



IFRS news

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Macro hedging – are you affected?

IASB is seeking feedback on accounting for macro hedging. This might be a well known concept for banks, but there is a question about whether anyone else would be interested.

The IASB has taken the first step in the final phase of the project to replace the financial instruments guidance in IFRS. They published their discussion paper (DP) on Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging.

Macro hedging has been treated as a separate project from IFRS 9. Why? The IASB wants to give this project separate treatment in order to gather views from a wider range of constituents. But will it achieve this objective?

What does the DP say?

The DP explores the use of a 'portfolio revaluation approach' (PRA). The PRA is not a full fair value approach; it identifies the risk being managed in an open portfolio and revalues the exposure to that risk based on a present value technique (the 'revaluation adjustment'). The PRA does not require a one-to-one matching of the hedged item and the hedging instrument. This will reduce operational complexities as compared to the current hedge accounting requirements in IAS 39 and IFRS 9.

A conceptual challenge introduced by the PRA is the inclusion of behavioural features, rather than just contractual features. For example, demand deposits (when assessed individually) are repayable on demand. However, when assessed on a portfolio level, core demand deposits are considered by financial institutions as long term fixed rate time deposits for the purposes of dynamic risk management.

The revaluation adjustments of the managed exposures and the fair value changes of the associated hedging instruments are accounted for in profit or loss. The DP suggests alternatives for the presentation of the revaluation adjustments in the statement of financial position and the statement of comprehensive income.

The DP asks a number of questions, mainly on whether the approach is operational, how the proposed approach could be applied to other risks (such as foreign exchange or commodity price risk) and whether it would enhance the usefulness of the information provided by the financial statements.

Who is affected?

All entities that use dynamic risk management strategies for open portfolios will be affected. The outcome of this project will replace the current fair value hedge accounting of interest rate risk in IAS 39.

The DP is likely to be of particular interest to financial institutions, but it might also be of interest to entities in industries such as mining, utilities or manufacturing. That said, the IASB might struggle to get a response to their proposals from non-financial institutions.

Why? Firstly, the DP is focused on banks. The PRA is illustrated using an example commonly applied by banks. Is this not a contradiction to the DP's objective? If the goal is to gather the views of the non-financial services sectors, why did they not include an example of the non-financial services world?

Secondly, use of general hedge accounting under IAS 39 has been noticeably low outside the financial services sector. IAS 39 is seen as too restrictive and too complicated. IFRS 9's general hedging model released in November 2013 has given hedging a new lease on life – it is simpler and easier to apply. It might be that non-financial institutions will focus on implementation of this model before exploring the relatively uncharted territory of macro hedging.

What is next?

The IASB's aim to get a wide range of feedback is appropriate - the non-financial world should get engaged. The deadline for comment is 17 October 2014.

Integrated reporting – are we moving forward?



Integrated reporting continues to be a hot topic for preparers, investors and regulators. Mark O'Sullivan, PwC's Director of Corporate Reporting, takes a look at where we are following the 2013 reporting season.

It is that time of year when many are taking a deep breath after the busy year-end reporting season, but what about integrated reporting? Has it been embraced or did it get lost among the rush of deadlines?

The Integrated Reporting Framework (the 'IR Framework') was launched by the International Integrated Reporting Council (IIRC) in December 2013. It was seen as an opportunity for entities to begin assessing connectivity across their businesses and how to communicate more relevant information more clearly. Application of the Framework is not mandatory but is it making a difference to how entities report?

What did the research say?

Research by PwC¹ shows that management is already responding to the need for a change but significant challenges remain. The research covers 400 companies across 10 territories and more than 20 industries

Key findings

- Many already report key elements of the IR framework, such as strategic priorities, key risks and key performance indicators.
- Other guiding principles, such as connectivity and future orientation, are less well-addressed.

¹<http://www.pwc.co.uk/assets/pdf/integrated-thinking-flyer-dec-2013.pdf>

- South Africa, the UK and Germany are leading adoption of many IR principles, perhaps because of regulatory changes.
- Some industries are slightly ahead of their peers – particularly mining, chemicals and real estate. This reflects more advanced stakeholder demand for broader information sets.

The challenges

There are still a number of challenges.

