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Volume II

Sri Lanka Public Sector Accounting Standards

Sri Lanka Public Sector Accounting Standards Volume - II

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Sri Lanka Public Sector Accounting Standards

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MESSAGE FROM THE SECRETARY TO THE TREASURY

The Public Sector Accounting Standards Committee of the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) with the participation of Auditor General and Ministry of Finance and Planning has formulated this second volume of the Sri Lanka Public Sector Accounting Standards (SLPSAS) which is based on the international Public Sector Accounting Standards (IPSAS). The first volume contained four standards and this volume contains a further six standards making a total of ten standards.

Accounting standards provide a framework for the preparation and presentation of Financial Statements under the accrual accounting system in compliance with international best practices for quality accounting and reporting, in order to facilitate to improve financial analysis & planning and management in the public Sector.

The Government of Sri Lanka is currently taking possible steps to move towards to accrual accounting system in the Ministries and Departments to enhance transparency and accountability in the public Sector.

The First volume of the Sri Lanka Public Sector Accounting Standards has already been made applicable to Non- commercial Public Corporations and Local Authorities which are on accrual system and the second volume of the six standards too would be made applicable in the same manner. Government Departments, Ministries and Provincial Councils could apply these standards once they move to the accrual based accounting system.

I take this opportunity to express my sincere appreciation for the dedicated efforts made by the Chairman and Members of the Public Sector Accounting Standards Committee of CA Sri Lanka including Auditor General in publishing these standards.



P.B. Jayasundera
Secretary to the Treasury

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MESSAGE FROM THE PRESIDENT OF CA SRI LANKA

CA Sri Lanka, in its capacity as the national accounting body, has spearheaded many initiatives to cater to the professional needs of members of the public sector financial management sector. The issuance of Sri Lanka Public Sector Accounting Standards (SLPSAS) is the outcome of one such initiative.

These accounting standards have been formulated, by the Public Sector Accounting Standards Committee of CA Sri Lanka in line with the International Public Sector Accounting Standards (IPSAS) issued by the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) and are published jointly by CA Sri Lanka and the Ministry of Finance & Planning.

The first volume of the Sri Lanka Public Sector Accounting Standards containing four SLPSAS was issued in 2009 and the first copy was handed to His Excellency the President at the 50th Anniversary of CA Sri Lanka held on the 23rd of November 2009.

This second volume of the SLPSAS, containing another six public sector accounting standards, totaling it to ten standards, is once again issued jointly by CA Sri Lanka and the Ministry of Finance & Planning based on IPSAS. These standards are meant to improve the quality of financial accounting and reporting enhancing transparency and accountability in the use of public funds.

Since these accounting standards are based on international best practices on financial accounting and reporting, proper implementation of these standards will facilitate effective public service delivery at the lowest possible cost through effective budgeting and resource allocations thereby meeting the aspirations of the general public.

I am sure that this publication would be of immense use to the preparers, auditors and the users of the public sector financial statements.

On behalf of the Council of CA Sri Lanka, I would like to take this opportunity to appreciate the dedicated work performed by the Chairman and Members of the Public Sector Accounting Standards Committee including the representatives of the Ministry of Finance and Planning.



Sujeewa Rajapakse
President
CA Sri Lanka

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FOREWORD

It is with great pleasure we are releasing the second volume of Sri Lanka Public Sector Accounting Standards (SLPSAS) containing six standards jointly with the Ministry of Finance & Planning. The first volume containing four standards were published in 2009 and we now have ten Standards based on the International Public Sector Accounting Standards.


These standards were formulated by the Public Sector Accounting Standards Committee consisting of members of CA Sri Lanka and senior officers nominated by the Ministry of Finance & Planning. We selected these standards on the need basis and followed the due process similar to those adopted in the first volume of standards giving opportunities for the interested parties to give their inputs.

Since these are accrual based standards, we believe that these standards will facilitate the efforts of the Government in making the Ministries and Departments to move towards Accrual System of Accounting and Reporting. Having identified the complexities of these standards, the Association of Public Finance Accountants of Sri Lanka, the Public Sector Wing of CA Sri Lanka is in the process of conducting awareness programmes on these standards with the assistance of the Chartered Institute of Public Finance & Accountancy (CIFPA) London to facilitate the preparation and presentation of financial statements in compliance with the standards.

We are confident that these standards which are based on the International Best Practices will enhance the accounting reporting practices in the Public Sector providing quality information for decision making enhancing transparency and public accountability.

The Committee will continue with its efforts in this process to formulate other standards which are applicable to the Sri Lankan Public Sector.

I would like to make use of this opportunity to express my sincere gratitude to the Secretary and Members of the Public Sector Accounting Standards Committee and the Consultant who provided valuable contribution in formulating these standards. I would also like to place on record the assistance provided by the President and Members of the Council of CA Sri Lanka in fulfilling this task.



V. Kanagasabapathy
President, Association of Public Finance Accountants of Sri Lanka and
Chairman, Public Sector Accounting Standards Committee.

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SLPSAS 5 – THE EFFECTS OF CHANGES IN FOREIGN

EXCHANGE RATES

Acknowledgement

The Sri Lanka Public Sector Accounting Standard SLPSAS 5 “ The Effects of Changes in Foreign Exchange Rates” is based on International Public Sector Accounting Standard (IPSAS) 4 “The Effects of Changes in Foreign Exchange Rates” of the International Public Sector Accounting Standards Board (IPASB), Published by the International Federation of Accountants (IFAC) in April 2008 (2009 Bound Volume) and is issued with permission of IFAC.

January 2013

SLPSAS 5 - THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

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Sri Lanka Public Sector Accounting Standard (SLPSAS) 5, “The Effects of Changes in Foreign Exchange Rates” is set out in paragraphs 1-70. All the paragraphs have equal authority. SLPSAS 5 should be read in the context of its objective, and the “Preface to Sri Lanka Public Sector Accounting Standards”. SLPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

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Objective

1. An entity may carry on foreign activities in two ways. It may have transactions in foreign currencies or it may have foreign operations. In addition, an entity may present its financial statements in a foreign currency. The objective of this Standard is to prescribe how to include foreign currency transactions and foreign operations in the financial statements of an entity and how to translate financial statements into a presentation currency.
2. The principal issues are which exchange rate(s) to use and how to report the effects of changes in exchange rates in the financial statements.

Scope

3. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard:**
 - (a) **In accounting for transactions and balances in foreign currencies, except for those derivative transactions and balances that are within the scope of the relevant international or national accounting standards dealing with the recognition and measurement of financial instruments;**
 - (b) **In translating the financial performance and financial position of foreign operations that are included in the financial statements of the entity by consolidation, proportionate consolidation or by the equity method; and**
 - (c) **In translating an entity's financial performance and financial position into a presentation currency.**
4. International or national accounting standards dealing with the recognition and measurement of financial instruments apply to many foreign currency derivatives and, accordingly, these are excluded from the scope of this Standard. However, those foreign currency derivatives that are not within the scope of these international or national accounting standards (e.g., some foreign currency derivatives that are embedded in other contracts) are within the scope of this Standard. In addition, this Standard applies when an entity

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translates amounts relating to derivatives from its functional currency to its presentation currency.

5. This Standard does not apply to hedge accounting for foreign currency items, including the hedging of a net investment in a foreign operation. Accordingly, entities may apply the relevant international or national accounting standards dealing with hedge accounting.
6. **This Standard applies to all public sector entities other than Government Business Enterprises.**
7. The “Preface to Sri Lanka Public Sector Accounting Standards” issued by the ICASL explains that Government Business Enterprises (GBEs) apply SLFRS/LKAS which are issued by the Institute of Chartered Accountants of Sri Lanka (ICASL). GBEs are defined in SLPSAS 1, “Presentation of Financial Statements.”
8. This Standard applies to the presentation of an entity’s financial statements in a foreign currency and sets out requirements for the resulting financial statements to be described as complying with SLPSASs. For translations of financial information into a foreign currency that do not meet these requirements, this Standard specifies information to be disclosed.
9. This Standard does not apply to the presentation in a cash flow statement of cash flows arising from transactions in a foreign currency, or to the translation of cash flows of a foreign operation (see SLPSAS 2, “Cash Flow Statements”).

Definitions

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

Closing rate is the spot exchange rate at the reporting date.

Economic entity means a group of entities comprising a controlling entity and one or more controlled entities

Exchange difference is the difference resulting from translating a given number of units of one currency into another currency at different exchange rates.

Exchange rate is the ratio for exchange of two currencies.

Foreign currency is a currency other than the functional currency of the entity.

Foreign operation is an entity that is a controlled entity, associate, joint venture or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity.

Functional currency is the currency of the primary economic environment in which the entity operates.

Monetary items are units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency.

Net investment in a foreign operation is the amount of the reporting entity's interest in the net assets/equity of that operation.

Presentation currency is the currency in which the financial statements are presented.

Spot exchange rate is the exchange rate for immediate delivery.

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

Functional Currency

11. The primary economic environment in which an entity operates is normally the one in which it primarily generates and expends cash. An entity considers the following factors in determining its functional currency:
- (a) The currency:
 - (i) That revenue is raised from, such as taxes, grants, and fines;
 - (ii) That mainly influences sales prices for goods and services (this will often be the currency in which sales prices for its goods and services are denominated and settled); and
 - (iii) Of the country whose competitive forces and regulations mainly determine the sale prices of its goods and services.
 - (b) The currency that mainly influences labor, material and other costs of providing goods and services (this will often be the currency in which such costs are denominated and settled).
12. The following factors may also provide evidence of an entity's functional currency:
- (a) The currency in which funds from financing activities (i.e., issuing debt and equity instruments) are generated.

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- (b) The currency in which receipts from operating activities are usually retained.

13. The following additional factors are considered in determining the functional currency of a foreign operation, and whether its functional currency is the same as that of the reporting entity (the reporting entity, in this context, being the entity that has the foreign operation as its controlled entity, branch, associate or joint venture):

- (a) Whether the activities of the foreign operation are carried out as an extension of the reporting entity, rather than being carried out with a significant degree of autonomy.

An example would be an overseas campus of a public university which operates under the management and direction of the domestic campus.

In contrast, a foreign operation with a significant degree of autonomy may accumulate cash and other monetary items, incur expenses, generate revenue and perhaps arrange borrowings, all substantially in its local currency. Some examples of government-owned foreign operations which may operate independently of other government agencies include tourist offices and trade boards. Such entities may be established as GBEs.

- (b) Whether transactions with the reporting entity are a high or a low proportion of the foreign operation's activities.
- (c) Whether cash flows from the activities of the foreign operation directly affect the cash flows of the reporting entity and are readily available for remittance to it.
- (d) Whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligations without funds being made available by the reporting entity.

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14. When the above indicators are mixed and the functional currency is not obvious, management uses its judgment to determine the functional currency that most faithfully represents the economic effects of the underlying transactions, events and conditions. As part of this approach, management gives priority to the primary indicators in paragraph 11 before considering the indicators in paragraphs 12 and 13, which are designed to provide additional supporting evidence to determine an entity's functional currency.
15. An entity's functional currency reflects the underlying transactions, events and conditions that are relevant to it. Accordingly, once determined, the functional currency is not changed unless there is a change in those underlying transactions, events and conditions.

Monetary Items

16. The essential feature of a monetary item is a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Examples include: social policy obligations and other employee benefits to be paid in cash; provisions that are to be settled in cash; and cash dividends or similar distributions that are recognized as a liability. Conversely, the essential feature of a nonmonetary item is the absence of a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Examples include: amounts prepaid for goods and services (e.g., prepaid rent); goodwill; intangible assets; inventories; property, plant and equipment; and provisions that are to be settled by the delivery of a nonmonetary asset.

Net Investment in a Foreign Operation

17. An entity may have a monetary item that is receivable from or payable to a foreign operation. An item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, a part of the

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entity's net investment in that foreign operation, and is accounted for in accordance with paragraphs 36 and 37. Such monetary items may include long-term receivables or loans. They do not include trade receivables or trade payables.

- 18 The entity that has a monetary item receivable from or payable to a foreign operation described in paragraph 17 may be any controlled entity of the economic entity. For example, an entity has two controlled entities, A and B. Controlled entity B is a foreign operation. Controlled entity A grants a loan to controlled entity B. Controlled entity A's loan receivable from controlled entity B would be part of the controlled entity A's net investment in controlled entity B if settlement of the loan is neither planned nor likely to occur in the foreseeable future. This would also be true if controlled entity A were itself a foreign operation.

Summary of the Approach Required by this Standard

19. In preparing financial statements, each entity – whether a standalone entity, an entity with foreign operations (such as a controlling entity) or a foreign operation (such as a controlled entity or branch) – determines its functional currency in accordance with paragraphs 11–15. The entity translates foreign currency items into its functional currency and reports the effects of such translation in accordance with paragraphs 22 – 43 and 56.
20. Many reporting entities comprise a number of individual entities (e.g., an economic entity is made up of a controlling entity and one or more controlled entities). Various types of entities, whether members of an economic entity or otherwise, may have investments in associates or joint ventures. They may also have branches. It is necessary for the financial performance and financial position of each individual entity included in the reporting entity to be translated into the currency in which the reporting entity presents its financial statements. This Standard permits the presentation currency of a reporting entity to be any currency (or currencies). The financial performance and financial position of any

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individual entity within the reporting entity whose functional currency differs from the presentation currency are translated in accordance with paragraphs 42 –56.

21. This Standard also permits a standalone entity preparing financial statements or an entity preparing separate financial statements in accordance with IPSAS 6, “Consolidated and Separate Financial Statements” or when adopted the equivalent SLPSAS to present its financial statements in any currency (or currencies). If the entity’s presentation currency differs from its functional currency, its financial performance and financial position are also translated into the presentation currency in accordance with paragraphs 42–56

Reporting Foreign Currency Transactions in the Functional Currency

Initial Recognition

22. A foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency, including transactions arising when an entity:
- (a) Buys or sells goods or services whose price is denominated in a foreign currency;
 - (b) Borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or
 - (c) Otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.
23. **A foreign currency transaction shall be recorded, on initial recognition in the functional currency, by applying to the foreign currency amount**

the spot exchange rate between the functional currency and the foreign currency at the date of the transaction.

24. The date of a transaction is the date on which the transaction first qualifies for recognition in accordance with SLPSASs . For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.
25. Exchange rate changes may have an impact on cash or cash equivalents held or due in a foreign currency. The presentation of such exchange differences is dealt with in SLPSAS 2 “Cash Flow Statements”. Although these changes are not cash flows, the effect of exchange rate changes on cash or cash equivalents held or due in a foreign currency are reported in the cash flow statement in order to reconcile cash and cash equivalents at the beginning and the end of the period. These amounts are presented separately from cash flows from operating, investing and financing activities and include the differences, if any, had those cash flows been reported at end-of-period exchange rates.

Reporting at Subsequent Reporting Dates

26. **At each reporting date:**
- (a) **Foreign currency monetary items shall be translated using the closing rate;**
 - (b) **Nonmonetary items that are measured in terms of historical cost in a foreign currency shall be translated using the exchange rate at the date of the transaction; and**
 - (c) **Nonmonetary items that are measured at fair value in a foreign currency shall be translated using the exchange rates at the date when the fair value was determined.**

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27. The carrying amount of an item is determined in conjunction with other relevant SLPSASs. For example, property, plant and equipment may be measured in terms of fair value or historical cost in accordance with SLPSAS 7, “Property, Plant and Equipment”. Whether the carrying amount is determined on the basis of historical cost or on the basis of fair value, if the amount is determined in a foreign currency it is then translated into the functional currency in accordance with this Standard.
28. The carrying amount of some items is determined by comparing two or more amounts. For example, the carrying amount of inventories held for sale is the lower of cost and net realizable value in accordance with SLPSAS 9 “Inventories.” Similarly, in accordance with IPSAS 21, “Impairment of Non-Cash-Generating Assets,” or when adopted the equivalent SLPSAS the carrying amount of a non-cash generating asset for which there is an indication of impairment is the lower of its carrying amount before considering possible impairment losses and its recoverable service amount. When such an asset is nonmonetary and is measured in a foreign currency, the carrying amount is determined by comparing:
- (a) The cost or carrying amount, as appropriate, translated at the exchange rate at the date when that amount was determined (i.e., the rate at the date of the transaction for an item measured in terms of historical cost); and
 - (b) The net realizable value or recoverable service amount, as appropriate, translated at the exchange rate at the date when that value was determined (e.g., the closing rate at the reporting date). The effect of this comparison may be that an impairment loss is recognized in the functional currency but would not be recognized in the foreign currency, or vice versa.
29. When several exchange rates are available, the rate used is that at which the future cash flows represented by the transaction or balance could have been settled if those cash flows had occurred at the measurement date. If exchangeability between two currencies is temporarily lacking, the rate used is the first subsequent rate at which exchanges could be made.

Recognition of Exchange Differences

30. As noted in paragraph 5, this Standard does not deal with hedge accounting for foreign currency items. Guidance in relation to hedge accounting, including the criteria for when to use hedge accounting, can be found in the relevant international or national accounting standards dealing with the recognition and measurement of financial instruments.
31. **Exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous financial statements shall be recognized in surplus or deficit in the period in which they arise, except as described in paragraph 36.**
32. When monetary items arise from a foreign currency transaction and there is a change in the exchange rate between the transaction date and the date of settlement, an exchange difference results. When the transaction is settled within the same accounting period as that in which it occurred, all the exchange difference is recognized in that period. However, when the transaction is settled in a subsequent accounting period, the exchange difference recognized in each period up to the date of settlement is determined by the change in exchange rates during each period.
33. The treatment of foreign currency exchange rate changes in a cash flow statement is described in paragraph 25.
34. **When a gain or loss on a nonmonetary item is recognized directly in net assets/equity, any exchange component of that gain or loss shall be recognized directly in net assets/equity. Conversely, when a gain or loss on a nonmonetary item is recognized in surplus or deficit, any exchange component of that gain or loss shall be recognized in surplus or deficit.**
35. Other Standards require some gains and losses to be recognized directly in net assets/equity. For example, SLPSAS 7 “Property, Plant & Equipment” requires some gains and losses arising on a revaluation of property, plant

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and equipment to be recognized directly in net assets/equity. When such an asset is measured in a foreign currency, paragraph 26 (c) of this Standard requires the revalued amount to be translated using the rate at the date the value is determined, resulting in an exchange difference that is also recognized in net assets/equity.

36. **Exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation (see paragraph 17) shall be recognized in surplus or deficit in the separate financial statements of the reporting entity or the individual financial statements of the foreign operation, as appropriate. In the financial statements that include the foreign operation and the reporting entity (e.g., consolidated financial statements when the foreign operation is a controlled entity), such exchange differences shall be recognized initially in a separate component of net assets/equity and recognized in surplus or deficit on disposal of the net investment in accordance with paragraph 54.**
37. When a monetary item forms part of a reporting entity's net investment in a foreign operation and is denominated in the functional currency of the reporting entity, an exchange difference arises in the foreign operation's individual financial statements in accordance with paragraph 31. If such an item is denominated in the functional currency of the foreign operation, an exchange difference arises in the reporting entity's separate financial statements in accordance with paragraph 31. If such an item is denominated in a currency other than the functional currency of either the reporting entity or the foreign operation, an exchange difference arises in the reporting entity's separate financial statements and in the foreign operation's individual financial statements in accordance with paragraph 31. Such exchange differences are reclassified to the separate component of net assets/equity in the financial statements that include the foreign operation and the reporting entity (i.e., financial statements in which the foreign operation is consolidated, proportionately consolidated or accounted for using the equity method).

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38. When an entity keeps its books and records in a currency other than its functional currency, at the time the entity prepares its financial statements all amounts are translated into the functional currency in accordance with paragraphs 22–29 . This produces the same amounts in the functional currency as would have occurred had the items been recorded initially in the functional currency. For example, monetary items are translated into the functional currency using the closing rate, and nonmonetary items that are measured on a historical cost basis are translated using the exchange rate at the date of the transaction that resulted in their recognition.

Change in Functional Currency

39. **When there is a change in an entity’s functional currency, the entity shall apply the translation procedures applicable to the new functional currency prospectively from the date of the change.**
40. As noted in paragraph 15, the functional currency of an entity reflects the underlying transactions, events and conditions that are relevant to the entity. Accordingly, once the functional currency is determined, it can be changed only if there is a change to those underlying transactions, events and conditions. For example, a change in the currency that mainly influences the sales prices or the provision of goods and services may lead to a change in an entity’s functional currency.
41. The effect of a change in functional currency is accounted for prospectively. In other words, an entity translates all items into the new functional currency using the exchange rate at the date of the change. The resulting translated amounts for nonmonetary items are treated as their historical cost. Exchange differences arising from the translation of a foreign operation previously classified in net assets/equity in accordance with paragraphs 36 and 43(c) are not recognized in surplus or deficit until the disposal of the operation.

Use of a Presentation Currency Other than the Functional Currency

Translation to the Presentation Currency

42. An entity may present its financial statements in any currency (or currencies). If the presentation currency differs from the entity's functional currency, it translates its financial performance and financial position into the presentation currency. For example, when an economic entity, such as an international organization contains individual entities with different functional currencies, the financial performance and financial position of each entity are expressed in a common currency so that consolidated financial statements may be presented. For Government/Provincial Councils the presentation currency is normally determined by the Ministry of Finance (or similar authority) or established in legislation.
43. **The financial performance and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:**
- (a) **Assets and liabilities for each statement of financial position presented (i.e., including comparatives) shall be translated at the closing rate at the date of that statement of financial position;**
 - (b) **Revenue and expenses for each statement of financial performance (i.e., including comparatives) shall be translated at exchange rates at the dates of the transactions; and**
 - (c) **All resulting exchange differences shall be recognized as a separate component of net assets/equity.**
44. In translating the cash flows, that is the cash receipts and cash payments, of a foreign operation for incorporation into its cash flow statement, the reporting entity shall comply with the procedures in SLPSAS 2 "Cash

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Flow Statements”. SLPSAS 2 requires that the cash flows of a controlled entity which satisfies the definition of a foreign operation shall be translated at the exchange rates between the presentation currency and the foreign currency at the dates of the cash flows. SLPSAS 2 also outlines the presentation of unrealized gains and losses arising from changes foreign currency exchange rates on cash and cash equivalents held or due in a foreign currency

45. For practical reasons, a rate that approximates the exchange rates at the dates of the transactions, for example an average rate for the period, is often used to translate revenue and expense items. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.
46. The exchange differences referred to in paragraph 43(c) result from:
- (a) Translating revenue and expenses at the exchange rates at the dates of the transactions and assets and liabilities at the closing rate. Such exchange differences arise both on revenue and expense items recognized in surplus or deficit and on those recognized directly in net assets/equity.
 - (b) Translating the opening net assets/equity at a closing rate that differs from the previous closing rate.
These exchange differences are not recognized in surplus or deficit because the changes in exchange rates have little or no direct effect on the present and future cash flows from operations. When the exchange differences relate to a foreign operation that is consolidated but is not wholly owned, accumulated exchange differences arising from translation and attributable to minority interests are allocated to, and recognized as part of, minority interest in the consolidated statement of financial position.

Translation of a Foreign Operation

- 47 Paragraphs 48–53 in addition to paragraphs 42–46, apply when the financial performance and financial position of a foreign operation are translated into a presentation currency so that the foreign operation can be

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included in the financial statements of the reporting entity by consolidation, proportionate consolidation or the equity method.

48. The incorporation of the financial performance and financial position of a foreign operation with those of the reporting entity follows normal consolidation procedures, such as the elimination of balances and transactions within an economic entity (see IPSAS 6 “Consolidated and Separate Financial Statements” or when adopted the equivalent SLPSAS and IPSAS 8, “Interests in Joint Ventures” or when adopted the equivalent SLPSAS).
49. However, a monetary asset (or liability) within an economic entity, whether short-term or long-term, cannot be eliminated against the corresponding liability (or asset) within an economic entity without showing the results of currency fluctuations in the consolidated financial statements. This is because the monetary item represents a commitment to convert one currency into another and exposes the reporting entity to a gain or loss through currency fluctuations. Accordingly, in the consolidated financial statements of the reporting entity, such an exchange difference continues to be recognized in surplus or deficit or, if it arises from the circumstances described in paragraph 36 it is classified as net assets/equity until the disposal of the foreign operation.
50. When the financial statements of a foreign operation are as of a date different from that of the reporting entity, the foreign operation often prepares additional statements as of the same date as the reporting entity’s financial statements. When this is not done, IPSAS 6 or when adopted the equivalent SLPSAS allows the use of a different reporting date provided that the difference is no greater than three months and adjustments are made for the effects of any significant transactions or other events that occur between the different dates.
51. When there is a difference between the reporting date of the reporting entity and the foreign operation, the assets and liabilities of the foreign operation are translated at the exchange rate at the reporting date of the foreign operation.

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52. Adjustments are made for significant changes in exchange rates up to the reporting date of the reporting entity in accordance with IPSAS 6 or when adopted the equivalent SLPSAS. The same approach is used in applying the equity method to associates and joint ventures and in applying proportionate consolidation to joint ventures in accordance with IPSAS 7 “Investments in Associates” or when adopted the equivalent SLPSAS, “Investments in Associates” and IPSAS 8 or when adopted the equivalent SLPSAS.
53. **Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation shall be treated as assets and liabilities of the foreign operation. Thus they shall be expressed in the functional currency of the foreign operation and shall be translated at the closing rate in accordance with paragraph 43.**

Disposal of a Foreign Operation.

