

# IFRS news

## In this issue:

- 1 Integrated reporting**  
IIRC publishes consultation draft
- 3 Levies**  
IC to issue interpretation on accounting for levies
- 4 Insurers face change**  
An update on the Insurance Contract project and other key accounting changes
- 6 Cannon Street Press**  
Exposure draft on interim standard for regulatory deferral accounts  
New Chairman of FASB  
EU endorses amendments to IFRS 10, 11 and 12
- 7 Questions and answers**  
'F' for fair value
- 9 The bit at the back...**

## IIRC publishes consultation on integrated reporting framework

Integrated reporting is getting more and more attention. The international integrated reporting framework promises to accelerate that debate and influence the future of corporate reporting. Jessica Fries, PwC's Integrated Reporting Leader, looks at the proposals and next steps.

The International Integrated Reporting Council<sup>1</sup> (IIRC) has issued the long awaited consultation draft of its international integrated reporting framework (the 'framework').

The framework outlines how businesses can better explain how they create, sustain and increase their value in the short and long term. The aim is also to enhance accountability and stewardship, and support integrated thinking and decision-making in the wake of increasing challenges to traditional business models.

Applying the framework is not without challenges. Companies will be pushed beyond the traditional boundaries of reporting, providing insight on inputs and outcomes along the value chain and insight into future performance. Although this poses a challenge, it is often in these areas that companies derive the greatest benefits.

### Why integrated reporting?

Integrated reporting is a voluntary initiative, so why should you pay attention?

The driver is often two fold – a way to have an honest conversation among senior management about the long-term sustainability of the business – and also to

communicate a clear strategic message to shareholders and other stakeholders who are key to future success.

The draft framework has already been piloted by over 135 companies and investors around the world. The results of the pilot speak for themselves: 95% of participants find that integrated reporting provides a clearer view of the business model, 93% feel it breaks down silos, 95% feel it increases board focus on the right KPIs and 93% feel it leads to better quality data collection.

Many of these findings relate to decision making rather than external reporting. However, PwC research underlines that investors also see value. We ran an experiment with a small group of investors. 80% recommended 'sell' when they did not have integrated information, while most recommended 'buy' when presented with more integrated information.

This finding is underlined by PwC research<sup>2</sup> which highlights the lack of an integrated picture in the majority of annual reports. These disconnects leave readers to make their own decisions on whether the business is responding effectively to the opportunities and risks faced.

<sup>1</sup> The IIRC is a global coalition of investors, companies, regulators, standard setters and other key stakeholders.

<sup>2</sup> "Trust through transparency", <http://www.pwc.co.uk/audit-assurance/publications/trust-through-transparency.jhtml>



## **The framework**

### **Overview**

The framework defines integrated reporting and an integrated report.

**Integrated reporting** is a process that results in communication by an organisation, most visibly a periodic integrated report, about value creation over time.

**Integrated report** is a concise communication about how an organisation's strategy, governance, performance and prospects, in the context of the external environment, lead to the creation of value over the short, medium and long term.

The framework proposes that the providers of financial capital are the primary users of integrated reports. However, it underlines that integrated reports will be of benefit and interest to all stakeholders. For many organisations, presenting a consistent message to all is vital in a world where it is easy to spot disconnects, something that integrated reporting helps to achieve.

### **Fundamental concepts**

The IIRC's framework is based on three fundamentals:

- the six categories of capital – financial, manufactured, intellectual, natural, human, social and relationship;
- the business model; and
- the creation of value over time.

### **Guiding principles**

The framework sets out six guiding principles to help preparers determine what and how to report:

- strategic focus and future orientation
- connectivity of information
- stakeholder responsiveness
- materiality and conciseness
- reliability and completeness
- consistency and comparability

### **Content elements**

The framework proposes a series of questions that an integrated report should answer. The starting point is existing elements of reporting, such as the management commentary, financial statements and sustainability reports. However, the framework suggests a broader scope of reporting – more focus on, for example, non-financial drivers, dependence on key resources and relationships and a long-term perspective.

### **Preparation and presentation**

Additional guidance on how to prepare an integrated report is provided in the final section of the framework covering areas such as materiality, reporting frequency, reporting boundary and use of technology.

### **How does the framework fit with existing reporting?**

Integrated reporting is intended to provide a blueprint rather than a detailed set of requirements. To this end, it influences the development of both financial and non-financial reporting. It is also, to a large extent, compatible with different regulatory regimes. Many hope that the work of the IIRC will help to drive greater convergence by providing an umbrella under which standard setters and regulators participate.

