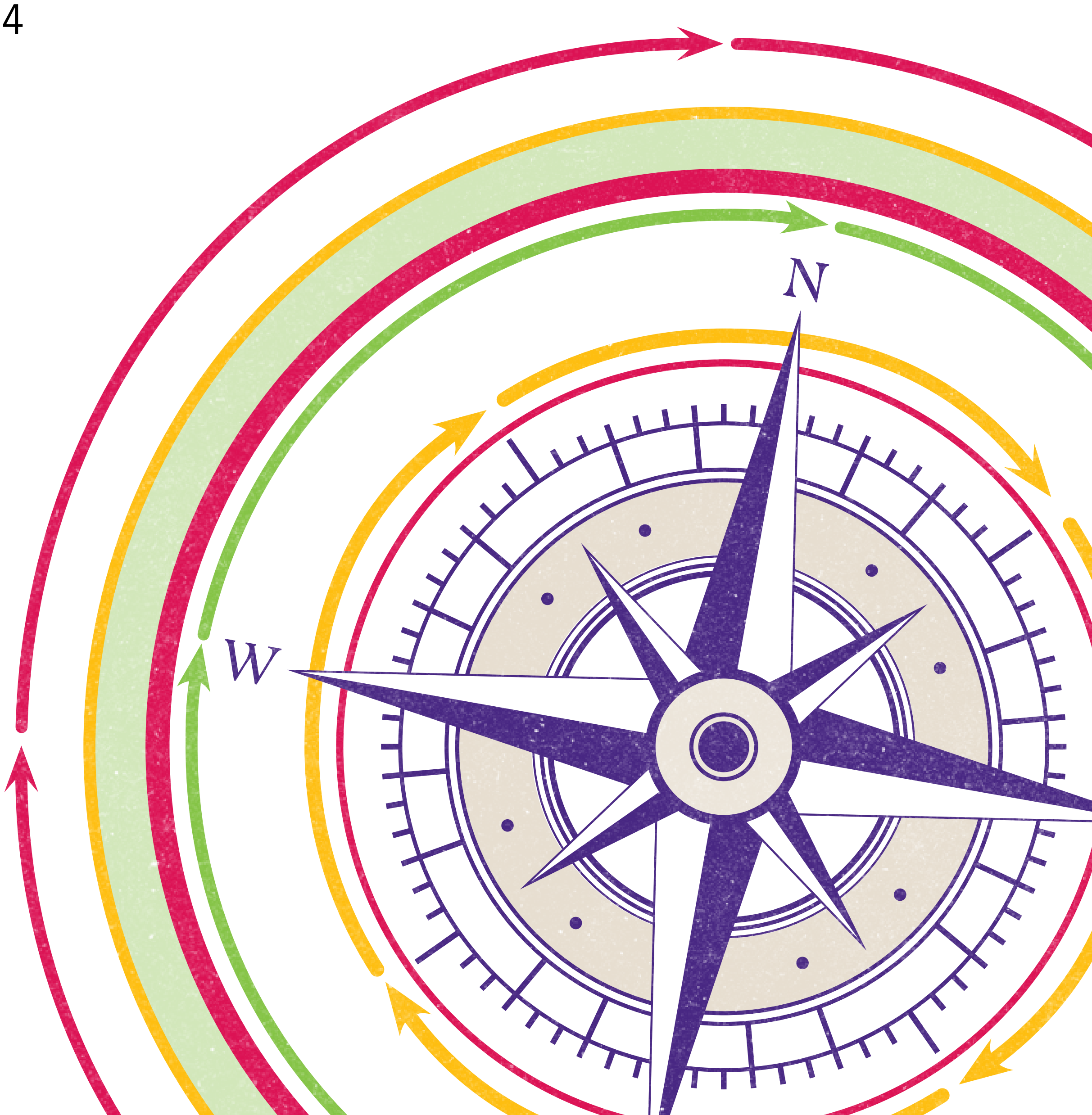
# Navigating the changes to International Financial Reporting Standards

A briefing for Chief Financial Officers
December 2014



# Introduction

Significant Standards covered for the first time in this year's edition include IFRS 15 'Revenue from Contracts with Customers' and the final version of IFRS 9 'Financial Instruments'.

## Overview

This publication is designed to give Chief Financial Officers a high-level awareness of recent changes to International Financial Reporting Standards that will affect companies' future financial reporting. It covers both new Standards and Interpretations that have been issued and amendments made to existing ones.

## What's new in the 2014 edition

The December 2014 edition of the publication has been updated for changes to International Financial Reporting Standards that have been published between 1 December 2013 and 30 November 2014.

The publication now covers 31 March 2014, 30 June 2014, 30 September 2014, 31 December 2014 and 31 March 2015 financial year ends.

## Contents

The table of contents on the next page lists all the changes covered in the publication, their effective dates, and the page in the publication on which the appropriate summary can be found.

## How to use the publication

### Identifying the changes that will affect you

The table of contents has been colour coded to help entities planning for a specific financial reporting year end identify:

- changes mandatorily effective for the first time
- changes not yet effective
- changes already in effect.

Where a change is not yet mandatorily effective for a particular year end, it may still be possible for an entity to adopt it early (depending on local legislation and the requirements of the particular change in concern).

Where a change has been made but an entity is yet to apply it, certain disclosures are required to be made under IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'. Disclosures required include the fact that the new or amended Standard or Interpretation is in issue but has not yet been applied, and known or reasonably estimable information relevant to assessing its possible impact on the financial statements in the period of initial application.

### Identifying the commercial significance of the changes in the publication

For each change covered in the publication, we have included a box on its commercial implications. These sections focus on two questions:

- how many entities will be affected?
- what will be the impact on affected entities?

A traffic light system indicates our assessment of the answers to these questions.

## Other Grant Thornton International publications

Where appropriate, references have been made to other Grant Thornton International publications that provide more detailed information. These publications can be obtained from your local IFRS contact.

**Grant Thornton International Ltd**
December 2014

# Effective dates of new Standards

## (based on Standards issued at 30 November 2014)

<table>
<tr><th>Standard</th><th>Title of Standard or Interpretation</th><th>Effective for accounting periods beginning on or after</th><th>Page ref</th><th>31 Mar 2014 year end</th><th>30 Jun 2014 year end</th><th>30 Sep 2014 year end</th><th>31 Dec 2014 year end</th><th>31 Mar 2015 year end</th></tr>
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<tr><td>IFRIC 20</td><td>Stripping Costs in the Production Phase of a Surface Mine</td><td>1 January 2013</td><td>18</td></tr>
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<tr><td>IAS 32</td><td>Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32)[2]</td><td>1 January 2014</td><td>21</td><td rowspan="20">not yet effective</td><td rowspan="20">not yet effective</td><td rowspan="20">not yet effective</td><td rowspan="5">effective for the first time</td><td rowspan="5">effective for the first time</td></tr>
<tr><td>IFRS 10, 12 & IAS 27</td><td>Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)[1]</td><td>1 January 2014</td><td>22</td></tr>
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[1] these changes (the 'consolidation package' and subsequent amendments to the transition requirements and for investment entities) are inter-related and entities are advised to assess their impact collectively

[2] the changes to IAS 32 and IFRS 7 dealing with offsetting are inter-related

The colour coding gives an indication of when the changes covered in the publication become effective in relation to the specific financial reporting year ends set out in the table.

**Key:** Change already in mandatory effect   Change effective for the first time   Change not yet effective

# IAS 19 Employee Benefits (Revised 2011)

In June 2011, the IASB issued an amended version of IAS 19 'Employee Benefits', which changes the way defined benefit plans are accounted for. The amended version is intended to improve the recognition, presentation, and disclosure of defined benefit plans. It will have a particular impact on the amounts presented in profit or loss and other comprehensive income (OCI).

### Major changes

The major changes made in the amended version of the Standard will result in:

- immediate recognition of all estimated changes in the cost of providing defined benefits and all changes in the value of plan assets. The various methods which allowed deferral of some of those gains or losses under the previous version of IAS 19, including the 'corridor' method, have been eliminated
- a new presentation approach that distinguishes the different types of gains and losses arising from defined benefit plans and requires that all gains and losses are presented in profit or loss apart from 'remeasurements' that are presented in OCI . The table sets out the changes in benefit costs which are to be presented separately under the new approach.

The previous IAS 19 option for entities to recognise in profit or loss all changes in defined benefit obligations and in the fair value of plan assets is eliminated.

**IAS 19 Employee Benefits (Revised 2011)**

| Type of gain or loss | Recognition |
|---|---|
| service cost | in profit or loss |
| net interest on the net defined benefit liability or asset | in profit or loss |
| remeasurement of the defined benefit liability or asset | in other comprehensive income |

One controversial change is that preparers will no longer be able to include the expected return on plan assets in profit or loss. The return on plan assets will instead represent interest, dividends and other income derived from the plan assets, together with realised and unrealised gains or losses on the plan assets, less certain costs. The change means that instead of crediting the expected return on pension plan assets separately and charging the calculated interest cost on the pension provision, the amended standard requires a charge or credit to be calculated by applying the market yield on a high quality corporate bond to the net pension deficit or surplus (in countries where there is no deep market in such bonds, market yields on government bonds should be used). This is likely to reduce the reported profit for many companies.

### Other changes

In addition to these major changes, the amended version of IAS 19 makes changes to a number of other areas. These include:

- more closely aligning the accounting for plan amendments, curtailments, settlements, termination benefits and restructurings
- miscellaneous clarifications, including:
  - the classification of short-term and long-term employee benefits is based on the timing of expected settlement
  - the mortality assumptions used to determine the defined benefit obligation are the current estimates of expected mortality rates
  - the allocation of tax and administration costs between the costs of the plan and a reduction of plan assets
  - the impact of risk-sharing and conditional indexation features
- some matters that had been submitted to the IFRIC for interpretation (special wage taxes, treatment of employee contributions, pension promises based on performance hurdles, and settlements).

In addition to these changes, the amendments also introduce improved disclosures relating to the following areas:

- the characteristics of the company's defined benefit plans
- the amounts recognised in the financial statements
- risks arising from defined benefit plans
- participation in multi-employer plans.

### Commercial significance

**Number of entities affected: Some**

The changes will affect those entities with defined benefit pension schemes. Other entities should not be significantly affected by the revised version of the Standard.

**Impact on affected entities: High**

The amendments can be expected to have a major impact on some entities. The elimination of the 'corridor' method that allowed some actuarial gains or losses to be deferred will be particularly significant, forcing companies to recognise the full pension scheme asset or deficit on balance sheet and adding to volatility in reported results. Separately the change in the way the return on plan assets is to be calculated is likely to reduce the reported profit for many of the companies affected.

# IAS 27 Separate Financial Statements (Revised 2011)

IAS 27 (Revised) 'Separate Financial Statements' was published in May 2011 along with IFRS 10 'Consolidated Financial Statements' , IFRS 11 'Joint Arrangements', IFRS 12 'Disclosure of Interests in Other Entities' and IAS 28 (Revised) 'Investments in Associates and Joint Ventures'. Together these Standards form a comprehensive package dealing with group issues and off-balance sheet activity.

The changes made to IAS 27 (Revised) 'Separate Financial Statements' are consequential changes arising from the publication of the new IFRSs. The main change is that IAS 27 (Revised) will now solely address separate financial statements, the requirements for which are substantially unchanged from the previous version of the Standard.

**Commercial significance**

**Number of entities affected: Some**

Companies preparing separate financial statements will fall under the scope of the revised Standard.

**Impact on affected entities: Low**

The changes made are consequential changes arising from the publication of IFRSs 10, 11 and 12. The requirements for separate financial statements are substantially unchanged from the previous version of the Standard.

# IAS 28 Investments in Associates and Joint Ventures (Revised 2011)

IAS 28 Investments in Associates and Joint Ventures (Revised 2011) was published in May 2011 along with IFRS 10 'Consolidated Financial Statements', IFRS 11 'Joint Arrangements', IFRS 12 'Disclosure of Interests in Other Entities' and IAS 27 (Revised) 'Separate Financial Statements'. Together these Standards form a comprehensive package dealing with group issues and off-balance sheet activity.

Prior to the publication of this package of new Standards, the accounting for joint ventures was addressed solely by IAS 31 'Interests in Joint Ventures'. Following the publication of the new Standards, an entity should now apply IFRS 11 to determine the type of joint arrangement in which it is involved.

Consequential changes have been made to the scope of IAS 28 so that once an entity has determined that it has an interest in a joint venture, it accounts for it using the equity method in accordance with IAS 28 (Revised).

The mechanics of equity accounting set out in the revised version of IAS 28 remain the same as in the previous version.

**Commercial significance**

**Number of entities affected: Some**

Those companies that have investments in associates and joint ventures will be affected by the revised version of the Standard.

**Impact on affected entities: Low**

Changes to the scope of IAS 28 have been made as a result of the publication of IFRSs 10, 11 and 12. The requirements on how to apply equity accounting are unchanged from the previous version of the Standard.

# Government Loans (Amendments to IFRS 1)

'Government Loans (Amendments to IFRS 1)' provides relief for first-time adopters of IFRSs from the retrospective application of the requirements of IAS 20 'Government Grants' on government loans. IAS 20 requires government loans to be measured at fair value on initial recognition, with the corresponding benefit of a below-market interest rate being accounted for as a government grant.

