determining whether an entity is an investment entity

B85A An entity shall consider all facts and circumstances when assessing whether it is an investment entity, including its purpose and design. An entity that possesses the three elements of the definition of an investment entity set out in paragraph 27 is an investment entity. Paragraphs B85B-B85M describes the elements of the definition in more detail.

Business purpose

B85B The definition of an investment entity requires that the purpose of the entity is to invest solely for capital appreciation, investment income (such as dividends,interest or rental income), or both. Documents that indicate what the entity's investment objectives are, such as the entity's offering memorandum,publications distributed by the entity and other corporate or partnership documents, will typically provide evidence of an investment entity's business purpose. Further evidence may include the manner in which the entity presents itself to other parties (such as potential investors or potential investees); for example, an entity may present its business as providing medium-term investment for capital appreciation. In contrast, an entity that presents itself as an investor whose objective is to jointly develop, produce or market products with its investees has a business purpose that is inconsistent with the business purpose of an investment entity, because the entity will earn returns from the development, production or marketing activity as well as from its investments (see paragraph B85I).

B85C An investment entity may provide investment-related services (*eg* investment advisory services, investment management, investment support and administrative services), either directly or through a subsidiary, to third parties as well as to its investors, even if those activities are substantial to the entity.

B85D An investment entity may also participate in the following investment-related activities, either directly or through a subsidiary, if these activities are undertaken to maximise the investment return (capital appreciation or investment income) from its investees and do not represent a separate substantial business activity or a separate substantial source of income 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.

B85E If an investment entity has a subsidiary that provides investment-related services or activities, such as those described in paragraphs B85C-B85D, to the entity or other parties, it shall consolidate that subsidiary in accordance with paragraph 32.

Exit strategies

B85F An entity's investment plans also provide evidence of its business 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 realise 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.

B85G 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 specialised property dealers or the open market.

B85H 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.

Earnings from investments

B85I An entity is not investing solely for capital appreciation, investment income, or both, if the entity or another member of the group containing the entity (*ie* the group that is controlled by the investment entity's ultimate parent) obtains, or has the objective of obtaining, other benefits from the entity's investments that are not available to other parties that are not related to the investee. Such benefits include:

(*a*) the acquisition, use, exchange or exploitation of the processes, assets or technology of an investee. This would include the entity or another group member having disproportionate, or exclusive, rights to acquire assets, technology, products or services of any investee; for example, by holding an option to purchase an asset from an investee if the asset's development is deemed successful;

(*b*) joint arrangements (as defined in SLFRS 11) or other agreements between the entity or another group member and an investee to develop, produce, market or provide products or services;

(*c*) financial guarantees or assets provided by an investee to serve as collateral for borrowing arrangements of the entity or another group member (however, an investment entity would still be able to use an investment in an investee as collateral for any of its borrowings);

(*d*) an option held by a related party of the entity to purchase, from that entity or another group member, an ownership interest in an investee of the entity;

(*e*) except as described in Paragraph B85J, transactions between the entity or another group member and an investee that –

(i) are on terms that are unavailable to entities that are not related parties of either the entity, another group member or the investee;

(ii) are not at fair value; or

(iii) represent a substantial portion of the investee's or the entity's business activity, including business activities of other group entities.

B85J An investment entity may have a strategy to invest in more than one investee in the same industry, market or geographical area in order to benefit from synergies that increase the capital appreciation and investment income from those investees. Notwithstanding paragraph B85I(e), an entity is not disqualified from being classified as an investment entity merely because such investees trade with each other.

Fair value measurement

B85K 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 subsidiaries 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 SLFRSs; and

(*b*) reports fair value information internally to the entity's key management personnel (as defined in LKAS 24), who use fair value as the primary measurement attribute to evaluate the performance of substantially all of its investments and to make investment decisions.

B85L In order to meet the requirement in B85K(a), an investment entity would:

(*a*) elect to account for any investment property using the fair value model in LKAS 40 Investment Property;

(*b*) elect the exemption from applying the equity method in LKAS 28 for its investments in associates and joint ventures; and

(*c*) measure its financial assets at fair value using the requirements in SLFRS 9.

B85M 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 in paragraph 27(c) applies to an investment entity's investments. Accordingly, an investment entity need not measure its non-investment assets or its liabilities atfair value.

Typical Characteristics of an Investment Entity

B85N In determining whether it meets the definition of an investment entity, an entity shall consider whether it displays the typical characteristics of one (see paragraph 28). The absence of one or more of these typical characteristics does not necessarily disqualify an entity from being classified as an investment entitybut indicates that additional judgment is required in determining whether the entity is an investment entity.

More than One Investment

B85O An investment entity typically holds several investments to diversify its risk and maximise 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.

B85P 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 (*eg* when the required minimum investment is too high for an individual investor); or

(*d*) is in the process of liquidation.

More Than One Investor

B85Q Typically, an investment entity would 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 group containing the entity, would obtain benefits other than capital appreciation or investment income (see paragraph B85I).

B85R Alternatively, an investment entity may be formed by, or for, a single investor that represents or supports the interests of a wider group of investors (*eg* a pension fund, government investment fund or family trust).

B85S There may also be times when the entity temporarily has a single investor. Forexample, an investment entity may have only a single investor when the entity:

(*a*) is within its initial offering period, which has not expired and the entityis actively identifying suitable investors;

(*b*) has not yet identified suitable investors to replace ownership interests that have been redeemed; or

(*c*) is in the process of liquidation.

Unrelated investors

B85T Typically, an investment entity has several investors that are not related parties (as defined in LKAS 24) of the entity or other members of the group containing the entity. Having unrelated investors would make it less likely that the entity, or other members of the group containing the entity, would obtain benefits other than capital appreciation or investment income (see paragraph B85I).

B85U However, an entity may still qualify as an investment entity even though its investors are related to the entity. For example, an investment entity may set up a separate 'parallel’ fund for a group of its employees (such as key management personnel) or other related party investor(s), which mirrors the investments of the entity’s main investment fund. This 'parallel’ fund may qualify as aninvestment entity even though all of its investors are related parties.

Ownership interests

B85V An investment entity is typically, but is not required to be, a separate legal entity. Ownership interests in an investment entity are typically in the form of equity or similar interests (*eg* partnership interests), to which proportionate shares of the net assets of the investment entity are attributed. However, 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.

B85W In addition, an entity that has significant ownership interests in the form of debt that, in accordance with other applicable SLFRSs, does not meet the definition of 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 theentity’s net assets.

Accounting requirements

Consolidation procedures

B86 Consolidated financial statements:

(*a*) combine like items of assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries.

(*b*) offset (eliminate) the carrying amount of the parent’s investment in each subsidiary and the parent’s portion of equity of each subsidiary (SLFRS 3 explains how to account for any related goodwill).

(*c*) eliminate in full intragroup assets and liabilities, equity, income,expenses and cash flows relating to transactions between entities of the group (profits or losses resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full). Intragroup losses may indicate an impairment that requires recognition in the consolidated financial statements. LKAS 12 Income Taxes applies to temporary differences that arise from the elimination of profits and losses resulting from intraxgroup transactions.

Uniform accounting policies

B87 If a member of the group 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 group member’s financial statements in preparing the consolidated financial statements toensure conformity with the group’s accounting policies.

Measurement

B88 An entity includes the income and expenses of a subsidiary in the consolidated financial statements from the date it gains control until the date when the entity ceases to control the subsidiary. Income and expenses of the subsidiary are based on the amounts of the assets and liabilities recognised in the consolidated financial statements at the acquisition date. For example,depreciation expense recognised in the consolidated statement of comprehensive income after the acquisition date is based on the fair values of the related depreciable assets recognised in the consolidated financial statements at the acquisition date.

Potential voting rights

B89 When potential voting rights, or other derivatives containing potential voting rights, exist, the proportion of profit or loss and changes in equity allocated to the parent 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 B90 applies.

B90 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 returns associated with an ownership interest. In such circumstances, the proportion allocated to the parent 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 returns.

B91 SLFRS 9 does not apply to interests in subsidiaries that are consolidated. When instruments containing potential voting rights in substance currently give access to the returns associated with an ownership interest in a subsidiary, the instruments are not subject to the requirements of SLFRS 9. In all other cases,instruments containing potential voting rights in a subsidiary are accounted for in accordance with SLFRS 9.

Reporting date

B92 The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements shall have the same reporting date. When the end of the reporting period of the parent is different from that of a subsidiary, the subsidiary prepares, for consolidation purposes,additional financial information as of the same date as the financial statements of the parent to enable the parent to consolidate the financial information of the subsidiary, unless it is impracticable to do so.

B93 If it is impracticable to do so, the parent shall consolidate the financial information of the subsidiary using the most recent financial statements of the subsidiary 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. In any case, the difference between the date of thesubsidiary's financial statements and that of the consolidated financial statements shall be no more than three months, and the length of the reporting periods and any difference between the dates of the financial statements shall be the same from period to period.

Non-controlling interests

B94 An entity shall attribute the profit or loss and each component of other comprehensive income to the owners of the parent and to the non-control linginterests. The entity shall also attribute total comprehensive income to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

B95 If a subsidiary has outstanding cumulative preference shares that are classified as equity and are held by non-controlling interests, the entity shall compute its share of profit or loss 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

B96 When the proportion of the 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 subsidiary. The entity shall recognise directly in 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 parent.

Loss of control

B97 A parent might lose control of a subsidiary 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 parent shall consider all the terms and conditions of the arrangements and their economic effects. One or more of the following indicate that the parent 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 atleast 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 shares is priced below market and is compensated for by a subsequent disposal priced above market.

B98 If a parent loses control of a subsidiary, it shall:

(*a*) derecognise:

(i) the assets (including any goodwill) and liabilities of the subsidiary at their carrying amounts at the date when control is lost; and

(ii) the carrying amount of any non-controlling interests in the former subsidiary at the date when control is lost (including any components of other comprehensive income attributable to them).

(*b*) recognise:

(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 subsidiary to owners in their capacity as owners, that distribution; and

(iii) any investment retained in the former subsidiary at its fair value at the date when control is lost.

(*c*) reclassify to profit or loss, or transfer directly to retained earnings if required by other SLFRSs, the amounts recognised in other comprehensive income in relation to the subsidiary on the basis described in paragraph B99.

(*d*) recognise any resulting difference as a gain or loss in profit or loss attributable to the parent.

B99 If a parent loses control of a subsidiary, the parent shall account for all amount spreviously recognised in other comprehensive income in relation to thatsubsidiary on the same basis as would be required if the parent had directly disposed of the related assets or liabilities. Therefore, if a gain or loss previouslyrecognised in other comprehensive income would be reclassified to profit or loss on the disposal of the related assets or liabilities, the parent shall reclassify the gain or loss from equity to profit or loss (as a reclassification adjustment) when it loses control of the subsidiary. If a revaluation surplus previously recognisedin other comprehensive income would be transferred directly to retained earnings on the disposal of the asset, the parent shall transfer the revaluation surplus directly to retained earnings when it loses control of the subsidiary.

Accounting for a change in investment entity status

B100 When an entity ceases to be an investment entity, it shall apply SLFRS 3 to any subsidiary that was previously measured at fair value through profit or loss in accordance with paragraph 31. The date of the change of status shall be the deemed acquisition date. The fair value of the subsidiary 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 subsidiaries shall be consolidated in accordance withparagraphs 19-24 of this SLFRS from the date of change of status.

B101 When an entity becomes an investment entity, it shall cease to consolidate its subsidiaries at the date of the change in status, except for any subsidiary that shall continue to be consolidated in accordance with paragraph 32. The investment entity shall apply the requirements of paragraphs 25 and 26 to those subsidiaries that it ceases to consolidate as though the investment entity had lost control of those subsidiaries at that date.

Appendix C

Effective date and transition

This appendix is an integral part of the SLFRS and has the same authority as the other parts of theSLFRS.

Effective date

C1 An entity shall apply this SLFRS for annual periods beginning on or after1 January 2014. Earlier application is permitted. If an entity applies this SLFRS earlier, it shall disclose that fact and apply SLFRS 11, SLFRS 12, LKAS 27 Separate Financial Statements and LKAS 28 at the same time.

C1A [Deleted]

C1B [Deleted]

Transition

C2 An entity shall apply this SLFRS retrospectively, in accordance with LKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, except as specified inparagraphs C2A-C6.

C2A Notwithstanding the requirements of paragraph 28 of LKAS 8, when this SLFRS is first applied, and, if later, when the *Investment Entities* amendments to this SLFRSare first applied, an entity need only present the quantitative information required by paragraph 28(f) of LKAS 8 for the annual period immediately preceding the date of initial application of this SLFRS (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.

C2B For the purposes of this SLFRS, the date of initial application is the beginning of the annual reporting period for which this SLFRS is applied for the first time.

C3 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 LKAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation-Special Purpose Entities* and are still consolidated inaccordance with this SLFRS; or

(*b*) entities that would not be consolidated at that date in accordance withLKAS 27 and SIC-12 and are not consolidated in accordance with this SLFRS.

C3A At the date of initial application, an entity shall assess whether it is aninvestment 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 C3B-C3Finstead of paragraphs C5-C5A.

C3B Except for any subsidiary that is consolidated in accordance with paragraph 32(to which paragraphs C3 and C6 or paragraphs C4-C4C, whichever is relevant,apply), an investment entity shall measure its investment in each subsidiary at fair value through profit or loss as if the requirements of this SLFRS had always been effective. The investment entity shall retrospectively adjust both the annual period that immediately precedes the date of initial application and equity at the beginning of the immediately preceding period for any difference between:

(*a*) the previous carrying amount of the subsidiary; and

(*b*) the fair value of the investment entity's investment in the subsidiary.

The cumulative amount of any fair value adjustments previously recognised in other comprehensive income shall be transferred to retained earnings at the beginning of the annual period immediately preceding the date of initial application.

C3C Before the date that SLFRS 13 *Fair Value Measurement* is adopted, an investment entity shall use the fair value amounts that were previously reported to investors or to management, if those amounts represent the amount for which the investment could have been exchanged between knowledgeable, willing parties in an arm's length transaction at the date of the valuation.

C3D If measuring an investment in a subsidiary in accordance with paragraphs C3B-C3C is impracticable (as defined in LKAS 8), an investment entity shall apply the requirements of this SLFRS at the beginning of the earliest period for which application of paragraphs C3B-C3C 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 equity shall be recognised at the beginning of the current period.

C3E If an investment entity has disposed of, or has lost control of, an investment in asubsidiary before the date of initial application of this SLFRS, the investment entity is not required to make adjustments to the previous accounting for that subsidiary.

C3F If an entity applies the *Investment Entities* amendments for a period later thanwhen it applies SLFRS 10 for the first time, references to 'the date of initialapplication' in paragraphs C3A-C3E shall be read as 'the beginning of the annual reporting period for which the amendments in *Investment Entities*, are applied for the first time.'

C4 If, at the date of initial application, an investor concludes that it shall consolidate an investee that was not consolidated in accordance with LKAS 27 andSIC-12, the investor shall:

(*a*) if the investee is a business (as defined in SLFRS 3 *Business Combinations*), measure the assets, liabilities and non-controlling interests in that previously unconsolidated investee as if that investee had been consolidated (and thus had applied acquisition accounting in accordancewith SLFRS 3) from the date when the investor obtained control of that investee on the basis of the requirements of this SLFRS. The investor 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 investor shall recognise, as an adjustment to equity at the beginning of the immediately preceding period, any difference between:

(i) the amount of assets, liabilities and non-controlling interests recognised; and

(ii) the previous carrying amount of the investor's involvement with the investee.

(*b*) if the investee is not a business (as defined in SLFRS 3), measure the assets,liabilities and non-controlling interests in that previously unconsolidated investee as if that investee had been consolidated (applying the acquisition method as described in SLFRS 3 but without recognising any goodwill for the investee) from the date when the investor obtained control of that investee on the basis of therequirements of this SLFRS. The investor 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 investor shall recognise, as an adjustment to equity at the beginning of the immediately preceding period, any difference between:

(i) the amount of assets, liabilities and non-controlling interests recognised; and

(ii) the previous carrying amount of the investor’s involvement with the investee.

C4A If measuring an investee’s assets, liabilities and non-controlling interests inaccordance with paragraph C4(a) or (b) is impracticable (as defined in LKAS 8), an investor shall:

(*a*) if the investee is a business, apply the requirements of SLFRS 3 as of the deemed acquisition date. The deemed acquisition date shall be the beginning of the earliest period for which application of paragraph C4(a)is practicable, which may be the current period.

(*b*) if the investee is not a business, apply the acquisition method as described in SLFRS 3 but without recognising any goodwill for the investee as of the deemed acquisition date. The deemed acquisition date shall be the beginning of the earliest period for which the application of paragraph C4(b) is practicable, which may be the current period.

The investor shall adjust retrospectively the annual period immediatelypreceding 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 investor shall recognise, as an adjustment to equity at the beginning of the immediately preceding period, any difference between:

(*c*) the amount of assets, liabilities and non-controlling interests recognised;and

(*d*) the previous carrying amount of the investor's involvement with the investee.

If the earliest period for which application of this paragraph is practicable is the current period, the adjustment to equity shall be recognised at the beginning of the current period.

C4B When an investor applies paragraphs C4-C4A and the date that control was obtained in accordance with this SLFRS is later than the effective date of SLFRS 3, the reference to SLFRS 3 in paragraphs C4 and C4A shall be to SLFRS 3.

C4C When an investor applies paragraphs C4-C4A and the date that control was obtained in accordance with this SLFRS is later than the effective date of LKAS 27, an investor shall apply the requirements of this SLFRS for all periods that the investee is retrospectively consolidated in accordance with paragraphs C4-C4A.

C5 If, at the date of initial application, an investor concludes that it will no longerconsolidate an investee that was consolidated in accordance with LKAS 27 and SIC-12, the investor shall measure its interest in the investee at the amount at which it would have been measured if the requirements of this SLFRS had been effective when the investor became involved with (but did not obtain control in accordance with this SLFRS), or lost control of, the investee. The investor shall adjust retrospectively the annual period immediately preceding the date of initial application. When the date that the investor became involved with (but did not obtain control in accordance with this SLFRS), or lost control of, the investee is earlier than the beginning of the immediately preceding period, the investor shall recognise, as an adjustment to equity at the beginning of the immediately preceding period, any difference between:

(*a*) the previous carrying amount of the assets, liabilities andnon-controlling interests; and

(*b*) the recognised amount of the investor's interest in the investee.

