
IFRS news

Disclosures - IASB takes on the challenge

There is a remarkable consensus in the IFRS world that we have a problem with disclosure but there is no consensus on what the problem is. John Hitchins, PwC Global Chief Accountant, provides his stance on the debate.

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It is evident that there is a problem with disclosure but there are different views on what the problem is and how to resolve it. The IASB hosted a public forum in January with both users and preparers. The discussion confirmed the consensus and tackled the issue of how to improve the usefulness and clarity of disclosures.

Too little or too much?

Preparers complain about disclosure overload pushing up the cost of financial reporting. Some regulators and users argue that there is too much irrelevant disclosure – 'clutter' – such that important disclosure gets lost amongst the trivial. Others say there is not actually enough disclosure on critical issues. Some feel that the amount of disclosure isn't the problem, it is the way it is organised and explained.

Finding a solution

Without agreement on what the problem is, it is no surprise that there is no obvious solution on the table. A cottage industry has developed in the last couple of years around producing discussion papers on the subject. The only common theme emerging from these is that we should all be braver in applying the materiality concept to disclosures. Even here, there are differences of view as to whether existing materiality guidance is sufficiently clear.

Materiality alone does not solve all the perceived problems – preparers still have to collect the data to decide whether something is material, and just reducing clutter does not necessarily make what is left any more readable or useful.

A more 'radical' idea

The debate needs to be expanded to consider more radical ideas. There has been much talk about establishing a single principle for disclosure but, so far, there has been little research into what that principle might be.

Two ideas that come to mind are:

- to disclose information that has direct predictive value for cash flows; or
- to disclose information that allows users to have an in-depth understanding of the quality of assets and claims as well as the expected timing of payments and the ultimate amount of liabilities.

Applying either would probably eliminate some disclosures; equally, it could highlight the need to expand other disclosures or introduce new ones. There is no guarantee that the amount of disclosure would reduce, but at least following a principle should help to present a more coherent set of information rather than a compliance checklist of data.

Interestingly, the first option above did come up at the IASB Discussion Forum but, apart from a disagreement among participants about how much disclosure it might eliminate, it was not really explored. This option should be explored, although we should not underestimate the difficulty in both agreeing a single principle and then agreeing how to apply it. But a more radical debate might well help in bringing closer together the different views on what the real problem is.

What is next?

The IASB Disclosure Forum concluded there are no quick fixes. This might be true but we can make short-term progress. We can establish a principle that every piece of disclosure be accompanied by an

explanation of its significance to the business. This could have two benefits:

- first, where that significance is difficult to find, it could embolden us to leave the disclosure out as not material, thus getting rid of clutter; and
- second, additional explanation would help the reader to navigate the financial statements – the ‘story’ behind the financial statements would be clearer.

The board will continue outreach on disclosures. The output from the disclosure forum will inform the IASB’s work on its Conceptual Framework. A discussion paper on the Conceptual Framework project is expected later this year. It is time to get involved in the debate.

[This article represents the individual view of the author.]

Improving IFRS – a point of view

Amidst the current, rather stagnant, debate on the merits and flaws of IFRS, Claude Lopater, PwC partner and member of the Board of the French accounting standards authority (ANC), suggests ten concrete measures for improving IFRS and increasing Europe’s influence over the IASB.

There are those in favour and those against IFRSs, the enthusiasts and the weary, the disheartened and the convinced. There is no question about it – rebellion is stirring among the ranks of users who find these standards hopelessly complex and far too prone to change. As for the standard setters, they ardently defend the principles. The stand-off between these two camps is about to turn ugly.

"France wants its voice to be heard, not for the sake of criticising IFRS standards, but to improve them", says Claude Lopater. He stresses the need for a rapid change of mindset, by both the IASB, who should set up an ‘after-sales service’ for existing standards, and their European users, who must not only show their willingness to

continue with IFRS, but also “fight for more freedom in order to make their voices heard”. Claude offers the following ten suggestions to improve IFRS and increase Europe’s influence over the IASB.

