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IFRS news

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TRG for Impairment of Financial Instruments weighs in again on IFRS 9 implementation issues

The Impairment of Financial Instruments Transition Resource Group (ITG) continues to discuss impairment implementation issues.

The ITG discussed issues related to significant increases in credit risk, use of changes in the risk of a default occurring over the next 12 months as an approximation of the changes in the lifetime risk of a default, measurement of expected credit losses for revolving credit facilities, and forward-looking information.

For more details, see In Transition.

The staff agreed to discuss the scope of the exception to the contractual terms in IFRS 9 with the IASB.

The ITG discussed how an entity should estimate future drawdowns on undrawn lines of credit when an entity has a history of allowing customers to exceed their contractually set credit limits on their overdrafts and other revolving credit facilities.

The ITG reaffirmed that the exception to the contractual terms in IFRS 9 is specific to the contractual period and could not be extended to the contractual credit limit.

However, a number of ITG members noted that the requirements of the standard will result in differences between credit risk management practices and accounting. In addition, it is not always clear what the 'contractual limit' is, for example when a revolving credit contract does not have a limit. The IASB staff agreed to discuss these points with the Board.

Topics discussed with no further action expected

Significant increases in credit risk

The ITG discussed how an entity should determine whether there has been a significant increase in credit risk in two particular scenarios:

(a) a portfolio of loans where identical pricing and contractual terms are applied to customers across broad credit quality bands, for example, most retail loans; and
(b) whether an entity can use behavioural indicators of credit risk as a proxy for the assessment of significant increases in credit risk since initial recognition.

The ITG agreed that if entities want to use the approach set out in Illustrative Example 6 in IFRS 9 – comparison to maximum initial credit risk – they need to ensure that the loans within the portfolio have similar initial credit risk, and that any movement in credit rating within that grouping will not significantly increase the credit risk. The ITG questioned whether a grouping of loans with credit grades 1 to 5 on a 10 grade scale would meet that requirement.

When using behavioural information, entities will have to demonstrate it is a proxy for a significant increase in credit risk. Behavioural information is usually based on historical information while IFRS 9 requires the use of forward-looking information. Entities should ensure that any proxy includes all reasonable and supportable information including forward-looking information.

Use of changes in the risk of a default occurring over the next 12 months when assessing for changes in the lifetime risk of a default

The ITG was asked for their views on whether and to what extent an entity would be required to perform an annual review to determine whether circumstances still support the use of a 12-month approximation of changes in the lifetime risk of default occurring.

Entities will need to perform appropriate analysis before concluding that changes in the risk of a default occurring over the next 12 months can be used as an approximation of changes in the lifetime risk of default occurring. At each reporting date, entities would need to consider whether there was any change in circumstances which would indicate that a lifetime assessment is necessary.

Forward-looking information

The paper asked the ITG for their views on:

(a) whether forward-looking information should be incorporated into impairment reviews differently; for example, on a portfolio by portfolio basis and/or on an entity basis (for macroeconomic information); and
(b) how to determine what is 'reasonable and supportable' forward-looking information about emerging issues and uncertain future events to include in the measurement of expected credit losses.

All available information should be considered by an entity to determine whether it is relevant and should be taken into account. Events which management believe will affect the assessment of the credit risk need to be taken into account even if there is a low likelihood of the event occurring.

However, where an entity views the outcome of an event, in the context of whether it affects the assessment of credit risk, as speculative in nature and having little or no basis, then the entity should not take this event into account in its expected credit loss assessment.

The ITG concluded that entities would need appropriate governance and controls around their processes for considering what events should and should not be considered. This includes documenting the rational for their decisions and including appropriate disclosure in the financial statements.

Guidance of Basel Committee on Banking Supervision on expected credit loss

The guidance is aimed at the internationally active banks using the IRB approach. It will consider materiality, individual and collective allowances, significant increase in credit risk, use of expert judgement, measurement uncertainty and forward-looking information. The guidance will limit the use of practical expedients and will not introduce new disclosure requirements. The final document is expected to be issued before the end of 2015.

