

IFRS news

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IASB issues Discussion Paper on Conceptual Framework

The IASB responds to public call to update its Conceptual Framework. Arjan Brouwer from PwC's Accounting Consulting Services looks at the proposals and next steps.

The IASB has issued a discussion paper (DP) on the Conceptual Framework (the 'Framework') project. The DP asks respondents for initial views on fundamental issues such as the recognition hurdles for assets and liabilities, debt versus equity, relevant measurement bases and which principles should underlie disclosure requirements. Many supported giving priority to this project during the consultation on the IASB's future work plan.

Why a new framework?

A conceptual framework is an important basis for the development of accounting standards that are both principles based and internally consistent. Some argue that such consistent conceptual basis has been missing in recent board deliberations. Debate about the definition of assets and liabilities, other comprehensive income and the relevance of disclosures might be traced back to an insufficient basis in the existing framework. Also the recent financial crisis has put pressure on the definition of performance and 'fair value' as a measurement model.

Where are we now with the Framework?

Separate chapters about the objectives of general purpose financial reporting and qualitative characteristics of useful financial information were completed in 2010. The old qualitative characteristics (understandability, relevance, reliability and comparability) were replaced by two fundamental qualitative characteristics, relevance and faithful representation, and four enhancing qualitative characteristics.

Restarting the project has already yielded discussions about whether concepts such as stewardship, reliability and prudence should find their way back into the Framework (explicit references were removed in 2010). The IASB does not intend to reconsider these chapters but requests feedback on this approach and the EFRAG has also recently issued a number of bulletins seeking views.

The Framework project was put on hold in 2010 and the remaining text from the existing Framework was simply added in a chapter with the appealing title "The Framework (1989): the remaining text".



The discussion paper

The Board restarted the project in 2012 and forged ahead with the DP focusing on the remaining areas of the Framework. The DP invites interested parties to reflect on Board proposals in certain areas and a range of alternatives in other areas. Some highlights are:

- **Elements:** The DP proposes that probability is no longer part of the definition of an asset or liability. The definitions now focus on whether a past event provides control over a right (or obligation) to receive (or transfer) economic resources. The IASB also asks for input on several possible approaches on how the definitions should be applied to conditional obligations.
- **Recognition:** Assets and liabilities would be recognised unless their recognition would not result in relevant information or no measurement basis would result in a faithful representation.
- **Liabilities and equity:** The DP retains the existing definition of 'equity' as the 'residual interest in the assets after deducting all liabilities'. But it proposes 'remeasuring' each class of equity and recognising those remeasurements as a transfer of wealth between classes.
- **Measurement:** The proposed objective of measurement is to represent faithfully the most relevant information. The IASB has not expressed an explicit preference for one measurement model. The DP acknowledges that a mix of measurement models might result in relevant information depending on the nature of the element.
- **Presentation:** The Board does not plan to define 'performance' in the Framework but the debate about what goes in other

comprehensive income is ongoing. The IASB suggests a number of possible options for dealing with this going forward.

- **Disclosure:** The DP complements the ongoing work by the IASB on disclosures. The IASB proposes that the Framework focuses on relevance and emphasises communication principles which should support efforts to reduce clutter.

Future proof?

The Framework is focused on financial reporting. This may seem narrow scoped given the current move towards integrated reporting. Integrated reporting is focused more broadly on the value creation and how aspects like strategy, risk, governance and performance relate to this. A wider scope might make the the Framework 'future proof'. However, the choice is understandable to achieve a new Framework in the short term. Many of the principles, like the qualitative characteristics, are likely to be applicable to broader reporting initiatives.

Next steps

The DP is open for comment until January 2014. This is the moment to influence the IASB on fundamental issues such as the recognition hurdles, debt versus equity, measurement and disclosure principles. It will not be easy to reach consensus on these issues.

After the DP phase, the next step will be an exposure draft. But even after the Framework is finalised, there is still the question of existing standards. The Framework will be the basis for new standard development and revision of existing standards but it may take a considerable amount of time before all IFRSs are based on the same new Framework.

IASB Chairman's 'ten-point plan' to improve disclosures

Hans Hoogervorst's speech at the IASB conference this week addressed head on the work that the IASB is doing to reduce the size of annual reporting requirements. But is it enough?