Ten measures to improve IFRS

1. Make the standards drafting process more stable

This is priority number one and is the best way to improve the standards. It will let the standards ‘live’, thereby giving the IASB time to improve them other than by preparing new exposure drafts. This will ensure that the IASB finally has the time to provide a real after-sales service for existing standards, for example, by implementing measures 2 to 8 suggested below.



2. Put an end to the drafting of complex new standards with no real added value

IFRS 10 and 11, which were reluctantly adopted by the EU in December, replaced previous IFRS standards which had not been called into question by those who applied them on an everyday basis. This concerns, first and foremost, the exposure drafts on revenue recognition and leases, both of which go against companies' business models.

The revenue exposure draft could lead to the recognition of revenue well before the receivable itself arises, particularly in the case of handset sales and subscriptions in the Telecoms sector. The exposure draft on leasing focuses on the liability relating to firm or quasi-firm lease commitments, which is to be recognised with an adjusting entry made to intangible assets (despite the fact that it is already disclosed in the notes), suggesting that all service agreements should be capitalised.

3. Make IFRS more realistic and easier to understand

The main counter-intuitive impacts of IFRS should be listed and examined. Certain concepts could be adjusted slightly to inspire a positive rather than hostile attitude among users. For example, who can understand:

- why a capital gain will never be recognised in income on the sale of 20% of a wholly-owned subsidiary?
- why should a liability relating to a put option on a non-controlling interest be recognised at fair value?
- why should a liability be recognised immediately on the dividends a company undertakes to pay to its shareholders before future earnings are generated?
- why must an expense be recognised on the cancellation of a stock option plan?

4. Ensure consistency between IFRS

In order for IFRS to be credible, it is essential that the same treatment be prescribed for identical situations. At present, the costs of acquiring a subsidiary must be expensed, whereas the costs of acquiring any other assets must be capitalised (including short-term assets).

5. Create protective measures

Some of the current methods increase the temptation to 'break the rules'. For example, the requirement to recognise contingent consideration or provisions after a 12-month period in the income statement encourages companies to record significant goodwill at the outset that will ultimately be converted into revenues.

6. Be clearer

In order to help companies and auditors properly account for transactions, the IASB should clearly explain whether the economic substance (economic compulsion), the legal substance (the actual consequences of contractual clauses) or the legal form of an agreement prevails. The IASB and IC have not consistently applied economic compulsion, for example, in the recognition of liabilities.

7. React to current events and interpret the standards

Current events have significant consequences for companies' annual financial statements. The IASB must take a stance on the accounting before the financial year-end in order to ensure a meaningful comparison of financial statements. They should certainly not criticise the positions taken by companies after the fact, as was the case in 2011 during the Greek crisis or, in 2012, as regards the discount rate for pension obligations.

In fact, the IASB rather than the IC would to be the best placed to interpret 'its' standards. That would also eliminate unproductive exchanges with the IC and irrational decisions, which was the case recently with put options on non-controlling interests and contingent consideration.

8. Revise the conceptual framework

Trying to please investors at all costs is not the right approach when it comes to establishing effective standards. Regardless of what is said, executive managers are the main users of financial statements. Creating an internal accounting system is costly, which is a good thing for IFRS as these managers can play a double role. It is certainly more positive than seeing businesses communicate with ever decreasing links with IFRS (more non-GAAP measures).

9. Amend European regulations and particularly rules on the right of veto

The right of veto must enable the EU to approve only part of IFRS. As it stands, the right of veto on IFRS enshrined in European law frightens no one, especially not the IASB given that the EU has approved every standard since 2005 with one exception.

If a more flexible right of veto were granted, EU members would feel not only freer but stronger, because the threat to the IASB of the EU not approving a new standard would be more real. This would prove an effective weapon for increasing European influence.

