



IFRS news

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Impairment through the eyes of regulators

Ruth Preedy from Accounting Consulting Services analyses the 2014 ESMA enforcement decisions in relation to IAS 36.

The first half of 2015 has been marked by increased volatility in global markets. This economic environment could lead to revised budgets and forecasts with an expectation of lower cash flows from existing non-financial assets. With the amount of headroom diminishing, regulators have put impairment at the top of the agendas. So, what do they focus on? This article is based on a review of the 2014 ESMA enforcement decisions in relation to IAS 36.

There were three common themes coming out of the 2014 enforcement decisions:

- 1) Cash flows should be reasonable and supportable.
- 2) The discount rate used should be determined in accordance with the standard.
- 3) Disclosure requirements are often missed.

Cash flows should be reasonable and supportable

Assumptions in cash flow models must be reasonable and supportable. They should represent management's best estimate of the economic circumstances that will prevail over the remaining life of the asset

or cash-generating unit (CGU). Greater weight should be given to external evidence. It is important that any assumptions are consistent with other data.

Regulators will consider different data to understand if the assumptions disclosed in the financial statements are supportable. For example, regulators will perform cross-checks by considering information about what's happening in the market, the industry, and other areas of the financial statements and past performance.

Market Data

If a CGU is an investment which has a quoted price, a regulator will check if its fair value equals the share price multiplied by the quantity of shares. Where issuers have argued that their share price is not active because the shares do not trade daily, regulators have pushed back.

Value in use and fair value less cost of disposal may be different for a listed entity. However, a significant difference will require some strong justification for any regulator to accept it. Why does the market see something different to management? Maybe they have already priced the impairment into their view of the entity.



Financial Statements

The standard requires key assumptions to be disclosed. Regulators are known to execute enforcement decisions when the assumptions used in the impairment model are more optimistic than other information in the financial statements. A common example would be disclosing a significantly lower operating margin in the operating segment note compared to the one used in the value in use calculation.

Past performance

Another example for enforcement decisions is that future estimates were not supported by past performance. For example, current year cash flows are negative and far below budget, but management still predicts that there will be a turnaround in the following year.

The discount rate used should be determined in accordance with the standard

The discount rate used should reflect the specific risks of the asset which have not already been incorporated in the cash flows. Different CGUs might warrant different discount rates. A number of enforcement decisions resulted from the use of an incorrect discount rate. Examples included:

- Value in use should be calculated using a pre-tax discount rate and pre-tax cash flows. Using a pre-tax rate is not as simple as just grossing up a post-tax rate and is best determined using an iterative computation.
- The usual starting point for determining the asset-specific discount rate would be the WACC. However, an entity should be able to justify how they calculated their discount rate. Simply taking the WACC

and adding a percentage for prudence does not ensure that the asset specific risks are reflected.

- Different CGUs, especially when they are operating in different geographical locations, might warrant different discount rates.
- Inputs into a discount rate should reflect the current market assessment.

Disclosure requirements are often missed

The disclosures required by IAS 36 are extensive and can sometimes be overlooked. An overview of the required items is available in the [IFRS disclosure checklist](#).

Some of the main areas of enforcement focus on why an impairment arose and how the impairment test was performed. The key reminders relating to disclosure are:

- The events and circumstances that led to an impairment loss should be disclosed.
- The methodology of determining the recoverable amount and the underlying assumptions should be disclosed.

IAS 36 often requires the disclosure of market sensitive data. One issuer did not include all required disclosures on the grounds of confidentiality. The enforcer concluded that confidentiality was not a valid reason for incomplete disclosure.

Where to get help?

See [PwC In depth – Top 5 tips to impairment testing](#) for helpful hints on impairment testing and the preparation of cash flow models. A video version is available on [YouTube](#).

IFRS research is separating the facts from the hype



Anna Schweizer from Accounting Consulting Services takes a closer look at findings from Professor Christopher Nobes' recent research.

Are IFRS financial statements truly comparable? Are entities considering the appropriate qualitative characteristics when making changes to accounting policies? Has the IASB driven the extensive use of fair value?

Christopher Nobes is professor of accounting at Royal Holloway (University of London) and the University of Sydney. He was a member of the Board of the IASB's predecessor, the IASC. Professor Nobes researches the nature and causes of international differences in financial reporting. In this article we take a closer look at three areas of his research.

Global comparability of IFRSs

According to the preface to IFRS, the IASB is committed to developing in the public interest a single set of high quality, global

accounting standards that require transparent and comparable information in general purpose financial statements. However, the standards allow quite a few options. Does this reduce comparability of financial statements?

Research shows that IFRS practice is not consistent across countries. It will be no surprise to many that pre-IFRS national practice continues where permitted by IFRS. By this, the existence of national patterns of accounting can be documented within IFRS.

Christopher Nobes' research looks at annual reports of companies in the 'blue chip' indices of the largest five stock markets that use IFRS (Australia, France, Germany, Spain and UK).