Under the Amendments, a first-time adopter:

- classifies government loans received as a financial liability or as equity in accordance with IAS 32 'Financial Instruments: Presentation'
- measures government loans at the date of transition to IFRSs at their previous GAAP carrying value, and subsequently applies IFRS 9 'Financial Instruments' or IAS 39 'Financial Instruments: Recognition and Measurement'
- applies IAS 20 to government loans received originated after the date of transition.

Despite these requirements, an entity may apply the requirements in IFRS 9 and IAS 20 retrospectively to any government loan originated before the date of transition to IFRSs, provided that the information needed to do so had been obtained at the time of initially accounting for that loan.

**Commercial significance**

**Number of entities affected: Few**

The Amendments to IFRS 1 are only relevant to those entities applying IFRSs for the first-time. Furthermore the guidance on government loans that carry a below-market interest rate will only affect a narrow sub-section of those companies.

**Impact on affected entities: Low**

The Amendments provide the same relief to first-time adopters of IFRSs as is available to existing IFRS preparers when first applying IAS 20's requirements on government loans. Prior to the Amendments a first-time adopter that received a government loan with a below-market interest rate before its transition date needed to estimate the fair value of that loan retrospectively which would require the use of hindsight.

# Disclosures – Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7)

The publication of 'Disclosures – Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7)' was influenced by the outcome of the joint project between the IASB and the US Financial Accounting Standards Board (FASB) on offsetting. The IASB and the FASB had originally intended to introduce common offsetting requirements for IFRSs and US GAAP. In the end, however, the two Boards decided to maintain their respective offsetting models (subject, for the IASB, to the limited clarifications described in page 34). While they were unable to achieve convergence on common offsetting requirements, they noted that requiring common disclosures would be helpful for users of financial statements.

Accordingly, qualitative and quantitative disclosures have been added to IFRS 7 relating to gross and net amounts of recognised financial instruments that are (a) set off in the statement of financial position and (b) subject to enforceable master netting arrangements and similar agreements, even if not set off in the statement of financial position. The required disclosures should be provided retrospectively.

**Commercial significance**

**Number of entities affected: Few**

The increased disclosure requirements will mainly affect financial institutions that enter into high volumes of trades with the same counterparty that are subject to master netting and similar arrangements.

**Impact on affected entities: Medium**

While the change affects neither recognition or measurement, entities affected will need to spend time in addressing the requirements of the new disclosures.

# IFRS 10 Consolidated Financial Statements

IFRS 10 'Consolidated Financial Statements' was published in May 2011 along with IFRS 11 'Joint Arrangements', IFRS 12 'Disclosure of Interests in Other Entities', IAS 27 (Revised) 'Separate Financial Statements' and IAS 28 (Revised) 'Investments in Associates and Joint Ventures'. Together these Standards form a comprehensive package dealing with group issues and off-balance sheet activity.

**Summary**

**IFRS 10 Consolidated Financial Statements**

- supersedes IAS 27 'Consolidated and Separate Financial Statements' and SIC-12 'Consolidation – Special Purpose Entities'
- changes the definition of control and applies it to all investees to determine the scope of consolidation
- has the potential to affect the outcome of many borderline and judgemental control assessments
- expected to lead to few changes for conventional group structures based on majority share ownership
- where such a change does arise, however, the impact could be very significant.

### Background to the project

IFRS 10 is in part a response to the financial crisis. Prior to its publication, consolidation has been addressed by IAS 27 'Consolidated and Separate Financial Statements' and SIC-12 'Consolidation – Special Purpose Entities'. There is some tension between these pronouncements, with IAS 27 focusing mainly on control through powers such as voting rights, and SIC-12 focusing more on exposure to risks and rewards of the investee.

IFRS 10 aims to address these concerns with a new, principle-based, definition of control that will be applied to all types of investee to determine which are consolidated.

### The new definition of control

IFRS 10 introduces the following revised definition of control together with accompanying guidance on how to apply it.

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

In order to determine whether a reporting entity has control over another entity in which it has invested, the following three elements must always be present:

a) power over the investee
b) exposure, or rights, to variable returns from its involvement with the investee
c) the ability to use its power over the investee to affect the amount of the investor's returns.

The new definition uses the term 'returns' rather than 'benefits' to avoid giving the impression that only positive returns are of relevance. In addition, the new definition focuses more specifically on the decisions that affect the level of returns and whether the investor controls those decisions. As a result, the decision whether to consolidate or not will need to be reconsidered in many borderline scenarios (see table).

In contrast to IAS 27 and SIC-12, which resulted in different criteria for determining control being applied to special purpose vehicles, IFRS 10's requirements will apply to all types of potential subsidiary.


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IFRS News
Special Edition

For more information on this Standard, please refer to our Special Edition of IFRS News 'New consolidations standards'.

**Examples of consolidation decisions that may change**

| Decision | Change |
|---|---|
| **Special purpose vehicles** | • exposure to risks and rewards is only an indicator of control under IFRS 10. It does not on its own lead to consolidation. This is a change from the requirements of SIC-12<br>• IFRS 10 requires a more specific identification of the decisions that have the greatest effect on returns, and who takes them<br>• this change may impact on the consolidation decision for entities that were previously within the scope of SIC-12 |
| **Large minority holdings** | • control may exist where other shareholdings are widely dispersed, and an investor holds significantly more voting rights than any other shareholder or group of shareholders |
| **Potential voting rights** | • under IFRS 10, potential voting rights may, in some circumstances, result in control even where they are not currently exercisable<br>• IFRS 10 considers a broader range of indicators on whether such rights are substantive |
| **Delegated power** | • new guidance in IFRS 10 on principals and agents may impact on consolidation decisions<br>• investment and asset managers in particular may be affected |

### Effective date and transition

The new Standards are effective for annual periods beginning on or after 1 January 2013. Certain transition provisions exist.

Early application of IFRS 10 is possible only if the other new Standards in the package (IFRS 11, IFRS 12, IAS 27 (Revised) and IAS 28 (Revised)) are also adopted at the same time.

### Commercial significance

**Number of entities affected: Most**

All companies with significant involvement in other entities will need to consider the requirements of the new Standard.

**Impact on affected entities: Medium**

We expect that in most cases, conclusions as to what should be consolidated will be unchanged. In some circumstances, it will however change the composition of a group as a consequence of reassessment of which entities a parent company controls. In these cases the impact could be substantial.

# IFRS 11 Joint Arrangements

IFRS 11 'Joint Arrangements' was published in May 2011 along with IFRS 10 'Consolidated Financial Statements', IFRS 12 'Disclosure of Interests in Other Entities', IAS 27 (Revised) 'Separate Financial Statements' and IAS 28 (Revised) 'Investments in Associates and Joint Ventures'. Together these Standards form a comprehensive package dealing with group issues and off-balance sheet activity.

Entities with interests in joint arrangements will need to consider the new terminology and classification requirements of IFRS 11. Where proportionate consolidation has been used in the past under IAS 31, entities will often need to switch to equity accounting.

**Summary**


**IFRS 11 Joint Arrangements**

- supersedes IAS 31 'Interests in Joint Ventures'
- introduces two accounting categories whose applicability is determined based on the substance of the joint arrangement
- eliminates the option of using proportionate consolidation for joint ventures
- eliminates IAS 31's 'jointly controlled operations' and 'jointly controlled assets' categories
- many of the arrangements that would have been classified under those categories will fall into the newly defined category 'joint operation'.


IFRS 11 has been issued with the intention of addressing two perceived deficiencies in IAS 31 'Interests in Joint Ventures':

- that the legal form of the arrangement was the critical determinant of the accounting
- that an entity had a choice of accounting treatment for interests in jointly controlled entities (proportionate consolidation or equity accounting).

IFRS 11 aims to improve on IAS 31 by establishing principles that are applicable to the accounting for all joint arrangements (a joint arrangement being an arrangement over which two or more parties have joint control).

IFRS 11 replaces IAS 31's three categories of 'jointly controlled entities', 'jointly controlled operations' and 'jointly controlled assets' with two new categories – 'joint operations' and 'joint ventures'.

- a joint operation is a joint arrangement whereby the parties that have joint control of the arrangement (ie joint operators) have rights to the assets, and obligations for the liabilities, relating to the arrangement.
- a joint venture is a joint arrangement whereby the parties that have joint control of the arrangement (ie joint venturers) have rights to the net assets of the arrangement.

Entities that have previously been classified as jointly controlled entities under IAS 31 (ie joint ventures that were structured through a separate legal entity) will more usually be classified as 'joint ventures' under IFRS 11.

In limited circumstances a jointly controlled entity under IAS 31 will however be classified and accounted for as a 'joint operation' – broadly when the venturers have rights and exposure to the underlying assets and liabilities. This determination requires an assessment of the legal form of the vehicle, other contractual arrangements and other facts and circumstances (such as whether the activities of the arrangement are primarily designed for the provision of output to the venturers).

### Effective date and transition

The new Standards are effective for annual periods beginning on or after 1 January 2013. Certain transition provisions exist.

Early application of IFRS 11 is possible only if the other new Standards forming part of the package (IFRS 10, IFRS 12, IAS 27 (Revised) and IAS 28 (Revised)) are also adopted at the same time.


For more information on this Standard, please refer to our Special Edition of IFRS News 'New consolidations standards'.

### Commercial significance

**Number of entities affected: Some**

IFRS 11 can be expected to affect many entities operating in the extractive industries, property and construction sectors where joint ventures and other joint arrangements are common. It may of course have a significant effect on individual companies in other industries.

**Impact on affected entities: High**

IFRS 11 eliminates the use of proportionate consolidation for joint ventures. This will be a significant presentational change for the many venturers that chose this accounting policy under IAS 31. Although net assets will not be affected, the removal of that method of accounting will affect individual balance sheet and performance ratios.

# IFRS 12 Disclosure of Interests in Other Entities

IFRS 12 'Disclosure of Interests in Other Entities' was published in May 2011 along with IFRS 10 'Consolidated Financial Statements', IFRS 11 'Joint Arrangements', IAS 27 (Revised) 'Separate Financial Statements' and IAS 28 (Revised) 'Investments in Associates and Joint Ventures'. Together these Standards form a comprehensive package of material dealing with group issues and off-balance sheet activity.

Unlike the other Standards mentioned above, entities are encouraged by the IASB to provide some or all of IFRS 12's disclosure requirements early even if they choose not to early adopt the entire package.

**Summary**

**IFRS 12 Disclosure of Interests in Other Entities**

- combines the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities within a comprehensive disclosure standard
- provides more transparency on 'borderline' consolidation decisions
- enhances disclosures about unconsolidated structured entities in which an investor or sponsor has involvement
- will help investors to assess the extent to which a reporting entity has been involved in setting up special structures and the risks to which it is exposed as a result.

IFRS 12 complements the other new Standards by:

- integrating and making consistent the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities
- providing transparency about the risks to which a reporting entity is exposed from its involvement with structured entities (the financial crisis of 2008/9 had exposed this area as a weakness in financial reporting).

The Standard establishes disclosure objectives according to which an entity discloses:

- significant judgements and assumptions (and changes) made by the reporting entity in determining whether it controls another entity
- the interest that the non-controlling interests have in the group's activities
- the effect of restrictions on the reporting entity's ability to access and use assets or settle liabilities of consolidated entities
- the nature of, and changes in, the risks associated with the reporting entity's interests in consolidated structured entities, joint arrangements, associates and unconsolidated structured entities.

**Commercial significance**

**Number of entities affected: Most**

Most entities can expect to be affected by the new disclosure requirements of IFRS 12. Parent companies whose subsidiaries have non-controlling interests and businesses that operate through so-called structured entities are likely to be especially affected.

**Impact on affected entities: High**

IFRS 12 specifies minimum disclosures that an entity must provide. Some of this information will be new and its preparation will require planning. System modifications and enhancements may be required to address the change in guidance and to provide the necessary information for the new disclosure requirements.

# Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance (Amendments to IFRS 10, IFRS 11 and IFRS 12)

In June 2012, the IASB published 'Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance (Amendments to IFRS 10, IFRS 11 and IFRS 12)' (the Amendments) with the primary intention of clarifying the transitional guidance in IFRS 10 'Consolidated Financial Statements'. In addition, it includes some related changes to IFRS 11 'Joint Arrangements' and IFRS 12 'Disclosure of Interests in Other Entities'.

### The amendments to IFRS 10

IFRS 10 contains transition guidance that is intended to achieve limited retrospective application of IFRS 10. The Amendments clarify this transition guidance, explaining that the 'date of initial application' in IFRS 10 means 'the beginning of the annual reporting period in which IFRS 10 is applied for the first time'.

In doing so, the IASB has amended the transition guidance to confirm that an entity is not required to apply IFRS 10 retrospectively:

- if the consolidation conclusion reached at the date of initial application of IFRS 10 is the same as when applying IAS 27 'Consolidated and Separate Financial Statements' and SIC-12 'Consolidation – Special Purpose Entities'
- to interests in investees that were disposed of during a comparative period in such a way that consolidation would not occur in accordance with either IAS 27/SIC-12 or IFRS 10 at the date of initial application.