10. Reform EFRAG governance

It is necessary to reform the European Financial Reporting Advisory Group (EFRAG), which filters the standards at the European level, in order to provide European standard setters with real powers of decision and representation.

This is particularly important at a time when the IFRS Foundation is planning to improve IASB governance by creating an Accounting Standards Advisory Forum, which will allow national standard setters to be more closely involved with the work of the IASB, under highly questionable conditions.

This article represents the individual view of the author.

IASB Profile: Mary Tokar

Mary Tokar has returned to standard setting, replacing Paul Pacter on the IASB from 1 January.



It is undoubtedly an interesting and perhaps daunting time to join the board. There are a number of new projects just kicking off and the IASB is refocusing on the fundamentals of IFRS in the Conceptual Framework project.

That said, there is a long tail of legacy projects. Mary faces the challenge of balloting decisions taken by fellow board members and predecessors on some significant projects, including revenue recognition, leases, financial instruments and insurance. About this Mary said “I might be unnaturally quiet as we wrap up the existing sweep issues and rack up an unprecedented number of abstentions.”

The quiet noticeably fades when the board debates new topics as it did with the Conceptual Framework in the February. It then becomes clear that, although Mary may be the ‘new kid on the block’, she is no

stranger to the IASB and standard setting. Mary is highly experienced in both standard setting and the implementation of IFRS. She served on the Interpretation Committee from 2001 – 2007. Before that she was with the U.S. Securities and Exchange Commission and most recently headed up KPMG’s Global IFRS Group.

Mary emphasises that IFRSs are ‘real and in use around the world’. She hopes to bring a sense of practicality to the IASB which is under pressure to develop new guidance and maintain existing IFRSs while balancing the cost of change to users.

Hans Hoogervorst, Chairman of the IASB, described Mary by reference to “her straight-talking, no-nonsense approach”. When asked about this portrayal, Mary commented, “I still need to think about whether I want to live up to it, or disprove it.” We will all have to wait and see.

IFRS 10 and IFRS 11: Are you affected?



IFRS 10 and IFRS 11 are effective as of 1 January 2013. Mark Bellantoni from PwC's Accounting Consulting Services highlights some key issues to consider on transition to these new standards.

Do you have investments in complex structures or entities over which you may exert control, for example, special purpose entities or securitisations? Do you have entities or operations that you jointly control with other investors?

If you answered 'no' to both of the above, you might believe that the implementation of IFRS 10 and IFRS 11 will result in minimal changes to current accounting. Do not be deceived; there are a number of subtleties in the new guidance and the transition requirements are complex.

This article highlights some of the key issues in implementing IFRS 10 and 11. But remember to examine all of the provisions carefully, including the transition guidance for both standards.

Are you affected by...

...IFRS 10?

IFRS 10 introduces a revised definition of control and has the potential to affect all reporting entities (investors) that control one or more investees. The new guidance needs to be understood and considered in the context of your business and the nature of the relationships with your investees.

Key message

Do not overlook subtle but significant changes in how control is determined. For example, potential voting rights are included in the determination of control if the rights are substantive, even if the rights are not presently exercisable.

...IFRS 11?

You will need to assess each joint arrangement to determine whether it is a joint operation or a joint venture. Industries where these types of arrangements are prevalent – such as oil and gas and pharmaceuticals – will likely notice the biggest changes.

Key message

Legal form remains important, but it is no longer the most significant determinant of the classification of a joint arrangement. The new model focuses on the rights and obligations of the investor.

This change might result in those who previously applied the equity method having to consider the complexities of accounting for their own rights and obligations.

Key thoughts on transition for IFRS 10 and 11

Modified retrospective application

Both IFRS 10 and 11 require a modified form of retrospective application. Amendments issued in June 2012 modify the transition requirements for both standards to require only the immediately preceding period to be adjusted. Restatement of additional comparative periods is at the discretion of the entity. If earlier comparative periods are presented but not restated, this must be clearly disclosed.

