IFRS news

In this issue:

1 **IFRS IC progress report**
Staff report on IC activities

3 **Joint standard setting**
The end of an era

5 **Conceptual Framework**
An 'academic' view from Chris Nobes

7 **Cannon Street Press**
IASB Revenue project

IASB Financial instruments project

Proposed IAS 1 amendments

Proposed IAS 19 amendments

Joint protocols with IOSCO

9 **Questions and answers**
'J' for joint arrangements

11 **The bit at the back...**

For further information or to subscribe, contact us at corporatereporting@uk.pwc.com or register online.

Intepreting the IC 'report card'

The IFRS Interpretations Committee (IC) was given a mandate to 'do more and do it differently' following a review by the IFRS Trustees two years ago. The IC staff have reported on activity in this new mode. We look at the report and IC activity.

The IFRS Trustees set out new challenges for the IC following a review two years ago. These included improving communications on issues not taken on the agenda and expanding outreach on issues the IC does address.

These new challenges also came with a new 'toolbox' for the IC and a clear message to use it. The new tools included non-mandatory guidance and proposals to the IASB for targeted amendments that are beyond the scope of an annual improvement.

Preparers, regulators and auditors have cried out for more implementation guidance and more maintenance of the existing standards. But has the cry been answered? You might be surprised at the standards giving rise to the most questions.

Highlights based on the staff report at the September 2013 IC meeting

- 35 issues have been considered through July 2013 (4 meetings). Twenty are new issues, 15 are redeliberations. This is comparable to a full year's activity in 2012.
- 80% of the new issues are dealt with through annual improvements and agenda decisions.
- The IC continues to reject issues; half of new issues considered were rejected compared to 43% in 2012.
- Six of the new issues in 2013 were recommended as annual improvements, up from three issues in 2012.
- Use of narrow scope amendments is on the rise compared with earlier years but remains at a low level.
- For an 'interpretations committee' they continue the trend of few interpretations.

IFRS blog: Join the discussion

John Hitchins, PwC's Global Chief Accountant, discusses hot IFRS topics. Sign up to be notified of new IFRS blogs by emailing corporatereporting@uk.pwc.com with the subject line "Subscribe IFRS blog".

What's being asked and why?

No-one would be surprised by the standards topping the list of submissions in 2013. They include IFRS 3, IAS 19 and IFRS 2 and IAS 7. IFRS 3, seen by many as a bold experiment in fair value measurement of assets, is undergoing a planned post-implementation review but what about the rest?

Why not IAS 39, you might be wondering? It could be that those who want to ask questions on financial instruments have learned that the IC is not inclined to answer them, given the current work on IFRS 9.

IAS 19 has only just been amended in 2011 with the amendments applicable from 1 January 2013. Why so many questions? No plan survives contact with the enemy and it seems few new standards survive contact with the real world. (There is a similar pattern developing with IFRS 11 – see page 10.) However, the IC has spent as much time on an old problem in IAS 19, discount rates, as it has on clarifying the changes in the standard.

A planned post implementation review of IFRS 2 has never materialised. New questions continue to pour in and there are also a number that were put aside by the IC in the hope that they would be addressed by a post-implementation review. The IC is now coming back to these questions and considering potential limited scope amendments. If they all go ahead, when IFRS 2 will be 10 years old it will have seen as many amendments as its big brother IAS 19.

Attempts were made by the IC to look at the classification of cash flows under IAS 7 following a number of submissions. The work resulted in some proposed annual improvements but they recognised a broader approach was needed. These issues have now been wrapped up in a medium term research project encompassing IAS 1, IAS 7 and IAS 8.

Any other standards noticeably absent from the list? One board member pointed out that no issues have been raised on IAS 36 on impairment over the last four years and clearly there have been some indicators.

The new 'tools' at work

The IC has dealt with issues predominantly through annual improvements and agenda decisions. This trend is likely to continue but there has been an increase in the use of narrow scope amendments.

Narrow scope amendments have some unintended consequences for stakeholders. Every exposure draft triggers due process requirements from those inclined to comment: other standard setters, regulators and auditors for example. All of which have their own due process requirements around comment letter preparation and analysis. However, narrow scope amendments have filled a gap in the standard setting process giving more attention to the existing standards beyond just annual improvements. The good news is that the IASB is looking to simplify the process going forward – potentially combining exposure drafts on multiple topics.

