

IFRS news

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IASB publishes exposure draft on leasing

Peter Hogarth of PwC's Global Accounting Consulting Services looks at the proposals and anticipates reactions to the second attempt at getting all leases 'on balance sheet'.

The revised proposals for leases have finally appeared. In my last report (IFRS News – October 2012), I said that a revised exposure draft 'should be here soon' – and here it is.

The headline of the new exposure draft (ED) released by the IASB and FASB (the 'boards') remains the same – all leases will be 'on-balance sheet' unless they are short-term (less than 12 months) or not leases at all. When is a lease not a lease? The ED includes new guidance to distinguish a lease from a service. This could mean that the accounting for some arrangements currently treated as leases might change.

The recent deliberations have focused on the criteria for identifying leases that will attract straight line expense recognition by lessees and revenue recognition by lessors. This 'bright line' coupled with the boundary between a lease and service is likely to attract comment.

Key proposals

Lessee accounting

The balance sheet distinction between operating and finance leases has been eliminated. A new asset (the right to use) and liability (the obligation to pay rentals)

are recognised for all leases except short-term leases.

The most significant change since the first ED issued in 2010 (although less of a change from today's accounting) is the proposal for two different models for expense recognition:

- When the lessee acquires or consumes more than an insignificant portion of the underlying asset ('type A'), expense is front-loaded (similar to today's finance lease accounting).
- For leases other than type A ('type B'), expense is recognised straight line.

The boards acknowledge the practical challenges of this approach. The ED proposes two presumptions depending on the nature of the underlying asset:

- Property leases are type B, unless the lease term is for the major part of the remaining economic life, or the present value of the payments accounts for substantially all of its fair value.
- Leases of assets other than property (for example, equipment) are type A, unless the term represents an insignificant portion of the underlying asset's economic life, or the present value of the fixed payments is insignificant relative to its fair value.

The definitions of 'lease term' and 'lease payment' have also changed since the 2010 ED. The lease term will include optional extension periods only where there is a significant economic incentive to extend. Lease payments will exclude contingent rents that vary on the basis of usage or performance (for example, sales from a retail store). These changes will result in lower carrying values for assets and liabilities than those under the 2010 ED, and are not significantly different from current accounting for finance leases.

Lessor accounting

Lessors will also need to identify leases as type A or type B using the same criteria as lessees. Type B leases are accounted for similar to today's operating leases model.

For type A leases, the lessor will derecognise the underlying asset and record a lease receivable (measured at the present value of the payments) and a residual asset (measured at the present value of the estimated residual value at the end of the term plus the present value of any expected variable payments). Any profit relating to the receivable component is recognised immediately, whereas profit relating to the residual component is

deferred until the underlying asset is released or sold by the lessor. Interest income on both the receivable and the residual asset is recognised over the lease term.

Short term leases

Both lessees and lessors can elect, by class of underlying asset, to account for leases with a maximum term of up to 12 months in a similar way to current operating lease accounting.

The next steps

Comments are due by 13 September, but there is no indication of when the proposals might be effective. The boards recently decided that the new revenue standard should be effective from 2017, so it likely that the leasing proposals will not apply any earlier than that. But whether it might be later, or even much later, is anybody's guess.

There is no exemption for pre-existing leases upon transition. All leases will need to be reassessed – so it is advisable to get an early start.

Wayne Upton talks about the IC – past and future

Wayne Upton took over as Chairman of the IFRS Interpretation Committee (IC) nearly two years ago. He shares his perspectives on how the role of the IC has changed since he came on board and looks at the road ahead.

Most will recognise Wayne Upton for his vast experience in standard setting but many are unaware of his unique way with words. In a mere 40 minutes, he was able to discuss the IFRS Interpretations Committee (IC) by reference to a marriage, a ping pong match, the Rolling Stones and finally, a plumber. (This last reference is not mentioned herein again – but perhaps it speaks for itself).

Wayne took on his latest role as the non-voting Chairman of the IC in July 2011 at a time when there was an impetus for change. The Trustees of the IFRS Foundation were in the midst of reviewing the efficiency and effectiveness of the IC. There was a cry from preparers for more implementation guidance and a focus on maintaining existing standards. The IC was 'set free', explained Wayne.



A new ‘toolbox’

Wayne Upton takes no personal credit for how the role of the IC has developed over the past two years. The Trustees set out new challenges which included improving the IC’s communications regarding issues not taken on the agenda and expanding the outreach on issues it does address.

The IC was presented with a new ‘toolbox’ and a clear message to use it. These tools included non-mandatory guidance and proposals to the IASB for targeted amendments beyond the scope of an annual improvement.