EU users

Those who apply IFRS as endorsed by the European Union should be aware that not all of the transition provisions for IFRS 10 and 11 have been endorsed by the EU. The amendments limiting the retrospective application of both standards to the immediately preceding period have not been endorsed as of the date of this article.

Opening balance sheet and comparative information

An opening balance sheet will be required where adoption of IFRS 10 or IFRS 11 results in a change in accounting for an investment or arrangement because the balances reported at the beginning of the earliest period presented are affected.

Important reminder – IFRS 10 transition

Consolidation decision at date of initial application is critical to determine additional effort required

Entities adopting IFRS 10 should assess control at the date of initial application (which is 1 January 2013 for calendar year-end companies that did not early adopt). The treatment of comparative figures depends on this assessment.

Adjustments to previous accounting are not required for investees for which the consolidation conclusion would be the same under both IFRS 10 and the previous guidance in IAS 27/SIC 12 as at the date of initial application. That is, the investees would be consolidated or not consolidated under both sets of guidance.

If the consolidation decision under the new guidance differs from the prior conclusion reached under IAS 27 / SIC 12, any difference between the IFRS 10 carrying amounts and previous carrying amounts is adjusted to equity.

Important reminders – IFRS 11 transition

Application guidance for transition is prescriptive in some places

IFRS 11 provides specific guidance for transition to a new accounting treatment for an existing arrangement (for example, changing from proportionate consolidation to equity method for a JV). The guidance not only offers practical expedients and requires their use in some cases. For example, allocation of goodwill to a JV that is switching to equity method accounting must be calculated on a relative carrying value basis.

No relief for restating comparatives

Reassessment of joint arrangements in comparative periods cannot be avoided based on the control determined at the date of initial application, unlike the exception provided in IFRS 10. For example, assume an entity disposes of an interest in a joint venture toward the end of 2012 and has no remaining interest or control on 1 January 2013. The lack of control at the date of initial application does not exempt the entity from applying IFRS 11 to that arrangement in its 2012 financial statements.

Refer to our practical guides ‘**Consolidated financial statements: redefining control**’ and ‘**Joint arrangements: a new approach to an age-old business issue**’ for additional information about IFRS 10 and 11.

Cannon Street Press

IASB and FASB near completion on revenue project

The IASB and FASB (the 'boards') reached decisions in February on disclosure, transition and effective date. These decisions substantively conclude the redeliberations.

Disclosures

The following key decisions on annual disclosures were made:

- *Disaggregation of revenue* – The requirement to disclose a disaggregation of revenue was retained.
- *Contract assets and liabilities* – The reconciliation of contract assets and liabilities was eliminated, while other quantitative and qualitative disclosures were introduced.
- *Remaining performance obligations* – The disclosure of the transaction price allocated to any remaining performance obligations not subject to significant revenue reversal was retained.
- *Contract costs* – The reconciliation of capitalised contract costs was eliminated but disclosure of the balances, amortisation and key assumptions was retained.

The boards diverged on disclosures for interim reporting. The IASB limited disclosures to a disaggregation of revenue. The FASB will require most of the quantitative disclosures required annually.

Transition

An entity can either apply the final standard retrospectively or use the following practical expedient:

- apply the standard to all existing contracts as of the effective date and contracts entered into subsequently;
- recognise the cumulative effect of applying the standard to existing contracts in retained earnings on the effective date; and
- disclose the impact of adopting the standard for existing and new contracts on all affected financial statement line items in the period of adoption.

A final standard is expected in the second quarter of 2013 and will be effective for annual reporting periods beginning on or after 1 January 2017.