A few examples:

- Income statement presentation is significantly influenced by pre-IFRS national practice. Australia, UK and Germany prefer presentation by function; whereas Spain prefers presentation by nature.
- French and Spanish entities are more inclined to show equity-accounted profits after finance items.
- Australia and UK are much more likely to show net assets in the statement of financial position than continental Europe.
- A clear majority of reporters in France, and about half of the reporters in Spain as well as Germany used the corridor method for accounting for post-employment benefits when this was still available. In Australia and the UK the vast majority accounted for actuarial gains / losses in OCI.
- A clear majority of reporters in Germany and France used proportionate consolidation of joint ventures when this was still allowed. In Australia, UK and Germany only a minority used this accounting policy choice.

Conclusions

Professor Nobes offers a solution – to reduce the choices available in order to

increase global comparability. He believes that the same economic circumstances should be accounted for in the same way.

The IASB is (slowly) reducing choices in IFRS; for example the option of proportionate consolidation was recently removed.

Another view is that accounting policy choices allow territories to norm more slowly into one global standard and have thus increased the global acceptability of IFRS. Choices permit flexibility. The Framework states clearly that disclosure of accounting policies helps achieve comparability and in particular that comparability should not be confused with uniformity.

Read more on international differences in IFRS policy choices [here](#) (behind paywall).

Changes in accounting policies

The qualitative characteristics (QCs) of financial information from the Framework are intended to be used by entities when making accounting policy choices and changes. Changes in accounting policy choices are required to be explained providing a reason why the new policy provides 'reliable and more relevant' information.

Christopher Nobes and his team have analysed information from the annual reports of companies at the major national stock market indices in the following ten

countries: Australia, Switzerland, China, Germany, Spain, France, United Kingdom, Hong Kong, Italy, and South Africa. They base their findings on over 400 changes to accounting policy choices.

The majority of examined changes refer to QCs from the Framework, in particular to relevance, faithful representation, comparability and understandability. However, entities also frequently refer to transparency, which is not directly mentioned in the framework. QCs are more often referred to if the change relates to measurement (i.e. to a more important accounting policy decision), as opposed to changes relating to presentation and disclosure.

Conclusions

Accounting policies changes are often not explained well but the work performed by Professor Nobes provides evidence that management is alert to QCs. The question remains whether the reference to the qualitative criteria is really that helpful, given that most entity's disclosures of reasons for changes in accounting policies seem somewhat boilerplate.

Read more on the QCs used by entities when changing accounting policies [here](#) (behind paywall).

Negative interest rates, not just for banks!

A prolonged period of very low interest rates has surfaced some interesting (and unique) accounting issues. These issues don't just impact banks, all borrowers and lenders could be impacted and the IC is currently looking at several of the issues. Gabriela Martinez from Accounting Consulting Services takes a closer look at the implications of negative interest rates.

A few years ago, the idea of negative interest rates was not on anyone's radar screen. The recent financial crisis has seen central banks, particularly in developed economies, fighting deflation and recession by reducing interest rates. Those policies, particularly in Europe, have driven certain government and corporate debt yields down to record

lows. In certain cases, interest rates have gone negative. For example, a German government bond with a low coupon might sell in an auction at a premium. Thus, the real return is negative.

Negative interest rates matter for all entities that borrow or lend money as they could



introduce significant volatility to an entity's financial statements under IFRS. Some of the potential implications are considered below.

Hedging

Entities commonly use derivatives to hedge risk exposures such as interest rate risk. It is important to take a close look to understand any potential effects that negative interest rates could have on the hedge relationship.

Let's consider a cash flow hedge scenario. The hedged item is debt issued at a floating rate (the debt), which contains a zero percent floor (see discussion of embedded derivatives that follows). The debt was issued when interest rates were not negative and the floor is not accounted for separately. The hedging instrument is an interest rate swap (the IRS), which does not contain a mirroring embedded zero percent floor.

When interest rates go negative, there are no interest cash flows arising from the debt to offset those of the IRS. This results in hedge ineffectiveness. An entity needs to assess whether the level of ineffectiveness would preclude continuation of hedge accounting. If hedge accounting is discontinued, subsequent fair value changes of the IRS would be accounted for in profit or loss, resulting in volatility in the income statement.

Presentation of negative interest rates in financial statements

Another topic the IC has discussed is the presentation in the financial statements. The IC observed that interest resulting from a negative effective interest rate on a financial asset does not meet the definition of revenue in IAS 18 because it reflects a gross outflow, instead of a gross inflow, of economic benefits.

As a result, an entity could present negative interest as a separate line item on the face of the income statement either within 'net finance costs' (being finance income, finance costs and negative interest) or as an other expense category. It could also be included within finance costs.

Negative effective interest arising on a financial liability is a gross inflow and should be presented within interest income or other income. Negative interest income or expense could be presented separately on the face of the income statement or disclosed separately in the notes to the financial statements. Once management has selected a particular presentation, they should apply it consistently.

Embedded derivatives - debt instruments containing interest rate floors

Many debt instruments including bank debt and bonds commonly include 'embedded' features. A typical example would be a zero percent floor, which is a feature that limits the amount of interest to be paid/received to zero. That is, no negative cash flows arise on the loan. These floors are commonly found in floating rate loans (that is, loans bearing a benchmark rate, such as Libor, plus a credit spread).