This was well-timed for many. Those who adopted IFRS in its early days were nearly settled in. But a new population of emerging economies was getting ready to adopt. This brought a steady flow of work.

‘You can’t always get what you want’

New requests and a new direction might lead one to think that the number of rejection notices (decisions not to take an issue on the agenda) would decrease. Instead, they have stayed much the same.

The IC has tried to make those notices more helpful by being transparent in their decisions. But when the answer is not what you expect, transparency is not always appreciated. Many have learned what Wayne expressed as a ‘lesson from a great philosopher, Mick Jagger – you can’t always get what you want’.

Single or married?

The increased interaction between the IASB and IC is obvious to most users. This is a response to feedback during the Trustee’s review. Many thought ‘the IASB and IC were operating on separate planets’ said Wayne.

Some issues seem to get stuck in a ping pong match between the IASB and IC – the most recent example is accounting for NCI put options. When asked about this, Wayne said, ‘I made a promise to the IC that they will never have to discuss this again.’

Putting aside a few games of ping pong, any perception about the IASB and IC not talking has likely dissipated. Wayne describes it now as a marriage which just requires a bit more cooperation than being single.

Has the pendulum swung too far?

Wayne does not think so. Some might say that the IASB previously resisted an active interpretation function on the basis that it was inconsistent with principles based standards. But Wayne supports continued implementation guidance and rejects any fears about IFRS turning into rules based standards.

The recent onslaught of narrow scope amendments is strong evidence of a renewed focus on maintenance of existing standards. There are fourteen narrow scope amendments at various stages in the process – many of which have their origins in the IC. The IASB and IC are already looking for more efficient ways to manage this process.

A look ahead

The IC will continue to be challenged to reduce diversity in practice as IFRS spreads. The IASB has also been hard at work on the Conceptual Framework which is likely to highlight inconsistencies in today’s standards. These issues, along with continued focus on the maintenance of existing IFRS, will no doubt keep the IC busy going forward.

But there is also a broader question about standards not yet adopted. Diversity and practice problems are the backbone of the IC’s agenda criteria but implementation issues on new standards may need time before they emerge. These issues might need to be held to a different, perhaps higher, standard until practice develops.

Wayne Upton – A quick biography

- 1984 to 2001 – Various roles at FASB
- 2001 – Joined IASB as Research Director
- 2008 – Appointed Director of International Activities at the IASB
- 2011 – Appointed non-voting Chairman of the IFRS Interpretations Committee

Cannon Street Press

IASB publishes Feedback Statement on disclosures

The IASB has published a Feedback Statement on the Discussion Forum on financial reporting disclosures held in January 2013. The Discussion Forum confirmed a shared view that there is a 'disclosure problem' but there was no clear consensus on how to define the problem or solve it.

The Feedback Statement describes the perspectives shared at the Discussion Forum and outlines the following actions to be taken by the IASB:

- amend IAS 1 to address 'perceived impediments to preparers exercising their judgment in presenting their financial reports',
- develop educational material on the materiality, and
- consider a separate disclosure project as part of the research agenda.

For more insight on the recent debate about financial reporting disclosures see 'Disclosures - IASB takes on the challenge' (IFRS News February 2013).

New appointments to the IASB and IC

The Trustees of the IFRS Foundation have made the following appointments to the IASB and IFRS Interpretations Committee.

IASB

Sue Lloyd has been appointed to the IASB from 1 January 2014 for an initial five-year term renewable for a further three years. She currently serves as a Senior Director of Technical Activities at the IASB. She will replace Prabhakar Kalavacherla (PK) who will retire after serving a five year term.

IFRS Interpretation Committee

The following new members have been appointed to the IFRS IC from 1 July 2013 for three-year terms, renewable once.

- Tony de Bell – member of PwC's Global Accounting Consulting Services Leadership Team in the UK

- Reinhard Dotzlaw – Canadian member of KPMG's Global IFRS Panel
- Dr Martin Schloemer – Head of Accounting Principles and Policies at Bayer AG in Germany

It was also agreed in 2012 that the IC should broaden the number of accountancy firms represented. Two further appointments to a single three-year rotating term have been made.

- Andrew Watchman – Executive Director of International Financial Reporting at Grant Thornton (from 1 July 2013)
- Andrew Buchanan – BDO's Global Head of IFRS (from 1 July 2016)

Feilong Li will complete his first term at the end of June 2013 and has been reappointed for a further three-year term.

IC published interpretation on levies

The IASB has issued IFRIC 21, 'Levies', an interpretation on the accounting for levies imposed by governments. IFRIC 21 is an interpretation of IAS 37, 'Provisions, contingent liabilities and contingent assets'. IFRIC 21 will affect entities that are subject to levies that are not income taxes

within the scope of IAS 12. These are common in many countries and in many industries –such as banking, retail and transportation.