C5A If measuring the interest in the investee in accordance with paragraph C5 isimpracticable (as defined in LKAS 8), an investor shall apply the requirements of this SLFRS at the beginning of the earliest period for which application of paragraph C5 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 the investor became involved with (but did not obtain control in accordance with this SLFRS), or lost control of, the investee is earlier than the beginning of the immediately preceding period, the investor shall recognise, as an adjustment to 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 recognised amount of the investor's interest in the investee.

If the earliest period for which application of this paragraph is practicable is the current period, the adjustment to equity shall be recognised at the beginning of the current period.

C6 Paragraphs 23, 25, B94 and B96-B99 were amendments to LKAS 27 that were carried forward in to SLFRS 10. Except when an entity applies paragraph C3, or is required to apply paragraphs C4-C5A, the entity shall apply the requirements in those paragraphs as follows:

(*a*) An entity shall not restate any profit or loss attribution for reporting periods before it applied the amendment in paragraph B94 for the first time.

(*b*) The requirements in paragraphs 23 and B96 for accounting for changes in ownership interests in a subsidiary after control is obtained do not apply to changes that occurred before an entity applied these amendments for the first time.

(*c*) An entity shall not restate the carrying amount of an investment in aformer subsidiary if control was lost before it applied the amendments in paragraphs 25 and B97-B99 for the first time. In addition, an entity shall not recalculate any gain or loss on the loss of control of a subsidiary that occurred before the amendments in paragraphs 25 and B97-B99 were applied for the first time.

References to the 'immediately preceding period'

C6A Notwithstanding the references to the annual period immediately preceding the date of initial application (the 'immediately preceding period') in paragraphs C3B-C5A, an entity may also present adjusted comparative information for any earlier periods presented, but is not required to do so. If an entity does present adjusted comparative information for any earlier periods, all references to the 'immediately preceding period' in paragraphs C3B-C5A shall be read as the'earliest adjusted comparative period presented'.

C6B If an entity presents unadjusted comparative information for any earlier periods, it shall clearly identify the information that has not been adjusted, state that it has been prepared on a different basis, and explain that basis.

References to SLFRS 9

C7 If an entity applies this SLFRS but does not yet apply SLFRS 9, any reference in thisSLFRS to SLFRS 9 shall be read as a reference to LKAS 39 *Financial Instruments:Recognition and Measurement.*

Withdrawal of other SLFRSs

C8 This SLFRS supersedes the requirements relating to consolidated financial statements in LKAS 27.

C9 This SLFRS also supersedes SIC-12 *Consolidation-Special Purpose Entities.*

SRI LANKA ACCOUNTING STANDARD
SLFRS 11

Joint Arrangements

CONTENTS *Paragraphs*

Sri Lanka Accounting Standard –SLFRS 11
Joint Arrangements

Sri Lanka Accounting Standard – SLFRS 11*Joint Arrangements* is set out in paragraphs 1–27 and Appendices A–C. All the paragraphs have equal authority.Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in*italics* the first time they appear in the Standard. Definitions of other terms are given inthe Glossary for Sri Lanka Accounting Standards. SLFRS 11 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Sri Lanka Accounting Standards* and the *Conceptual Framework for Financial Reporting*. LKAS 8*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 SLFRS is to establish principles for financial reporting by entities that have an interest in arrangements that are controlled jointly (ie *joint arrangements)*.**

Meeting the objective

2 To meet the objective in paragraph 1, this SLFRS 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 **This SLFRS shall be applied by all entities that are a party to a joint arrangement.**

Joint arrangements

4 **A joint arrangement is an arrangement of which two or more parties have joint control.**

5 **A joint arrangement has the following characteristics:**

(*a*) **The parties are bound by a contractual arrangement (see paragraphs B2–B4).**

(*b*) **The contractual arrangement gives two or more of those parties joint control of the arrangement (see paragraphs 7–13).**

6 **A joint arrangement is either a *joint operation* or a *joint venture*.**

Joint control

7 **Joint control is the contractually agreed sharing of control of an arrangement,which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.**

8 An entity that is a party to an arrangement shall assess whether the contractual 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 returns of the arrangement (ie the relevant activities).

9 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.

10 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.

11 An arrangement can be a joint arrangement even though not all of its parties have joint control of the arrangement. This SLFRS distinguishes between parties that have joint control of a joint arrangement (*joint operators* or *joint ventures*) and parties that participate in, but do not have joint control of, a joint arrangement.

12 An entity will need to apply judgment when assessing whether all the parties, ora group of the parties, have joint control of an arrangement. An entity shall make this assessment by considering all facts and circumstances (see paragraphs B5–B11).

13 If facts and circumstances change, an entity shall reassess whether it still has joint control of the arrangement.

Types of joint arrangement

14 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.

15 A joint operation is a joint arrangement where by the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. Those parties are called joint operators.

16 A joint venture is a joint arrangement where by the parties that have joint control of the arrangement have rights to the net assets of the arrangement. Those parties are called joint ventures.

17 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 byconsidering the structure and legal form of the arrangement, the terms agreed by the parties in the contractual arrangement and, when relevant, other facts and circumstances (see paragraphs B12–B33).

18 Sometimes the parties are bound by a framework agreement that sets up the general contractual 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.

19 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

Joint operations

20 A joint operator shall recognise 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.

21 A joint operator shall account for the assets, liabilities, revenues and expenses relating to its interest in a joint operation in accordance with the SLFRSs applicable to the particular assets, liabilities, revenues and expenses.

22 The accounting for transactions such as the sale, contribution or purchase ofassets between an entity and a joint operation in which it is a joint operator is specified in paragraphs B34–B37.

23 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 withparagraphs 20–22 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 SLFRSs applicable to that interest.

Joint ventures

24 A joint venturer shall recognise its interest in a joint venture as an investment and shall account for that investment using the equity method in accordance with LKAS 28 *Investments in Associates and Joint Ventures* unless the entity is exempted from applying the equity method as specified in that standard.

25 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 SLFRS 9*Financial Instruments*, unless it has significant influence over the joint venture, in which case it shall account for it in accordance with LKAS 28.

Separate financial statements

26 In its separate financial statements, a joint operator or joint venturer shallaccount for its interest in:

(*a*) a joint operation in accordance with paragraphs 20–22;

(*b*) a joint venture in accordance with paragraph 10 of LKAS 27 *Separate Financial Statements*.

27 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 23;

(*b*) a joint venture in accordance with SLFRS 9, unless the entity has significant influence over the joint venture, in which case it shall apply paragraph 10 of LKAS 27.

Appendix A

Defined terms

This appendix is an integral part of the SLFRS.

joint arrangement	An arrangement of which two or more parties have **joint control**.
joint control	The contractually agreed sharing of control of an arrangement which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.
joint operation	A **joint arrangement** whereby the parties that have **joint control** ofthe arrangement have rights to the assets, and obligations for theliabilities, relating to the arrangement.
joint operator	A party to a **joint operation** that has **joint control** of that joint operation.
joint venture	A **joint arrangement** where by the parties that have **joint control** of the arrangement have rights to the net assets of the arrangement.
joint venturer	A party to a **joint venture** that has **joint control** of that joint venture.
party to a joint arrangement	An entity that participates in a **joint arrangement**, regardless of whether that entity has **joint control** of the arrangement
separate vehicle	A separately identifiable financial structure, including separate legal entities or entities recognised by statute, regardless of whether those entities have a legal personality.

The following terms are defined in LKAS 27, LKAS 28 or SLFRS 10 *Consolidated Financial Statements* and are used in this SLFRS with the meanings specified in those SLFRSs:

- control of an investee
- equity method
- power
- protective rights
- relevant activities
- separate financial statements
- significant influence.

Appendix B

Application guidance

This appendix is an integral part of the SLFRS. It describes the application of paragraphs 1–27 and has the same authority as the other parts of the SLFRS.

B1 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 SLFRS 11.

Joint arrangements

Contractual arrangement (paragraph 5)

B2 Contractual arrangements can be evidenced in several ways. An enforceable contractual arrangement is often, but not always, in writing, usually in the form of a contract or documented discussions between the parties. Statutory mechanisms can also create enforceable arrangements, either on their own or in conjunction with contracts between the parties.

B3 When joint arrangements are structured through a *separate vehicle* (see paragraphs B19–B33), the contractual arrangement, or some aspects of the contractual arrangement, will in some cases be incorporated in the articles, charter or by-laws of the separate vehicle.

B4 The contractual arrangement sets out the terms upon which the parties participate in the activity that is the subject of the arrangement. The contractual 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 contractual arrangement establishes joint control of the arrangement (see paragraphs B5–B11).

(*d*) the capital or other contributions required of the parties.

(*e*) how the parties share assets, liabilities, revenues, expenses or profit or loss relating to the joint arrangement.

Joint control (paragraphs 7–13)

B5 In assessing whether an entity has joint control of an arrangement, an entity shallassess first whether all the parties, or a group of the parties, control the arrangement. SLFRS 10 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 returns from their involvement with the arrangement and have the ability to affect those returns 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 returns of the arrangement (ie the relevant activities), the parties control the arrangement collectively.

B6 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 ofthe 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 judgement.

B7 Sometimes the decision-making process that is agreed upon by the parties in their contractual 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 contractual 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.

B8 In other circumstances, the contractual 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 contractual 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 contractual 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 contractual 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 contractual 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 (ie either A and B or A and C). In such a situation, to be a joint arrangement the contractual arrangement between the parties would need tospecify which combination of the parties is required to agree unanimously to decisions about the relevant activities of the arrangement.

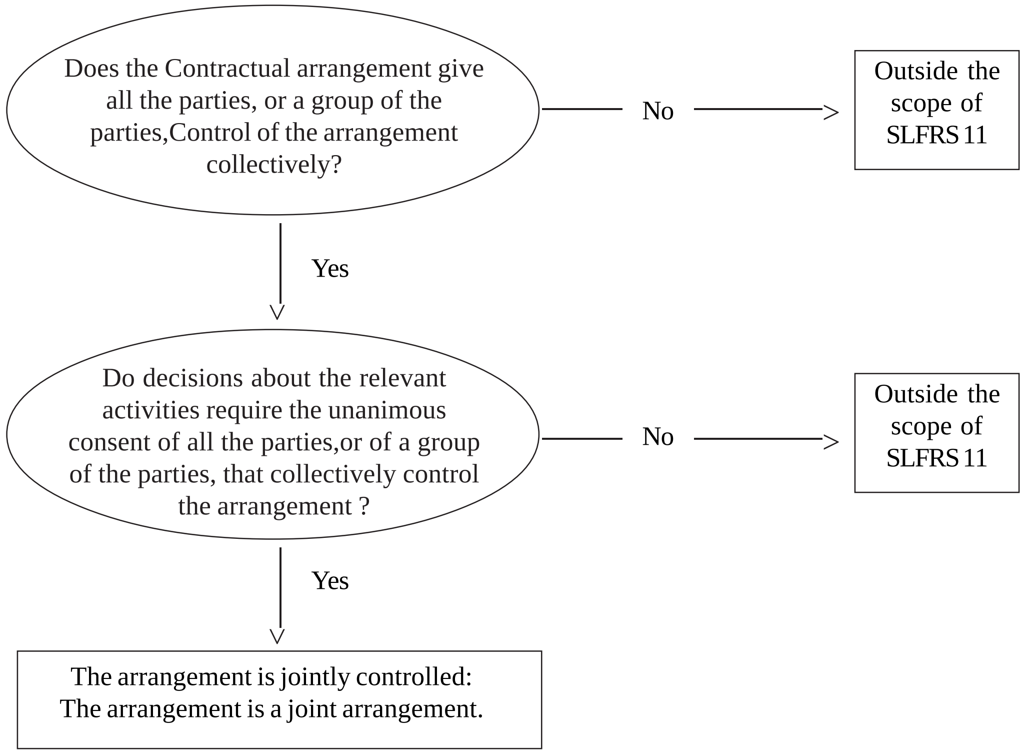
Example 3

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 contractual arrangement specifies that decisions about the relevant activities of the arrangement require both A and B agreeing.

B9 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.

B10 A contractual 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.

Assessing Joint Control



B11 When an arrangement is outside the scope of SLFRS 11, an entity accounts for its interest in the arrangement in accordance with relevant SLFRSs, such as SLFRS 10, LKAS 28 or SLFRS 9.

Types of joint arrangement (paragraphs 14–19)

B12 Joint arrangements are established for a variety of purposes (eg 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.

B13 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.

B14 The classification of joint arrangements required by this SLFRS depends upon the parties' rights and obligations arising from the arrangement in the normal course of business. This SLFRS 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 B16–B33 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

B15 As stated in paragraph B14, 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 B16–B21).

(*b*) when the joint arrangement is structured through a separate vehicle:

(i) the legal form of the separate vehicle (see paragraphs B22–B24);

(ii) the terms of the contractual arrangement (see paragraphs B25–B28);and

(iii) when relevant, other facts and circumstances (see paragraphs B29–B33).

Structure of the joint arrangement

Joint arrangements not structured through a separate vehicle

B16 A joint arrangement that is not structured through a separate vehicle is a joint operation. In such cases, the contractual 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.

B17 The contractual 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 manufacture a product together, with each party being responsible for aspecific task and each using its own assets and incurring its own liabilities.The contractual 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 recognises in its financial statements the assets and liabilities used for the specific task, and recognises its share of the revenues and expenses inaccordance with the contractual arrangement.

B18 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 contractual arrangement establishes the parties' rights to the asset that is operated jointly, and how outputor 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 recognises its share of the output, revenues and expenses in accordance with the contractual arrangement.

Joint arrangements structured through a separate vehicle

B19 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 ajoint operation.

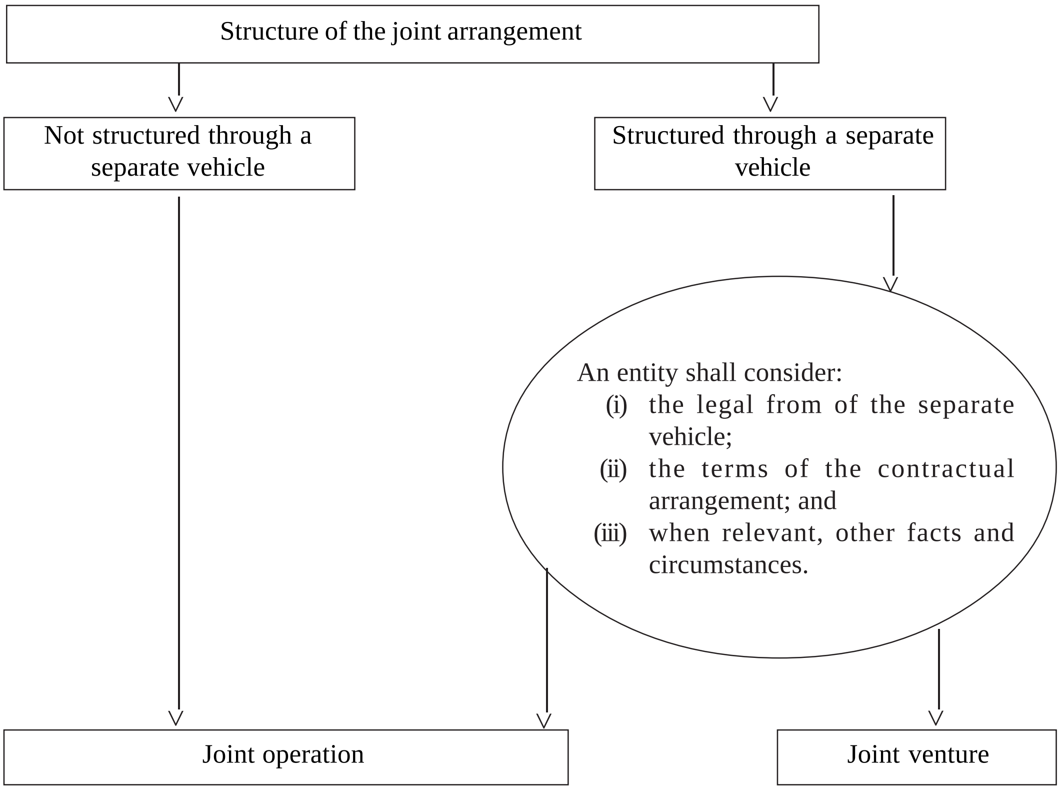
B20 Whether a party is a joint operator or a joint venturer depends on the party's rights to the assets, and obligations for the liabilities, relating to the arrangement that are held in the separate vehicle.

B21 As stated in paragraph B15, 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 contractual 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 (ie the arrangement is a joint operation); or

(*b*) rights to the net assets of the arrangement (ie 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

B22 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.

B23 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 (ie 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 contractual arrangement (see paragraphs B25–B28) and, when relevant, other facts and circumstances (see paragraphs B29–B33) can override the assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle.

B24 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 (ie the assets and liabilities held in the separate vehicle are the parties' assets and liabilities).

Assessing the terms of the contractual arrangement

B25 In many cases, the rights and obligations agreed to by the parties in their contractual 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.

B26 In other cases, the parties use the contractual arrangement to reverse or modify the rights and obligations conferred by the legal form of the separate vehicle inwhich 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 contractual 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 contractual modifications to the features of a corporation can cause an arrangement to be a joint operation.

B27 The following table compares common terms in contractual arrangements of parties to a joint operation and common terms in contractual arrangements of parties to a joint venture. The examples of the contractual terms provided in the following table are not exhaustive.

Assessing the terms of the contractual arrangement		
	Joint operation	*Joint venture*
The terms of the contractual arrangement	The contractual arrangement provides the parties to the joint arrangement with rights to the assets, and obligations for the liabilities, relating to the arrangement.	The contractual arrangement provides the parties to the joint arrangement with rights to the net assets of the arrangement (*ie* 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 contractual arrangement establishes that the parties to the joint arrangement share all interests (*eg* rights, title or ownership) in the assets relating to the arrangement in a specified proportion (*eg* 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 contractual 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 (ie no rights, title or ownership) in the assets of the arrangement

Continuted....