Hans Hoogervorst addressed the IASB conference on disclosures in June outlining ten ways to improve disclosures. The speech follows a Feedback Statement on the January 2013 Discussion Forum which highlighted a 'disclosure problem' with no clear consensus on how to define the problem or solve it.

Hans' 'ten-point plan' (extract follows) includes a number of amendments to IAS 1 including a fresh look at materiality. This was also highlighted in the IASB's most recent two exposure drafts (Insurance Contracts and Regulatory Deferral Balances). In each, the proposals include an explicit statement that disclosures that are not relevant may be omitted.

The IASB are not the only ones who have been grappling with materiality, this also a significant issue for the IIRC highlighted in their recent consultation on a framework for integrated reporting. Something that can be tricky in the context of financial reporting becomes an order of magnitude more

difficult. The IIRC framework considers forward looking information over long timescales and not only covers value creation from financial capital, but also from five other forms of 'capital' that are less susceptible to agreed bases of measurement. The materiality concept is fundamental to the IIRC aim of combining this broad coverage with conciseness.

John Hitchins, Global Chief Accountant at PwC, said, 'It is a start, although this is only a clarification of the existing position. The fundamental issue is whether we approach disclosure as a communication tool or as a compliance exercise. A good question is to consider how each disclosure is relevant to a preparer's business, if you can't explain its relevance it is probably immaterial. There is a risk however that less clutter for users could mean more work for preparers and auditors documenting how and why they concluded all that clutter they left out was not material and explaining this to regulators.'

Extract from 'Breaking the boilerplate'

Hans Hoogervorst, IFRS Foundation conference, Amsterdam 27 June 2013

1. We should clarify in IAS 1 that the materiality principle does not only mean that material items should be included, but also that it can be better to exclude nonmaterial disclosures. Too much detail can make the material information more difficult to understand— so companies should proactively reduce the clutter! In other words, less is often more.
2. We should clarify that a materiality assessment applies to the whole of the financial statements, including the notes. Many think that items that do not make it onto the face of primary financial statements as a line item need to be disclosed in the notes, just to be sure. We will have to make clear that this is not the case. If an item is not material, it does not need to be disclosed anywhere at all in the financial statements.

3. We should clarify that if a Standard is relevant to the financial statements of an entity, it does not automatically follow that every disclosure requirement in that Standard will provide material information. Instead, each disclosure will have to be judged individually for materiality.
4. We will remove language from IAS 1 that has been interpreted as prescribing the order of the notes to the financial statements. This should make it easier for entities to communicate their information in a more logical and holistic fashion.
5. We could make sure IAS1 gives companies flexibility about where they disclose accounting policies in the financial statements. Important accounting policies should be given greater prominence in financial statements. Less important accounting policies could be relegated to the back of the financial statements.
6. At the request of many users around the world, we will consider adding a net-debt reconciliation requirement. Not only would this provide users with clarity around what the company is calling 'net debt' but it also consolidates and links the clutter of scattered debt disclosures through the financial statements.
7. We will look into the creation of either general application guidance or educational material on materiality. Doing so should provide auditors, preparers and regulators with a much clearer, more uniform view of what constitutes material information. We want to work with the IAASB and IOSCO on this important matter.
8. When developing new Standards, we will also seek to use less prescriptive wordings for disclosure requirements. Instead, we will focus on disclosure objectives and examples of disclosures that meet that objective. In recent Standards we have already started doing this, creating more explicit room for judgement on materiality.
9. During the second half of 2013, we will begin a research project to undertake a more fundamental review of IAS 1, IAS 7 and IAS 8. This project will revisit some of the work we already did in the Financial Statement Presentation project. The goal will be to replace those Standards, in essence creating a new disclosure framework.
10. Finally, once the review of these Standards has been completed, we will then undertake a general review of disclosure requirements in existing Standards.

Available now: Essential guide to international accounting – IFRS summaries

This publication is a compendium of PwC's IFRS topic summaries, which include key information on each of the major accounting topic areas. We've compiled all the essential information to provide you with an easy way of getting to grips with a topic and finding related resources. This publication can be used in conjunction with the online version on PwC inform, our accounting research tool, which is continually being updated as the topics develop. Visit pwc.com/ifrssummaries or inform.pwc.com for more information.



Proposals for insurance contracts – the final act?