54. **On the disposal of a foreign operation, the cumulative amount of the exchange differences deferred in the separate component of net assets/equity relating to that foreign operation shall be recognized in surplus or deficit when the gain or loss on disposal is recognized.**
55. An entity may dispose of its interest in a foreign operation through sale, liquidation, repayment of contributed capital or abandonment of all, or part of, that entity. The payment of a dividend or similar distribution is part of a disposal only when it constitutes a return of the investment, for example when the dividend or similar distribution is paid out of pre-acquisition surplus. In the case of a partial disposal, only the proportionate share of the related accumulated exchange difference is included in the gain or loss. A write-down of the carrying amount of a foreign operation does not constitute a partial disposal. Accordingly, no part of the deferred foreign exchange gain or loss is recognized in surplus or deficit at the time of a write-down.

Tax Effects of Exchange Differences

- 56 For reporting entities subject to income taxes, guidance on the treatment of tax effects associated with the gains and losses on foreign currency transactions and exchange differences arising on translating the financial performance and financial position of an entity (including a foreign operation) into a different currency can be found in the relevant international or national accounting standards dealing with income taxes.

Disclosure

- 57 **In paragraphs 59 and 61–63 references to “functional currency” apply, in the case of an economic entity, to the functional currency of the controlling entity.**
58. **The entity shall disclose:**
- (a) **The amount of exchange differences recognized in surplus or deficit except for those arising on financial instruments measured at fair value through surplus or deficit in accordance with the relevant international or national accounting standards dealing with the recognition and measurement of financial instruments; and**
 - (b) **Net exchange differences classified in a separate component of net assets/equity and a reconciliation of the amount of such exchange differences at the beginning and end of the period.**
59. **When the presentation currency is different from the functional currency, that fact shall be stated, together with disclosure of the functional currency and the reason for using a different presentation currency.**
60. **When there is a change in the functional currency of either the reporting entity or a significant foreign operation, that fact and the reason for the change in functional currency shall be disclosed.**

61. **When an entity presents its financial statements in a currency that is different from its functional currency, it shall describe the financial statements as complying with International Public Sector Accounting Standards only if they comply with all the requirements of each applicable Standard including the translation method set out in paragraph 43.**
62. An entity sometimes presents its financial statements or other financial information in a currency that is not its functional currency without meeting the requirements of paragraph 61. For example, an entity may convert into another currency only selected items from its financial statements. Or, an entity whose functional currency is not the currency of a hyperinflationary economy may convert the financial statements into another currency by translating all items at the most recent closing rate. Such conversions are not in accordance with International Public Sector Accounting Standards and the disclosures set out in paragraph 63 are required.
63. **When an entity displays its financial statements or other financial information in a currency that is different from either its functional currency or its presentation currency and the requirements of paragraph 61 are not met, it shall:**
- (a) **Clearly identify the information as supplementary information to distinguish it from the information that complies with International Public Sector Accounting Standards;**
 - (b) **Disclose the currency in which the supplementary information is displayed; and**
 - (c) **Disclose the entity's functional currency and the method of translation used to determine the supplementary information.**

Transitional Provisions

First-time Adoption of Accrual Accounting

64. **A reporting entity need not comply with the requirements for cumulative translation differences that existed at the date of first adoption of accrual accounting in accordance with SLPSASs. If a first-time adopter uses this exemption:**
- (a) **The cumulative translation differences for all foreign operations are deemed to be zero at the date of first adoption to SLPSASs and**
 - (b) **The gain and loss on a subsequent disposal of any foreign operation shall exclude translation differences that arose before the date of first adoption to SLPSASs, and shall include later translation differences.**
65. This Standard requires entities to:
- (a) Classify some translation differences as a separate component of net assets/equity; and
 - (b) On disposal of a foreign operation, to transfer the cumulative translation difference for that foreign operation to the statement of financial performance as part of the gain or loss on disposal.

The transitional provisions provide first-time adopters of SLPSAS with relief from this requirement.

Transitional Provisions for All Entities

66. **An entity shall apply paragraph 53 prospectively to all acquisitions occurring after the beginning of the financial reporting period in**

which this ISLPSAS is first applied. Retrospective application of paragraph 53 to earlier acquisitions is permitted. For an acquisition of a foreign operation treated prospectively but which occurred before the date on which this Standard is first applied, the entity shall not restate prior years and accordingly may, when appropriate, treat goodwill and fair value adjustments arising on that acquisition as assets and liabilities of the entity rather than as assets and liabilities of the foreign operation. Therefore, those goodwill and fair value adjustments either are already expressed in the entity's functional currency or are nonmonetary foreign currency items, which are reported using the exchange rate at the date of the acquisition.

67. **All other changes resulting from the application of this SLPSAS shall be accounted for in accordance with the requirements of SLPSAS 3, "Accounting Policies, Changes in Accounting Estimates and Errors."**

Compliance with International Public Sector Accounting Standards

68. Compliance with this SLPSAS ensures compliance in all material respects with IPSAS 4 "The Effects of Changes in Foreign Exchange Rates"

Effective Date

69. **An entity shall apply this SLPSAS for annual periods beginning on or after 01 January, 2014. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 01, 2014, it shall disclose that fact.**
70. When an entity adopts the accrual basis of accounting, as defined by SLPSASs for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

SPLSAS 6—EVENTS AFTER THE REPORTING DATE

Acknowledgment

The Sri Lanka Public Sector Accounting Standard (SLPSAS) 6 “Events after the Reporting Date” is based on International Public Sector Accounting Standard (IPSAS) 14 “Events after the Reporting Date” of the International Public Sector Accounting Standards Board (IPSASB), published by the International Federation of Accountants (IFAC) in December 2006 (2009 Bound Volume) and is used with permission of IFAC.

SLPSAS 6 – EVENTS AFTER THE REPORTING DATE

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Sri Lanka Public Sector Accounting Standard 6, “Events after the Reporting Date” is set out in paragraphs 1–32. All the paragraphs have equal authority. SLPSAS 6 should be read in the context of the “Preface to Sri Lanka Public Sector Accounting Standard.” SLPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

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Objective

1. The objective of this Standard is to prescribe:
 - (a) When an entity should adjust its financial statements for events after the reporting date; and
 - (b) The disclosures that an entity should give about the date when the financial statements were authorized for issue and about events after the reporting date.

The Standard also requires that an entity should not prepare its financial statements on a going concern basis if events after the reporting date indicate that the going concern assumption is not appropriate

Scope

2. **An entity which prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in the accounting for, and disclosure of, events after the reporting date.**
3. **This Standard applies to all public sector entities other than Government Business Enterprises (GBEs).**
4. The “Preface to Sri Lanka Public Sector Accounting Standards” issued by the Institute of Chartered Accountants of Sri Lanka (ICASL) explains that Government Business Enterprises (GBEs) apply Sri Lanka Accounting Standards (SLFRS/LKAS) issued by the ICASL. GBEs are defined in SLPSAS 1-“Presentation of Financial Statements” paragraph 7.

Definitions

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

specified:

Events after the reporting date are those events, both favorable and unfavorable, that occur between the reporting date and the date when the financial statements are authorized for issue. Two types of events can be identified:

- (a) **Those that provide evidence of conditions that existed at the reporting date (adjusting events after the reporting date); and**
- (b) **Those are indicative of conditions that arose after the reporting date (non-adjusting events after the reporting date).**

Reporting date means the date of the last day of the reporting period to which the financial statements relate.

Terms defined in other national and International Public Sector Accounting Standards are used in this Standard with the same meaning as in those other Standards, and are reproduced in the Glossary of Defined Terms published separately.

Authorizing the Financial Statements for Issue

6. In order to determine which events satisfy the definition of events after the reporting date, it is necessary to identify both the reporting date and the date on which the financial statements are authorized for issue. The reporting date is the last day of the reporting period to which the financial statements relate. The date of authorization for issue is the date on which the financial statements have received approval from the individual or body with the authority to finalize those statements for issue. The audit opinion

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is provided on those finalized financial statements. Events after the reporting date are all events, both favorable and unfavorable, that occur between the reporting date and the date when the financial statements are authorized for issue, even if those events occur after the publication of an announcement of the surplus or deficit, the authorization of the financial statements of a controlled entity, or publication of other selected information relating to the financial statements.

7. The process involved in preparing and authorizing the financial statements for issue may vary for different types of entities. It can depend upon the nature of the entity, the governing body structure, the statutory requirements relating to that entity and the procedures followed in preparing and finalizing the financial statements. Responsibility for authorization of financial statements of individual government authorities/agencies may rest with the head of the entity (the head, chief executive or governing body, board of management) or equivalent. Responsibility for authorization of consolidated financial statements of the government as a whole may rest jointly with the head of the General Treasury (Secretary to the Treasury) jointly with the Director General State Accounts in the case of government, Chief Secretary and Deputy Chief Secretary (Finance) in the case of provincial council.

Recognition and Measurement

Adjusting Events after the Reporting Date

8. **An entity shall adjust the amounts recognized in its financial statements to reflect adjusting events after the reporting date.**
9. The following are examples of adjusting events after the reporting date that require an entity to adjust the amounts recognized in its financial statements, or to recognize items that were not previously recognized:
 - (a) The settlement after the reporting date of a court case that confirms that the entity had a present obligation at the reporting date. The entity adjusts any previously recognized provision

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related to this court case in accordance with SLPSAS 8, “Provisions, Contingent Liabilities and Contingent Assets” or recognizes a new provision. The entity does not merely disclose a contingent liability because the settlement provides additional evidence that would be considered in accordance with paragraph 24 in SLPSAS 8 “ Provisions, Contingent Liabilities and Contingent Assets”

- (b) The receipt of information after the reporting date indicating that an asset was impaired at the reporting date, or that the amount of a previously recognized impairment loss for that asset needs to be adjusted. For example:
 - (i) The bankruptcy of a debtor which occurs after the reporting date usually confirms that a loss already existed at the reporting date on a receivable account and that the entity needs to adjust the carrying amount of the receivable account; and
 - (ii) The sale of inventories after the reporting date may give evidence about their net realizable value at the reporting date;
- (c) The determination after the reporting date of the cost of assets purchased, or the proceeds from assets sold, before the reporting date;
- (d) The determination after the reporting date of the amount of revenue collected during the reporting period to be shared with other jurisdictions under a revenue sharing arrangements in place during the reporting period;
- (e) The determination after the reporting date of performance bonus payments to be made to staff if the entity had a present legal or constructive obligation at the reporting date to make such payments as a result of events before that date; and
- (f) The discovery of fraud or errors that show that the financial statements were incorrect.

Non-adjusting Events After the Reporting Date

- 10 **An entity shall not adjust the amounts recognized in its financial statements to reflect non-adjusting events after the reporting date.**
11. The following are examples of non-adjusting events after the reporting date:
- (a) Where an entity has adopted a policy of regularly revaluing property to fair value, a decline in the fair value of property between the reporting date and the date when the financial statements are authorized for issue. The fall in fair value does not normally relate to the condition of the property at the reporting date, but reflects circumstances that have arisen in the following period. Therefore, despite its policy of regularly revaluing, an entity would not adjust the amounts recognized in its financial statements for the properties. Similarly, the entity does not update the amounts disclosed for the property as at the reporting date, although it may need to give additional disclosure under paragraph 27; and
 - (b) Where an entity charged with operating particular community service programs decides after the reporting date, but before the financial statements are authorized, to provide/distribute additional benefits directly or indirectly to participants in those programs. The entity would not adjust the expenses recognized in its financial statements in the current reporting period, although the additional benefits may meet the conditions for disclosure as non-adjusting events under paragraph 27.

Dividends or Similar Distributions

12. **If an entity declares dividends or similar distributions after the reporting date, the entity shall not recognize those distributions as a liability at the reporting date.**

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13. Dividends may arise in the public sector when, for example, a public sector entity controls and consolidates the financial statements of a GBE that has outside ownership interests to whom it pays dividends. In addition, some public sector entities adopt a financial management framework, for example “purchaser provider” models, that require them to pay income distributions to their controlling entity, such as the central government.
14. If dividends or similar distributions to owners are declared (i.e., the dividends or similar distributions are appropriately authorized and no longer at the discretion of the entity) after the reporting date but before the financial statements are authorized for issue, the dividends or similar distributions are not recognized as a liability at the reporting date because they do not meet the criteria of a present obligation in SLPSAS 8. Such dividends or similar distributions are disclosed in the notes in accordance with SLPSAS 1, “Presentation of Financial Statements.” Dividends and similar distributions do not include a return of capital.

Going Concern

15. The determination of whether the going concern assumption is appropriate needs to be considered by each entity. However, the assessment of going concern is likely to be of more relevance for individual entities than for a government as a whole. For example, an individual government agency may not be a going concern because the government of which it forms part has decided to transfer all its activities to another government agency. However, this restructuring has no impact upon the assessment of going concern for the government itself.
16. **An entity shall not prepare its financial statements on a going concern basis if those responsible for the preparation of the financial statements or the governing body determine after the reporting date either that there is an intention to liquidate the entity or to cease operating, or that there is no realistic alternative but to do so.**

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17. In assessing whether the going concern assumption is appropriate for an individual entity, those responsible for the preparation of the financial statements, and/or the governing body, need to consider a wide range of factors. Those factors will include the current and expected performance of the entity, any announced and potential restructuring of organizational units, the likelihood of continued government funding and, if necessary, potential sources of replacement funding.
18. In the case of entities whose operations are substantially budget-funded, going concern issues generally only arise if the government announces its intention to cease funding the entity.
19. Some agencies, although not GBEs, may be required to be fully or substantially self-funding, and to recover the cost of goods and services from users. For any such entity, deterioration in operating results and financial position after the reporting date may indicate a need to consider whether the going concern assumption is still appropriate.
20. If the going concern assumption is no longer appropriate, this Standard requires an entity to reflect this in its financial statements. The impact of such a change will depend upon the particular circumstances of the entity, for example, whether operations are to be transferred to another government entity, sold or liquidated. Judgment is required in determining whether a change in the carrying value of assets and liabilities is required.
21. When the going concern assumption is no longer appropriate, it is also necessary to consider whether the change in circumstances leads to the creation of additional liabilities or triggers clauses in debt contracts leading to the reclassification of certain debts as current liabilities.
22. SLPSAS 1 – “Presentation of Financial Statements” requires certain disclosures:

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- (a) SLPSAS 1 requires that when the financial statements are not prepared on a going concern basis, this must be disclosed, together with the basis on which the financial statements are prepared and the reason why the entity is not considered to be a going concern; or
- (b) Those responsible for the preparation of the financial statements are aware of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern. The events or conditions requiring disclosure may arise after the reporting date. SLPSAS 1 requires such uncertainties to be disclosed.

Restructuring

23. Where a restructuring announced after the reporting date meets the definition of a non-adjustable event, the appropriate disclosures are made in accordance with this Standard. Guidance on the recognition of provisions associated with restructuring is found in SLPSAS 8. Simply because a restructuring involves the disposal of a component of an entity this does not in itself bring into question the entity's ability to continue as a going concern. However, where a restructuring announced after the reporting date means that an entity is no longer a going concern, the nature and amount of assets and liabilities recognized may change.

Disclosure

Disclosure of Date of Authorization for Issue

24. **An entity shall disclose the date when the financial statements were authorized for issue and who gave that authorization.**
25. It is important for users to know when the financial statements were authorized for issue, as the financial statements do not reflect events after this date.

Updating Disclosure about Conditions at the Reporting Date

26. **If an entity receives information after the reporting date, but before the financial statements are authorized for issue, about conditions that existed at the reporting date, the entity shall update disclosures that relate to these conditions, in the light of the new information.**
27. In some cases, an entity needs to update the disclosures in its financial statements to reflect information received after the reporting date but before the financial statements are authorized for issue, even when the information does not affect the amounts that the entity recognizes in its financial statements. One example of the need to update disclosures is when evidence becomes available after the reporting date about a contingent liability that existed at the reporting date. In addition to considering whether it should now recognise a provision an entity updates its disclosures about the contingent liability in the light of that evidence.

Disclosure of Non-adjusting Events After the Reporting Date

28. **If non-adjusting events after the reporting date are material nondisclosure could influence the economic decisions of users taken on the basis of the financial statements. Accordingly, an entity shall disclose the following for each material category of non-adjusting event after the reporting date:**
- (a) **The nature of the event; and**
 - (b) **An estimate of its financial effect or a statement that such an estimate cannot be made.**
29. The following are examples of non-adjusting events after the reporting date that would generally result in disclosure:

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- (a) An unusually large decline in the value of property carried at fair value, where that decline is unrelated to the condition of the property at reporting date, but is due to circumstances that have arisen since reporting date;
- (b) The entity decides after reporting date, to provide/distribute substantial additional benefits in the future directly or indirectly to participants in community service programs that it operates, and those additional benefits have a major impact on the entity;
- (c) An acquisition or disposal of a major controlled entity or the outsourcing of all or substantially all of the activities currently undertaken by an entity after the reporting date;
- (d) Announcing a plan to discontinue an operation or major program, disposing of assets or settling liabilities attributable to a discontinued operation or major program, or entering into binding agreements to sell such assets or settle such liabilities (guidance on the treatment and disclosure of discontinued operations can be found in the relevant international or national accounting standard dealing with discontinued operations);
- (e) Major purchases and disposals of assets;
- (f) The destruction of a major building by a fire after the reporting date;
- (g) Announcing, or commencing the implementation of, a major restructuring (guidance on accounting for provisions associated with restructuring is found in accounting standards on provisions, contingent liabilities and contingent assets);
- (h) The introduction of legislation to forgive loans made to entities or individuals as part of a program;

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- (i) Abnormally large changes after the reporting date in asset prices or foreign exchange rates;
- (j) In the case of entities that are liable for income tax or income tax equivalents, changes in tax rates or tax laws enacted or announced after the reporting date that have a significant effect on current and deferred tax assets and liabilities (guidance on accounting for income taxes can be found in the relevant international or national accounting standard dealing with income taxes);
- (k) Entering into significant commitments or contingent liabilities, for example, by issuing significant guarantees after the reporting date; and
- (l) Commencing major litigation arising solely out of events that occurred after the reporting date.

Compliance with International Public Sector Accounting Standards

- 30 Compliance with this SLPSAS ensures compliance in all material respects with International Public Sector Accounting Standard (IPSAS) 14, *“Events After the Reporting Date.”*

Effective Date

31. **This Sri Lanka Public Sector Accounting Standard becomes effective for annual financial statements covering periods beginning on or after January 01, 2014 . Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 01, 2014, it shall disclose that fact.**
32. When an entity adopts the accrual basis of accounting, as defined by Sri Lanka Public Sector Accounting Standards, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity’s annual financial statements covering periods beginning on or after the date of adoption.

SLPSAS 7— PROPERTY, PLANT AND EQUIPMENT

Acknowledgment

The Sri Lanka Public Sector Accounting Standard (SLPSAS) 7 “Property, Plant and Equipment” is based on International Public Sector Accounting Standard (IPSAS) 17 “Property, Plant and Equipment” of the International Public Sector Accounting Standards Board (IPSASB), published by the International Federation of Accountants (IFAC) in December 2006 (2009 Bound Volume) and is used with permission of IFAC.

SLPSAS 7 – PROPERTY, PLANT & EQUIPMENT**January 2013****CONTENTS***paragraph*

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Property, Plant and Equipment” (SLPSAS) 7 is set out in paragraphs 1-105 All the paragraphs have equal authority. SLPSAS 7 should be read in the context of its objective and the Preface to Sri Lanka Public Sector Accounting Standards. SLPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe the accounting treatment for property, plant and equipment so that users of financial statements can discern information about an entity's investment in its property, plant and equipment and the changes in such investment. The principal issues in accounting for property, plant and equipment are the recognition of the assets, the determination of their carrying amounts and the depreciation charges and impairment losses to be recognized in relation to them.

Scope

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for property, plant and equipment, except:**
 - (a) **When a different accounting treatment has been adopted in accordance with another Sri Lanka Public Sector Accounting Standard; and**
 - (b) **In respect of heritage assets that are recognized however, the disclosure requirements of paragraphs 86, 87 and 90 apply.**
3. **This Standard applies to all public sector entities other than Government Business Enterprises.**
4. This Standard applies to property, plant and equipment including:
 - (a) Specialized military equipment; and
 - (b) Infrastructure assets.

The transitional provisions in paragraphs 93 to 102 provide relief from the requirement to recognize all property, plant and equipment during the five year transitional period.

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5. This Standard does not apply to:
- (a) Biological assets related to agricultural activity (see the relevant international or national accounting standard dealing with agriculture); or
 - (b) Mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources (see the relevant international or national accounting standard dealing with mineral rights, mineral reserves and similar non-regenerative resources).

However, this Standard applies to property, plant and equipment used to develop or maintain the assets described in 5(a) or 5(b).

6. Other International Public Sector Accounting Standards may require recognition of an item of property, plant and equipment based on an approach different from that in this Standard. For example, IPSAS 13, “Leases” or when adopted the equivalent *SLPSAS* requires an entity to evaluate its recognition of an item of leased property, plant and equipment on the basis of the transfer of risks and rewards. However, in such cases other aspects of the accounting treatment for these assets, including depreciation, are prescribed by this Standard.
7. An entity shall apply this Standard to property that is being constructed or developed for future use as investment property but does not yet satisfy the definition of investment property in IPSAS 16, “Investment Property.” or when adopted the equivalent *SLPSAS* Once the construction or development is complete, the property becomes investment property and the entity is required to apply IPSAS 16 or when adopted the equivalent *SLPSAS*. IPSAS 16 or when adopted the equivalent *SLPSAS* also applies to investment property that is being redeveloped for continued future use as investment property. An entity using the cost model for investment property in accordance with IPSAS 16 or when adopted the equivalent *SLPSAS* shall use the cost model in this Standard.

Heritage Assets

8. This Standard does not require an entity to recognize heritage assets that would otherwise meet the definition of, and recognition criteria for, property, plant and equipment. If an entity does recognize heritage assets, it must apply the disclosure requirements of this Standard and may, but is not required to, apply the measurement requirements of this Standard.

9. Some assets are described as heritage assets because of their cultural, environmental or historical significance. Examples of heritage assets include historical buildings and monuments, archaeological sites, conservation areas and nature reserves, and works of art. Certain characteristics, including the following, are often displayed by heritage assets (although these characteristics are not exclusive to such assets):
 - (a) Their value in cultural, environmental, educational and historical terms is unlikely to be fully reflected in a financial value based purely on a market price;
 - (b) Legal and/or statutory obligations may impose prohibitions or severe restrictions on disposal by sale;
 - (c) They are often irreplaceable and their value may increase over time even if their physical condition deteriorates; and
 - (d) It may be difficult to estimate their useful lives, which in some cases could be several hundred years.

Public sector entities may have large holdings of heritage assets that have been acquired over many years and by various means, including purchase, donation, bequest and sequestration. These assets are rarely held for their ability to generate cash inflows, and there may be legal or social obstacles to using them for such purposes.

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10. Some heritage assets have service potential other than their heritage value, for example, an historic building being used for office accommodation. In these cases, they may be recognized and measured on the same basis as other items of property, plant and equipment. For other heritage assets, their service potential is limited to their heritage characteristics, for example, monuments and ruins. The existence of alternative service potential can affect the choice of measurement base.

11. The disclosure requirements in paragraphs 86 to 92 require entities to make disclosures about recognized assets. Therefore, entities that recognize heritage assets are required to disclose in respect of those assets such matters as, for example:
 - (a) The measurement basis used;
 - (b) The depreciation method used, if any;
 - (c) The gross carrying amount;
 - (d) The accumulated depreciation at the end of the period, if any; and
 - (e) A reconciliation of the carrying amount at the beginning and end of the period showing certain components thereof.

Government Business Enterprises

12. The “Preface to Sri Lanka Public Sector Accounting Standards” issued by the Institute of Chartered Accountants of Sri Lanka (ICASL) explains that Government Business Enterprises (GBEs) apply Sri Lanka Accounting Standards (SLFRS/LKAS) issued by the ICASL. GBEs are defined in SLPSAS 1, “Presentation of Financial Statements.”

Definitions

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

Carrying amount (for the purpose of this Standard) is the amount at which an asset is recognized after deducting any accumulated depreciation and accumulated impairment losses.

Class of property, plant and equipment means a grouping of assets of a similar nature or function in an entity's operations that is shown as a single item for the purpose of disclosure in the financial statements.

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction.

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.

Entity-specific value is the present value of the cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.

Exchange transactions are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

An **impairment loss** of a cash-generating asset is the amount by which the carrying amount of an asset exceeds its recoverable amount.

Non-exchange transactions are transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.

Property, plant and equipment are tangible items that:

- (a) Are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
- (b) Are expected to be used during more than one reporting period.

Recoverable amount is the higher of a cash-generating asset's fair value less costs to sell and its value in use.

Recoverable service amount is the higher of a non-cash-generating asset's fair value less costs to sell and its value in use.

The **residual value** of an asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life

Useful life is:

- (a) The period over which an asset is expected to be available for use by an entity; or

- (b) **The number of production or similar units expected to be obtained from the asset by an entity.**

Terms defined in other Sri Lanka Public Sector Accounting Standards are used in this Standard with the same meaning as in those other Standards, and are reproduced in the Glossary of Defined Terms published separately.