Continuted....

Assessing the terms of the contractual arrangement		
	Joint operation	*Joint venture*
Obligations for liabilities	The contractual arrangement establishes that the parties to the joint arrangement share all liabilities, obligations, costs and expenses in a specified proportion (eg inproportion 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 contractual arrangement establishes that the jointarrangement is liable for the debts and obligations of the arrangement.
		The contractual arrangement establishes that the parties tothe joint arrangement areliable 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 contractual arrangement establishes that the parties to the joint arrangement are liable for claims raised by third parties.	The contractual 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.
Revenues, expenses, profit or loss	The contractual 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 contractual arrangement might establishthat 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 profit or loss 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 ajoint operation if the parties have rights to the assets, and obligations for the liabilities, relating to the arrangement.	The contractual arrangement establishes each party's sharein the profit or loss 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).	

B28 When the contractual 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 B29–B33) for the purposes of classifying the joint arrangement.

Assessing other facts and circumstances

B29 When the terms of the contractual 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 assesswhether the arrangement is a joint operation or a joint venture.

B30 A joint arrangement might be structured in a separate vehicle whose legal form confers separation between the parties and the separate vehicle. The contractual 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.

B31 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 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.

B32 The effect of an arrangement with such a design and purpose is that the liabilitiesincurred by the arrangement are, in substance, satisfied by the cash flowsreceived from the parties through their purchases of the output. When the parties are substantially the only source of cash flows contributing tothe 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 contractual 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 contractual 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.

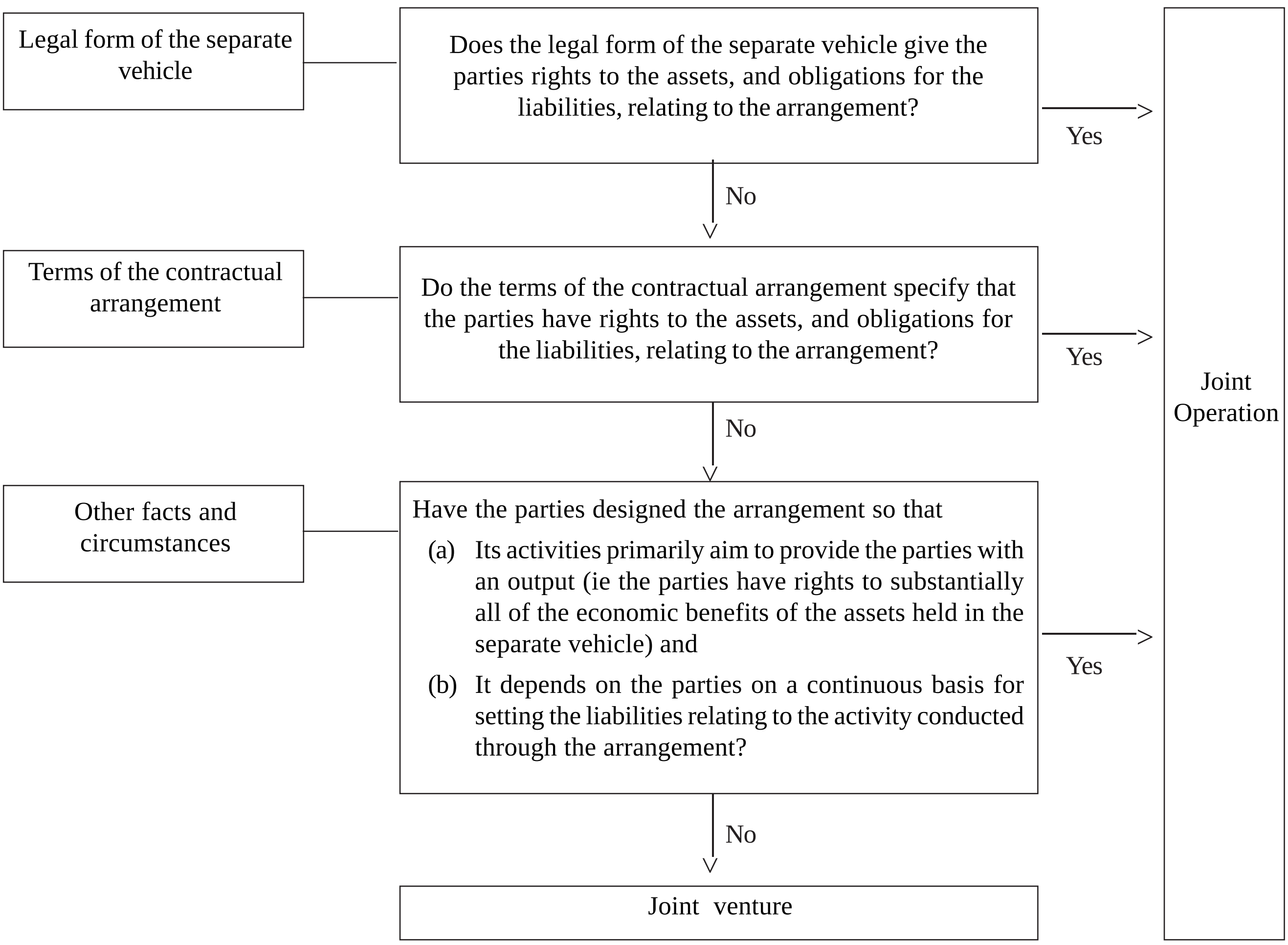
- The fact that the parties have rights to all the output produced by entity C means that the parties are consuming, and therefore have rights to, all the economic benefits of the assets of entity C.

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 contractual 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 changein 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.

B33 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 (paragraph 22)

Accounting for sales or contributions of assets to a joint operation

B34 When an entity enters into a transaction with a joint operation in which it is ajoint 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 recognise gains and losses resulting from such a transaction only to the extent of the other parties' interests in the joint operation.

B35 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 recognised fully by the joint operator.

Accounting for purchases of assets from a joint operation

B36 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 recognise its share of the gains and losses until it resells those assets to a third party.

B37 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 recognise its share of those losses.

Appendix C

Effective date, transition and withdrawal of other SLFRSs

This appendix is an integral part of the SLFRS and has the same authority as the other parts of the SLFRS.

Effective date

C1 An entity shall apply this SLFRS for annual periods beginning on or after1st January 2014. Earlier application is permitted. If an entity applies this SLFRS earlier, it shall disclose that fact and apply SLFRS 10, SLFRS 12 *Disclosure of Interests in Other Entities*, LKAS 27 and LKAS 28 at the same time.

C1A [Deleted]

Transition

C1B Notwithstanding the requirements of paragraph 28 of LKAS 8 Accounting Policies,Changes in Accounting Estimates and Errors, when this SLFRS is first applied, an entityneed only present the quantitative information required by paragraph 28(f) of LKAS 8 for the annual period immediately preceding the first annual period for which SLFRS 11 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

C2 When changing from proportionate consolidation to the equity method, anentity shall recognise 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 entityhad previously proportionately consolidated, including any goodwill arising from acquisition. 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 belonged.

C3 The opening balance of the investment determined in accordance with paragraph C2 is regarded as the deemed cost of the investment at initial recognition. An entity shall apply paragraphs 40–43 of LKAS 28 to the opening balance of the investment to assess whether the investment is impaired and shall recognise any impairment loss as an adjustment to retained earnings at the beginning of the immediately preceding period. The initial recognition exception in paragraphs 15 and 24 of LKAS 12 *Income Taxes* does not apply when the entity recognises an investment in a joint venture resulting from applying the transition requirements for joint ventures that had previously been proportionately consolidated.

C4 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 recognise 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 recognise the corresponding liability but it shall adjust retained earnings at the beginning of the immediately preceding period. The entity shall disclose this fact,along with its cumulative unrecognised share of losses of its joint ventures as at the beginning of the immediately preceding period and at the date at which this SLFRS is first applied.

C5 An entity shall disclose a break down 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 C2–C6.

C6 After initial recognition, an entity shall account for its investment in the joint venture using the equity method in accordance with LKAS 28.

Joint operations—transition from the equity method to accounting for assets and liabilities

C7 When changing from the equity method to accounting for assets and liabilities inrespect of its interest in a joint operation, an entity shall, at the beginning of the immediately preceding period, derecognise the investment that was previously accounted for using the equity method and any other items that formed part ofthe entity’s net investment in the arrangement in accordance with paragraph 38of LKAS 28 and recognise 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.

C8 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 contractual 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.

C9 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 38 of LKAS 28, and the net amount of the assets and liabilities, including any goodwill, recognised shall be:

(*a*) offset against any goodwill relating to the investment with any remaining difference adjusted against retained earnings at the beginning of the immediately preceding period, if the net amount of the assets and liabilities,including any goodwill, recognised is higher than the investment (and any other items that formed part of the entity’s net investment) derecognised.

(*b*) adjusted against retained earnings at the beginning of the immediately preceding period, if the net amount of the assets and liabilities, including anygoodwill, recognised is lower than the investment (and any other items that formed part of the entity’s net investment) derecognised.

C10 An entity changing from the equity method to accounting for assets and liabilities shall provide a reconciliation between the investment derecognised, and the assets and liabilities recognised, together with any remaining difference adjusted against retained earnings, at the beginning of the immediately preceding period.

C11 The initial recognition exception in paragraphs 15 and 24 of LKAS 12 does not applywhen the entity recognises assets and liabilities relating to its interest in a joint operation.

Transition provisions in an entity's separate financial statements

C12 An entity that, in accordance with paragraph 10 of LKAS 27, was previously accounting in its separate financial statements for its interest in a joint operation as an investment at cost or in accordance with SLFRS 9 shall:

(*a*) derecognise the investment and recognise the assets and the liabilities inrespect of its interest in the joint operation at the amounts determined in accordance with paragraphs C7–C9.

(*b*) provide a reconciliation between the investment derecognised, and the assets and liabilities recognised, together with any remaining difference adjusted in retained earnings, at the beginning of the immediately preceding period.

References to the 'immediately preceding period'

C12A Notwithstanding the references to the 'immediately preceding period' inparagraphs C2–C12, an entity may also present adjusted comparative information for any earlier periods presented, but is not required to do so. If an entity does present adjusted comparative information for any earlier periods, all references to the 'immediately preceding period' in paragraphs C2–C12 shall beread as the 'earliest adjusted comparative period presented'.

C12B If an entity presents unadjusted comparative information for any earlier periods, it shall clearly identify the information that has not been adjusted, state that it has been prepared on a different basis, and explain that basis.

C13 The initial recognition exception in paragraphs 15 and 24 of LKAS 12 does not apply when the entity recognises assets and liabilities relating to its interest in a jointoperation in its separate financial statements resulting from applying thetransition requirements for joint operations referred to in paragraph C12.

References to SLFRS 9

C14 If an entity applies this SLFRS but does not yet apply SLFRS 9, any reference to SLFRS 9 shall be read as a reference to LKAS 39 *Financial Instruments: Recognition and Measurement*.

Withdrawal of other SLFRSs

C15 This SLFRS supersedes the following SLFRSs:

(*a*) LKAS 31 *Interests in Joint Ventures*; and

(*b*) SIC-13 *Jointly Controlled Entities—Non-Monetary Contributions by Venturers*.

Sri Lanka Accounting Standard

SLFRS 12

Disclosure of Interests in Other Entities

CONTENTS

from paragraph

Sri Lanka Accounting Standard - SLFRS 12
Disclosure of Interests in Other Entities

Sri LankaAccounting Standard - SLFRS 12 *Disclosure of Interests in Other Entities* is set out in paragraphs 1–31 and Appendices A–C. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the SLFRS. Definitions of other terms are given in the Glossary for Sri Lanka Accounting Standards. SLFRS 12should be read in the context of its objective and the Basis for Conclusions, the *Preface to Sri Lanka Accounting Standards* and the *Conceptual Framework for Financial Reporting*. LKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basisfor selecting and applying accounting policies in the absence of explicit guidance.

Objective

1 The objective of this SLFRS 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 other entities*; and

(*b*) the effects of those interests on its financial position, financial performance and cash flows.

Meeting the objective

2 To meet the objective in paragraph 1, an entity shall disclose:

(*a*) the significant judgements 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 7–9);

(iii) that it meets the definition of an investment entity, if applicable(paragraph 9A); and

(*b*) information about its interests in:

(i) subsidiaries (paragraphs 10–19);

(ii) joint arrangements and associates (paragraphs 20–23); and

(iii) *structured entities* that are not controlled by the entity (unconsolidated structured entities) (paragraphs 24–31).

3 If the disclosures required by this SLFRS, together with disclosures required by other SLFRSs, do not meet the objective in paragraph 1, an entity shall disclose whatever additional information is necessary to meet that objective.

4 An entity shall consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the requirements in this SLFRS. 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 B2–B6).

Scope

5 This SLFRS shall be applied by an entity that has an interest in any of the following:

(*a*) subsidiaries

(*b*) joint arrangements (ie joint operations or joint ventures) (*c*) associates

(*d*) unconsolidated structured entities.

6 This SLFRS does not apply to:

(*a*) post-employment benefit plans or other long-term employee benefit plans to which LKAS 19 *Employee Benefits* applies.

(*b*) an entity's separate financial statements to which LKAS 27 *Separate Financial Statements* applies. However, if an entity has interests in unconsolidated structured entities and prepares separate financialstatements as its only financial statements, it shall apply the requirements in paragraphs 24–31 when preparing those separate financial statements.

(*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 SLFRS 9 *Financial Instruments*. However, an entity shall apply this SLFRS:

(i) when that interest is an interest in an associate or a joint venture that, in accordance with LKAS 28 *Investments in Associates and JointVentures*, is measured at fair value through profit or loss; or

(ii) when that interest is an interest in an unconsolidated structured entity.

Significant judgements and assumptions

7 An entity shall disclose information about significant judgements and assumptions it has made (and changes to those judgements and assumptions) in determining:

(*a*) that it has control of another entity,ie an investee as described in paragraphs 5 and 6 of SLFRS 10 *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 (ie joint operation or joint venture) when the arrangement has been structured through a separate vehicle.

8 The significant judgements and assumptions disclosed in accordance with paragraph 7 include those made by the entity when changes in facts and circumstances are such that the conclusion about whether it has control, joint control or significant influence changes during the reporting period.

9 To comply with paragraph 7, an entity shall disclose, for example, significant judgements and assumptions made in determining that:

(*a*) it does not control another entity even though it holds more than half of the voting rights of the other entity.

(*b*) it controls another entity even though it holds less than half of the voting rights of the other entity.

(*c*) it is an agent or a principal (see paragraphs B58–B72 of SLFRS 10).

(*d*) it does not have significant influence even though it holds 20 per cent or more of the voting rights of another entity.

(*e*) it has significant influence even though it holds less than 20 per cent of the voting rights of another entity.

Investment entity status

9A **When a parent determines that it is an investment entity in accordance with paragraph 27 of SLFRS 10, the investment entity shall disclose information about significant judgements and assumptions it has made in determining that it is an investment entity. If the investment entity does not have one or more of the typical characteristics of an investmententity (see paragraph 28 of SLFRS 10), it shall disclose its reasons for concluding that it is nevertheless an investment entity.**

9B 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 subsidiaries that cease to be consolidated;

(*b*) the total gain or loss, if any, calculated in accordance with paragraph B101 of SLFRS 10; and

(*c*) the line item(s) in profit or loss in which the gain or loss is recognised (if not presented separately).

Interests in subsidiaries

10 An entity shall disclose information that enables users of its consolidated financial statements

(*a*) to understand:

(i) the composition of the group; and

(ii) the interest that non-controlling interests have in the group's activities and cash flows (paragraph 12); 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 group (paragraph 13);

(ii) the nature of, and changes in, the risks associated with its interests in consolidated structured entities (paragraphs14–17);

(iii) the consequences of changes in its ownership interest in a subsidiary that do not result in a loss of control (paragraph 18);and

(iv) the consequences of losing control of a subsidiary during the reporting period (paragraph 19).

11 When the financial statements of a subsidiary 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 paragraphs B92 and B93 of SLFRS 10), an entity shall disclose:

(*a*) the date of the end of the reporting period of the financial statements of that subsidiary; and

(*b*) the reason for using a different date or period.

The interest that non-controlling interests have in the group's activities and cash flows

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

(*a*) the name of the subsidiary.

(*b*) the principal place of business (and country of incorporation if different from the principal place of business) of the subsidiary.

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

(*f*) accumulated non-controlling interests of the subsidiary at the end of the reporting period.

(*g*) summarised financial information about the subsidiary (see paragraph B10).

The nature and extent of significant restrictions

13 An entity shall disclose:

(*a*) significant restrictions (eg statutory, contractual and regulatory restrictions) on its ability to access or use the assets and settle the liabilities of the group, such as:

(i) those that restrict the ability of a parent or its subsidiaries to transfer cash or other assets to (or from) other entities within thegroup.

(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 group.

(*b*) the nature and extent to which protective rights of non-controlling interests can significantly restrict the entity's ability to access or use theassets and settle the liabilities of the group (such as when a parent is obliged to settle liabilities of a subsidiary 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 subsidiary).

(*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

14 An entity shall disclose the terms of any contractual arrangements that could require the parent or its subsidiaries to provide financial support to a consolidated structured entity, including events or circumstances that could expose the reporting entity to a loss (eg liquidity arrangements or credit rating triggers associated with obligations to purchase assets of the structured entity or provide financial support).

15 If during the reporting period a parent or any of its subsidiaries has, without having a contractual obligation to do so, provided financial or other support to a consolidated structured entity (eg 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 parent or its subsidiaries assisted the structured entity in obtaining financial support; and

(*b*) the reasons for providing the support.

16 If during the reporting period a parent or any of its subsidiaries has, without having a contractual obligation 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.

17 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 parent's ownership interest in a subsidiary that do not result in a loss of control

18 An entity shall present a schedule that shows the effects on the equity attributable to owners of the parent of any changes in its ownership interest in a subsidiary that do not result in a loss of control.