- Overcoming silos – reporting often shows a lack of connectivity. Better connection is seen as key to integrated thinking.
- Looking to the future – many adopt the ‘rear view mirror’ approach, focusing on the last year rather than looking forward.
- Value creation – many reports lack insight into how key relationships and resources outside the organisation create value.
- Performance – reporting remains largely focused on financial performance rather than thinking of multiple “capitals”.

2013 reporting so far

We have recently started looking at UK companies in the 2013 reporting cycle. The findings suggest that there is continued improvement in the reporting of strategy

and business models and the integration of these concepts into other areas such as KPIs and risk. For more insight into FTSE 350, see [corporate reporting blog](#).

How does IFRS fit in?

The IASB have signed a memorandum of understanding with the IIRC to deepen their co-operation in developing an integrated reporting framework. The IASB continues to work on its broad-based disclosure initiative. The initiative comprises a number of projects, including a look at materiality in practice, research into ‘net debt’ disclosures, and a review of existing IFRS disclosures to identify and assess conflicts, duplication, and overlaps.

The first stage of the project was an exposure draft which proposed certain narrow scope amendments to IAS 1. These proposals could provide IFRS preparers with more flexibility on how they comply with IFRS disclosure requirements. See [straight away](#).

The longer term objective of the Disclosure Initiative is to explore how disclosure in IFRS can be improved. It seems clear that the mindset is moving towards a disclosure model that should support the principles of integrated reporting.

IFRS in the US – why it is important

IFRS continues to receive attention in the US despite the recent end to an era of joint standard setting. Erin Bennett, US Accounting Consulting Services, looks at why IFRS is still important in the US.



If you are looking for a prediction of when the US will adopt IFRS, you should stop reading now. A prediction at this point would be speculative to say the least. The only thing to say right now is ‘not in the near future’. That said, US markets are continuing to grow familiar with IFRS but how and why?

For US preparers, public or private, big or small, knowledge of IFRS is important.

IFRS is increasingly relevant to many US businesses as they engage in cross-border mergers and acquisitions², report to their non-US stakeholders, and manage their overseas operations.

From an investor perspective, the need to understand IFRS is arguably even greater. US investors keep looking overseas for investment opportunities. Recent estimates suggest that over \$6 trillion of US capital is

²For more information, see <http://www.pwc.com/us/en/audit-assurance-services/accounting-advisory/publications/cross-border-transaction-financial-reporting-implications.jhtml>

invested in foreign securities. The US markets continue to allow non-US companies to prepare their financial statements using IFRS. There are currently over 450 non-US filers with market capitalization in the multiple trillions of US dollars who use IFRS without reconciliation to US GAAP.

Nearly 50% of the foreign private issuers file financial statements prepared in accordance with IFRS. In a recent speech, Keith F. Higgins, Director of the SEC's Division of Corporation Finance³, observed 'that many foreign companies continue to find the US public market attractive'. He also

acknowledged the challenges faced by foreign companies over and above US companies.

Meanwhile, the IASB and FASB are further apart than they have been in many years on joint standard setting. The joint revenue standard expected later this month is another opportunity to test how the US and international community work with the same set of words. Business combinations and segments guidance are already virtually aligned. But will continued exposure to IFRS move the US closer to adoption or further away? Only time will tell.

Foreign exchange - a moving target

The foreign exchange legislation in Venezuela moved into a new phase early this year. The exchange mechanism is a moving target that continues to challenge overseas parents.

Most entities with foreign operations are familiar with the judgment on functional currency so the rest should be easy – right? Once the functional currency is selected, simply translate it. In some countries however, it is not that simple.

Let's take Venezuela. Exchange rate legislation in Venezuela was amended earlier this year to create a new mechanism (SICAD II). Prior to this, there were two official exchange rates (CENCOEX and SICAD I). SICAD II introduces the ability for both individuals and entities to buy and sell foreign exchange with significantly fewer restrictions than other mechanisms. If SICAD II operates as described, it seems like good news for entities trying to get funds out of Venezuela. But what are the accounting implications?

The creation of SICAD II means that there are now three official exchange rates. All three published exchange rates qualify as a spot rate and can be used to translate

monetary assets and liabilities. Judgment is required to determine which rate best reflects the rate that will be available for dividends and this judgement should then be disclosed in the Financial Statements. For more guidance, see [In Brief – Exchange rates in Venezuela](#).

