IFRS news

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Behind the Scenes at the Interpretations Committee

Satenik Vanyan, PwC Consultant on secondment at the IASB, gives a behind the scenes tour of the Interpretations committee (IC).

Before I started my secondment at the IASB I had little knowledge about the IC. I knew about IFRIC agenda decisions that sometimes create panic amongst preparers if the guidance is not in line with their policies! However, I didn't know how the IC operates, its members, how and what kind of decisions the IC makes, etc. 6 months into my secondment, I know more.

The IC is composed of 14 members from around the world. It includes preparers, auditors, investors and academics. The IC meetings take place 6 times a year. Meetings are also attended by observers who are IFRS Board members and securities and prudential regulators.

All IC discussions start with a question from a submitter. Any individual or organisation can submit a question. The IC is not a technical helpdesk and it will only consider submissions that meet specific criteria outlined in the Due Process Handbook. For example, whether the issue is widespread and has a material effect on those affected. The IC's resources should be used efficiently to solve problems that really matter and lead to better accounting.

All submissions are discussed in public meetings. The Committee then decides whether to add a standard-setting project to its agenda to address the question. The IC will either develop an Interpretation or recommend that the Board issues a Narrow-scope amendment to the standard. Narrow-scope amendments change the existing requirements whereas Interpretation adds to those requirements. Some of the most recently issued Interpretations and amendments that started as an IC submission are IFRIC 23 Uncertainty over Income Tax Treatments, and the amendment to IAS 40 that clarifies the principle for transfers to/from Investment Property.

Quite often the IC decides that no change to the Standards is needed and publishes an Agenda Decision. This is educational material that explains which requirements in the Standards apply to the question, set out the approach companies need to take to answer the question and can sometimes highlight relevant disclosure requirements. Agenda decisions have a peculiar status. Unlike Interpretations they are non-authoritative, they are not part of the existing standards and are not mandatory. Nonetheless, enforcers in many jurisdictions expect entities to apply accounting policies in line with explanatory material in these decisions. This can create issues for entities. The Board has started a project to amend IAS 8 to address this. You can follow the progress of the project on the IASB website here.

One of the perceptions that people have of the IC is that it's slow in making decisions. From behind the scenes I see the IC's processes are a fine balancing act. Stakeholders have always indicated their desire to be involved in the standard setting processes, to be consulted. Therefore the Due Process Handbook that governs the IC procedures includes extensive consultations along the process. For example, when a submission is received the staff often performs an outreach with various stakeholders, including regulators, standard setters and the accounting firms to try to understand how widespread the issue is and what is the prevailing accounting treatment in each jurisdiction. The time period for the outreach is normally 3 weeks. If after the IC meeting an agenda decision is issued, it's a tentative agenda decision that is open for public comments for 60 days. Then the staff needs time to analyse those comments, to make sure none of them are left out and come up with a recommendation for the IC. People, as always, want to have a say in the process and they want to get quick answers. You can't have it all!

Quite often we hear that IC is unresponsive. There is a perception that if no standard-setting is proposed then it means that IC is not being helpful. However, not many people realise the costs associated with standard-setting. And it's not just the time of the IASB staff and the Board. Importantly, there is a cost for stakeholders in commenting on proposals, endorsing and putting into legislation and ultimately there is a cost for companies in implementing the changes and all this in more than 100 countries around the world.

Behind the scenes at the IC is an interesting place to be. The immense work that goes into balancing different views from any number of people around the world has impressed me. Standard setting requires a public process and does take time but ultimately it leads to high quality financial reporting.

IFRS 16 - How To Guide

In this new series of articles we'll explain how to implement IFRS 16; Sharing practical tips and insights to help identify issues and focus your transition effort. In this article, Richard Brown, explains how to get started.

By now you're probably familiar with IFRS 16's headline change; lessees will recognise a lease liability, and a right-of-use asset for almost all leases.

You can estimate the size of your lease liability at a high level by taking your operating lease commitments and discounting the cash flows. This is comparable to what many users of the financial statements already do this.

Understanding the other changes to your financial statements, and actually implementing it in practice, need a little more work. Throughout this new series, we'll share practical tips and insights about identifying issues and where to focus during your transition to IFRS 16.

Why do you need to get started now?

All the usual reasons that we suggest starting early for any new accounting standard- it's a big project, it takes time, there's complexity etc. Many companies are already working on IFRS 16 because of how material it will be for them. The significance in many industries means it's getting attention from audit committees, regulators and in lease negotiations.