Recognition

14. **The cost of an item of property, plant and equipment shall be recognized as an asset if, and only if:**
- (a) **It is probable that future economic benefits or service potential associated with the item will flow to the entity; and**
 - (b) **The cost or fair value of the item can be measured reliably.**
15. Spare parts and servicing equipment are usually carried as inventory and recognized in surplus or deficit as consumed. However, major spare parts and stand-by equipment qualify as property, plant and equipment when an entity expects to use them during more than one period. Similarly, if the spare parts and servicing equipment can be used only in connection with an item of property, plant and equipment, they are accounted for as property, plant and equipment.
16. This standard does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgment is required in applying the recognition criteria to an entity's specific circumstances. It may be appropriate to aggregate individually insignificant items, such as library books, computer peripherals and small items of equipment, and to apply the criteria to the aggregate value.
17. An entity evaluates under this recognition principle all its property, plant and equipment costs at the time they are incurred. These costs include costs

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incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service it.

18. Specialist military equipment will normally meet the definition of property, plant and equipment and should be recognized as an asset in accordance with this Standard.

Infrastructure Assets

19. Some assets are commonly described as infrastructure assets. While there is no universally accepted definition of infrastructure assets, these assets usually display some or all of the following characteristics:
- (a) They are part of a system or network;
 - (b) They are specialized in nature and do not have alternative uses;
 - (c) They are immovable; and
 - (d) They may be subject to constraints on disposal.

Although ownership of infrastructure assets is not confined to entities in the public sector, significant infrastructure assets are frequently found in the public sector. Infrastructure assets meet the definition of property, plant and equipment and should be accounted for in accordance with this Standard. Examples of infrastructure assets include road networks, sewer systems, water and power supply systems and communication networks.

Initial Costs

20. Items of property, plant and equipment may be required for safety or environmental reasons. The acquisition of such property, plant and equipment, although not directly increasing the future economic benefits or service potential of any particular existing item of property, plant and equipment, may be necessary for an entity to obtain the future economic

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benefits or service potential from its other assets. Such items of property, plant and equipment qualify for recognition as assets because they enable an entity to derive future economic benefits or service potential from related assets in excess of what could be derived had those items not been acquired. For example, fire safety regulations may require a hospital to retro-fit new sprinkler systems. These enhancements are recognized as an asset because without them the entity is unable to operate the hospital in accordance with the regulations. However, the resulting carrying amount of such an asset and related assets is reviewed for impairment in accordance with IPSAS 21, “Impairment of Non-Cash-Generating Assets.” or when adopted the equivalent SLPSAS

Subsequent Costs

21. Under the recognition principle in paragraph 14, an entity does not recognize in the carrying amount of an item of property, plant and equipment the costs of the day-to-day servicing of the item. Rather, these costs are recognized in surplus or deficit as incurred. Costs of day-to-day servicing are primarily the costs of labour and consumables, and may include the cost of small parts. The purpose of these expenditures is often described as for the “repairs and maintenance” of the item of property, plant and equipment.

22. Parts of some items of property, plant and equipment may require replacement at regular intervals. For example, a road may need resurfacing every few years, a furnace may require relining after a specified number of hours of use, or aircraft interiors such as seats and galleys may require replacement several times during the life of the airframe. Items of property, plant and equipment may also be required to make a less frequently recurring replacement, such as replacing the interior walls of a building, or to make a non-recurring replacement. Under the recognition principle in paragraph 14, an entity recognizes in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met. The carrying amount of those parts that are replaced is derecognized in accordance with the derecognition provisions of this Standard (see paragraphs 80 to 85).

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23. A condition of continuing to operate an item of property, plant and equipment (for example, an aircraft) may be performing regular major inspections for faults regardless of whether parts of the item are replaced. When each major inspection is performed, its cost is recognized in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of previous inspection (as distinct from physical parts) is derecognized. This occurs regardless of whether the cost of the previous inspection was identified in the transaction in which the item was acquired or constructed. If necessary, the estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was when the item was acquired or constructed.

Measurement at Recognition

24. **An item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its cost.**
25. **Where an asset is acquired through a non-exchange transaction, its cost shall be measured at its fair value as at the date of acquisition.**
26. An item of property, plant and equipment may be acquired through a non-exchange transaction. For example, land may be contributed to a local government by a developer at no or nominal consideration, to enable the local government to develop parks, roads and paths in the development. An asset may also be acquired through a non-exchange transaction by the exercise of powers of sequestration. Under these circumstances the cost of the item is its fair value as at the date it is acquired.
27. For the purposes of this Standard, the measurement at recognition of an item of property, plant and equipment, acquired at no or nominal cost, at its fair value consistent with the requirements of paragraph 25, does not constitute a revaluation. Accordingly, the revaluation requirements in paragraph 42, and the supporting commentary in paragraphs 43 to 48, only apply where an entity elects to revalue an item of property, plant and equipment in subsequent reporting periods.

Elements of Cost

28. The cost of an item of property, plant and equipment comprises:
- (a) Its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
 - (b) Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.
 - (c) The initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.
29. Examples of directly attributable costs are:
- (a) Costs of employee benefits (as defined in the relevant international or national accounting standard dealing with employee benefits) arising directly from the construction or acquisition of the item of property, plant and equipment;
 - (b) Costs of site preparation;
 - (c) Initial delivery and handling costs;
 - (d) Installation and assembly costs;
 - (e) Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment); and
 - (f) Professional fees.

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30. An entity applies SLPSAS 9 “Inventories,” or to the costs of obligations for dismantling, removing and restoring the site on which an item is located that is incurred during a particular period as a consequence of having used the item to produce inventories during that period. The obligations for costs accounted for in accordance with SLPSAS 9 and SLPSAS 7 are recognized and measured in accordance with SLPSAS 8 “Provisions, Contingent Liabilities and Contingent Assets.”
31. Examples of costs that are not costs of an item of property, plant and equipment are:
- (a) Costs of opening a new facility;
 - (d) Costs of introducing a new product or service (including costs of advertising and promotional activities);
 - (e) Costs of conducting business in a new location or with a new class of Customers (including costs of staff training); and
 - (f) Administration and other general overhead costs
32. Recognition of costs in the carrying amount of an item of property, plant and equipment ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management. Therefore, costs incurred in using or redeploying an item are not included in the carrying amount of that item. For example, the following costs are not included in the carrying amount of an item of property, plant and equipment:
- (a) Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity;
 - (b) Initial operating losses, such as those incurred while demand for the item’s output builds up; and
 - (c) Costs of relocating or reorganizing part or all of the entity’s operations.

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33. Some operations occur in connection with the construction or development of an item of property, plant and equipment, but are not necessary to bring the item to the location and condition necessary for it to be capable of operating in the manner intended by management. These incidental operations may occur before or during the construction or development activities. For example, revenue may be earned through using a building site as a car park until construction starts. Because incidental operations are not necessary to bring an item to the location and condition necessary for it to be capable of operating in the manner intended by management, the revenue and related expenses of incidental operations are recognized in surplus or deficit, and included in their respective classifications of revenue and expense.
34. The cost of a self-constructed asset is determined using the same principles as for an acquired asset. If an entity makes similar assets for sale in the normal course of operations, the cost of the asset is usually the same as the cost of constructing an asset for sale (see SLPSAS 9, “Inventories”). Therefore, any internal surpluses are eliminated in arriving at such costs. Similarly, the cost of abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset is not included in the cost of the asset. SLPSAS 4 “Borrowing Costs” establishes criteria for the recognition of interest as a component of the carrying amount of a self-constructed item of property, plant and equipment.

Measurement of cost

35. The cost of an item of property, plant and equipment is the cash price equivalent or, for an item referred to in paragraph 25, its fair value at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognized as interest over the period of credit unless such interest is recognized in the carrying amount of the item in accordance with the allowed alternative treatment in SLPSAS 4.

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36. One or more items of property, plant and equipment may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. The following discussion refers simply to an exchange of one non-monetary asset for another, but it also applies to all exchanges described in the preceding sentence. The cost of such an item of property, plant and equipment is measured at fair value unless
- (a) the exchange transaction lacks commercial substance or
 - (b) The fair value of neither the asset received nor the asset given up is reliably measurable. The acquired item is measured in this way even if an entity cannot immediately derecognize the asset given up. If the acquired item is not measured at fair value, its cost is measured at the carrying amount of the asset given up.
37. An entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows or service potential is expected to change as a result of the transaction. An exchange transaction has commercial substance if:
- (a) The configuration (risk, timing and amount) of the cash flows or service potential of the asset received differs from the configuration of the cash flows or service potential of the asset transferred; or
 - (b) The entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and
 - (c) The difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

For the purpose of determining whether an exchange transaction has commercial substance, the entity-specific value of the portion of the entity's operations affected by the transaction shall reflect post-tax cash flows, if tax applies. The result of these analyses may be clear without an entity having to perform detailed calculations.

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38. The fair value of an asset for which comparable market transactions do not exist is reliably measurable if
- (a) the variability in the range of reasonable fair value estimates is not significant for that asset or
 - (b) The probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value. If an entity is able to determine reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure the cost of the asset received unless the fair value of the asset received is more clearly evident.
39. The cost of an item of property, plant and equipment held by a lessee under a finance lease is determined in accordance with IPSAS 13, “Leases” or when adopted the equivalent SLPSAS.

Measurement after Recognition

40. **An entity shall choose either the cost model in paragraph 41 or the revaluation model in paragraph 42 as its accounting policy and shall apply that policy to an entire class of property, plant and equipment.**

Cost Model

41. **After recognition as an asset, an item of property, plant and equipment shall be carried at its cost less any accumulated depreciation and any accumulated impairment losses.**

Revaluation Model

42. **After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the reporting date. The accounting treatment for revaluations is set out in paragraphs 52 to 54.**
43. The fair value of items of property is usually determined from market-based evidence by appraisal. The fair value of items of plant and equipment is usually their market value determined by appraisal. An appraisal of the value of an asset is normally undertaken by a member of the valuation profession, who holds a recognized and relevant professional qualification. For many assets, the fair value will be readily ascertainable by reference to quoted prices in an active and liquid market. For example, current market prices can usually be obtained for land, non-specialized buildings, motor vehicles and many types of plant and equipment.
44. For some public sector assets, it may be difficult to establish their market value because of the absence of market transactions for these assets. Some public sector entities may have significant holdings of such assets.
45. If no evidence is available to determine the market value in an active and liquid market of an item of property, the fair value of the item may be established by reference to other items with similar characteristics, in similar circumstances and location. For example, the fair value of vacant government land that has been held for a long period during which time there have been few transactions may be estimated by reference to the market value of land with similar features and topography in a similar location for which market evidence is available. In the case of specialized

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buildings and other man-made structures, fair value may be estimated using depreciated replacement cost, or the restoration cost or service units approaches (see IPSAS 21 or when adopted the equivalent SLPSAS). In many cases, the depreciated replacement cost of an asset can

Be established by reference to the buying price of a similar asset with similar remaining service potential in an active and liquid market. In some cases, an asset's reproduction cost will be the best indicator of its replacement cost. For example, in the event of loss, a parliament building may be reproduced rather than replaced with alternative accommodation because of its significance to the community.

46. If there is no market-based evidence of fair value because of the specialized nature of the item of plant and equipment, an entity may need to estimate fair value using, for example, reproduction cost, depreciated replacement cost, or the restoration cost or service units approaches (see IPSAS 21 or when adopted the equivalent SLPSAS). The depreciated replacement cost of an item of plant or equipment may be established by reference to the market buying price of components used to produce the asset or the indexed price for the same or a similar asset based on a price for a previous period. When the indexed price method is used, judgment is required to determine whether production technology has changed significantly over the period, and whether the capacity of the reference asset is the same as that of the asset being valued.
47. The frequency of revaluations depends upon the changes in the fair values of the items of property, plant and equipment being revalued. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is necessary. Some items of property, plant and equipment experience significant and volatile changes in fair value, thus necessitating annual revaluation. Such frequent revaluations are unnecessary for items of property, plant and equipment with only insignificant changes in fair value. Instead, it may be necessary to revalue the item only every three or five years.

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48. When an item of property, plant and equipment is revalued, any accumulated depreciation at the date of the revaluation is treated in one of the following ways:
- (a) Restated proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued amount. This method is often used when an asset is revalued by means of applying an index to its depreciated replacement cost.
 - (b) Eliminated against the gross carrying amount of the asset and the net amount restated to the revalued amount of the asset. This method is often used for buildings.

The amount of the adjustment arising on the restatement or elimination of accumulated depreciation forms part of the increase or decrease in carrying amount that is accounted for in accordance with paragraphs 52 and 53.

49. **If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs shall be revalued.**

50. A class of property, plant and equipment is a grouping of assets of a similar nature or function in an entity's operations. The following are examples of separate classes:

- (a) Land;
- (b) Operational buildings;
- (c) Roads;
- (d) Machinery;
- (e) Electricity transmission networks;
- (f) Ships;

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- (g) Aircraft;
- (h) Specialist military equipment;
- (i) Motor vehicles;
- (j) Furniture and fixtures;
- (k) Office equipment; and
- (l) Oil rigs.

51. The items within a class of property, plant and equipment are revalued simultaneously in order to avoid selective revaluation of assets and the reporting of amounts in the financial statements that are a mixture of costs and values as at different dates. However, a class of assets may be revalued on a rolling basis provided revaluation of the class of assets is completed within a short period and provided the revaluations are kept up to date.
52. **If the carrying amount of a class of assets is increased as a result of a revaluation, the increase shall be credited directly to revaluation surplus. However, the increase shall be recognized in surplus or deficit to the extent that it reverses a revaluation decrease of the same class of assets previously recognized in surplus or deficit.**
53. **If the carrying amount of a class of assets is decreased as a result of a revaluation, the decrease shall be recognized in surplus or deficit. However, the decrease shall be debited directly to revaluation surplus to the extent of any credit balance existing in the revaluation surplus in respect of that class of assets.**
54. **Revaluation increases and decreases relating to individual assets within a class of property, plant and equipment must be offset against one another within that class but must not be offset in respect of assets in different classes.**

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55. Some or the entire revaluation surplus included in net assets/equity in respect of property, plant and equipment may be transferred directly to accumulated surpluses or deficits when the assets are derecognized. This may involve transferring some or the whole of the surplus when the assets within the class of property, plant and equipment to which the surplus relates are retired or disposed of. However, some of the surplus may be transferred as the assets are used by the entity. In such a case, the amount of the surplus transferred would be the difference between depreciation based on the revalued carrying amount of the assets and depreciation based on the assets' original cost. Transfers from revaluation surplus to accumulated surpluses or deficits are not made through surplus or deficit.
56. Guidance on the effects on taxes on surpluses, if any, resulting from the revaluation of property, plant and equipment can be found in the relevant international or national accounting standard dealing with income taxes.

Depreciation

57. **Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.**
58. An entity allocates the amount initially recognized in respect of an item of property, plant and equipment to its significant parts and depreciates separately each such part. For example, in most cases, it would be required to depreciate separately the pavements, formation, curbs and channels, footpaths, bridges and lighting within a road system. Similarly, it may be appropriate to depreciate separately the airframe and engines of an aircraft, whether owned or subject to a finance lease.
59. A significant part of an item of property, plant and equipment may have a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item. Such parts may be grouped in determining the depreciation charge.

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60. To the extent that an entity depreciates separately some parts of an item of property, plant and equipment, it also depreciates separately the remainder of the item. The remainder consists of the parts of the item that are individually not significant. If an entity has varying expectations for these parts, approximation techniques may be necessary to depreciate the remainder in a manner that faithfully represents the consumption pattern and/or useful life of its parts.
61. An entity may choose to depreciate separately the parts of an item that do not have a cost that is significant in relation to the total cost of the item.
62. **The depreciation charge for each period shall be recognized in surplus or deficit unless it is included in the carrying amount of another asset.**
63. The depreciation charge for a period is usually recognized in surplus or deficit. However, sometimes, the future economic benefits or service potential embodied in an asset is absorbed in producing other assets. In this case, the depreciation charge constitutes part of the cost of the other asset and is included in its carrying amount. For example, the depreciation of manufacturing plant and equipment is included in the costs of conversion of inventories (see SLPSAS 9) similarly; depreciation of property, plant and equipment used for development activities may be included in the cost of an intangible asset recognized in accordance with the relevant international or national accounting standard dealing with intangible assets.

Depreciation Amount and Depreciation Period

64. **The depreciable amount of an asset shall be allocated on a systematic basis over its useful life.**
65. **The residual value and the useful life of an asset shall be reviewed at least at each annual reporting date and, if expectations differ from previous estimates, the change(s) shall be accounted for as a change in**

an accounting estimate in accordance with SLPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors.”

66. Depreciation is recognized even if the fair value of the assets exceeds its carrying amount; as long as the asset’s residual value does not exceed its carrying amount. Repair and maintenance of an asset does not negate the need to depreciate it. Conversely, some assets may be poorly maintained or maintenance may be deferred indefinitely because of budgetary constraints. Where asset management policies exacerbate the wear and tear of an asset, its useful life should be reassessed and adjusted accordingly.
67. The depreciable amount of an asset is determined after deducting its residual value. In practice, the residual value of an asset is often insignificant and therefore immaterial in the calculation of the depreciable amount.
68. The residual value of an asset may increase to an amount equal to or greater than the asset’s carrying amount. If it does, the asset’s depreciation charge is zero unless and until its residual value subsequently decreases to an amount below the asset’s carrying amount.
69. Depreciation of an asset begins when it is available for use i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation of an asset ceases when the asset is derecognized. Therefore, depreciation does not cease when the asset becomes idle or is retired from active use and held for disposal unless the asset is fully depreciated. However, under usage methods of depreciation the depreciation charge can be zero while there is no production.
70. The future economic benefits or service potential embodied in an item of property, plant and equipment are consumed by the entity principally through the use of the asset. However, other factors such as technical or commercial obsolescence and wear and tear while an asset remains idle

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often result in the diminution of the economic benefits or service potential that might have been obtained from the asset. Consequently, all the following factors are considered in determining the useful life of an asset:

- (a) Expected usage of the asset. Usage is assessed by reference to the asset's expected capacity or physical output.
- (b) Expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance program, and the care and maintenance of the asset while idle.
- (c) Technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset.
- (d) Legal or similar limits on the use of the asset, such as the expiry dates of related leases.

71. The useful life of an asset is defined in terms of the asset's expected utility to the entity. The asset management policy of an entity may involve the disposal of assets after a specified time or after consumption of a specified proportion of the future economic benefits or service potential embodied in the asset. Therefore, the useful life of an asset may be shorter than its economic life. The estimation of the useful life of the asset is a matter of judgment based on the experience of the entity with similar assets.

72. Land and buildings are separable assets and are accounted for separately, even when they are acquired together. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated. Buildings have a limited useful life and therefore are depreciable assets. An increase in the value of the land on which a building stands does not affect the determination of the depreciable amount of the building.

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73. If the cost of land includes the cost of site dismantlement, removal and restoration, that portion of the land asset is depreciated over the period of benefits or service potential obtained by incurring those costs. In some cases, the land itself may have a limited useful life, in which case it is depreciated in a manner that reflects the benefits or service potential to be derived from it.

Depreciation Method

74. **The depreciation method shall reflect the pattern in which the asset's future economic benefits or service potential is expected to be consumed by the entity.**
75. **The depreciation method applied to an asset shall be reviewed at least at each annual reporting date and, if there has been a significant change in the expected pattern of the consumption of the future economic benefits or service potential embodied in the asset, the method shall be changed to reflect the changed pattern. Such a change shall be accounted for as a change in an accounting estimate in accordance with SLPSAS 3.**
76. A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. Straight-line depreciation results in a constant charge over the useful life if the asset's residual value does not change. The diminishing balance method results in a decreasing charge over the useful life. The units of production method results in a charge based on the expected use or output. The entity selects the method that most closely reflects the expected pattern of consumption of the future economic benefits or service potential embodied in the asset. That method is applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits or service potential.

Impairment

77. To determine whether an item of property, plant and equipment is impaired, an entity applies IPSAS 21, “Impairment of Non-Cash-Generating Assets” or when adopted the equivalent *SLPSAS*. That Standard explains how an entity reviews the carrying amount of its assets, how it determines the recoverable service amount or recoverable amount of an asset, and when it recognizes, or reverses the recognition of, an impairment loss.

Compensation for impairment

78. **Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up shall be included in surplus or deficit when the compensation becomes receivable.**
79. Impairments or losses of items of property, plant and equipment, related claims for or payments of compensation from third parties and any subsequent purchase or construction of replacement assets are separate economic events and are accounted for separately as follows:
- (a) Impairments of items of property, plant and equipment are recognized in accordance with IPSAS 21 or when adopted the equivalent *SLPSAS*;
 - (b) De recognition of items of property, plant and equipment retired or disposed of is determined in accordance with this Standard;
 - (c) Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up is included in determining surplus or deficit when it becomes receivable; and
 - (d) The cost of items of property, plant and equipment restored, purchased or constructed as replacement is determined in accordance with this Standard.

De recognition

80. **The carrying amount of an item of property, plant and equipment shall be derecognized:**
- (a) **On disposal; or**
 - (b) **When no future economic benefits or service potential is expected from its use or disposal.**
81. **The gain or loss arising from the de recognition of an item of property, plant and equipment shall be included in surplus or deficit when the item is derecognized (unless IPSAS 13, “Leases” or when adopted the equivalent SLPSAS requires otherwise on a sale and leaseback). Gains shall not be classified as revenue.**
82. The disposal of an item of property, plant and equipment may occur in a variety ways (e.g., by sale, by entering into a finance lease or by donation). In determining the date of disposal of an item, an entity applies the criteria in SLPSAS 10, “Revenue from Exchange Transactions” for recognizing revenue from the sale of goods. IPSAS 13, “Leases” or when adopted the equivalent SLPSAS applies to disposal by a sale and leaseback.
83. If, under the recognition principle in paragraph 14, an entity recognizes in the carrying amount of an item of property, plant and equipment the cost of a replacement for part of the item, then it derecognizes the carrying amount of the replaced part regardless of whether the replaced part had been depreciated separately. If it is not practicable for an entity to determine the carrying amount of the replaced part, it may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or constructed.
84. **The gain or loss arising from the de recognition of an item of property, plant and equipment shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.**

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85. The consideration receivable on disposal of an item of property, plant and equipment is recognized initially at its fair value. If payment for the item is deferred, the consideration received is recognized initially at the cash price equivalent. The difference between the nominal amount of the consideration and the cash price equivalent is recognized as interest revenue in accordance with SLPSAS 10 reflecting the effective yield on the receivable.

Disclosure

86. **The financial statements shall disclose, for each class of property, plant and equipment recognized in the financial statements:**
- (a) **The measurement bases used for determining the gross carrying amount;**
 - (b) **The depreciation methods used;**
 - (c) **The useful lives or the depreciation rates used;**
 - (d) **The gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and**
 - (e) **A reconciliation of the carrying amount at the beginning and end of the period showing:**
 - (i) **Additions;**
 - (ii) **Disposals;**
 - (iii) **Acquisitions through entity combinations;**
 - (iv) **Increases or decreases resulting from revaluations under paragraphs 42, 52 and 53 and from impairment losses (if any) recognized or reversed directly in net assets/equity in accordance with IPSAS 21 or when adopted the equivalent SLPSAS ;**

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- (v) **Impairment losses recognized in surplus or deficit in accordance with IPSAS 21** or when adopted the equivalent *SLPSAS*;
- (vi) **Impairment losses reversed in surplus or deficit in accordance with IPSAS 21** or when adopted the equivalent *SLPSAS*;
- (vii) **Depreciation;**
- (viii) **The net exchange differences arising on the translation of the financial statements from the functional currency into a different presentation currency, including the translation of a foreign operation into the presentation currency of the reporting entity; and**
- (ix) **Other changes.**

87. **The financial statements shall also disclose for each class of property, plant and equipment recognized in the financial statements:**

- (a) **The existence and amounts of restrictions on title, and property, plant and equipment pledged as securities for liabilities;**
- (b) **The amount of expenditures recognized in the carrying amount of an item of property, plant and equipment in the course of its construction;**
- (c) **The amount of contractual commitments for the acquisition of property, plant and equipment; and**
- (c) **If it is not disclosed separately on the face of the statement of Financial performance, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in surplus or de ficit.**

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88. Selection of the depreciation method and the estimation of the useful life of the assets are matters of judgment. Therefore, disclosure of the methods adopted and the estimated useful lives or depreciation rates provides users of financial statements with information that allows them to review the policies selected by management and enables comparisons to be made with other entities. For similar reasons, it is necessary to disclose:
- (a) Depreciation, whether recognized in surplus or deficit or as a part of the cost of other assets, during a period; and
 - (b) Accumulated depreciation at the end of the period.
89. In accordance with SLPSAS 3 "Accounting Policies, Changes in Accounting Estimates And Errors" , an entity discloses the nature and effect of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in subsequent periods. For property, plant and equipment, such disclosure may arise from changes in estimates with respect to:
- (a) Residual values;
 - (b) The estimated costs of dismantling, removing or restoring items of property, plant and equipment;
 - (c) Useful lives; and
 - (d) Depreciation methods.
90. **If a class of property, plant and equipment is stated at revalued amounts, the following shall be disclosed:**
- (a) **The effective date of the revaluation;**
 - (b) **Whether an independent valuer was involved;**
 - (c) **The methods and significant assumptions applied in estimating the assets' fair values;**
 - (d) **The extent to which the assets' fair values were determined directly by reference to observable prices in an active market**

or recent market transactions on arm's length terms or were estimated using other valuation techniques;

- (e) **The revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders or other equity holders;**
- (f) **The sum of all revaluation surpluses for individual items of property, plant and equipment within that class; and**
- (g) **The sum of all revaluation deficits for individual items of property, plant and equipment within that class.**

91. In accordance with IPSAS 21 or when adopted the equivalent SLPSAS , an entity discloses information on impaired property, plant and equipment in addition to the information required by paragraph 86 (e) (iv) to (vi).

