



# IFRS news

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## IFRS 9 finally hits the streets

**The IASB has published the final 'full' version of IFRS 9 – Financial Instruments. The new standard includes clarifications on the classification and measurement requirements as well as the new expected credit losses model. Mercedes Baño looks at the key impacts of the replacement of IAS 39.**

One would have expected a brass band walking down Cannon street when the IASB finally published IFRS 9. Perhaps the band was waiting in the wings so long they were recruited to perform in the opening ceremony of the Commonwealth Games.

The IASB buffed up the chapter on classification and measurement and added a new chapter on credit losses to the previous published hedge accounting requirements; thus bringing down the curtain on the main body of IFRS 9.

There is an epilogue waiting in the wings as the macrohedging chapter is still in the discussion paper stage. The comment period ends in October.

### Classification and measurement requirements

There are three categories for debt instruments under IFRS 9: amortised cost, fair value through OCI (FVOCI) and fair value through profit or loss (FVPL). The measurement principles of each category are similar to the current requirements under IAS 39.

Classification depends on the business model for managing the financial assets and whether their contractual cash flows represent solely payments of principal and interest (SPPI).

An entity's business model refers to how the entity manages its financial assets in order to generate cash flows and create value for the entity. An entity's business model determines whether the cash flows will result from collecting contractual cash flows, selling financial assets or both. If a debt instrument is held to collect, it may be classified as amortised cost if it also meets the SPPI requirement. Debt instruments may be classified as FVOCI if they meet the SPPI requirement and are held in a portfolio where an entity both holds to collect assets' cash flows and sells assets. Financial assets that do not contain cash flows that are SPPI must be measured at FVPL (for example, derivatives).

Investments in equity instruments are always measured at fair value. However, management has the irrevocable election to present changes in fair value in OCI as long as the instrument is not held for trading. If held for trading, changes in fair value are presented in profit or loss.

### Expected credit losses model

The new expected credit losses model (ECL) aims at addressing the criticism of 'too little, too late' raised during the recent economic crisis.



IFRS 9 contains a 'three stage' approach to accounting for credit losses that is based on the change in credit quality of financial assets since initial recognition. Assets move through the three stages as credit quality changes and these stages dictate how an entity measures impairment losses or applies the effective interest rate method.

Impairment is measured using lifetime ECL rather than 12-month ECL where there has been a significant increase in credit risk. There are operational simplifications for lease and trade receivables.

In practice, the rules mean that entities will have to record a day 1 loss equal to the 12-month ECL on initial recognition of financial assets (or lifetime ECL for trade receivables). This will have a significant impact on entities with large portfolios of financial assets at amortised cost or FVOCI.

### **Who will be most affected?**

IFRS 9 applies to all entities. However, financial institutions and other entities with large portfolios of financial assets measured at amortised cost or FVOCI will be the most affected, in particular, by the ECL model. Entities should assess the implications of the new standard as soon as possible. Implementation of the new ECL model is expected to be challenging and might involve significant modifications to credit management systems.

An implementation group has been set up by the IASB in order to consider the most challenging aspects of implementation of the new ECL model.

### **Convergence?**

The new and complete Standard is IASB only. The IASB and FASB could not agree on either classification and measurement or impairment models, although IFRS 9 was originally envisioned as a convergence project.

## **Revenue TRG brings the usual suspects...and the unexpected**

**The debate on the implementation of the IASB and FASB's new revenue standard began this month with the first meeting of the Revenue Transition Resource Group.**

IFRS 15 has only been out for two months but application questions have already started to flood in. The Revenue Transition Resource Group (TRG) met for the first time last week to start the debate on these issues. The TRG includes representation from both the US and international accounting worlds including preparers, users and auditors.

The discussions were inconclusive. This is not surprising as the TRG is not designed to interpret or set standards. Rather, the objective of the TRG is to inform the boards about potential implementation challenges that might require action. Let's have a look at the first issues out of the gate.

### **What was discussed?**

#### **Principal versus agent**

Two of the four papers addressed the question of principal versus agent. You might be asking why as the indicators in IFRS 15 are exactly the same as existing GAAP. Well that is the problem. IFRS 15 has the same indicators but the core model has changed significantly – from a risk and rewards approach to one based on transfer of control.

