

PwC Nigeria IFRS Newsletter

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New Accounting Developments effective for accounting periods commencing on / after 1 January 2013

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Introduction

This guide relates to reporting requirements for accounting periods commencing on / after 1 January 2013. It concludes with a brief summary of new accounting developments effective after 1 January 2014.

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IAS 19 (Revised) - Employee benefits

At a glance

The revision to IAS 19 requires retrospective application of the changes except in certain circumstances. This means apart from restating the comparative information you may require an opening balance sheet for adjustments. The most significant effect of the changes is on defined benefit plans and other post-employment benefits; however, termination benefits and other employee benefits are also affected. It affects both accounting for them and their financial statements disclosures. Another change is in the level of disclosures required, in particular sensitivity analysis for possible variations in actuarial assumptions for retirement benefit obligations.

Amendments

- **Net interest cost** - The revised standard replaces the interest cost on the defined benefit obligation and the expected return on plan assets with a net interest cost based on the net defined benefit asset or liability and the discount rate, measured at the beginning of the year. The net defined benefit asset or liability is adjusted for actual benefit payments and contributions during the year.
- **Remeasurements** - This is made up of actuarial gains and losses on the defined benefit obligation, the difference between actual investment returns and the return implied by the net interest cost and the effect of the asset ceiling. Remeasurements are recognized immediately in Other Comprehensive Income (OCI) and are not reclassified; other methods including the 'corridor' approach are withdrawn.
- **Past service costs** - Past service costs arises when an entity amends a benefit plan to provide additional benefits for services in prior periods. The amendment changes the definition of past service costs to clarify the distinction between curtailments and past service costs; it also requires all past-service costs to be recognized immediately in profit or loss, regardless of vesting requirements.
- **Termination benefits** - Benefits that must be earned by working in a future period are not termination benefits. Termination benefit is recognized when the entity can no longer withdraw the offer i.e. it must be earned by the employee.
- **Risk and cost sharing plans** - The amendment clarifies the accounting for features such as employee contributions or benefits that vary depending on the experience of the plan, for example employee contributions to meet deficits, reductions in employee contributions from surpluses, contingent benefit increases relating to the investment performance of the plan and limits on the employer's obligation to contribute to a plan. It requires the expected cost of benefits to reflect all these plan terms, which may therefore require specific actuarial assumptions.

- **Settlement** - A settlement arises when an entity makes a payment to the employees covered by a plan or a third party that eliminates all further liability under the plan. The amendment clarified the definition of a settlement but did not make significant changes to the accounting for gains and losses on settlement. Settlement gain or loss is defined as the difference between (a) the present value on the settlement date of the defined benefit obligation being settled, and (b) the settlement price, including any plan assets transferred and any payments made directly by the entity. It is recognized in profit or loss when the settlement occurs.
- **Taxes** - Taxes payable by a benefit plan are currently included in the actual and expected return on plan assets. The revised standard requires taxes related to defined benefit plans to be included either in the return on plan assets or the calculation of the benefit obligation, depending on the nature of the taxes. Taxes on the return on plan assets will be part of the actual investment return and will be recognized in OCI. Social charges or other taxes levied on benefit payments or contributions to the plan will be included in the measurement of the benefit obligation to the extent that they relate to benefits in respect of service before the balance sheet date.
- **Administration costs and other expenses** - The amendment requires costs associated with the management of plan assets to be deducted from the return on plan assets, which is unchanged from the existing standard. Other expenses such as record-keeping costs or actuarial valuation fees should be recognized in profit or loss when the services are received. This changes the existing standard, under which there is a choice to include expenses in the calculation of the defined benefit obligation or in the actual and expected return on plan assets.
- **Classification of defined benefit and defined contribution plans** - The amendment added the words 'in substance' to the guidance that explains the distinction between defined contribution and defined benefit plans. The guidance now says that, in a defined contribution plan, the actuarial risk falls 'in substance' on the employee. This makes the description of a defined contribution plan consistent with the description of a defined benefit plan, which refers to the risks falling, 'in substance', on the employer.

IFRS 10 - Consolidated financial statements

At a glance

IFRS 10 consolidated financial statements outlines the requirements for the preparation and presentation of consolidated financial statements, requiring entities to consolidate entities it controls. Control requires exposure or rights to variable returns and the ability to affect those returns through power over an investee. IFRS 10 also aims to provide more guidance than was provided under IAS 27.

The end result of IFRS 10 is that some entities may end up consolidating more entities while others fewer.

IFRS 10 replaces the consolidation guidance in IAS 27 and SIC 12 – Special Purpose Entities (now withdrawn).