The Amendments also:

- clarify how an investor would adjust comparative period(s) retrospectively if the consolidation assessment at the date of initial application is different under IFRS 10 compared to IAS 27/SIC-12
- provide additional transition relief by limiting the requirement to present adjusted comparatives to the period immediately preceding the date of initial application. Presentation of adjusted comparatives for earlier periods is allowed but not required.

### The amendments to IFRS 11 and IFRS 12

The Amendments also make changes to IFRS 11 and IFRS 12 which:

- provide similar relief from the presentation or adjustment of comparative information for periods prior to the immediately preceding period
- provide additional relief by removing the requirement to present comparatives for the disclosures relating to unconsolidated structured entities for any period before the first annual period for which IFRS 12 is applied.

### Commercial significance

**Number of entities affected: Some**

The additional transitional relief relating to the presentation of adjusted comparative information will affect a relatively narrow group of entities where the adoption of IFRS 10 results in a change to previous consolidation conclusions.

The changes to the other parts of the transition guidance will have a wider impact on entities but are more in the nature of clarifications rather than fundamental changes.

**Impact on affected entities: Medium**

The provision of additional transitional relief relating to the presentation of adjusted comparative information will be a useful simplification for those entities affected by it.

# IFRS 13 Fair Value Measurement

IFRS 13 'Fair Value Measurement' (IFRS 13) was published in May 2011. Prior to its publication, the guidance on fair value was distributed across many IFRSs, with some containing quite limited guidance while others contained extensive guidance that was not always consistent. IFRS 13 has been developed to remedy these problems.

The new Standard:

- explains how to measure fair value by providing a new definition and introducing a single set of requirements for (almost) all fair value measurements
- clarifies how to measure fair value when a market becomes less active
- improves transparency through additional disclosures.

IFRS 13 applies to both financial and non-financial items but does not address or change the requirements on when fair value should be used.

The table summarises the main requirements of the new Standard.

**Summary of IFRS 13's requirements**

| Requirement | Significance |
|---|---|
| **Scope** | • addresses all fair value and 'fair value-based' measurements (except those in IFRS 2 and IAS 17)<br>• covers both financial and non-financial items<br>• fair values that are required to be disclosed in the notes are also captured |
| **Definition of fair value** | • an exit value-based approach<br>• emphasis on market participants<br>• excludes entity specific factors<br>• a transaction or entry price may not necessarily represent fair value eg where related parties are involved or a transaction takes place under duress |
| **Fair value measurement** | • transactions are assumed to take place in the principal (or most advantageous) market<br>• for non-financial assets, the highest and best use of the asset is considered<br>• guidance is provided for measuring the fair value of a liability in the absence of an active market for the liability<br>• adjustments for premiums and discounts must be consistent with the unit of account, blockage factors should not be reflected |
| **Valuation techniques** | • entities are required to maximise the use of relevant observable inputs and minimise the use of unobservable inputs<br>• a three-level fair value hierarchy gives the highest priority to quoted prices in active markets (Level 1) and lowest priority to unobservable (Level 3) inputs |

**Summary of IFRS 13's requirements**

| Requirement | Significance |
|---|---|
| **Disclosures** | • fair value hierarchy disclosures are required for financial and non-financial items measured at fair value and for which fair value is disclosed<br>• disclosure requirements are greater for Level 3 fair value measurements |
| **Effective date** | • annual periods beginning on or after 1 January 2013<br>• earlier application is permitted<br>• prospective application |

## Scope of IFRS 13

In general, IFRS 13 applies when another IFRS requires or permits fair value measurements – either in the primary statements themselves or in the footnotes (including 'fair value-based' measurements). In other words it explains how to measure fair value rather than when to.

## The definition of fair value

IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (ie an exit price).

The Standard clarifies that fair value is based on a transaction taking place in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market. The principal market is the market with the greatest volume and level of activity for the asset or liability.

Having established the basic context in which fair value is to be determined, IFRS 13 then goes into further depth, considering:

- the characteristics of the asset or liability
- application to non-financial assets
- application to liabilities and own equity.

## The characteristics of the asset or liability

Under IFRS 13, characteristics of an asset or liability are taken into account in fair value estimates if they are:

a) a characteristic of the asset or liability in question (rather than a characteristic of the entity that holds the item)
b) they would influence market participants' pricing decisions.

The Standard indicates that this will result in some cases in an adjustment being made to observable market inputs (eg a control premium when measuring the fair value of a controlling interest) but only when this is consistent with the unit of account. Questions have been raised as to what is the appropriate unit of account in certain scenarios, and the IASB is currently discussing this matter. Pending clarification of this matter by the IASB, regulators have indicated that they expect issuers to disclose clearly their analysis regarding the unit of account.

## Application to non-financial assets

IFRS 13 states that a fair value measurement of a non-financial asset takes into account the highest and best use of the asset. To be relevant, the highest and best use of a non-financial asset must be:

- physically possible
- legally permissible
- financially feasible.

### Application to liabilities and own equity

Measuring fair value can be problematic for liabilities and an entity's own equity instruments due to quoted prices for the transfers of such items not being available. To overcome this problem, IFRS 13 states that fair value shall be measured from the perspective of a market participant that holds the identical item as an asset. Where this is not possible, IFRS 13 requires an entity to use a valuation technique from the perspective of a market participant that owes the liability or has issued the claim on equity.

### Non-performance risk

The fair value of a liability should reflect the effect of non-performance risk which includes, but is not limited to, an entity's own credit risk. This is particularly relevant to entities that have entered into derivatives transactions. For a liability related to a derivative financial instrument, the fair value should incorporate changes in non-performance risk (Debit Valuation Adjustments or DVAs) in order to take account of the entity's own credit risk.

There should also be proper recognition of counterparty credit risk (Credit Valuation Adjustments or CVAs) when determining the fair value of financial instruments and providing relevant disclosures.

Regulators have noted that they expect issuers to provide an appropriate level of transparency on the methodologies used, and when the amounts are significant, on the effects of counterparty credit risk on measurement of the fair value of assets and non-performance risk on the measurement of the fair value of liabilities.

### Fair value hierarchy

IFRS 13 establishes a fair value hierarchy under which the inputs to valuation techniques used to measure fair value are categorised into three levels. This requirement, which had previously applied only to financial instruments, is aimed at increasing consistency and comparability when measuring fair value and making related disclosures. The three levels of the hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly
- Level 3 inputs are unobservable inputs for the asset or liability.


For more information on this Standard, please refer to our Special Edition of IFRS News 'IFRS 13 Fair Value Measurement'.

### Disclosures

IFRS 13 introduces a comprehensive disclosure framework for fair value measurements. This framework is intended to help users of financial statements assess the valuation techniques and inputs used to develop those measurements.

The disclosures required are affected by the fair value hierarchy discussed above, with increased disclosure requirements applying to the lower levels of that hierarchy.

### Commercial significance

**Number of entities affected: Most**

Even entities largely unaffected by IFRS 13's valuation guidance are likely to be affected by its extensive disclosure requirements.

**Impact on affected entities: Medium**

For many entities, IFRS 13 will not actually change fair values significantly, as much of the new guidance is intended to be consistent with common valuation practices. However, its impact will ultimately depend on the items being fair valued and the techniques currently used. For example, if a company includes 'blockage' adjustments when valuing a large shareholding, then IFRS 13 may well make a difference.

# IFRIC 20 Stripping Costs in the Production Phase of a Surface Mine

IFRIC 20 'Stripping Costs in the Production Phase of a Surface Mine' sets out authoritative guidance on accounting for costs incurred by mining companies in removing waste materials to gain access to mineral ore deposits ('stripping costs'). The Interpretation is narrowly focused on surface mines, not underground mines, and on extracting mineral ore such as coal, not oil and gas.

In a surface mine, stripping activities can result in two benefits for a mining company: usable ore that can be used to produce inventory and improved access to further quantities of material that will be mined in future periods.

### Accounting requirements

Under IFRIC 20, the accounting treatment of stripping costs depends on whether the related activity results in inventory production or in improved access to ore deposits. In summary:

- IAS 2 'Inventories' applies if the benefits from the activity are realised through inventory production
- costs incurred on improving access to ore deposits are recognised as a 'stripping activity asset' if certain conditions are met. This asset is treated as an addition to, or as an enhancement of, an existing asset. The stripping activity asset's classification as a tangible or intangible asset reflects that of the existing asset
- costs incurred on dual purpose activities are allocated to the different elements on a relevant production measure basis.

IFRIC 20 includes more guidance on the asset recognition conditions, cost allocation and on the initial and subsequent measurement of stripping activity assets.

### Commercial significance

**Number of entities affected: Few**

The Interpretation is very narrowly focused. Only mining entities that have surface mines will be affected.

**Impact on affected entities: Medium**

IFRIC 20 has been introduced to address diversity in practice over how mining companies treat stripping costs. As a result, some companies that have previously expensed those costs may now need to capitalise them. Other companies who have previously capitalised them may find that their policies do not meet IFRIC 20's criteria for capitalisation.

# Annual Improvements to IFRSs 2009-2011 Cycle

Published in May 2012, 'Annual Improvements 2009-2011 Cycle' is a collection of amendments to IFRSs resulting from issues that were discussed by the IASB during the project cycle for making annual improvements that began in 2009, and which were subsequently included in an Exposure Draft published in June 2011. The IASB uses the Annual Improvements process to make necessary, but non-urgent, amendments to IFRSs that will not be included as part of any other project.

A summary of the issues addressed is given in the table:

**Summary of Annual Improvements to IFRSs 2009-2011 Cycle**

| Standard affected | Subject | Summary of amendment |
|---|---|---|
| **IFRS 1 'First-time Adoption of International Financial Reporting Standards'** | Repeated application of IFRS 1 | • addresses the question of whether IFRS 1 can be applied more than once<br>• clarifies that in a situation where an entity readopts IFRSs, it can elect to either apply IFRS 1 or apply IFRSs retrospectively in accordance with IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' as if the entity had never stopped applying IFRSs. |
| | Borrowing costs | Addresses situations where an entity chooses to apply IFRS 1's exemption from the requirements of IAS 23 'Borrowing Costs', clarifying that:<br>• borrowing costs that were capitalised before the date of transition in accordance with previous GAAP should be carried forward in the opening statement of financial position<br>• borrowing costs incurred after the date of transition in relation to qualifying assets under construction at the date of transition should be accounted for in accordance with IAS 23<br>• where a first-time adopter chooses to apply the requirements of IAS 23 from a date earlier than the date of transition, it should account for borrowing costs in accordance with IAS 23 on or after the earlier date selected. |
| **IAS 1 'Presentation of Financial Statements'** | Clarification of the requirements for comparative information | The amendment covers two issues:<br>1) Opening statement of financial position<br>• addresses the comparative requirements for the opening statement of financial position when an entity changes accounting policies, or makes retrospective restatements or reclassifications, in accordance with IAS 8<br>• clarifies that the appropriate date for the opening statement of financial position is the beginning of the preceding period. Related notes to this opening statement of financial position are no longer required to be presented.<br>2) Comparative information beyond minimum requirements<br>• addresses whether an entity should be required to present a complete set of financial statements when it provides financial statements beyond the minimum comparative information requirements (ie additional comparative information)<br>• clarifies that additional financial statement information need not be presented in the form of a complete set of financial statements for periods beyond the minimum comparative requirements. Any additional information presented should however be presented in accordance with IFRSs and the entity should present comparative information in the related notes for that additional information. |

**Summary of Annual Improvements to IFRSs 2009-2011 Cycle**

| Standard affected | Subject | Summary of amendment |
|---|---|---|
| **IAS 16 'Property, Plant and Equipment'** | Classification of servicing equipment | • addresses a perceived inconsistency in the classification requirements for servicing equipment which had led some to think that servicing equipment used during more than one period would be classified as part of inventory<br>• the amendment clarifies that items such as spare parts, stand-by equipment and servicing equipment shall be recognised as property, plant and equipment when they meet the definition of property, plant and equipment. If they do not meet this definition they are classified as inventory. |
| **IAS 32 'Financial Instruments: Presentation'** | Tax effect of distribution to holders of equity instruments | • addresses perceived inconsistencies between IAS 12 'Income Taxes' and IAS 32 with regards to recognising the consequences of income tax relating to distributions to holders of an equity instrument and to transaction costs of an equity transaction<br>• clarifies that the intention of IAS 32 is to follow the requirements in IAS 12 for accounting for income tax relating to distributions to holders of an equity instrument and to transaction costs of an equity transaction. IAS 12 requires the recognition of the income tax consequences of dividends in profit or loss except to the extent that the tax arises from a business combination or from a transaction which is recognised outside profit or loss (either in other comprehensive income or directly in equity). |
| **IAS 34 'Interim Financial Reporting'** | Interim financial reporting and segment information for total assets and liabilities | • clarifies the requirements on segment information for total assets and liabilities for each reportable segment to enhance consistency with the requirements in paragraph 23 of IFRS 8 'Operating Segments'<br>• The amendment clarifies that the total assets and liabilities for a particular reportable segment are required to be disclosed if, and only if:<br>a) a measure of total assets or of total liabilities (or both) is regularly provided to the chief operating decision maker; and<br>b) there has been a material change from those measures disclosed in the last annual financial statements for that reportable segment. |

## Commercial significance

**Number of entities affected: Few**

The amendments make changes to relatively narrow areas within IFRSs.