Consequences of losing control of a subsidiary during the reporting period

19 An entity shall disclose the gain or loss, if any, calculated in accordance with paragraph 25 of SLFRS 10, and:

(*a*) the portion of that gain or loss attributable to measuring any investment retained in the former subsidiary at its fair value at the date when control is lost; and

(*b*) the line item(s) in profit or loss in which the gain or loss is recognised (if not presented separately).

Interests in unconsolidated subsidiaries (investment entities)

19A An investment entity that, in accordance with SLFRS 10, is required to apply the exception to consolidation and instead account for its investment in a subsidiary at fair value through profit or loss shall disclose that fact.

19B For each unconsolidated subsidiary, an investment entity shall disclose:

(*a*) the subsidiary's name;

(*b*) the principal place of business (and country of incorporation if different from the principal place of business) of the subsidiary; and

(*c*) the proportion of ownership interest held by the investment entity and, if different, the proportion of voting rights held.

19C If an investment entity is the parent of another investment entity, the parent shall also provide the disclosures in 19B(a)–(c) for investments that are controlled by its investment entity subsidiary. The disclosure may be provided by including, in the financial statements of the parent, the financial statements of the subsidiary (or subsidiaries) that contain the above information.

19D An investment entity shall disclose:

(*a*) the nature and extent of any significant restrictions (eg resulting from borrowing arrangements, regulatory requirements or contractual arrangements) on the ability of an unconsolidated subsidiary to transfer funds to the investment entity in the form of cash dividends or to repay loans or advances made to the unconsolidated subsidiary by the investment entity; and

(*b*) any current commitments or intentions to provide financial or other support to an unconsolidated subsidiary, including commitments orintentions to assist the subsidiary in obtaining financial support.

19E If, during the reporting period, an investment entity or any of its subsidiaries has, without having a contractual obligation to do so, provided financial orother support to an unconsolidated subsidiary (eg purchasing assets of, or instruments issued by, the subsidiary or assisting the subsidiary in obtaining financial support), the entity shall disclose:

(*a*) the type and amount of support provided to each unconsolidated subsidiary; and

(*b*) the reasons for providing the support.

19F An investment entity shall disclose the terms of any contractual arrangements that could require the entity or its unconsolidated subsidiaries to provide financial support to an unconsolidated, controlled, structured entity, including events or circumstances that could expose the reporting entity to a loss (*eg* : liquidity arrangements or credit rating triggers associated with obligations topurchase assets of the structured entity or to provide financial support).

19G If during the reporting period an investment entity or any of its unconsolidated subsidiaries has, without having a contractual obligation 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.

Interests in joint arrangements and associates

20 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 contractual relationship with the other investors with joint control of, or significant influence over, joint arrangements and associates (paragraphs 21 and 22); and

(*b*) the nature of, and changes in, the risks associated with its interests in joint ventures and associates (paragraph 23).

Nature, extent and financial effects of an entity's interests in joint arrangements and associates

21 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 principal place of business (and country of incorporation, if applicable and different from the principal place of business) ofthe joint arrangement or associate.

(iv) the proportion of ownership interest or participating share held by the entity and, if different, the proportion of voting right sheld (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) summarised financial information about the joint venture or associate as specified in paragraphs B12 and B13.

(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 B16 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, separately,

(ii) in aggregate for all individually immaterial associates.

21A An investment entity need not provide the disclosures required by paragraphs 21(b)–21(c).

22 An entity shall also disclose:

(*a*) the nature and extent of any significant restrictions (eg resulting from borrowing arrangements, regulatory requirements or contractual 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 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 unrecognised share of losses of a joint venture or associate, both for the reporting period and cumulatively, if the entity has stopped recognising 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

23 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 B18–B20.

(*b*) in accordance with LKAS 37 *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 unconsolidated structured entities

24 An entity shall disclose information that enables users of its financial statements:

(*a*) to understand the nature and extent of its interests in unconsolidated structured entities (paragraphs 26–28); and

(*b*) to evaluate the nature of, and changes in, the risks associated with its interests in unconsolidated structured entities (paragraphs29–31).

25 The information required by paragraph 24(b) includes information about an entity's exposure to risk from involvement that it had with unconsolidated structured entities in previous periods (eg sponsoring the structured entity), even if the entity no longer has any contractual involvement with the structured entity at the reporting date.

25A An investment entity need not provide the disclosures required by paragraph 24 for an unconsolidated structured entity that it controls and for which it presentsthe disclosures required by paragraphs 19A–19G.

Nature of interests

26 An entity shall disclose qualitative and quantitative information about its interests in unconsolidated structured entities, including, but not limited to, the nature, purpose, size and activities of the structured entity and how the structured entity is financed.

27 If an entity has sponsored an unconsolidated structured entity for which it does not provide information required by paragraph 29 (eg 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*) *income from those structured entities* during the reporting period, including a description of the types of income presented; and

(*c*) the carrying amount (at the time of transfer) of all assets transferred to those structured entities during the reporting period.

28 An entity shall present the information in paragraph 27(b) and (c) in tabular format, unless another format is more appropriate, and classify its sponsoring activities into relevant categories (see paragraphs B2–B6).

Nature of risks

29 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 recognised in its financial statements relating to its interests in unconsolidated structured entities.

(*b*) the line items in the statement of financial position in which those assets and liabilities are recognised.

(*c*) the amount that best represents the entity's maximum exposure to loss from its interests in unconsolidated structured entities, including howthe maximum exposure to loss is determined. If an entity cannot quantify its maximum exposure to loss from its interests inunconsolidated structured entities it shall disclose that fact and the reasons.

(*d*) a comparison of the carrying amounts of the assets and liabilities of the entity that relate to its interests in unconsolidated structured entities and the entity's maximum exposure to loss from those entities.

30 If during the reporting period an entity has, without having a contractual obligation to do so, provided financial or other support to an unconsolidated structured entity 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.

31 An entity shall disclose any current intentions to provide financial or other support to an unconsolidated structured entity, including intentions to assist the structured entity in obtaining financial support.

Appendix A

Defined terms

This appendix is an integral part of the SLFRS.

income from astructured entity	For the purpose of this SLFRS, income from a **structured entity** includes, but is not limited to, recurring and non-recurring fees,interest, dividends, 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.
interest in another entity	For the purpose of this SLFRS, an interest in another entity refers to contractual and non-contractual involvement that exposes anentity to variability of returns from the performance of the otherentity. An interest in another entity can be evidenced by, but is not limited to, the holding of equity or debt instruments as wellas 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 customer supplier relationship. Paragraphs B7–B9 provide further information about interests inother entities. Paragraphs B55–B57 of SLFRS 10 explain variability of returns.
structured entity	An entity that has been designed so that voting or similar rightsare not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks onlyand the relevant activities are directed by means of contractual arrangements. Paragraphs B22–B24 provide further information about structured entities.

The following terms are defined in LKAS 27, LKAS 28, SLFRS 10 and SLFRS 11 *Joint Arrangements* and are used in this SLFRS with the meanings specified in those SLFRSs:

- associate
- consolidated financial statements
- control of an entity
- equity method
- group
- investment entity
- joint arrangement
- joint control
- joint operation
- joint venture
- non-controlling interest
- parent
- protective rights
- relevant activities
- separate financial statements
- separate vehicle
- significant influence
- subsidiary.

Appendix B

Application guidance

This appendix is an integral part of the SLFRS. It describes the application of paragraphs 1–31 andhas the same authority as the other parts of the SLFRS.

B1 The examples in this appendix portray hypothetical situations. Although some aspects of the examples may be present in actual fact patterns, all relevant factsand circumstances of a particular fact pattern would need to be evaluated when applying SLFRS 12.

Aggregation (paragraph 4)

B2 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.

B3 An entity may aggregate the disclosures required by this SLFRS for interests in similar entities if aggregation is consistent with the disclosure objective and the requirement in paragraph B4, and does not obscure the information provided.An entity shall disclose how it has aggregated its interests in similar entities.

B4 An entity shall present information separately for interests in:

(*a*) subsidiaries;

(*b*) joint ventures;

(*c*) joint operations;

(*d*) associates; and

(*e*) unconsolidated structured entities.

B5 In determining whether to aggregate information, an entity shall consider quantitative and qualitative information about the different risk and return 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.

B6 Examples of aggregation levels within the classes of entities set out in paragraph B4 that might be appropriate are:

(*a*) natureof activities (eg a research and development entity, a revolving credit card securitisation entity).

(*b*) industry classification.

(*c*) geography (eg country or region).

Interests in other entities

B7 An interest in another entity refers to contractual and non-contractual involvement that exposes the reporting entity to variability of returns 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 SLFRS. 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.

B8 A reporting entity is typically exposed to variability of returns 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 returns from the performance of the structured entity because the credit default swap absorbs variability of returns of the structured entity.

B9 Some instruments are designed to transfer risk from a reporting entity to another entity. Such instruments create variability of returns for the other entity but do not typically expose the reporting entity to variability of returns 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-linkednotes) 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 acredit 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 a higher return that reflects 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 returns from the performance of the structured entity because the CDS transfers variability to the structured entity, rather than absorbing variability of returns of the structured entity.

Summarised financial information for subsidiaries, joint ventures and associates (paragraphs 12 and 21)

B10 For each subsidiary that has non-controlling interests that are material to the reporting entity, an entity shall disclose:

(*a*) dividends paid to non-controlling interests.

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

B11 The summarised financial information required by paragraph B10(b) shall be the amounts before inter-company eliminations.

B12 For each joint venture and associate that is material to the reporting entity, an entity shall disclose:

(*a*) dividends received from the joint venture or associate.

(*b*) summarised financial information for the joint venture or associate (see paragraphs B14 and B15) including, but not necessarily limited to:

(i) current assets.
(ii) non-current assets.
(iii) current liabilities.
(iv) non-current liabilities.
(v) revenue.
(vi) profit or loss from continuing operations.
(vii) post-tax profit or loss from discontinued operations.
(viii) other comprehensive income.
(ix) total comprehensive income.

B13 In addition to the summarised financial information required by paragraph B12, 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 B12(b)(i).

(*b*) current financial liabilities (excluding trade and other payables and provisions) included in paragraph B12(b)(iii).

(*c*) non-current financial liabilities (excluding trade and other payables and provisions) included in paragraph B12(b)(iv).

(*d*) depreciation and amortisation.

(*e*) interest income.

(*f*) interest expense.

(*g*) income tax expense or income.

B14 The summarised financial information presented in accordance with paragraphs B12 and B13 shall be the amounts included in the SLFRS 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 SLFRS 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 summarised financial information presented to the carrying amount of its interest in the joint venture or associate.

B15 An entity may present the summarised financial information required by paragraphs B12 and B13 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 LKAS 28; and

(*b*) the joint venture or associate does not prepare SLFRS 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.

B16 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*) profit or loss from continuing operations.

(*b*) post-tax profit or loss from discontinued operations.

(*c*) other comprehensive income.

(*d*) total comprehensive income.

An entity provides the disclosures separately for joint ventures and associates.

B17 When an entity's interest in a subsidiary, a joint venture or an associate (or a portion of its interest in a joint venture or an associate) is classified as held for sale in accordance with SLFRS 5 *Non-current Assets Held for Sale and Discontinued Operations,* the entity is not required to disclose summarised financial information for that subsidiary, joint venture or associate in accordance with paragraphs B10–B16.

Commitments for joint ventures (paragraph 23(a))

B18 An entity shall disclose total commitments it has made but not recognised 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.

B19 Unrecognised commitments that may give rise to a future outflow of cash or other resources include:

(*a*) unrecognised 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) unrecognised commitments to provide loans or other financial support to a joint venture.

(v) unrecognised commitments to contribute resources to a joint venture, such as assets or services.

(vi) other non-cancellable unrecognised commitments relating to a joint venture.

(*b*) unrecognised commitments to acquire another party's ownership interest (or a portion of that ownership interest) in a joint venture if aparticular event occurs or does not occur in the future.

B20 The requirements and examples in paragraphs B18 and B19 illustrate some of the types of disclosure required by paragraph 18 of LKAS 24 *Related Party Disclosures*.

Interests in unconsolidated structured entities (paragraphs 24–31)

Structured entities

B21 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, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements.

B22 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 effect a tax-efficient lease, 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 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).

B23 Examples of entities that are regarded as structured entities include, but are not limited to:

(*a*) securitisation vehicles.

(*b*) asset-backed financings.

(*c*) some investment funds.

B24 An entity that is controlled by voting rights is not a structured entity simply because, for example, it receives funding from third parties following a restructuring.

Nature of risks from interests in unconsolidated structured entities (paragraphs 29–31)

B25 In addition to the information required by paragraphs 29–31, an entity shall disclose additional information that is necessary to meet the disclosure objective in paragraph 24(b).

B26 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 an unconsolidated structured entity are:

(*a*) the terms of an arrangement that could require the entity to provide financial support to an unconsolidated structured entity (*eg* 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 unconsolidated structured entities.

(*c*) the types of income the entity received during the reporting period from its interests in unconsolidated structured entities.

(*d*) whether the entity is required to absorb losses of an unconsolidated structured entity 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'sinterest in the unconsolidated structured entity.

(*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 unconsolidated structured entities.

(*f*) any difficulties an unconsolidated structured entity has experienced in financing its activities during the reporting period.

(*g*) in relation to the funding of an unconsolidated structured entity, the forms of funding (*eg* commercial paper or medium-term notes) and their weighted-average life. That information might include maturity analyses of the assets and funding of an unconsolidated structured entityif the structured entity has longer-term assets funded by shorter-term funding.

Appendix C

Effective date and transition

This appendix is an integral part of the SLFRS and has the same authority as the other parts of theSLFRS.

Effective date and transition

C1 An entity shall apply this SLFRS for annual periods beginning on or after 1 January 2014. Earlier application is permitted.

C1A [Deleted]

C1B [Deleted]

C2 An entity is encouraged to provide information required by this SLFRS earlier than annual periods beginning on or after 1 January 2014. Providing some of the disclosures required by this SLFRS does not compel the entity to comply with all the requirements of this SLFRS or to apply SLFRS 10, SLFRS 11, LKAS 27 and LKAS 28 early.

C2A The disclosure requirements of this SLFRS need not be applied for any period presented that begins before the annual period immediately preceding the first annual period for which SLFRS 12 is applied.

C2B The disclosure requirements of paragraphs 24–31 and the corresponding guidance in paragraphs B21–B26 of this SLFRS need not be applied for any period presented that begins before the first annual period for which SLFRS 12 is applied.

References to SLFRS 9

C3 If an entity applies this SLFRS but does not yet apply SLFRS 9, any reference to SLFRS 9 shall be read as a reference to LKAS 39 *Financial Instruments: Recognition and Measurement*.

SRI LANKA ACCOUNTING STANDARD

SLFRS 13

Fair Value Measurement

CONTENTS

from paragraph

Sri Lanka Accounting Standard–SLFRS 13
Fair Value Measurement

Sri Lanka Accounting Standard - SLFRS13 *FairValue Measurement* is set out in paragraphs 1–99 and Appendices A–C.All the paragraphs have equal authority.Paragraphs in **bold type** state the main principles.Terms defined in Appendix A are in *italics* the first time they appear in the Standard.Definitions of other terms are given in the Glossary for Sri Lanka Accounting Standards.SLFRS 13 should be read in the context of its objectiveand the Basis for Conclusions, the *Preface to Sri Lanka Accounting Standards* and the *Conceptual Framework for Financial Reporting*.LKAS 8 *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 **This SLFRS:**

(*a*) **defines fair value*;***

(*b*) sets out in a single SLFRS a framework for measuring fair value;and

(*c*) requires disclosures about fair value measurements.

2 Fair value is a market-based measurement, not an entity-specific measurement.For some assets and liabilities, observable market transactions or market information might be available. For other assets and liabilities, observable market transactions and market information might not be available. However, the objective of a fair value measurement in both cases is the same—to estimate the price at which an *orderly transaction* to sell the asset or to transfer the liability would take place between *market participants* at the measurement date under current market conditions (ie an *exitprice* at the measurement date from the perspective of a market participant that holds the asset or owes the liability).

3 When a price for an identical asset or liability is not observable, an entity measures fair value using another valuation technique that maximises the use ofrelevant *observable inputs* andminimises the use of *unobservable inputs*. Because fair value is a market-based measurement, it is measured using the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk. As a result, an entity's intention to hold an asset or to settle or otherwise fulfill a liability is not relevant when measuring fair value.

4 The definition of fair value focuses on assets and liabilities because they are aprimary subject of accounting measurement.In addition, this SLFRS shall beapplied to an entity's own equity instruments measured at fair value.

Scope

5 **This SLFRS applies when another SLFRS requires or permits fair value measurements or disclosures about fair value measurements (and measurements, such as fair value less costs to sell, based on fair value or disclosures about those measurements), except as specified in paragraphs 6 and 7.**

6 The measurement and disclosure requirements of this SLFRS do not apply to the following:

(*a*) share-based payment transactions within the scope of SLFRS 2 *Share-basedPayment;*

(*b*) leasing transactions within the scope of LKAS 17 *Leases*; and

(*c*) measurements that have some similarities to fair value but are not fair value, such as net realisable value in LKAS 2 *Inventories* or value in use in LKAS 36 *Impairment of Assets* .

7 The disclosures required by this SLFRS are not required for the following:

(*a*) plan assets measured at fair value in accordance with LKAS19 *Employee Benefits;*

(*b*) retirement benefit plan investments measured at fair value in accordance with LKAS26 *Accounting and Reporting by Retirement Benefit Plans ;* and

(*c*) assets for which recoverable amount is fair value less costs of disposal in accordance with LKAS36.

8 The fair value measurement framework described in this SLFRS applies to both initial and subsequent measurement if fair value is required or permitted by other SLFRSs.

Measurement

Definition of fair value

9 This SLFRS defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

10 Paragraph B2 describes the overall fair value measurement approach.

The asset or liability

11 A fair value measurement is for a particular asset or liability.Therefore, when measuring fair value an entity shall take into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Such characteristics include, for example, the following:

(*a*) the condition and location of the asset; and

(*b*) restrictions, if any, on the sale or use of the asset.