The headline change is liabilities going on the lessee's balance sheet. The other big change for lessees is that they will recognise more expense earlier in a lease. The depreciation of the right-of-use asset will typically be the same in each period but the interest will be front-loaded because the liability is bigger at the start of the lease.

This front-loading is for each individual lease so overall lease expense may be more volatile. For example, when you enter key long-term leases your lease liabilities will increase overnight and your lease expenses will be higher in the next few years. A balanced portfolio of leases may mitigate this volatility. It's something you'll need to forecast and understand now so you have time to reshape your portfolio, or set clear performance expectations, before IFRS 16 arrives.

How long do you have?

Just over a year - IFRS 16 is mandatory for periods beginning on or after 1 January 2019. If you choose the fully retrospective transition option, you would also restate the comparatives. We'll cover transition options in detail in another installment.

Who should you be involving?

The PwC/CBRE 2017 lease accounting survey found that 66% of companies have already formed a working group. Given the significant changes you should consider involving:

- Investor relations - what are your external stakeholders expecting?
- Treasury - how will the lease liabilities affect your debt covenants and future financing?
- Procurement - does this change lease ***vs*** buy decisions?
- Remuneration - do you need to adjust targets for long-term incentives?
- Tax departments - do the new requirements have any tax implications?

What next?

Next we'll explain how to identify all your leases and then over the coming months we'll move on to what you should look for in leases which include other services (e.g. real estate) and that to consider when selecting a system to monitor and account for your leases.

For more information please see the IFRS 16 page of our website pwc.com/ifrs

You might also find our range of videos helpful.

Scene 6, Take 1: Demystifying IFRS 9 for Corporates: Hedge accounting optional deferral

Sandra Thompson, Global Financial Instruments leader, explains that even though keeping your IAS 39 hedge accounting might sound easier, there's more to consider.

LIGHTS, CAMERA, ACTION!

Dear Corporate,

IFRS 9 becomes mandatory for 2018. But companies can choose whether to adopt its new hedge accounting requirements along with the rest of IFRS 9, or keep their hedge accounting under IAS 39. This is an 'all or nothing' choice – a company must either move all of its hedge accounting to IFRS 9, or must continue to apply IAS 39 to all of its hedges. All entities have this choice and it applies to all of their hedges but it is limited to hedge accounting; the other parts of IFRS 9 have to be adopted for 2018 regardless.

Keeping IAS 39 hedge accounting might sound easier (particularly in a year when companies also have to adopt IFRS 15, the new revenue standard) but we'll explain what companies should consider before deciding.

What work is involved to adopt IFRS 9 hedge accounting?

There is some work to adopt IFRS 9 hedge accounting. For example, even a corporate that has only a few simple hedges for which it applies hedge accounting under IAS 39 will need to update the hedge documentation to be IFRS 9 complaint. Companies will also need to include the time value of money when measuring any ineffectiveness, so companies that have not done this under IAS 39 will need to make a change. But for simple hedges, this work shouldn't be too onerous.

For more complex hedges, there may be more work to do. However, this will generally be in order to obtain one or more of the benefits of IFRS 9's revised hedge accounting requirements (the biggest of which are noted below) – and indeed may mean that the company can now obtain hedge accounting in cases where it was unable to under IAS 39.

What work is involved even if you don't adopt IFRS 9 hedge accounting?

A company that chooses to keep their IAS 39 hedge accounting will nevertheless need to give the new IFRS 9 disclosures. These complement the IFRS 9 hedge accounting requirements. For example the new disclosures include the company's risk management strategy, how it determines that there is an economic relationship and how it establishes the hedge ratio for each kind of hedge. But these are similar to what needs to be included in the hedge documentation under IFRS 9. This means that much of the work needed to comply with IFRS 9 hedge accounting will be required anyway for the new disclosures, even if the company chooses to keep IAS 39 hedge accounting. So the incremental effort needed to move to IFRS 9 hedge accounting may be small.

What are the benefits of adopting IFRS 9 hedge accounting?