92. Users of financial statements may also find the following information relevant to their needs:

- (a) The carrying amount of temporarily idle property, plant and equipment;
- (b) The gross carrying amount of any fully depreciated property, plant and equipment that is still in use;
- (c) The carrying amount of property, plant and equipment retired from active use and held for disposal; and
- (d) When the cost model is used, the fair value of property, plant and equipment when this is materially different from the carrying amount.

Therefore, entities are encouraged to disclose these amounts.

Transitional Provisions

93. Entities are not required to recognize property, plant and equipment for reporting periods beginning on a date within five years following the date

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of first adoption of accrual accounting in accordance with Sri Lanka Public Sector Accounting Standards:-

94. **An entity that adopts accrual accounting for the first time in accordance with Sri Lanka Public Sector Accounting Standards shall initially recognize property, plant and equipment at cost or fair value. For items of property, plant and equipment that were acquired at no cost, or for a nominal cost, cost is the item's fair value as at the date of acquisition.**
95. **The entity shall recognize the effect of the initial recognition of property, plant and equipment as an adjustment to the opening balance of accumulated surpluses or deficits for the period in which the property, plant and equipment is initially recognized.**
96. Prior to first application of this Standard, an entity may recognize its property, plant and equipment on a basis other than cost or fair value as defined in this Standard, or may control assets that it has not recognized. This Standard requires entities to initially recognize items of property, plant and equipment at cost or, fair value as at the date of initial recognition in accordance with this Standard. Where assets are initially recognized at cost and were acquired at no cost, or for a nominal cost, cost will be determined by reference to the asset's fair value as at the date of acquisition. Where the cost of acquisition of an asset is not known, its cost may be estimated by reference to its fair value as at the date of acquisition.
97. SLPSAS 3 requires an entity to retrospectively apply accounting policies unless it is impracticable to do so. Therefore, when an entity initially recognizes an item of property, plant and equipment at cost in accordance with this Standard, it shall also recognize any accumulated depreciation and any accumulated impairment losses that relate to that item, as if it had always applied those accounting policies.
98. Paragraph 14 of this Standard requires the cost of an item of property, plant and equipment to be recognized as an asset if, and only if:

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- (b) It is probable that future economic benefits or service potential associated with the item will flow to the entity; and
- (c) The cost or fair value of the item can be measured reliably.

99. The transitional provisions in paragraphs 93 and 94 are intended to give relief in situations where an entity is seeking to comply with the provisions of this Standard, in the context of implementing accrual accounting for the first time in accordance with Sri Lanka Public Sector Accounting Standards, with effect from the effective date of this Standard or subsequently. When entities adopt accrual accounting in accordance with Sri Lanka Public Sector Accounting Standards for the first time, there are often difficulties in compiling comprehensive information on the existence and valuation of assets. For this reason, for a five year period following the date of first adoption of accrual accounting in accordance with International Public Sector Accounting Standards, entities are not required to comply fully with the requirements of paragraph 14.
100. Notwithstanding the transitional provisions in paragraph 93 and 94, entities that are in the process of adopting accrual accounting are encouraged to comply in full with the provisions of this Standard as soon as possible.
101. The exemption from the requirements of paragraph 14 implies that the associated measurement and disclosure provisions of this Standard do not need to be complied with in respect of those assets or classes of asset that are not recognized under paragraphs 93 and 94.
102. **When an entity takes advantage of the transitional provisions in paragraphs 93 and 94 that fact shall be disclosed. Information on the major classes of asset that have not been recognized by virtue of paragraph 93 shall also be disclosed. When an entity takes advantage of the transitional provisions for a second or subsequent reporting period, details of the assets or classes of asset that were not recognized at the previous reporting date but that are now recognized shall be disclosed.**

Compliance with International Public Sector Accounting Standards

- 103 Compliance with this SLPSAS 7 ensures compliance in all material respects with International Public Sector Accounting Standard (IPSAS) 17 “Property, Plant and Equipment”.

Effective Date

104. **An entity shall apply this Sri Lanka Public Sector Accounting Standard for annual financial statements covering periods beginning on or after January 1, 2014. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2014, it shall disclose that fact.**
105. When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity’s annual financial statements covering periods beginning on or after the date of adoption.

Implementation Guidance 1—Frequency of Revaluation of Property, Plant and Equipment

This guidance accompanies, but is not part of SLPSAS 7.

- IG1. Paragraph 42 SLPSAS 7 requires entities that adopt the revaluation model to measure its assets at a revaluated amount does not differ significantly from that which would be determined using fair value at the reporting date. Paragraph 47 of SLPSAS 7 specifies that the frequency of revaluations depends upon the changes in the fair values of the items of property, plant and equipment being revalued. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is necessary. The purpose of this guidance is to assist entities that adopt the revaluation model to determine whether carrying amounts differ materially from the fair value as at reporting date.
- IG2. An entity assesses at each reporting date whether there is any indication that a revalued asset's carrying amount may differ materially from that which would be determined if the asset were revalued at the reporting date. If any such indication exists, the entity determines the asset's fair value and revalues the asset to that amount.
- IG3. In assessing whether there is any indication that a revalued asset's carrying amount may differ materially from that which would be determined if the asset were revalued at the reporting date, an entity considers, as a minimum, the following indications:

External sources of information

- (a) Significant changes affecting the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which the asset is dedicated;
- (b) Where market exists for the assets of the entity, market values are different from their carrying amounts;
- (c) During the period, a price index relevant to the asset has undergone a material change;

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Internal sources of information

- (d) Evidence is available of obsolescence or physical damage of an asset;
- (e) Significant changes affecting the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. Adverse changes include the asset becoming idle, or plans to dispose of an asset before the previously expected date, and reassessing the useful life of an asset as finite rather than indefinite. Favourable changes include capital expenditure incurred during the period to improve or enhance an asset in excess of its standard of performance assessed immediately before the expenditure is made; and
- (f) Evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse or better than expected.

IG4. The list in paragraph IG3 is not exhaustive. An entity may identify other indications that a revalued asset's carrying amount may differ materially from that which would be determined if the asset were revalued at the reporting date. The existence of these additional indicators would also indicate that the entity should revalue the asset to its current fair value as at the reporting date.

Implementation Guidance 2—Illustrative Disclosures Examples

This guidance accompanies, but is not part of, SLPSAS 7.

The Department of the Irrigation is a public sector entity that controls a wide range of property, plant and equipment and is responsible for replacement and maintenance of the property. The following are extracts from the notes to its Statement of Financial Position for the year ended 31 December 20X1 and illustrate the principal disclosures required in accordance with this Standard.

Notes

1 Land

(a) Land consists of twenty thousand hectares at various locations. Land is valued at fair value as at 31 December 20X1, as determined by the Office of the Chief Valuer, an independent valuer.

(b) Restrictions on Titles:

Five hundred hectares of land (carried at Rs. 62.5 million) is designated as national interest land and may not be sold without the approval of the legislature. Two hundred hectares (carried at Rs. 25 million) of the national interest land and a further two thousand hectares (carried at Rs. 250 million) of other land are subject to title claims by former owners in Court of Law and the Court has ordered that the land may not be disposed of until the claim is decided; the Department recognizes the jurisdiction of the Court of to hear these cases.

2. Buildings

(a) Buildings consist of office buildings and industrial facilities at various locations.

(b) Buildings are initially recognized at cost, but are subject to revaluation to fair value on an ongoing basis. The Office of the Chief Valuer determines fair value on a rolling basis within a short period of time. Revaluations are kept up to date.

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- (c) Depreciation is calculated on a straight-line basis over the useful life of the building. Office buildings have a useful life of twenty-five years, and industrial facilities have a useful life of fifteen years.
- (d) The Department has entered into five contracts for the construction of new buildings; total contract costs are Rs. 250,000 million.

3. Machinery

- (a) Machinery is measured at cost less depreciation.
- (b) Depreciation is calculated on a straight-line basis over the useful life of the machine.
- (c) The machinery has various useful lives:
Tractors: 10 years
Washing Equipment: 4 years
Cranes: 15 years
- (e) The Department has entered into a contract to replace the cranes it uses to clean and maintain the buildings - the contracted cost is Rs. 100,000.

4. Furniture and Fixtures

- (a) Furniture and fixtures are measured at cost less depreciation.
- (b) Depreciation is calculated on a straight-line basis over the useful life of the furniture and fixtures.
- (c) All items within this class have a useful life of five years.

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Reconciliations

(in Rs. millions)

Reporting Period	Land		Buildings		Machinery		Furniture and Fixtures	
	20X1	20X0	20X1	20X0	20X1	20X0	20X1	20X0
Opening Balance	2,250	2,025	2,090	2,260	1,085	1,100	200	150
Additions			250	100	120	200	20	100
Disposals			150	40	60	80	20	
Depreciation (As per Statement of Financial Performance)			160	180	145	135	50	50
Revaluations (net)	250	225	30	50				
Closing Balance (As per Statement of Financial Position)	2,500	2,250	2,000	2,090	1,000	1,085	150	200
Sum of Revaluation Surpluses (Paragraph 90(f))	750	500	250	250				
Sum of Revaluation Deficits (Paragraph 90(g))	25	25	380	350				
Gross Carrying Amount	2,500	2,250	2,500	2,430	1,500	1,440	250	250
Accumulated Depreciation			500	340	500	355	100	50
Net Carrying Amount	2,500	2,250	2,000	2,090	1,000	1,085	150	200

**SLPSAS 8 - PROVISIONS, CONTINGENT LIABILITIES
AND CONTINGENT ASSETS**

Acknowledgment

The Sri Lanka Public Sector Accounting Standard (SLPSAS) 8 “Provisions, Contingent Liabilities and Contingent Assets” “is based on International Public Sector Accounting Standard (IPSAS) 19 – “Provisions, Contingent Liabilities and Contingent Assets” of the International Public Sector Accounting Standards Board (IPSASB), published by the International Federation of Accountants (IFAC) in October 2002 (2009 Bound Volume) and is used with the permission of IFAC.

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Sri Lanka Public Sector Accounting Standard 8, “Provisions, Contingent Liabilities and Contingent Assets,” is set out in the objective and paragraphs 1–113. All the paragraphs have equal authority. SLPSAS 8 should be read in the context of its objective and the “Preface to Sri Lanka Public Sector Accounting Standards”. SLPSAS 3 “Accounting Policies, Changes in Accounting Estimates and Errors,” provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

The standards, which have been set in bold type, should be read in the context of the commentary paragraphs in this Standard, which are in plain type, and in the context of the “Preface to Sri Lanka Public Sector Accounting Standard”. Sri Lanka Public Sector Accounting Standards are not intended to apply to immaterial items.

Objective

The objective of this Standard is to define provisions, contingent liabilities and contingent assets, identify the circumstances in which provisions should be recognized, how they should be measured and the disclosures that should be made about them. The Standard also requires that certain information be disclosed about contingent liabilities and contingent assets in the notes to the financial statements to enable users to understand their nature, timing and amount.

Scope

1. An entity which prepares and presents financial statements under the accrual basis of accounting should apply this Standard in accounting for provisions, contingent liabilities and contingent assets, except:
 - (a) Those provisions and contingent liabilities arising from social benefits provided by an entity for which it does not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of those benefits;
 - (b) Those resulting from financial instruments that are carried at fair value;
 - (c) Those resulting from executory contracts, other than where the contract is onerous subject to other provisions of this paragraph;
 - (d) Those arising in insurance entities from contracts with policyholders;
 - (e) Those covered by another Sri Lanka Public Sector Accounting Standard;

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- (g) Those arising from employee benefits except employee termination benefits that arise as a result of a restructuring as dealt with in this Standard.
2. This Standard applies to all public sector entities other than Government Business Enterprises.
 3. **The “Preface to Sri Lanka Public Sector Accounting Standards” issued by the Institute of Chartered Accountants of Sri Lanka (ICASL)) explains that Government Business Enterprises (GBEs) apply Sri Lanka Accounting Standards - (SLFRS/LKAS) which are issued by the Institute of Chartered Accountants of Sri Lanka (ICASL). GBEs are defined in SLPSAS 1, “Presentation of Financial Statements.”**
 4. **This Standard applies to financial instruments (including guarantees) that are not carried at fair value.**
 5. **This Standard applies to provisions, contingent liabilities and contingent assets of insurance entities other than those arising from contracts with policyholders.**
 6. **This Standard applies to provisions for restructuring (including discontinued operations). In some cases, a restructuring may meet the definition of a discontinued operation. Guidance on disclosing information about discontinued operations is found in “SLFRS 5 “Non Current Assets Held for Sale and Discontinued Operations”**

Social Benefits

7. **For the purposes of this Standard “social benefits” refer to goods, services and other benefits provided in the pursuit of the social policy objectives of a government. These benefits may include:**
 - (a) **The delivery of health, education, housing, transport and other social services to the community. In many cases, there is no requirement for the beneficiaries of these services to pay an amount equivalent to the value of these services; and**

(b) **Payment of benefits to families, the aged, the disabled, the unemployed, veterans and others. That is, governments at all levels may provide financial assistance to individuals and groups in the Community to access services to meet their particular needs, or to supplement their income.**

8. **In many cases, obligations to provide social benefits arise as a consequence of a government’s commitment to undertake particular activities on an ongoing basis over the long term in order to provide particular goods and services to the community. The need for, and nature and supply of, goods and services to meet social policy obligations will often depend on a range of demographic and social conditions and are difficult to predict. These benefits generally fall within the social protection, education and health classifications under the International Monetary Fund’s Government Finance Statistics framework and often require an actuarial assessment to determine the amount of any liability arising in respect of them.**
9. **For a provision or contingency arising from a social benefit to be excluded from the scope of this Standard, the public sector entity providing the benefit will not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of the benefit. This exclusion would encompass those circumstances where a charge is levied in respect of the benefit but there is no direct relationship between the charge and the benefit received. The exclusion of these provisions and contingent liabilities from the scope of this Standard reflects the Committee’s view that both the determination of what constitutes the obligating event and the measurement of the liability require further consideration before proposed Standards are exposed. For example, the Committee is aware that there are differing views about whether the obligating event occurs when the individual meets the eligibility criteria for the benefit or at some earlier stage. Similarly, there are differing views about whether the amount of any obligation reflects an estimate of the current period’s entitlement or the present value of all expected future benefits determined on an actuarial basis.**
- 10 **Where an entity elects to recognize a provision for such obligations, the entity discloses the basis on which the provisions have been recognized and the measurement basis adopted. The entity also makes**

other disclosures required by this Standard in respect of those provisions. SLPSAS 1 “Presentation of Financial Statements,” provides guidance on dealing with matters not specifically dealt with by another SLPSAS. SLPSAS 1 also includes requirements relating to the selection and disclosure of accounting policies.

- 11 In some cases, social benefits may give rise to a liability for which there is:
- (a) Little or no uncertainty as to amount; and
 - (b) The timing of the obligation is not uncertain.

Accordingly, these are not likely to meet the definition of a provision in this Standard. Where such liabilities for social benefits exist, they are recognized where they satisfy the criteria for recognition as liabilities (refer also to paragraph 19). An example would be a period-end accrual for an amount owing to the existing beneficiaries in respect of aged or disability pensions that have been approved for payment consistent with the provisions of a contract or legislation.

Other Exclusions from the Scope of the Standard

- 12 This Standard does not apply to executory contracts unless they are onerous. Contracts to provide social benefits entered into with the expectation that the entity will not receive consideration that is approximately equal to the value of goods and services provided directly in return from the recipients of those benefits are excluded from the scope of this Standard.
- 13 Where another Sri Lanka Public Sector Accounting Standard deals with a specific type of provision, contingent liability or contingent asset, an entity applies that Standard instead of this Standard.
- 14 This Standard does not apply to provisions for income taxes or income tax equivalents (guidance on accounting for income taxes is found in LKAS 12 Income Taxes. Nor does it apply to provisions arising from employee benefits (guidance on accounting for employee benefits is found in LKAS 19 “Employee Benefits”

- 15 **Some amounts treated as provisions may relate to the recognition of revenue, for example where an entity gives guarantees in exchange for a fee. This Standard does not address the recognition of revenue. SLPSAS 10, “Revenue from Exchange Transactions,” identifies the circumstances in which revenue from exchange transactions is recognized and provides practical guidance on the application of the recognition criteria. This Standard does not change the requirements of SLPSAS 10.**
- 16 **This Standard defines provisions as liabilities of uncertain timing or amount. The term provision is also used in the context of items such as depreciation, impairment of assets and doubtful debts: these are adjustments to the carrying amounts of assets and are not addressed in this Standard.**
- 17 **Other Sri Lanka Public Sector Accounting Standards specify whether expenditures are treated as assets or as expenses. These issues are not addressed in this Standard. Accordingly, this Standard neither prohibits nor requires capitalization of the costs recognized when a provision is made.**

Definitions

18. The following terms are used in this Standard with the meanings specified:
- A constructive obligation is an obligation that derives from an entity’s actions where:
- (a) By an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and
 - (b) As a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.
- A contingent asset is a possible asset that arises from past events, and whose existence will be confirmed only by the occurrence or non-

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occurrence of one or more uncertain future events not wholly within the control of the entity.

A contingent liability is:

- (a) A possible obligation that arises from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
- (b) A present obligation that arises from past events but is not recognized because:
 - (i) It is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; or
 - (ii) The amount of the obligation cannot be measured with sufficient reliability.

Executory contracts are contracts under which neither party has performed any of its obligations, or both parties have partially performed their obligations to an equal extent.

A legal obligation is an obligation that derives from:

- (a) A contract (through its explicit or implicit terms);
- (b) Legislation; or
- (c) Other operation of law.

Liabilities are present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.

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An obligating event is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.

An onerous contract is a contract for the exchange of assets or services in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits or service potential expected to be received under it.

A provision is a liability of uncertain timing or amount.

A restructuring is a program that is planned and controlled by management, and materially changes either:

- (a) The scope of an entity's activities; or
- (b) The manner in which those activities are carried out.

Provisions and Other Liabilities

19. Provisions can be distinguished from other liabilities such as payables and accruals because there is uncertainty about the timing or amount of the future expenditure required in settlement. By contrast:

- (a) **Payables are liabilities to pay for goods or services that have been received or supplied and have been invoiced or formally agreed with the supplier (and include payments in respect of social benefits where formal agreements for specified amounts exist); and**
- (b) **Accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier, including amounts due to employees (for example, amounts relating to accrued vacation**

pay). Although it is sometimes necessary to estimate the amount or timing of accruals, the uncertainty is generally much less than for provisions.

Accruals are often reported as part of accounts payable, whereas provisions are reported separately.

Relationship between Provisions and Contingent Liabilities

20. In a general sense, all provisions are contingent because they are uncertain in timing or amount. However, within this Standard the term contingent is used for liabilities and assets that are not recognized because their existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. In addition, the term contingent liability is used for liabilities that do not meet the recognition criteria.
21. This Standard distinguishes between:
- (a) Provisions which are recognized as liabilities (assuming that a reliable estimate can be made) because they are present obligations and it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligations; and
 - (b) Contingent liabilities which are not recognized as liabilities because they are either:
 - (i) Possible obligations, as it has yet to be confirmed whether the entity has a present obligation that could lead to an outflow of resources embodying economic benefits or service potential; or
 - (ii) Present obligations that do not meet the recognition criteria in this Standard (because either it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation, or a sufficiently reliable estimate of the amount of the obligation cannot be made).

Recognition

Provisions

22. A provision should be recognized when:
- (a) An entity has a present obligation (legal or constructive) as a result of a past event;
 - (b) It is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; and
 - (c) A reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision should be recognized.

Present Obligation

23. In some cases it is not clear whether there is a present obligation. In these cases, a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is more likely than not that a present obligation exists at the reporting date.
24. **In most cases it will be clear whether a past event has given rise to a present obligation. In other cases, for example in a lawsuit, it may be disputed either whether certain events have occurred or whether those events result in a present obligation. In such cases, an entity determines whether a present obligation exists at the reporting date by taking account of all available evidence, including, for example, the opinion of experts.**

The evidence considered includes any additional evidence provided by events after the reporting date. On the basis of such evidence:

- (a) **Where it is more likely than not that a present obligation exists at the reporting date, the entity recognizes a provision (if the recognition criteria are met); and**
- (b) **Where it is more likely that no present obligation exists at the reporting date, the entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits or service potential is remote (see paragraph 100).**

Past Event

- 25. A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the entity has no realistic alternative to settling the obligation created by the event. This is the case only:**
- (a) **Where the settlement of the obligation can be enforced by law; or**
 - (b) **In the case of a constructive obligation, where the event (which may be an action of the entity) creates valid expectations in other parties that the entity will discharge the obligation.**
- 26. Financial statements deal with the financial position of an entity at the end of its reporting period and not its possible position in the future. Therefore, no provision is recognized for costs that need to be incurred to continue an entity's ongoing activities in the future. The only liabilities recognized in an entity's statement of financial position are those that exist at the reporting date.**
- 27. It is only those obligations arising from past events existing independently of an entity's future actions (that is, the future conduct of its activities) that are recognized as provisions. Examples of such obligations are penalties or clean-up costs for unlawful environmental damage imposed by legislation on a public sector entity. Both of these**

obligations would lead to an outflow of resources embodying economic benefits or service potential in settlement regardless of the future actions of that public sector entity. Similarly, a public sector entity would recognize a provision for the decommissioning costs of a defence installation or a government-owned nuclear power station to the extent that the public sector entity is obliged to rectify damage already caused. SLPSAS 7 “Property, Plant and Equipment,” deals with items, including dismantling and site restoring costs that are included in the cost of an asset). In contrast, because of legal requirements, pressure from constituents or a desire to demonstrate community leadership, an entity may intend or need to carry out expenditure to operate in a particular way in the future. An example would be where a public sector entity decides to fit emission controls on certain of its vehicles or a government laboratory decides to install extraction units to protect employees from the fumes of certain chemicals. Because the entities can avoid the future expenditure by their future actions— for example, by changing their method of operation, they have no present obligation for that future expenditure and no provision is recognized.

28. An obligation always involves another party to whom the obligation is owed. It is not necessary, however, to know the identity of the party to whom the obligation is owed — indeed the obligation may be to the public at large. Because an obligation always involves a commitment to another party, it follows that a decision by an entity’s management, governing body or controlling entity does not give rise to a constructive obligation at the reporting date unless the decision has been communicated before the reporting date to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will discharge its responsibilities.
29. An event that does not give rise to an obligation immediately may do so at a later date, because of changes in the law or because an act (for example, a sufficiently specific public statement) by the entity gives rise to a constructive obligation. For example, when environmental damage is caused by a government agency there may be no obligation

to remedy the consequences. However, the causing of the damage will become an obligating event when a new law requires the existing damage to be rectified or when the controlling government or the individual agency publicly accepts responsibility for rectification in a way that creates a constructive obligation.

30. Where details of a proposed new law have yet to be finalized, an obligation arises only when the legislation is virtually certain to be enacted as drafted. For the purpose of this Standard, such an obligation is treated as a legal obligation. However, differences in circumstances surrounding enactment often make it impossible to specify a single event that would make the enactment of a law virtually certain. In many cases, it is not possible to judge whether a proposed new law is virtually certain to be enacted as drafted and any decision about the existence of an obligation should await the enactment of the proposed law.

Probable Outflow of Resources Embodying Economic Benefits or Service Potential

31. For a liability to qualify for recognition there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits or service potential to settle that obligation. For the purpose of this Standard, an outflow of resources or other event is regarded as probable if the event is more likely than not to occur, that is, the probability that the event will occur is greater than the probability that it will not. Where it is not probable that a present obligation exists, an entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits or service potential is remote (see paragraph 100).
32. Where there are a number of similar obligations (for example, a government's obligation to compensate individuals who have received contaminated blood from a government-owned hospital) the

probability that an outflow will be required in settlement is determined by considering the class of obligations as a whole. Although the likelihood of outflow for any one item may be small, it may well be probable that some outflow of resources will be needed to settle the class of obligations as a whole. If that is the case, a provision is recognized (if the other recognition criteria are met).