Are they making the grade?

So what is the final assessment? It is probably too soon to conclude. The report was described by one member of the IC as a typical 'output report' prepared by an accountant. It has lots of figures but nothing linking them to what they are measuring.

The IC objectives include interpreting IFRS, providing timely guidance and undertaking other tasks at the request of the IASB. It is currently unclear how or whether the increased activity fulfils those objectives. The IC has asked the staff to consider what other analysis might give better insight into how well the IC is meeting its objectives.

Next steps

The high level of activity at the IC is likely to continue as the adoption of IFRS spreads and new standards are issued. It is not clear yet how will the IC interact, for example, with the recently announced joint transition group with the FASB for the new standard on revenue recognition. One thing seems certain – the IC will not be short on work over the next few years.

Joint standard setting – the end of an era

Beth Paul, PwC Accounting Services Partner in the US, looks at what happens now that the formal joint standard-setting era comes to a close.

The IASB and FASB were back together again this month in a joint meeting to discuss two major projects. They reconsidered certain matters on revenue recognition. And, they covered some ongoing matters on financial instruments but there was no joint decision-making.

As the era of joint standard setting comes to a close, the FASB is at a crossroads. While many stakeholders continue to believe in the long-term vision of a single set of high quality global standards, the lack of support for near term adoption of IFRS in the US means the end of convergence efforts for now.

We believe the FASB's road ahead should focus on improving the quality of US GAAP in key areas while preventing further divergence between US GAAP and IFRS when feasible.

Where have we been?

For the past decade, the IASB and FASB's agendas have been dominated by the goal of converging IFRS and US GAAP. Driven by the demands of increasingly global capital markets, the boards formed an agreement in 2002 with the objective of improving the quality of both IFRS and US GAAP while simultaneously bringing the two frameworks closer together.

At times the process of joint standard-setting proved to be difficult and time-consuming. But the journey has been largely successful, improving financial reporting, bringing greater cross-border consistency, and delivering significant benefits to investors around the globe.

What is next?

The standard setting agenda

The IASB's next steps are driven by the results of its 2011 agenda consultation. The focus is on a 'period of relative calm' following completion of the four big projects. The IASB has targeted completion of the Conceptual Framework, making improvements to certain standards and implementation and maintenance as its key priorities.

But what about the FASB? Without any clear indication from the SEC on whether or when it will further consider incorporating IFRS into the US financial reporting system, the FASB needs to strategically consider its next steps.

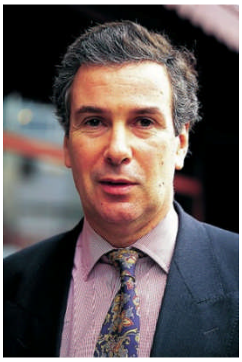
A key challenge for the FASB will be to balance the focus on enhancements to the overall quality of US GAAP with the desire to maintain a high degree of comparability with IFRS. We believe the FASB should prioritise topics where there are gaps or a lack of clear principles, where simplification is needed to improve quality and consistency and where the current guidance no longer provides decision useful information that meets the evolving needs of stakeholders.

Implementation of new standards

Adoption of final standards for the priority projects will represent the culmination of a long, rigorous due process on topics that have broad applicability to a wide range of preparers. The issuance of converged standards is a notable achievement. The standards will improve the quality of reporting and increase comparability in critical areas, benefiting investors across the globe but only if convergence is maintained. The IASB and FASB should continue to work together to provide implementation guidance on the converged standards. This will help to ensure that implementation of those standards results in quality financial reporting while maintaining a high degree of global comparability. For example, the boards' recently announced joint transition resource group for the revenue standard will provide a useful forum to debate and analyse issues arising during implementation.

The future of standard setting

What happens next remains to be seen. However, stakeholders globally share a common goal for improving accounting standards. With major accomplishments becoming visible in its rear-view mirror, the FASB has the opportunity to strategically consider its next steps. This should hopefully include continued collaboration with the IASB, where appropriate, to maintain a high degree of global comparability.



Chris Nobes was a member of the Board of the International Accounting Standards Committee from 1993 to 2001. He has been a consultant with PwC since 1986.

The Conceptual Framework Project – an academic exercise?