12 The effect on the measurement arising from a particular characteristic will differdepending on how that characteristic would be taken into account by marketparticipants.

13 The asset or liability measured at fair value might be either of the following:

(*a*) a stand-alone asset or liability (eg afinancial instrument or a non-financialasset); or

(*b*) a group of assets, a group ofliabilities or a group of assets and liabilities(eg a cash-generating unit or a business).

14 Whether the asset or liability is a stand-alone asset or liability, a group of assets,a group of liabilities or a group of assets and liabilities for recognition or disclosure purposes depends on its unit of account.The unit of account for the asset or liability shall be determined in accordance with the SLFRS that requires orpermits the fair value measurement, except as provided in this SLFRS.

The transaction

15 A fair value measurement assumes that the asset or liability is exchanged in an orderly transaction between market participants to sell the asset or transfer the liability at the measurement date under current market conditions.

16 A fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place either:

(*a*) in the *principal market* for the asset or liability; or

(*b*) in the absence of a principal market, in the *most advantageous market* for the asset or liability.

17 An entity need not undertake an exhaustive search of all possible markets to identify the principal market or, in the absence of a principal market, the most advantageous market, but it shall take into account all information that is reasonably available. In the absence of evidence to the contrary, the market inwhich the entity would normally enter into a transaction to sell the asset or to transfer the liability is presumed to be the principal market or, in the absence of a principal market, the most advantageous market.

18 If there is a principal market for the asset or liability, the fair value measurement shall represent the price in that market (whether that price is directly observable or estimated using another valuation technique), even if the price in a different market is potentially more advantageous at the measurement date.

19 The entity must have access to the principal (or most advantageous) market at the measurement date. Because different entities (and businesses within those entities) with different activities may have accessto different markets, the principal (or most advantageous) market for the same asset or liability might be different for different entities (and businesses within those entities). Therefore,the principal (or most advantageous) market (and thus, market participants) shall be considered from the perspective of the entity, thereby allowing for differences between and among entities with different activities.

20 Although an entity must be able to access the market, the entity does not need tobe able to sell the particular asset or transfer the particular liability on the measurement date to be able to measure fair value on the basis of the price in thatmarket.

21 Even when there is no observable market to provide pricing information about the sale of an asset or the transfer ofa liability at the measurement date, a fair value measurement shall assume that a transaction takes place at that date,considered from the perspective of a market participant that holds the asset or owes the liability. That assumed transaction establishes a basis for estimating the price to sell the asset or to transfer the liability.

Market participants

22 An entity shall measure the fair value of an asset or a liability using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

23 In developing those assumptions, an entity need not identify specific market participants.Rather, the entity shall identify characteristics that distinguishmarket participants generally, considering factors specific to all the following:

(*a*) the asset or liability;

(*b*) the principal (or most advantageous)market for the asset or liability; and

(*c*) market participants with whom the entity would enter into a transactionin that market.

The price

24 Fair value is the price that would be received to sell an asset or paid to transfer aliability in an orderly transaction in the principal (or most advantageous) marketat the measurement date under current market conditions (ie an exit price)regardless of whether that price is directly observable or estimated using another valuation technique.

25 The price in the principal (or most advantageous) market used to measure the fairvalue of the asset or liability shall not be adjusted for *transaction costs*. Transaction costs shall be accounted for in accordance with other

SLFRSs.Transaction costs are not a characteristic of an asset or a liability; rather, they are specific to atransaction and will differ depending on how an entity enters into a transaction for the asset or liability.

26 Transaction costs do not include *transport costs*.If location is a characteristic of the asset (as might be the case, for example, for a commodity), the price in the principal (or most advantageous) market shall be adjusted for the costs, if any,that would be incurred to transport the asset from its current location to that market.

Application to non-financial assets

Highest and best use for non-financial assets

27 A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its *highest and best* use or by selling it to another market participant that would use the asset in its highest and best use.

28 The highest and best use of a non-financial asset takes into account the use of the asset that is physically possible, legally permissible and financially feasible,as follows:

(*a*) A use that is physically possible takes into account the physical characteristics of the asset that market participants would take into account when pricing the asset (*eg*. the location or size of a property).

(*b*) A use that is legally permissible takes into account any legal restrictions onthe use of the asset that market participants would take into account when pricing the asset (*eg*. the zoning regulations applicable to a property).

(*c*) A use that is financially feasible takes into account whether a use of the asset that is physically possible and legally permissible generates adequate income or cash flows (taking into account the costs of converting the assetto that use) to produce an investment return that market participants would require from an investment in that asset put to that use.

29 Highest and best use is determined from the perspective of market participants,even if the entity intends a different use. However, an entity's current use of a non-financial asset is presumed to be its highest and best use unless market or other factors suggest that a different use by market participants would maximize the value of the asset.

30 To protect its competitive position, or for other reasons, an entity may intend not to use an acquired non-financial asset actively or it may intend not to use the asset according to its highest and best use.For example, that might be the case for an acquired intangible asset that the entity plans to use defensively by preventing others from using it.Nevertheless, the entity shall measure the fair value of anon-financial asset assuming its highest and best use by market participants.

Valuation premise for non-financial assets

31 The highest and best use of a non-financial asset establishes the valuation premise used to measure the fair value of the asset, as follows:

(*a*) The highest and best use of a non-financial asset might provide maximum value to market participants through its use in combination with other assets as a group (as installed or otherwise configured for use) or incombination with other assets and liabilities (eg a business).

(i) If the highest and best use of the asset is to use the asset in combination with other assets or with other assets and liabilities, the fair value of the asset is the price that would be received in a current transaction to sell the asset assuming that the asset would be used with other assets or with other assets and liabilities and that those assets and liabilities (ie its complementary assets and the associated liabilities) would be available to market participants.

(ii) Liabilities associated with the asset and with the complementary assets include liabilities that fundworking capital, but do not include liabilities used to fund assets other than those within the group of assets.

(iii) Assumptions about the highest and best use of a non-financial asset shall be consistent for all the assets (for which highest and best use is relevant) of the group of assets or the group of assets and liabilities within which the asset would be used.

(*b*) The highest and best use of a non-financial asset might provide maximum value to market participants on a stand-alone basis.If the highest and best use of the asset is to use it on a stand-alone basis, the fair value of the assetis the price that would be received in a current transaction to sell the asset to market participants that would use the asset on a stand-alone basis.

32 The fair value measurement of a non-financial asset assumes that the asset is sold consistently with the unit of account specified in other SLFRSs (which may be an individual asset).That is the case even when that fair value measurement assumes that the highest and best use of the asset is to use it in combination with other assets or with other assets and liabilities because a fair value measurement as sumes that the market participant already holds the complementary assets andthe associated liabilities.

33 Paragraph B3 describes the application of the valuation premise concept for non-financial assets.

Application to liabilities and an entity’s own equity instruments

General principles

34 A fair value measurement assumes that a financial or non-financial liability or anentity’s own equity instrument (*eg*. equity interests issued as consideration in abusiness combination) is transferred to a market participant at the measurement date. The transfer of a liability or an entity’s own equity instrument assumesthe following:

(*a*) A liability would remain outstanding and the market participant transferee would be required to fulfill the obligation.The liability would not be settled with the counterparty or otherwise extinguished on the measurement date.

(*b*) An entity’s own equity instrument would remain outstanding and the market participant transferee would take on the rights and responsibilitiesassociated with the instrument. The instrument would not be cancelled or otherwise extinguished on the measurement date.

35 Even when there is no observable market to provide pricing information about the transfer of a liability or an entity’s own equity instrument (*eg*. because contractual or other legal restrictions prevent the transfer of such items), there might be an observable market for such items if they are held by other parties asassets (*eg*. a corporate bond or a call option on an entity’s shares).

36 In all cases, an entity shall maximise the use of relevant observable inputs and minimise the use of unobservable inputs to meet the objective of a fair value measurement, which is to estimate the price at which an orderly transaction totransfer the liability or equity instrument would take place between market participants at the measurement date under current market conditions.

Liabilities and equity instruments held by other parties as assets

37 When a quoted price for the transfer ofan identical or a similar liability orentity’s own equity instrument is not available and the identical item is held by another party as an asset, an entity shall measure the fair value of the liability or equity instrument from the perspective of a market participant that holds the identical item as an asset at the measurement date.

38 In such cases, an entity shall measure the fair value of the liability or equity instrument as follows:

(*a*) using the quoted price in an *active market* for the identical item held by another party as an asset,if that price is available.

(*b*) if that price is not available, using other observable inputs, such as the quoted price in a market that is not active for the identical item held by another party as an asset.

(*c*) if the observable prices in (a) and (b) are not available, using another valuation technique, such as:

(i) an *income approach* (*eg*. a present value technique that takes into account the future cash flows that a market participant would expect to receive from holding the liability or equity instrument as an asset;see paragraphs B10 and B11).

(ii) a *market approach* (eg using quoted prices for similar liabilities or equityinstruments held by other parties as assets; see paragraphs B5–B7).

39 An entity shall adjust the quoted price of a liability or an entity's own equityinstrument held by another party as an asset only if there are factors specific to the asset that are not applicable to the fair value measurement of the liability orequity instrument.An entity shall ensure that the price of the asset does not reflect the effect of a restriction preventing the sale of that asset.Some factors that may indicate that the quoted price of the asset should be adjusted include the following:

(*a*) The quoted price for the asset relates to a similar (but not identical) liability or equity instrument held by another party as an asset.For example, the liability or equity instrument may have a particular characteristic (eg the credit quality of the issuer) that is different from that reflected in the fairvalue of the similar liability or equity instrument held as an asset.

(*b*) The unit of account for the asset is not the same as for the liability or equity instrument.For example, for liabilities, in some cases the price for an asset reflects a combined price for a package comprising both the amounts duefrom the issuer and a third-party credit enhancement.If the unit of account for the liability is not for the combined package, the objective is to measure the fair value of the issuer's liability, not the fair value of the combined package.Thus, in such cases, the entity would adjust the observed price for the asset to exclude the effect of the third-party credit enhancement.

Liabilities and equity instruments not held by other parties as assets

40 When a quoted price for the transfer of an identical or a similar liability orentity's own equity instrument is not available and the identical item is not held by another party as an asset, an entity shall measure the fair value of the liability or equity instrument using a valuation technique from the perspective of a market participant that owes the liability or has issued the claim on equity.

41 For example, when applying a present value technique an entity might take into account either of the following:

(*a*) the future cash outflows that a market participant would expect to incur in fulfilling the obligation, including the compensation that a market participant would require for taking on the obligation (see paragraphsB31–B33).

(*b*) the amount that a market participant would receive to enter into or issue an identical liability or equity instrument, using the assumptions that market participants would use when pricing the identical item (*eg*. having the same credit characteristics) in the principal (or most advantageous) market for issuing a liability or an equity instrument with the samecontractual terms.

Non-performance risk

42 The fair value of a liability reflects the effect of *non-performance risk*.Non-performance risk includes, but may not be limited to, an entity's own creditrisk (as defined in SLFRS*7 Financial Instruments: Disclosures*).Non-performance risk is assumed to be the same before and after the transfer of the liability.

43 When measuring the fair value of a liability, an entity shall take into account the effect of its credit risk (credit standing) and any other factors that might influence the likelihood that the obligation will or will not be fulfilled.That effect may differ depending on the liability, for example:

(a) whether the liability is an obligation to deliver cash (a financial liability) or an obligation to deliver goods or services (a non-financial liability).

(b) the terms of credit enhancements related to the liability, if any.

44 The fair value of a liability reflects the effect of non-performance risk on the basis of its unit of account.The issuer of a liability issued with an inseparable third-party credit enhancement that is accounted for separately from the liability shall not include the effect of the credit enhancement (*eg*. a third-party guarantee of debt) in the fair value measurement of the liability. If the credit enhancement is accounted for separately from the liability, the issuer would take into account its own credit standing and not that of the third party guarantor when measuring the fair value of the liability.

Restriction preventing the transfer of a liability or an entity's own equity instrument

45 When measuring the fair value of a liability or an entity's own equity instrument,an entity shall not include a separate input oran adjustment to other *inputs* relating to the existence of a restriction that prevents the transfer of the item.The effect of a restriction that prevents the transfer of a liability or an entity's own equity instrument is either implicitly or explicitly included in the other inputs tothe fair value measurement.

46 For example, at the transaction date, both the creditor and the obligor accepted the transaction price for the liability with full knowledge that the obligationincludes a restriction that prevents its transfer.As a result of the restrictionbeing included in the transaction price, a separate input or an adjustment to anexisting input is not required at the transaction date to reflect the effect of the restriction on transfer.Similarly, a separate input or an adjustment to an existing input is not required at subsequent measurement dates to reflect the effect of the restriction on transfer.

Financial liability with a demand feature

47 The fair value of a financial liability with a demand feature (eg 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.

Application to financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk

48 An entity that holds a group of financial assets and financial liabilities is exposed to market risks (as defined inSLFRS 7) and to the credit risk (as defined in SLFRS 7) of each of the counterparties.If the entity manages that group of financial assets and financial liabilities on the basis of its net exposure to either market risks orcredit risk, the entity is permitted to apply an exception to this SLFRS for measuring fair value.That exception permits an entity to measure the fair value of a groupof financial assets and financial liabilities on the basis of the price that would be received to sell a net long position (ie anasset) for a particular risk exposure or paid to transfer a net short position (ie a liability) for a particular risk exposure in an orderly transaction between market participants at the measurement dateunder current market conditions.Accordingly, an entity shall measure the fair value of the group of financial assets and financial liabilities consistently with howmarket participants would price the net risk exposure at the measurement date.

49 An entity is permitted to use the exception in paragraph 48 only if the entity does all the following:

(*a*) manages the group of financial assets and financial liabilities on the basis of the entity's net exposure to a particular market risk (or risks) or to the credit risk of a particular counterparty in accordance with the entity's documented risk management or investment strategy;

(*b*) provides information on that basis about the group of financial assets and financial liabilities to the entity's key management personnel, as defined in LKAS 24 *Related Party Disclosures;* and

(*c*) is required or has elected to measure those financial assets and financial liabilities at fair value in the statement of financial position at the end of each reporting period.

50 The exception in paragraph 48 does not pertain to financial statement presentation.In some cases the basis for the presentation of financial instruments in the statement of financial position differs from the basis for the measurement of financial instruments, for example, if an SLFRS does not require or permit financial instruments to be presented on a net basis.In such cases an entity may need to allocate the portfolio-level adjustments (see paragraphs 53–56) to the individual assets or liabilities that make up the group of financial assets and financial liabilities managed on the basis of the entity's net risk exposure.An entity shall perform such allocations on a reasonable and consistent basis using a methodology appropriate in the circumstances.

51 An entity shall make an accounting policy decision in accordance with LKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to use the exception in paragraph 48.An entity that uses the exception shall apply that accounting policy, including its policy for allocating bid-ask adjustments (see paragraphs53–55) and credit adjustments (see paragraph 56), if applicable, consistently from period to period for a particular portfolio.

52 The exception in paragraph 48 applies only to financial assets and financial liabilities within the scope of LKAS 39*Financial Instruments: Recognition and Measurement* or SLFRS9 *Financial Instruments.*

Exposure to market risks

53 When using the exception in paragraph 48 to measure the fair value of a group of financial assets and financial liabilities managed on the basis of the entity's net exposure to a particular market risk (or risks), the entity shall apply the price within the bid-ask spread that is most representative of fair value in the circumstances to the entity's net exposure to those market risks (see paragraph70 and 71).

54 When using the exception in paragraph 48, an entity shall ensure that the market risk (or risks) to which the entity is exposed within that group of financial assets and financial liabilities is substantially the same. For example, an entity would not combine the interest rate risk associated with a financial asset with the commodity price risk associated with a financial liability because doing so wouldnot mitigate the entity's exposure to interest raterisk or commodity price risk.When using the exception in paragraph 48, any basis risk resulting from the market risk parameters not being identical shall be taken into account in the fair value measurement of the financial assets and financial liabilities within the group.

55 Similarly, the duration of the entity's exposure to a particular market risk (or risks) arising from the financial assets and financial liabilities shall be substantially the same.For example, an entity that uses a 12-month futures contract against the cash flows associated with 12 months' worth of interest rate risk exposure on a five-year financial instrument within a group made up of onlythose financial assets and financial liabilities measures the fair value of the exposure to 12-month interest rate risk on a net basis and the remaining interest rate risk exposure (ie years 2–5) on a gross basis.

Exposure to the credit risk of a particular counterparty

56 When using the exception in paragraph 48 to measure the fair value of a group of financial assets and financial liabilities entered into with a particular counterparty, the entity shall include the effect of the entity's net exposure

to the credit risk of that counterparty or the counterparty's net exposure to the credit risk of the entity in the fair value measurement when market participants would take into account any existing arrangements that mitigate credit risk exposure inthe event of default (*eg*. a master netting agreement with the counterparty or an agreement that requires the exchange of collateral on the basis of each party's net exposure to the credit risk of the other party).The fair value measurement shall reflect market participants' expectations about the likelihood that such an arrangement would be legally enforceable in the event of default.

Fair value at initial recognition

57 When an asset is acquired or a liability is assumed in an exchange transaction for that asset or liability, the transaction price is the price paid to acquire the asset or received to assume the liability (an *entry price*).In contrast, the fair value of the asset or liability is the price that would be received to sell the asset or paid to transfer the liability (an exit price). Entities do not necessarily sell assets at the prices paid to acquire them.Similarly, entities do not necessarily transfer liabilities at the prices received to assume them.

58 In many cases the transaction price will equal the fair value (eg that might be the case when on the transaction date the transaction to buy an asset takes place inthe market in which the asset would be sold).

59 When determining whether fair value at initial recognition equals the transaction price, an entity shall take into account factors specific to the transaction and to the asset or liability.Paragraph B4 describes situations in which the transaction price might not represent the fair value of an asset or a liability at initial recognition.