**Impact on affected entities: Low**

The IASB's Annual Improvements process addresses non-urgent, but necessary minor amendments to IFRSs. By nature then, their commercial significance can be expected to be low.

The guidance on the repeated application of IFRS 1 will be useful in a situation such as where an entity was previously required to apply IFRSs in order to meet listing requirements but then delists and no longer presents financial statements in accordance with IFRSs. In a subsequent reporting period, the entity relists, or its local jurisdiction's requirements change from national GAAP to IFRSs, requiring it to present its financial statements in accordance with IFRSs again. The amendment to IFRS 1 clarifies that such an entity will be able to choose to apply IFRS 1.

# Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32)

'Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32)' adds application guidance to IAS 32 to address inconsistencies in applying the criteria for offsetting financial assets and financial liabilities. Two areas of inconsistency are addressed by the amendments.

The first relates to the meaning of 'currently has a legally enforceable right of set-off'. The IASB has clarified that a right of set-off is required to be legally enforceable in the normal course of business, in the event of default and in the event of insolvency or bankruptcy of the entity and all of the counterparties. The right must also exist for all counterparties.

The second area relates to gross settlement systems, such as clearing houses, used by banks and other financial institutions. There had been diversity in practice over the interpretation of IAS 32's requirement for there to be 'simultaneous settlement' of an asset and a liability in order to achieve offsetting.

The IASB has clarified in the amendments the principle behind net settlement and included an example of a 'gross settlement system' with characteristics that would satisfy the IAS 32 criterion for net settlement.

These Amendments were made in conjunction with additional disclosures in IFRS 7 on the effects of rights of set-off and similar arrangements (see page 20).

**Commercial significance**

**Number of entities affected: Few**

The first amendment deals with quite a narrow set of transactions, while the second amendment will mainly be of interest to major financial institutions that enter into high volumes of derivative transactions using a centralised counterparty such as a clearing house.

**Impact on affected entities: Medium**

The first amendment is a clarification of the meaning of 'currently has a legally enforceable right of set-off' rather than a substantial change. The second will lead to a change in practice for some financial institutions who routinely use gross settlement systems as part of their operations. For entities that do need to change their offsetting practice (from net to gross or vice versa) the impact on reported financial position could be material.

# Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)

Many commentators have long held the view that consolidating the financial statements of an investment entity and its investees does not provide the most useful information. Consolidation makes it more difficult for investors to understand what they are most interested in – the value of the entity's investments.

The IASB has been influenced by these arguments. On 31 October 2012 it published 'Investment Entities – Amendments to IFRS 10, IFRS 12 and IAS 27' (the Amendments). The Amendments define an investment entity and provide detailed application guidance on that definition. Entities that meet the definition are required to measure investments that are controlling interests in another entity (in other words, subsidiaries) at fair value through profit or loss instead of consolidating them. The Amendments also introduce new disclosure requirements for investment entities.

The table summarises the key features of the Amendments:

**The amendments at a glance**

| | Summary |
|---|---|
| **Who's affected?** | Entities that:<br>• meet the new definition of 'investment entity'<br>• hold one or more investments that are controlling interests in another entity |
| **What is the impact?** | Investment entities will:<br>• no longer consolidate investments that are controlling interests in another entity<br>• make additional disclosures about these investments |
| **Other key points** | • a non-investment parent entity that controls an investment entity will continue to consolidate its subsidiaries (the consolidation exemption does not 'roll up')<br>• an investment entity's service subsidiaries (subsidiaries that are not 'investments') will continue to be consolidated<br>• if an investment entity has no non-investment subsidiaries it presents separate financial statements as its only financial statements |
| **When are the changes effective?** | • annual periods beginning on or after 1 January 2014<br>• early application permitted |

### Definition of an 'investment entity'

An investment entity is an entity that:

a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services (investment services condition)
b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both (business purpose condition)
c) measures and evaluates the performance of substantially all of its investments on a fair value basis (fair value condition).

### Typical characteristics

In assessing whether it meets the definition an entity shall consider whether it has the following typical characteristics of an investment entity:

a) it has more than one investment
b) it has more than one investor
c) it has investors that are not related parties of the entity
d) it has ownership interests in the form of equity or similar interests.

### Accounting requirements for an investment entity

The Amendments do not set out a comprehensive accounting framework for investment entities – they are instead limited to an exception from consolidation of investments in certain subsidiaries. The Amendments also affect the separate financial statements of an investment entity (if these are prepared). The key changes are shown in the table:

**Accounting requirements for investment entities**

| | Summary |
|---|---|
| **Accounting for subsidiaries held as investments** | • subsidiaries held as investments are measured at fair value through profit or loss in accordance with IFRS 9 'Financial Instruments' instead of being consolidated. This accounting is mandatory not optional<br>• IFRS 3 'Business Combinations' does not apply to the obtaining of control over an exempt subsidiary<br>• the consolidation exception also applies to controlling interests in another investment entity |
| **Accounting for service subsidiaries** | • an investment entity is still required to consolidate subsidiaries that provide services that relate to its investment activities<br>• IFRS 3 applies on obtaining control over a service subsidiary |
| **Accounting in separate financial statements** | • an investment entity's fair value accounting for its controlled investees also applies in its separate financial statements<br>• if the consolidation exception applies to all an investment entity's subsidiaries throughout the current and all comparative periods (ie it has no services subsidiaries) its separate financial statements are its only financial statements |

### Disclosures

The Amendments introduce customised disclosure requirements in IFRS 12 'Disclosure of Interests in Other Entities' relating to an investment entity's subsidiaries that are no longer consolidated. Most existing disclosures in IFRS 12 cease to apply, either because they are specifically dis-applied or because they are not relevant to subsidiaries that are not consolidated (such as summarised financial information and information about non-controlling interests).

### Effective date and transition

The Amendments are effective for annual periods beginning on or after 1 January 2014. This is one year later than the 1 January 2013 effective date of IFRS 10, but the IASB has permitted early adoption in order to allow investment entities to apply the Investment Entities amendments at the same time they first apply the rest of IFRS 10.

### Commercial significance

**Number of entities affected: Some**

The Amendments affect qualifying investment entities. Private equity organisations, venture capital organisations, pension funds, sovereign wealth funds and other investment funds are likely to be particularly interested in the Amendments.

**Impact on affected entities: High**

The consolidation exception will have a huge impact on affected entities and, if adopted early, could spare them from much of the time and effort they would otherwise need to spend on reassessing their control conclusions under IFRS 10's new requirements.


For more information on the amendments, please refer to our Special Edition of IFRS News 'A consolidation exception for investment entities'.

# IFRIC 21 Levies

IFRIC 21 'Levies' considers how an entity should account for liabilities to pay levies imposed by governments, other than income taxes, in its financial statements. A number of new levies were raised following the global financial crisis, particularly on banks. However, IFRIC 21 also applies to several more established types of non-income tax: for example certain property, environmental and payroll taxes (excluding social security contributions or similar taxes within the scope of IAS 19 'Employee Benefits'). As levies and taxes are not based on taxable profits, they fall outside the scope of IAS 12 'Income Taxes' and are therefore accounted for under IAS 37 'Provisions, Contingent Liabilities and Contingent Assets'.

IFRIC 21 addresses the accounting for a liability to pay a levy that is within the scope of IAS 37, in particular when an entity should recognise a liability to pay a levy. It also addresses the accounting for a liability to pay a levy whose timing and amount is certain.

Under IFRIC 21, the obligating event that gives rise to a liability to pay a levy is the activity that triggers the payment of the levy, as identified by the legislation. For example, if the activity that triggers the payment of the levy is the generation of revenue in the current period and the calculation of that levy is based on the revenue that was generated in a previous period, the obligating event for that levy is the generation of revenue in the current period. Where the activity that triggers the payment of the levy occurs over a period of time, the liability to pay a levy is recognised progressively. For example, if the obligating event is the generation of revenue over a period of time, the corresponding liability is recognised as the entity generates that revenue.

IFRIC 21 also clarifies that an entity does not have a constructive obligation to pay a levy that will be triggered by operating in a future period as a result of the entity being economically compelled to continue to operate in that future period. This can lead to accounting outcomes that some find counter-intuitive for levies that are measured by reference to current period activities but are triggered only if the entity continues to operate on a specified date in a future period.

IFRIC 21 is to be applied retrospectively.

**Commercial significance**

**Number of entities affected: Some**

The Interpretation will affect entities that are subject to levies which are not based on taxable profits. As noted above, it will apply to many different types of levy and non-income tax. That said, it is expected to change current practice mainly in cases when the relevant legislation identifies a trigger date in a future accounting period but the amount payable is based on current period activity.

**Impact on affected entities: Medium**

IFRIC 21 will result in some levies being recognised as expenses on a specific date rather than over an accounting period.

# Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36)

'Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36)' addresses the disclosure of information about the recoverable amount of impaired assets if that amount is based on fair value less costs of disposal.

When developing IFRS 13 'Fair Value Measurement', the IASB decided to amend IAS 36 'Impairment of Assets' to require disclosures about the recoverable amount of impaired assets. The IASB noticed however that some of the amendments made in introducing those requirements resulted in the requirement being more broadly applicable than the IASB had intended. The Amendments to IAS 36 therefore clarify the IASB's original intention that the scope of those disclosures is limited to the recoverable amount of impaired assets that is based on fair value less costs of disposal.

The Amendments to IAS 36 should be applied retrospectively for annual periods beginning on or after 1 January 2014. Earlier application is permitted provided the entity has already adopted IFRS 13.

**Commercial significance**

**Number of entities affected: Some**
The Amendments will be relevant in situations where the recoverable amount of an impaired asset is based on fair value less costs of disposal.

**Impact on affected entities: Low**
The Amendments to IAS 36 are uncontroversial in nature.

# Novation of Derivatives and Continuation of Hedge Accounting (Amendments to IAS 39)

'Novation of Derivatives and Continuation of Hedge Accounting (Amendments to IAS 39)' provides relief from discontinuing hedge accounting when the novation of a derivative designated as a hedging instrument meets certain criteria.

In 2009, the Group of Twenty Finance Ministers and Central Bank Governors (G20) made a decision that standardised 'over the counter' (OTC) derivatives should be cleared through a central counterparty (CCP). Following that decision a number of jurisdictions have introduced legal or regulatory requirements that OTC derivatives have to be novated to a CCP. The European Market Infrastructure Regulation in the European Union is one such example.

The Amendments to IAS 39 will allow hedge accounting to continue in a situation where a derivative, which has been designated as a hedging instrument, is novated to effect clearing with a central counterparty as a result of laws or regulation, if specific conditions are met.

The Amendments to IAS 39 should be applied retrospectively. Similar relief has been included in IFRS 9 'Financial Instruments'.

**Commercial significance**

**Number of entities affected: Few**

The Interpretation will only affect entities that have elected to use hedge accounting under IAS 39 and who find that a derivative used as a hedging instrument is novated to a central counterparty due to the introduction of a new law or regulation.

**Impact on affected entities: High**

The amendments are significant as affected entities would otherwise have had to discontinue hedge accounting which would in turn have led to increased profit or loss volatility.

# Defined Benefit Plans: Employee Contributions (Amendments to IAS 19)

**'Defined Benefit Plans: Employee Contributions** (Amendments to IAS 19)' makes narrow scope amendments to IAS 19 'Employee Benefits' which:

- clarify the requirements on how contributions from employees (or third parties) that are linked to service should be attributed to periods of service when accounting for post-employment defined benefit plans
- permit a practical expedient if the amount of the contributions is independent of the number of years of service.

### Background

Prior to the publication of IAS 19 (Revised 2011), it was common practice for entities to deduct employee contributions to defined benefit plans from service cost in the period in which the service was rendered. IAS 19 (Revised 2011) however requires contributions that are linked to service to be attributed to periods of service as a reduction of service cost (ie as a negative benefit). Concerns were raised however about the complexity of this requirement when it was applied to simple contributory plans.

### The Amendments to IAS 19

The IASB has responded to these concerns by both clarifying the requirements of IAS 19 and introducing a practical expedient to the Standard.

### The practical expedient

The practical expedient applies where the amount of contributions from employees or third parties is independent of the number of years of service, and permits an entity to recognise such contributions as a reduction in the service cost in the period in which the related service is rendered, instead of attributing the contributions to the periods of service.

Examples of contributions that are independent of the number of years of service include those that are a fixed percentage of the employee's salary, a fixed amount throughout the service period or dependent on the employee's age.

### The clarification of the requirements of IAS 19

Separately the IASB has clarified that if the amount of the contributions from employees or third parties is dependent on the number of years of service, then an entity shall attribute the contributions to periods of service using the same attribution method required by IAS 19.70 for the gross benefit (ie either using the plan's contribution formula or on a straight-line basis).

IAS 19.93 had previously caused confusion by stating that contributions from employees or third parties in respect of service are attributed to periods of service as a negative benefit in accordance with IAS 19.70, and then stating that the net benefit is attributed in accordance with IAS 19.70.

### Commercial significance

**Number of entities affected: Some**

The Interpretation will only affect entities with defined benefit pension schemes.