Chris Nobes, Professor of Accounting at the University of London and the University of Sydney, gives his view on the IASB's Discussion Paper reviewing the Conceptual Framework.

As a former member of both UK and international standard-setting committees, I can confirm the usefulness and importance of a conceptual framework. It speeds up discussion and assists with consistency in standard setting. For example, it made the development of IAS 37 Provisions and contingencies relatively easy because everyone had already agreed that a liability is a present obligation.

The present discussion paper (DP) on reviewing the framework (published in July 2013) proposes amendments to the definitions of elements, the recognition criteria, measurement and presentation. In principle, the IASB is not re-opening decisions made in 2010 about objectives and qualities. However, it will be under pressure to do so, for example to re-insert a discussion of prudence. How else can one explain accounting for impairments but ignore most increases in value?

The DP's proposed amendments to the definitions are small and uncontroversial. I comment below on five other issues.

What is revenue?

In the existing framework, in IAS 18 and in the latest draft of the proposed new 'revenue' standard, revenue is defined as income from ordinary activities. This is a major problem: (i) there is now no definition of 'ordinary' anywhere in IFRS, (ii) IAS 1 does not permit presentation of any item as extraordinary, and (iii) when ordinary was defined (in an old version of IAS 8 replaced in 1997) it was a very wide concept which included the sale of non-current assets.

So, where does this leave us? The sale of non-current assets was (and presumably still is) ordinary, and therefore meets the definition of revenue. Furthermore, it is obvious that dividend and interest income are 'ordinary' and IAS 18 confirms that they are a type of revenue. However, surely a manufacturing company or a retail group should not include such things as revenue?

The DP admits that IFRS has no definition of 'ordinary' and then proposes to retain the word in the definition of revenue. This makes no sense.

Probability

At present, under IAS 37, contingent liabilities are not recognised because there is no probable outflow of resources. The DP proposes to delete the 'expected' from the outflow part of the definition of liability and also to delete the recognition criterion of probability. This is a major change. It implies that, for example, an obligation that is 40% likely should be recognised, although the DP proposes that the precise recognition criteria should be considered standard by standard.

This has always been opposed by most accounting firms, who have argued that it involves too much estimation. However, suppose that Company A has such an obligation and Company B does not. Surely, Company A is in a worse position? Surely, we should account for that? If so, the DP is right.

Enforceable and conditional

At present, various forms of 'constructive obligation' are treated as liabilities (for example, certain informal pension arrangements). The DP gives arguments on both sides. At first glance, the arguments in favour of restricting liabilities to only those strictly enforceable look strong. There is also the issue of whether to recognise obligations that are conditional on an entity's future actions, such as an employee bonus which has not yet vested and could therefore be avoided in the unlikely event that the employee were sacked.

Having looked at the examples in the DP, I am reluctantly forced to agree with the DP's conclusion against the neat idea of restricting recognition to obligations that are strictly enforceable and unconditional. However, since this means continuing to recognise obligations which could be avoided (for example, in a financial crisis), they should at least be presented separately. The DP does not suggest that.

Measurement

Accounting has been criticised by some academics for using a messy mixture of measurement bases, with the result that any totals of assets, liabilities or equity are incoherent. However, the DP has come up with good arguments in favour of basing measurement on how an asset or liability is expected to affect future cash flows, and therefore retaining a mixture of measurements.

Unfortunately, the DP then goes off the rails and concludes that cost-based information is more relevant for assets which are used up in business operations. However, for which decisions would it be useful to know the cost (or the depreciated cost) of a building purchased in 1970? For which decisions would it be useful to know the depreciation expense of a machine purchased in 1990? And, suppose that an entity buys materials for CU100 and later sells a product made from them for CU118, when the replacement cost of the materials is CU120. In my view, the apparent profit of the entity is overstated by ignoring the holding gain of CU20, which might also have occurred in a previous period. At the least, disclosure of the CU20 would be useful. Cost-based information has other advantages, but surely not relevance?

The DP also favours cost-based measurement for several types of liabilities, although it would be cleaner to talk in terms of proceeds rather than costs: assets involve costs, liabilities involve proceeds. The DP's arguments in favour of 'cost' for liabilities are even less convincing than those about using cost for assets. If an entity has liabilities which it expects to settle according to terms (for example, a lease liability or a pension liability) why is it not best to measure them at discounted expected outflows?