However, before the subsidiary is translated, IAS 29 should be applied if the country is hyperinflationary, which Venezuela is. For countries where hyperinflation applies, see [Hyperinflationary economies at 31 December 2013](#).

So watch this space - translating your foreign subsidiary might require a bit more thought. Venezuela is the latest to receive attention but Argentina might be the next on the list. Its history of exchange restrictions reflects some similar patterns and it continues to be on the watch list for hyperinflation.

³<http://www.sec.gov/News/Speech/Detail/Speech/1370541190424#.U1pjhPldVTI>

Cannon Street Press

Joint revenue standard expected in May

The IASB announced that they expect to publish the new revenue standard in the second half of May. *IFRS 15, Revenue from contracts with customers* is the result of a joint standard setting process with the FASB and will be published at the same

time as the FASB's Accounting Standards Update. The guidance is expected to be substantially converged. The proposed effective date is expected to be 1 January 2017 for IFRS preparers with early adoption permitted.

IASB's research programme

Ongoing research

The IASB discussed its ongoing research programme in April. The programme aims to identify issues earlier and create a better basis for standard setting. The programme currently has nine short and medium term projects and four longer term projects.

The IASB specifically discussed the next steps for the project on Financial Instruments with Characteristics of Equity. The timetable sets an aggressive target to issue a discussion paper by the end of 2014 at the same time as an exposure draft on the Conceptual Framework Project.

IFRS Research Centre

The IASB announced the IFRS research centre to facilitate communication between the IASB and the research community. The objectives set out are to:

- increase awareness of the issues that the IASB will be considering in the coming two to three years,
- encourage researchers to undertake targeted research projects in these areas, and
- support the IASB in moving to more evidence-based standard-setting.

IASB and FASB leasing deliberations

The IASB and FASB met in April to discuss leasing. They reached a number of converged decisions. The highlights are:

- Modifications – A lease modification is any change to the contractual terms that was not part of the original terms and conditions. The accounting will depend on the nature of the change. Specific guidance is provided to determine if modification is deemed to be a new lease. Substance of the modification should govern over form.
- Contract combination – Contracts should be combined if they are negotiated as a package with a single commercial objective and consideration in one contract depends on the price or performance of the other.
- Variable payments – These are included in the lease asset and liability at lease commencement if they vary based on

an index or rate or are in substance fixed payments.

- Discount rate – Several topics were discussed around the discount rate used to measure, at present value, the lessee's lease liability, lessor's lease receivable and residual asset (for Type A leases).

The Boards diverged on reassessment of variable lease payments. The IASB voted to require reassessment only when there is a contractual change in the cash flows (that is, when the adjustment to the lease payment takes effect). The FASB voted to require reassessment only when the lease liability is reassessed for other reasons.

Joint redeliberations will continue with the objective to maximise convergence but the IASB and FASB remain diverged on a number of key issues. See the [IFRS News April 2014 'Leases – another nail in the coffin of convergence?'](#)

Know your IFRS ‘ABC’: P is for ‘Perpetual debt’

Philip Garcia from PwC’s Accounting Consulting Services recaps the accounting for perpetual debt instruments.

A perpetual debt instrument has no requirement to repay the principle – so why is it sometimes classified as a liability?

When an entity issues a perpetual ‘debt’ it must first understand all the features to determine whether the instrument is a liability, equity or a compound financial instrument. This then drives whether gains and losses are recognised in equity or in the income statement.

The basics

What’s a perpetual debt instrument?

Perpetual debt instruments (such as perpetual bonds, debentures and capital notes) normally provide the holder with the contractual right to receive payments in respect of interest at fixed dates extending into the indefinite future. The holder often has no right to receive a return of principal or might have a right under terms that make it unlikely or far in the future.

Liability or equity?

Where the issuer has discretion over making payments (both principal and interest) this will give rise to equity classification. This is the case even when it is likely that the payments will be made. Classification under IAS 32 is not influenced by the issuer’s intentions or compulsion to make a payment.

Where there are mandatory payments, the contractual obligation must be recognised as a financial liability. This would be the case if the principal is returned at any point in the future. It is also the case even if the only mandatory payments are termed interest payments that are paid in perpetuity. Let’s take a look at an example.