60 If another SLFRS requires or permits an entity to measure an asset or a liability initially at fair value and the transaction price differs from fair value, the entity shall recognise the resulting gain or loss in profit or loss unless that SLFRS specifies otherwise.

Valuation techniques

61 An entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value,maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

62 The objective of using a valuation technique is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions.Three widely used valuation techniques are the market approach, the *cost approach* and the income approach.The main aspects of those approaches are summarised in paragraphs B5–B11.An entity shall use valuation techniques consistent with one or more of those approaches to measure fair value.

63 In some cases a single valuation technique will be appropriate (eg when valuing an asset or a liability using quoted prices in an active market for identical assets or liabilities). In other cases, multiple evaluation techniques will be appropriate (eg that might be the case when valuing a cash-generating unit). If multiple valuation techniques are used to measure fair value, the results (ie respective indications of fair value) shall be evaluated considering the reasonableness of the range of values indicated by those results.A fair value measurement is the point within that range that is most representative of fair value in the circumstances.

64 If the transaction price is fair value at initial recognition and a valuation technique that uses unobservable inputs will be used to measure fair value in subsequent periods, the valuation technique shall be calibrated so that at initial recognition the result of the valuation technique equals the transaction price.Calibration ensures that the valuation technique reflects current market conditions, and it helps an entity to determine whether an adjustment to the valuation technique is necessary (*eg*. there might be a characteristic of the asset or liability that is not captured by the valuation technique). After initial recognition, when measuring fair value using a valuation technique or techniques that use unobservable inputs, an entity shall ensure that those valuation techniques reflect observable market data (eg the price for a similar asset or liability) at the measurement date.

65 Valuation techniques used to measure fair value shall be applied consistently.However, a change in a valuation technique or its application (*eg*. a change in its weighting when multiple valuation techniques are used or a change in an adjustment applied to a valuation technique) is appropriate if the change results in a measurement that is equally or more representative of fair value in the circumstances.That might be the case if, for example, any of the following events take place:

(*a*) new markets develop;

(*b*) new information becomes available;

(*c*) Information previously used is no longer available;

(*d*) valuation techniques improve; or

(*e*) market conditions change.

66 Revisions resulting from a change in the valuation technique or its application shall be accounted for as a change in accounting estimate in accordance with LKAS 8.However, the disclosures in LKAS 8for a change in accounting estimate are not required for revisions resulting from a change in a valuation technique or its application.

Inputs to valuation techniques

General principles

67 Valuation techniques used to measure fair value shall maximise the use of relevant observable inputs and minimise the use of unobservable inputs.

68 Examples of markets in which inputs might be observable for some assets and liabilities (eg financial instruments) include exchange markets, dealer markets,brokered markets and principal-to-principal markets (see paragraph B34).

69 An entity shall select inputs that are consistent with the characteristics of the asset or liability that market participants would take into account in a transaction for the asset or liability (see paragraphs 11 and12).In some cases those characteristics result in the application of an adjustment, such as a premium or discount (eg a control premium or non-controlling interest discount).However, a fair value measurement shall not incorporate a premium or discount that is inconsistent with the unit of account in the SLFRS that requires or permits the fair value measurement (see paragraphs 13 and 14).Premiums or discounts that reflect size as a characteristic of the entity's holding (specifically, a blockage factor that adjusts the quoted price of an asset or a liability because the market's normal daily trading volume is not sufficient to absorb the quantity held by the entity, as described in paragraph 80) rather than as a characteristic of the asset or liability (eg a control premium when measuring the fair value of a controlling interest) are not permitted in a fair value measurement.In all cases,if there is a quoted price in an active market (ie a *Level 1 input*) for an asset or a liability, an entity shall use that price without adjustment when measuring fair value, except as specified in paragraph 79.

Inputs based on bid and ask prices

70 If an asset or a liability measured at fair value has a bid price and an ask price(eg an input from a dealer market), the price within the bid-ask spread that is most representative of fair value in the circumstances shall be used to measure fair value regardless of where the input is categorised within the fair value hierarchy (ie Level 1, 2 or 3; see paragraphs 72–90).The use of bid prices for asset positions and ask prices for liability positions is permitted, but is not required.

71 This SLFRS does not preclude the use of mid-market pricing or other pricing conventions that are used by market participants as a practical expedient for fair value measurements within a bid-ask spread.

Fair value hierarchy

72 To increase consistency and comparability in fair value measurements and related disclosures, this SLFRS establishes a fair value hierarchy that categorises into three levels (see paragraphs 76–90) the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (*Level 3 inputs*).

73 In some cases, the inputs used to measure the fair value of an asset or a liability might be categorised within different levels of the fair value hierarchy. In those cases, the fair value measurement is categorised in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant tothe entire measurement. Assessing the significance of a particular input to the entire measurement requires judgement, taking into account factors specific to the asset or liability. Adjustments to arrive at measurements based on fair value,such as costs to sell when measuring fair value less costs to sell, shall not be taken into account when determining the level of the fair value hierarchy within which a fair value measurement is categorised.

74 The availability of relevant inputs and their relative subjectivity might affect the selection of appropriate valuation techniques (see paragraph 61). However,the fair value hierarchy prioritises the inputs to valuation techniques, not the valuation techniques used to measure fair value. For example, a fair value measurement developed using a present value technique might be categorized within Level 2 or Level 3, depending on the inputs that are significant to the entire measurement and the level of the fair value hierarchy within which those inputs are categorised.

75 If an observable input requires an adjustment using an unobservable input and that adjustment results in a significantly higher or lower fair value measurement,the resulting measurement would be categorised within Level 3 of the fair value hierarchy. For example, if a market participant would take into account the effect of a restriction on the sale of an asset when estimating the price for the asset, an entity would adjust the quoted price to reflect the effect of that restriction. If that quoted price is a *Level 2 input* and the adjustment is an unobservable input that is significant to the entire measurement, the measurement would be categorized within Level 3 of the fair value hierarchy.

Level 1 inputs

76 Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.

77 A quoted price in an active market provides the most reliable evidence of fair value and shall be used without adjustment to measure fair value whenever available, except as specified in paragraph 79.

78 A Level 1 input will be available for many financial assets and financial liabilities,some of which might be exchanged in multiple active markets (eg on different exchanges). Therefore, the emphasis within Level 1 is on determining both of the following:

(*a*) the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability;and

(*b*) whether the entity can enter into a transaction for the asset or liability at the price in that market at the measurement date.

79 An entity shall not make an adjustment to a Level 1 input except in the followingcircumstances:

(*a*) when an entity holds a large number of similar (but not identical) assets or liabilities (eg debt securities) that are measured at fair value and a quoted price in an active market is available but not readily accessible for each of those assets or liabilities individually (ie given the large number of similar assets or liabilities held by the entity, it would be difficult to obtain pricingin formation for each individual asset or liability at the measurement date).

In that case, as a practical expedient, an entity may measure fair value using an alternative pricing method that does not rely exclusively on quoted prices (eg matrix pricing). However, the use of an alternative pricing method results in a fair value measurement categorised within alower level of the fair value hierarchy.

(*b*) when a quoted price in an active market does not represent fair value at the measurement date. That might be the case if, for example, significant events (such as transactions in a principal-to-principal market, trades in a brokered market or announcements) take place after the close of a market but before the measurement date. An entity shall establish and consistently apply a policy for identifying those events that might affect fair value measurements. However, if the quoted price is adjusted for new information, the adjustment results in a fair value measurement categorised within a lower level of the fair value hierarchy.

(*c*) When measuring the fair value of a liability or an entity's own equity instrument using the quoted price for the identical item traded as an asset in an active market and that price needs to be adjusted for factors specific to the item or the asset (see paragraph 39). If no adjustment to the quoted price of the asset is required, the result is a fair value measurement categorised within Level 1 of the fair value hierarchy. However, any adjustment to the quoted price of the asset results in a fair value measurement categorised within a lower level of the fair value hierarchy.

80 If an entity holds a position in a single asset or liability (including a position comprising a large number of identical assets or liabilities, such as a holding of financial instruments) and the asset or liability is traded in an active market, the fair value of the asset or liability shall be measured within Level 1 as the product of the quoted price for the individual asset or liability and the quantity held by the entity. That is the case even if a market's normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price.

Level 2 inputs

81 Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

82 If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following:

(*a*) quoted prices for similar assets or liabilities in active markets.

(*b*) quoted prices for identical or similar assets or liabilities in markets that arenot active.

(*c*) inputs other than quoted prices that are observable for the asset or liability,for example:

(i) interest rates and yield curves observable at commonly quoted intervals;

(ii) implied volatilities; and

(iii) credit spreads.

(*d*) *market-corroborated inputs.*

83 Adjustments to Level 2 inputs will vary depending on factors specific to the asset or liability. Those factors include the following:

(*a*) the condition or location of the asset;

(*b*) the extent to which inputs relate to items that are comparable to the asset or liability (including those factors described in paragraph 39); and

(*c*) the volume or level of activity in the markets within which the inputs are observed.

84 An adjustment to a Level 2 input that is significant to the entire measurement might result in a fair value measurement categorised within Level 3 of the fair value hierarchy if the adjustment uses significant unobservable inputs.

85 Paragraph B35 describes the use of Level 2 inputs for particular assets and liabilities.

Level 3 inputs

86 Level 3 inputs are unobservable inputs for the asset or liability.

87 Unobservable inputs shall be used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. However, the fair value measurement objective remains the same, ie an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability. Therefore,unobservable inputs shall reflect the assumptions that market participants wouldduse when pricing the asset or liability, including assumptions about risk.

88 Assumptions about risk include the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model) and the risk inherent in the inputs to the valuation technique. A measurement that does not include an adjustment for risk would not represent a fair value measurement ifmarket participants would include one when pricing the asset or liability. For example, it might be necessary to include a risk adjustment when there is significant measurement uncertainty (*eg*. when there has been a significant decrease in the volume or level of activity when compared with normal market activity for the asset or liability, or similar assets or liabilities, and the entity hasdetermined that the transaction price or quoted price does not represent fair value, as described in paragraphs B37–B47).

89 An entity shall develop unobservable inputs using the best information available in the circumstances, which might include the entity's own data. In developing unobservable inputs, an entity may begin with its own data, but it shall adjust those data if reasonably available information indicates that other market participants would use different data or there is something particular to theentity that is not available to other market participants (*eg*. an entity-specific synergy). An entity need not undertake exhaustive efforts to obtain information about market participant assumptions. However, an entity shall take into account all information about market participant assumptions that is reasonably available. Unobservable inputs developed in the manner described above are considered market participant assumptions and meet the objective of a fair value measurement.

90 Paragraph B36 describes the use of Level 3 inputs for particular assets andliabilities.

Disclosure

91 An entity shall disclose information that helps users of its financial statements assess both of the following:

(*a*) for assets and liabilities that are measured at fair value on a recurring ornon-recurring basis in the statement of financial position after initial recognition, the valuation techniques and inputs used to develop those measurements.

(*b*) for recurring fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income for the period.

92 To meet the objectives in paragraph 91, an entity shall consider all the following:

(*a*) the level of detail necessary to satisfy the disclosure requirements;

(*b*) how much emphasis to place on each of the various requirements;

(*c*) how much aggregation or disaggregation to undertake; and

(*d*) whether users of financial statements need additional information to evaluate the quantitative information disclosed.

If the disclosures provided in accordance with this SLFRS and other SLFRSs are insufficient to meet the objectives in paragraph 91, an entity shall disclose additional information necessary to meet those objectives.

93 To meet the objectives in paragraph 91, an entity shall disclose, at a minimum,the following information for each class of assets and liabilities (see paragraph 94 for information on determining appropriate classes of assets and liabilities) measured at fair value (including measurements based on fair value within the scope of this SLFRS) in the statement of financial position after initial recognition:

(*a*) for recurring and non-recurring fair value measurements, the fair value measurement at the end of the reporting period, and for non-recurring fair value measurements, the reasons for the measurement. Recurring fairvalue measurements of assets or liabilities are those that other SLFRSs require or permit in the statement of financial position at the end of each reporting period. Non-recurring fair value measurements of assets or liabilities are those that other SLFRSs require or permit in the statement of financial position in particular circumstances (eg when an entity measures an asset held for sale at fair value less costs to sell in accordance with SLFRS 5*Non-current Assets Held for Sale and Discontinued Operations* because the asset's fair value less costs to sell is lower than its carrying amount).

(*b*) for recurring and non-recurring fair value measurements, the level of the fair value hierarchy within which the fair value measurements are categorised in their entirety (Level 1, 2 or 3).

(*c*) for assets and liabilities held at the end of the reporting period that are measured at fair value on a recurring basis, the amounts of any transfers between Level 1 and Level 2 of the fair value hierarchy, the reasons for those transfers and the entity's policy for determining when transfers between levels are deemed to have occurred (see paragraph 95). Transfers into each level shall be disclosed and discussed separately from transfers out of each level.

(*d*) for recurring and non-recurring fair value measurements categorized within Level 2 and Level 3 of the fair value hierarchy, a description of the valuation technique(s) and the inputs used in the fair value measurement.If there has been a change in valuation technique (eg changing from a market approach to an income approach or the use of an additional valuation technique), the entity shall disclose that change and the reason(s) for making it. For fair value measurements categorised within Level 3 of the fair value hierarchy, an entity shall provide quantitative information about the significant unobservable inputs used in the fair value measurement.An entity is not required to create quantitative information to comply with this disclosure requirement if quantitative unobservable inputs are not developed by the entity when measuring fair value (eg when an entity uses prices from prior transactions or third-party pricing information without adjustment). However, when providing this disclosure an entity cannot ignore quantitative unobservable inputs that are significant to the fair value measurement and are reasonably available to the entity.

(*e*) for recurring fair value measurements categorised within Level 3 of the fair value hierarchy, a reconciliation from the opening balances to the closing balances, disclosing separately changes during the period attributable to the following:

(i) total gains or losses for the period recognised in profit or loss, and the line item(s) in profit or loss in which those gains or losses are recognised.

(ii) total gains or losses for the period recognised in other comprehensive income, and the line item(s) in other comprehensive income in which those gains or losses are recognised.

(iii) purchases, sales, issues and settlements (each of those types of changes disclosed separately).

(iv) the amounts of any transfers into or out of Level 3 of the fair value hierarchy, the reasons for those transfers and the entity's policy for determining when transfers between levels are deemed to have occurred (see paragraph 95). Transfers into Level 3 shall be disclosed and discussed separately from transfers out of Level 3.

(*f*) for recurring fair value measurements categorised within Level 3 of the fairvalue hierarchy, the amount of the total gains or losses for the period in (e)(i) included in profit or loss that is attributable to the change in unrealised gains or losses relating to those assets and liabilities held at the end of the reporting period, and the line item(s) in profit or loss in which those unrealised gains or losses are recognised.

(g) for recurring and non-recurring fair value measurements categorized within Level 3 of the fair value hierarchy, a description of the valuation processes used by the entity (including, for example, how an entity decides its valuation policies and procedures and analyses changes in fair value measurements from period to period).

(h) for recurring fair value measurements categorised within Level 3 of the fair value hierarchy:

(i) for all such measurements, a narrative description of the sensitivityof the fair value measurement to changes in unobservable inputs if a change in those inputs to a different amount might result in a significantly higher or lower fair value measurement. If there are interrelationships between those inputs and other unobservable inputs used in the fair value measurement, an entity shall also provide a description of those relationships and of how they might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement. To comply with that disclosure requirement, the narrative description of the sensitivity to changes in unobservable inputs shall include, at a minimum, the unobservable inputs disclosed when complying with (d).

(ii) for financial assets and financial liabilities, if changing one or more of the unobservable inputs to reflect reasonably possible alternative assumptions would change fair value significantly, an entity shall state that fact and disclose the effect of those changes. The entity shall disclose how the effect of a change to reflect a reasonably possible alternative assumption was calculated. For that purpose,significance shall be judged with respect to profit or loss, and total assets or total liabilities, or, when changes in fair value are recognised in other comprehensive income, total equity.

(i) for recurring and non-recurring fair value measurements, if the highest and best use of a non-financial asset differs from its current use, an entity shall disclose that fact and why the non-financial asset is being used in a manner that differs from its highest and best use.

94 An entity shall determine appropriate classes of assets and liabilities on the basis of the following:

(*a*) the nature, characteristics and risks of the asset or liability; and

(*b*) the level of the fair value hierarchy within which the fair value measurement is categorised.

The number of classes may need to be greater for fair value measurements categorised within Level 3 of the fair value hierarchy because those measurements have a greater degree of uncertainty and subjectivity.Determining appropriate classes of assets and liabilities for which disclosures about fair value measurements should be provided requires judgement. A class of assets and liabilities will often require greater disaggregation than the line items presented in the statement of financial position. However, an entity shall provide information sufficient to permit reconciliation to the line items presented in the statement of financial position. If another SLFRS specifies the class for an asset or a liability, an entity may use that class in providing the disclosures required in this SLFRS if that class meets the requirements in this paragraph.

95 An entity shall disclose and consistently follow its policy for determining when transfers between levels of the fair value hierarchy are deemed to have occurred in accordance with paragraph 93(c) and (e)(iv). The policy about the

timing of recognising transfers shall be the same for transfers into the levels as for transfers out of the levels. Examples of policies for determining the timing of transfers include the following:

(*a*) the date of the event or change in circumstances that caused the transfer.

(*b*) the beginning of the reporting period.

(*c*) the end of the reporting period.

96 If an entity makes an accounting policy decision to use the exception in paragraph 48, it shall disclose that fact.

97 For each class of assets and liabilities not measured at fair value in the statementof financial position but for which the fair value is disclosed, an entity shall disclose the information required by paragraph 93(b), (d) and (i). However, an entity is not required to provide the quantitative disclosures about significant unobservable inputs used in fair value measurements categorised within Level 3of the fair value hierarchy required by paragraph 93(d). For such assets and liabilities, an entity does not need to provide the other disclosures required by this SLFRS.

98 For a liability measured at fair value and issued with an inseparable third-party credit enhancement, an issuer shall disclose the existence of that credit enhancement and whether it is reflected in the fair value measurement of the liability.

99 An entity shall present the quantitative disclosures required by this SLFRS in a tabular format unless another format is more appropriate.