Other comprehensive income

One of the great embarrassments about IFRS (when trying to explain it to students or non-financial executives) is that no-one can explain why we have two income statements, what the principle is for explaining which items are in which, and why only some items are later recycled from other comprehensive income (OCI) to profit/loss.

At last, the DP has come up with some plausible suggestions. There is not space here to explain the details, but OCI would contain: (i) mismatches and (ii) items measured differently for income and balance sheet purposes. The DP offers an extra possible category: (iii) re-measurement of items expected to be held for the long-term. I would include that.

The DP suggests that there is no over-arching principle, but I think that there should be and there can be. All the above three issues relate to re-measurement, and the IASB should be encouraged to formulate a single principle from them. Recycling should later occur if and when the reason for initially using OCI unwinds.

Conclusion

The DP is important. Its contents will affect Board discussions for years to come, which will affect the content of IFRS. We should all read the DP and respond to it, via the firm, our accountancy bodies or individually.

This article represents the individual view of the author.

Have you seen our IFRS quarterly updates?

Our IFRS quarterly update summarises the reporting requirements (including topical issues, standards and interpretations that are mandatory for the first time and standards and interpretations issued not yet effective) for a specific quarter end. The next edition will be released in December.

Download the publication free from PwC inform (inform.pwc.com), where you can also apply for a free trial of PwC inform's subscriber-only content.

Cannon Street Press

IASB and FASB revenue recognition project

The IASB and FASB (the 'boards') discussed the next steps in three areas of the revenue project in their September meeting.

Licences

The boards decided to retain guidance that distinguishes a licence as either a performance obligation that provides access to intellectual property that transfers over time or that provides a right that transfers at a point in time. The boards will consider language in October to help distinguish between the two types of licences.

Constraint on variable consideration

The boards had tentatively agreed that revenue recognised from variable consideration will be constrained to the amounts that management is confident will not be subject to significant reversal. Feedback suggested confusion about the overall objective of the constraint and how to apply it. Most concerns, however, focused on the implications of estimating a minimum amount of variable consideration and reassessing that estimate each reporting period.

The boards asked the staff to focus on evaluating the following possible solutions for discussion in October:

- including a specific level of confidence for applying the constraint;
- reinstating guidance on usage-based royalty for licences; and
- an alternative approach focused on quality of the estimate.

Collectibility

The boards had tentatively decided that credit risk should be excluded from the transaction price unless there is a significant financing component. Some are concerned about reporting revenue 'gross' of credit risk adjustments in industries where collections can be a challenge.

The board will look at a two options for addressing these concerns in October:

- including a collectability threshold in assessing whether a contract exists; or
- clarifying when a customer is committed to a contract and what circumstances indicate that an entity intends to issue a price concession.

IASB and FASB on financial instruments accounting

Classification and measurement

In a joint session, the IASB and FASB discussed clarifications and improvements to the solely principal and interest (P&I) condition in the IASB's recent ED.

The boards tentatively decided to:

- clarify the meaning of principle and interest;
- provide guidance on the quantitative assessment of a financial asset with a modified time value of money component, replacing the 'not more than significant' threshold with 'not significant' threshold; and
- clarify that the nature of the trigger event related to both contingent features and prepayments options does not determine classification of the financial asset.

The Boards continue to have different views on the impact of contingent features and prepayments on the solely P&I condition. The boards' views will be revisited in a subsequent meeting.

Impairment

The IASB tentatively decided to:

- clarify and provide examples that the objective of the model is to recognise lifetime expected credit losses on all instruments for which there has been a significant increase in credit risk, whether on an individual or portfolio basis;
- confirm the 12-month expected credit losses measurement objective for instruments in Stage 1; and
- require default definition to be consistent with the entity's credit risk management practices, emphasising qualitative factors. A rebuttable presumption of 90 days past due was introduced.

IASB discuss amendments to IAS 1

The IASB has begun discussions of the narrow focus amendments to IAS 1. Some of the amendments form part of the broad-based initiative to explore how disclosures can be improved. Others arose from submissions to the IC. An exposure draft is expected in the first quarter of 2014.

Disclosure initiative

The proposed amendments address the following matters:

- application of materiality;
- disaggregation of line items if it provides relevant information;
- no prescriptive order of notes; and
- disclosure of a net-debt reconciliation.

