Year-end Accounting Reminders

Regulatory interest and key reminders for impairment reviews

Impairment is an ongoing area of concern for many of our clients. Regulators remain focused on this area and continue to push for increased transparency in disclosures. Groups holding significant amounts of goodwill and intangibles are at greater risk of a regulatory challenge to their impairment assessments and in particular the related disclosures.

Key points in impairment testing are:

• Look out for impairment triggers (both internal and external factors). For example, when the market capitalisation of a listed entity is significantly lower than the carrying amount of its net assets.

• For the value-in-use model, which is a pre-tax model, key assumptions should stand up against external market data. Cash flow growth assumptions should be comparable with up-to-date economic forecasts.

• If an impairment review results in a 'near miss', IAS 36 requires that the value-in-use model uses pre-tax cash flows discounted using a pretax discount rate. In practice, pre-tax discount rates are not commonly available, therefore the next step is often to determine fair value less costs of disposal (FVLCD).

• The fair value model, which is a post-tax model, must use market participant assumptions, rather than those of management.

• In assessing for impairment, the carrying value should be determined on a consistent basis as the recoverable amount. For example:

- Where the recoverable amount is determined using the fair value model, the carrying amount tested should include current and deferred tax assets/liabilities (but exclude assets for tax losses, because these are treated as separate transactions).

- Where the value in use model is applied, deferred tax assets do not need to be added to the carrying value but deferred tax liabilities should not be deducted (i.e. are not included in the carrying amount of the CGU). This could result in the carrying value for value in use being higher than the carrying value for FVLCD. However, in situations where there is significant deferred tax upfront, an IAS 36 VIU test may not be the most appropriate method to determine the recoverable amount of a CGU.

The required disclosures in IAS 36 are extensive. IAS 36 requires disclosure of the key assumptions (those that the recoverable amount is most sensitive to) and related sensitivity analysis. Regulators have observed that, whilst the long-term growth rate used to extrapolate cash flow projections (to estimate a terminal value) and the pretax discount rate are important; they are not 'key assumptions' on which the cash flow projections for the period covered by the most recent budgets or forecasts are based. Therefore, attention should also be paid to the discrete growth rate assumptions applied to the cash flows projected to occur before the terminal period.

IFRS 10,'Consolidated financial statements', reminders

De facto control

With the introduction of IFRS 10 there is now clearer guidance on de facto control* compared with IAS 27. (**De facto control is the situation where an entity owning less than 50% of the voting shares in another entity that is controlled by voting rights is deemed to have control when it has the practical ability to direct the relevant activities*). However, although IFRS 10 includes specific guidance on de facto control, it remains a highly judgmental area of accounting. This is an area of focus of regulators (in particular, to ensure that the requirements are applied carefully and objectively to the particular circumstances).

Relevant activities

When an entity assesses whether it has control over an investee one of the factors it must consider is whether it has the power to direct the 'relevant activities' of that investee. IAS 27/SIC 12 did not include specific guidance on the relevant activities, but rather focussed on control over the entity's financial and operating policies. IFRS 10 defines relevant activities as "*activities of the investee that significantly affect the investee's returns*". This is the part of the assessment that is often missed but is key in assessing control.

Comparative information on transition to IFRS 10 for EU-IFRS

In the EU, IFRS 10 is endorsed from 1 January 2014). It applies from the first day of the annual period in which the standard is adopted and not from the beginning of the comparative period. Therefore, for an EU entity with a 31 December 2014 year end, IFRS 10 applies from 1 January 2014. Where the consolidation conclusion under IFRS 10 differs from that under IAS 27/SIC 12, the comparative period should be restated (unless the relevant interest in an entity was disposed of in the comparative period). Where restatement is required, a third statement of financial position is needed as of the beginning of the comparative period. [**IFRS 10 App C para C3, C4**].

Adjusted comparative information should only be presented for the annual period immediately preceding the first annual period for which IFRS 10 is applied.

IFRS 12, 'Disclosure of interests in other entities', practical application issues

Significant judgments and assumptions

IFRS 12 specifically requires disclosure of significant judgments and assumptions the entity has made (and changes to those judgments and assumptions) in determining that it has control, joint control or significant influence over an investee. Examples include situations when an entity holds more than 50% of the voting rights but concluded that it does not have control, or, in contrast, when an entity has de-facto control. This is one of the focus areas of the regulators.

How should an entity determine whether NCI in a subsidiary is material for the purposes of IFRS 12 disclosures?

The assessment of materiality will depend upon the specific facts and circumstances, but it is likely that it would be appropriate to assess the materiality of NCI based on gross assets and liabilities. The objective of IFRS 12 is to enable users to understand the interests that NCI has in the group's activities, for example, cash flows that are not accessible to the parent. This objective may not be met if the assessment of materiality is performed on a net asset basis, particularly where a subsidiary has low net assets comprised of large amounts of assets and liabilities.

Where there is a subgroup and there is NCI within the subgroup's parent company, how should an entity determine whether that NCI is material?

In our view the assessment should be performed based on the share that the NCI has in the entire sub-group. The financial performance and position of the entire sub-group will be consolidated within the reporting entity and the share of the NCI in the parent of the sub-group will also extend to the rest of the subgroup. It would be therefore appropriate to perform the materiality assessment on this basis. The IFRS IC confirmed in January 2015 that judgement should be applied in determining whether the summarized financial information about the sub-group of the subsidiary that has material NCI should be based on the consolidated financial information of the sub-group (information of the subsidiary together with its investees) or disaggregated further to present information about individual subsidiaries that have material NCIs within that subgroup.

Disclosure of summarized financial information about material joint ventures and associates

Paragraph 21(b) (ii) of IFRS 12 requires the disclosure of summarized information on an individual basis for each joint venture or associate that is material to the reporting entity. This information should be 100% of the joint venture or associate's results as reported in its IFRS financial statements, not the entity's share of those amounts. [IFRS 12 para B14]. The IFRS IC confirmed in January 2015 that there is no provision in IFRS 12 that permits nondisclosure of this information.