This feature appears in many loans and in a 'normal' interest rate environment is not seen as a significant feature for the borrower or the lender. The assumption has been that the feature is unlikely to be relevant and cash flows of the arrangement will not be modified because of it. This means that the 'floor' was assessed as 'closely related' to the host instrument at the inception of a borrowing.

An entity is required under IAS 39 to assess whether an embedded floor is closely related (or not) to the loan. If not closely related, it must be accounted for separately from the loan, as if it was a stand-alone derivative, introducing volatility to the income statement.

The closely related assessment requires an entity, at inception of the instrument, to compare the embedded floor to the corresponding market rate. The lower interest rates are, the more important this assessment becomes.

Different views have been expressed on which market rate should be used for purposes of this assessment. Should it be the benchmark rate or should it be the

benchmark rate plus the credit spread. If the credit spread is not considered, it is likely that more embedded zero percent floors would be accounted for separately when the interest rates are negative.

Most companies, in practice, have used the benchmark rate and the credit spread. Thus, few companies are separating the embedded zero floor and accounting for it separately today.

This topic will be further discussed by the IC

in September. Companies that are affected should continue to monitor the discussions.

What should you be doing?

The extent to which negative interest rates could impact an entity's financial statements varies depending on particular facts and circumstances; careful consideration should be given. Have you assessed the effects that negative interest rates bring to your entity's financial statements? If not, now is the time to start!

Cannon Street Press

The IASB has issued its **work plan 2016-2020**, and asks for comment on whether they have set the right priorities, and whether the projects identified are indeed the most pressing areas for improving IFRSs.

In parallel with this agenda consultation, the trustees of the IFRS foundation are also seeking input on the structure and effectiveness of the IFRS foundation, including the IASB.

Request for views on work plan

The request for views also discusses the effect of the 2011-2012 agenda consultation, and how the work plan developed in 2012-2015. The current work plan covers the time period until 2020 and is split into different categories, reflecting the different stages of the standard-setting process:

- **Research projects:** In response to the 2011-2012 agenda consultation, the IASB had introduced a research programme. Its purpose is to analyse possible problems based on evidence on the nature and extent of the perceived shortcoming and assessing potential ways to improve financial reporting. The main output of such research programs are discussion papers (DP) and research papers, for example the **DP on macro hedging**, which helped the IASB decide whether

they should start a standards-level project.

- Standard setting projects aim at developing a new standard or substantially amending an existing standard. They are only started when the IASB has sufficient evidence that the problem is defined properly and that the staff have identified possible high-quality solutions that are implementable.
- Maintenance and implementation projects include projects to make minor amendments to existing standards, issuing formal interpretations, and post-implementation reviews (PIRs). In response to the 2011-2012 agenda consultation, the IASB has devoted more resources to maintenance and implementation projects, which also include post-implementation reviews (PIR).

In addition to these categories, the IASB has included the Conceptual Framework and the Disclosure Initiative as separate areas for the purpose of allocating resources, as they are cross-cutting and so significant that they justify separate mention.

Research projects

The projects that are currently in the research phase (per the IASB):

Assessment stage:

- Definition of a business
- Discount rates
- Goodwill and Impairment
- Income taxes
- Pollutant pricing mechanisms
- Post-employment benefits
- Primary financial statements
- Provisions, contingent liabilities and contingent assets

Development stage:

- Business combinations under common control
- Disclosure Initiative: Principles of Disclosure
- Dynamic risk management
- Equity Method
- Financial instruments with characteristics of equity

Inactive:

- Extractive activities / Intangible assets / Research and Development
- Foreign currency translation
- High inflation

Share-based payments The IASB will decide on which inactive projects to remove from its work plan, and which projects to add based on the comments received.

Standard setting projects

The request for views lists the following major projects including the announcement that it is likely that these will be completed in the first part of the work plan period:

- Insurance contracts
- Leases
- Disclosure Initiative:
 - Changes in accounting policies and estimates
 - Materiality practice statements
 - Principles of Disclosure

- Conceptual Framework
- Dynamic risk management
- Rate-regulated activities

Additionally the IASB noted the next review of the IFRS for SMEs, and post-issuance support for completed projects.

Maintenance and implementation projects

Most of the projects on the current list for interpretations, annual improvements or other narrow-scope amendments are expected to be completed within the next six months, and new projects are likely to replace them. The request for views includes an overview of the amount of maintenance and implementation projects finalised since the 2011/2012 agenda consultation.

Next steps

The 2015 request for views is open for comment until 31 December 2015. The IASB seeks feedback on the balance of their projects, the research programme, the major projects, and the level of change. Additionally the IASB raises the question of what frequency would be appropriate for agenda consultations.