Going concern

The amendment addresses when and how material uncertainties should be disclosed.

Current and non-current classification

The amendment proposes an approach to classify liabilities based on the contractual arrangements at the reporting date.

OCI arising from equity investments

The amendment clarifies that the share of other comprehensive income arising from equity investments is presented in aggregate as a single item, and the share is classified between those items that will or will not be reclassified to profit or loss.

IAS 19 amendments on employee contributions

The IASB has decided to go ahead with planned amendments to IAS 19 on employee contributions. The amendments will allow contributions from employees and third parties to be recognised as a reduction to service cost subject to certain conditions. Otherwise, the negative benefit should be attributed in the same way the gross benefit is attributed. The staff are working on the detailed drafting based on the Board and IC Committee discussion.

IOSCO and IFRS Foundation joint protocols

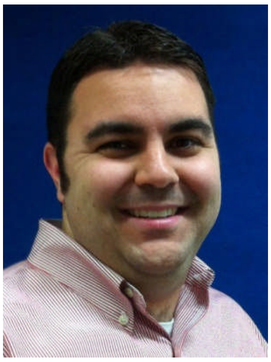
The IFRS Foundation and International Organisation of Securities Commissions (IOSCO) agreed a Statement of Protocols (SOP). It reaffirms their common interest in developing and maintaining IFRS.

The SOP outlines four new focus areas:

- periodic exchange of information about the use of IFRS around the world;
- organise more frequent discussions of IFRS enforcement matters;
- identify and explain aspects of new standards that are most likely to be of interest to securities regulators; and
- work together on time sensitive IFRS implementation issues which require urgent input from securities regulators.

IOSCO's membership includes more than 120 securities regulators, many of which operate in jurisdictions using IFRS.

Know your IFRS 'ABC': J is for 'joint arrangements'



Mark Bellantoni from PwC's Accounting Consulting Services Central team gives his top five practical tips for classifying joint arrangements under IFRS 11.

IFRS 11 has created a fundamental shift in the classification and accounting for joint arrangements. We have moved from three types of joint arrangements to two types. But do not be fooled, a joint venture is not the same as a jointly controlled entity. Legal form is no longer the primary driver for classification and the policy election for proportionate consolidation no longer exists.

The new guidance continues to focus on joint control over relevant activities, however now looks to the rights and obligations of the investors to determine classification. Classification is the critical step in determining the accounting for a joint arrangement. This article offers some practical tips for identifying and classifying joint arrangements as much of the world adopts IFRS 11 in the coming months (IFRS 11 is effective 1 Jan 2014 for the EU),

This list is not comprehensive, nor is it prescriptive for all arrangements. Remember to examine all key terms and contracts of an arrangement to assess classification.

Joint control is, well… joint

The starting point for classification of joint arrangements is verifying that joint control exists. IFRS 11 defines joint control as 'contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.'

Joint control is clearly established for many arrangements contained in legal entities through a Board of Directors (BoD) and/or shareholder voting requirements. However, it is important to consider all terms of an arrangement when assessing control. If one party is given significant decision making power through an operating agreement and decisions are not overseen by a BoD, that party may have control.

Key message
Joint control exists when decision-making over relevant activities is unanimous.

Not all legal entities create separation

Legal form is the first step in assessing classification; it plays a major role in determining the rights and obligations of each investor. However, not all legal entities create separation between the investors and the arrangement.

For example, a general partnership in many jurisdictions will expose investors to the legal rights and obligations of the joint arrangement, indicating classification as a joint operation. Other contractual agreements could alter the investors' rights and obligations such that the legal separation typically created by a limited liability company is overridden.

Key message
A legal wrapper doesn't automatically mean a joint venture. Key terms of the arrangement will drive the rights and obligations of the investors.

Third-party financing is not determinative

Third-party financing is not determinative for classification in isolation. Lenders might be looking to the investors in the joint arrangement to guarantee the financing and there could be 'take or pay' arrangements in place.

An inability to obtain third-party financing may be an indicator of joint operation classification. That is, without third-party financing, the investors are the only source of funding for the arrangement. However, the existence of third-party financing does not mean the arrangement is a joint venture. Investors may establish an arrangement where they are required to purchase all of the output at a price that provides sufficient cash flow to fund third party financing and cover costs.