What's next?

The next ITG meeting is scheduled for December 2015. There are no meetings scheduled after that date. However the ITG will stand ready to receive and discuss relevant issues in 2016 should the need arise.

IASB proposes deferral of effective date of amendments to IFRS 10 and IAS 28

The IASB has proposed to indefinitely defer the date when entities must change some aspects of how they account for transactions between investors and associates or joint ventures. This means that diversity in practice will remain until the IASB has finalised its equity accounting projects. Tatiana Geykhman from Accounting Consulting Services looks into the implications.

The IASB decided in July to indefinitely defer the 'Sale or contribution of assets between an investor and its associate or Joint Venture' amendment to IAS 28 and IFRS 10. The related question was instead added to the equity method research project. At the same time, early adoption of the amendments is permitted.

What has happened before?

In September 2014 the IASB issued a narrow-scope amendment to IAS 28 and IFRS 10 that was intended to resolve a current inconsistency between the two standards. Based on the amendment, full gain or loss would be recognised by the investor where the non-monetary assets contributed constitute a 'business'. If the assets do not meet the definition of a business, the gain or loss would only be recognised by the investor to the extent of the other investors' interests, i.e. partial gain or loss recognition.

The amendments would only have applied when an investor sells or contributes assets to its associate or joint venture.

In January 2015 the IASB discussed an unintended consequence of this amendment; IAS 28 requires that an entity should recognise as income any excess of the fair value of the net assets of an acquired associate (or JV) over the cost of that associate (or JV) on initial acquisition. Applying these requirements in the limited circumstances described would result in a re-recognition of the gain eliminated by the September 2014 amendments as income.

The IASB thus decided in January 2015 to amend IFRS 10 to explain that, in these limited circumstances, the cost on initial recognition of the retained investment is the fair value of that investment, and any gains or losses to be eliminated are a subsequent adjustment. This is intended to prevent a reversal of the partial elimination of the gain.

In June 2015 the IASB decided to suspend work on the new amendment and instead address these issues as part of the research project on the equity method of accounting. As a result the IASB proposed indefinite deferral of the application date of the September 2014 amendments.

The implications

Whilst the guidance is not finalised, the affected entities could continue applying an accounting policy choice. Where the non-monetary assets sold or transferred to its associate or joint venture constitute a 'business', entities could either recognise full gain or loss on the sale or transfer, or the gain or loss only to the extent of the other investors' interests, i.e. partially. The policy chosen should be applied to all other similar transactions.

Has the IASB driven the extensive use of fair value?

Anna Schweizer from Accounting Consulting Services takes a closer look at findings from Prof. Christopher Nobes' recent research.

Christopher Nobes is professor of accounting at Royal Holloway (University of London) and the University of Sydney. He was a member of the Board of the IASB's predecessor, the IASC. Professor Nobes researches the nature and causes of international differences in financial reporting. In this article we take a closer look at his research around the use of fair value in IFRS.

Has the IASB extended FV accounting?

One often reads in the financial or academic press that IFRS requires extensive use of fair value and that the IASB is inexorably moving towards fair value (FV). Professor Nobes has exploded this myth.

The IASB is now in its fifteenth year and has issued 15 new standards (IFRS 1 to IFRS 15). How many of these introduce the FV basis, that is, consistent measurement at FV? None.

The IASB has also amended many of the old IASs, but none of these amendments has introduced or extended the fair value basis.

Apart from IAS 39, the FV basis is required only for few and specific purposes by pre-IASB standards, such as for biological assets and pension funds. The FV basis is *allowed* for many other non-current assets but closer inspection reveals that it is largely confined to the financial sector and to property rather than all PPE. In conclusion, most companies do not use the FV basis for assets or liabilities shown in their balance sheets, except for financial instruments, and then for only a small proportion of them.