Input to other activities of the IASB, such as education and content services, the IFRS taxonomy, and the impact of developments in technology are being considered in the separate review by the trustees. This review is open for comment until 30 November 2015. Additionally the trustees ask for views about the focus of the IASB, involvement in developments in wider corporate reporting, how the IASB can best support regulators in their efforts to improve digital access and in general what steps the IASB should take with regards to changes in technology and the consistent application of IFRS. Respond to the IASB's [invitation to comment here](#).

Have you seen the latest PwC IFRS blogs

Mary Dolson demands sensible guidance for investment entities

Dave Walter sings the final countdown about the leasing standard

IFRS rejections in short – IAS 7

Nitassha Somai of Global Accounting Consulting Services examines the practical implications of IFRIC rejections related to IAS 7.

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 7 as per below.

The saying goes that 'cash is king'. Users of financial statements stay true to this saying and continue to focus on the ability of an entity to generate cash as well as how it has used that cash. The cash flow statement is the tool designed by standard setters to communicate this information, splitting cash flows into operating, investing and financing activities.

Theoretically, the preparation of a cash flow statement is not overly complex. Cash movements should be a simple function of reconciling cash received to cash paid. Nonetheless, in an accruals based framework, complexities arise. To date there have been four NIFRICs in relation to IAS 7.

Classification in cash flow statement

Value added tax (August 2005)

The IC was asked to consider whether cash flows reported should be measured as inclusive or exclusive of Value Added Tax ('VAT'). The IC acknowledged that IAS 7 does not address the treatment of VAT, but noted that it would be appropriate for entities to disclose whether they present their gross cash flows inclusive or exclusive of VAT.

The IC concluded that whilst different practices may emerge, this issue is not expected to be widespread. Where sales tax is recoverable we believe that cash flows should be shown net of tax. On the contra, where sales tax incurred by the entity is

irrecoverable, the cash flows should be shown gross.

Classification of expenditure (March 2008)

The IC was asked to consider the classification of expenditures in the cash flow statement in particular, those expenditures that might be recognised, according to the applicable standard, as an asset or an expense (for example, exploration and evaluation activities and advertising and promotional activities). There was diversity in practice for expenses which did not qualify for asset recognition. Whilst some entities included these expenses as part of operating activities, other entities included it as part of investing activities.

The IC recommended to the Board and IAS 7 was subsequently amended to make it explicit that only expenditures which result in a recognised asset can be classified as investing activities.

Definition of cash and cash equivalents

Classification of money market funds (July 2009)

The IC was asked to consider whether shares in money market funds that are readily convertible and rated as being subject to an insignificant risk of changes in value qualify as cash equivalents.

The IC noted that the purpose of holding cash equivalents is to meet short-term cash commitments. The critical considerations in making this assessment is that cash equivalents should be 'convertible to known amounts of cash' and 'subject to insignificant risk of changes in value'. The first consideration means that the amount of cash that will be received must be known at the time of the initial investment. Units cannot be considered cash equivalents simply because they can be converted to cash at any time at the then market price in an active market. An entity would also have to satisfy itself that any investment was subject to an insignificant risk of changes in value for it to be classified as a cash equivalent. At the time of the initial investment the risk of future changes in value is insignificant.

Possible approaches to the assessment include strict fund management policies to ensure that the investments in the fund meet all the requirements for cash and cash equivalents. This could include an investment in instruments with the highest credit quality or short-term instruments with high liquidity. Another approach would be to look through the fund to establish whether substantially all of its investments qualify individually as cash and cash equivalents.

Summary of IAS7 rejections

The IC did not expect significant diversity in practice on the basis that the guidance in IAS 7 is adequate and the purpose of holding the instrument and the satisfaction

of the criteria should be clear from its terms and conditions.

Identification of cash equivalents (May 2013)

The IC was asked to consider if the classification of investments as cash equivalents based on the remaining period to maturity as at balance sheet date would lead to a more consistent classification, as opposed to focusing on the investment's maturity at inception.

The IC noted that for an investment to qualify as a cash equivalent it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition. The IC observed that this three month presumption promotes consistency between entities in the classification of cash equivalents. It therefore concluded that in light of existing guidance, an interpretation or amendment to IAS 7 was not necessary. The IC does not expect significant diversity in practice.

Topic	Summary conclusion
VAT (August 2005)	The IC was asked to consider whether cash flows should be provided inclusive or exclusive of VAT. The IC concluded that cash flows can be presented either inclusive or exclusive of VAT, however, it would be appropriate for entities to disclose the approach
Classification of expenditure (March 2008)	The IC was asked to consider the classification of expenditures in the cash flow statement. The issue was referred to the IASB and IAS 7 was subsequently amended to explicitly state that only expenses that result in the recognition of an asset should be presented as investing activities.
Investments in money market funds (May 2009)	The IC was asked to consider if investments that are redeemable at any time meet the definition of cash equivalents. It was concluded that such instruments could meet the definition of cash equivalents when the investment was convertible to a known amount of cash and was subject to an insignificant risk of changes in value.
Identification of cash equivalents (May 2013)	The IC was asked to consider whether the classification of investments based on its remaining term to maturity would lead to a more consistent classification of investments. The IC did not add this issue to its agenda in light of the existing guidance and confirmed that investments should be classified based on their maturity from the date of acquisition.