The TRG was asked whether a principal must control the goods or services before they are delivered and how the principal/agent indicators interact with the notion of control. The discussion was wide

ranging and the one thing that seemed to get consensus is that the evaluation requires judgment. Some suggested that the standard is not clear but there is no indication yet of what action the boards might take on these issues.

#### *The 'royalty exception'*

A question about how to apply the 'exception', which delays revenue from sales and usage based royalties from licences of intellectual property until the sales or usage occurs, was also not surprising. Any 'exception' is going to create debate about how widely or narrowly it should be applied. There were mixed views expressed at the TRG and again, it is unclear how the boards might move the discussion forward.

#### *Impairment testing*

The good news is there seems to be consensus that the cash flows from renewals and extensions may be considered for the impairment test performed on capitalised contract costs. Still, there is no sign of possible action from the boards on resolving the potential inconsistency in the words in the standard.

#### *What is next?*

The boards indicated that there will be full transparency of how they will respond to submissions, and whether or not action will be taken. The first look at how this will be communicated will likely happen in October at the next TRG meeting.

## ***Business combinations attract regulatory attention***

**ESMA's report on business combination accounting identifies some good business combination disclosures as well as some areas for improvements.**

The European Securities and Markets Authority (ESMA) published a report on the for business combinations accounting under IFRS. ESMA looked at how IFRS 3 was applied by 56 issuers in the EU. They identified some positive points but the report suggests a number of areas of diversity in practice and where the quality of financial information could be improved.

The more significant concerns are summarised as follows:

- Goodwill and bargain purchase gains: ESMA remain concerned about 'boiler plate' descriptions of both factors that make up goodwill and factors that lead to a bargain purchase. ESMA also implies that the number of entities reporting a gain from a bargain purchase (11%) was greater than the IASB might have anticipated.
- Intangible assets and contingent liabilities: ESMA encourages more disaggregation in disclosures for intangible assets and contingent liabilities. They highlighted that valuation techniques and assumptions will be different depending on the nature of the balance. They also encouraged the IASB to continue its assessment of customer relationship intangibles, specifically whether accounting guidance should distinguish between contractual and non-contractual relationships.
- Fair value measurement techniques: ESMA noted that many entities only disclose the existence of an external valuation rather than the methods and assumptions used to determine fair value. They suggest that disclosures might be enhanced if some of the disclosures required by IFRS 13 were brought into IFRS 3.

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## ***Cannon Street Press***

### ***Amendments to IAS 41 and IAS 16 for bearer plants***

The IASB has amended IAS 16 and IAS 41 in relation to bearer plants. Prior to the amendments, all biological assets were in the scope of IAS 41 and measured at fair value less costs to sell. Bearer plants will now be accounted for differently to all other biological assets.

The amendments distinguish bearer plants from other biological assets as bearer plants are solely used to grow produce over their productive lives. Bearer plants are seen as similar to an item of machinery in a

manufacturing process and therefore will be classified as PP&E and accounted for under IAS 16.

The amendments are to be applied retrospectively and are effective for annual periods beginning on or after 1 January 2016. Early application is permitted. Existing IFRS preparers who measure bearer plants at fair value less costs to sell are permitted to use fair value as deemed cost for these assets upon adoption of the amendments.

### ***EU endorses IFRIC 21***

The European Union has endorsed IFRIC 21, 'Levies', an interpretation of IAS 37, 'Provisions, contingent liabilities and contingent assets'. The interpretation is effective for annual periods starting on or after 1 January 2014 (17 June 2014 for EU entities).

IFRIC 21 sets out the accounting for an obligation to pay a levy that is not income tax. The interpretation could result in recognition of a liability later than previously, particularly in connection with levies that are triggered by circumstances on a specific date. For further details see [Straight away 119](#).

### ***Leasing redeliberations***

The IASB and FASB ('the Boards') continued discussions in June and July on subleases, sale and leaseback transactions and presentation and disclosure requirements.

#### ***Subleases***

The Boards agreed that an entity that is both a lessee and a lessor of the same underlying asset should account for a 'head lease' and a sublease as two separate contracts, unless those contracts meet the contract combinations guidance previously discussed.

The IASB decided that classification of the sublease should be assessed by reference to the ROU asset arising from the head lease. The FASB decided that the classification of the sublease should be assessed by reference to the underlying asset.