One-off use of FV (as opposed to the FV basis) is sometimes used to estimate 'cost' for initial recognition, e.g. assets acquired in a business combination. We were already doing this for decades before IFRS.

Some version of FV is also used as one of the ways of measuring loss of value of assets under IAS 36 and IFRS 5. However, of course, this is only for writing assets *down*, and is really part of prudence, of which opponents of FV approve.

Conclusions

The FV basis is used for a substantial portion of assets by financial companies. However, for a large proportion of IFRS-using entities, the FV basis is confined to a very small minority of their assets: a small proportion of their financial assets. When FV is used, it is often to help determine initial cost when there is no sensible alternative, or to measure loss of value in specific assets.

Thus, extensive use of the FV basis under IFRS is a myth. Read more in Chris Nobes' blog.

Have you seen the latest PwC IFRS blogs?

Irina Sedelnikova asks why insurers want to defer adoption of IFRS 9

Christopher Nobes questions whether the IASB is really hell-bent on introducing fair value

Insurance contracts

A summary of the IASB's recent tentative decisions relating to the new standard for insurance contracts.

The IASB continued deliberations on contracts with participation features.

Disaggregating changes arising from changes in market variables in the statement of comprehensive income

Presentation of changes arising from changes in market variables

For all insurance contracts, an entity should present changes in estimates of the amount of cash flows that result from changes in market variables in the same location in the statement of comprehensive income consistently with the changes in discount rates.

The standard will specify objective rather than detailed mechanics for using the cost measurement basis

The forthcoming standard will specify that the objective of disaggregating changes in the insurance contract arising from changes in market variables between profit or loss and other comprehensive income is to present an insurance investment expense in profit or loss using a cost measurement basis. The standard would not include detailed mechanics, but only require that the cost measurement basis should result in an allocation of the yield over the life of the contract on a systematic basis. An entity could also opt for a FVPL approach as an accounting policy choice.

Modification of the objective for contracts with no economic mismatches

The IASB voted to allow the "current period book yield approach" for contracts that meet the direct participation criteria, and where the entity is eitherrequired to hold the underlying items or hols them by choice. This approach was described as a "modified objective" from the cost basis approach. An entity could also opt for a FVPL approach as an accounting policy choice.

Changing approaches

The IASB tentatively decided upon transition requirements when an entity is required to change between the effective yield approach and the current book yield approach.

Transition requirements

When on transition retrospective application is impracticable, the IASB have tentatively decided upon several measures to simplify the approach determining the insurance investment expense.

Avoiding accounting mismatches arising from use of the variable fee approach combined with hedging activities

If an entity uses the variable fee approach and a derivative measured at FVPL to mitigate the financial market risk from the guarantee embedded in the insurance contract, the entity would be permitted to recognise in profit or loss the changes in the value of the guarantee, determined using fulfilment cash flows. Furthermore, the IASB tentatively decided upon the conditions for applying this approach and the documentation requirements.

Next steps

The IASB expects to complete its deliberations on insurance contracts in 2015 and draft the standard in 2016 with a goal of issueing the final standard in 2016 or early 2017.

Cannon Street Press

Insurance contracts: IFRS 9 and IFRS 4

The IASB continued discussions on the possible accounting consequences of the different effective dates of IFRS 9 *Financial Instruments* and the new insurance contracts standard. The IASB voted (based on the chairman's casting vote) to issue an exposure draft in late 2015 to amend IFRS 4 to give entities whose business model is to predominantly issue insurance contracts the option to defer the effective date of IFRS 9 until 2021 (the 'deferral approach').

The IASB tentatively decided that applying the deferral approach would be permitted for entities with predominantly insurance activities which would be assessed at the reporting entity level. The IASB tentatively decided not to include quantitative thresholds in the standard, but include an example in the Basis of Conclusions with a threshold for IFRS 4 liabilities that would be somewhat higher than 67%. The deferral approach would apply to all financial assets. At each reporting date a reassessment would be required.