Reliable Estimate of the Obligation

- 33. The use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability. This is especially true in the case of provisions, which by their nature are more uncertain than most other assets or liabilities. Except in extremely rare cases, an entity will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is sufficiently reliable to use in recognizing a provision.**
- 34. In the extremely rare case where no reliable estimate can be made, a liability exists that cannot be recognized. That liability is disclosed as a contingent liability (see paragraph 100).**

Contingent Liabilities

- 35. An entity should not recognize a contingent liability.**
- 36. A contingent liability is disclosed, as required by paragraph 100, unless the possibility of an outflow of resources embodying economic benefits or service potential is remote.**
- 37. Where an entity is jointly and severally liable for an obligation the part of the obligation that is expected to be met by other parties is treated as a contingent liability. For example, in the case of joint venture debt, that part of the obligation that is to be met by other joint venture participants is treated as a contingent liability. The entity**

recognizes a provision for the part of the obligation for which an outflow of resources embodying economic benefits or service potential is probable, except in the rare circumstances where no reliable estimate can be made.

38. **Contingent liabilities may develop in a way not initially expected. Therefore, they are assessed continually to determine whether an outflow of resources embodying economic benefits or service potential has become probable. If it becomes probable that an outflow of future economic benefits or service potential will be required for an item previously dealt with as a contingent liability, a provision is recognized in the financial statements of the period in which the change in probability occurs (except in the extremely rare circumstances where no reliable estimate can be made). For example, a local government entity may have breached an environmental law but it remains unclear whether any damage was caused to the environment. Where, subsequently it becomes clear that damage was caused and remediation will be required, the entity would recognize a provision because an outflow of economic benefits is now probable.**

Contingent Assets

39. An entity should not recognize a contingent asset.
40. **Contingent assets usually arise from unplanned or other unexpected events that are not wholly within the control of the entity and give rise to the possibility of an inflow of economic benefits or service potential to the entity. An example is a claim that an entity is pursuing through legal processes, where the outcome is uncertain.**
41. **Contingent assets are not recognized in financial statements since this may result in the recognition of revenue that may never be realized. However, when the realization of revenue is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate.**

42. **A contingent asset is disclosed, as required by paragraph 105, where an inflow of economic benefits or service potential is probable.**
43. **Contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it has become virtually certain that an inflow of economic benefits or service potential will arise and the asset's value can be measured reliably, the asset and the related revenue are recognized in the financial statements of the period in which the change occurs. If an inflow of economic benefits or service potential has become probable, an entity discloses the contingent asset (see paragraph 105).**

Measurement

Best Estimate

44. The amount recognized as a provision should be the best estimate of the expenditure required to settle the present obligation at the reporting date.
45. **The best estimate of the expenditure required to settle the present obligation is the amount that an entity would rationally pay to settle the obligation at the reporting date or to transfer it to a third party at that time. It will often be impossible or prohibitively expensive to settle or transfer an obligation at the reporting date. However, the estimate of the amount that an entity would rationally pay to settle or transfer the obligation gives the best estimate of the expenditure required to settle the present obligation at the reporting date.**
46. The estimates of outcome and financial effect are determined by the judgment of the management of the entity, supplemented by experience of similar transactions and, in some cases, reports from independent experts. The evidence considered includes any additional evidence provided by events after the reporting date.

Example

A government medical laboratory provides diagnostic ultrasound scanners to both governments owned and privately owned medical centers and hospitals on a full cost recovery basis. The equipment is provided with a warranty under which the medical centers and hospitals are covered for the cost of repairs of any defects that become apparent within the first six months after purchase. If minor defects were detected in all equipment provided, repair costs of Rs. 1 million would result. If major defects were detected in all equipment provided, repair costs of Rs. 4 million would result. The laboratory's past experience and future expectations indicate that, for the coming year, 75% of the equipment will have no defects, 20% of the equipment will have minor defects and 5% of the equipment will have major defects. In accordance with paragraph 32, the laboratory assesses the probability of an outflow for the warranty obligations as a whole.

The expected value of the cost of repairs is:

$$(75\% \text{ of nil}) + (20\% \text{ of Rs. 1 m}) + (5\% \text{ of Rs.4 m}) = \text{Rs. 400,000}$$

47. **Uncertainties surrounding the amount to be recognized as a provision are dealt with by various means according to the circumstances. Where the provision being measured involves a large population of items, the obligation is estimated by weighting all possible outcomes by their associated probabilities. The name for this statistical method of estimation is expected value. The provision will therefore be different depending on whether the probability of a loss of a given amount is, for example, 60% or 90%. Where there is a continuous range of possible outcomes, and each point in that range is as likely as any other, the mid-point of the range is used.**
48. **Where a single obligation is being measured, the individual most likely outcome may be the best estimate of the liability. However, even in such a case, the entity considers other possible outcomes. Where other**

possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount. For example, if a government has to rectify a serious fault in a defence vessel that it has constructed for another government, the individual most likely outcome may be for the repair to succeed at the first attempt at a cost of Rs. 100,000 but a provision for a larger amount is made if there is a significant chance that further attempts will be necessary.

49. The provision is measured before tax or tax equivalents. Guidance on dealing with the tax consequences of a provision, and changes in it, is found in LKAS 12 Income Taxes

Risks and Uncertainties

50. The risks and uncertainties that inevitably surround many events and circumstances should be taken into account in reaching the best estimate of a provision.
51. Risk describes variability of outcome. A risk adjustment may increase the amount at which a liability is measured. Caution is needed in making judgments under conditions of uncertainty, so that revenue or assets are not overstated and expenses or liabilities are not understated. However, uncertainty does not justify the creation of excessive provisions or a deliberate overstatement of liabilities. For example, if the projected costs of a particularly adverse outcome are estimated on a prudent basis, that outcome is not then deliberately treated as more probable than is realistically the case. Care is needed to avoid duplicating adjustments for risk and uncertainty with consequent overstatement of a provision.
52. Disclosure of the uncertainties surrounding the amount of the expenditure is made under paragraph 98(b).

Present Value

53. Where the effect of the time value of money is material, the amount of a provision should be the present value of the expenditures expected to be required to settle the obligation.
54. **Because of the time value of money, provisions relating to cash outflows that arise soon after the reporting date are more onerous than those where cash outflows of the same amount arise later. Provisions are therefore discounted, where the effect is material.**
55. **When a provision is discounted over a number of years, the present value of the provision will increase each year as the provision comes closer to the expected time of settlement (refer to Appendix E). Paragraph 97(e) of this Standard requires disclosure of the increase during the period in the discounted amount arising from the passage of time.**
56. The discount rate (or rates) should be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability. The discount rate(s) should not reflect risks for which future cash flow estimates have been adjusted.
57. **In some jurisdictions, income taxes or income tax equivalents are levied on a public sector entity's surplus for the period. Where such income taxes are levied on public sector entities, the discount rate selected should be a pre tax rate.**

Future Events

58. Future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that they will occur.
59. **Expected future events may be particularly important in measuring provisions. For example, certain obligations may be index linked to compensate recipients for the effects of inflation or other specific price changes. If there is sufficient evidence of likely expected rates of inflation this should be reflected in the amount of the provision. Another example of future events affecting the amount of a provision is where a government believes that the cost of cleaning up the tar, ash and other pollutants associated with a gasworks' site at the end of its life will be reduced by future changes in technology. In this case, the amount recognized reflects the cost that technically qualified, objective observers reasonably expect to be incurred, taking account of all available evidence as to the technology that will be available at the time of the clean-up. Thus it is appropriate to include, for example, expected cost reductions associated with increased experience in applying existing technology or the expected cost of applying existing technology to a larger or more complex clean-up operation than has previously been carried out. However, an entity does not anticipate the development of a completely new technology for cleaning up unless it is supported by sufficient objective evidence.**
60. **The effect of possible new legislation which may affect the amount of an existing obligation of a government or an individual public sector entity is taken into consideration in measuring that obligation when sufficient objective evidence exists that the legislation is virtually certain to be enacted. The variety of circumstances that arise in practice makes it impossible to specify a single event that will provide sufficient, objective evidence in every case. Evidence is required both of what legislation will demand and of whether it is virtually certain to be enacted and implemented in due course. In many cases, sufficient objective evidence will not exist until the new legislation is enacted.**

Expected Disposal of Assets

- 61 Gains from the expected disposal of assets should not be taken into account in measuring a provision.
- 62. Gains on the expected disposal of assets are not taken into account in measuring a provision, even if the expected disposal is closely linked to the event giving rise to the provision. Instead, an entity recognizes gains on expected disposals of assets at the time specified by the Sri Lanka Public Sector Accounting Standard dealing with the assets concerned.**

Reimbursements

63. Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognized when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation. The reimbursement should be treated as a separate asset. The amount recognized for the reimbursement should not exceed the amount of the provision.
- 64. In the statement of financial performance, the expense relating to a provision may be presented net of the amount recognized for a reimbursement.**
- 65. Sometimes, an entity is able to look to another party to pay part or all of the expenditure required to settle a provision (for example, through insurance contracts, indemnity clauses or suppliers' warranties). The other party may either reimburse amounts paid by the entity or pay the amounts directly. For example, a government agency may have legal liability to an individual as a result of misleading advice provided by its employees. However, the agency may be able to recover some of the expenditure from professional indemnity insurance.**

66. **In most cases, the entity will remain liable for the whole of the amount in question so that the entity would have to settle the full amount if the third party failed to pay for any reason. In this situation, a provision is recognized for the full amount of the liability, and a separate asset for the expected reimbursement is recognized when it is virtually certain that reimbursement will be received if the entity settles the liability.**
67. **In some cases, the entity will not be liable for the costs in question if the third party fails to pay. In such a case, the entity has no liability for those costs and they are not included in the provision.**
68. **As noted in paragraph 37, an obligation for which an entity is jointly and severally liable is a contingent liability to the extent that it is expected that the obligation will be settled by the other parties.**

Changes in Provisions

69. Provisions should be reviewed at each reporting date and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation, the provision should be reversed.
70. **Where discounting is used, the carrying amount of a provision increases in each period to reflect the passage of time. This increase is recognized as an interest expense.**

Use of Provisions

71. A provision should be used only for expenditures for which the provision was originally recognized.
72. **Only expenditures that relate to the original provision are set against it. Setting expenditures against a provision that was originally recognized for another purpose would conceal the impact of two different events.**

Application of the Recognition and Measurement Rules

Future Operating Net Deficits

73. Provisions should not be recognized for net deficits from future operating activities.
74. **Net deficits from future operating activities do not meet the definition of liabilities in paragraph 18 and the general recognition criteria set out for provisions in paragraph 22.**
75. **An expectation of net deficits from future operating activities is an indication that certain assets used in these activities may be impaired. An entity tests these assets for impairment. Guidance on accounting for impairment is found in LKAS 36, “Impairment of Assets.”**

Onerous Contracts

76. If an entity has a contract that is onerous, the present obligation (net of recoveries) under the contract should be recognized and measured as a provision.
77. **Paragraph 76 of this Standard applies only to contracts that are onerous. Contracts to provide social benefits entered into with the expectation that the entity does not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of those benefits are excluded from the scope of this Standard.**
78. **Many contracts evidencing exchange transactions (for example, some routine purchase orders) can be cancelled without paying compensation to the other party, and therefore there is no obligation. Other contracts establish both rights and obligations for each of the contracting parties. Where events make such a contract onerous, the**

contract falls within the scope of this Standard and a liability exists which is recognized. Executory contracts that are not onerous fall outside the scope of this Standard.

- 79. This Standard defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits or service potential expected to be received under it which includes amounts recoverable. Therefore, it is the present obligation net of recoveries that is recognized as a provision under paragraph 76. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfill it.**
- 80. Before a separate provision for an onerous contract is established, an entity recognizes any impairment loss that has occurred on assets dedicated to that contract.**

Restructuring

- 81. The following are examples of events that may fall under the definition of restructuring:**
- (a) Termination or disposal of an activity or service;**
 - (b) The closure of a branch office or termination of activities of a government agency in a specific location or regions or the relocation of activities from one region to another;**
 - (c) Changes in management structure, for example, eliminating a layer of management or executive service; and**
 - (d) Fundamental reorganizations that have a material effect on the nature and focus of the entity's operations.**

- 82. A provision for restructuring costs is recognized only when the general recognition criteria for provisions set out in paragraph 22 are met. Paragraphs 83 to 96 set out how the general recognition criteria apply to restructurings.**
- 83.** A constructive obligation to restructure arises only when an entity:
- (a) Has a detailed formal plan for the restructuring identifying at least:
 - (i) The activity/operating unit or part of an activity /operating unit concerned;
 - (ii) The principal locations affected;
 - (iii) The location, function, and approximate number of employees who will be compensated for terminating their services;
 - (iv) The expenditures that will be undertaken; and
 - (v) When the plan will be implemented; and
 - (b) Has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.
- 84. Within the public sector, restructuring may occur at the whole-of government, portfolio or ministry, or agency level.**
- 85. Evidence that a government or an individual entity has started to implement a restructuring plan would be provided, for example, by the public announcement of the main features of the plan, the sale or transfer of assets, notification of intention to cancel leases or the**

establishment of alternative arrangements for clients of services. A public announcement of a detailed plan to restructure constitutes a constructive obligation to restructure only if it is made in such a way and in sufficient detail (that is, setting out the main features of the plan) that it gives rise to valid expectations in other parties such as users of the service, suppliers and employees (or their representatives) that the government or the entity will carry out the restructuring.

86. For a plan to be sufficient to give rise to a constructive obligation when communicated to those affected by it, its implementation needs to be planned to begin as soon as possible and to be completed in a timeframe that makes significant changes to the plan unlikely. If it is expected that there will be a long delay before the restructuring begins or that the restructuring will take an unreasonably long time, it is unlikely that the plan will raise a valid expectation on the part of others that the government or individual entity is at present committed to restructuring, because the timeframe allows opportunities for the government or entity to change its plans.
87. A decision by management or the governing body to restructure taken before the reporting date does not give rise to a constructive obligation at the reporting date unless the entity has, before the reporting date:
- (a) Started to implement the restructuring plan; or
 - (b) Announced the main features of the restructuring plan to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will carry out the restructuring.

If an entity starts to implement a restructuring plan, or announces its main features to those affected, only after the reporting date, disclosure may be required under SLPSAS 6 “Events after the Reporting Date,” if the restructuring is material and non-disclosure

could influence the economic decisions of users taken on the financial statements.

- 88. Although a constructive obligation is not created solely by a management or governing body decision, an obligation may result from other earlier events together with such a decision. For example, negotiations with employee representatives for termination payments, or with purchasers for the sale or transfer of an operation, may have been concluded subject only to governing body or board approval. Once that approval has been obtained and communicated to the other parties, the entity has a constructive obligation to restructure, if the conditions of paragraph 83 are met.**
- 89. In some jurisdictions , the ultimate authority for making decisions about a public sector entity is vested in a governing body or board whose membership includes representatives of interests other than those of management (for example, employees) or notification to these representatives may be necessary before the governing body or board decision is taken. Because a decision by such a governing body or board involves communication to these representatives, it may result in a constructive obligation to restructure.**

Sale or Transfer of Operations

- 90. No obligation arises as a consequence of the sale or transfer of an operation until the entity is committed to the sale or transfer, that is, there is a binding agreement.**
- 91. Even when an entity has taken a decision to sell an operation and announced that decision publicly, it cannot be committed to the sale until a purchaser has been identified and there is a binding sale agreement, the entity will be able to change its mind and indeed will have to take another course of action if a purchaser cannot be found**

on acceptable terms. When a sale is only part of a restructuring, a constructive obligation can arise for the other parts of the restructuring before a binding sale agreement exists.

92. **Restructuring within the public sector often involves the transfer of operations from one controlled entity to another and may involve the transfer of operations at no or nominal consideration. Such transfers will often take place under a government directive and will not involve binding agreements as described in paragraph 90. An obligation exists only when there is a binding transfer agreement. Even where proposed transfers do not lead to the recognition of a provision, the planned transaction may require disclosure under other Sri Lanka Public Sector Accounting Standards or proposed Standards such as the SLPSAS 6 “Events after the Reporting Date” and IPSAS 20, “Related Party Disclosures.” or when adopted the equivalent SLPSAS.**

Restructuring Provisions

93. A restructuring provision should include only the direct expenditures arising from the restructuring, which are those that are both:

- (a) Necessarily entailed by the restructuring; and
- (b) Not associated with the ongoing activities of the entity.

94. **A restructuring provision does not include such costs as:**

- (a) **Retraining or relocating continuing staff;**
- (b) **Marketing; or**
- (c) **Investment in new systems and distribution networks. These expenditures relate to the future conduct of an activity and are not liabilities for restructuring at the reporting date. Such expenditures are recognized on the same basis as if they arose independently of a restructuring**

- 95. Identifiable future operating net deficits up to the date of a restructuring are not included in a provision, unless they relate to an onerous contract as defined in paragraph 18.**
- 96. As required by paragraph 61, gains on the expected disposal of assets are not taken into account in measuring a restructuring provision, even if the sale of assets is envisaged as part of the restructuring.**

Disclosure

97. For each class of provision, an entity should disclose:
- (a) The carrying amount at the beginning and end of the period;
 - (b) Additional provisions made in the period, including increases to existing provisions;
 - (c) Amounts used (that is, incurred and charged against the provision) during the period;
 - (d) Unused amounts reversed during the period; and
 - (e) The increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate.
- Comparative information is not required.
98. An entity should disclose the following for each class of provision:
- (a) A brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits or service potential;

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- (b) An indication of the uncertainties about the amount or timing of those outflows. Where necessary to provide adequate information, an entity should disclose the major assumptions made concerning future events, as addressed in paragraph 58; and
 - (c) The amount of any expected reimbursement, stating the amount of any asset that has been recognized for that expected reimbursement.
99. Where an entity elects to recognize in its financial statements provisions for social benefits for which it does not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of those benefits, it should make the disclosures required in paragraphs 97 and 98 in respect of those provisions.
- 100. Unless the possibility of any outflow in settlement is remote, an entity should disclose for each class of contingent liability at the reporting date a brief description of the nature of the contingent liability and, where practicable:**
- (a) **An estimate of its financial effect, measured under paragraphs 44 to 62;**
 - (b) **An indication of the uncertainties relating to the amount or timing of any outflow; and**
 - (c) **The possibility of any reimbursement.**
- 101. In determining which provisions or contingent liabilities may be aggregated to form a class, it is necessary to consider whether the nature of the items is sufficiently similar for a single statement about them to fulfill the requirements of paragraphs 98(a) and (b) and 100(a) and (b). Thus, it may be appropriate to treat as a single class of provision amounts relating to one type of obligation, but it would not be appropriate to treat as a single class amounts relating to environmental restoration costs and amounts that are subject to legal proceedings.**

- 102. Where a provision and a contingent liability arise from the same set of circumstances, an entity makes the disclosures required by paragraphs 97, 98 and 100 in a way that shows the link between the provision and the contingent liability.**
- 103. An entity may in certain circumstances use external valuation to measure a provision. In such cases, information relating to the valuation can usefully be disclosed.**
- 104. The disclosure requirements in paragraph 100 do not apply to contingent liabilities that arise from social benefits provided by an entity for which it does not receive consideration that is approximately equal to the value of goods or services provided, directly in return from the recipients of those benefits (see paragraphs 1(a) and 7–11 for a discussion of the exclusion of social benefits from this Standard).**
- 105. Where an inflow of economic benefits or service potential is probable, an entity should disclose a brief description of the nature of the contingent assets at the reporting date, and, where practicable, an estimate of their financial effect, measured using the principles set out for provisions in paragraphs 44 to 62.**
- 106. The disclosure requirements in paragraph 105 are only intended to apply to those contingent assets where there is a reasonable expectation that benefits will flow to the entity. That is, there is no requirement to disclose this information about all contingent assets (see paragraphs 39 to 43 for a discussion of contingent assets). It is important that disclosures for contingent assets avoid giving misleading indications of the likelihood of revenue arising. For example, a contingent asset would arise from a contract where a public sector entity allows a private sector company to mine one of its properties in exchange for a royalty based on a set price per ton extracted and the company has commenced mining. In addition to disclosing the nature of the arrangement, the contingent asset should**

be quantified where a reasonable estimate can be made of the quantity of mineral to be extracted and the timing of the expected cash inflows. If there were no proven reserves or some other circumstances prevailed that indicated that it would be unlikely that any minerals would be extracted, the public sector entity would not disclose information required by paragraph 105 as there is no probable flow of benefits.

- 107.** The disclosure requirements in paragraph 105 encompass contingent assets from both exchange and non-exchange transactions. Whether a contingent asset exists in relation to taxation revenues rests on the interpretation of what constitute s a taxable event. The determination of the taxable event for taxation revenue and its possible implications for the disclosure of contingent assets related to taxation revenues are to be dealt with as a part of a separate project on non-exchange revenue.
108. Where any of the information required by paragraphs 100 and 105 is not disclosed because it is not practicable to do so, that fact should be stated.
109. In extremely rare cases, disclosure of some or all of the information required by paragraphs 97 to 107 can be expected to prejudice seriously the position of the entity in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset. In such cases, an entity need not disclose the information, but should disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.

Transitional Provisions

- 110.** The effect of adopting this Standard on its effective date (or earlier) should be reported as an adjustment to the opening balance of accumulated surpluses/(deficits) for the period in which the Standard is first adopted. Entities are encouraged, but not required, to adjust the opening balance of accumulated surpluses/(deficits) for the earliest period presented and to

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restate comparative information. If comparative information is not restated, this fact should be disclosed.

Compliance with International Public Sector Accounting Standards

- 111 **Compliance with this SLPSAS 8 ensures compliance in all material respects with International Public Sector Accounting Standard 19 “Provisions, Contingent Liabilities and Contingent Assets”**

Effective Date

112. This Sri Lanka Public Sector Accounting Standard becomes effective for annual financial statements covering periods beginning on or after 01 January 2014. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 01, 2014, it shall disclose that fact.
113. **When an entity adopts the accrual basis of accounting, as defined by Sri Lanka Public Sector Accounting Standards, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity’s annual financial statements covering periods beginning on or after the date of adoption.**

Tables—Provisions, Contingent Liabilities, Contingent Assets and Reimbursements

The purpose of this appendix is to summarize the main requirements of the standards. It does not form part of the standards and should be read in the context of the full text of the standards.

Provisions and Contingent Liabilities

Where, as a result of past events, there may be an outflow of resources embodying future economic benefits or service potential in settlement of: (a) a present obligation; or (b) a possible obligation whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity		
There is a present obligation that probably requires an outflow of resources.	There is a possible obligation or present obligations that may, but probably will not, require an outflow of resources.	There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote.
A provision is recognized (Paragraph 22). Disclosures are required for the provision (Paragraphs 97 and 98).	No provision is recognized (Paragraph 35). Disclosures are required for the contingent liability (Paragraph 100).	No provision is recognized (Paragraph 35). No disclosure is required (Paragraph 100).

A contingent liability also arises in the extremely rare case where there is a liability that cannot be recognized because it cannot be measured reliably. Disclosures are required for the contingent liability.

Contingent Assets

Where, as a result of past events, there is a possible asset whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity		
The inflow of economic benefits or service potential is virtually certain.	The inflow of economic benefits or service potential is probable, but not virtually certain.	The inflow of economic benefits or service potential is not probable
The asset is not contingent (Paragraph 41).	No asset is recognized (Paragraph 39).	No asset is recognized (Paragraph 39).
	Disclosures are required (Paragraph 105).	No disclosure is Required (Paragraph 105).

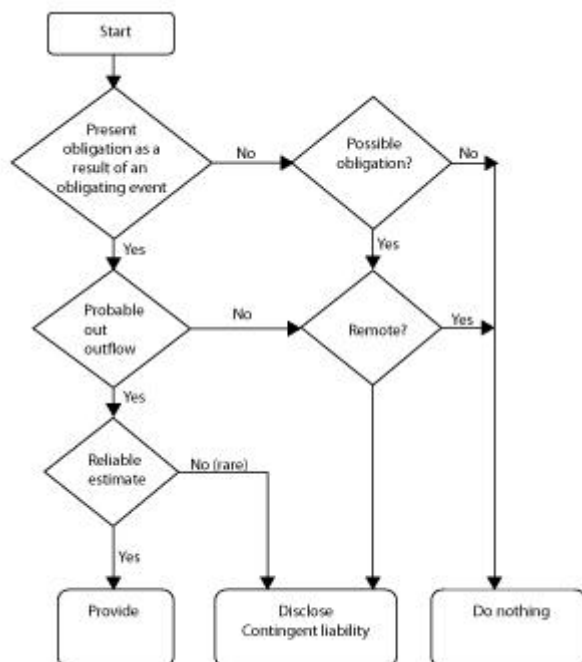
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Reimbursements

Some or all of the expenditure required to settle a provision is expected to be reimbursed by another party.		
The entity has no obligation for the part of the expenditure to be reimbursed by the other party.	The obligation for the amount expected to be reimbursed remains with the entity and it is virtually certain that reimbursement will be received if the entity Settles the provision.	The obligation for the amount expected to be reimbursed remains with the entity and the reimbursement is not virtually certain if the entity settles the provision
The entity has no liability for the amount to be reimbursed (paragraph 67).	The reimbursement is recognized as a separate asset in the statement of financial position and may be offset against the expense in the statement of financial performance. The amount recognized for the expected reimbursement does not exceed the liability (paragraphs 63 and 64).	The expected reimbursement is not recognized as an asset (paragraph 63).
No disclosure is required	The reimbursement is disclosed together with the amount recognized for the Reimbursement (paragraph 98(c)).	The expected reimbursement is disclosed (paragraph 98(c)).