#### ***Sale and leaseback transactions***

The Boards agreed that a seller-lessee should account for the sale of an asset based on the new revenue recognition guidance. If the seller-lessee has a repurchase option with respect to the underlying asset, the buyer-lessor would not obtain control of that asset. The FASB decided to do more analysis regarding call options exercisable at fair value.

The IASB agreed that a seller-lessee should account for a sale of a portion of the underlying asset (that is, a sale of its interest in the residual). However, the FASB agreed that a gain should be recognized in the same manner as for any other sale of a nonfinancial asset.

The Boards agreed that if the sale price of the underlying asset is less than its fair value, the difference should be accounted for as an adjustment to the ROU asset. If the sale price exceeds the fair value of the underlying asset, a seller-lessee should recognize the amount of any excess sale price as an additional financial liability. A buyer-lessor should account for a deficiency of the sale price as a prepayment of rent by the seller-lessee, and an excess of the sale price as additional financing provided to the seller-lessee.

### *Disclosure initiative*

The IASB continued discussions on its Disclosure Initiative. The highlights were:

- IAS 7 amendments – The IASB plans to propose an amendment to IAS 7 that requires a reconciliation of liabilities related to financing activities. Further outreach will be performed on the need for additional disclosures about certain restrictions on cash and cash equivalents such as limitation on the ability to distribute cash within the group.

### *Conceptual Framework discussions*

The IASB moved forward with their discussion on the Conceptual Framework in June and July. The next due process step is an exposure draft which is expected at the end of this year. Some of the key tentative decisions are as follows:

- A present obligation to transfer an economic resource as a result of past events exists if both the entity has ‘no practical ability to avoid’ the transfer, and the amount of the transfer is determined by reference to benefits that the entity has received or activities that it has conducted in the past. Consideration of what ‘no practical ability’ means will be considered at the standards level.
- The Framework will require a profit or loss total or subtotal. Profit or loss is

### *Presentation and disclosure requirements*

The Boards also discussed presentation and disclosure requirements including presentation in the balance sheet and statement of cash flows and lessor disclosure requirements.

The IASB still have a number of topics to be discussed before issuing a final standard.

- Presentation – The IASB decided not restart the financial statement presentation project. They will introduce a project to the growing research agenda on Performance Reporting. The staff will prepare a detailed plan on the project and its interactions with the Disclosure initiative and the Conceptual Framework project.

described as the primary, but not the only, source of information about performance for the period.

- The Framework will not define a separate measurement objective but will rather describe how measurement contributes to the overall objective of financial reporting. The IASB has begun to discuss measurement categories.
- The unit of account will be standards-level decision, but the Framework will include a list of factors to consider when determining the unit of account.
- No amendments will be made to the concept of materiality in the existing Framework.



## ***Know your IFRS ‘ABC’: R is for ‘Related party’ disclosures***

**Anna Schweizer from PwC’s Accounting Consulting Services Central looks at the most common challenges around related party disclosures.**

You might ask “why did they pick this topic?” Most are of the view that the standard is clear and that disclosures should be straight forward, but they might be missing a few tricks. The topic still remains an area of focus for many regulators around the world. Let’s look at some common questions around related party disclosures.

### ***A commitment to do something***

Many think related party disclosures are about transactions but they actually capture more than that. IAS 24 requires an entity to disclose commitments with related parties, including ‘a commitment to do something if a particular event occurs or does not occur in the future’.

Let’s take an example. Entity A enters into an arrangement with its finance director in 2011. The entity is relocating its head office and requires the finance director to relocate. Entity A will purchase the finance director’s residential property if she is unable to find a buyer before 30 June 2012. Entity A is preparing its accounts for the year ended 31 December 2011. Is disclosure of this agreement required?

The commitment for Entity A to purchase the property from the finance director if she is not able to sell it should be disclosed, even though the actual purchase of the property has not yet occurred. This disclosure is applicable even if Entity A expects to purchase the property for market price.

It is also important to remember that ‘Key management personnel’ includes all directors of the entity (whether executive

or otherwise). Therefore the finance director is a related party of Entity A, so any transaction or commitment between the two parties should be disclosed in Entity A’s financial statements if it meets the definition of a related-party transaction.