Key points

- **Comparative information on transition** - Unlike other standards, IFRS 10 applies from the first day of the annual period in which the standard is adopted, not from the beginning of the comparative period. For entities applying IFRS 10 for 31 December 2013 year ends, the standard applies from 1 January 2013 prospectively. Only where the consolidation conclusion under IFRS 10 differs from that under IAS 27/SIC 12 at 1 January 2013 should the comparative period be restated. Where comparatives are restated, entities should present a third statement of financial position as required by IAS 8.
- **Control** – IFRS 10 identifies one model of control applying to all situations. There is a new definition of “Control”. The new control definition reflects that an investor can achieve power over an investee in many ways, not just through governing financial and operating policies. The investor must assess whether it has rights to direct the relevant activities (as defined by the standard). Although exposure to risks and rewards is an indicator of control, it is not the sole focus for consolidation for any type of entity. Only substantive potential voting rights are considered when assessing control. The new standard also provides specific application guidance when assessing de-facto control (situation where an investor has control without a majority of voting rights) and states that an investor can control an investee with less than 50% of the voting rights of the investee.
- **Principal-agent relationship** - the new standard contains specific application guidance for agency relationships. When decision making authority has been delegated by a principal to an agent, an agent in such a relationship does not control the entity. The principal that has delegated the decision-making authority would consolidate the entity.

IFRS 11 - Joint Arrangements

At a glance

IFRS 11 joint arrangements applies to all entities that are party to a joint arrangement, being a contractual agreement that gives two or more parties joint control over an arrangement. This joint arrangement is subsequently classified into one of two classifications, being either:

- A joint operation or
- A joint venture.

The distinction between the two arrangements is based on substance rather than legal form. IFRS 11 supersedes IAS 31 Interests in joint ventures.

Key points

- Main distinction between joint operation and joint venture - under IFRS 11 the legal structure of the arrangement is not a deciding factor in determining the classification of the arrangement. Instead, the rights and obligations specified in the joint arrangement agreement must be analyzed to determine whether the parties with joint control have either:
 - Rights to the assets, and obligations for the liabilities (joint operation), or
 - Rights to the net assets (joint venture).
- Disclosure requirements – The disclosure requirements for joint arrangements have been incorporated into a separate stand-alone standard, IFRS 12 Disclosure of Interests in Other Entities.
- Accounting for joint ventures - Equity accounting is now the only accounting method for entities classified as joint ventures measured as initial cost plus post-acquisition changes in joint venturer’s share of net assets. In addition, proportionate consolidation allowed under IAS 31 is prohibited for entities that meet the definition of a joint venture. A joint venturer does not have to apply equity accounting to its investment in an associate or joint venture provided that it is exempt from preparing consolidated financial statements in accordance with IFRS 10.4(a), and all the conditions listed there apply. The conditions are:
 - The entity’s debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets).
 - The joint venturer’s ultimate or any intermediate parent produces IFRS compliant consolidated financial statements that are available for public use.
- Accounting for joint operations - each entity should recognize its share of assets, liabilities, income and expenses on a line-by-line basis.
- Other parties to a joint arrangement – the standard provides guidance for the accounting treatment of a joint arrangement by those parties which do not have joint control over the joint arrangement (non-joint controlling parties). The accounting treatment by non-joint controlling parties is dependent on:
 - The classification of the joint arrangement
 - Whether non-joint controlling parties have rights and obligations for assets, liabilities, expenses, and revenues (joint operations only)

- Whether the non-joint controlling parties have significant influence (i.e. the interest is accounted for as an associate).

IFRS 12 - Disclosure of interests in other entities

At a glance

IFRS 12 Disclosure of interests in other entities makes consistent, certain existing disclosures that were previously included, in some cases with overlapping requirements, in IAS 27 Consolidated and Separate Financial Statements, IAS 28 Investments in Associates and IAS 31 Interests in Joint Ventures.

Key points

- Disclosure requirements - IFRS 12 is a comprehensive disclosure standard that sets out disclosure requirements for interests an entity holds in:
 - Joint arrangements (accounted in accordance with IFRS 11 Joint Arrangements)
 - Subsidiaries (consolidated in accordance with IFRS 10 Consolidated Financial Statements)
 - Associates (accounted in accordance with IAS 28 (2011) Investments in Associates and Joint Ventures)
 - Unconsolidated structured entities (IFRS 12.5). Disclosing information about, including but not limited to, the nature, purpose, size, and activities of the structured entity and how it is financed.
- Disclosure requirements for joint arrangements – The more significant disclosure requirements for entities with interests in joint arrangements are:
 - Significant judgments and assumptions: An entity with a joint arrangement is required to provide

information about significant judgments and assumptions it has made (and changes to those judgments and assumptions) in determining:

- (a) That it has joint control of an arrangement; and
- (b) The classification of joint arrangement (i.e. joint operation or joint venture) when the arrangement has been structured through a separate vehicle.