ED on novation of derivatives and hedge accounting

The IASB have proposed a narrow scope exception to the requirement for the discontinuation of hedge accounting in IAS 39. The ED proposes an exception when a derivative that has been designated as a hedging instrument is novated from one counterparty to a central counterparty

(CCP), as a consequence of new laws or regulations if specific conditions are met (in this context, novation of the derivative contract is the substitution of the original counterparty to the contract for a new counterparty, being a CCP).

Gary Kabureck to join the IASB in April 2013

Gary Kabureck will serve an initial term of three years ending 30 June 2017. He is a recognised leader in the accounting profession and has most recently served as the Chief Accounting Officer for Xerox

Corporation with global responsibility for both IFRS and US GAAP accounting. He is also well versed in standard setting and has experience with the US FASB, PCAOB and a wide range of other advisory boards.

FASB issues ED on classification and measurement of financial instruments

The FASB exposure draft (ED) issued in February 2013 contains comprehensive requirements for the classification and measurement of financial instruments. The IASB only proposed to make limited amendments to IFRS 9 (see IFRS News – December 2012 / January 2013).

The limited amendments proposed in the IASB ED mainly focus on debt instruments with the objective of reducing the differences between the IFRS and US GAAP. A few of the remaining differences are summarised below.

Unrestricted fair value option

The FASB ED introduces an unrestricted fair value option (FVO) for debt instruments classified at fair value through other comprehensive income (FVOCI). The IASB ED proposes that the FVO is only allowed for accounting mismatches.

Equity investments

IFRS 9 allows companies to irrevocably elect FVOCI on an instrument by instrument basis for non-trading equity investments. Gains and losses recognised in OCI are not recycled to profit or loss. The FASB ED does not propose this option.

IFRS 9 also allows the use of cost for unquoted equity investments only when it is a reasonable approximation of fair value (this provision is expected to have limited

application). The FASB ED allows cost less impairment for equity investments without a readily determinable fair value.

Assets subsequently held for sale

For financial assets measured at amortised cost, the FASB ED proposes immediate recognition of impairment losses in profit or loss for differences between amortised cost and fair value when such assets are identified for sale (unrealised gains are not recognised until the sale is complete). The IASB ED does not have similar requirements.

Financial liabilities under FVO

Under IFRS 9, remeasurements related to 'own credit' are not recycled from OCI. The FASB ED requires such amounts to be recycled in profit or loss when the liability is settled during the period.

Non-recourse liabilities

Non-recourse liabilities that can only be settled with specified assets are measured consistently with the assets under the FASB ED. There is no similar requirement under IFRS 9.

Other differences might arise in application of the detailed guidance. The comment period for the IASB ED ends on 28 March 2013 and for the FASB ED on 15 May 2013.

FASB publishes clarifications to disclosures for offsetting

The FASB amended its guidance to limit the scope of the disclosures about offsetting financial assets and liabilities in response to concerns raised by US constituents. The IASB has not made a similar amendment.

The IASB and FASB published joint offsetting disclosure requirements in December 2011 that are effective 1 January 2013 as they were unable to converge the requirements for offsetting financial instruments in the balance sheet. The

objective of the disclosures is to provide transparent information about the effect of offsetting and to allow comparability between IFRS and US GAAP (which allows 'net presentation' in more circumstances).

The new US GAAP guidance could create differences from the disclosures required under IFRS. However, the disclosures will be the same for transactions with the most significant differences in presentation.

Know your IFRS 'ABC': D is for 'disclosure of interests in other entities'

Fernando Chiqueto from PwC's Accounting Consulting Services Central team looks at the new requirements of IFRS 12 'Disclosure of Interests in Other entities'.

The last global financial crisis highlighted a lack of transparency about the risks arising from involvement with 'off balance sheet' entities. In response, IFRS 12 introduces new disclosure requirements about unconsolidated structured entities and enhances the disclosures about interests in subsidiaries, joint arrangements and associates.

This month we take a look at some of the disclosures required by IFRS 12 and the concept of 'structured entity'.