### **What's next?**

Read the draft framework and consider commenting on the proposals by **15 July 2013**.

Assess the implications of the proposals for your reporting. Consider your full suite of external and internal communications. Ask yourself whether they present a connected and coherent picture.

Consider whether there are 'quick wins' to implement in the next reporting cycle to gain competitive advantage. You can find more detail on integrated reporting and get inspiration from our examples of good practice and practical insights at [www.pwc.com/corporatereporting](http://www.pwc.com/corporatereporting).

## IC to issue interpretation on the accounting for levies



The Interpretations Committee (IC) addresses diversity in practice around when the liability to pay a levy is recognised. Ariane Amiot from PwC's Accounting Consulting Services discusses the potential effects of the interpretation.

The IC will shortly issue an interpretation setting out the accounting for levies that are not income tax.

The interpretation could have ranging implications. Levies vary in form but exist in many countries and industries – banking, retail and transportation to name a few. This liability for a levy could be recognised earlier or later than today, particularly when it is triggered by circumstances on a specific date.

For example, assume an entity is required to pay a levy equal to 1% of its 2013 sales. The levy is due on 1 January 2014. How would you account for this? The man on the street would say that an expense should be accrued as the sales are generated - but the interpretation says otherwise. The liability, and likely the corresponding expense, should be recognised in full when it is due, that is on 1 January 2014.

### Scope and objective

Levies are imposed by governments in accordance with legislation and are generally measured by reference to an entity's revenues, assets or liabilities.

The interpretation addresses the accounting for a levy recognised in accordance with IAS 37, 'Provisions'. It excludes income taxes from its scope. Application to liabilities arising from emissions trading schemes is optional.

The interpretation only addresses the recognition of the liability. It does not specify whether that liability gives rise to an asset or an expense. Management will need to apply other standards to determine the accounting for the costs.

### Key provisions

The interpretation addresses the following:

#### *What is the obligating event that gives rise to a liability to pay a levy?*

The obligating event that creates a liability to pay a levy is the event identified by the legislation that triggers the obligation to pay the levy.

An economic obligation to continue operating in a future period or the preparation of financial statements under the going concern principle does not create an obligation to pay a levy that will arise from operating in the future.

#### *When is a liability to pay a levy recognised?*

A liability to pay a levy is recognised when the obligating event occurs. This might occur at a point in time, or progressively over time, and could result in different accounting for levies that appear quite similar. Take for example the following three levies:

*Levy A – 1% of current year revenues is payable if the entity is operating on 1 January A liability equal to 1% of the current year revenues is recognised progressively as revenue is generated.*

*Levy B - 1% of prior year revenues is payable if the entity is operating on 1 January A liability equal to 1% of the prior year revenues is recognised in full on 1 January.*

*Levy C – 1% of current year revenues is payable if the entity is operating on 31 December A liability equal to 1% of the current year revenues is recognised in full on 31 December.*

The interpretation also confirms that an obligation to pay a levy triggered by a minimum threshold is recognised when the threshold is reached.

*Levy D – 1% of current year revenues is due if the entity is operating on 1 January (same as Levy A) and if revenue exceeds CU20m*  
A liability equal to 1% of CU20m is recognised in full when the threshold is reached. The liability is then increased progressively as revenue over CU20m is generated.

*Is the accounting at an interim reporting date the same than at year end?*

The same recognition principles apply in interim and annual financial statements. The obligation should not be anticipated or deferred in the interim financial report if it would not be anticipated or deferred in annual financial statements.

### **What's next?**

The IASB ratified the interpretation in April 2013. The interpretation is expected to be released shortly and effective on 1 January 2014 with early adoption permitted. Management should identify and consider the accounting for any levies that are in the scope of the interpretation.

The interpretation should solve the issue of when a liability for levies is recognised but we expect that diversity in practice will persist on the 'debit' side (that is, whether an asset or expense is recognised).

The interpretation also highlights one of the practice problems of determining when a liability should be recognised. The board continues to discuss this issue in connection with the Conceptual Framework project.

## **Insurers face significant accounting changes**



The IASB is close to finalising a revised exposure draft (ED) on insurance contracts. This is only one of the many accounting challenges insurers will be facing in the coming years. Bob Owl from PwC's Global Accounting Consulting Services highlights some of these challenges.

Currently accounting for insurance contracts is the flagship of 'mixed practice' accounting. This is driven by the guidance (or lack there of) in IFRS 4 – an 'interim' standard which provides minimal guidance on insurance contract accounting. Many believe the market capitalisation of the industry is below its actual value, which may be partially attributable to the current accounting model.