The ED proposes to fundamentally change the accounting for insurance contracts. Could this be the last opportunity for respondents to influence the debate? Bob Owel from PwC's Accounting Consulting Services looks at the proposals and the next steps.

Do you remember what you were doing when the Insurance Contracts project started? Tiger Woods was winning his first Masters, 'Dolly' the sheep was cloned and millions of others were watching Comet Hale-Bopp pass over earth.

Sixteen years after the IASC, the predecessor body of the IASB, approved a project on Insurance Accounting in 1997, the IASB has published its second exposure draft (ED). These proposals will replace IFRS 4 which was intended to be an interim standard when it was issued in 2004. IFRS 4 currently permits a wide variety of practices in accounting for insurance contracts.

The most recent ED focuses on addressing concerns raised about perceived 'artificial' volatility resulting from the previous proposals. The proposals do seem to reduce income statement volatility to some extent. But they also add significant complexity and create extra demands on resources, data and modelling systems.

The proposals in a 'nutshell'

The proposals apply to all insurance contracts and investment contracts with discretionary participating features issued by insurers. Fixed-fee service contracts whose primary purpose is the provision of services are outside the scope of the proposals. Similar to IFRS 4, the revised ED does not address the accounting by holders of insurance contracts (other than reinsurance).

The ED proposes a current measurement model. That is, estimates are re-measured each reporting period. The measurement of the insurance contract liability is based on the building blocks of discounted, probability-weighted cash flows, a risk adjustment and a contractual service margin (previously known as a residual margin) representing the unearned profit of the contract. A simplified approach is permitted if it provides a reasonable approximation to the building block model or if the coverage period is one year or less.

What has changed?

The new proposals are aimed at minimising 'artificial accounting volatility' as well as enhancing the guidance on presentation and measurement. The IASB is seeking comments on the five key areas (described below) as well as on whether it has appropriately balanced costs and benefits.

Using other comprehensive income (OCI)

The difference between discounted cash flows using current market rates and the discount rates at initial recognition is recognised in OCI for cash flows that do not depend on returns on the underlying assets. The previous ED proposed recognition of all the effects of updating the discount rate in profit or loss. This reduces some of the income statement volatility for insurers where debt securities are measured at amortised cost or fair value through OCI (based on the proposed limited amendments to IFRS 9). But it will increase volatility where assets are measured at fair value through profit or loss.

Unlocking the contractual service margin

Changes in cash flows related to future services are recognised against the contractual service margin included within the balance sheet amount, rather than through profit or loss (as proposed in the previous ED). The contractual service margin cannot be negative. So, negative changes in future cash flows that are greater than the remaining contractual service margin are recognised in profit or loss.

Contracts that require an entity to hold underlying items and specify a link to the returns on those items

Some insurance contracts specify a link between payments to the policyholder and the returns on underlying items that the entity is required to hold, such as some 'participating', 'with profits' and 'unit linked' contracts. The proposals require the contract cash flows to be split into those that are expected to vary directly with returns on underlying items and those that are not.

The portion of the liability where cash flows vary directly with underlying items will mirror the carrying value of the underlying items in both measurement and presentation. Other cash flows, such as specified fixed payments, are measured in accordance with the building block model. Although, changes in cash flows that vary indirectly with the underlying items (such as options and guarantees) are recognised directly in profit or loss.

Presentation of revenue and expenses

The revised ED moves away from the 'summarised margin' income statement approach, in response to the request for volume information. It strives to align the presentation of revenue with other industries. Premiums are allocated to periods in proportion to the value of

expected coverage and other services that the insurer provides in the period. Claims are presented when incurred. Investment components (that is, amounts repaid to policyholders even if the insured event does not occur) are excluded from revenue. In the simplified approach, premiums are recognised in a systematic way that best reflects the transfer of services under the contract.

Transition

The revised ED requires retrospective application for insurance contracts in force at transition and also provides for a number of simplifications to determine the building blocks. Additionally, it will allow entities to revisit, at transition, their fair value options under IFRS 9.

The previous ED did not allow for unearned profit on existing insurance contracts on transition. This would have meant that entities with existing long-term insurance contracts would have had no profit recognised in the income statement on these contracts in future periods, other than the unwinding risk adjustment.

What's next?

The comment period ends on 25 October 2013. The effective date is likely to be 2018. But management should start to assess the implications of the new proposals now as this might be the last chance to shape the debate.