**Impact on affected entities: Medium**

The introduction of the practical expedient for accounting for certain contributions from employees or third parties should alleviate the need for complex calculations, and disruption to established practices, in relation to straightforward employee contributions to defined benefit plans.

# Annual Improvements to IFRSs 2010-2012 Cycle

Issued in December 2013, 'Annual Improvements to IFRSs 2010-2012 Cycle' is a collection of amendments to IFRSs, in response to issues that were discussed by the IASB during the 2010-2012 project cycle that began in 2010, and which were subsequently included in an Exposure Draft published in May 2012. The IASB uses the process for making non-urgent, but necessary, minor amendments to IFRSs that will not be included as part of any other project.

A summary of the issues addressed is set out in the table:

**Summary of Improvements to IFRSs 2010-2012**

| Standard affected | Subject | Summary of amendment |
|---|---|---|
| **IFRS 2 'Share-based Payment'** | Definition of vesting conditions | • clarifies the definition of 'vesting conditions' by defining a 'performance condition' and a 'service condition'<br>• amends the definition of a 'market condition' to clarify that a market condition is a performance condition<br>• clarifies that a 'market condition' can be based on the market price (or value) of the entity's equity instruments or the equity instruments of another entity in the same group<br>• clarifies that a share market index is a non-vesting condition because it not only reflects the performance of the entity, but also of other entities outside the group. |
| **IFRS 3 'Business Combinations'** | Accounting for contingent consideration in a business combination | • clarifies that the classification of contingent consideration in a business combination as either a financial liability or an equity instrument is based solely on the requirements of IAS 32 'Financial Instruments: Presentation'<br>• states that the subsequent measurement of contingent consideration in a business combination should be measured at fair value at each reporting date and changes in fair value should be recognised in profit or loss, regardless of whether it is a financial instrument or a non-financial instrument. |
| **IFRS 8 'Operating Segments'** | Aggregation of operating segments<br><br>Reconciliation of the total of the reportable segments' assets to the entity's assets | • requires entities to disclose the judgements made in identifying their reportable segments when operating segments have been aggregated, including a brief description of the operating segments that have been aggregated and the economic indicators that determine the aggregation criteria.<br>• clarifies that the entity is required to provide a reconciliation between the total reportable segments' assets and the entity's assets only if the segment assets are regularly reported to the chief operating decision maker. |
| **IFRS 13 'Fair Value Measurement'** | Short-term receivables and payables | • amends the Basis for Conclusions to clarify that an entity is not required to discount short-term receivables and payables without a stated interest rate below their invoice amount when the effect of discounting is immaterial. |

**Summary of Improvements to IFRSs 2010-2012**

| Standard affected | Subject | Summary of amendment |
|---|---|---|
| **IAS 16 'Property, Plant and Equipment'** | Revaluation method-proportionate restatement of accumulated depreciation | • addresses the diversity in practice in calculating the accumulated depreciation for an item of PP&E that is measured using the revaluation method<br>• clarifies that the gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount<br>• clarifies that the accumulated depreciation is calculated as the difference between the gross carrying amount and the carrying amount after taking into account accumulated impairment losses. |
| **IAS 24 'Related Party Disclosures'** | Key management personnel | • amends the definition of a 'related party' in order to include 'management entities' that provide key management personnel services to the reporting entity<br>• requires the disclosure of the amounts recognised by the reporting entity as a service fee to a separate management entity for the provision of the key management personnel services<br>• provides a relief so that the reporting entity is not required to disclose components of the compensation to key management personnel where the compensation is paid via a management entity. |
| **IAS 38 'Intangible Assets'** | Revaluation method-proportionate restatement of accumulated amortisation | • makes equivalent changes to the accounting of intangible assets, as described above for IAS 16 'Property, Plant and Equipment'. |

The amendments to IFRSs contained in the publication are effective for annual periods beginning on or after 1 July 2014, although entities are permitted to apply them earlier. Certain of the amendments are effective on a prospective basis.

### Commercial significance

**Number of entities affected: Few**

The amendments make changes to relatively narrow areas within IFRSs.

**Impact on affected entities: Low**

The IASB's Annual Improvements process addresses non-urgent, but necessary minor amendments to IFRSs. By their nature then, their commercial significance can be expected to be low. Overall the changes are uncontroversial.

# Annual Improvements to IFRSs 2011-2013 Cycle

Issued in December 2013, 'Annual Improvements to IFRSs 2011-2013 Cycle' is a collection of amendments to IFRSs, in response to issues that were discussed by the IASB during the 2011-2013 project cycle that began in 2011, and which were subsequently included in an Exposure Draft published in November 2012. The IASB uses the process for making non-urgent, but necessary, minor amendments to IFRSs that will not be included as part of any other project.

A summary of the issues addressed is set out in the table:

**Summary of Improvements to IFRSs 2011-2013**

| Standard affected | Subject | Summary of amendment |
|---|---|---|
| **IFRS 1 'First-time Adoption of International Financial Reporting Standards'** | Meaning of 'effective IFRSs' | Amends the Basis for Conclusions to clarify that a first time adopter has the choice between:<br>• applying an existing and currently effective IFRS or<br>• applying early a new or revised IFRS that is not yet mandatorily effective, provided that the new or revised IFRS permits early application.<br><br>A first time adopter is required however to apply the same version of the IFRS throughout the periods covered by those first IFRS financial statements unless IFRS 1 provides an exemption or an exception that permits or requires otherwise. |
| **IFRS 3 'Business Combinations'** | Scope exceptions for joint ventures | • amends IFRS 3 to exclude from its scope the accounting for the formation of all types of joint arrangements as defined in IFRS 11 'Joint Arrangements'<br>• clarifies that the above mentioned scope exclusion only addresses the accounting in the financial statements of the joint arrangement itself, and not the accounting by the parties to the joint arrangement for their interests in the joint arrangement. |
| **IFRS 13 'Fair Value Measurement'** | Scope of paragraph 52 (portfolio exception) | • clarifies that the portfolio exception in IFRS 13.52 applies to all contracts accounted for within the scope of IAS 39 'Financial Instruments: Recognition and Measurement' or IFRS 9 'Financial Instruments', regardless of whether those contracts meet the definitions of financial assets or financial liabilities in accordance with IAS 32 'Financial Instruments: Presentation'<br>• this means for example that commodity contracts that can be settled net in cash and which are accounted for as financial instruments, can qualify for the exemption. |

**Summary of Improvements to IFRSs 2011-2013**

| Standard affected | Subject | Summary of amendment |
|---|---|---|
| **IAS 40 'Investment Property'** | Clarifying the interrelationship of IFRS 3 and IAS 40 when classifying property as investment property or owner-occupied property | Clarifies that IFRS 3 and IAS 40 are not mutually exclusive. Therefore, in determining:<br>• whether a property is owner-occupied property or investment property requires judgement based on IAS 40.7-14<br>• whether the acquisition of an investment property meets the definition of a business combination or is the acquisition of an asset, reference should be made to IFRS 3 to determine whether it is a business combination (not to IAS 40.7-14).<br><br>The amendments to IAS 40 are to be applied prospectively. An entity may however choose to apply the amendment to individual transactions that occurred prior to the beginning of the first annual period occurring on or after the effective date but only where the information needed is available to the entity. |

The amendments to IFRSs contained in the publication are effective for annual periods beginning on or after 1 July 2014, although entities are permitted to apply them earlier. Certain of the amendments are effective on a prospective basis.

### Commercial significance

**Number of entities affected: Few**

The amendments make changes to relatively narrow areas within IFRSs.

**Impact on affected entities: Medium**

The IASB's Annual Improvements process addresses non-urgent, but necessary minor amendments to IFRSs. By their nature then, their commercial significance can be expected to be low and overall the changes are largely uncontroversial.

One change that may have more significance however is the amendment to IAS 40, which states that reference should be made to IFRS 3 to determine whether the acquisition of an investment property meets the definition of a business combination or is the acquisition of an asset. Depending on how IAS 40 has been interpreted in the past, this could lead to changes in practice in the accounting for investment properties.

# Clarification of Acceptable Methods of Depreciation and Amortisation (Amendments to IAS 16 and IAS 38)

In May 2014, Amendments were made to IAS 16 'Property, Plant and Equipment' and IAS 38 'Intangible Assets' in order to address depreciation and amortisation methods which are based on revenue.

The Amendments stem from concerns regarding the use of a revenue-based method for depreciating an asset. By way of background, the two Standards require that a depreciation or amortisation method should reflect the expected pattern of consumption of the future economic benefits of the asset. The Amendments result from a request to clarify the meaning of the term 'consumption of the expected future economic benefits of the asset'.

### The Amendments to IAS 16

The Amendments to IAS 16 prohibit the use of a revenue-based depreciation method for property, plant and equipment because:

- a depreciation method which is based on revenue allocates the asset's depreciable amount based on revenue generated in an accounting period as a proportion of total expected revenue during the asset's useful life
- revenue reflects a pattern of economic benefits that are generated from operating the business rather than the economic benefits that are being consumed through use of the asset.

### The Amendments to IAS 38

The Amendments to IAS 38 present a rebuttable presumption that a revenue-based amortisation method for intangible assets is inappropriate for the same reasons set out above. This rebuttable presumption can be overcome, ie a revenue-based amortisation method might be appropriate, only in two limited circumstances:

1. the intangible asset is expressed as a measure of revenue, for example when the predominant limiting factor inherent in an intangible asset is the achievement of a revenue threshold, or
2. when it can be demonstrated that revenue and the consumption of the economic benefits of the intangible asset are highly correlated.

### Application of the diminishing balance method

In addition, the IASB has taken the opportunity to expand on the guidance on applying the diminishing balance method to property, plant and equipment and to intangible assets.

### Commercial significance

**Number of entities affected: Few**

The amendments are fairly narrow in scope and would only impact those entities using revenue as a basis for depreciating and amortising their tangible/intangible assets.

**Impact on affected entities: Medium**

The amendments will require entities to reconsider their basis for depreciating their assets. While such a change would be accounted for prospectively as a change in accounting estimate, the effect could be significant depending on the materiality of the depreciation charge.

# Agriculture: Bearer Plants (Amendments to IAS 16 and IAS 41)

IAS 41 'Agriculture' requires all biological assets that are related to agricultural activity to be measured at fair value less costs to sell (subject to fair value being reliably measurable), based on the principle that their biological transformation is best reflected by fair value measurement. However, there is a class of biological assets, known as bearer plants, that, once mature, are held by an entity solely to grow produce over their productive life. Examples include grape vines, rubber trees and oil palms.

Constituents told the IASB that IAS 41's fair value model was not appropriate for mature bearer plants that are no longer undergoing significant biological transformation as the way they use these assets is more similar in nature to manufacturing. The IASB listened to these concerns and made changes by issuing 'Agriculture: Bearer Plants (Amendments to IAS 16 and IAS 41)'. The Amendments:

- define a bearer plant as a living plant that:
  - is used in the production or supply of agricultural produce;
  - is expected to bear produce for more than one period; and
  - has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales (this definition is not met if there is a more than 'remote' likelihood that the plant will be sold as agricultural produce, incidental scrap sales excepted)
- include bearer plants within the scope of IAS 16 'Property, Plant and Equipment' instead of IAS 41 (produce growing on bearer plants remains within the scope of IAS 41)
- clarify that until bearer plants are mature, they are to be accounted for as self-constructed items of property, plant and equipment
- require any difference between fair value and the carrying amount under IAS 41 (fair value less costs to sell) at the time of initial adoption to be recognised in opening retained earnings
- exempt entities from the requirement in IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' to disclose the impact of initial application on each financial statement line item affected
- permit the fair value of the bearer plants at the beginning of the earliest period presented to be used as the deemed cost for IAS 16 purposes when first applied.

The Amendments do not result in any changes to existing accounting for 'bearer livestock' or plants with more than a remote likelihood of being harvested and sold as agricultural produce.

**Commercial significance**

**Number of entities affected: Few**
The Amendments will only impact those entities that have bearer plants.

**Impact on affected entities: Medium**
Once implemented, the Amendments should serve to reduce the cost, complexity and practical difficulties of measuring bearer plants at fair value less costs to sell in the absence of markets for these assets. They will also enable the entities to better reflect the economic nature of these plants as productive assets.

# Equity Method in Separate Financial Statements (Amendments to IAS 27)

In August 2014, the IASB published narrow scope amendments to IAS 27 'Separate Financial Statements', entitled 'Equity Method in Separate Financial Statements (Amendments to IAS 27)', which allow the use of the equity method to account for investments in subsidiaries, joint ventures and associates.

Prior to the publication of the Amendments to IAS 27, the Standard required an entity to account for its investments in subsidiaries, joint ventures and associates either at cost or in accordance with IFRS 9 'Financial Instruments' (or IAS 39 'Financial Instruments: Recognition and Measurement' where an entity has not yet adopted IFRS 9).

In responses to the IASB's 2011 Agenda Consultation, some of the IASB's constituents noted however that:

- the laws of some countries require listed companies to present separate financial statements prepared in accordance with local regulations
- those local regulations require the use of the equity method to account for investments in subsidiaries, joint ventures and associates
- in most cases, the use of the equity method would be the only difference between the separate financial statements prepared in accordance with IFRSs and those prepared in accordance with local regulations.