An entity issues an instrument requiring it to make annual payments in perpetuity equal to a stated interest rate of 8% applied to a stated par or principal amount of C1m. Assuming a market rate of 8% when issued, the instrument is classified as a liability in its entirety at the net present value of the interest payments. In this case, the holder and issuer have a financial asset and a financial liability, respectively.

Measurement of contractual interest

Contractual cash flows of a financial instrument can vary over time, for example, with changes in the applicable interest rate. Interest expense is recognised using the effective interest rate method (EIR) as required by IAS 39 (assuming it is not classified as at fair value through profit or loss).

In effect, interest is recognised at a constant rate over the term of the financial instrument. Where the interest is paid to perpetuity, this means that at each reporting date, the debt instrument will be recorded at its principal amount, which is also its amortised cost.

Treatment of transaction costs

If the entity incurs transaction costs, the debt instrument will be recorded in each reporting period at its initial amount, which is the amount received less transaction costs. The result is that the transaction costs are never amortised, but reflected in the carrying amount indefinitely.

In practice

Perpetual debt comes in a variety of different forms but it is often just ‘normal’ debt repackaged. A common way to achieve repayment of the principle is through a high rate of interest for a number of years

(the primary period) and a negligible amount into perpetuity.

If interest was simply charged to profit or loss based on the contractual terms, the entity would bear an artificially high interest expense during the primary period and little or no interest expense thereafter to perpetuity. This treatment might reflect the form of the loan agreement, but not its substance. From an economic perspective, some or all of the interest payments are repayment of principal. Let's take a look at an example.

An entity issues a perpetual bond for C100,000 on which interest at 14% is paid annually for the first ten years and thereafter at a nominal rate of 0.125%.

Substance

The bond has little or no value at the end of the ten year period. The principal amount is repaid, in effect, over the initial ten year primary period. Consequently, the interest payments during the primary period represent a payment for interest and repayment of principal.

Remaining balance

Interest continues to be recognised on the carrying amount of the debt instrument on an effective interest rate method. Although the carrying value at the end of year ten is small, an amount of C100,000 may be repayable should the entity go into liquidation. In practice, however, there will usually be arrangements to enable the entity to repurchase the debt instrument for a nominal amount and, therefore, extinguish any liability.

What else should you consider?

Disclosure – maturity analysis

It is difficult to determine how, if at all, to

include amounts in the required IFRS 7 maturity analysis which requires a maturity analysis for non-derivative financial liabilities that shows the remaining contractual maturities. For example, in the case of perpetual bonds where the issuer has a call option to redeem the bond, the issuer has discretion over the repayment of the principal. Until the option is exercised, the bond's contractual terms are that it is a non-redeemable perpetual bond. Once the call option is exercised, the bond's contractual terms are changed and the bond has a maturity date. If the call option was not exercised, then the undiscounted cash flows would be paid in perpetuity.

If the instrument pays contractual interest to perpetuity, the payments are disclosed in the period that they will be paid but this raises the question of what amount should be shown in the last time band. IFRS 7 does not deal explicitly with such a situation so a number of alternative approaches could be applied. One would be to include the principal amount in the last time band. Another option would be not to include any cash flows in the last time band, but disclose the principal amount in time band entitled 'no maturity'. Whatever form of disclosure is chosen, this is an area where it will be important to provide a clear narrative description of the instrument's terms.

Classification from the holder's perspective

From the perspective of the holder of a perpetual debt instrument, if the financial instrument pays interest for an indefinite period, the instrument would not qualify for held to maturity because there is no maturity date. Whether the instrument is classified as available for sale or held for trading will depend on the facts and circumstances.

Updated guidance on interim financial reporting

Our 'Manual of accounting - Interim financial reporting 2014' contains comprehensive guidance on preparing interim financial reports under IAS 34. It includes a detailed commentary on the requirements of IAS 34 together with an illustrative set of condensed interim financial statements, with additional guidance in 'commentary' boxes on how to present this information. Also included is a checklist of the minimum disclosures required by IAS 34. Hard copies will be available to order from ifrspublicationsonline.com from mid-May.



The bit at the back.....



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