While this is not a joint project, the IASB and FASB have been working together in their deliberations. The FASB recently also issued an exposure draft on insurance contracts. However, the EDs have a number of differences and convergence seems unlikely at this point.

Cannon Street Press

IFRS foundation on global adoption of IFRS

The IFRS Foundation reported on the first phase of its assessment of the global adoption of IFRS. This phase included publication of the IFRS profiles of the G20 and the survey results of 66 jurisdictions with an interest in IFRS and global accounting standards. The highlights are:

- 95% made public commitments supporting IFRSs as the single set of global financial reporting standards

- 80% have already adopted IFRSs as a requirement for all or nearly all public companies
- Jurisdictions that have adopted IFRS have made very few modifications to IFRSs.

The second phase of the project will result in the publication of more profiles with the objective of covering most of the globe by the end of the year.

Exposure draft on bearer plants

The IASB published an exposure draft (ED) proposing to include bearer plants within the scope of IAS 16, 'Property, plant and equipment'. Bearer plants are a class of biological assets 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.

IAS 41, 'Agriculture' requires all biological assets that are related to agricultural activity, including bearer plants, to be measured at fair value less costs to sell. This is based on the principle that

biological transformation is best reflected by fair value measurement. However, according to the ED, once mature, bearer plants no longer undergo significant biological transformation and their operation is similar to manufacturing. Consequently, this ED proposes that bearer plants are within the scope of IAS 16, thus permitting the use of either a cost model or a revaluation model. The produce growing on the bearer plants would remain under the fair value model in IAS 41. The exposure draft is open for comment until 28 October 2013.

IASB amends IAS 39 for novation of derivatives

The IASB issued a narrow scope amendment to IAS 39 to allow hedge accounting to continue 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. A novation in this context indicates that parties to a contract agree to replace their original counterparty with a new one.

This relief has been introduced in response to legislative changes across many jurisdictions that would lead to the widespread novation of over-the-counter derivatives. These changes were prompted by a G20 commitment to improve transparency and regulatory oversight of over-the-counter derivatives. Similar relief will be included in IFRS 9. The amendments are effective 1 January 2014.

EU requirements on payments to governments

The European Commission approved a directive introducing new disclosure requirements for entities in the extractive and logging industries. Affected entities will be required to report annually made payments to governments.

Each EU member state is responsible for passing the requirements of the directive into local legislation. It is expected that the requirements will come into effect for periods beginning on or after 1 January 2016.



IFRS 'ABC': H is for 'hedging'

Gabriela Martinez from PwC Accounting Consulting Services, in the Central team, provides an overview on hedge accounting.

More than ten years have passed since IAS 39 was first published, however, many still find hedge accounting challenging. Below we provide an overview of the basics of hedge accounting and some insights regarding its practical application.

What is hedge accounting?

In simple terms, hedge accounting modifies the normal basis of accounting for gains and losses in the income statement. It allows the recognition of gains and losses arising from the hedged item and hedging instrument in the same period, therefore, eliminating or reducing volatility.

Hedge accounting is optional. Since it is an exception to the general rules, IAS 39 requires entities to comply with certain criteria to prevent abuse. Compliance might be onerous. Management should

assess the costs and benefits when deciding whether to apply hedge accounting.

What can be hedged?

Entities can hedge assets, liabilities, firm commitments, highly probable transactions or net investments in foreign operations that expose the entity to risk of changes in fair value or future cash flows and will impact net income. These are commonly referred as 'hedged items'. Common examples are a highly probable purchase in foreign currency (FX) or a variable interest rate loan.

What instruments can be used to hedge?

Most derivatives can be used as hedging instruments (written options not allowed). Certain non-derivative instruments can also be hedging instruments, but these are only permitted for hedging FX risk.

What are the accounting impacts of hedging?

IAS 39 permits 3 different types of hedge accounting:

Fair value hedge

Cash flow hedge

Net investment hedge

The examples below demonstrate the basics of hedge accounting. In all the examples it is assumed the hedging criteria are met and for simplicity purposes all are 100% effective.

Fair Value Hedges

A metal refining entity owns silver inventory. It enters into a contract to sell silver at a fixed price in the future (derivative future contract) to protect its inventory from declines in silver prices.