In response, the IASB published the Amendments to IAS 27, so introducing a third option which allows entities to account for investments in subsidiaries, joint ventures and associates under the equity method. As a result, entities will have an accounting policy choice in their separate financial statements between accounting:

- at cost
- in accordance with IFRS 9 (or IAS 39)
- under the equity method.

Entities are required to apply the same accounting for each category of investments. No transitional provisions have been included as the IASB believes entities should be able to use information that is already available to them in applying the Amendments.

**Commercial significance**

**Number of entities affected: Some**

The Amendments will give an additional option to entities that prepare separate financial statements that have investments in subsidiaries, joint ventures and associates.

**Impact on affected entities: Medium**

The inclusion of the equity method as one of the options to account for an entity's investments in subsidiaries, joint ventures and associates in the entity's separate financial statements should serve to reduce the burdens on entities in some jurisdictions and encourage greater use of IFRS.

# Annual Improvements to IFRSs 2012-2014 Cycle

This publication is a collection of amendments to IFRSs resulting from issues that were discussed by the IASB during the project cycle for making annual improvements that began in 2012 and which were included in an Exposure Draft published in December 2013. The IASB uses the Annual Improvements process to make necessary, but non-urgent, amendments to IFRSs that will not be included as part of any other project. By presenting the amendments in a single document rather than as a series of piecemeal changes, the IASB aims to ease the burden of change for all concerned. A summary of the issues addressed is set out in the table.

**Summary of Improvements to IFRSs 2012-2014**

| Standard affected | Subject | Summary of amendment |
|---|---|---|
| **IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations'** | Change in methods of disposal | Amends IFRS 5 to clarify that a direct reclassification of an asset (or disposal group) from being held for sale to being held for distribution (or vice-versa) is not treated as a cessation of held for sale classification. Accordingly the entity continues to measure the asset (or disposal group) at the lower of carrying amount and fair value less costs to sell.<br>The amendments also state that when an entity determines that the asset (or disposal group) is no longer available for immediate distribution or that the distribution is no longer highly probable, it should cease held-for-distribution accounting and apply the guidance in paragraphs 27-29. |
| **IFRS 7 'Financial Instruments: Disclosures'** | Servicing contracts | The amendments provide additional guidance to help entities identify the circumstances under which a contract to 'service' financial assets is considered to be 'continuing involvement' in those assets for the purposes of applying the disclosure requirements in paragraphs 42E-42H of IFRS 7. Such circumstances commonly arise when, for example, the servicing fee is dependent on the amount or timing of the cash flows collected from the transferred financial asset or when a fixed fee is not paid in full due to non-performance of that asset. |
| | Applicability of the amendments to IFRS 7 to condensed interim financial statements | These amendments clarify that the additional disclosures required by the recent amendments to IFRS 7 'Disclosure–Offsetting Financial Assets and Financial Liabilities' are not specifically required for all interim periods. However, these disclosures may still be required in some circumstances to meet the general principles of IAS 34. |
| **IAS 19 'Employee Benefits'** | Discount rate: regional market issue | Paragraph 83 of IAS 19 requires that the currency and term of the corporate or government bonds used to determine the discount rate for post-employment benefit obligations must be consistent with the currency and estimated term of the obligations. The amendments clarify that the assessment of the depth of the corporate bond market shall be made at the currency level rather than the country level. This will be particularly relevant to Eurozone entities with defined benefit plans. |

**Summary of Improvements to IFRSs 2012-2014**

| Standard affected | Subject | Summary of amendment |
|---|---|---|
| **IAS 34 'Interim Financial Reporting'** | Disclosure of information 'elsewhere in the interim financial report' | The amendments clarify the meaning of disclosure of information 'elsewhere in the interim financial report' and require the inclusion of a cross-reference from the interim financial statements to the location of this information. The amendments specify that information incorporated by cross-reference must be available to users of the interim financial statements on the same terms and at the same time as those statements. |

The amendments are effective for annual periods beginning on or after 1 January 2016, although entities are permitted to apply them earlier. The amendments are effective on a retrospective basis, except for the amendments to IFRS 5 which are to be applied prospectively.

### Commercial significance

**Number of entities affected: Few**

The amendments make changes to relatively narrow areas within IFRSs.

**Impact on affected entities: Medium**

The IASB's Annual Improvements process addresses non-urgent, but necessary minor amendments to IFRSs. By their nature then, their commercial significance can be expected to be low. Overall the changes are largely uncontroversial although the Amendments to IAS 19 may be significant for some entities in the Eurozone that have defined benefit plans.

# Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28)

The Amendments to IFRS 10 and IAS 28 address an acknowledged inconsistency between IFRS 10 'Consolidated Financial Statements' and IAS 28 (2011) 'Investments in Associates'. This relates to accounting for transactions in which a parent entity loses control of a subsidiary by contributing it to an associate or joint venture.

The inconsistency stemmed originally from a conflict between the requirements of IAS 27 'Consolidated and Separate Financial Statements (Revised 2008)' and SIC-13 'Jointly Controlled Entities – Non-Monetary Contributions by Venturers'. While IAS 27 required the full gain or loss to be recognised on the loss of control of a subsidiary, SIC-13 required a partial gain or loss recognition in transactions between an investor and its associate or joint venture. Although IFRS 10 supersedes IAS 27, and IAS 28 (2011) supersedes both IAS 28 and SIC-13, the conflict remained.

The Amendments alter IFRS 10 so that:

- the current requirements for the partial gain or loss recognition for transactions between an investor and its associate or joint venture only apply to the gain or loss resulting from the sale or contribution of assets that do not constitute a business, as defined in IFRS 3
- the gain or loss from the sale or contribution of assets that constitute a business between an investor and its associate or joint venture is recognised in full.

Corresponding amendments have been made to IAS 28 (2011) to reflect these changes. In addition IAS 28 (2011) has been amended to clarify that when determining whether assets that are sold or contributed constitute a business, an entity shall consider whether the sale or contribution of those assets is part of multiple arrangements that should be accounted for as a single transaction.

**Commercial significance**

**Number of entities affected: Few**
The scope of the Amendments are narrow in nature.

**Impact on affected entities: Medium**
The Amendments offer a pragmatic solution to a well-known conflict between IFRS 10 and IAS 28.

# Accounting for Acquisitions of Interests in Joint Operations (Amendments to IFRS 11)

The Amendments to IFRS 11 'Joint Arrangements' provide guidance on the accounting for the acquisition of an interest in a joint operation in which the activity of the joint operation constitutes a business.

More specifically, the Amendments state that an acquirer of an interest in a joint operation in which the activity of the joint operation constitutes a business, as defined in IFRS 3 'Business Combinations', should:

- apply all of the principles on business combinations accounting in IFRS 3 and other IFRSs apart from principles that conflict with the guidance of IFRS 11. This requirement also applies to the acquisition of additional interests in an existing joint operation and to the acquisition of an interest in a joint operation on its formation
- provide disclosures for business combinations as required by IFRS 3 and other IFRSs.

Additionally, consequential amendments to IFRS 1 'First-time Adoption of International Financial Reporting Standards' have been made so that IFRS 1's exemption for past business combinations can also apply to past acquisitions of interests in joint operations in which the activity of the joint operation constitutes a business.

The Amendments to IFRS 11 are to be applied prospectively for annual periods beginning on or after 1 January 2016, with earlier application permitted.

**Commercial significance**

**Number of entities affected: Few**

The Amendments will affect entities accounting for the acquisition of an interest in a joint operation that constitutes a business.

**Impact on affected entities: Low**

Prior to the publication of the Amendments, there was diversity in the way that entities accounted for the acquisition of an interest in a Joint Operation that constitutes a business. Some entities applied an IFRS 3 approach, some a cost approach and some a hybrid approach. The Amendments will reduce such diversity by requiring an IFRS 3 approach to be used. The impact is softened however by the fact that the Amendments are to be applied prospectively.

# IFRS 14 Regulatory Deferral Accounts

In January 2014, the IASB issued an interim Standard on rate-regulated activities entitled IFRS 14 'Regulatory Deferral Accounts'.

Many governments regulate the supply and pricing of particular types of activity by private entities, including utilities such as gas, electricity and water. These regulations are often designed to allow the suppliers to recover specified costs and other amounts through the prices they charge to customers. However, rate regulation is also designed to protect the interests of customers. Consequently, the rate regulation may defer the recovery of these amounts in order to reduce price volatility. The suppliers usually keep track of these deferred amounts in separate regulatory deferral accounts until they are recovered through future sales of the regulated goods or services.

As a result, the requirements of some national accounting standard-setting bodies permit or require entities that are subject to certain types of rate regulation to capitalise and defer expenditures (or income) that would otherwise be recognised as expenses (or income) in the statement of profit or loss and other comprehensive income by non-rate-regulated entities. These amounts are often referred to as 'regulatory deferral' (or 'variance') accounts.

IFRS 14 has been published as an interim Standard that will allow entities that adopt IFRS for the first-time to preserve the existing accounting policies that they have in place for rate-regulated activities with some modifications designed to enhance comparability (the Standard requires that the effect of recognising the deferred account balances that arise from rate regulation must be presented separately from other items).

**Rate-regulated activities**

Short-term interim solution for first-time adopters of IFRS: IFRS 14 'Regulatory Deferral Accounts'

Longer-term comprehensive project for all rate-regulated entities: research phase is ongoing – Discussion Paper 'Reporting the Financial Effects of Rate Regulation' issued in September 2014

A longer term project will address the more difficult question of whether regulatory deferral account balances meet the definitions of assets and liabilities in the 'Conceptual Framework'. Depending on the outcome of this longer term project, the IASB could decide to issue a comprehensive Standard for rate-regulated activities or alternatively not to develop any specific requirements. In the meantime however, the publication of IFRS 14 allows entities in jurisdictions that are transitioning to IFRS to continue to use the accounting for regulatory deferral accounts that they have previously used until the outcome of the IASB's longer term project is resolved. The following table illustrates the main points of the Standard.

**Summary of IFRS 14 Regulatory Deferral Accounts**

| Features | Key points |
|---|---|
| **Scope** | • applies to first-time adopters that conduct rate-regulated activities and have recognised regulatory deferral accounts under their previous GAAP<br>• application is not mandatory, but if a first-time adopter is eligible to apply the Standard, it must elect to do so in its first financial statements. If it does not, the entity will not be eligible to apply the Standard in subsequent periods<br>• entities that already present IFRS financial statements are not eligible to apply IFRS 14 |
| **Accounting requirements** | • permits an entity that adopts IFRS to continue to use, in its first and subsequent IFRS financial statements, its previous GAAP accounting policies for the recognition, measurement, impairment and derecognition of regulatory deferral account balances<br>• a regulatory deferral account balance is defined as the balance of any expense (or income) account that would not be recognised as an asset or a liability in accordance with other Standards, but that qualifies for deferral because it is included, or is expected to be included, by the rate regulator in establishing the rate(s) that can be charged to customers. |
| **Presentation** | Isolates impact of recognising regulatory deferral account balances in IFRS financial statements by requiring the following separate line items:<br><br>Two line items in the statement of financial position:<br>• regulatory deferral account debit balances – after total assets<br>• regulatory deferral account credit balances – after total liabilities<br><br>Two line items in the statement of profit or loss and Other Comprehensive Income (OCI):<br>• movement in regulatory deferral account balances related to profit or loss<br>• movement in regulatory deferral account balances related to OCI. |
| **Disclosures** | Specific disclosures are required to identify the nature of, and risks associated with, the rate regulation that has resulted in the recognition of regulatory deferral account balances in accordance with the Standard. |

## Commercial significance

**Number of entities affected: Few**

IFRS 14 is a very limited scope Standard which aims to provide a transitory solution for rate-regulated entities that have not yet adopted IFRS.

**Impact on affected entities: High**

The inability to recognise regulatory assets and liabilities had proved to be a significant issue which had prevented rate-regulated entities in some jurisdictions from moving to IFRS.

IFRS 14 will reduce this significant barrier to the adoption of IFRS, and should improve comparability by reducing the number of different accounting frameworks being used.

# IFRS 15 Revenue from Contracts with Customers

IFRS 15 'Revenue from Contracts with Customers' is the product of a major joint project between the IASB and the US Financial Accounting Standards Board. The previous requirements of IFRS and US GAAP were not harmonised and often resulted in different accounting treatments for economically significant transactions. In response, the Boards have developed new, fully converged requirements for the recognition of revenue under both IFRS and US GAAP. IFRS 15:

- replaces IAS 18 'Revenue', IAS 11 'Construction Contracts' and some revenue-related Interpretations
- establishes a new control-based revenue recognition model
- changes the basis for deciding whether revenue is recognised at a point in time or over time
- provides new and more detailed guidance on specific topics
- expands and improves disclosures about revenue.