### ***How to interpret ‘government’?***

Let’s assume Entity A, controlled by Region X government in Country Z, enters into a transaction with Entity B, controlled by Region Y government in Country Z. Are these entities related parties? Would the exception for related party transactions with governments be applicable?

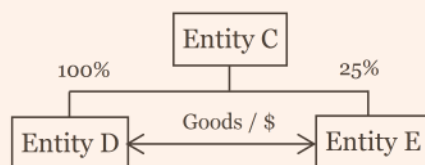
IAS 24 does not provide additional guidance on the definition of government, and the relationship between different parts of the government might differ across jurisdictions. The IASB did not provide additional guidance because they felt that a more detailed definition could not capture every structure across every jurisdiction. Thus judgment is required to determine whether an entity is related to a government. This judgment would consider, for example, how much control or influence the ‘parent’ government has over the ‘subsidiary’ units, similar to the control assessment in other standards.

### ***Is an associate of the parent a related party to a subsidiary?***

The definition of a related party in IAS 24 has a number of different features, sometimes making it hard to evaluate which parties are related to complex organizations with associates and joint ventures.



The core principle behind the definition is that related parties might enter into transactions that unrelated parties would not – such transactions should be disclosed. Let's look at an example.



Entity C has a subsidiary, Entity D, and an associate, Entity E. During the year, Entity D sold goods to Entity E. Do these transactions require disclosure in either the consolidated and separate financial statements of Entity C or the separate financial statements of Entity D?

An entity is a related party of the reporting entity where it is 'an associate or joint venture of the other entity (or an associate or joint venture of a member of the group of which the other entity is a member)'.

- The transaction should be disclosed in Entity C's consolidated financial statements where Entity C is the reporting entity. Entity E is an associate of Entity C group and is therefore a related party;
- The transaction should not be disclosed in Entity C's separate financial statements. Entity C is not a party in the transaction; and
- The transaction should be disclosed in entity D's separate financial statements because Entity E is an 'associate of a member of the group of which Entity D is a member'.

#### *Parties related only for part of the year*

When parties are related only for part of the year, the disclosure requirements are only applicable for the period the parties are related, but not for the period before and / or after.

#### *Transactions that are eliminated by consolidation*

Transactions that are eliminated by consolidation are exempt from the disclosure requirements in the consolidated financial statements. However, those between an investment entity and its subsidiaries measured at fair value through profit or loss in the consolidated financial statements still need to be disclosed.

#### *Key management personnel services from another entity*

An entity that obtains key management personnel services from another entity is required to disclose these services as key management personnel compensation. The reporting entity is required to disclose the amount incurred for the service fee paid or payable to the management entity, but not the key management personnel.

However, what if a subsidiary bears no cost for the services received from a parent? In this case, the subsidiary still needs to disclose details of the compensation paid by the parent entity in respect of the subsidiary's key management personnel, when the services received are significant.

#### *Ultimate controlling parties that are individuals*

Some groups have ultimate controlling parties that are individuals. Should the name of the individual be disclosed in such a case? The name of the individual should be disclosed as the 'ultimate controlling party' and is supplemental to the disclosure of the 'ultimate parent' (legal entity).

#### *IFRS blog: Join the discussion*

See the latest discussions on IFRS 9 and IFRS 15 and sign up for notifications at

<http://pwc.blogs.com/ifrs/email-alerts.html>

## *The bit at the back.....*



### **For further help on IFRS technical issues contact:**

#### **Business combinations and adoption of IFRS**

mary.dolson@uk.pwc.com: Tel: + 44 (0) 207 804 2930

caroline.woodward@uk.pwc.com: Tel: +44 (0) 207 804 7392

#### **Financial instruments and financial services**

gail.l.tucker@uk.pwc.com: Tel: + 44 (0) 117 923 4230

jessica.taurae@uk.pwc.com: Tel: + 44 (0) 207 212 5700

tina.farington@uk.pwc.com: Tel: + 44 (0) 207 212 2826

#### **Liabilities, revenue recognition and other areas**

tony.m.debell@uk.pwc.com: Tel: +44 (0) 207 213 5336

richard.davis@uk.pwc.com: Tel: +44 (0) 207 212 3238

a.allocco@uk.pwc.com: Tel: +44 (0) 207 212 3722

#### **IFRS news editor**

Andrea Allocco

a.allocco@uk.pwc.com: Tel: +44 (0) 207 212 3722

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