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
ruth.e.preedy@uk.pwc.com: Tel: + 44 (0) 207 213 2123

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

Financial instruments and financial services

jessica.taurae@uk.pwc.com: Tel: + 44 (0) 207 212 5700
gabriela.d.martinez@uk.pwc.com: Tel: + 44 (0) 207 804 4464

IFRS news editor

Anna Schweizer
anna.k.schweizer@uk.pwc.com: Tel: +44 (0) 207 804 3129

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TRG for Impairment of Financial Instruments weighs in again on IFRS 9 implementation issues

The Impairment of Financial Instruments Transition Resource Group (ITG) continues to discuss impairment implementation issues.

The ITG discussed issues related to significant increases in credit risk, use of changes in the risk of a default occurring over the next 12 months as an approximation of the changes in the lifetime risk of a default, measurement of expected credit losses for revolving credit facilities, and forward-looking information.

For more details, see [In Transition](#).

The staff agreed to discuss the scope of the exception to the contractual terms in IFRS 9 with the IASB.

The ITG discussed how an entity should estimate future drawdowns on undrawn lines of credit when an entity has a history of allowing customers to exceed their contractually set credit limits on their overdrafts and other revolving credit facilities.

The ITG reaffirmed that the exception to the contractual terms in IFRS 9 is specific to the contractual period and could not be extended to the contractual credit limit.

However, a number of ITG members noted that the requirements of the standard will result in differences between credit risk management practices and accounting. In

addition, it is not always clear what the 'contractual limit' is, for example when a revolving credit contract does not have a limit. The IASB staff agreed to discuss these points with the Board.

Topics discussed with no further action expected

Significant increases in credit risk

The ITG discussed how an entity should determine whether there has been a significant increase in credit risk in two particular scenarios:

- (a) a portfolio of loans where identical pricing and contractual terms are applied to customers across broad credit quality bands, for example, most retail loans; and
- (b) whether an entity can use behavioural indicators of credit risk as a proxy for the assessment of significant increases in credit risk since initial recognition.

The ITG agreed that if entities want to use the approach set out in Illustrative Example 6 in IFRS 9 – comparison to maximum initial credit risk – they need to ensure that the loans within the portfolio have similar initial credit risk, and that any

movement in credit rating within that grouping will not significantly increase the credit risk. The ITG questioned whether a grouping of loans with credit grades 1 to 5 on a 10 grade scale would meet that requirement.

When using behavioural information, entities will have to demonstrate it is a proxy for a significant increase in credit risk. Behavioural information is usually based on historical information while IFRS 9 requires the use of forward-looking information. Entities should ensure that any proxy includes all reasonable and supportable information including forward-looking information.

Use of changes in the risk of a default occurring over the next 12 months when assessing for changes in the lifetime risk of a default

The ITG was asked for their views on whether and to what extent an entity would be required to perform an annual review to determine whether circumstances still support the use of a 12-month approximation of changes in the lifetime risk of default occurring.

Entities will need to perform appropriate analysis before concluding that changes in the risk of a default occurring over the next 12 months can be used as an approximation of changes in the lifetime risk of default occurring. At each reporting date, entities would need to consider whether there was any change in circumstances which would indicate that a lifetime assessment is necessary.

Forward-looking information

The paper asked the ITG for their views on:

- (a) whether forward-looking information should be incorporated into impairment reviews differently; for example, on a portfolio by portfolio basis and/or on an entity basis (for macroeconomic information); and
- (b) how to determine what is 'reasonable and supportable' forward-looking information about emerging issues

and uncertain future events to include in the measurement of expected credit losses.

All available information should be considered by an entity to determine whether it is relevant and should be taken into account. Events which management believe will affect the assessment of the credit risk need to be taken into account even if there is a low likelihood of the event occurring.

However, where an entity views the outcome of an event, in the context of whether it affects the assessment of credit risk, as speculative in nature and having little or no basis, then the entity should not take this event into account in its expected credit loss assessment.

The ITG concluded that entities would need appropriate governance and controls around their processes for considering what events should and should not be considered. This includes documenting the rationale for their decisions and including appropriate disclosure in the financial statements.

Guidance of Basel Committee on Banking Supervision on expected credit loss

The guidance is aimed at the internationally active banks using the IRB approach. It will consider materiality, individual and collective allowances, significant increase in credit risk, use of expert judgement, measurement uncertainty and forward-looking information. The guidance will limit the use of practical expedients and will not introduce new disclosure requirements. The final document is expected to be issued before the end of 2015.

What's next?

The next ITG meeting is scheduled for December 2015. There are no meetings scheduled after that date. However the ITG will stand ready to receive and discuss relevant issues in 2016 should the need arise.

IASB proposes deferral of effective date of amendments to IFRS 10 and IAS 28



The IASB has proposed to indefinitely defer the date when entities must change some aspects of how they account for transactions between investors and associates or joint ventures. This means that diversity in practice will remain until the IASB has finalised its equity accounting projects. Tatiana Geykhman from Accounting Consulting Services looks into the implications.