IAS 37 sets out criteria for the recognition of a liability, one of which is the

requirement for the entity to have a present obligation as a result of a past event (known as an obligating event). The interpretation clarifies that the obligating event that gives rise to a liability to pay a levy is the activity described in the relevant legislation that triggers the payment of the levy. The interpretation provides examples

that illustrate the accounting for the liability to pay a levy.

IFRIC 21 is effective for annual periods beginning on or after 1 January 2014. For more information, see 'IC to issue interpretation on the accounting for levies' (IFRS News – May 2013).

IASB publishes narrow scope amendment to IAS 36

The IASB has made small changes to the disclosures required by IAS 36, Impairment of assets when recoverable amount is determined based on fair value less costs of disposal. The amendments are effective from 1 January 2014.

The IASB made consequential amendments to the disclosure requirements of IAS 36 when it issued IFRS 13. One of the amendments was drafted more widely than intended. This limited scope amendment corrects and introduces additional disclosures about fair value measurements when there has been impairment or a reversal of impairment.

The IASB has amended IAS 36 as follows:

- to remove the requirement to disclose recoverable amount when a cash generating unit (CGU) contains goodwill or indefinite lived intangible assets but there has been no impairment;
- to require disclosure of the recoverable amount of an asset or CGU when an impairment loss has been recognised or reversed; and
- to require detailed disclosure of how the fair value less costs of disposal has been measured when an impairment loss has been recognised or reversed.

IASB and FASB continue revenue deliberations

The FASB and IASB (the 'boards') met together and separately in May to discuss certain issues related to their revenue recognition project.

The boards jointly discussed the accounting for credit card reward programmes and decided not to provide specific guidance on the accounting for such arrangements. An entity will need to apply the principles in the new revenue model to determine the appropriate accounting. This includes determining whether the reward programme is an arrangement with a customer (and therefore in the scope of the guidance), and whether the programme creates separate performance obligations or involves a distributor relationship.

The IASB decided that first-time adopters of IFRS will not be permitted to use the

simplified approach for transition to the revenue standard. They will instead be required to adopt the revenue standard retrospectively. However, they will not be required to restate contracts completed under legacy revenue requirements if they were completed before the earliest date presented.

The IASB also agreed that entities applying the retrospective transition method will not need to disclose the effect of adopting the standard on the financial statements in the year of initial adoption. This is an exemption from existing disclosure requirements in IFRS when a new standard affects the current period.

The boards' timeline indicates the final standard is expected in the third quarter of this year.

IFRS 'ABC': *G* is for 'government grants'



Ariane Amiot from PwC's Accounting Consulting Services Central team looks at the accounting for government grants.

Government grants are defined in IAS 20 as 'assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity'.

This article looks at some of the issues in applying the three key components of IAS 20's definition of government grants in practice.

Assistance by government

Transfers of resources

Compliance with certain conditions

Judgments associated with these aspects of the definition can be complex and have significant consequences for financial statements.

Assistance by government

Resources provided to an entity by government acting in its capacity of government are grants, whereas those provided by government acting as shareholder are equity contributions.

Example 1: Government owned entity

Facts: An entity owned by the government receives cash from the government to reimburse the entity for losses incurred assisting the government to implement a specific policy (for example, to increase investment in public transportation options between two locations).

Is the cash received a government grant or an equity contribution?

Analysis: Judgment is required to determine whether the entity is receiving a grant or an equity contribution. Indicators that the entity is receiving a grant include:

- the entity provides public services that might also be provided by the private sector;
- the government has similar arrangements with the private sector;
- the funds only cover expenses that relate to the implementation of the specific government policy; and
- the initial capital of the entity was sufficient to meet its objectives and ongoing needs.

Equity contributions will be recorded in equity while grants will affect the income statement.

Transfers of resources

Transfers of resources are not limited to transfers of cash. Other examples include land or property and loans at below market rates.

Example 2: Government loan at below market-rate

Facts: An entity receives a government loan of C10,000 at a 0% interest rate to finance the purchase of equipment. It is repayable after five years. The market rate for a similar loan would be 3%.

Analysis: The fair value of the loan is C8,626 (C10,000 discounted at 3%). The entity has received a resource of C1,374 (the difference between the proceeds and the initial fair value of the loan).

The loan is a financial instrument that should be accounted for initially at fair value. The difference between the initial carrying value and the proceeds received (C1,374) is accounted for as a grant.

Example 3: Non-monetary grants

Facts: An entity that operates public transportation purchases ten buses from the government for 59% of market price.