Decision Tree

The purpose of the decision tree is to summarize the main recognition requirements of the standards for provisions and contingent liabilities that fall within the scope of the Standard. The decision tree does not form part of the standards and should be read in the context of the full text of the standards.



Note: in some cases, it is not clear whether there is a present obligation. In these cases, a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is more likely than not that a present obligation exists at the reporting date (paragraph 23 of the Standard).

Examples: Recognition

This appendix illustrates the application of the standards to assist in clarifying their meaning. It does not form part of the standards.

All the entities in the examples have a reporting date of December 31. In all cases, it is assumed that a reliable estimate can be made of any outflows expected. In some examples the circumstances described may have resulted in impairment of the assets — this aspect is not dealt with in the examples.

The cross-references provided in the examples indicate paragraphs of the Standard that are particularly relevant. The appendix should be read in the context of the full text of the standards.

References to “best estimate” are to the present value amount, where the effect of the time value of money is material.

Example 1: Warranties

Government Department A manufactures search and rescue equipment for use within the Government and for sale to the public. At the time of sale the Department gives warranties to purchasers in relation to certain products. Under the terms of the sale the Department undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. On past experience, it is probable (that is, more likely than not) that there will be some claims under the warranties.

Analysis

Present obligation as a result of a past obligating event—the obligating event is the sale of the product with a warranty, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits or service potential in settlement—probable for the warranties as a whole (see paragraph 32).

Conclusion—A provision is recognized for the best estimate of the costs of making good under the warranty products sold on or before the reporting date (see paragraphs 22 and 32).

Example 2A: Contaminated Land—Legislation Virtually Certain to be Enacted

A provincial Council owns a warehouse on land near a port. The provincial Council has retained ownership of the land because it may require the land for future expansion of its port operations. For the past ten years a group of farmers have leased the property as a storage facility for agricultural chemicals. The Central government announces its intention to enact environmental legislation requiring property owners to accept liability for environmental pollution, including the cost of cleaning-up contaminated land. As a result, the provincial government introduces.

hazardous chemical policy and begins applying the policy to its activities and properties. At this stage it becomes apparent that the agricultural chemicals have contaminated the land surrounding the warehouse. The Provincial Council has no recourse against the farmers or its insurance company for the clean-up costs. At December 31, 20XX it is virtually certain that a draft law requiring a clean-up of land already contaminated will be enacted shortly after the year end.

Analysis

Present obligation as a result of a past obligating event—The obligating event is the contamination of the land because of the virtual certainty of legislation requiring the clean-up.

An outflow of resources embodying economic benefits or service potential in settlement1—Probable

Conclusion—A provision is recognized for the best estimate of the costs of the clean-up (see paragraphs 22 and 30).

Example 2B: Contamination and Constructive Obligation

A government has a widely published environmental policy in which it undertakes to clean up all contamination that it causes. The government has a record of honouring this published policy. There is no environmental legislation in place in the jurisdiction. During the course of a naval exercise a vessel is damaged and leaks a substantial amount of oil. The government agrees to pay for the costs of the immediate clean-up and the ongoing costs of monitoring and assisting marine animals and birds.

Analysis

Present obligation as a result of a past obligating event—The obligating event is the contamination of the environment, which gives rise to a constructive obligation because the policy and previous conduct of the government has created a valid expectation that the government will clean up the contamination.

An outflow of resources embodying economic benefits or service potential in settlement—Probable.

Conclusion—A provision is recognized for the best estimate of the costs of the clean-up (see paragraphs 22 and 30).

Example 3: Gravel Quarry

A government operates a gravel quarry on land that it leases on a commercial basis from a private sector company. The gravel is used for the construction and maintenance of roads. The agreement with the landowners requires the government to restore the quarry site by removing all buildings, reshaping the land and replacing all topsoil. 60% of the eventual restoration costs relate to the removal of the quarry buildings and restoration of the site, and 40% arise through the extraction of gravel. At the reporting date, the quarry buildings have been constructed and excavation of the site has begun but no gravel has been extracted.

Analysis

Present obligation as a result of a past obligating event—The construction of buildings and the excavation of the quarry creates a legal obligation under the terms of the agreement to remove the buildings and restore the site and is thus an obligating event. At the reporting date, however, there is no obligation to rectify the damage that will be caused by extraction of the gravel.

An outflow of resources embodying economic benefits or service potential in settlement—Probable.

Conclusion—A provision is recognized for the best estimate of 60% of the eventual costs that relate to the removal of the buildings and restoration of the site (see paragraph 22). These costs are included as part of the cost of the quarry. The 40% of costs that arise through the extraction of gravel are recognized as a liability progressively when the gravel is extracted.

Example 4: Refunds Policy

A government stores agency operates as a centralized purchasing agency and allows the public to purchase surplus supplies. It has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known.

Analysis

Present obligation as a result of a past obligating event—**part of its customers that the agency will refund purchases. The obligating event is the sale of the supplies, which gives rise to a constructive obligation because the conduct of the agency has created a valid expectation on the part of its customers that the agency will refund purchases.**

An outflow of resources embodying economic benefits or service potential in settlement—**Probable that a proportion of goods are returned for refund (see paragraph 32).**

Conclusion—**A provision is recognized for the best estimate of the costs of refunds (see paragraphs 18 (the definition of a constructive obligation), 22, 25 and 32).**

Example 5A: Closure of a Division—No Implementation before Reporting Date

On 2 December 20XX a government decides to close down a division of a government agency. The decision was not communicated to any of those affected before the reporting date (December 31, 20XX) and no other steps were taken to implement the decision.

Analysis

Present obligation as a result of a past obligating event—**There has been no obligating event and so there is no obligation.**

Conclusion—**No provision is recognized (see paragraphs 22 and 83).**

Example 5B: Outsourcing of a Division—Implementation before the Reporting Date

On December 12, 20XX a government decided to outsource a division of a government department. On December 20, 20XX a detailed plan for outsourcing the division was agreed by the government, and redundancy notices were sent to the staff of the division.

Analysis

Present obligation as a result of a past obligating event—**The obligating event is the communication of the decision to employees, which gives rise to a constructive obligation from that date, because it creates a valid expectation that the division will be outsourced.**

An outflow of resources embodying economic benefits or service potential in settlement—**Probable.**

Conclusion—**A provision is recognized at December 31, 20XX for the best estimate of the costs of outsourcing the division (see paragraphs 22 and 83).**

Example 6: Legal Requirement to Fit Air Filters

Under new legislation, a local government entity is required to fit new air filters to its public buildings by 30 June 20X1 . The entity has not fitted the air filters.

Analysis

(a) **At the reporting date of December 31, 20X0**

Present obligation as a result of a past obligating event—**There is no obligation because there is no obligating event either for the costs of fitting air filters or for fines under the legislation.**

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Conclusion—No provision is recognized for the cost of fitting the filters (see paragraphs 22 and 25–27).

(b) At the reporting date of December 31, 20X1

Present obligation as a result of a past obligating event—There is still no obligation for the costs of fitting air filters because no obligating event has occurred (the fitting of the filters). However, an obligation might arise to pay fines or penalties under the legislation because the obligating event has occurred (the non-compliance of the public buildings).

An outflow of resources embodying economic benefits or service potential in Settlement — Assessment of probability of incurring fines and penalties for non compliance depends on the details of the legislation and the stringency of the enforcement regime.

Conclusion—No provision is recognized for the costs of fitting air filters. However, a provision is recognized for the best estimate of any fines and penalties that are more likely than not to be imposed (see paragraphs 22 and 25–27).

Example 7: Staff Retraining as a Result of Changes in the Income Tax System

The government introduces a number of changes to the income tax system. As a result of these changes, the taxation department (reporting entity) will need to retrain a large proportion of its administrative and compliance staff in order to ensure continued compliance with financial services regulation. At the reporting date, no retraining of staff has taken place.

Analysis

Present obligation as a result of a past obligating event—There is no obligation

Because no obligating event (retraining) has taken place.

Conclusion—**No provision is recognized (see paragraphs 22 and 25–27).**

Example 8: An Onerous Contract

A hospital laundry operates from a building that the hospital (the reporting entity) has leased under an operating lease. During December 20XX the laundry relocates to a new building. The lease on the old building continues for the next four years: it cannot be cancelled. The hospital has no alternative use for the building and the building cannot be re-let to another user.

Analysis

Present obligation as a result of a past obligating event—**The obligating event is the signing of the lease contract, which gives rise to a legal obligation.**

An outflow of resources embodying economic benefits or service potential in settlement— **When the lease becomes onerous, an outflow of resources embodying economic benefits is probable. (Until the lease becomes onerous, the hospital accounts for the lease under IPSAS 13, “Leases” or when adopted the equivalent).**

Conclusion—**A provision is recognized for the best estimate of the unavoidable lease payments (see paragraphs 13(b), 22 and 76).**

Example 9: A Single Guarantee

During, 20X0 a Provincial Council gives a guarantee of certain borrowings of a private sector operator providing public services for a fee, whose financial condition at that time is sound. During, 20X1 the financial condition of the operator deteriorates and at June 30, 20X1 the operator files for protection from its creditors.

Analysis

(a) At December 31 20X0

Present obligation as a result of a past obligating event—**The obligating event is the giving of the guarantee, which gives rise to a legal obligation.**

An outflow of resources embodying economic benefits or service potential in settlement—**No outflow of benefits is probable at December 31, 20X0.**

Conclusion—**No provision is recognized (see paragraphs 22 and 31). The guarantee is disclosed as a contingent liability unless the probability of any outflow is regarded as remote (see paragraphs 100 and 109).**

(b) At December 31, 20X1

Present obligation as a result of a past obligating event—**The obligating event is the giving of the guarantee, which gives rise to a legal obligation.**

An outflow of resources embodying economic benefits or service potential in settlement—**At December 31, 20X1, it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation.**

Conclusion—**A provision is recognized for the best estimate of the obligation (see paragraphs 22, 31 and 109).**

Note: This example deals with a single guarantee. If an entity has a portfolio of similar guarantees, it will assess that portfolio as a whole in determining whether an outflow of resources embodying economic benefits or service potential is probable (see paragraph 32). Where an entity gives guarantees in

exchange for a fee, revenue is recognized under SLPAS 10, “Revenue from Exchange Transactions.”

Example 10: A Court Case

After a luncheon in 20X0, ten people died, possibly as a result of food poisoning from products sold by a restaurant at a public institution (the reporting entity). Legal proceedings are started seeking damages from the entity but it disputes liability. Up to the date of authorization of the financial statements for the year to December 31, 20X0 for issue, the entity’s lawyers advise that it is probable that the entity will not be found liable. However, when the entity prepares the financial statements for the year to December 31, 20X1, its lawyers advise that, owing to developments in the case, it is probable that the entity will be found liable.

Analysis

(a) At December 31, 20X0

Present obligation as a result of a past obligating event—**On the basis of the evidence available when the financial statements were approved, there is no obligation as a result of past events.**

Conclusion—No provision is recognized by the institution (see paragraphs 23 and 24). The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote (paragraphs 100 and 109).

(b) At December 31, 20X1

Present obligation as a result of a past obligating event—**On the basis of the evidence available, there is a present obligation.**

An outflow of resources embodying economic benefits or service potential in settlement—**Probable.**

Conclusion—A provision is recognized for the best estimate of the amount to settle the obligation (paragraphs 22–24 and 109).

Example 11: Repairs and Maintenance

Some assets require, in addition to routine maintenance, substantial expenditure every few years for major refits or refurbishment and the replacement of major components. SLPSAS 7, “Property, Plant and Equipment,” gives guidance on allocating expenditure on an asset to its component parts where these components have different useful lives or provide benefits in a different pattern.

Example 11A: Refurbishment Costs – No Legislative

A furnace for heating a building that is leased out by a government department to a number of public sector tenants has a lining that needs to be replaced every five years for technical reasons. At the reporting date, the lining has been in use for three years.

Analysis

Present obligation as a result of a past obligating event—There is no present obligation.

Conclusion—No provision is recognized (see paragraphs 22 and 25–27).

The cost of replacing the lining is not recognized because, at the reporting date, no obligation to replace the lining exists independently of the entity’s future actions — even the intention to incur the expenditure depends on the entity deciding to continue operating the furnace or to replace the lining. Instead of a provision being recognized, the depreciation of the lining takes account of its consumption, that is, it is depreciated over five years. The re-lining costs then

incurred are capitalized with the consumption of each new lining shown by depreciation over the subsequent five years.

Example 11B: Refurbishment Costs—Legislative Requirement

A government cartography service is required by law to overhaul its aircraft used for aerial mapping once every three years.

Analysis

Present obligation as a result of a past obligating event—There is no present obligation.

Conclusion—No provision is recognized (see paragraphs 22 and 25–27).

The costs of overhauling aircraft are not recognized as a provision for the same reasons as the cost of replacing the lining is not recognized as a provision in Example 11A. Even a legal requirement to overhaul does not make the costs of overhaul a liability, because no obligation exists to overhaul the aircraft independently of the entity’s future actions—the entity could avoid the future expenditure by its future actions, for example by selling the aircraft

Examples: Disclosures

The appendix is illustrative only and does not form part of the standards. The purpose of the appendix is to illustrate the application of the standards to assist in clarifying their meaning.

Two examples of the disclosures required by paragraph 98 are provided below and on the following page.

Example 1: Warranties

A government institution with responsibility for the prevention of workplace accidents gives warranties at the time of sale to purchasers of its safety products. Under the terms of the warranty, the department undertakes to repair or replace items that fail to perform satisfactorily for two years from the date of sale. At the reporting date, a provision of Rs. 60,000 has been recognized. The provision has not been discounted as the effect of discounting is not material. The following information is disclosed:

A provision of Rs. 60,000 currency units has been recognized for expected warranty claims on products sold during the last three financial years. It is expected that the majority of this expenditure will be incurred in the next financial year, and all will be incurred within two years of the reporting date.

Example 2: Decommissioning Costs

In 2012, a state-owned research facility, which uses a nuclear reactor to develop radio isotopes that are used for medical purposes, recognizes a provision for decommissioning costs of Rs. 300 million. The provision is estimated using the assumption that decommissioning will take place in 60–70 years' time. However, there is a possibility that it will not take place until 100–110 years' time, in which case the present value of the costs will be significantly reduced.

The following information is disclosed:

A provision of Rs. 300 million has been recognized for decommissioning costs. These costs are expected to be incurred between 2072 and 2082; however, there is a possibility that decommissioning will not take place until 2112–2122. If the costs were measured based upon the expectation that they would not be incurred until 2112–2122 the provision would be

An example is given below of the disclosures required by paragraph 109 where some of the information required is not given because it can be expected to prejudice seriously the position of the entity.

Example 3: Disclosure Exemption

A government research agency is involved in a dispute with a company, which is alleging that the research agency has infringed copyright in its use of genetic material and is seeking damages of Rs. 100 million. The research agency recognizes a provision for its best estimate of the obligation, but discloses none of the information required by paragraphs 97 and 98 of the Standard. The following information is disclosed:

Litigation is in process against the agency relating to a dispute with a company that alleges that the agency has infringed patents and is seeking damages of Rs. 100 million currency units. The information usually required by SLPSAS 08, "Provisions, Contingent Liabilities and Contingent Assets" is not disclosed on the grounds that it can be expected to prejudice seriously the outcome of the litigation. The board is of the opinion that the claim can be successfully defended by the agency.

Example: Present Value of a Provision

The appendix is illustrative only and does not form part of the standards. The purpose of the appendix is to illustrate the application of the standards to assist in clarifying their meaning.

The following example illustrates the journal entries made on initial recognition of the present value of a provision and the subsequent recognition of increases in the present value of that provision. The increase in the provision is recognized as an interest expense (paragraph 70).

The expected value of a provision at the end of year 5 is Rs. 2,000. This expected value has not been risk adjusted. An appropriate discount rate which takes account of the risk associated with this cash flow has been estimated at 12%

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Journal entries to record the provision and changes in the value of the provision each year are as follows:

	Rs. Cts	Rs. Cts
End of current reporting period		
DR Interest Expense	1,134.85	
CR Provision		1,134.85
End of Year 1		
DR Interest Expense	136.18	
CR Provision		136.18
End of Year 2		
DR Interest Expense	152.52	
CR Provision		152.52
End of Year 3		
DR Interest Expense	170.83	
CR Provision		170.83
End of Year 4		
DR Interest Expense	191.33	
CR Provision		191.33
End of Year 5		
DR Interest Expense	214.29	
CR Provision		214.29

Increase

Calculations:

Current time : Present value = $2000/(1.12)^5 = 1134.85$	
End of Year 1: Present value = $2000/(1.12)^4 = 1271.04$	136.18
End of Year 2: Present value = $2000/(1.12)^3 = 1423.56$	152.52
End of Year 3: Present value = $2000/(1.12)^2 = 1594.39$	170.83
End of Year 4: Present value = $2000/(1.12)^1 = 1785.71$	191.33
End of Year 5: Present value = $2000/(1.12)^0 = 2000.00$	214.29

SPLSAS 9- INVENTORIES

Acknowledgment

The Sri Lanka Public Sector Accounting Standard (SLPSAS) 9 “Inventories,” is based on International Public Sector Accounting Standard (IPSAS) 12 “Inventories,” of the International Public Sector Accounting Standards Board (IPSASB), published by the International Federation of Accountants (IFAC) in December 2006 (2009 Bound Volume) and is used with permission of IFAC.

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Sri Lanka Public Sector Accounting Standard 9, “Inventories,” is set out in paragraphs 1–53. All the paragraphs have equal authority. SLPSAS 9 should be read in the context of its objective and the “Preface to Sri Lanka Public Sector Accounting Standards.” SLPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors,” provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe the accounting treatment for inventories. A primary issue in accounting for inventories is the amount of cost to be recognized as an asset and carried forward until the related revenues are recognized. This Standard provides guidance on the determination of cost and its subsequent recognition as an expense, including any write down to net realizable value. It also provides guidance on the cost formulas that are used to assign costs to inventories.

Scope

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for all inventories except:**
 - (a) **Work-in-progress arising under construction contracts, including directly related service contracts (see IPSAS 11, “Construction Contracts” or when adopted the equivalent SLPSAS);**
 - (b) **Financial instruments (see IPSAS 28, “Financial Instruments: Presentation” or when adopted the equivalent SLPSAS and IPSAS 29, “Financial Instruments: Recognition and Measurement” or when adopted the equivalent SLPSAS);**
 - (c) **Biological assets related to agricultural activity and agricultural produce at the point of harvest (see IPSAS 27, “Agriculture” or when adopted the equivalent SLPSAS); and**
 - (d) **Work-in-progress of services to be provided for no or nominal consideration directly in return from the recipients.**
3. **This Standard does not apply to the measurement of inventories held by:**
 - (a) **Producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products, to the extent that they are measured at net realizable value in accordance with well-established practices in those industries. When such inventories are measured at net realizable value, changes in that value are recognized in surplus or deficit in the period of the change; and**
 - (b) **Commodity broker-traders who measure their inventories at fair value less costs to sell. When such inventories are**

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measured at fair value less costs to sell, changes in fair value less costs to sell are recognized in surplus or deficit in the period of the change.

4. **This Standard applies to all public sector entities other than Government Business Enterprises.**
5. The “Preface to Sri Lanka Public Sector Accounting Standards” issued by the Institute of Chartered Accountants of Sri Lanka (ICASL) explains that Government Business Enterprises (GBEs) apply SLFRS/LKAS issued by the ICASL. GBEs are defined in SLPSAS 1, “Presentation of Financial Statements.”
6. The inventories referred to in paragraph 2(d) are not encompassed by LKAS 2 “Inventories,” and are excluded from the scope of this Standard because they involve specific public sector issues that require further consideration.
7. The inventories referred to in paragraph 3(a) are measured at net realizable value at certain stages of production. This occurs, for example, (a) when agricultural crops have been harvested or minerals have been extracted and sale is assured under a forward contract or a government guarantee, or (b) when an active market exists and there is a negligible risk of failure to sell. These inventories are excluded only from the measurement requirements of this Standard.
8. Broker-traders are those who buy or sell commodities for others or on their own account. The inventories referred to in paragraph 3(b) are principally acquired with the purpose of selling in the near future and generating a surplus from fluctuations in price or broker-traders’ margin. When these inventories are measured at fair value less costs to sell, they are excluded only from the measurement requirements of this Standard.

Definitions

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

Current replacement cost is the cost the entity would incur to acquire the asset on the reporting date.

Inventories are assets:

- (a) **In the form of materials or supplies to be consumed in the production process;**
- (b) **In the form of materials or supplies to be consumed or distributed in the rendering of services;**
- (c) **Held for sale or distribution in the ordinary course of operations; or**
- (d) **In the process of production for sale or distribution.**

Exchange Transactions

Transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange

Fair Value

The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Net realizable value is the estimated selling price in the ordinary course of operations, less the estimated costs of completion and the estimated costs necessary to make the sale, exchange, or distribution.

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

Net Realizable Value

10. Net realizable value refers to the net amount that an entity expects to realize from the sale of inventory in the ordinary course of operations. Fair value reflects the amount for which the same inventory could be exchanged between knowledgeable and willing buyers and sellers in the marketplace. The former is an entity-specific value; the latter is not. Net realizable value for inventories may not equal fair value less costs to sell.

Inventories

11. Inventories encompass goods purchased and held for resale including, for example, merchandise purchased by an entity and held for resale, or land and other property held for sale. Inventories also encompass finished goods produced, or work-in- progress being produced, by the entity. Inventories also include (a) materials and supplies awaiting use in the production process, and (b) goods purchased or produced by an entity, which are for distribution to other parties for no charge or for a nominal charge, for example, educational books produced by a health authority for donation to schools. In many public sector entities, inventories will relate to the provision of services rather than goods purchased and held for resale or goods manufactured for sale. In the case of a service provider, inventories include the costs of the service, as described in paragraph 28, for which the entity has not yet recognized the related revenue (guidance on recognition of revenue can be found in SLPSAS 10 “Revenue from Exchange Transactions.”)
12. Inventories in the public sector may include:
 - (a) Ammunition;
 - (b) Consumable stores;
 - (c) Maintenance materials;
 - (d) Spare parts for plant and equipment, other than those dealt with in standard on Property, Plant and Equipment;
 - (e) Strategic stockpiles (for example, energy reserves);
 - (f) Stocks of unissued currency;
 - (g) Postal service supplies held for sale (for example, stamps);
 - (h) Work-in-progress, including:
 - (i) Educational/training course materials; and
 - (ii) Client services (for example, auditing services), where those services are sold at arm’s length prices; and
 - (i) Land/property held for sale.
13. Where the government controls the rights to create and issue various assets, including postal stamps and currency, these items of inventory are recognized as inventories for the purposes of this Standard. They are not

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reported at face value, but measured in accordance with paragraph 15, that is, at their printing or minting cost.

14. When a government maintains strategic stockpiles of various reserves, such as energy reserves (for example, oil), for use in emergency or other situations (for example, natural disasters or other civil defense emergencies), these stockpiles are recognized as inventories for the purposes of this Standard and treated accordingly.

Measurement of Inventories

15. **Inventories shall be measured at the lower of cost and net realizable value, except where paragraph 16 applies.**
16. **Where inventories are acquired through a non-exchange transaction, their cost shall be measured at their fair value as at the date of acquisition.**
17. **Inventories shall be measured at the lower of cost and current replacement cost where they are held for:**
 - (a) **Distribution at no charge or for a nominal charge; or**
 - (b) **Consumption in the production process of goods to be distributed at no charge or for a nominal charge.**

Cost of Inventories

18. **The cost of inventories shall comprise all costs of purchase, costs of conversion, and other costs incurred in bringing the inventories to their present location and condition.**

Costs of Purchase

19. The costs of purchase of inventories comprise (a) the purchase price, (b) import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities), and (c) transport, handling, and other costs directly attributable to the acquisition of finished goods, materials, and supplies. Trade discounts, rebates, and other similar items are deducted in determining the costs of purchase.

Costs of Conversion

20. The costs of converting work-in-progress inventories into finished goods inventories are incurred primarily in a manufacturing environment. The costs of conversion of inventories include costs directly related to the units of production, such as direct labor. They also include a systematic

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allocation of fixed and variable production overheads that are incurred in converting materials into finished goods.

Fixed production overheads are those indirect costs of production that remain relatively constant regardless of (a) the volume of production, such as depreciation and maintenance of factory buildings and equipment, and (b) the cost of factory management and administration. Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labor.

21. The allocation of fixed production overheads to the costs of conversion is based on the normal capacity of the production facilities. Normal capacity is the production expected to be achieved on average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The actual level of production may be used if it approximates normal capacity. The amount of fixed overhead allocated to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognized as an expense in the period in which they are incurred. In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is decreased, so that inventories are not measured above cost. Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.
22. For example, the allocation of costs, both fixed and variable, incurred in the development of undeveloped land held for sale into residential or commercial landholdings could include costs relating to landscaping, drainage, pipe laying for utility connection, etc.
23. A production process may result in more than one product being produced simultaneously. This is the case, for example, when joint products are produced or when there is a main product and a by-product. When the costs of conversion of each product are not separately identifiable, they are allocated between the products on a rational and consistent basis. The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production. Most by-products, by their nature, are immaterial. When this is the case, they are often measured at net realizable value, and this value is deducted from the cost of the main product. As a result, the carrying amount of the main product is not materially different from its cost.