The IASB decided in July to indefinitely defer the 'Sale or contribution of assets between an investor and its associate or Joint Venture' amendment to IAS 28 and IFRS 10. The related question was instead added to the equity method research project. At the same time, early adoption of the amendments is permitted.

What has happened before?

In September 2014 the IASB issued a narrow-scope amendment to IAS 28 and IFRS 10 that was intended to resolve a current inconsistency between the two standards. Based on the amendment, full gain or loss would be recognised by the investor where the non-monetary assets contributed constitute a 'business'. If the assets do not meet the definition of a business, the gain or loss would only be recognised by the investor to the extent of the other investors' interests, i.e. partial gain or loss recognition.

The amendments would only have applied when an investor sells or contributes assets to its associate or joint venture.

In January 2015 the IASB discussed an unintended consequence of this amendment; IAS 28 requires that an entity should recognise as income any excess of the fair value of the net assets of an acquired associate (or JV) over the cost of that associate (or JV) on initial acquisition.

Applying these requirements in the limited circumstances described would result in a re-recognition of the gain eliminated by the September 2014 amendments as income.

The IASB thus decided in January 2015 to amend IFRS 10 to explain that, in these limited circumstances, the cost on initial recognition of the retained investment is the fair value of that investment, and any gains or losses to be eliminated are a subsequent adjustment. This is intended to prevent a reversal of the partial elimination of the gain.

In June 2015 the IASB decided to suspend work on the new amendment and instead address these issues as part of the research project on the equity method of accounting. As a result the IASB proposed indefinite deferral of the application date of the September 2014 amendments.

The implications

Whilst the guidance is not finalised, the affected entities could continue applying an accounting policy choice. Where the non-monetary assets sold or transferred to its associate or joint venture constitute a 'business', entities could either recognise full gain or loss on the sale or transfer, or the gain or loss only to the extent of the other investors' interests, i.e. partially. The policy chosen should be applied to all other similar transactions.

Has the IASB driven the extensive use of fair value?

Anna Schweizer from Accounting Consulting Services takes a closer look at findings from Prof. Christopher Nobes' recent research.



Christopher Nobes is professor of accounting at Royal Holloway (University of London) and the University of Sydney. He was a member of the Board of the IASB's predecessor, the IASC. Professor Nobes researches the nature and causes of international differences in financial reporting. In this article we take a closer look at his research around the use of fair value in IFRS.

Has the IASB extended FV accounting?

One often reads in the financial or academic press that IFRS requires extensive use of fair value and that the IASB is inexorably moving towards fair value (FV). Professor Nobes has exploded this myth.

The IASB is now in its fifteenth year and has issued 15 new standards (IFRS 1 to IFRS 15). How many of these introduce the FV basis, that is, consistent measurement at FV? None.

The IASB has also amended many of the old IASs, but none of these amendments has introduced or extended the fair value basis.

Apart from IAS 39, the FV basis is required only for few and specific purposes by pre-IASB standards, such as for biological assets and pension funds. The FV basis is *allowed* for many other non-current assets but closer inspection reveals that it is largely confined

to the financial sector and to property rather than all PPE. In conclusion, most companies do not use the FV basis for assets or liabilities shown in their balance sheets, except for financial instruments, and then for only a small proportion of them.

One-off use of FV (as opposed to the FV basis) is sometimes used to estimate 'cost' for initial recognition, e.g. assets acquired in a business combination. We were already doing this for decades before IFRS.

Some version of FV is also used as one of the ways of measuring loss of value of assets under IAS 36 and IFRS 5. However, of course, this is only for writing assets *down*, and is really part of prudence, of which opponents of FV approve.

Conclusions

The FV basis is used for a substantial portion of assets by financial companies. However, for a large proportion of IFRS-using entities, the FV basis is confined to a very small minority of their assets: a small proportion of their financial assets. When FV is used, it is often to help determine initial cost when there is no sensible alternative, or to measure loss of value in specific assets.

Thus, extensive use of the FV basis under IFRS is a myth. Read more in [Chris Nobes' blog](#).

Have you seen the latest PwC IFRS blogs?

Irina Sedelnikova asks why insurers want to defer adoption of IFRS 9

Christopher Nobes questions whether the IASB is really hell-bent on introducing fair value

Insurance contracts

A summary of the IASB's recent tentative decisions relating to the new standard for insurance contracts.

The IASB continued deliberations on contracts with participation features.

Disaggregating changes arising from changes in market variables in the statement of comprehensive income

Presentation of changes arising from changes in market variables

For all insurance contracts, an entity should present changes in estimates of the amount of cash flows that result from changes in market variables in the same location in the statement of comprehensive income consistently with the changes in discount rates.

The standard will specify objective rather than detailed mechanics for using the cost measurement basis

The forthcoming standard will specify that the objective of disaggregating changes in the insurance contract arising from changes in market variables between profit or loss and other comprehensive income is to present an insurance investment expense in profit or loss using a cost measurement basis. The standard would not include detailed mechanics, but only require that the cost measurement basis should result in an allocation of the yield over the life of the contract on a systematic basis. An entity could also opt for a FVPL approach as an accounting policy choice.