Appendix A

Defined terms

This appendix is an integral part of the SLFRS.

active market	A market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.
cost approach	A valuation technique that reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).
entry price	The price paid to acquire an asset or received to assume a liability in an exchange transaction.
exit price	The price that would be received to sell an asset or paid to transfer a liability.
expected cash flow	The probability-weighted average (ie mean of the distribution) of possible future cash flows.
fair value	The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the Measurement date.
highest and best use	The use of a non-financial asset by market participants that would maximise the value of the asset or the group of assets and liabilities (eg a business) within which the asset would be used.
income approach	Valuation techniques that convert future amounts (eg cash flows or income and expenses) to a single current (ie discounted) amount. The fair value measurement is determined on the basis of the value indicated by current market expectations about those future amounts.
inputs	The assumptions that market participants would use when pricing the asset or liability, including assumptions about risk, such as the following: (*a*) the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model); and (*b*) the risk inherent in the inputs to the valuation technique. Inputs may be observable or unobservable.
Level 1 inputs	Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.
Level 2 inputs	Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
Level 3 inputs	Unobservable inputs for the asset or liability.
market approach	A valuation technique that uses prices and other relevant information generated by market transactions involving identical or comparable (ie similar) assets, liabilities or a group of assets and liabilities, such as a business.
market-corroborated inputs	Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

market participant	Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics: (*a*) They are independent of each other, ie they are not related parties as defined in LKAS 24, although the price in a related party transaction may be used as an input to a fair value measurement if the entity has evidence that the transaction was entered into at market terms. (*b*) They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary. (*c*) They are able to enter into a transaction for the asset or liability. (*d*) They are willing to enter into a transaction for the asset or liability, ie they are motivated but not forced or otherwise compelled to do so.
most advantageous market	The market that maximises the amount that would be received to sell the asset or minimises the amount that would be paid to transfer the liability, after taking into account transaction costs and transport costs.
non-performance risk	The risk that an entity will not fulfill an obligation. Non-performance risk includes, but may not be limited to, the entity's own credit risk.
observable inputs	Inputs that are developed using market data, such as publicly available information about actual events or transactions, and that reflect the assumptions that market participants would use when pricing the asset or liability.
orderly transaction	A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (eg a forced liquidation or distress sale).
principal market	The market with the greatest volume and level of activity for the asset or liability.
risk premium	Compensation sought by risk-averse market participants for bearing the uncertainty inherent in the cash flows of an asset or a liability. Also referred to as a 'risk adjustment'.
transaction costs	The costs to sell an asset or transfer a liability in the principal (or most advantageous) market for the asset or liability that are directly attributable to the disposal of the asset or the transfer of the liability and meet both of the following criteria: (*a*) They result directly from and are essential to that transaction. (*b*) They would not have been incurred by the entity had the decision to sell the asset or transfer the liability not been made(similar to costs to sell, as defined in SLFRS 5).
transport costs	The costs that would be incurred to transport an asset from its current location to its principal (or most advantageous) market.
unit of account	The level at which an asset or a liability is aggregated or disaggregated in an SLFRS for recognition purposes.
unobservable inputs	Inputs for which market data are not available and that are developed using the best information available about the assumptions that market participants would use when pricing the asset or liability.

Appendix B

Application guidance

This appendix is an integral part of the SLFRS. It describes the application of paragraphs 1–99 and has the same authority as the other parts of the SLFRS.

B1 The judgements applied in different valuation situations may be different. This appendix describes the judgements that might apply when an entity measures fair value in different valuation situations.

The fair value measurement approach

B2 The objective of a fair value measurement is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions. A fair value measurement requires an entity to determine all the following:

(*a*) the particular asset or liability that is the subject of the measurement (consistently with its unit of account).

(*b*) for a non-financial asset, the valuation premise that is appropriate for the measurement (consistently with its highest and best use).

(*c*) the principal (or most advantageous) market for the asset or liability.

(*d*) the valuation technique(s) appropriate for the measurement, considering the availability of data with which to develop inputs that represent the assumptions that market participants would use when pricing the asset or liability and the level of the fair value hierarchy within which the inputs are categorised.

Valuation premise for non-financial assets (paragraphs 31–33)

B3 When measuring the fair value of a non-financial asset used in combination with other assets as a group (as installed or otherwise configured for use) or in combination with other assets and liabilities (eg a business), the effect of the valuation premise depends on the circumstances. For example:

(*a*) the fair value of the asset might be the same whether the asset is used on astand-alone basis or in combination with other assets or with other assets and liabilities. That might be the case if the asset is a business that market participants would continue to operate. In that case, the transaction would involve valuing the business in its entirety. The use of the assets as a group in an on going business would generate synergies that would be available to market participants (ie market participant synergies that, therefore, should affect the fair value of the asset on either a stand-alone basis or in combination with other assets or with other assets and liabilities).

(*b*) an asset's use in combination with other assets or with other assets and liabilities might be incorporated into the fair value measurement through adjustments to the value of the asset used on a stand-alone basis. That might be the case if the asset is a machine and the fair value measurement is determined using an observed price for a similar machine (not installed or otherwise configured for use), adjusted for transport and installation costs so that the fair value measurement reflects the current condition and location of the machine (installed and configured for use).

(*c*) an asset's use in combination with other assets or with other assets and liabilities might be incorporated into the fair value measurement through the market participant assumptions used to measure the fair value of the asset. For example, if the asset is work in progress inventory that is unique and market participants would convert the inventory into finished goods,the fair value of the inventory would assume that market participants have acquired or would acquire any specialised machinery necessary to convert the inventory into finished goods.

(*d*) an asset's use in combination with other assets or with other assets and liabilities might be incorporated into the valuation technique used to measure the fair value of the asset. That might be the case when using the multi-period excess earnings method to measure the fair value of an intangible asset because that valuation technique specifically takes into account the contribution of any complementary assets and the associated liabilities in the group in which such an intangible asset would be used.

(*e*) in more limited situations, when an entity uses an asset within a group of assets, the entity might measure the asset at an amount that approximates its fair value when allocating the fair value of the asset group to the individual assets of the group. That might be the case if the valuation involves real property and the fair value of improved property (ie an asset group) is allocated to its component assets (such as land and improvements).

Fair value at initial recognition (paragraphs 57–60)

B4 When determining whether fair value at initial recognition equals the transaction price, an entity shall take into account factors specific to the transaction and to the asset or liability. For example, the transaction price might not represent the fair value of an asset or a liability at initial recognition if any of the following conditions exist:

(*a*) The transaction is between related parties, although the price in a related party transaction may be used as an input into a fair value measurement ifthe entity has evidence that the transaction was entered into at market terms.

(*b*) The transaction takes place under duress or the seller is forced to accept the price in the transaction. For example, that might be the case if the seller is experiencing financial difficulty.

(*c*) The unit of account represented by the transaction price is different from the unit of account for the asset or liability measured at fair value.For example, that might be the case if the asset or liability measured at fairvalue is only one of the elements in the transaction (eg in a business combination), the transaction includes unstated rights and privileges thatare measured separately in accordance with another SLFRS, or the transaction price includes transaction costs.

(*d*) The market in which the transaction takes place is different from the principal market (or most advantageous market). For example, those markets might be different if the entity is a dealer that enters into transactions with customers in the retail market, but the principal (or most advantageous) market for the exit transaction is with other dealers in the dealer market.

Valuation techniques (paragraphs 61–66)

Market approach

B5 The market approach uses prices and other relevant information generated by market transactions involving identical or comparable (ie similar) assets,liabilities or a group of assets and liabilities, such as a business.

B6 For example, valuation techniques consistent with the market approach often use market multiples derived from a set of comparables. Multiples might be in rangeswith a different multiple for each comparable. The selection of the appropriate multiple within the range requires judgement, considering qualitative and quantitative factors specific to the measurement.

B7 Valuation techniques consistent with the market approach include matrix pricing. Matrix pricing is a mathematical technique used principally to value some types of financial instruments, such as debt securities, without relying exclusively on quoted prices for the specific securities, but rather relying on the securities' relationship to other benchmark quoted securities.

Cost approach

B8 The cost approach reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).

B9 From the perspective of a market participant seller, the price that would be received for the asset is based on the cost to a market participant buyer to acquireor construct a substitute asset of comparable utility, adjusted for obsolescence.That is because a market participant buyer would not pay more for an asset than the amount for which it could replace the service capacity of that asset.Obsolescence encompasses physical deterioration, functional (technological)obsolescence and economic (external) obsolescence and is broader than depreciation for financial reporting purposes (an allocation of historical cost) ortax purposes (using specified service lives). In many cases the current replacementcost method is used to measure the fair value of tangible assets that are used in combination with other assets or with other assets and liabilities.

Income approach

B10 The income approach converts future amounts (*eg*. cash flows or income and expenses) to a single current (ie discounted) amount. When the income approach is used, the fair value measurement reflects current market expectations aboutthose future amounts.

B11 Those valuation techniques include, for example, the following:

(*a*) present value techniques (see paragraphs B12–B30);

(*b*) option pricing models, such as the Black-Scholes-Merton formula or abinomial model (ie a lattice model), that incorporate present value techniques and reflect both the time value and the intrinsic value of an option; and

(*c*) the multi-period excess earnings method, which is used to measure the fairvalue of some intangible assets.

Present value techniques

B12 Paragraphs B13–B30 describe the use of present value techniques to measure fairvalue. Those paragraphs focus on a discount rate adjustment technique and an*expected cash flow* (expected present value) technique. Those paragraphs neither prescribe the use of a single specific present value technique nor limit the use of present value techniques to measure fair value to the techniques discussed.The present value technique used to measure fair value will depend on facts and circumstances specific to the asset or liability being measured (eg whether prices for comparable assets or liabilities can be observed in the market) and the availability of sufficient data.

The components of a present value measurement

B13 Present value (ie an application of the income approach) is a tool used to link future amounts (eg cash flows or values) to a present amount using a discountrate. A fair value measurement of an asset or a liability using a present value technique captures all the following elements from the perspective of market participants at the measurement date:

(*a*) an estimate of future cash flows for the asset or liability being measured.

(*b*) expectations about possible variations in the amount and timing of the cash flows representing the uncertainty inherent in the cash flows.

(*c*) the time value of money, represented by the rate on risk-free monetaryassets that have maturity dates or durations that coincide with the period covered by the cash flows and pose neither uncertainty in timing nor risk of default to the holder (ie a risk-free interest rate).

(*d*) the price for bearing the uncertainty inherent in the cash flows (ie a risk premium).

(*e*) other factors that market participants would take into account in the circumstances.

(*f*) for a liability, the non-performance risk relating to that liability, including the entity's (ie the obligor's) own credit risk.

General principles

B14 Present value techniques differ in how they capture the elements in paragraph B13.However, all the following general principles govern the application of any present value technique used to measure fair value:

(*a*) Cash flows and discount rates should reflect assumptions that market participants would use when pricing the asset or liability.

(*b*) Cash flows and discount rates should take into account only the factors attributable to the asset or liability being measured.

(*c*) To avoid double-counting or omitting the effects of risk factors, discount rates should reflect assumptions that are consistent with those inherent in the cash flows. For example, a discount rate that reflects the uncertainty in expectations about future defaults is appropriate if using contractual cash flows of a loan (ie a discount rate adjustment technique). That samerate should not be used if using expected (ie probability-weighted) cash flows (ie an expected present value technique) because the expected cash flows already reflect assumptions about the uncertainty in future defaults;instead, a discount rate that is commensurate with the risk inherent in the expected cash flows should be used.

(*d*) Assumptions about cash flows and discount rates should be internally consistent. For example, nominal cash flows, which include the effect of inflation, should be discounted at a rate that includes the effect of inflation.The nominal risk-free interest rate includes the effect of inflation. Real cash flows, which exclude the effect of inflation, should be discounted at a rate that excludes the effect of inflation. Similarly, after-tax cash flows should be discounted using an after-tax discount rate. Pre-tax cash flows should be discounted at a rate consistent with those cash flows.

(*e*) Discount rates should be consistent with the underlying economic factors of the currency in which the cash flows are denominated.

Risk and uncertainty

B15 A fair value measurement using present value techniques is made under conditions of uncertainty because the cash flows used are estimates rather than known amounts. In many cases both the amount and timing of the cash flows areuncertain. Even contractually fixed amounts, such as the payments on a loan,are uncertain if there is risk of default.

B16 Market participants generally seek compensation (ie a risk premium) for bearing the uncertainty inherent in the cash flows of an asset or a liability. A fair value measurement should include a risk premium reflecting the amount that market participants would demand as compensation for the uncertainty inherent in the cash flows. Otherwise, the measurement would not faithfully represent fairvalue. In some cases determining the appropriate risk premium might edifficult. However, the degree of difficulty alone is not a sufficient reason to exclude a risk premium.

B17 Present value techniques differ in how they adjust for risk and in the type of cash flows they use. For example:

(*a*) The discount rate adjustment technique (see paragraphs B18–B22) uses arisk-adjusted discount rate and contractual, promised or most likely cash flows.

(*b*) Method 1 of the expected present value technique (see paragraph B25) uses risk-adjusted expected cash flows and a risk-free rate.

(*c*) Method 2 of the expected present value technique (see paragraph B26) uses expected cash flows that are not risk-adjusted and a discount rate adjustedto include the risk premium that market participants require. That rate isdifferent from the rate used in the discount rate adjustment technique.

Discount rate adjustment technique

B18 The discount rate adjustment technique uses a single set of cash flows from therange of possible estimated amounts, whether contractual or promised (as isthe case for a bond) or most likely cash flows. In all cases, those cash flows are conditional upon the occurrence of specified events (eg contractual or promised cash flows for a bond are conditional on the event of no default by the debtor).The discount rate used in the discount rate adjustment technique is derived from observed rates of return for comparable assets or liabilities that are traded in the market. Accordingly, the contractual, promised or most likely cash flows are discounted at an observed or estimated market rate for such conditional cash flows (ie a market rate of return).

B19 The discount rate adjustment technique requires an analysis of market data forcomparable assets or liabilities. Comparability is established by considering the nature of the cash flows (eg whether the cash flows are contractual or non-contractual and are likely to respond similarly to changes in economic conditions), as well as other factors (*eg*. credit standing, collateral, duration,restrictive covenants and liquidity). Alternatively, if a single comparable asset or liability does not fairly reflect the risk inherent in the cash flows of the assetor liability being measured, it may be possible to derive a discount rate using data for several comparable assets or liabilities in conjunction with the risk-free yieldcurve (ie using a 'build-up' approach).

B20 To illustrate a build-up approach, assume that Asset A is a contractual right toreceive Rs.800[1] in one year (ie there is no timing uncertainty). There is an established market for comparable assets, and information about those assets, including price information, is available. Of those comparable assets:

(*a*) Asset B is a contractual right to receive Rs.1,200 in one year and hasa market price of Rs.1,083. Thus, the implied annual rate of return (ie a one-year market rate of return) is 10.8 per cent [(Rs.1,200/Rs1,083) – 1].

(*b*) Asset C is a contractual right to receive Rs.700 in two years and hasa market price of Rs.566. Thus, the implied annual rate of return (ie a two-year market rate of return) is 11.2 per cent [(Rs.700/Rs.566)^0.5 – 1].

(*c*) All three assets are comparable with respect to risk (ie dispersion of possible pay-offs and credit).

B21 On the basis of the timing of the contractual payments to be received for Asset Arelative to the timing for Asset B and Asset C (ie one year for Asset B versus two years for Asset C), Asset B is deemed more comparable to Asset A. Using the contractual payment to be received for Asset A (Rs. 800) and the one-year market rate derived from Asset B (10.8 per cent), the fair value of Asset A is Rs.722(Rs.800/1.108). Alternatively, in the absence of available market information forAsset B, the one-year market rate could be derived from Asset C using thebuild-up approach. In that case the two-year market rate indicated by Asset C(11.2 per cent) would be adjusted to a one-year market rate using the termstructure of the risk-free yield curve. Additional information and analysis might be required to determine whether the risk premiums for one-year and two-year assets are the same. If it is determined that the risk premiums for one-year and two-year assets are not the same, the two-year market rate of return would be further adjusted for that effect.

B22 When the discount rate adjustment technique is applied to fixed receipts or payments, the adjustment for risk inherent in the cash flows of the asset or liability being measured is included in the discount rate. In some applications of the discount rate adjustment technique to cash flows that are not fixed receipts or payments, an adjustment to the cash flows may be necessary to achieve comparability with the observed asset or liability from which the discount rateis derived.

1. In this SLFRS monetary amounts are denominated in 'Rupees (Rs)'.

Expected present value technique

B23 The expected present value technique uses as a starting point a set of cash flows that represents the probability-weighted average of all possible future cash flows (ie the expected cash flows). The resulting estimate is identical to expectedvalue, which, in statistical terms, is the weighted average of a discrete randomvariable's possible values with the respective probabilities as the weights. Because all possible cash flows are probability-weighted, the resulting expected cash flowis not conditional upon the occurrence of any specified event (unlike the cash flows used in the discount rate adjustment technique).

B24 In making an investment decision, risk-averse market participants would takeinto account the risk that the actual cash flows may differ from the expected cashflows. Portfolio theory distinguishes between two types of risk:

(*a*) unsystematic (diversifiable) risk, which is the risk specific to a particular asset or liability.

(I) systematic (non-diversifiable) risk, which is the common risk shared by anasset or a liability with the other items in a diversified portfolio.

Portfolio theory holds that in a market in equilibrium, market participants will be compensated only for bearing the systematic risk inherent in the cash flows.(In markets that are inefficient or out of equilibrium, other forms of return or compensation might be available.)

B25 Method 1 of the expected present value technique adjusts the expected cash flows of an asset for systematic (ie market) risk by subtracting a cash risk premium(ie risk-adjusted expected cash flows). Those risk-adjusted expected cash flows represent a certainty-equivalent cash flow, which is discounted at a risk-freeinterest rate. A certainty-equivalent cash flow refers to an expected cash flow(as defined), adjusted for risk so that a market participant is different to tradinga certain cash flow for an expected cash flow. For example, if a market participant was willing to trade an expected cash flow of Rs.1,200 for a certain cash flow of Rs.1,000, the Rs.1,000 is the certainty equivalent of the Rs.1,200 (ie the Rs.200 would represent the cash risk premium). In that case the market participant would be indifferent as to the asset held.