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Other Costs

24. Other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition. For example, it may be appropriate to include non-production overheads or the costs of designing products for specific customers in the cost of inventories.
25. Examples of costs excluded from the cost of inventories and recognized as expenses in the period in which they are incurred are:
 - (a) Abnormal amounts of wasted materials, labour, or other production costs;
 - (b) Storage costs, unless those costs are necessary in the production process before a further production stage;
 - (c) Administrative overheads that do not contribute to bringing inventories to their present location and condition; and
 - (d) Selling costs.
26. SLPSAS 4 “Borrowing Costs,” identifies limited circumstances where borrowing costs are included in the cost of inventories.
27. An entity may purchase inventories on deferred settlement terms. When the arrangement effectively contains a financing element, that element, for example a difference between the purchase price for normal credit terms and the amount paid, is recognized as interest expense over the period of the financing.

Cost of Inventories of a Service Provider

28. To the extent that service providers have inventories (except those referred to in paragraph 2(d)), they measure them at the costs of their production. These costs consist primarily of the labour and other costs of personnel directly engaged in providing the service, including supervisory personnel and attributable overheads. The costs of labor not engaged in providing the service are not included. Labour and other costs relating to sales and general administrative personnel are not included, but are recognized as expenses in the period in which they are incurred. The cost of inventories of a service provider does not include surplus margins or non-attributable overheads that are often factored into prices charged by service providers.

Cost of Agricultural Produce Harvested from Biological Assets

29. In accordance with IPSAS 27 or when adopted the equivalent SLPSAS, inventories comprising agricultural produce that an entity has harvested from its biological assets shall be measured on initial recognition at their fair value less costs to sell at the point of harvest. This is the cost of the inventories at that date for application of this Standard.

Techniques for the Measurement of Cost

30. Techniques for the measurement of the cost of inventories, such as the standard cost method or the retail method, may be used for convenience if the results approximate cost. Standard costs take into account normal levels of materials and supplies, labour, efficiency, and capacity utilization. They are regularly reviewed and, if necessary, revised in the light of current conditions.
31. Inventories may be transferred to the entity by means of a non-exchange transaction. For example, an international aid agency may donate medical supplies to a public hospital in the aftermath of a natural disaster. Under such circumstances, the cost of inventory is its fair value as at the date it is acquired.

Cost Formulas

32. **The cost of inventories of items that are not ordinarily interchangeable, and goods or services produced and segregated for specific projects, shall be assigned by using specific identification of their individual costs.**
33. Specific identification of costs means that specific costs are attributed to identify items of inventory. This is an appropriate treatment for items that are segregated for a specific project, regardless of whether they have been bought or produced. However, specific identification of costs is inappropriate when there are large numbers of items of inventory that are ordinarily interchangeable. In such circumstances, the method of selecting those items that remain in inventories could be used to obtain predetermined effects on the net surplus or deficit for the period.
34. **When applying paragraph 33 an entity shall use the same cost formula for all inventories having similar nature and use to the entity. For inventories with different nature or use (for example, certain**

commodities used in one segment and the same type of commodities used in another segment), different cost formulas may be justified. A difference in geographical location of inventories (and in the respective tax rules), by itself, is not sufficient to justify the use of different cost formulas.

35. **The cost of inventories, other than those dealt with in paragraph 32, shall be assigned by using the first-in, first-out (FIFO) or weighted average cost formulas. An entity shall use the same cost formula for all inventories having a similar nature and use to the entity. For inventories with a different nature or use, different cost formulas may be justified.**
36. For example, inventories used in one segment may have a use to the entity different from the same type of inventories used in another segment. However, a difference in geographical location of inventories, by itself, is not sufficient to justify the use of different cost formulas.
37. The FIFO formula assumes that the items of inventory that were purchased first are sold first, and consequently the items remaining in inventory at the end of the period are those most recently purchased or produced. Under the weighted average cost formula, the cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period, and the cost of similar items purchased or produced during the period. The average may be calculated on a periodic basis, or as each additional shipment is received, depending upon the circumstances of the entity.

Net Realizable Value

38. The cost of inventories may not be recoverable if those inventories are damaged, if they have become wholly or partially obsolete, or if their selling prices have declined. The cost of inventories may also not be recoverable if the estimated costs of completion or the estimated costs to be incurred to make the sale, exchange, or distribution have increased. The practice of writing inventories down below cost to net realizable value is consistent with the view that assets are not to be carried in excess of the future economic benefits or service potential expected to be realized from their sale, exchange, distribution, or use.
39. Inventories are usually written down to net realizable value on an item by item basis. In some circumstances, however, it may be appropriate to group similar or related items. This may be the case with items of inventory that

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have similar purposes or end uses, and cannot practicably be evaluated separately from other items in that product line. It is not appropriate to write down inventories based on a classification of inventory, for example, finished goods, or all the inventories in a particular operation or geographical segment. Service providers generally accumulate costs in respect of each service for which a separate selling price is charged. Therefore, each such service is treated as a separate item.

40. Estimates of net realizable value also take into consideration the purpose for which the inventory is held. For example, the net realizable value of the quantity of inventory held to satisfy firm sales or service contracts is based on the contract price. If the sales contracts are for less than the inventory quantities held, the net realizable value of the excess is based on general selling prices. Guidance on the treatment of provisions or contingent liabilities, such as those arising from firm sales contracts in excess of inventory quantities held, and on firm purchase contracts can be found in SLPSAS 8 “Provisions, Contingent Liabilities and Contingent Assets.”
41. Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold, exchanged, or distributed at or above cost. However, when a decline in the price of materials indicates that the cost of the finished products exceeds net realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value.
42. A new assessment is made of net realizable value in each subsequent period. When the circumstances that previously caused inventories to be written down below cost no longer exist, or when there is clear evidence of an increase in net realizable value because of changed economic circumstances, the amount of the write down is reversed (i.e., the reversal is limited to the amount of the original write down) so that the new carrying amount is the lower of the cost and the revised net realizable value. This occurs, for example, when an item of inventory that is carried at net realizable value because its selling price has declined is still on hand in a subsequent period and its selling price has increased.

Distributing Goods at No Charge or for a Nominal Charge

43. A public sector entity may hold inventories whose future economic benefits or service potential are not directly related to their ability to generate net cash inflows. These types of inventories may arise when a government has determined to distribute certain goods at no charge or for a nominal amount. In these cases, the future economic benefits or service potential of the inventory for financial reporting purposes is reflected by the amount the entity would need to pay to acquire the economic benefits or service potential if this was necessary to achieve the objectives of the entity. Where the economic benefits or service potential cannot be acquired in the market, an estimate of replacement cost will need to be made. If the purpose for which the inventory is held changes, then the inventory is valued using the provisions of paragraph 15.

Recognition as an Expense

44. **When inventories are sold, exchanged, or distributed, the carrying amount of those inventories shall be recognized as an expense in the period in which the related revenue is recognized. If there is no related revenue, the expense is recognized when the goods are distributed or the related service is rendered. The amount of any write down of inventories and all losses of inventories shall be recognized as an expense in the period the write down or loss occurs. The amount of any reversal of any write down of inventories shall be recognized as a reduction in the amount of inventories recognized as an expense in the period in which the reversal occurs.**
45. For a service provider, the point when inventories are recognized as expenses normally occurs when services are rendered, or upon billing for chargeable services.
46. Some inventories may be allocated to other asset accounts, for example, inventory used as a component of self-constructed property, plant, or equipment. Inventories allocated to another asset in this way are recognized as an expense during the useful life of that asset.

Disclosure

47. **The financial statements shall disclose:**
- (a) **The accounting policies adopted in measuring inventories, including the cost formula used;**
 - (b) **The total carrying amount of inventories and the carrying amount in classifications appropriate to the entity;**
 - (c) **The carrying amount of inventories carried at fair value less costs to sell;**
 - (d) **The amount of inventories recognized as an expense during the period;**
 - (e) **The amount of any write down of inventories recognized as an expense in the period in accordance with paragraph 42;**
 - (f) **The amount of any reversal of any write down that is recognized in the statement of financial performance in the period in accordance with paragraph 42;**
 - (g) **The circumstances or events that led to the reversal of a write down of inventories in accordance with paragraph 42; and**
 - (h) **The carrying amount of inventories pledged as security for liabilities.**
48. Information about the carrying amounts held in different classifications of inventories and the extent of the changes in these assets is useful to financial statement users. Common classifications of inventories are merchandise, production supplies, materials, work-in-progress, and finished goods. The inventories of a service provider may be described as work-in-progress.
49. The amount of inventories recognized as an expense during the period consists of (a) those costs previously included in the measurement of inventory that has now been sold, exchanged, or distributed, and (b) unallocated production overheads and abnormal amounts of production costs of inventories. The circumstances of the entity may also warrant the inclusion of other costs, such as distribution costs.
50. Some entities adopt a format for surplus or deficit that results in amounts being disclosed other than the cost of inventories recognized as an expense during the period. Under this format, an entity presents an analysis of

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expenses using a classification based on the nature of expenses. In this case, the entity discloses the costs recognized as an expense for (a) raw materials and consumables, (b) labour costs, and (c) other costs, together with the amount of the net change in inventories for the period.

Compliance with International Public Sector Accounting Standards

- 51 Compliance with this SLPSAS ensures compliance in all material respects with IPSAS 12 “Inventories “

Effective Date

52. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2014. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 01,2014, it shall disclose that fact.**
53. When an entity adopts the accrual basis of accounting as defined by SLPSASs for financial reporting purposes subsequent to this effective date, this Standard applies to the entity’s annual financial statements covering periods beginning on or after the date of adoption.

**SLPSAS 10 - REVENUE FROM EXCHANGE
TRANSACTIONS**

Acknowledgment

The Sri Lanka Public Sector Accounting Standard (SLPSAS) 10 “Revenue From Exchange Transactions” is based on International Public Sector Accounting Standard (IPSAS) 9 “Revenue From Exchange Transactions” of the International Public Sector Accounting Standards Board (IPSASB), published by the International Federation of Accountants (IFAC) in July 2001 (2009 Bound Volume) and is used with permission of IFAC.

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Sri Lanka Public Sector Accounting Standard 10 , “Revenue from Exchange Transactions,” is set out in the paragraphs 1–43. All the paragraphs have equal authority. SLPSAS 10 should be read in the context of its objective and the “Preface to Sri Lanka Public Sector Accounting Standards.” SLPSAS 3 “Accounting Policies, Changes in Accounting Estimates and Errors,” provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

The SLAS's "Framework for the Preparation and Presentation of Financial Statements" defines income as "increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants." The SLAS definition of income encompasses both revenue and gains. This Standard uses the term "revenue," which encompasses both revenues and gains, in place of the term "income." Certain specific items to be recognized as revenues are addressed in other standards, and are excluded from the scope of this Standard. For example, gains arising on the sale of property, plant, and equipment are specifically addressed in standards on property, plant, and equipment and are not covered in this Standard.

The objective of this Standard is to prescribe the accounting treatment of revenue arising from exchange transactions and events.

The primary issue in accounting for revenue is determining when to recognize revenue. Revenue is recognized when it is probable that (a) future economic benefits or service potential will flow to the entity, and (b) these benefits can be measured reliably. This Standard identifies the circumstances in which these criteria will be met and, therefore, revenue will be recognized. It also provides practical guidance on the application of these criteria.

Scope

1. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for revenue arising from the following exchange transactions and events:**
 - (a) **The rendering of services;**
 - (b) **The sale of goods; and**
 - (c) **The use by others of entity assets yielding interest, royalties, and dividends.**
2. **This Standard applies to all public sector entities other than Government Business Enterprises.**

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3. The “Preface to Sri Lanka Public Sector Accounting Standards” issued by the ICASL explains that Government Business Enterprises (GBEs) apply SLFRS / LKAS issued by the ICASL. GBEs are defined in SLPSAS 1, “Presentation of Financial Statements.”
4. This Standard does not deal with revenue arising from non-exchange transactions.
5. Public sector entities may derive revenues from exchange or non-exchange transactions. An exchange transaction is one in which the entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of goods, services, or use of assets) to the other party in exchange. Examples of exchange transactions include:
 - (a) The purchase or sale of goods or services; or
 - (b) The lease of property, plant, and equipment at market rates.
6. In distinguishing between exchange and non-exchange revenues, substance rather than the form of the transaction should be considered. Examples of non-exchange transactions include revenue from the use of sovereign powers (for example, direct and indirect taxes, duties, and fines), grants, and donations.
7. The rendering of services typically involves the performance by the entity of an agreed task over an agreed period of time. The services may be rendered within a single period, or over more than one period. Examples of services rendered by public sector entities for which revenue is typically received in exchange may include the provision of housing, management of water facilities, management of toll roads, and management of transfer payments. Some agreements for the rendering of services are directly related to construction contracts, for example, those for the services of project managers and architects. Revenue arising from these agreements is not dealt with in this Standard, but is dealt with in accordance with the requirements for construction contracts as specified in IPSAS 11, “Construction Contracts” or when adopted the equivalent SLPSAS.
8. Goods include (a) goods produced by the entity for the purpose of sale, such as publications, and (b) goods purchased for resale, such as merchandise or land and other property held for resale.

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9. The use by others of entity assets gives rise to revenue in the form of:
- (a) Interest – charges for the use of cash or cash equivalents, or amounts due to the entity;
 - (b) Royalties –charges for the use of long-term assets of the entity, for example, patents, trademarks, copyrights, and computer software; and
 - (c) Dividends or equivalents – distributions of surpluses to holders of equity investments in proportion to their holdings of a particular class of capital.
10. This Standard does not deal with revenues:
- (a) Addressed in other IPSASs/SLPSASs, including those arising from:
 - (i) Lease agreements (see IPSAS 13, “Leases” or when adopted the equivalent SLPSAS);
 - (ii) Dividends arising from investments that are accounted for under the equity method (see IPSAS 7, “Investments in Associates” or when adopted the equivalent SLPSAS); and
 - (iii) Gains from the sale of property, plant, and equipment (which are dealt with in SLPSAS 7 “Property, Plant and Equipment”);
 - (b) Arising from insurance contracts of insurance entities;
 - (c) Arising from changes in the fair value of financial assets and financial liabilities or their disposal (guidance on the recognition and measurement of financial instruments can be found in IPSAS 29, “Financial Instruments: Recognition and Measurement” or when adopted the equivalent SLPSAS);
 - (d) Arising from changes in the value of other current assets;
 - (e) Arising from initial recognition, and from changes in the fair value of biological assets related to agricultural activity (see IPSAS 27, “Agriculture” or when adopted the equivalent SLPSAS);

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- (f) Arising from initial recognition of agricultural produce (see IPSAS 27 or when adopted the equivalent SLPSAS); and
- (g) Arising from the extraction of mineral ores.

Definitions

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

Exchange transactions are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Non-exchange transactions are transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.

Revenue is the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets/equity, other than increases relating to contributions from owners.

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

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Revenue

12. Revenue includes only the gross inflows of economic benefits or service potential received and receivable by the entity on its own account. Amounts collected as an agent of the government or another government organization or on behalf of other third parties; for example, the collection of telephone and electricity payments by the post office on behalf of entities providing such services are not economic benefits or service potential that flow to the entity, and do not result in increases in assets or decreases in liabilities. Therefore, they are excluded from revenue. Similarly, in a custodial or agency relationship, the gross inflows of economic benefits or service potential include amounts collected on behalf of the principal that do not result in increases in net assets/equity for the entity. The amounts collected on behalf of the principal are not revenue. Instead, revenue is the amount of any commission received, or receivable, for the collection or handling of the gross flows.
13. Financing inflows, notably borrowings, do not meet the definition of revenue because they (a) result in an equal change in both assets, and liabilities and (b) have no impact upon net assets/equity. Financing inflows are taken directly to the statement of financial position and added to the balances of assets and liabilities.

Measurement of Revenue

14. **Revenue should be measured at the fair value of the consideration received or receivable.**
15. The amount of revenue arising on a transaction is usually determined by agreement between the entity and the purchaser or user of the asset or service. It is measured at the fair value of the consideration received, or receivable, taking into account the amount of any trade discounts and volume rebates allowed by the entity.
16. In most cases, the consideration is in the form of cash or cash equivalents, and the amount of revenue is the amount of cash or cash equivalents received or receivable. However, when the inflow of cash or cash equivalents is deferred, the fair value of the consideration may be less than the nominal amount of cash received or receivable. For example, an entity may provide interest-free credit to the purchaser or accept a note receivable bearing a below-market interest rate from the purchaser as consideration

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for the sale of goods. When the arrangement effectively constitutes a financing transaction, the fair value of the consideration is determined by discounting all future receipts using an imputed rate of interest. The imputed rate of interest is the more clearly determinable of either:

- (a) The prevailing rate for a similar instrument of an issuer with a similar credit rating; or
- (b) A rate of interest that discounts the nominal amount of the instrument to the current cash sales price of the goods or services.

The difference between the fair value and the nominal amount of the consideration is recognized as interest revenue in accordance with paragraphs 33 and 34.

17. When goods or services are exchanged or swapped for goods or services that are of a similar nature and value, the exchange is not regarded as a transaction that generates revenue. This is often the case with commodities like oil or milk, where suppliers exchange or swap inventories in various locations to fulfill demand on a timely basis in a particular location. When goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction that generates revenue. The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred.

Identification of the Transaction

18. The recognition criteria in this Standard are usually applied separately to each transaction. However, in certain circumstances, it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction. For example, when the price of a product includes an identifiable amount for subsequent servicing, that amount is deferred, and recognized as revenue over the period during which the service is performed. Conversely, the recognition criteria are applied to two or more transactions together when they are linked in such a way that the effect cannot be understood without reference to the series of transactions as a whole. For example, an entity may sell goods and, at the same time, enter into a separate agreement to

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repurchase the goods at a later date, thus negating the substantive effect of the transaction; in such a case, the two transactions are dealt with together.

Rendering of Services

19. **When the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction shall be recognized by reference to the stage of completion of the transaction at the reporting date. The outcome of a transaction can be estimated reliably when all the following conditions are satisfied:**
- (a) **The amount of revenue can be measured reliably;**
 - (b) **It is probable that the economic benefits or service potential associated with the transaction will flow to the entity;**
 - (c) **The stage of completion of the transaction at the reporting date can be measured reliably; and**
 - (d) **The costs incurred for the transaction and the costs to complete the transaction can be measured reliably.**
20. The recognition of revenue by reference to the stage of completion of a transaction is often referred to as the percentage of completion method. Under this method, revenue is recognized in the reporting periods in which the services are rendered. For example, an entity providing property valuation services would recognize revenue as the individual valuations are completed. The recognition of revenue on this basis provides useful information on the extent of service activity and performance during a period. IPSAS 11 or when adopted the equivalent SLPSAS also requires the recognition of revenue on this basis. The requirements of that Standard are generally applicable to the recognition of revenue and the associated expenses for a transaction involving the rendering of services.
21. Revenue is recognized only when it is probable that the economic benefits or service potential associated with the transaction will flow to the entity. However, when an uncertainty arises about the collectability of an amount already included in revenue, the uncollectable amount, or the amount in respect of which recovery has ceased to be probable, is recognized as an expense, rather than as an adjustment of the amount of revenue originally recognized.

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22. An entity is generally able to make reliable estimates after it has agreed to the following with the other parties to the transaction:
- (a) Each party's enforceable rights regarding the service to be provided and received by the parties;
 - (b) The consideration to be exchanged; and
 - (c) The manner and terms of settlement.

It is also usually necessary for the entity to have an effective internal financial budgeting and reporting system. The entity reviews and, when necessary, revises the estimates of revenue as the service is performed. The need for such revisions does not necessarily indicate that the outcome of the transaction cannot be estimated reliably.

23. The stage of completion of a transaction may be determined by a variety of methods. An entity uses the method that measures reliably the services performed. Depending on the nature of the transaction, the methods may include:
- (a) Surveys of work performed;
 - (b) Services performed to date as a percentage of total services to be performed; or
 - (c) The proportion that costs incurred to date bear to the estimated total costs of the transaction. Only costs that reflect services performed to date are included in costs incurred to date. Only costs that reflect services performed or to be performed are included in the estimated total costs of the transaction.
- Progress payments and advances received from customers often do not reflect the services performed.

24. For practical purposes, when services are performed by an indeterminate number of acts over a specified time frame, revenue is recognized on a straight line basis over the specified time frame, unless there is evidence that some other method better represents the stage of completion. When a specific act is much more significant than any other acts, the recognition of revenue is postponed until the significant act is executed.

25. **When the outcome of the transaction involving the rendering of services cannot be estimated reliably, revenue shall be recognized only to the extent of the expenses recognized that are recoverable.**

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26. During the early stages of a transaction, it is often the case that the outcome of the transaction cannot be estimated reliably. Nevertheless, it may be probable that the entity will recover the transaction costs incurred. Therefore, revenue is recognized only to the extent of costs incurred that are expected to be recoverable. As the outcome of the transaction cannot be estimated reliably, no surplus is recognized.
27. When (a) the outcome of a transaction cannot be estimated reliably, and (b) it is not probable that the costs incurred will be recovered, revenue is not recognized and the costs incurred are recognized as an expense. When the uncertainties that prevented the outcome of the contract being estimated reliably no longer exist, revenue is recognized in accordance with paragraph 19 rather than in accordance with paragraph 25.

Sale of Goods

28. **Revenue from the sale of goods shall be recognized when all the following conditions have been satisfied:**
- (a) **The entity has transferred to the purchaser the significant risks and rewards of ownership of the goods;**
 - (b) **The entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;**
 - (c) **The amount of revenue can be measured reliably;**
 - (d) **It is probable that the economic benefits or service potential associated with the transaction will flow to the entity; and**
 - (e) **The costs incurred or to be incurred in respect of the transaction can be measured reliably.**
29. The assessment of when an entity has transferred the significant risks and rewards of ownership to the purchaser requires an examination of the circumstances of the transaction. In most cases, the transfer of the risks and rewards of ownership coincides with the transfer of the legal title or the passing of possession to the purchaser. This is the case for most sales. However, in certain other cases, the transfer of risks and rewards of ownership occurs at a different time from the transfer of legal title or the passing of possession.

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30. If the entity retains significant risks of ownership, the transaction is not a sale, and revenue is not recognized. An entity may retain a significant risk of ownership in a number of ways. Examples of situations in which the entity may retain the significant risks and rewards of ownership are:
- (a) When the entity retains an obligation for unsatisfactory performance not covered by normal warranty provisions;
 - (b) When the receipt of the revenue from a particular sale is contingent on the derivation of revenue by the purchaser from its sale of the goods.
 - (c) When the goods are shipped subject to installation and the installation is a significant part of the contract that has not yet been completed by the entity; and
 - (d) When the purchaser has the right to rescind the purchase for a reason specified in the sales contract, and the entity is uncertain about the probability of return.
31. If an entity retains only an insignificant risk of ownership, the transaction is a sale and revenue is recognized. For example, a seller may retain the legal title to the goods solely to protect the collectability of the amount due. In such a case, if the entity has transferred the significant risks and rewards of ownership, the transaction is a sale and revenue is recognized. Another example of an entity retaining only an insignificant risk of ownership may be a sale when a refund is offered if the purchaser is not satisfied. Revenue in such cases is recognized at the time of sale, provided the seller can reliably estimate future returns and recognizes a liability for returns based on previous experience and other relevant factors.
32. Revenue is recognized only when it is probable that the economic benefits or service potential associated with the transaction will flow to the entity. In some cases, this may not be probable until the consideration is received or until an uncertainty is removed. For example, the revenue may be dependent upon the ability of another entity to supply goods as part of the contract, and if there is any doubt that this will occur, recognition may be delayed until it has occurred. When the goods are supplied, the uncertainty is removed and revenue is recognized. However, when an uncertainty arises about the collectability of an amount already included in revenue, the uncollectable amount, or the amount in respect of which recovery has ceased to be probable, is recognized as an expense, rather than as an adjustment of the amount of revenue originally recognized.

Interest, Royalties, and Dividends

33. **Revenue arising from the use by others of entity assets yielding interest, royalties, and dividends shall be recognized using the accounting treatments set out in paragraph 34 when:**
- (a) **It is probable that the economic benefits or service potential associated with the transaction will flow to the entity; and**
 - (b) **The amount of the revenue can be measured reliably.**
34. **Revenue should be recognized using the following accounting treatments:**
- (a) **Interest should be recognized on a time proportion basis that takes into account the effective yield on the asset;**
 - (b) **Royalties should be recognized as they are earned in accordance with the substance of the relevant agreement; and**
 - (c) **Dividends or their equivalents should be recognized when the shareholder's or the entity's right to receive payment is established.**
35. The effective yield on an asset is the rate of interest required to discount the stream of future cash receipts expected over the life of the asset to equate to the initial carrying amount of the asset. Interest revenue includes the amount of amortization of any discount, premium, or other difference between the initial carrying amount of a debt security and its amount at maturity.
36. When unpaid interest has accrued before the acquisition of an interest-bearing investment, the subsequent receipt of interest is allocated between pre-acquisition and post-acquisition periods; only the post-acquisition portion is recognized as revenue. When dividends on equity securities are declared from pre-acquisition net surplus, those dividends are deducted from the cost of the securities. If it is difficult to make such an allocation except on an arbitrary basis; dividends are recognized as revenue unless they clearly represent a recovery of part of the cost of the equity securities.
37. Royalties, such as petroleum royalties, accrue in accordance with the terms of the relevant agreement, and are usually recognized on that basis unless, having regard to the substance of the agreement, it is more appropriate to recognize revenue on some other systematic and rational basis.

