IFRS news

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IASB issues ED amending IAS 19

The IASB has issued an exposure draft that proposes amendments to the discount rate for currencies where there is no deep market in high-quality corporate bonds

What is the issue?

The gap between yields on government bonds and high-quality corporate bonds has widened significantly in the last 12-18 months. The yields on government bonds fell, while corporate bond yields rose in some territories. IAS 19, 'Employee benefits', currently requires employee benefit obligations to be discounted using a rate based on the yield on high-quality corporate bonds in territories where there is a deep market in such bonds. The yield on government bonds is used where there is no deep market in high-quality corporate bonds.

The IASB has concluded that a distinction, based on whether or not there is a deep market in high-quality corporate bonds, creates a distortion between markets. For example, there is a deep market in high-quality corporate bonds in Europe only in sterling and euros. Companies based in the EU outside the eurozone and the UK are required to use discount rates that are currently much lower than those used by companies in the eurozone and the UK. The IASB has decided to fast-track an amendment that will remove this distinction and instead require the use of a high-quality corporate bond rate, even where such a rate is not observable and must be estimated. The discount rate will be estimated using observable inputs in the same way as the fair value of financial instruments.

The proposed amendment is expected to be implemented before 31 December 2009 and to allow but not require adoption in the current year. The transition provisions in the exposure draft are not clear, but the intention appears to be to require prospective application from the start of the year of adoption, with an adjustment to retained earnings and the balance sheet when the defined benefit obligation is adjusted for the change in the discount rate

Am I affected?

This change will affect companies applying IAS 19 in territories where there is no deep market in high-quality corporate bonds, including for example Sweden, Norway, Australia, South Africa and Hong Kong. The amendment will reduce post-employment benefit obligations in those territories, so it is likely that some companies will want to early adopt the changes.

What do I need to do?

The comment deadline of 30 September gives very little time for comment. Entities, particularly those that may wish to early-adopt the amendment, should consider this exposure draft to allow themselves time to comment on the proposals and plan the actuarial work that will be required to implement the changes.

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Radical changes for the energy industry?

What is the issue?

There is little guidance on the accounting for exploration, development and production of minerals and oil and gas in current IFRS. The Extractive Activities Discussion Paper (DP), published in draft form on 10 August 2009, is the first step towards an IFRS for these activities.

The draft DP considers the financial reporting issues for extractive activities and provides views on:

- The definitions of reserves and resources for financial reporting purposes.
- The basis for recognising mineral and oil and gas assets.
- Initial and subsequent measurement of mineral and oil and gas assets.
- Disclosures.

The final DP will be published formally by the IASB in Quarter 1, 2010, with an invitation to comment. Publishing a DP in draft form is an unusual step, and it is not clear whether or how much the recommendations may change prior to formal publication, as the IASB has yet to review it.

The key recommendations in the draft DP are:

- A single financial reporting model for mining and oil and gas activities. The main business activities (ie, exploration, evaluation, development and production) and the risks and uncertainties are very similar for both industries.
- Reserves and resources definitions for financial reporting should be the definitions of the Committee for Mineral Reserves International Reporting Standards and the equivalent definitions of the Society of Petroleum Engineers.
- Mineral and oil and gas assets are recognised when a legal right to explore is acquired. Information gained from exploration and evaluation activities, as well as development activities, represent enhancement of the exploration/reserves and resources asset.
  - The level of detail/aggregation at which assets are recognised and presented (known as the ‘unit of account’) is initially the geographical area of the exploration right. This is refined over time as exploration and development plans are developed, ultimately resulting in one or more units of account, generally at the level of the individual mine or field.
  - The components approach used for property, plant and equipment is applicable for the components of a mineral or oil and gas asset.
- Mineral and oil and gas assets are measured at historical cost, supplemented by disclosure of volume and current value of reserves. The historical cost recommendation was driven by:
  - Views of analysts, suggesting that current values included in financial statements would be used primarily as a comparison for the analysts’ own current value calculations; and
  - Cost/benefit concerns from preparers that fair values would not provide sufficient benefits to users. The use of standardised measures to determine a current value other than fair value addresses some of these concerns but is less likely to be relevant to a user’s understanding of the entity’s net future cash inflows.
- Detailed disclosures in the financial statements of:
  - Reserve quantities, by commodity, and by country or project (where material) including:
    - Proved reserves and proved and probable reserves.
    - Estimation methods and assumptions.
    - Sensitivity analysis to the main economic assumptions (for example, price assumptions and exchange rate assumptions).
    - Reconciliation of changes in reserve quantities.
  - Either current value or fair value measurement of proved and probable reserves, by major geographical region:
    - Standardised measure or fair value estimate.
    - Preparation basis and assumptions.
    - Sensitivity analysis.
    - Reconciliation of changes in reserve values.
  - Production revenues by commodity.
  - Costs, disaggregated in the same way as reserve quantities, with a five-year track record, of:
    - Exploration costs.
    - Development costs.
    - Production costs.
- Scoped out of the project are issues common to other industries, such as revenue recognition, inventory valuation, decommissioning obligations and joint arrangements.

The DP also considers the proposals from the Publish What You Pay (PWYP) campaign. PWYP is a global civil society coalition that campaigns for the mandatory disclosure of company payments and government revenues from the oil, gas and mining sector. The PWYP proposals suggest similar disclosure as above but generally in more detail and on a country-by-country basis. They also propose country-by-country disclosure of all payments to governments (for example, income taxes and royalties). The project team’s proposals involve the use of materiality to determine what disclosures should be presented. However, the project team recognises that some of the additional disclosures proposed by PWYP may be important for making informed investment and lending decisions. They suggest further study to see if additional disclosures meet the cost-benefit test, in particular country-by-country disclosure of payments to governments.