- Nature, extent and financial effects of an entity's interests in joint arrangements:

- An entity with a joint arrangement is required to disclose the following qualitative information:

- (a) Name of the joint arrangement
- (b) Nature of the investor's relationship with the joint arrangement
- (c) Place of business
- (d) The proportion owned and, if different, the proportion of voting rights held.
- (e) Commitments in respect of joint ventures

and the following quantitative information:

- (a) Whether the investment in the joint venture is accounted for under the equity method or at fair value
- (b) Summarized financial information
- (c) If the joint venture is accounted for using the equity method, the fair value of the joint venture if there is a quoted market price for the investment.

IFRS 13 - Fair value measurement

At a glance

IFRS 13 Fair value measurement sets out a framework for measuring fair value and requires disclosures about fair value measurement. IFRS 13 does not determine when an asset, a liability or an entity's own equity instrument is measured at fair value; this is dealt with in other applicable IFRSs.

The standard applies when another IFRS requires or permits fair value measurement or disclosures about fair value measurements.

Key points

- **Definition of fair value:** Fair value is (IFRS 13.9): 'The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.' This definition of fair value is sometimes referred to as an 'exit price'.
 - **Measurement of fair value:** Fair value measurement is specific to each asset or liability. Consequently, fair value measurement needs to take into account the specific characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date.
 - **Exit price vs. Entry price:** The entry price is the transaction price paid to acquire an asset, or received to assume a liability. On the other hand the exit price is the fair value received to sell an asset or paid to transfer a liability.
 - **Principal market concept:** Fair value is the price obtained from selling an asset (or paid for transferring a liability) in transaction that takes place in either:
 - The principal market; or
 - The most advantageous market (where no principal market exists). In order to establish the principal (or the most advantageous) market, an entity needs to evaluate potential markets. Once an entity identifies the principal market, the fair value must be measured in that market, even if another market (or markets) exist that are more advantageous.
 - **Market-based measure, not entity-specific measure:** Fair value is reflective of a market-based measurement, taken from a market participant's perspective. Consequently, fair value cannot be specific to the entity measuring the asset or liability, as the intention of the entity itself is irrelevant.
 - **Initial recognition:** Generally, the transaction price (entry price) will equal the fair value (exit price), although there is a conceptual difference between the two. It is therefore important to understand that
 - transaction costs will not cause a difference between entry price and exit price. When determining whether fair value at initial recognition equals the transaction price, an entity must take into account factors specific to the transaction and to the asset or liability. IFRS 13.B4 describes situations in which the transaction price may not represent the fair value of an asset or a liability at initial recognition. Any difference between the transaction price and fair value is commonly known as a day one gain or loss.
 - **Non-financial assets:** IFRS 13 requires the fair value of a non-financial asset to be measured based on its Highest and Best use (HBU) from a market participant's perspective. This requirement does not apply to financial instruments, liabilities or equity.
 - **Liabilities and entity's own credit risk:** The general principle for measuring the fair value of liabilities (and an entity's own equity instruments) in accordance with IFRS 13.34 is that fair value assumes that a financial or non-financial liability or an entity's own equity instrument (e.g. equity interests issued as consideration in a business combination) is transferred to a market participant at the measurement date.
 - **Bid and ask prices:** Bid and ask prices are common within markets for securities, financial instruments and commodities. IFRS 13 states that the entity should use the price within the bid-ask spread that is most representative of fair value.
 - **Premium and Discount:** IFRS 13 requires that fair value measurement takes into account characteristics which market participants would consider in determining fair value. In certain instances this will result in the application of a premium or a discount when this is necessary to reflect the characteristics of the asset or liability.
 - **Valuation techniques:** IFRS 13 requires the valuation technique used for fair value measurement to:
 - be appropriate based on the circumstances;
 - be a technique for which sufficient data is available; and
 - maximize the use of relevant observable inputs and minimize the use of unobservable inputs.
 - be consistent with the objective of estimating the price at which an orderly transaction to sell an asset or to transfer a liability would take place between market participants at the measurement date under current market conditions.
- The standard lists three valuation techniques commonly used in practice:
- **Market approach:** A valuation technique that uses prices and other relevant information generated by market transactions involving identical or comparable (i.e. similar) assets, liabilities, or a group of assets and liabilities, such as a business.