Alternatively, an entity could implement IFRS 9, but opt to remove from profit or loss some of the accounting mismatches and temporarily volatility that could occur before the new insurance contracts standard is implemented (the 'overlay approach'). The IASB further tentatively decided on redesignation of financial assets, transition and on presentation and disclosure requirements.

Disclosure Initiative

Principles of Disclosure

The IASB continued to discuss a new approach for drafting disclosure requirements in standards. The IASB agreed with the refined version of the proposed approach and tentatively decided to include the draft chapter presented in the Principles of Disclosure DP.

Reconciliation of liabilities arising from financing activities

The IASB discussed feedback to the ED and tentatively decided to proceed with the amendment to IAS 7 as proposed in the ED subject to clarifying in the standard the objective for the disclosure requirement and that an entity has flexibility to determine what information is needed and to what extent.

Cash restrictions

The IASB started discussion of the proposals for consideration and will continue deliberations at its next meeting

Revenue from contracts with customers

The IASB discussed an implementation question relating to the transition requirements in IFRS 15 and decided not to propose any amendments.

Research programme

The IASB discussed the current research programme. Initial preparatory work has now commenced on the project on primary financial statements. However, the staff noted it would be several months before plans for this project can be discussed by the IASB.

Financial Instruments with characteristics of equity

The IASB discussed an analysis and possible improvements of the existing definitions and other related requirements in IAS 32. The IASB will continue its discussion at a future meeting.

IFRS Rejections in short - IAS 8

Chen Wu of Global Accounting Consulting Services examines the practical implications of IFRIC rejections related to IAS 8.

Looking for an answer? Maybe it was already addressed by the experts.

The Interpretations Committee (IC) regularly considers anywhere up to 20 issues at its periodic meetings. A very small percentage of the issues discussed result in an interpretation. Many issues are rejected; some go on to become an improvement or a narrow scope amendment. The issues that are not taken on to the agenda end up as 'IFRIC rejections', known in the accounting trade as 'not an IFRIC' or NIFRICs. The NIFRICs are codified (since 2002) and included in the 'green book' of standards published by the IASB although they technically have no standing in the authoritative literature. This series covers what you need to know about issues that have been 'rejected' by the IC. We go standard by standard and continue with IAS 8 as per below.

IAS 8 deals with accounting policies, changes in accounting estimates, and errors. One would think this is an area where preparers and auditors might have raised numerous questions. However, this is apparently not the case.

There are only two IAS 8 NIFRICs. One relates to the application of the IAS 8 'impracticability exception' in the context of first time adoption and the other relates to the application of the IAS 8 hierarchy when developing accounting policies.

Application of IAS 8 'impracticability exception' for first time adopters (October 2004)

IAS 8 provides an 'impracticability exception' which allows entities to deviate from the full retrospective application of the new accounting policy if it is impracticable to determine the prior year effects caused by the accounting policy change.

The IC was asked whether this 'impracticability exception' should also apply to first time adopters under IFRS 1. The IC agreed that there were potential issues, especially with respect to 'old' items. For example, data may not have been collected in prior periods for long-lived assets in a way that allows the retrospective application of a new accounting policy, and it may be impractical to recreate the information.

However, the IC believed those issues could usually be resolved by using one of the transition options available under IFRS 1. For example, IFRS 1 allows the first-time adopter to assess whether or not an arrangement contains a lease to be carried out at the date of the transition based on the facts at that date instead of at the inception of the arrangement, which would be required in the full retrospective adoption of IFRIC 4.

Application of IAS 8 hierarchy (January 2011)

Where there is no standard or interpretation that specifically applies to a transaction, IAS 8 requires management to use its judgment to develop and apply an accounting policy that is relevant and reliable. The hierarchy suggested in IAS 8 is:

a) Applying the requirements in IFRSs dealing with similar and related issues;
b) Applying the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework.
c) Considering the most recent pronouncements of other standard-setting bodies that use a similar framework, other accounting literature and accepted industry practices, to the extent these do not conflict with the IFRS sources.