The debate on accounting for insurance contracts is still ongoing. And this is only one of the accounting changes facing the insurers over the next few years. The level of change will be a challenge but could offer an opportunity to regain the trust of the market and show the real performance of the industry.

### **Insurance Contracts project**

The accounting for insurance contracts varies widely across the globe from using historic cost assumptions in some countries in Europe to a current measurement model in the United Kingdom.

The IASB (and its predecessor) have been working on developing a consistent model for insurance contracts since 1997. So, what is taking so long?

One of the significant impacts of the revised ED will be the use of current market interest rates to measure insurance contract liabilities. This means that in the current environment with low interest rates, the value of the insurance contract liabilities might significantly increase. However, the

impact on profit and loss will be limited as the changes in interest rates will be recognised in other comprehensive income (OCI).

Critics of the proposals argue that because of the long-term nature of life insurers, market fluctuations will lead to unnecessary short term volatility. Unsurprisingly, many would prefer to keep something close to their current accounting to minimise system changes and volatility in profit or loss.

Hans Hoogervorst, Chairman of the IASB, recently addresses the critics' concerns in a speech entitled 'buy-and-hold should not mean buy-and-hope'. He stresses that insurers cannot ignore short-term fluctuations, because you never know how short the short-term is. For example, Japan has been suffering from low interest rates for fifteen years. In his view, the revised proposals will give better insight into the financial position of an insurance company, reveal the real risks and give a view of the true performance.

The revised ED is expected to be issued in June and the questions to respondents will target five key areas that have significantly changed since the last ED. A final standard is expected at the end of 2014 (at the earliest) with an effective date of 2018.

### **What else?**

As big as the changes may be, IFRS for insurance contracts is just one of the many challenges the insurers face in the coming years.

#### **IFRS 9 - financial instruments**

It is not only the liability side of insurers' balance sheets that will be changing. The exposure draft of limited amendments to IFRS 9: 'Classification and Measurement' was recently issued and proposes a new fair value through OCI (FVOCI) category. The industry lobbied for this but many do not think the proposals go far enough. Insurers argue that assets backing insurance contracts are managed in one business

model together with the related liabilities. Since these portfolios frequently contain equities, derivatives and investment properties, these also need to be accounted for at FVOCI.

In this wave of change, the new proposals for impairment of financial assets have attracted little interest from insurers so far. However, as insurers are likely to have significant portfolios of assets being measured at FVOCI under revised IFRS 9, the proposals should be of interest.

A bit further down the road, the macro hedge accounting discussion paper will address the accounting requirements for hedging of open portfolios of financial assets. This might be a way for insurers to reduce accounting volatility.

#### **IFRS 10 - consolidation**

The new consolidation requirements that have come in this year (or 2014 for the EU) are also proving a challenge for life insurers who may have to consolidate more of their investment funds.

#### **Solvency II**

Although the implementation of the European regulatory framework Solvency II is likely to be postponed until at least 2016, it will have a huge impact on insurers. Solvency II will require a balance sheet based on fair value. The biggest challenge will be how to benefit from the common ground between the IFRS and Solvency II frameworks.

#### **What's next?**

Over the next few years, insurers' financial statements are going to change significantly. The proposals will lead to increased volatility in the reported results and changes in presentation, but should give better insight into the financial performance of the business. The biggest challenge is to keep stakeholders engaged, hence insurers should prepare well for the changes ahead of them.

## ***Cannon Street Press***

### ***IASB issues exposure draft on regulatory deferral balances***

The IASB has issued an exposure draft (ED) 'Regulatory Deferral Accounts'. The ED uses the term 'regulatory deferral account balances' to describe certain balances that arise from the accounting for rate-regulated activities.

The proposals are only applicable to entities applying IFRS 1 as first-time adopters of IFRS that currently recognise regulatory deferral balances and meet certain criteria. This is common in the utilities industry but the proposals might affect other industries where prices are regulated.

The ED proposes that such entities can continue to apply their previous GAAP accounting policies for the recognition, measurement and impairment of regulatory deferral accounts when IFRS is adopted. The ED proposes additional presentation and disclosure requirements.

There is currently no standard that specifically addresses rate-regulated activities. The objective of the interim standard is to allow entities adopting IFRS to avoid major changes in accounting policy until the IASB project to develop an IFRS on rate-regulated activities is completed.

The rate regulated activities project was restarted last year in response to feedback on the IASB's 2011 Agenda Consultation. The project was originally suspended in 2010 because the IASB could not quickly resolve the question of whether assets and liabilities arising from regulation should be recognised. A discussion paper on the project is expected later in 2013.