**IFRS 15 at a glance**

| Features | Key points |
|---|---|
| **Who is affected?** | • all entities that enter into contracts with customers with few exceptions |
| **What is the impact?** | • entities affected will need to reassess their revenue recognition policies and may need to revise them<br>• the timing and amount of revenue recognised may not change for simple contracts for a single deliverable but most complex arrangements will be affected to some extent<br>• IFRS 15 requires more and different disclosures |
| **When are the changes effective?** | • annual periods beginning on or after 1 January 2017<br>• early application is permitted. |

### A five step model for revenue recognition


IFRS 15 is based on a core principle that requires an entity to recognise revenue:

- in a manner that depicts the transfer of goods or services to customers
- at an amount that reflects the consideration the entity expects to be entitled to in exchange for those goods or services.

A "customer" is defined as "a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities."

Applying this core principle involves following a five step model depicted above. The table below expands on the factors to consider in applying this new model.

The 'five step model'

| | Step | Principal considerations | Other factors to consider |
|---|---|---|---|
| 1. | **Identify the contract(s) with a customer** | The first step in IFRS 15 is to identify the "contract," which IFRS 15 defines as "an agreement between two or more parties that creates enforceable rights and obligations." A contract can be written, oral, or implied by an entity's customary business practices.<br>In addition the general IFRS 15 model applies only when or if:<br>• the contract has commercial substance<br>• the parties have approved the contract<br>• the entity can identify<br>– each party's rights<br>– the payment terms for the goods and services to be transferred<br>• it is probable the entity will collect the consideration.<br>If a customer contract does not meet these criteria, revenue is recognised only when either:<br>• the entity's performance is complete and substantially all of the consideration in the arrangement has been collected and is non-refundable<br>• the contract has been terminated and the consideration received is non-refundable.<br>For purposes of IFRS 15, a contract does not exist if each party has an enforceable right to terminate a wholly unperformed contract without compensating the other party. | Guidance is also given on:<br>• combining contracts<br>• contract modifications. |
| 2. | **Identify the separate performance obligations in the contract** | Having identified a contract, the entity next identifies the performance obligations within that contract. A performance obligation is a promise in a contract with a customer to transfer either (1) a good or service, or a bundle of goods or services, that is 'distinct'; or (2) a series of distinct goods or services that are substantially the same and meet certain criteria.<br>Performance obligations are normally specified in the contract but could also include promises implied by an entity's customary business practices, published policies or specific statements that create a valid customer expectation that goods or services will be transferred under the contract. | Guidance is given on the criteria that need to be met in order to determine whether a promised good or service is distinct. |
| 3. | **Determine the transaction price** | Under IFRS 15, the "transaction price" is defined as the amount of consideration an entity expects to be entitled to in exchange for the goods or services promised under a contract, excluding any amounts collected on behalf of third parties (for example, sales taxes).<br>The transaction price is not adjusted for effects of the customer's credit risk, but is adjusted if the entity (eg based on its customary business practices) has created a valid expectation that it will enforce its rights for only a portion of the contract price. | An entity must consider the effects of all the following factors when determining the transaction price:<br>• variable consideration<br>• the constraint on variable consideration<br>• time value of money<br>• non-cash consideration<br>• consideration payable to the customer. |
| 4. | **Allocate the transaction price to the performance obligations** | Under IFRS 15, an entity allocates a contract's transaction price to each separate performance obligation within that contract on a relative stand-alone selling price basis at contract inception. IFRS 15 defines a stand-alone selling price as "the price at which an entity would sell a promised good or service separately to a customer." | IFRS 15 suggests, but does not require, the following three methods as suitable for estimating the stand-alone selling price:<br>• adjusted market assessment approach<br>• expected cost plus margin approach<br>• residual approach. |
| 5. | **Recognise revenue when or as an entity satisfies performance obligations** | Under IFRS 15, an entity recognises revenue when or as it transfers promised goods or services to a customer. A "transfer" occurs when the customer obtains control of the good or service.<br>A customer obtains control of an asset (good or service) when it can direct the use of and obtain substantially all the remaining benefits from it. Control includes the ability to prevent other entities from directing the use of and obtaining the benefits from an asset. The benefits of an asset are the potential cash flows that can be obtained directly or indirectly from the asset in many ways. | A key part of the model is the concept that for some performance obligations control is transferred over time while for others control transfers at a point in time. Guidance is given in the Standard to help entities decide which is appropriate. |

## Other matters

In addition to the items discussed above in relation to the five step model, IFRS 15 contains guidance on a number of other matters including:

- contract costs
- warranties
- licensing
- rights of return and repurchase obligations.


The Grant Thornton International Ltd IFRS team has published a special edition of IFRS News on IFRS 15 'Revenue from Contracts with Customers'. The special edition takes readers through the key features of the new Standard and gives practical insights into how it may affect entities. To obtain a copy of the special edition, please get in touch with the IFRS contact in your local Grant Thornton office.

## Effective date and transition

IFRS 15 is effective for annual reporting periods beginning on or after 1 January 2017. Early adoption is permitted.

Entities are required to apply the new revenue Standard either:

- retrospectively to each prior period presented, subject to some practical expedients or
- retrospectively, with the cumulative effect of initial application recognised in the current period.

An entity that chooses to restate only the current period is required to provide the following additional disclosures in the initial year of adoption:

- the current year impact of applying the new revenue Standard by financial statement line item
- an explanation of the reasons behind the significant impacts.

### Commercial significance

**Number of entities affected: Most**

IFRS 15 impacts all entites that enter into contracts with customers with few exceptions.

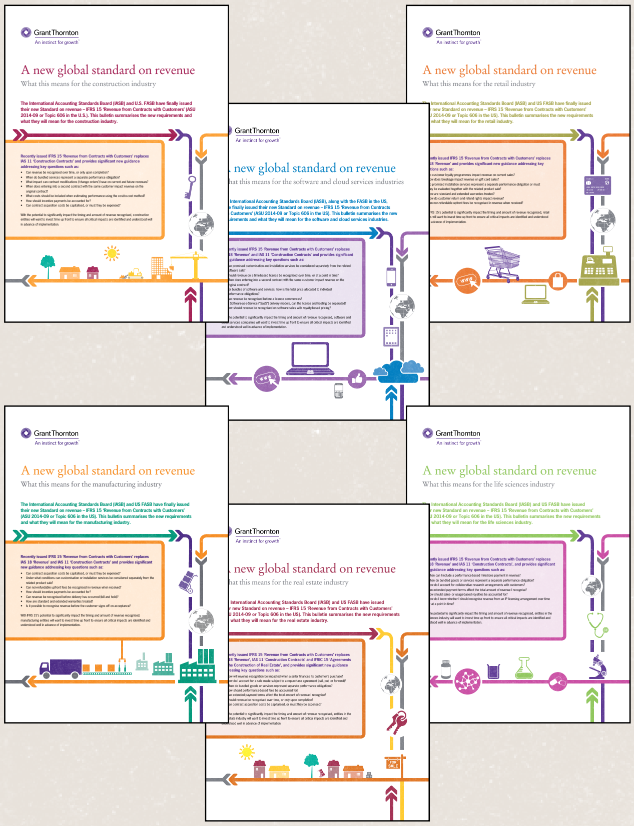
**Impact on affected entities: High**

The impact on the top line will very much depend on each entity's specific customer contracts and how the much less detailed existing Standards have been applied. For some it will be a significant shift while others may see only minor changes. Entities are advised to start their assessment of IFRS 15 now in order to determine the impact on their financial statements.

The Grant Thornton International Ltd IFRS Team has released six publications in a series of 'industry insights' on IFRS 15 'Revenue from Contracts with Customers'.

The industry insights publications look at what the new Standard means for the following industries:

- construction
- software & cloud services
- retail
- manufacturing
- real estate
- life sciences.




To obtain a copy of any of the industry insights publications, please get in touch with the IFRS contact in your local Grant Thornton office.

# IFRS 9 (2014) Financial Instruments

The IASB began its overhaul of the accounting for financial instruments in the summer of 2009 in response to the widespread criticism of IAS 39 and its alleged role in contributing to the financial crisis of 2007/8. Due to the complexity of the issues involved, the project was completed in a number of stages as follows:

- November 2009: the classification and measurement of financial assets
- October 2010: requirements for classifying and measuring financial liabilities and derecognising financial assets and financial liabilities were added
- November 2013: requirements on hedge accounting were introduced
- July 2014: the IASB issued IFRS 9 (2014) adding requirements on impairment and amending the Standard's classification and measurement requirements.

Following the publication of IFRS 9 (2014) the Standard as a whole is now complete. The different parts of the Standard are discussed in greater detail below.

## Classification and measurement of financial assets

The classification and measurement of financial assets was one of the areas of IAS 39 that received the most criticism during the financial crisis. In publishing the original version of IFRS 9, the IASB therefore made a conscious effort to reduce the complexity in accounting for financial assets by just having two categories (fair value and amortised cost). However following comments that having just two categories created too sharp a dividing line and failed to reflect the way many businesses manage their financial assets, an additional category was added in July 2014 when IFRS 9 (2014) was published.

### Classification

Under IFRS 9 each financial asset is classified into one of three main classification categories:

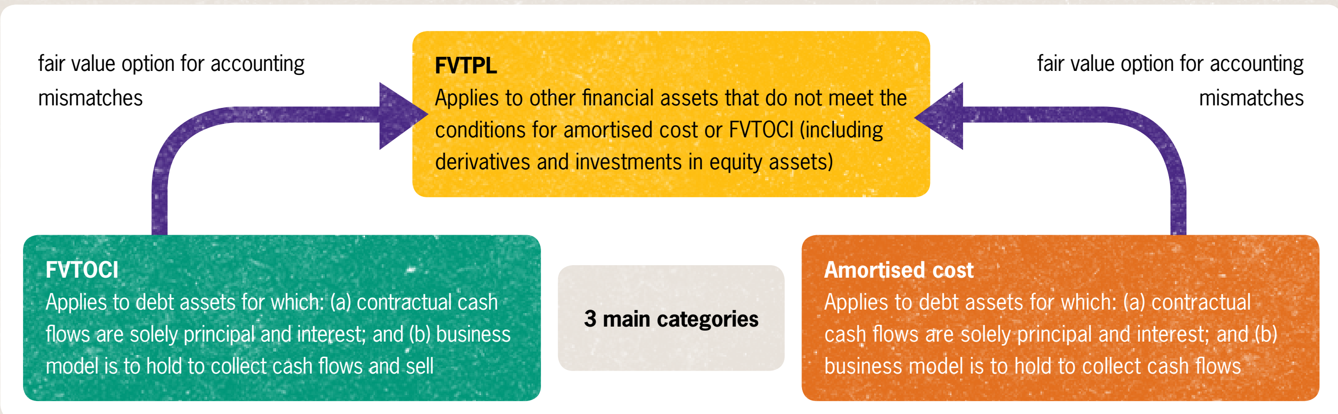
- amortised cost
- fair value through other comprehensive income (FVTOCI)
- fair value through profit or loss (FVTPL).

The classification is determined by both:

a) the entity's business model for managing the financial asset ('business model test'); and
b) the contractual cash flow characteristics of the financial asset ('cash flow characteristics test').

The diagramme below summarises the three main categories and how the business model and cash flow characteristics determine the applicable category.

In addition, IFRS 9 contains an option which allows an entity to designate a financial asset at fair value through profit or loss and an additional option to classify investments in equity instruments in a special 'equity – FVTOCI' category.



### The business model test

IFRS 9 uses the term 'business model' in terms of how financial assets are managed and the extent to which cash flows will result from collecting contractual cash flows, selling financial assets or both. The Standard positively defines two such 'business models':

- a business model whose objective is to hold the financial asset in order to collect contractual cash flows ('hold to collect'); and
- a business model in which assets are managed to achieve a particular objective by both collecting contractual cash flows and selling financial assets ('hold to collect and sell').

Business models other than the two above result in classification of financial assets at fair value through profit or loss.

### The cash flow characteristics test

The second condition for classification in the amortised cost classification or FVTOCI category can be labelled the 'solely payments of principal and interest' (SPPI) test. The requirement is that the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

For the purpose of applying this test, 'principal' is the fair value of the financial asset at initial recognition. 'Interest' consists of consideration for:

- the time value of money
- the credit risk associated with the principal amount outstanding during a particular period of time
- other basic lending risks and costs
- a profit margin.

Contractual cash flows that are SPPI are consistent with a basic lending arrangement. Contractual terms that introduce exposures to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement however, such as exposure to changes in equity prices or commodity prices, fail the SPPI test. Similarly contracts that increase leverage fail the test as they increase the variability of the contractual cash flows with the result that they do not have the economic characteristics of interest.

### Summary of classification model

The diagramme below shows how IFRS 9's business model test and cash flow characteristics test interact in determining the classification of financial assets.