B26 In contrast, Method 2 of the expected present value technique adjusts for systematic (ie market) risk by applying a risk premium to the risk-free interestrate. Accordingly, the expected cash flows are discounted at a rate that corresponds to an expected rate associated with probability-weighted cash flows(ie an expected rate of return). Models used for pricing risky assets, such as the capital asset pricing model, can be used to estimate the expected rate of return.Because the discount rate used in the discount rate adjustment technique is a rateof return relating to conditional cash flows, it is likely to be higher than the discount rate used in Method 2 of the expected present value technique, which is an expected rate of return relating to expected or probability-weighted cash flows.

B27 To illustrate Methods 1 and 2, assume that an asset has expected cash flows of Rs.780 in one year determined on the basis of the possible cash flows and probabilities shown below. The applicable risk-free interest rate for cash flowswith a one-year horizon is 5 per cent, and the systematic risk premium for an asset with the same risk profile is 3 per cent.

Possible cash flows	Probability	Probability-weighted Cash flows
Rs.500	15%	Rs. 75
Rs.800	60%	Rs. 480
Rs.900	25%	Rs. 225
Expected cash flows		Rs. 780

B28 In this simple illustration, the expected cash flows (Rs.780) represent the probability-weighted average of the three possible outcomes. In more realistic situations, there could be many possible outcomes. However, to apply the expected present value technique, it is not always necessary to take into account distributions of all possible cash flows using complex models and techniques.Rather, it might be possible to develop a limited number of discrete scenarios and probabilities that capture the array of possible cash flows. For example, an entity might use realised cash flows for some relevant past period, adjusted for changesin circumstances occurring subsequently (eg changes in external factors,including economic or market conditions, industry trends and competition as well as changes in internal factors affecting the entity more specifically), taking into account the assumptions of market participants.

B29 In theory, the present value (ie the fair value) of the asset's cash flows is the same whether determined using Method 1 or Method 2, as follows:

(*a*) Using Method 1, the expected cash flows are adjusted for systematic(ie market) risk. In the absence of market data directly indicating theamount of the risk adjustment, such adjustment could be derived from anasset pricing model using the concept of certainty equivalents.For example, the risk adjustment (ie the cash risk premium of Rs.22)could be determined using the systematic risk premium of 3 per cent(Rs.780 – [Rs.780 × (1.05/ 1.08)]), which results in risk-adjusted expected cash flows of Rs.758 (Rs.780 – Rs.22). The Rs.758 is the certainty equivalent of Rs.780 and is discounted at the risk-free interest rate (5 per cent).The present value (ie the fair value) of the asset is 722 (Rs.758/1.05).

(*b*) Using Method 2, the expected cash flows are not adjusted for systematic (ie market) risk. Rather, the adjustment for that risk is included in the discount rate. Thus, the expected cash flows are discounted at an expected rate of return of 8 per cent (ie the 5 per cent risk-free interest rate plus the 3 per cent systematic risk premium). The present value (ie the fair value) of the asset is Rs. 722 (Rs. 780/1.08).

B30 When using an expected present value technique to measure fair value, either Method 1 or Method 2 could be used. The selection of Method 1 or Method 2 will depend on facts and circumstances specific to the asset or liability being measured, the extent to which sufficient data are available and the judgments applied.

Applying present value techniques to liabilities and an entity's own equity instruments not held by other parties as assets (paragraphs 40 and 41)

B31 When using a present value technique to measure the fair value of a liability that is not held by another party as an asset (eg a decommissioning liability), an entity shall, among other things, estimate the future cash outflows that market participants would expect to incur in fulfilling the obligation. Those future cash outflows shall include market participants' expectations about the costs of fulfilling the obligation and the compensation that a market participant would require for taking on the obligation. Such compensation includes the return that a market participant would require for the following:

(*a*) undertaking the activity (ie the value of fulfilling the obligation; eg by using resources that could be used for other activities); and

(*b*) assuming the risk associated with the obligation (ie a *risk premium* that reflects the risk that the actual cash outflows might differ from the expected cash outflows; see paragraph B33).

B32 For example, a non-financial liability does not contain a contractual rate of return and there is no observable market yield for that liability. In some cases the components of the return that market participants would require will be indistinguishable from one another (eg when using the price a third party contractor would charge on a fixed fee basis). In other cases an entity needs to estimate those components separately (eg when using the price a third party contractor would charge on a cost plus basis because the contractor in that case would not bear the risk of future changes in costs).

B33 An entity can include a risk premium in the fair value measurement of a liability or an entity's own equity instrument that is not held by another party as an asset in one of the following ways:

(*a*) by adjusting the cash flows (ie as an increase in the amount of cash outflows); or

(*b*) by adjusting the rate used to discount the future cash flows to their present values (ie as a reduction in the discount rate).

An entity shall ensure that it does not double-count or omit adjustments for risk. For example, if the estimated cash flows are increased to take into account the compensation for assuming the risk associated with the obligation, the discount rate should not be adjusted to reflect that risk.

Inputs to valuation techniques (paragraphs 67–71)

B34 Examples of markets in which inputs might be observable for some assets and liabilities (eg financial instruments) include the following:

(*a*) *Exchange markets.* In an exchange market, closing prices are both readily available and generally representative of fair value. An example of such a market is the London Stock Exchange.

(*b*) *Dealer markets.* In a dealer market, dealers stand ready to trade (either buy or sell for their own account), thereby providing liquidity by using their capital to hold an inventory of the items for which they make a market. Typically bid and ask prices (representing the price at which the dealer is willing to buy and the price at which the dealer is willing to sell, respectively) are more readily available than closing prices. Over-the-counter markets (for which prices are publicly reported) are dealer markets. Dealer markets also exist for some other assets and liabilities, including some financial instruments, commodities and physical assets (eg used equipment).

(*c*) *Brokered markets.* In a brokered market, brokers attempt to match buyers with sellers but do not stand ready to trade for their own account. In other words, brokers do not use their own capital to hold an inventory of the items for which they make a market. The broker knows the prices bid and asked by the respective parties, but each party is typically unaware of another party's price requirements. Prices of completed transactions are sometimes available. Brokered markets include electronic communication networks, in which buy and sell orders are matched, and commercial and residential real estate markets.

(*d*) *Principal-to-principal markets.* In a principal-to-principal market, transactions, both originations and resales, are negotiated independently with no intermediary. Little information about those transactions may be made available publicly.

Fair value hierarchy (paragraphs 72–90)

Level 2 inputs (paragraphs 81–85)

B35 Examples of Level 2 inputs for particular assets and liabilities include the following:

(*a*) *Receive-fixed, pay-variable interest rate swap based on the London Interbank Offered Rate (LIBOR) swap rate.* A Level 2 input would be the LIBOR swap rate if that rate is observable at commonly quoted intervals for substantially the full term of the swap.

(*b*) *Receive-fixed, pay-variable interest rate swap based on a yield curve denominated in a foreign currency.* A Level 2 input would be the swap rate based on a yield curve denominated in a foreign currency that is observable at commonly quoted intervals for substantially the full term of the swap. That would be the case if the term of the swap is 10 years and that rate is observable at commonly quoted intervals for 9 years, provided that any reasonable extrapolation of the yield curve for year 10 would not be significant to the fair value measurement of the swap in its entirety.

(*c*) *Receive-fixed, pay-variable interest rate swap based on a specific bank's prime rate.* A Level 2 input would be the bank's prime rate derived through extrapolation if the extrapolated values are corroborated by observable market data, for example, by correlation with an interest rate that is observable over substantially the full term of the swap.

(*d*) *Three-year option on exchange-traded shares.* A Level 2 input would be the implied volatility for the shares derived through extrapolation to year 3 if both of the following conditions exist:

(i) Prices for one-year and two-year options on the shares are observable.

(ii) The extrapolated implied volatility of a three-year option is corroborated by observable market data for substantially the full term of the option.

In that case the implied volatility could be derived by extrapolating from the implied volatility of the one-year and two-year options on the shares and corroborated by the implied volatility for three-year options on comparable entities' shares, provided that correlation with the one-year and two-year implied volatilities is established.

(*e*) *Licensing arrangement.* For a licensing arrangement that is acquired in a business combination and was recently negotiated with an unrelated party by the acquired entity (the party to the licensing arrangement), a Level 2 input would be the royalty rate in the contract with the unrelated party at inception of the arrangement.

(*f*) *Finished goods inventory at a retail outlet.* For finished goods inventory that is acquired in a business combination, a Level 2 input would be either a price to customers in a retail market or a price to retailers in a wholesale market, adjusted for differences between the condition and location of the inventory item and the comparable (ie similar) inventory items so that the fair value measurement reflects the price that would be received in a transaction to sell the inventory to another retailer that would complete the requisite selling efforts. Conceptually, the fair value measurement will be the same, whether adjustments are made to a retail price (downward) or to a wholesale price (upward). Generally, the price that requires the least amount of subjective adjustments should be used for the fair value measurement.

(*g*) *Building held and used.* A Level 2 input would be the price per square metre for the building (a valuation multiple) derived from observable market data, eg multiples derived from prices in observed transactions involving comparable (ie similar) buildings in similar locations.

(*h*) *Cash-generating unit.* A Level 2 input would be a valuation multiple (eg a multiple of earnings or revenue or a similar performance measure) derived from observable market data, eg multiples derived from prices in observed transactions involving comparable (ie similar) businesses, taking into account operational, market, financial and non-financial factors.

Level 3 inputs (paragraphs 86–90)

B36 Examples of Level 3 inputs for particular assets and liabilities include the following:

(*a*) *Long-dated currency swap.* A Level 3 input would be an interest rate in a specified currency that is not observable and cannot be corroborated by observable market data at commonly quoted intervals or otherwise for substantially the full term of the currency swap. The interest rates in a currency swap are the swap rates calculated from the respective countries' yield curves.

(*b*) *Three-year option on exchange-traded shares.* A Level 3 input would be historical volatility, ie the volatility for the shares derived from the shares' historical prices. Historical volatility typically does not represent current market participants' expectations about future volatility, even if it is the only information available to price an option.

(*c*) *Interest rate swap.* A Level 3 input would be an adjustment to a mid-market consensus (non-binding) price for the swap developed using data that are not directly observable and cannot otherwise be corroborated by observable market data.

(*d*) *Decommissioning liability assumed in a business combination.* A Level 3 input would be a current estimate using the entity's own data about the future cash outflows to be paid to fulfill the obligation (including market participants' expectations about the costs of fulfilling the obligation and the compensation that a market participant would require for taking on the obligation to dismantle the asset) if there is no reasonably available information that indicates that market participants would use different assumptions. That Level 3 input would be used in a present value technique together with other inputs, eg a current risk-free interest rate or a credit-adjusted risk-free rate if the effect of the entity's credit standing on the fair value of the liability is reflected in the discount rate rather than in the estimate of future cash outflows.

(*e*) *Cash-generating unit.* A Level 3 input would be a financial forecast (eg of cash flows or profit or loss) developed using the entity's own data if there is no reasonably available information that indicates that market participants would use different assumptions.

Measuring fair value when the volume or level of activity for an asset or a liability has significantly decreased

B37 The fair value of an asset or a liability might be affected when there has been a significant decrease in the volume or level of activity for that asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities). To determine whether, on the basis of the evidence available, there has been a significant decrease in the volume or level of activity for the asset or liability, an entity shall evaluate the significance and relevance of factors such asthe following:

(*a*) There are few recent transactions.

(*b*) Price quotations are not developed using current information.

(*c*) Price quotations vary substantially either over time or among market-makers (eg some brokered markets).

(*d*) Indices that previously were highly correlated with the fair values of the asset or liability are demonstrably uncorrelated with recent indications of fair value for that asset or liability.

(*e*) There is a significant increase in implied liquidity risk premiums, yields or performance indicators (such as delinquency rates or loss severities) for observed transactions or quoted prices when compared with the entity's estimate of expected cash flows, taking into account all available market data about credit and other non-performance risk for the asset or liability.

(*f*) There is a wide bid-ask spread or significant increase in the bid-ask spread.

(*g*) There is a significant decline in the activity of, or there is an absence of, a market for new issues (ie a primary market) for the asset or liability or similar assets or liabilities.

(*h*) Little information is publicly available (eg for transactions that take place in a principal-to-principal market).

B38 If an entity concludes that there has been a significant decrease in the volume or level of activity for the asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities), further analysis of the transactions or quoted prices is needed. A decrease in the volume or level of activity on its own may not indicate that a transaction price or quoted price does not represent fair value or that a transaction in that market is not orderly. However, if an entity determines that a transaction or quoted price does not represent fair value (eg there may be transactions that are not orderly), an adjustment to the transactions or quoted prices will be necessary if the entity uses those prices as a basis for measuring fair value and that adjustment may be significant to the fair value measurement in its entirety. Adjustments also may be necessary in other circumstances (eg when a price for a similar asset requires significant adjustment to make it comparable to the asset being measured or when the price is stale).

B39 This SLFRS does not prescribe a methodology for making significant adjustments to transactions or quoted prices. See paragraphs 61–66 and B5–B11 for a discussion of the use of valuation techniques when measuring fair value. Regardless of the valuation technique used, an entity shall include appropriate risk adjustments, including a risk premium reflecting the amount that market participants would demand as compensation for the uncertainty inherent in the cash flows of an asset or a liability (see paragraph B17). Otherwise, the measurement does not faithfully represent fair value. In some cases determining the appropriate risk adjustment might be difficult. However, the degree of difficulty alone is not a sufficient basis on which to exclude a risk adjustment. The risk adjustment shall be reflective of an orderly transaction between market participants at the measurement date under current market conditions.

B40 If there has been a significant decrease in the volume or level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate (eg the use of a market approach and a present value technique). When weighting indications of fair value resulting from the use of multiple valuation techniques, an entity shall consider the reasonableness of the range of fair value measurements. The objective is to determine the point within the range that is most representative of fair value under current market conditions. A wide range of fair value measurements may be an indication that further analysis is needed.

B41 Even when there has been a significant decrease in the volume or level of activity for the asset or liability, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (ie not a forced liquidation or distress sale) between market participants at the measurement date under current market conditions.

B42 Estimating the price at which market participants would be willing to enter into a transaction at the measurement date under current market conditions if there has been a significant decrease in the volume or level of activity for the asset or liability depends on the facts and circumstances at the measurement date and requires judgement. An entity's intention to hold the asset or to settle or otherwise fulfill the liability is not relevant when measuring fair value because fair value is a market-based measurement, not an entity-specific measurement.

Identifying transactions that are not orderly

B43 The determination of whether a transaction is orderly (or is not orderly) is more difficult if there has been a significant decrease in the volume or level of activity for the asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities). In such circumstances it is not appropriate to conclude that all transactions in that market are not orderly (ie forced liquidations or distress sales). Circumstances that may indicate that a transaction is not orderly include the following:

(*a*) There was not adequate exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities under current market conditions.

(*b*) There was a usual and customary marketing period, but the seller marketed the asset or liability to a single market participant.

(*c*) The seller is in or near bankruptcy or receivership (ie the seller is distressed).

(*d*) The seller was required to sell to meet regulatory or legal requirements (ie the seller was forced).

(*e*) The transaction price is an outlier when compared with other recent transactions for the same or a similar asset or liability. An entity shall evaluate the circumstances to determine whether, on the weight of the evidence available, the transaction is orderly.

B44 An entity shall consider all the following when measuring fair value or estimating market risk premiums:

(*a*) If the evidence indicates that a transaction is not orderly, an entity shall place little, if any, weight (compared with other indications of fair value) on that transaction price.

(*b*) If the evidence indicates that a transaction is orderly, an entity shall take into account that transaction price. The amount of weight placed on that transaction price when compared with other indications of fair value will depend on the facts and circumstances, such as the following:

(i) the volume of the transaction.

(ii) the comparability of the transaction to the asset or liability being measured.

(iii) the proximity of the transaction to the measurement date.

(*c*) If an entity does not have sufficient information to conclude whether a transaction is orderly, it shall take into account the transaction price. However, that transaction price may not represent fair value (ie the transaction price is not necessarily the sole or primary basis for measuring fair value or estimating market risk premiums). When an entity does not have sufficient information to conclude whether particular transactions are orderly, the entity shall place less weight on those transactions when compared with other transactions that are known to be orderly.

An entity need not undertake exhaustive efforts to determine whether a transaction is orderly, but it shall not ignore information that is reasonably available. When an entity is a party to a transaction, it is presumed to have sufficient information to conclude whether the transaction is orderly.

Using Quoted Prices Provided by Third Parties

B45 This SLFRS does not preclude the use of quoted prices provided by third parties, such as pricing services or brokers, if an entity has determined that the quoted prices provided by those parties are developed in accordance with this SLFRS.

B46 If there has been a significant decrease in the volume or level of activity for the asset or liability, an entity shall evaluate whether the quoted prices provided by third parties are developed using current information that reflects orderly transactions or a valuation technique that reflects market participant assumptions (including assumptions about risk). In weighting a quoted price as an input to a fair value measurement, an entity places less weight (when compared with other indications of fair value that reflect the results of transactions) on quotes that do not reflect the result of transactions.

B47 Furthermore, the nature of a quote (eg whether the quote is an indicative price or a binding offer) shall be taken into account when weighting the available evidence, with more weight given to quotes provided by third parties that represent binding offers.

Appendix C

Effective date and transition

This appendix is an integral part of the SLFRS and has the same authority as the other parts of the SLFRS.

C1 An entity shall apply this SLFRS for annual periods beginning on or after 01 January 2014. Earlier application is permitted. If an entity applies this SLFRS for an earlier period, it shall disclose that fact.

C2 This SLFRS shall be applied prospectively as of the beginning of the annual period in which it is initially applied.

C3 The disclosure requirements of this SLFRS need not be applied in comparative information provided for periods before initial application of this SLFRS.

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