General Accounting	Hedge Accounting
<p>Balance sheet:</p> <ul style="list-style-type: none"> Inventory = lower of cost or net realisable value Derivative = fair value (FV) with changes in profit and loss (P&L) <p>Income statement:</p> <ul style="list-style-type: none"> Inventory = cost of sales Changes in FV of the derivative = other operating 	<p>Balance sheet: Effects are offset</p> <ul style="list-style-type: none"> Inventory = adjusted for changes in silver prices Derivative = FV with changes in the P&L <p>Income statement: Effects are offset</p> <ul style="list-style-type: none"> Changes in FV of inventory = cost of sales Changes in FV of the derivative = cost of sales.

Cash Flow Hedge

On 1 January, an entity forecasts to buy a fixed asset in 18 months time from a foreign supplier. The purchase is highly probable. The entity enters into forward contracts to buy foreign currency in 18 months time at a fixed price to hedge its exposure to FX risk.

General Accounting	Hedge Accounting
<p>Balance sheet:</p> <ul style="list-style-type: none"> • Purchase not recorded until asset is acquired • Derivative = FV with changes in P&L <p>OCI: No impact</p> <p>Income statement:</p> <ul style="list-style-type: none"> • Fixed asset depreciated = cost of sales • Changes in FV of the derivative = other operating 	<p>Balance sheet:</p> <ul style="list-style-type: none"> • Purchase not recorded until asset is acquired • Derivative = FV with changes in Other comprehensive income (OCI) <p>OCI: Captures volatility</p> <ul style="list-style-type: none"> • Changes in FV from derivative = OCI • Policy choice for reclassifying out of OCI: <ul style="list-style-type: none"> - upon acquisition of fixed asset to cost of asset; or - to P&L in the same periods the fixed asset is depreciated. <p>Income statement: Effect of the derivative and the fixed asset offset over the useful life of the asset</p>

Net Investment Hedges

An entity with EUR functional currency decides to hedge its investment in a US subsidiary with a loan denominated in US dollars.

General Accounting	Hedge Accounting
<p>Balance sheet:</p> <ul style="list-style-type: none"> • US subsidiary translated to EUR • US dollar loan accounted for in EUR and remeasured at each reporting date <p>OCI: Translation of US subsidiary recorded in OCI</p> <p>Income statement: Loan remeasurement recorded in the P&L as other operating.</p>	<p>Balance sheet: No change</p> <ul style="list-style-type: none"> • US subsidiary translated to EUR • US dollar loan accounted for in EUR and remeasured at each reporting date <p>OCI: Captures volatility</p> <ul style="list-style-type: none"> • Translation of US subsidiary recorded in OCI • Loan remeasurement recorded in OCI <p>Income statement: Effects from both the translation and the remeasurement are reclassified to profit and loss on disposal or partial disposal of the subsidiary.</p>

Be Alert – IFRS 9 is coming!!

The IASB finalised its deliberations on IFRS 9 Hedge Accounting in April this year. We expect the final standard in Q3 2013. The changes to be introduced by the final standard are anticipated to be beneficial for all entities, but in particular for entities outside the financial services

industry. It is expected that entities will have a one-time accounting policy choice to either continue applying IAS 39 or to adopt IFRS 9 Hedge Accounting. It is important to stay tuned as the application of IFRS 9 might be a popular choice.

The bit at the back.....



For further help on IFRS technical issues contact:

Business combinations and adoption of IFRS

mary.dolson@uk.pwc.com: Tel: + 44 (0) 207 804 2930
caroline.woodward@uk.pwc.com: Tel: +44 (0) 207 804 7392

Financial instruments and financial services

gail.l.tucker@uk.pwc.com: Tel: + 44 (0) 117 923 4230
jessica.taurae@uk.pwc.com: Tel: + 44 (0) 207 212 5700
tina.farington@uk.pwc.com: Tel: + 44 (0) 207 212 2826

Liabilities, revenue recognition and other areas

tony.m.debell@uk.pwc.com: Tel: +44 (0) 207 213 5336
richard.davis@uk.pwc.com: Tel: +44 (0) 207 212 3238
a.allocco@uk.pwc.com: Tel: +44 (0) 207 212 3722

IFRS news editor

Andrea Allocco
a.allocco@uk.pwc.com: Tel: +44 (0) 207 212 3722

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