### Classification and measurement of financial liabilities

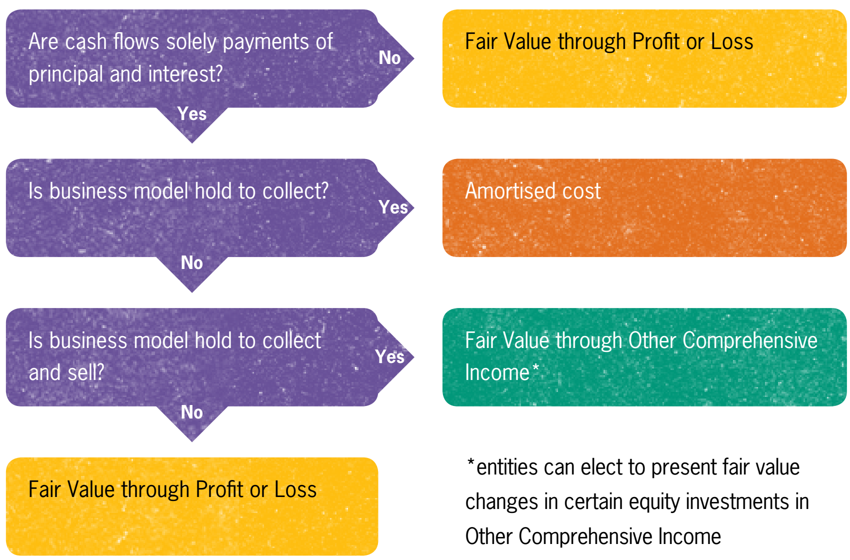
In October 2010, the IASB amended IFRS 9 to incorporate requirements on the classification and measurement of financial liabilities. Most of IAS 39's requirements have been carried forward unchanged to IFRS 9. Changes were however made to address issues related to own credit risk where an entity takes the option to measure financial liabilities at fair value.

### Majority of requirements retained

Under IAS 39 most liabilities are measured at amortised cost or bifurcated into a host instrument measured at amortised cost, and an embedded derivative, measured at fair value.

Liabilities that are held for trading (including all derivative liabilities) are measured at fair value. These requirements have been retained.

**Summary of classification model**



### Own credit risk

The requirements related to the fair value option for financial liabilities have however been changed to address own credit risk. Where an entity chooses to measure its own debt at fair value, IFRS 9 now requires the amount of the change in fair value due to changes in the entity's own credit risk to be presented in other comprehensive income. This change addresses the counterintuitive way in which a company in financial trouble was previously able to recognise a gain based on its theoretical ability to buy back its own debt at a reduced cost.

The only exception to the new requirement is where the effects of changes in the liability's credit risk would create or enlarge an accounting mismatch in profit or loss, in which case all gains or losses on that liability are to be presented in profit or loss.

In November 2013, the IASB amended IFRS 9 to allow these changes to be applied in isolation without the need to change any other accounting for financial instruments.

### Elimination of the exception from fair value measurement for certain derivative liabilities

The new version of IFRS 9 also eliminates the exception from fair value measurement for derivative liabilities that are linked to and must be settled by delivery of an unquoted equity instrument. Under IAS 39, if those derivatives were not reliably measurable, they were required to be measured at cost. IFRS 9 requires them to be measured at fair value.

## Derecognition of financial assets and financial liabilities

In October 2010, the requirements in IAS 39 related to the derecognition of financial assets and financial liabilities were incorporated unchanged into IFRS 9.

The IASB had originally envisaged making changes to the derecognition requirements of IAS 39. In the summer of 2010, however, the IASB revised its strategy, having concluded that IAS 39's requirements in this area had performed reasonably during the financial crisis. IAS 39's derecognition requirements have therefore been incorporated into IFRS 9 unchanged, while new disclosure requirements were instead issued in October 2010 as an amendment to IFRS 7 'Financial Instruments: Disclosures'.

## Hedge accounting

In November 2013, the IASB published Chapter 6 of IFRS 9 'Hedge Accounting'.

IAS 39's hedge accounting requirements had been heavily criticised for containing complex rules which either made it impossible for entities to use hedge accounting or, in some cases, simply put them off doing so. As an example, hedge effectiveness was judged on both a prospective and a retrospective basis, with a 'bright-line' quantitative range of 80-125% being used to assess retrospective effectiveness on a quantitative basis. Anything outside this range resulted in the discontinuance of hedge accounting, leading to a sharp increase in profit and loss volatility.

In part this complexity was a reflection of the fact that the hedge accounting requirements were an exception to IAS 39's normal requirements. There was however also a perception that hedge accounting did not properly reflect entities' actual risk management activities, thereby reducing the usefulness of their financial statements. IFRS 9's new requirements look to rectify some of these problems, aligning hedge accounting more closely with entities' risk management activities by:

- increasing the eligibility of both hedged items and hedging instruments
- introducing a more principles-based approach to assessing hedge effectiveness.

**Simplifications compared to IAS 39**

| Features | Key points |
|---|---|
| **Objective of the Standard** | • to better align hedging from an accounting point of view with entities' underlying risk management activities |
| **Similarities with IAS 39** | • hedge accounting remains an optional choice<br>• the three types of hedge accounting (fair value hedges, cash flow hedges and hedges of a net investment) remain<br>• formal designation and documentation of hedge accounting relationships is required<br>• ineffectiveness needs to be measured and included in profit or loss<br>• hedge accounting cannot be applied retrospectively |
| **The major changes** | • increased eligibility of hedged items<br>• increased eligibility of hedging instruments and reduced volatility<br>• revised criteria for hedge accounting qualification and for measuring hedge ineffectiveness<br>• a new concept of rebalancing hedging relationships<br>• new requirements restricting the discontinuance of hedge accounting |

As a result, the new requirements should serve to reduce profit or loss volatility. The increased flexibility of the new requirements are however partly offset by entities being prohibited from voluntarily discontinuing hedge accounting and also by enhanced disclosure requirements. The table above gives a highly summarised view of the new requirements.


For more information on IFRS 9's hedge accounting requirements, please refer to our Special Edition of IFRS News 'IFRS 9 Hedge accounting' which can be obtained from your local IFRS contact.

### Impairment

IFRS 9 (2014) contains the Standard's requirements on impairment, including the recognition of expected credit losses. IAS 39's impairment requirements had been criticised for being overly complicated and resulting in impairment being recognised at too late a stage. IFRS 9 (2014) addresses these criticisms by applying the same impairment model to all financial instruments that are subject to impairment accounting and by using more forward-looking information. In applying this more forward-looking approach, a distinction is made between:

- financial instruments that have not deteriorated significantly in credit quality since initial recognition or that have low credit risk and
- financial instruments that have deteriorated significantly in credit quality since initial recognition and whose credit risk is not low.

'12-month expected credit losses' are recognised for the first category while 'lifetime expected credit losses' are recognised for the second category. There is also a third step to the model in the sense that for assets which actually become credit-impaired after initial recognition, interest is calculated on the asset's amortised cost (i.e. the amount net of the loss allowance) as opposed to its gross carrying amount.

### Effective date and transition disclosures

IFRS 9 (2014) introduces a new mandatory effective date for the Standard of accounting periods beginning on or after 1 January 2018.

Extensive transition provisions have been included due to the complexity of the material and the phased way in which the project has been completed.

**Expected credit losses**

**Deterioration in credit quality**

| Stage 1 – Performing | Stage 2 – Under-performing | Stage 3 – Non-performing |
|---|---|---|
| • financial instruments that have not deteriorated significantly in credit quality since initial recognition or that have low credit risk at the reporting date | • financial instruments that have deteriorated significantly in credit quality since initial recognition (unless they have low credit risk at the reporting date) but that do not have objective evidence of a credit loss event | • financial assets that have objective evidence of impairment at the reporting date |
| • 12-month expected credit losses are recognised<br>• interest revenue is calculated on the gross carrying amount of the asset. | • lifetime expected credit losses are recognised<br>• interest revenue is still calculated on the asset's gross carrying amount. | • lifetime expected credit losses are recognised<br>• interest revenue is calculated on the net carrying amount (ie reduced for expected credit losses). |
| **Credit risk = low** | **Credit risk > low** | |

## Advantages and disadvantages of early adoption of IFRS 9

### Advantages

- improved ability to align accounting with the company's business model for managing financial assets
- gives a (one-off) opportunity to reclassify financial assets on initial adoption (assuming all the criteria are met)
- only one set of impairment rules needs to be considered, with no separate impairment assessment (or losses) for investment in equity instruments
- simplified accounting for and valuation of financial instruments containing embedded derivatives in asset host contracts
- enables hedge accounting to be aligned more closely with entities' risk management activities
- avoids counter-intuitive results arising from changes in own credit risks where the option to measure financial liabilities at fair value has been taken

### Disadvantages

- need to re-evaluate the classification of all instruments within the scope of IAS 39, with consequent implications for system changes
- restricted ability to reclassify financial instruments on an ongoing basis
- system changes will need to be made in order to generate the information necessary to implement the Standard's three-stage impairment model
- inability to voluntarily discontinue hedge accounting
- complicated transition provisions as a result of the phased completion of the project.


For more information on this Standard, please refer to our Special Edition of IFRS News 'IFRS 9 (2014)', which can be obtained from your local IFRS contact.

### Commercial significance

**Number of entities affected: Most**

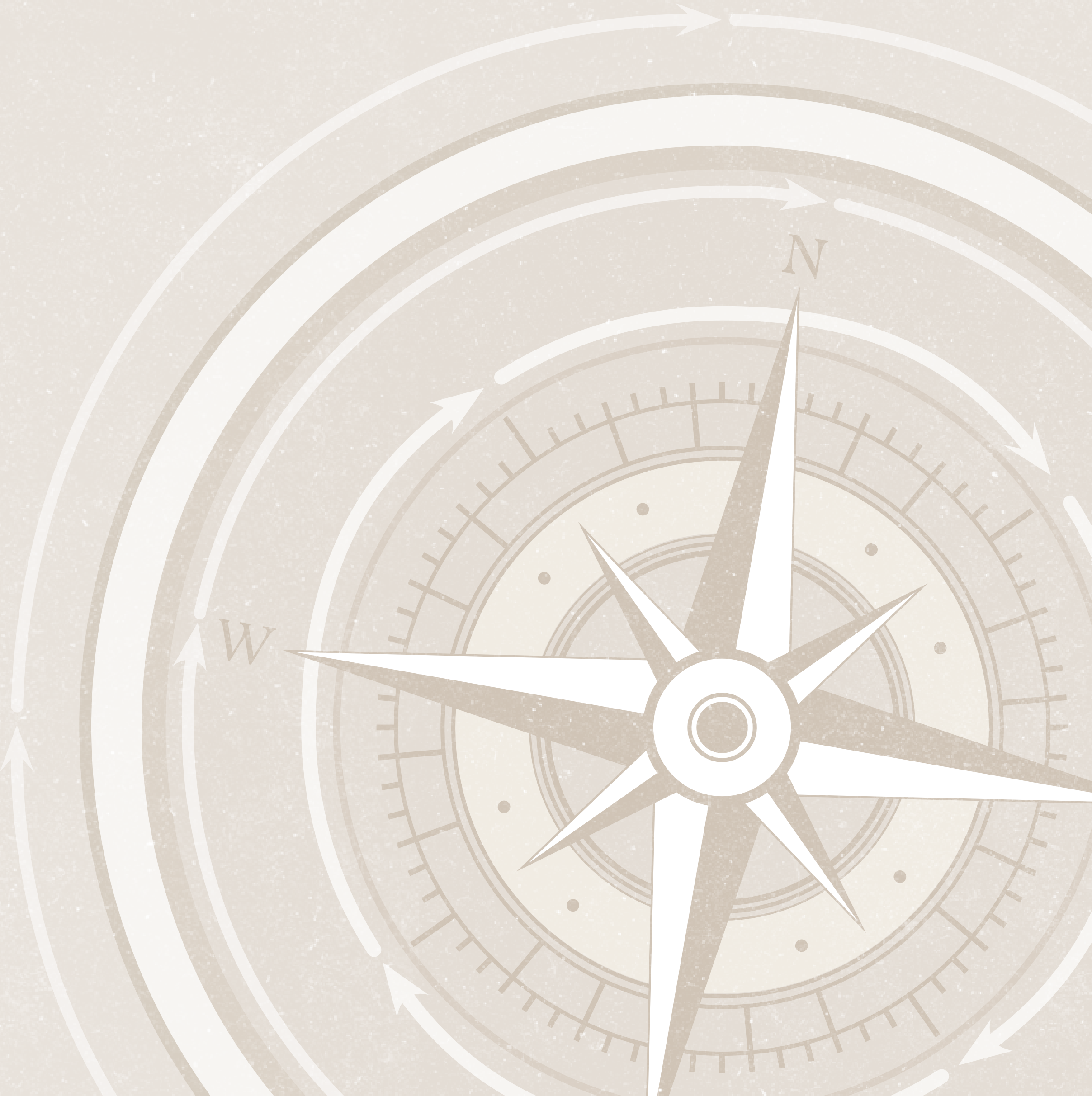
Because the definition of a financial instrument is so wide, most companies can expect to be affected. Even companies with relatively simple debtors and creditors should consider the changes. In addition, the greater alignment of IFRS 9's hedge accounting requirements with entities risk management practices may encourage entities who engage in economic hedging to also apply hedge accounting.

**Impact on affected entities: High**

The new Standard, with its reduced number of measurement categories, should help to reduce the complexity in accounting for financial instruments. In the short-term however, it may lead to far reaching changes, with companies needing to re-evaluate the classification of all instruments within the scope of IAS 39.

In addition to the impact on companies' financial position and reported results, many businesses will need to collect and analyse additional data and implement changes to systems in order to implement the new requirements on impairment.

While its effective date of 2018 may seem a long way off, we strongly advise companies to start evaluating the new Standard now.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