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38. Revenue is recognized only when it is probable that the economic benefits or service potential associated with the transaction will flow to the entity. However, when an uncertainty arises about the collectability of an amount already included in revenue, the uncollectable amount, or the amount in respect of which recovery has ceased to be probable, is recognized as an expense, rather than as an adjustment of the amount of revenue originally recognized.

Disclosure

39. **An entity should disclose:**
- (a) **The accounting policies adopted for the recognition of revenue, including the methods adopted to determine the stage of completion of transactions involving the rendering of services;**
 - (b) **The amount of each significant category of revenue recognized during the period, including revenue arising from:**
 - (i) **The rendering of services;**
 - (ii) **The sale of goods;**
 - (iii) **Interest;**
 - (iv) **Royalties; and**
 - (v) **Dividends or their equivalents; and**
 - (c) **The amount of revenue arising from exchanges of goods or services included in each significant category of revenue.**
40. Guidance on disclosure of any contingent assets and contingent liabilities can be found in, SLPSAS 8 “Provisions, Contingent Liabilities and Contingent Assets”. Contingent assets and contingent liabilities may arise from items such as warranty costs, claims, penalties, or possible losses.

Compliance with International Public Sector Accounting Standards

41. Compliance with this SLPSAS 10 ensures compliance in all material respects with International Public Sector Accounting Standard 9 “Revenue from Exchange Transactions.”

Effective Date

42. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 01, 2014. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 01, 2014, it shall disclose that fact.**

43. When an entity adopts the accrual basis of accounting as defined by SLPSASs for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

Implementation Guidance

This guidance accompanies, but is not part of, SLPSAS 10

- IG1. Public sector entities derive revenues from exchange or non-exchange transactions. This Standard deals only with revenue arising from exchange transactions. Revenue from exchange transactions is derived from:
- (a) Sale of goods or provision of services to third parties;
 - (b) Sale of goods or provision of services to other government agencies; and
 - (c) The use by others of entity assets yielding interest, royalties, and dividends.
- IG2. The application of the recognition criteria to particular transactions may be affected by:
- (a) The law in different countries, which may determine the point in time at which the entity transfers the significant risks and rewards of ownership. Therefore, the examples in this section of the implementation guidance need to be read in the context of the laws in the country in which the transaction takes place; and
 - (b) The nature of the relationship (contractual or otherwise) between the entity that pays and the entity that receives the revenue (that is, the entities may agree on specific points in time at which the receiving entity can recognize revenue).

Rendering of Services

Housing

- IG3. Rental income from the provision of housing is recognized as the income is earned in accordance with the terms of the tenancy agreement.

School Transport

- IG4. Revenue from fares charged to passengers for the provision of school transport is recognized as the transport is provided.

Management of Toll Roads

- IG5. Revenue from the management of toll roads is recognized as it is earned based on the usage of the roads.

Processing of Court Cases

- IG6. Revenue from the processing of court cases can be recognized either by reference to the stage of completion of the processing, or based on the periods during which the courts are in session.

Management of Facilities, Assets, or Services

- IG7. Revenue from the management of facilities, assets, or services is recognized over the term of the contract as the management services are provided.

Science and Technology Research

- IG8. Revenue received from clients from contracts for undertaking science and technology research is recognized by reference to the stage of completion on individual projects.

Installation Fees

- IG9. Installation fees are recognized as revenue by reference to the stage of completion of the installation, unless they are incidental to the sale of a product, in which case they are recognized when the goods are sold.

Servicing Fees Included in the Price of the Product

- IG10. When the selling price of a product includes an identifiable amount for subsequent servicing (for example, after sales support and product enhancement on the sale of software), that amount is deferred and recognized as revenue over the period during which the service is performed. The amount deferred is that which will cover the expected costs of the services under the agreement, together with a reasonable return on those services.

Insurance Agency Commissions

- IG11. Insurance agency commissions received or receivable that do not require the agent to render further service are recognized as revenue by the agent on the effective commencement or renewal dates of the related policies. However, when it is probable that the agent will be required to render further services during the life of the policy, the commission, or part thereof, is deferred and recognized as revenue over the period during which the policy is in force.

Financial Service Fees

IG12. The recognition of revenue for financial service fees depends on (a) the purposes for which the fees are assessed, and (b) the basis of accounting for any associated financial instrument. The description of fees for financial services may not be indicative of the nature and substance of the services provided. Therefore, it is necessary to distinguish between fees that are an integral part of the effective yield of a financial instrument, fees that are earned as services are provided, and fees that are earned on the execution of a significant act.

(a) **Fees that are an integral part of the effective interest rate of a financial instrument**

Such fees are generally treated as an adjustment to the effective interest rate. However, when the financial instrument is measured at fair value with the change in fair value recognized in surplus or deficit, the fees are recognized as revenue when the instrument is initially recognized.

(b) **Fees earned as services are provided**

(i) *Fees charged for servicing a loan* Fees charged by an entity for servicing a loan are recognized as revenue as the services are provided.

(ii) *Commitment fees to originate or purchase a loan when the loan commitment is outside the scope of IPSAS 29 or when adopted the equivalent SLPSAS* If it is unlikely that a specific lending arrangement will be entered into and the loan commitment is outside the scope of IPSAS 29 or when adopted the equivalent SLPSAS, the commitment fee is recognized as revenue on a time proportion basis over the commitment period.

(c) **Fees that are earned on the execution of a significant act**

The fees are recognized as revenue when the significant act has been completed.

Admission Fees

- IG13. Revenue from artistic performances, banquets, and other special events is recognized when the event takes place. When a subscription to a number of events is sold, the fee is allocated to each event on a basis that reflects the extent to which services are performed at each event.

Tuition Fees

- IG14. Revenue is recognized over the period of instruction.

Initiation, Entrance, and Membership Fees

- IG15. Revenue recognition depends on the nature of the services provided. If the fee permits only membership, and all other services or products are paid for separately, or if there is a separate annual subscription, the fee is recognized as revenue when no significant uncertainty as to its collectability exists. If the fee entitles the member to services or publications to be provided during the membership period, or to purchase goods or services at prices lower than those charged to non-members, it is recognized on a basis that reflects the timing, nature, and value of the benefits provided.

Franchise or Concession Fees

- IG16. Franchise or concession fees may cover the supply of initial and subsequent services, equipment and other tangible assets, and know-how. Accordingly, franchise or concession fees are recognized as revenue on a basis that reflects the purpose for which the fees were charged. The following methods of franchise or concession fee recognition are appropriate:

(a) **Supplies of Equipment and Other Tangible Assets**

The amount, based on the fair value of the assets sold, is recognized as revenue when the items are delivered or title passes.

(b) **Supplies of Initial and Subsequent Services**

Fees for the provision of continuing services, whether part of the initial fee or a separate fee, are recognized as revenue as the services are rendered. When the separate fee does not cover the cost of continuing services together with a reasonable return, part of the initial fee, sufficient to cover the costs of continuing services and to provide a reasonable return on those services, is deferred and recognized as revenue as the services are rendered.

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(c) **Continuing Franchise or Concession Fees**

Fees charged for the use of continuing rights granted by the agreement, or for other services provided during the period of the agreement, are recognized as revenue as the services are provided or the rights used.

(d) **Agency Transactions**

Transactions may take place between the franchisor and the franchisee that, in substance, involve the franchisor acting as agent for the franchisee. For example, the franchisor may order supplies and arrange for their delivery to the franchisee at no return. Such transactions do not give rise to revenue.

Fees from the Development of Customized Software

IG17. Fees from the development of customized software are recognized as revenue by reference to the stage of completion of the development, including completion of services provided for post-delivery service support.

Sale of Goods

“Bill and Hold” Sales, in Which Delivery is Delayed at the Purchaser’s Request but the Purchaser Takes Title and Accepts Billing

IG18. Revenue is recognized when the purchaser takes title, provided:

- (a) *It is probable that delivery will be made;*
- (b) *The item is on hand, identified and ready for delivery to the purchaser at the time the sale is recognized;*
- (c) *The purchaser specifically acknowledges the deferred delivery instructions; and*
- (d) *The usual payment terms apply.*

Revenue is not recognized when there is simply an intention to acquire or manufacture the goods in time for delivery.

IG19. *Goods Shipped Subject to Conditions*

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(a) **Installation and inspection**

Revenue is normally recognized when the purchaser accepts delivery, and installation and inspection are complete. However, revenue is recognized immediately upon the purchaser's acceptance of delivery when:

- (i) The installation process is simple in nature; or
- (ii) The inspection is performed only for purposes of final determination of contract prices.

(b) **On approval when the purchaser has negotiated a limited right of return**

If there is uncertainty about the possibility of return, revenue is recognized when the shipment has been formally accepted by the purchaser or the goods have been delivered and the time period for rejection has elapsed.

(c) **Consignment sales under which the recipient (purchaser) undertakes to sell the goods on behalf of the shipper (seller)**

Revenue is recognized by the shipper when the goods are sold by the recipient to a third party.

(d) **Cash on delivery sales**

Revenue is recognized when delivery is made and cash is received by the seller or its agent.

Lay away Sales under Which the Goods are delivered Only when the Purchaser Makes the Final Payment in a Series of Installments

- IG20. Revenue from such sales is recognized when the goods are delivered .However, when experience indicates that most such sales are consummated, revenue may be recognized when a significant deposit is received, provided the goods are on hand, identified, and ready for delivery to the purchaser.

Orders When Payment (or Partial Payment) is Received in Advance of Delivery for Goods Not Presently Held in Inventory; For Example, the Goods are Still to be Manufactured or will be Delivered Directly to the Customer from a Third Party

- IG21. Revenue is recognized when the goods are delivered to the purchaser.

Sale And Repurchase Agreements (Other than Swap Transactions) under Which the Seller Concurrently Agrees to Repurchase the Same Goods at a

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Later Date, or when the Seller has a Call Option to Repurchase, or the Purchaser has a Put Option to Require the Repurchase by the Seller, of the Goods

- IG22. The terms of the agreement need to be analyzed to ascertain whether, in substance, the seller has transferred the risks and rewards of ownership to the purchaser, and hence revenue is recognized. When the seller has retained the risks and rewards of ownership, even though legal title has been transferred, the transaction is a financing arrangement and does not give rise to revenue.

Sales to Intermediate Parties, Such as Distributors, Dealers, or Others for Resale

- IG23. Revenue from such sales is generally recognized when the risks and rewards of ownership have passed. However, when the purchaser is acting, in substance, as an agent, the sale is treated as a consignment sale.

Subscriptions to Publications and Similar Items

- IG24. When the items involved are of similar value in each time period, revenue is recognized on a straight line basis over the period in which the items are dispatched. When the items vary in value from period to period, revenue is recognized on the basis of the sales value of the item dispatched in relation to the total estimated sales value of all items covered by the subscription.

Installment Sales, under Which the Consideration is Receivable in Installments

- IG25. Revenue attributable to the sales price, exclusive of interest, is recognized at the date of sale. The sale price is the present value of the consideration, determined by discounting the installments receivable at the imputed rate of interest. The interest element is recognized as revenue as it is earned, on a time proportion basis that takes into account the imputed rate of interest.

Real Estate Sales

- IG26. Revenue is normally recognized when legal title passes to the purchaser. However, in some jurisdictions the equitable interest in a property may vest in the purchaser before legal title passes, and therefore the risks and rewards of ownership have been transferred at that stage. In such cases, provided that the seller has no further substantial acts to complete under the contract, it may be appropriate to recognize revenue. In either case, if the seller is obliged to perform any significant acts after the transfer of the equitable and/or legal title, revenue is recognized as the acts are performed. An example is a building or other facility on which construction has not been completed.

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- IG27. In some cases, real estate may be sold with a degree of continuing involvement by the seller, such that the risks and rewards of ownership have not been transferred. Examples are (a) sale and repurchase agreements that include put and call options, and (b) agreements whereby the seller guarantees occupancy of the property for a specified period, or guarantees a return on the purchaser's investment for a specified period. In such cases, the nature and extent of the seller's continuing involvement determines how the transaction is accounted for. It may be accounted for as a sale, or as a financing, leasing, or some other profit-sharing arrangement. If it is accounted for as a sale, the continuing involvement of the seller may delay the recognition of revenue.
- IG28. A seller must also consider the means of payment and evidence of the purchaser's commitment to complete payment. For example, when the aggregate of the payments received, including the purchaser's initial down payment, or continuing payments by the purchaser, provide insufficient evidence of the purchaser's commitment to complete payment, revenue is recognized only to the extent cash is received.

Interest, Royalties, and Dividends

License Fees and Royalties

- IG29. Fees and royalties paid for the use of an entity's assets (such as trademarks, patents, software, music copyright, record masters, and motion picture films) are normally recognized in accordance with the substance of the agreement. As a practical matter, this may be on a straight line basis over the life of the agreement, for example, when a licensee has the right to use certain technology for a specified period of time.
- IG30. An assignment of rights for a fixed fee or non-refundable guarantee under a non-cancelable contract that (a) permits the licensee to exploit those rights freely and (b) the licensor has no remaining obligations to perform is, in substance, a sale. An example is a licensing agreement for the use of software when the licensor has no obligations subsequent to delivery. Another example is the granting of rights to exhibit a motion picture film in markets where the licensor has no control over the distributor, and expects to receive no further revenues from the box office receipts. In such cases, revenue is recognized at the time of sale.
- IG31. In some cases, whether or not a license fee or royalty will be received is contingent on the occurrence of a future event. In such cases, revenue is recognized only when it is probable that the fee or royalty will be received, which is normally when the event has occurred.

GLOSSARY OF DEFINED TERMS

SRI LANKA PUBLIC SECTOR ACCOUNTING STANDARDS

GLOSSARY OF DEFINED TERMS

This Glossary contains all terms defined in the 10 accrual basis Sri Lanka Public Sector Accounting Standards (SLPSASs) on issue as at December 31, 2012. A list of these SLPSASs is located on the inside back cover of the Glossary..

Where multiple definitions of the same term exist, this Glossary indicates all SLPSASs in which the term appears and the definition that applies to that particular SLPSAS

Definitions

References to accrual basis SLPSASs are by Standard number and paragraph number. For Example, 1.7 refers users to SLPSAS 1, “Presentation of Financial Statements,” paragraph 7. References set out in brackets indicate a minor variation in wording.

Term	Definition	Location
accounting policies	The specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.	3.7
accrual basis	A basis of accounting under which transactions and other events are recognized when they occur (and not only when cash or its equivalent is received or paid). Therefore, the transactions and events are recorded in the accounting records and recognized in the financial statements of the periods to which they relate. The elements recognized under accrual accounting are assets, liabilities, net assets/equity, revenue and expenses.	1.7, 2.8, 3.7, 4.5
assets ¹	Resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity	1.7, 2.8, 4.5,

¹ *Commentary:* Assets provide a means for entities to achieve their objectives. Assets that are used to deliver goods and services in accordance with an entity’s objectives but which do not directly generate net cash inflows are often described as embodying “service potential.” Assets that are used to generate net cash inflows are often described as embodying “future economic benefits.” To encompass all the purposes to which assets may be put, this series of Standards uses the term “future economic benefits or service potential” to describe the essential characteristic of assets.

Sri Lanka Public Sector Accounting Standards

Term	Definition	Location
borrowing costs	Interest and other expenses incurred by an entity in connection with the borrowing of funds.	4.5
carrying amount	The amount at which an asset is recognized after deducting any accumulated depreciation and accumulated impairment losses.	7.13
Cash	Comprises cash on hand and demand deposits.	2.8, 4.5
cash equivalents	Short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.	2.8
cash flows	Inflows and outflows of cash and cash equivalents.	2.8,
change in accounting estimate	An adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not correction of errors.	3.7
class of property, plant and equipment	A grouping of assets of a similar nature or function in an entity's operations that is shown as a single item for the purpose of disclosure in the financial statements	7.13
closing rate	The spot exchange rate at the reporting date	5.10
Constructive obligation	An obligation that derives from an entity's actions where: <ol style="list-style-type: none"> (a) By an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and (b) As a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities. 	8.18

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Term	Definition	Location
contingent asset	A possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity	8.18
contingent liability	<p>(a) A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or</p> <p>(b) A present obligation that arises from past events but is not recognized because:</p> <p style="margin-left: 20px;">(i) It is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; or</p> <p style="margin-left: 20px;">(ii) The amount of the obligation cannot be measured with sufficient reliability.</p>	8.18
contributions from owners	<p>Future economic benefits or service potential that has been contributed to the entity by parties external to the entity, other than those that result in liabilities of the entity, that establish a financial interest in the net assets/equity of the entity, which:</p> <p>(a) Conveys entitlement both to distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or</p> <p>(b) Can be sold, exchanged, transferred or redeemed</p>	1.7, 2.8, 4.5

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Term	Definition	Location
Control	Power to govern the financial and operating policies of another entity so as to benefit from its activities.	2.8
Cost	The amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction	7.13
current replacement cost	The cost the entity would incur to acquire the asset on the reporting date.	9.9
Depreciation	Systematic allocation of the depreciable amount of an asset over its useful life.	7-13
depreciable amount	The cost of an asset, or other amount substituted for cost, less its residual value	7.13
distribution to owners	Future economic benefits or service potential distributed by the entity to all or some of its owners, either as a return on investment or as a return of investment.	1.7, 2.8, 4.5
economic entity²	A group of entities comprising a controlling entity and one or more controlled entities	2.8, 4.5, 5.10,
entity specific value	The present value of the cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.	7.13
events after the reporting date	Those events, both favorable and unfavorable, that occur between the reporting date and the date when the financial statements are Authorized for issue. Two types of events can be identified: (a) Those that provide evidence of conditions that existed at the reporting date (adjusting events after the reporting date); and (b) Those that are indicative of conditions that arose after the reporting date (non adjusting events after the reporting date).	6.5

² *Commentary:* The term economic entity is used in this series of Standards to define, for financial reporting purposes, a group of entities comprising the controlling entity and any controlled entities. Other terms sometimes used to refer to an economic entity include administrative entity, financial entity (*SLPSAS 5, "financial reporting entity"*), consolidated entity and group. An economic entity may include entities with both social policy and commercial objectives. For example, Sri Lanka Railway Department may be an economic entity which includes entities that provide transport for a nominal charge, as well as entities that provide services on a commercial basis.

Sri Lanka Public Sector Accounting Standards

Term	Definition	Location
Exchange difference	The difference resulting from reporting the same number of units of a foreign currency in the reporting currency at different exchange rates.	5.10
exchange rate	The ratio for exchange of two currencies	5.10
exchange transaction	Transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange	7.13, 10.11
executory contracts	Contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent	8.18
expenses	Decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrence of liabilities that result in decreases in net assets/equity, other than those relating to distributions to owner	1.7, 2.8, 4.5
fair value	The amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction.	7.13, 10.11
financing activities	Activities that result in changes in the size and composition of the contributed capital and borrowings of the entity	2.8,
foreign currency	A currency other than the functional currency of the entity	5.10
foreign operation	An entity that is a controlled entity, associate, joint venture or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity	5.10
functional currency	The currency of the primary economic environment in which the entity operates	5.10

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Term	Definition	Location
Government Business Enterprise ³	An entity that has all the following characteristics: (a) Is an entity with the power to contract in its own name; (b) Has been assigned the financial and operational authority to carry on a business; (c) Sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery; (d) Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length); and (e) Is controlled by a public sector entity	1.7, 2.8, 4.5
impairment loss of a cash-generating asset	The amount by which the carrying amount of an asset exceeds its recoverable amount.	7.13
impairment loss of a non-cash-generating asset	The amount by which the carrying amount of an asset exceeds its recoverable service amount	7.13

³ *Commentary:* Government Business Enterprises (GBEs) include both trading enterprises, such as utilities, and financial enterprises, such as financial institutions. GBEs are, in substance, no different from entities conducting similar activities in the private sector. GBEs generally operate to make a profit, although some may have limited community service obligations under which they are required to provide some individuals and organizations in the community with goods and services at either no charge or a significantly reduced charge. IPSAS 6, "Consolidated Financial Statements and Accounting for Controlled Entities" provides guidance on determining whether control exists for financial reporting purposes, and should be referred to in determining whether a GBE is controlled by another public sector entity.

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Term	Definition	Location
impracticable	<p>Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.</p> <p>For a particular prior period, it is impracticable to apply a change in an accounting policy retrospectively or to make a retrospective restatement to correct an error if:</p> <ul style="list-style-type: none"> (a) The effects of the retrospective application or retrospective restatement are not determinable; (b) The retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period; or (c) The retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that: <ul style="list-style-type: none"> (i) Provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognized, measured or disclosed; and (ii) Would have been available when the financial statements for that prior period were authorized for issue from other information. 	1.7, 3.7
inventories	<p>Assets:</p> <ul style="list-style-type: none"> (a) In the form of materials or supplies to be consumed in the production process; (b) In the form of materials or supplies to be consumed or distributed in the rendering of services; (c) Held for sale or distribution in the ordinary course of operations; or (d) In the process of production for sale or distribution 	9.9

Sri Lanka Public Sector Accounting Standards

Term	Definition	Location
investing activities	The acquisition and disposal of long-term assets and other investments not included in cash equivalents	2.8
legal obligation	An obligation that derives from: (a) A contract (through its explicit or implicit terms); (b) Legislation; or Other operation of law	8.18
liabilities	Present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.	1.7, 2.8, 3.54, 5, 8.18
material	Omissions or misstatements of items are material if they could, individually or collectively, influence the decisions or assessments of users made on the basis of the financial statements. Materiality depends on the nature and size of the omission or misstatement judged in the surrounding circumstances. The nature or size of the item, or a combination of both, could be the determining factor	1.7, 3.7,
monetary items	Units of currency held and assets and liabilities to be received or paid in fixed or determinable number of units of currency.	5.10
net assets/equity 4	The residual interest in the assets of the entity after deducting all its liabilities.	1.7, 2.8, 4.5
net investment in a Foreign operation	The amount of the reporting entity's interest in the net assets/equity of that operation.	5.10
net realizable value	The estimated selling price in the ordinary course of operations less the estimated costs of completion and the estimated costs necessary to make the sale, exchange or distribution.	9.9

⁴ *Commentary:* "Net assets/equity" is the term used in this series of Standards to refer to the residual measure in the statement of financial position (assets less liabilities). Net assets/equity may be positive or negative. Other terms may be used in place of net assets/equity, provided that their meaning is clear.

Sri Lanka Public Sector Accounting Standards

Term	Definition	Location
non-exchange transactions	Transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange	7.13, 10.11
notes	Contain information in addition to that presented in the statement of financial position, statement of financial performance, statement of changes in net assets/equity and cash flow statement. Notes provide narrative descriptions or disaggregation of items disclosed in those statements and information about items that do not qualify for recognition in those statements.	1. 7
obligating event	An event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation	8.18
onerous contract	A contract for the exchange of assets or services in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits or service potential expected to be received under it.	8.18
operating activities	The activities of the entity that are not investing or financing activities	2.8
Presentation currency	The currency in which the financial statements are presented	5.10
prior period errors	<p>Omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:</p> <ul style="list-style-type: none"> (a) Was available when financial statements for those periods were authorized for issue; and (b) Could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements. <p>Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.</p>	3.7

Sri Lanka Public Sector Accounting Standards

Term	Definition	Location
property, plant and equipment	<p>Tangible items that:</p> <p>(a) Are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and</p> <p>(b) Are expected to be used during more than one reporting period.</p>	7.13
prospective application	<p>Prospective application of a change in accounting policy and of recognizing the effect of a change in an accounting estimate, respectively, are:</p> <p>(a) Applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the policy is changed; and</p> <p>(b) Recognizing the effect of the change in the accounting estimate in the current and future periods affected by the change</p>	3.7
provision	A liability of uncertain timing or amount	8.18
qualifying asset	An asset that necessarily takes a substantial period of time to get ready for its intended use or sale.	4.5
recoverable amount	The higher of a non-cash-generating asset's fair value less cost to sell and its value in use.	7.13
recoverable service amount	The higher of a non-cash-generating asset's fair value less costs to sell and its value in use.	7.13
reporting date	The date of the last day of the reporting period to which the financial statements relate.	6.5
residual value	The estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life	7.13
restructuring	<p>A program that is planned and controlled by management, and materially changes either:</p> <p>(a) The scope of an entity's activities; or</p> <p>(b) The manner in which those activities are carried out</p>	8.18

Sri Lanka Public Sector Accounting Standards

Term	Definition	Location
retrospective application	Applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied	3,7
retrospective restatement	Correcting the recognition, measurement and disclosure of amounts of elements of financial statements as if a prior period error had never occurred.	3.7
revenue	The gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets/equity, other than increases relating to contributions from owners.	1.7, 2.8, 4.5,
spot exchange rate	The exchange rate for immediate delivery	5.10
useful life (of property, plant and equipment)	<p>Either:</p> <p>(a) The period over which an asset is expected to be available for use by an entity; or</p> <p>(b) The number of production or similar units expected to be obtained from the asset by an entity.</p>	7.13