Modification of the objective for contracts with no economic mismatches

The IASB voted to allow the “current period book yield approach” for contracts that meet the direct participation criteria, and where the entity is either required to hold the underlying items or holds them by choice.

This approach was described as a “modified objective” from the cost basis approach. An entity could also opt for a FVPL approach as an accounting policy choice.

Changing approaches

The IASB tentatively decided upon transition requirements when an entity is required to change between the effective yield approach and the current book yield approach.

Transition requirements

When on transition retrospective application is impracticable, the IASB have tentatively decided upon several measures to simplify the approach determining the insurance investment expense.

Avoiding accounting mismatches arising from use of the variable fee approach combined with hedging activities

If an entity uses the variable fee approach and a derivative measured at FVPL to mitigate the financial market risk from the guarantee embedded in the insurance contract, the entity would be permitted to recognise in profit or loss the changes in the value of the guarantee, determined using fulfilment cash flows. Furthermore, the IASB tentatively decided upon the conditions for applying this approach and the documentation requirements.

Next steps

The IASB expects to complete its deliberations on insurance contracts in 2015 and draft the standard in 2016 with a goal of issuing the final standard in 2016 or early 2017.

Cannon Street Press

Insurance contracts: IFRS 9 and IFRS 4

The IASB continued discussions on the possible accounting consequences of the different effective dates of IFRS 9 *Financial Instruments* and the new insurance contracts standard. The IASB voted (based on the chairman's casting vote) to issue an exposure draft in late 2015 to amend IFRS 4 to give entities whose business model is to predominantly issue insurance contracts the option to defer the effective date of IFRS 9 until 2021 (the 'deferral approach').

The IASB tentatively decided that applying the deferral approach would be permitted for entities with predominantly insurance activities which would be assessed at the reporting entity level. The IASB tentatively

decided not to include quantitative thresholds in the standard, but include an example in the Basis of Conclusions with a threshold for IFRS 4 liabilities that would be somewhat higher than 67%. The deferral approach would apply to all financial assets. At each reporting date a reassessment would be required.

Alternatively, an entity could implement IFRS 9, but opt to remove from profit or loss some of the accounting mismatches and temporarily volatility that could occur before the new insurance contracts standard is implemented (the 'overlay approach'). The IASB further tentatively decided on redesignation of financial assets, transition and on presentation and disclosure requirements.

Disclosure Initiative

Principles of Disclosure

The IASB continued to discuss a new approach for drafting disclosure requirements in standards. The IASB agreed with the refined version of the proposed approach and tentatively decided to include the draft chapter presented in the Principles of Disclosure DP.

Reconciliation of liabilities arising from financing activities

The IASB discussed feedback to the ED and

tentatively decided to proceed with the amendment to IAS 7 as proposed in the ED subject to clarifying in the standard the objective for the disclosure requirement and that an entity has flexibility to determine what information is needed and to what extent.

Cash restrictions

The IASB started discussion of the proposals for consideration and will continue deliberations at its next meeting

Revenue from contracts with customers

The IASB discussed an implementation question relating to the transition

requirements in IFRS 15 and decided not to propose any amendments.

Research programme

The IASB discussed the current research programme. Initial preparatory work has now commenced on the project on primary

financial statements. However, the staff noted it would be several months before plans for this project can be discussed by the IASB.

Financial Instruments with characteristics of equity

The IASB discussed an analysis and possible improvements of the existing definitions and other related requirements

in IAS 32. The IASB will continue its discussion at a future meeting.

IFRS Rejections in short - IAS 8

Chen Wu of Global Accounting Consulting Services examines the practical implications of IFRIC rejections related to IAS 8.

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 8 as per below.



IAS 8 deals with accounting policies, changes in accounting estimates, and errors. One would think this is an area where preparers and auditors might have raised numerous questions. However, this is apparently not the case.

There are only two IAS 8 NIFRICs. One relates to the application of the IAS 8 'impracticability exception' in the context of first time adoption and the other relates to the application of the IAS 8 hierarchy when developing accounting policies.

Application of IAS 8 'impracticability exception' for first time adopters (October 2004)

IAS 8 provides an 'impracticability exception' which allows entities to deviate from the full retrospective application of the new accounting policy if it is impracticable to determine the prior year effects caused by the accounting policy change.

The IC was asked whether this 'impracticability exception' should also apply to first time adopters under IFRS 1. The IC agreed that there were potential issues, especially with respect to 'old' items. For example, data may not have been collected in prior periods for long-lived assets in a way that allows the retrospective application of a new accounting policy, and it may be impractical to recreate the information.

However, the IC believed those issues could usually be resolved by using one of the

transition options available under IFRS 1. For example, IFRS 1 allows the first-time adopter to assess whether or not an arrangement contains a lease to be carried out at the date of the transition based on the facts at that date instead of at the inception of the arrangement, which would be required in the full retrospective adoption of IFRIC 4.