The IASB's main objective in revising IAS 39's hedge accounting requirements was to make it easier for economic hedges to qualify for hedge accounting. For example,

- The 80-125% 'bright line' effectiveness test is replaced with a requirement that there is an economic relationship. This removes a key reason why some hedge relationships fail to get hedge accounting today
- Companies can designate more risk components and 'layers' of groups of items.
- Hedging with options, cross currency swaps and forwards can lead to less volatility in the income statement

It is more likely, under IFRS 9, that where a hedge is economically effective the accounting will reflect this. This is important for three reasons:

- IFRS 9 is a significant opportunity for corporates to get their accounting more in line with how they manage risk.

- IFRS 9 is a chance for companies to reassess their hedging strategies. Past strategies that were rejected because they gave rise to income statement volatility might now be used. Adopting IFRS 9 could impact risk management and not be 'just' an accounting change.
- IFRS 9 will enable companies to 'tell the risk management story' better. Investors increasingly focus on risk and how it is managed so this is a key part of any company's communication strategy.

Conclusion

– There will be some extra work to adopt IFRS 9 hedge accounting so keeping your IAS 39 hedge accounting may seem easier.

– The new IFRS 9 disclosures mean that you will have to do most of the work anyway so, overall, keeping IAS 39 is unlikely to be significantly easier

– If you keep your IAS 39 hedge accounting, you will miss out on all the benefits of moving to IFRS 9 .

Check this out !! Our full range of IFRS 9 content and videos can be found here

The IFRS 15 Mole

Akemi Miura, revenue specialist, investigates how to determine whether an entity should recognise contract costs as assets under IFRS 15 with the help of the IFRS 15 Mole

Suspects

Entities often incur costs to obtain or to fulfil a contract. IFRS 15 has more guidance on accounting for these costs than existing GAAP.

IFRS 15 sets out when costs to obtain or fulfil a contract are capitalised.

Incident description - Incremental costs to obtain a contract

An entity recognises the 'incremental' costs of obtaining a contract under IFRS 15, as an asset, if it expects to recover the costs. Costs that are chargeable to the customer regardless of whether the contract is obtained are recognised as assets. Incremental costs are those costs which would not have been incurred if the contract had not been obtained.

There is a practical expedient: an entity can recognise incremental costs as an expense when the costs are incurred if the expected amortisation period is one year or less.

Facts

Case 1: Incremental costs to obtain a contract—telecommunication industry

Telecom sells mobile phones and telecom service plans from its retail store. The store's sales agents signed 120 customers to two-year service contracts in a particular month. Telecom pays its sales commissions for the sale of such contracts in addition to their salaries. The retail store also incurred some advertising costs.

The commissions paid to the sales agents are incremental costs that would not have been incurred if the contracts had not been sold. Provided the incremental costs are recoverable, they should be recognised as assets.

Other costs, including salaries and the advertising costs, should be expensed. These costs would be incurred even if the contract was not signed.

Incident description - Fulfilment costs

An entity first determines whether the costs of fulfilling a contract are within the scope of another standard (for example, inventories or PP&E). If so, then the relevant standard should be followed.

Otherwise the costs are recognised as an asset when the costs:

1) relate directly to a contract or specific anticipated contract;

2) generate or enhance resources that will be used in satisfying performance obligation in future; and

3) are expected to be recovered.

Costs that relate directly to a contract include for example direct labour, direct materials, as well as costs that are explicitly chargeable to the customer under the contract. Costs of contract management and supervision and insurance are also included, provided they are costs that are directly related to a contract.

Costs of materials that are wasted, and are not required as part of the contract should be recognised as expenses when they incurred. Such costs neither generate nor enhance resources and so do not meet the second criterion. Costs that relate to satisfied (or partially satisfied) performance obligations should also be expensed as incurred as they do not relate to future performance obligation and so again do not meet the second criterion.

Facts - Case 2: fulfilment costs—set-up costs

TechCo enters into an outsourcing contract with a customer to track and monitor payment activities for a five-year period. TechCo incurs costs at the outset of the contract consisting of uploading data and payment information which is required to perform the contract.

The ongoing tracking and monitoring is automated after customer set up.

TechCo should recognise the set-up costs incurred at the outset of the contract as an asset, because the costs:

1) relate directly to the contract;

2) enhance the resources of the entity to perform under the contract and relate to future performance; and

3) are expected to be recovered through the contractual terms

Recommendations

a) Think about whether the costs would be incurred even if the contract had not been obtained. These are incremental costs.

b) Ensure all three recognition criteria must be met to recognise fulfilment costs as assets.

Further investigations

An entity must consider what period a capitalised contract asset should be amortised over. The contract assets are subject to impairment testing. This will be covered in the next article.