The submission to the IC questioned the appropriateness of applying only certain aspects of the IFRS standard being applied by analogy. For example, if management refers to IFRS 3 when developing the accounting policy for business combinations between entities under common control, can it apply only the requirement to measure net identifiable assets at fair value but not the requirement to recognise in earnings any gain or loss relating to a previously held equity interest?

The IC rejected this issue as it felt that the current guidance is sufficient. The IC concluded that when analogising to an IFRS dealing with similar and related matters, management should use its judgment in applying all aspects of the IFRS that are applicable to the particular issue.

Summary of IAS 8 rejections

Topic	Summary conclusion
Application of IAS 8 ‘impracticability exception’ under IFRS 1 (October 2004)	The IC was asked whether the IAS 8 ‘impracticability exception’ should also apply to first time adopters. The IFRIC agreed that there were potential issues, especially with respect to “old” items. However, the IC felt that those issues could usually be resolved by using one of the transition options available under IFRS 1.
Application of IAS 8 hierarchy (January 2011)	The IC concluded that when analogising to an IFRS dealing with similar and related matters, management should use its judgment in determining which aspects of the IFRS that are applicable to the particular issue.

P * Q

Yet again, you might want to mind your p’s and q’s,

The IASB is still developing its own views.

What does all this really mean?

That still remains to be seen.

Let’s remember that when looking at a fair value measure,

Control premium is something many preparers treasure.

So should fair value be P*Q?

Ignore premiums/ discounts, that's one view.

The Board is still locked in a debate -

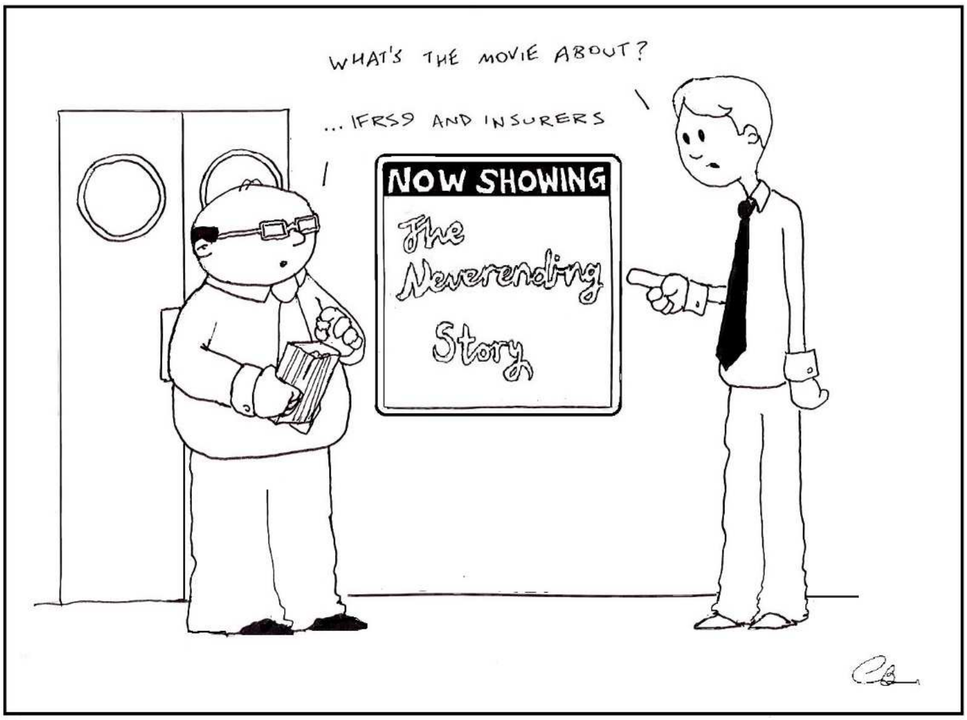
How do share price and quantity relate?

Watch this space because there might be a change

To value investments listed on a stock exchange.

by Ruth Preedy

The bit at the back.....



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