Application of IAS 8 hierarchy (January 2011)

Where there is no standard or interpretation that specifically applies to a transaction, IAS 8 requires management to use its judgment to develop and apply an accounting policy that is relevant and reliable. The hierarchy suggested in IAS 8 is:

- a) Applying the requirements in IFRSs dealing with similar and related issues;
- b) Applying the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework.
- c) Considering the most recent pronouncements of other standard-setting bodies that use a similar framework, other accounting literature and accepted industry practices, to the extent these do not conflict with the IFRS sources.

The submission to the IC questioned the appropriateness of applying only certain aspects of the IFRS standard being applied

by analogy. For example, if management refers to IFRS 3 when developing the accounting policy for business combinations between entities under common control, can it apply only the requirement to measure net identifiable assets at fair value but not the requirement to recognise in earnings any gain or loss relating to a previously held equity interest?

The IC rejected this issue as it felt that the current guidance is sufficient. The IC concluded that when analogising to an IFRS dealing with similar and related matters, management should use its judgment in applying all aspects of the IFRS that are applicable to the particular issue.

Summary of IAS 8 rejections

Topic	Summary conclusion
Application of IAS 8 'impracticability exception' under IFRS 1 (October 2004)	The IC was asked whether the IAS 8 'impracticability exception' should also apply to first time adopters. The IFRIC agreed that there were potential issues, especially with respect to "old" items. However, the IC felt that those issues could usually be resolved by using one of the transition options available under IFRS 1.
Application of IAS 8 hierarchy (January 2011)	The IC concluded that when analogising to an IFRS dealing with similar and related matters, management should use its judgment in determining which aspects of the IFRS that are applicable to the particular issue.



P * Q

Yet again, you might want to mind your p's and q's,

The IASB is still developing its own views.

What does all this really mean?

That still remains to be seen.

Let's remember that when looking at a fair value measure,

Control premium is something many preparers treasure.

So should fair value be P*Q?

Ignore premiums/ discounts, that's one view.

The Board is still locked in a debate -

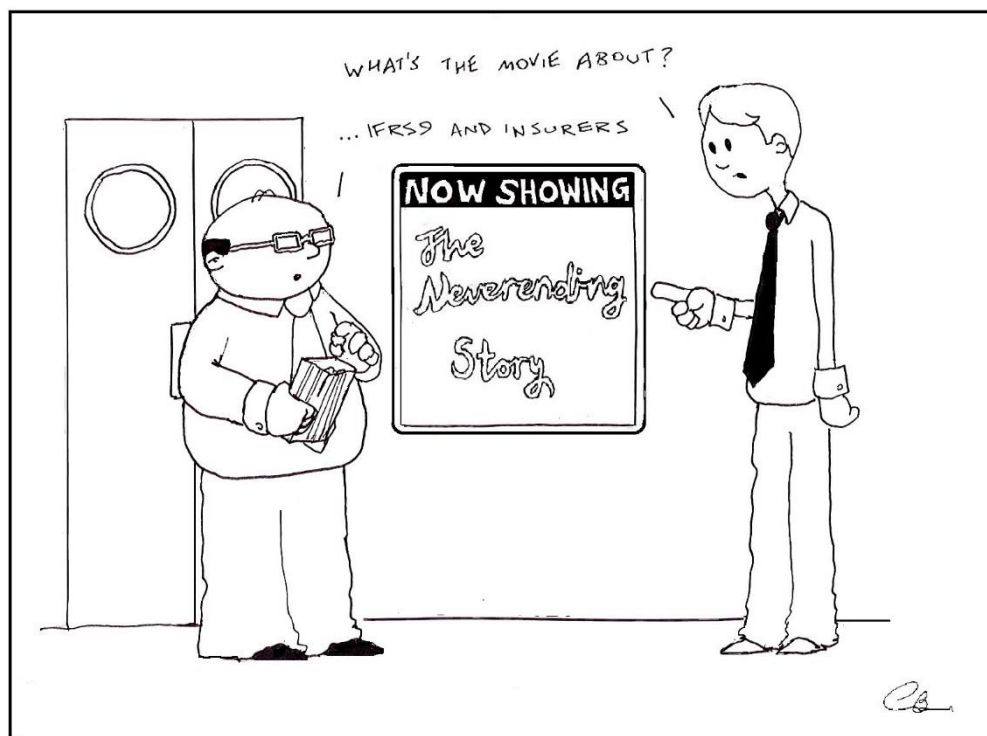
How do share price and quantity relate?

Watch this space because there might be a change

To value investments listed on a stock exchange.

by Ruth Preedy

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
ruth.e.preedy@uk.pwc.com: Tel: + 44 (0) 207 213 2123

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

Financial instruments and financial services

jessica.taurae@uk.pwc.com: Tel: + 44 (0) 207 212 5700
gabriela.d.martinez@uk.pwc.com: Tel: + 44 (0) 207 804 4464

IFRS news editor

Anna Schweizer
anna.k.schweizer@uk.pwc.com: Tel: +44 (0) 207 804 3129

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