Cannon Street Press

Editors choice

Changes in accounting policies arising from agenda decisions

The Board tentatively decided not to amend IAS 8 to address the time challenges for changes in accounting policies arising from agenda decisions published by the Interpretations Committee. This could put pressure on preparers' when the reporting date is close to an agenda decision publication date.

It has however tentatively decided to amend IAS 8 to explain that voluntary changes in accounting policies should be applied retrospectively unless impracticable; or the cost would outweigh the benefits for those effects. Additionally, the Board tentatively decided to provide application guidance on how an entity would assess the costs and benefits of applying a policy change retrospectively resulting from an agenda decision.

Other Highlights

IFRS Maintenance

IAS 19 and IFRIC 14 amendment

The Board decided to finalise the amendments to IAS 19 on plan amendments, curtailment or settlement. It expects to issue the amendment in December 2017 with effective date on 1 January 2019. Early application is allowed.

The Board tentatively decided to perform further work to assess whether it can establish a more principle-based approach on amendments to IFRIC 14. The Board will further consider this at a future meeting.

Annual Improvements 2015-2017

The Board tentatively decided to finalise the Annual improvements 2015-2017 process with an effective date of 1 January 2019 with earlier application permitted.

Business Combinations under common control

The staff presented the results of their research work on Business Combinations under common control. The staff research confirmed the diversity in practice in accounting for BCUCC and the need to proceed with the next steps for the project aiming to publish a discussion paper.

Primary Financial Statements

The Board tentatively decided to prioritise introducing subtotals such as EBIT in the statements of financial performance to allow comparability between entities. The Board agreed to consider introducing an investing category into the statement of financial performance.

The Board tentatively decided that the introduction of EBIT or similar subtotals and an investing category could result in additional line items to reflect the capital structure of the entity.

The Board also tentatively decided to provide additional guidance on the analysis of expenses by nature of by function.

IFRIC Rejections - IAS 39

Hannah King of Accounting Consulting Services examines the practical implications of IC rejections related to IAS 39.

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 39 as per below.

IAS 39 sets out the recognition, classification and measurement requirements for financial assets and financial liabilities. Many issues, about all aspects of IAS 39 have been submitted to the IC, resulting in roughly 40 agenda rejections. This reflects the complexity and interpretation challenges of the standard. Consequently, the IASB has replaced IAS 39 with IFRS 9. IFRS 9 comes into effect from 1 January 2018.

IFRS 9 carries forward some of the requirements from IAS 39 largely or wholly unchanged (eg derecognition and embedded derivatives for financial liabilities). The two issues below remain relevant under IFRS 9.

Accounting for embedded foreign currency derivatives in host contracts (Jan 2015)

IAS 39 (for all host contracts) and IFRS 9 (for non-financial host contracts and financial liabilities) require an embedded derivative to be separately accounted for as a derivative if it is not 'closely-related' to the host contract.

IAS 39 and IFRS 9 give an example of an embedded foreign currency derivative in a contract for the purchase or sale of a non-financial item where the price is denominated in a foreign currency. An embedded derivative is closely related to the host contract if it requires payments in the same currency in which the price of the related good or service is routinely denominated in commercial transactions around the world (the 'routinely denominated' criterion).

The IC was asked to consider whether a licence agreement (the host contract) contained an embedded foreign currency derivative that was closely related to the host contract. It was suggested that the contractual payments were denominated in a currency that meets the routinely denominated criterion based on market practice for such contracts.

The IC rejected this argument, noting that an assessment of the routinely denominated criterion is based on evidence of whether such commercial transactions are denominated in that currency around the world and not just in a local area or on market practice. The IC observed that this assessment is a matter of fact based on the available evidence.

In practice, the routinely denominated criterion is interpreted narrowly and is evidenced with reference to items that are traded (mostly on an organised exchange) in a single currency throughout the world. As a result, only a few items, such as crude oil and certain metals, would meet the routinely denominated criterion.