Am I affected?

The project team's draft recommendations, if carried through to an IFRS, may have a far-reaching impact. The recommendations will affect all stages of upstream mining and oil and gas; from capitalisation of exploration costs, through to detailed disclosure of proved and probable reserve volumes and values on a disaggregated basis.

What do I need to do?

The draft discussion paper is available now. The formal publication, with invitation to comment, is expected in Quarter 1 2010, with a six-month comment period. This provides approximately only 12 months to analyse and digest the recommendations, to assess the practical consequences and respond to the IASB's recommendations. Now is the time to start to explore the impact on your business with your local PricewaterhouseCoopers extractive industries specialist.

IASB issues exposure draft of 2010 annual improvements to IFRSs

What is the issue?

Each year the IASB seeks to improve IFRSs through consultation with users. Amendments this year are proposed to 10 standards and one IFRIC: IFRS 1, IFRS 3, IFRS 5, IFRS 7, IAS 1, IAS 8, IAS 27, IAS 28, IAS 34 and IAS 40, and IFRIC 13. The amendments application dates vary, from 'when approved', 1 July 2010 or 1 January 2011.

Am I affected?

These are seemingly minor changes. However, if you are affected, the change could be significant. Please read the improvements exposure draft with close attention.

- **IFRS 1** – A first-time adopter that changes its accounting policies or its use of exemptions in IFRS 1 after it has published its interim financial information in accordance with IAS 34 should explain those changes and include them in its opening reconciliations in their year-end reporting.
- **IFRS 1** – The exemption to use a 'deemed cost' arising from a revaluation that was triggered by an event such as a privatisation that occurred at or before the date of transition to IFRS will be extended to revaluations occurring in all periods covered by the first IFRS financial statements.
- **IFRS 3** – The choice of measuring non-controlling interests at fair value or at the proportionate share of the acquiree's net assets will apply only to instruments that are entitled to a share of the net assets. If not entitled, the instruments should be measured at fair value.
- **IFRS 3** – The application guidance in IFRS will apply to all share-based payment transactions that are part of a business combination.
- **IFRS 5** – An entity classifies its interest in an associate or a jointly controlled entity as held for sale when it is committed to a sale plan involving loss of significant influence or joint control.
- **IFRS 7** – The Board proposes seven small changes/ clarifications for the disclosure of financial instruments.
- **IAS 1** – The components of the changes in equity do not need to be in both the statement of changes in equity and in the notes. Once is enough!
- **IAS 8** – Changes only in the terminology.
- **IAS 27** – An investor is to apply the IAS 39 impairment provisions when testing its own investments; the consequential amendments to IAS 21, IAS 28 and IAS 31 as a result of IFRS 3 (2008) will require prospective application.
- **IAS 28** – Different measurement bases can be applied to portions of an investment in an associate if on initial recognition part of it was designated as at fair value through the income statement.
- **IAS 34** – IAS 34 will change, to cover 'significant events and transactions', instead of 'selected explanatory notes.' This will involve significant changes, including updating the equivalent information from the last annual report. Other changes include some IFRS 7 disclosures being mandated.
- **IAS 40** – Investment property being developed for sale will have a new heading in the statement of financial position. It will no longer be carried in inventory.
- **IFRIC 13** – The meaning of the term 'fair value' is clarified.

What do I need to do?

The Board is seeking comments by 24 November 2009 and we encourage you to reply. The IASB asks respondents to send their comments electronically to the IASB website (www.iasb.org) using the 'Open to Comments' page.

Proposed IFRIC interpretation on the accounting for 'debt for equity swaps'

What is the issue?

The IFRIC issued a proposed interpretation, D25, 'Extinguishing financial liabilities with equity instruments', last month to clarify the accounting for a debtor issuing own equity instruments to the creditor to extinguish a liability (referred to as a 'debt for equity swap').

There is diversity in practice in the accounting for such transactions, and the issues are becoming more common in the current economic environment. Some entities recognise the equity instrument at the carrying amount of the financial liability and do not recognise any gain or loss in profit or loss. Others recognise the equity instruments at the fair value of equity instruments issued and recognise any difference between that amount and the carrying amount of the financial liability in profit or loss.

Am I affected?

The proposal affects all entities that enter into debt for equity swap transactions (in full or partial settlement of a financial liability). It does not impact the creditor's accounting, nor does it change the guidance for inducement of convertible bonds.

What is the overarching proposal?

The equity shares issued to the creditor are consideration paid to extinguish the liability. A gain or loss is therefore recognised in profit or loss when the liability is settled through the issuance of the entity's own equity instruments.

What is the impact of the proposals?

Some of the implications are:

- Entities will no longer be permitted to reclassify the carrying value of the existing financial liability into equity (with no gain or loss being recognised in profit or loss).
- The amount of gain or loss recognised in profit or loss will be the difference between the carrying value of the financial liability and the fair value of the equity instruments issued or the fair value of the existing financial liability, whichever is more reliably determinable.
- The amount of the gain or loss should be separately disclosed on the face of the statement of comprehensive income or in the notes.

When should the proposed changes apply?

The effective date will be confirmed once the final standard is published. It is expected to apply retrospectively, with early adoption permitted.