Key message
Third-party financing may indicate that the investors operate the arrangement as a business from which they share in the residual returns. However, it must be looked at in the context of the purpose and design of the entity.

Price matters but maybe not as much as you think

Pricing may be viewed as an indicator of the role of the investors in the operations of an arrangement (consumer, distributor, etc.), the extent to which investors are funding the ongoing operations and the level of returns created by the arrangement.

However, pricing in a joint arrangement may be driven by a variety of factors, including:
- nature of the output (for example, commodities at market prices);
- level of net return desired by investors;
- legal transfer pricing requirements for sales to related parties; and
- covenants in financing agreements

Thus, the ability for investors to influence pricing will vary by arrangement, as will the importance of pricing in the classification assessment.

Key message
Pricing is a significant factor that can speak to purpose and design of the arrangement, but classification of an arrangement is not determined by pricing alone.

Rights and obligations

The assessment of 'other facts and circumstances' of an arrangement in a legal entity will typically focus on whether the investors are required to take substantially all of the output.

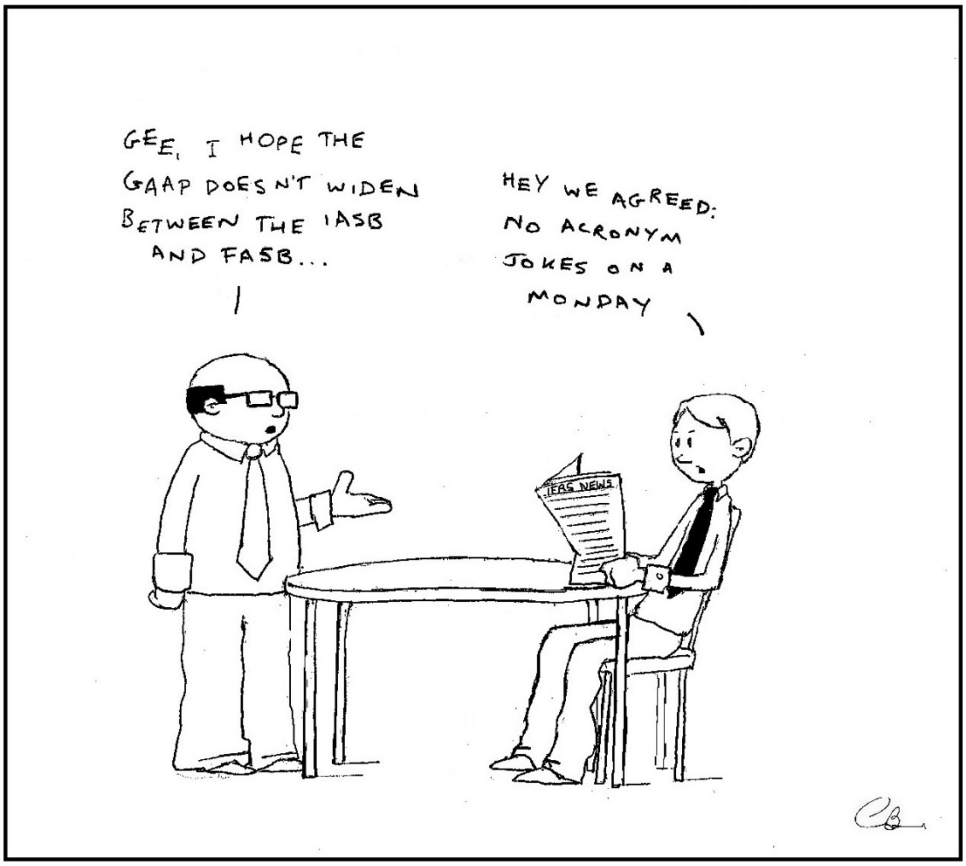
Investors must have the rights to substantially all of the economic benefit and obligations for the liabilities of the arrangement for the joint arrangement to be classified as a joint operation. A right to take output, without the obligation to do so, is less likely to result in joint operation classification.

And finally…judgments should be disclosed

If you have gotten to the end this article and found the tips relevant, it might be that determining the classification for your arrangement is a significant judgement. IFRS 12 requires companies to disclose information about significant judgements and assumptions made in determining:
- joint control of an arrangement; and
- the type of joint arrangement when the arrangement has been structured through a separate vehicle.

www.pwc.com/ifrs

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