Effective interest method when cash flows are linked to inflation (July 2008)

Entities sometimes issue or invest in debt instruments whose payments (principal and/or interest) are linked to the change in an inflation index of the period. For those instruments that are accounted for in their entirety (ie any embedded derivatives are 'closely related' to the host contract) at amortised cost, the IC was asked to provide guidance on how to apply the effective

interest rate (EIR) method. The IC noted that paragraphs AG6 to AG8 of IAS 39 (which are identical to paras B5.4.4 to B5.4.6 of IFRS 9) provide the relevant application guidance. As such, there are two possible approaches:

- Apply the guidance in paragraph AG7 of IAS 39 (B5.4.5 of IFRS 9) for floating rate instruments that are reset to market rates of interest. Changes to the interest payments due to changes in the inflation index alters the EIR. This would normally result in no adjustment to the carrying amount of the instrument and no gain or loss.
- Applying the guidance in paragraph AG8 of IAS 39 (B5.4.6 of IFRS 9) for changes in estimates. The EIR is not adjusted due to changes in the inflation index. The instrument's carrying amount is recalculated by discounting the revised estimated cash flows using the original EIR. The resulting adjustment is recognised immediately in the income statement as a gain or loss, giving rise to more volatility than the first approach.

Judgement is required to determine which approach is most appropriate. This would be based on whether the inflation-linked instrument is considered to be economically similar to a floating-rate instrument that is reset to a market rate of interest.

The table below summarises a selection of IAS 39 NIFRICs which will still apply under IFRS 9.

Topic	Summary of the conclusion
Separation of an embedded floor from a floating rate host contract (Jan 16	The embedded derivative guidance in IAS 39 for financial assets and liabilities (and IFRS 9 for financial liabilities) applies in the same way to interest rate floors in a negative interest rate environment as to those in a positive interest rate environment. An entity should compare the overall interest rate floor for the hybrid contract to the market rate of interest for a similar instrument without the interest rate floor.
Income and expenses arising on financial instruments with a negative yield—presentation in the statement of comprehensive income (Jan 15)	The expense arising on a financial asset because of a negative effective interest rate should not be presented as interest revenue, but in an appropriate expense classification.
Accounting for embedded foreign currency derivatives in host contracts (January 2015)	An assessment of the routinely denominated criterion is based on evidence of whether such commercial transactions are denominated in that currency all around the world and not merely in one local area.
Derecognition of financial instruments upon modification (Sept 2012)	Under the restructuring of Greek government bonds (GGB), a portion of the old GGBs were exchanged for twenty new bonds with different maturities and interest rates. The IC concluded that, the old GGBs should be derecognised in their entirety, whether assessed as an extinguishment or a substantial change of the terms of the asset.
Determining the discount rate for fair value measurements of financial instruments in inactive markets (March 2009)	The IC concluded that a valuation technique that considers factors differently from the way a market participant would be expected to consider them would not be consistent with IAS 39.

Effective interest method when cash flows are linked to inflation (July 2008)	The IC noted that paragraphs AG6–AG8 of IAS 39 provide the relevant application guidance. Judgement is required to determine whether an instrument is a floating rate instrument within the scope of paragraph AG7 or an instrument within the scope of paragraph AG8.
Gaming transactions wagers received (July 2007)	The IC noted that when a gaming institution takes a position against a customer, the resulting unsettled wager is likely to meet the definition of a derivative financial instrument that should be accounted for under IAS 39. In other cases when a gaming institution provides services to manage the organisation of games between two or more gaming parties, a commission the gaming institution earns is likely to meet the definition of revenue under IAS 18.
Definition of a derivative – indexation on own EBITDA or own revenue (Nov 2006)	The IC noted that the exclusion from the definition of a derivative for a non-financial variable specific to a party to a contract does not only apply to insurance contracts. The standard is unclear as to what is meant by a non-financial variable.
Revolving structures (Nov 2005)	Revolving structures do not meet the pass through requirements in IAS 39 para 19 and therefore fail to achieve derecognition of the financial assets.
Retention of servicing rights (Nov 2005)	Retention of servicing rights by the entity transferring the financial asset does not itself cause the transfer to fail the derecognition requirements in IAS 39.
Meaning of delivery (Aug 2005)	A synthetic arrangement that results from the linking of a non-deliverable contract entered into with a customer to fix the price of a commodity with a transaction to buy or sell the commodity through an intermediary would not satisfy the paragraph 5 scope exemption in IAS 39.
Accounting for securities sold but not yet purchased (April 2005)	Entities are not given a choice of applying trade date or settlement date accounting for short positions. They must apply the recognition and derecognition requirements in IAS 39. Consequently an entity could be required to monitor its long or short position in every security that it trades to determine which accounting it is allowed to follow.

The bit at the back ...

Business combinations and adoption of IFRS

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161110-205338-RP-OS