The deadline for comment is 4 September 2013. The ED does not propose an effective date, but early adoption is permitted.

### ***Russ Golden announced as new Chairman of FASB***

Russ Golden has been named as the next chairman of the Financial Accounting Standards Board (FASB) effective 1 July 2013. He succeeds Leslie F. Seidman.

Russ Golden has been a member of the FASB since September 2010. He served as a senior technical advisor on the FASB staff

for the preceding six years. Prior to this, he was a partner at Deloitte & Touche LLP.

The initial term of the appointment will be 4 years with a possibility of extension for another 3 years. The total term of FASB board members is limited to 10 years.

### ***EU endorse amendments to IFRS 10, 11 and 12***

The amendments to IFRS 10, 11 and 12 provide additional transition relief in limiting the requirement to provide adjusted comparative information to the immediately preceding period only. For disclosures related to unconsolidated structured entities, the amendments will remove the requirement to present comparative information for periods before IFRS 12 is first applied.

The amendments also clarify that the date of initial application is the first day of the

annual period in which IFRS 10 is adopted – for example, 1 January 2014 for a calendar-year entity that adopts IFRS 10 in 2014. Entities adopting IFRS 10 should assess control at the date of initial application; the treatment of comparative figures depends on this assessment.

The amendments have been endorsed with an effective date of 1 January 2014. Earlier application is required if the underlying standards are early-adopted.

## IFRS ‘ABC’: F is for ‘fair value’

Caroline Woodward from PwC’s Accounting Consulting Services Central team looks at IFRS 13, the new standard on fair value requirements.



Here is a quick quiz to get your mind focused on this month topic – fair value.

1. How many IFRS standards reference the term ‘fair value’?
  - (a) 5
  - (b) 14
  - (c) 22
2. How many IFRS standards define the term ‘fair value’?
  - (a) 1
  - (b) 5
  - (c) 14

If you answered question 1 as (c) and question 2 as (a), you are correct. Guidance and observations on fair value were previously widely distributed throughout the standards and were not always consistent. IFRS 13, the fair value measurement standard effective this year, has brought this all together. Now that everything is in one place this should makes life simpler, or does it?

### IFRS 13 – the basics

IFRS 13 is all about how to measure and disclose fair value. Other standards continue to deal with what should or may be measured at fair value. Contrary to popular belief, IFRS 13 does not introduce any new requirements to fair value assets and liabilities.

#### What is fair value?

Fair value is now defined as ‘the price that would be received to sell an asset or paid to transfer a liability’. The new definition is little changed from the previous one. It remains a market participant notion, rather than an entity specific price. It reflects an arm’s length price in a freely negotiated transaction in the market.

IFRS 13 requires fair value to be measured using one or more of the most commonly used valuation approaches:

- The market approach, based on recent transactions in identical or similar assets and liabilities;
- The income approach, based on the present value of the cash flows generated or saved by an asset or those absorbed by a liability;
- The cost approach, based on the replacement cost of an asset.

Whichever technique is used, use of market based observable inputs is encouraged.

#### Who is affected?

Pretty much everybody. The scope of the fair value standard is wide with few exceptions.

Measurement applies to all standards except:	Disclosure applies to all balance sheet FV measures and FV disclosures except:
IFRS 2 – Share based payments	IAS 19 plan assets
IAS 17 - Leases	IAS 26 benefit plan investments
	IAS 36 impairment tests*

\* However, the apparent benefit is offset by equivalent disclosure requirements added to the impairment standard!

#### Key message

IFRS 13 explains that the other standards establish the unit of account of the asset or liability being measured - so other standards continue to tell you ‘what’ while IFRS 13 tells you ‘how’.

### **What's changed?**

Very little has changed from the previous widely dispersed guidance. The main changes are:

*Fair value is now an 'exit' price instead of the previous 'exchange' price.*

This has little practical impact on assets but may change the way some have measured liabilities. Previous practice was often to measure a liability based on the amount required to settle or extinguish it. An exit price is the amount for which the liability could be transferred to a third party.

*Financial assets and liabilities are no longer measured at bid and ask prices respectively.*

Now the fair value is measured using the price within the bid-ask spread that is most representative of fair value in the circumstances. Many will already have established the point within the range at which they normally transact; others may need to establish a policy.

*Non-financial assets at fair value attract similar disclosures to financial assets.*

Where non-financial assets are measured at fair value in the balance sheet, they require disclosure similar to that required for financial assets and liabilities. This includes the level of the hierarchy in which the measurement is classified.