Objective of IFRS 12

IFRS 12 aims to provide disclosure that enables users to evaluate the nature and financial effects of an entity's interests in other entities, particularly those associated with unconsolidated structured entities. The required disclosures are summarised below.

Structured entity

IFRS 12 introduces the term 'structured entity'. Structured entity is an entity that has been designed so that voting rights are not the dominant factor in deciding who controls the entity.

Impact

The impact of implementing the disclosure requirements in IFRS 12 will vary from entity to entity and have the most impact on entities with interests in unconsolidated structured entities. Investment funds, securitisation vehicles and asset-backed financings are some common vehicles that might be structured entities.

IFRS 12 must be applied retrospectively with comparative disclosures required for annual periods beginning on or after 1 January 2013.

Summary of IFRS 12 disclosure requirements

Subsidiaries	Joint arrangements and associates	Unconsolidated structured entities (SE)
<ul style="list-style-type: none"> group composition; interests of NCI and information about each subsidiary that has material NCI; significant restrictions on access to assets and obligations to settle liabilities; risks associated with a consolidated SE, such as arrangements that could require financial support; changes in the ownership interest in a subsidiary without a loss of control; loss of control and any resulting gain/loss; and subsidiaries that are consolidated using different year ends. 	<ul style="list-style-type: none"> the name, country of incorporation and principal place of business; proportion of ownership interest and measurement method; summarised financial information; fair value (if published quotations are available); significant restrictions on ability to transfer funds or repay loans; year-ends if different from the parent's; and unrecognised share of losses, commitments and contingent liabilities. 	<ul style="list-style-type: none"> the nature, purpose, size, activities and financing of the SE; the policy for determining SE that are sponsored; a summary of income from SE; the carrying amount of assets transferred to SE; the recognised assets and liabilities relating to SE; the maximum loss arising from such involvement; and information about financial or other support provided, or intentions to provide support.

Questions and answers

When is an investment fund a structured entity?

Background: Fund A is a private equity fund whose limited partners are not permitted by law to vote or have any other involvement in the management of the fund. They cannot remove the fund manager.

Is the private equity a structured entity?

Analysis: The starting point to assess whether a fund is a structured entity is to establish whether the fund is controlled by the asset management contract or the unitholders. If the unitholders have the power to change the decisions of the asset manager, the fund is less likely to be a structured entity.

How should we interpret 'size of the structured entity'?

Background: IFRS 12 states that an entity shall disclose qualitative and quantitative information about its interests in unconsolidated structured entities, including, but not limited to, the nature, purpose, activities and *size of the structured entity*.

How should we interpret 'size'?

Analysis: IFRS 12 does not define size. Total assets seem relevant to allow users to evaluate the risk of recovering investments. However, it could be burdensome for some financial institutions and investment entities to provide this information. The underlying rationale for requiring the disclosures was to enable users to evaluate maximum possible loss. The level of disclosure will depend on specific circumstances and the amounts involved.

How should we interpret 'income from structured entity during the period'?

Background: IFRS 12 states that an entity shall disclose *income from this structured entity during the reporting period, including a description of the types of income presented*.

How should we interpret 'income from structured entity during the period'?

Analysis: Based on IFRS 12's definition of income from structured entity, 'income' should include: i) income arising from the transfer of any assets or instruments into the structured entity; ii) gains and losses on the sales of any interests held in the structured entity during the period; and iii) payments made to the structured entity, that is, 'negative' income.

Can a 'held for trading instruments' be an interests in a structured entity?

Background: An entity's only involvement with a structured entity might be to hold some interests from time to time as part of ongoing trading activities. For example, an investment bank may hold some positions in structured asset-backed securities in its trading book.

Are these 'held for trading instruments' interests in structured entities?

Analysis: These are interests for which IFRS 12 disclosures are required, unless immaterial. However, as IFRS 12 does not exclude such disclosures, judgement should be exercised.

The bit at the back.....



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