- Income approach: A valuation technique that converts future amounts (e.g. cash flows or income and expenses) to a single current (i.e. discounted) amount. The fair value measurement is determined on the basis of the value indicated by current market expectations about those future amounts.
- Cost approach: A valuation technique that reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).
- Fair value hierarchy – The IFRS 13 fair value hierarchy categorizes elements of the financial statements (that fall within the scope of IFRS 13) into three levels, based on the inputs used in the valuation techniques to determine their fair value. The fair value hierarchy gives the highest priority to Level 1 (observable) inputs, and the lowest priority to Level 3 (unobservable) inputs. The fair value hierarchy prioritizes the inputs utilized in the fair value valuation techniques (emphasizing the use of Level 1 inputs), rather than the type of valuation techniques being used.
- Disclosure – The standard introduces a comprehensive disclosure framework for fair value measurement. This framework is intended to help users of financial statements assess the valuation techniques and inputs used to develop those measurements. The disclosures required are affected by the fair value hierarchy discussed above, with increased disclosure requirements applying to the lower levels of that hierarchy (in particular Level 3). A distinction is also made between recurring fair value measurements (measurements made on a fair value basis at each reporting date) and non-recurring measurements (measurements triggered by particular circumstances).
- Debt instrument valuation to be assessed on the basis of the objective of an entity’s business model and its determined by the entity’s key management personnel.
- “Held to collect contractual cash flow” and “cash flows represent only principal and interest” – amortised cost; otherwise fair value.
- Financial liabilities: Fair value changes on own credit risk taken to OCI (for fair value option); embedded derivative rules retained.
- No recycling of fair value changes to profit or loss on impairment / disposal or in any other circumstances.
- Derecognition: No change from IAS 39; disclosures added to IFRS 7 about transfers of financial assets.
- Impact: Equity investments at fair value through OCI result in no gains and losses in profit or loss, even when sold; No cost exemption for unquoted equity investments, all equities at fair value; More disclosures but restatement rules are relaxed

General hedge accounting

- Better alignment with risk management strategies.
- Hedge effectiveness tests relaxed; no bright-lines (e.g. 80-125%), prospective only and generally qualitative in nature.
- Risk components of non-financial items may be eligible for hedging.
- Treatment of forward points, time value of options and currency basis risk as ‘costs of hedging’ reduces volatility and improves the use of forwards, purchased options and cross currency interest rate swaps.
- Impact: Easier to achieve hedge accounting; reconsider hedging strategies.

Effective date and transition

- Mandatory effective date of 1 January 2015 is removed, but the standard is available for immediate application, however this is subject to local regulators like the Financial Reporting Council of Nigeria.
- Choice to continue to apply IAS 39 hedge accounting instead of IFRS 9 until completion of macro hedging project.
- Choice to apply IFRS 9 for any of: own credit risk in OCI, classification and measurement for financial assets, classification and measurement for financial assets and liabilities, and the full current version of IFRS 9.
- Retrospectively applied other than hedging accounting prospectively.

Disclosure of the effect of the fair value measurement on profit or loss or other comprehensive income for the period is required for recurring fair value measurements that involve significant unobservable (Level 3) inputs.

Disclosure requirements also apply to each class of asset and liability not measured at fair value in the statement of financial position but for which the fair value is disclosed (e.g. financial instruments measured at amortized cost, and investment property accounted for in accordance with the cost model). For these items, the disclosures requirements are less extensive.

New accounting developments

IFRS 9 - Financial instruments

Classification and measurement

- Financial assets: Reduced from six to three categories – one at amortised cost and two at fair value; no bifurcation or separation of embedded derivative.

- Impact: Mandatory effective date for whole IFRS 9 to be determined after Impairment is completed

Amendment to IAS 16

- Clarifies that spare parts and servicing equipment are classified as Property, Plant and Equipment (PPE) rather than inventory when they meet the definition of PPE.
- This amendment will reduce diversity in practice.

Amendment to IAS 32

- Clarifies the treatment of income tax relating to distributions and transaction costs.
- Clarifies income tax related to distributions is recognized in the income statement, and income tax related to the costs of equity transactions is recognized in equity.

Amendment to IFRS 1

- Clarifies that an entity may apply IFRS 1 more than once under certain circumstances. For example if an entity that previously applied IFRS delists from an exchange and as a result elects to revert to its local GAAP which is not consistent with IFRS. Then subsequently adopts IFRS as a result of regulatory requirements, it is able to adopt IFRS 1 again.
- Clarifies that an entity can choose to adopt IAS 23, 'Borrowing costs', either from its date of transition or from an earlier date.

- Clarifies that a first-time adopter should provide the supporting notes for all statements presented.
- The amendment reduces the burden of re-adoption of IFRS.
- It eases transition burden if borrowing costs under previous GAAP is different from IFRS.
- It clarifies disclosure requirements.

Amendment to IAS 1

- Clarifies the disclosure requirements for comparative information when an entity provides a third balance sheet either: as required by IAS 8, 'Accounting policies, changes in accounting estimates and errors'; or voluntarily.
- The standard clarifies that notes are not required to opening balance sheets; However, notes are required for additional comparative statements.

Amendment to IAS 34

- Clarifies the disclosure requirements for segment assets and liabilities in interim financial statements.
- The amendment brings IAS 34 into line with the requirements of IFRS 8, 'Operating segments'.



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