Analysis: The purchase price for the entity is less than the market price. The transfer of resources is the difference between the market price and the purchase price.

IAS 20 permits the entity to choose whether to account for both the grant and the buses at fair value or record both grant and buses at nominal amount and include disclosure in the notes.

Compliance with certain conditions

Government grants are recognised only when the entity is reasonably assured that it will fulfil the conditions attached to them. Grants are classified as relating to assets and/or to income, depending on the type of expenditure for which they compensate.

Accounting basics

The existence, measurement and classification of a grant could have a significant impact on the accounting. IAS 20 provides a number of options on how to measure and present government grants in the balance sheet and income statement. Accounting policies should be applied consistently to the accounting for of all grants received.

| Nature of the grant | Balance sheet | Income statement |
|----------------------------|---|---|
| Capital | Reduction of asset carrying amount OR Deferred income | If recorded as reduction of asset, offset to depreciation expense If deferred income, other income OR Reduction of related costs |
| Income | Deferred income | Other income OR Reduction of related costs |

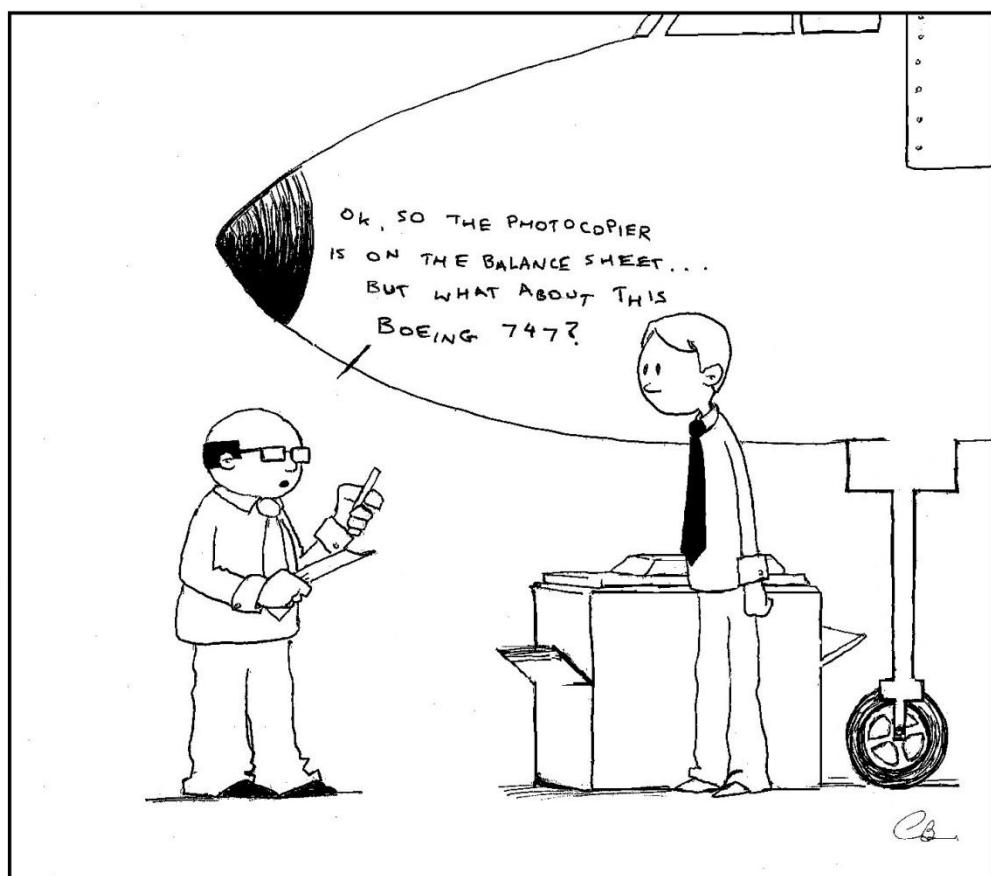
The grant terms and conditions should be analysed carefully to determine the classification. Entities should account for similar grants on a consistent basis.

Example 4: Grants related to capital expenditure and number of jobs created

Facts: An entity is entitled to receive a grant if it opens a business center in a designated location and employs a specified number of workers. The government's stated objective is to reduce unemployment in this location. The entity will have to repay the grant if either the capital expenditure or the jobs created are less than a pre-determined level after three years.

Analysis: The conditions attached to the grant are linked to both capital expenditure and jobs created. It might be appropriate to allocate the grant as part relating to assets and part relating to income. The amount allocated requires judgment and depends on a number of factors, such as the significance of the stated objective and the amount repaid when one of the conditions is not met. This judgment, if significant, should be disclosed..

The bit at the back....



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