### **Practical challenges**

Some of the old challenges in determining fair value, such as identifying who is a market participant and what to do when a market is or becomes inactive, are partly solved by IFRS 13. However, some new challenges are posed.

*Does measurement fall into level 2 or 3?*

Each input to a fair value measurement is categorised by reference to the three levels described in IFRS 13.

- Level 1 – unadjusted quoted prices in active markets. Typically this would be the price listed on an exchange.
- Level 2 – observable inputs which are not level 1. These include quoted prices for similar assets in active markets.
- Level 3 – unobservable inputs. Typically these would be management forecasts or estimates.

The categorisation of the most significant input to the measurement determines the level of the hierarchy.

This judgment is not a new one for financial instruments but non-financial assets measured at fair value can present a challenge. The main implication of the hierarchy level is the amount of disclosure required – the less observable the inputs, the more disclosure required.

*Does P x Q trump unit of account?*

Yes, at the moment. The IASB have been asked to clarify how to determine the fair value of investments in associates and subsidiaries. They tentatively decided that the unit of account is the investment as a whole and that price times quantity (P x Q) provides the most reliable evidence of fair value. But this is still under discussion. An exposure draft on a proposed clarification is expected.

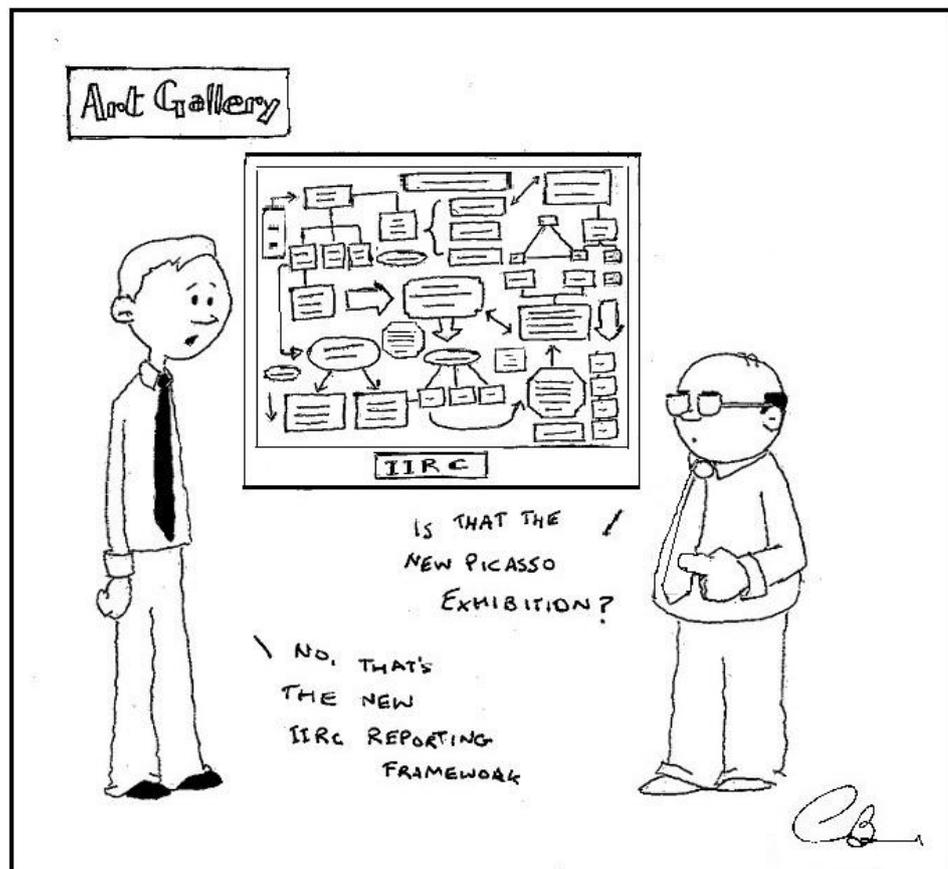
### **What's coming up?**

Whilst the actual changes from what was previously in the standards are few, the perceived changes are more numerous.

The IASB has also begun to debate the substantive practice issues arising from the application of IFRS 13. Further debate is expected but there is currently only modest support for change.

It is likely that, as more entities apply IFRS 13 for the first time, more questions will be put to the IASB or IC which might lead to change.

## 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

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. It does not take into account any objectives, financial situation or needs of any recipient; any recipient should not act upon the information contained in this publication without obtaining independent professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PricewaterhouseCoopers LLP, its members, employees and agents do not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it.