



IFRS news

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IC tentative decisions indicate potential guidance on IFRS 11

Derek Carmichael from PwC's Accounting Consulting Services looks at the latest developments on joint arrangements and what management might need to consider for year-end reporting.

November 2014 saw the IFRS Interpretations Committee (IC) publish their series of tentative agenda decisions on joint arrangements. This follows 12 months of discussion and deliberation on a variety of IFRS 11 implementation issues submitted for their consideration.

A common phrase in the tentative decisions is:
"The Interpretations Committee [decided] not to add this issue to its agenda."

This recurring conclusion was reached on the basis that there is already sufficient guidance in the standard to address the issues raised.

The rationale given for the conclusions provides additional clarity on the application of some of the more challenging aspects of IFRS 11, such as:

- the assessment of whether 'other facts and circumstances' affect the classification of the arrangement; and
- accounting for joint operations that are separate vehicles.

The IC also agreed that two joint arrangements with similar features could be classified differently when one is structured through a separate vehicle and the other is not. This is because the legal form of a separate vehicle affects the rights and obligations of the parties.

Key observations

Classification - other facts and circumstances

- The assessment of other facts and circumstances should focus on whether they create enforceable rights to assets and obligations for liabilities.
- An arrangement is a joint operation when other facts and circumstances mean the parties have rights and obligations relating to the assets of the arrangement and have a legal or contractual obligation to provide cash to settle liabilities on a continuous basis.



- Sale of output to the parties to a joint arrangement at market price is not, on its own, a determinative factor for classification of the arrangement. Consideration is still required to determine whether sales at that price will enable the arrangement to settle its liabilities on a continuous basis.
- Financing from a third party does not prevent classification as a joint operation if repayment of that financing is funded from sales to the parties to the joint arrangement.
- The nature of output (whether it is fungible or bespoke) is not a determinative factor for classification.
- Assessing whether parties to the arrangement are taking “substantially all of the output is based on the monetary value rather than physical quantities.

Joint operator accounting – joint operations in a separate vehicle

- Joint operators should not recognise any revenue related to output purchased by the joint operators until it has been sold to third parties where a separate vehicle has been classified as a joint operation because the parties take all output.
- No additional guidance will be provided for situations when the share of output purchased by a joint operator differs from its ownership interest in the joint operation. The IC noted that it was important to understand the reason for the difference, and then apply judgement to determine the appropriate accounting.
- The accounting by a joint operator for its interest in a joint operation should be the same in both its consolidated and separate financial statements. The joint operator accounts for its share of assets and liabilities, but does not

recognise its shareholding in the separate vehicle.

Accounting by a joint operation which is a separate vehicle

IFRS 11 does not apply to the accounting by a joint operation. Financial statements of a joint operation should be prepared in accordance with applicable accounting standards and include the assets, liabilities, revenue and expenses of the joint operation. It is, however, important to understand the rights of the joint operators to those assets and liabilities, and how those rights would affect the assets and liabilities recognised by the joint operation.

What is next?

The agenda decisions in the November 2014 IFRIC Update are open for comment and will be redeliberated at the IC meeting in March 2015.

Although the tentative decisions do not propose any amendments to the standard, preparers of financial statements should consider whether the conclusions they have reached on joint arrangement classification and accounting are consistent with the views expressed by the IC. They should also consider whether to provide comments to the IC on the tentative decisions.

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Santa's other present – the new revenue standard

Dave Walters gives us the gift of laughter over the holiday season with his take on the accounting challenges faced by Father Christmas.



On Christmas Eve, Santa's Chief Financial Reporting Elf rushes into his office. "Santa, I need to talk to you about revenue."

"Really, is it important?"

"According to the management accounts it is. Can I start with the second hand mince pies?"

"Those... well I collect about a billion on my way around and can't manage them all, so I've sold the remainder, sight unseen, to a third party. We'll get cash on delivery on 26 December and that's it – no returns!"

"Seems straight forward then – revenue on 26th December" said the Elf, "just in time for the year end! What about the technology deal with the logistics company?"

"Ah, I'm very proud of that. I negotiated an extra fee if our software improved their delivery efficiency by 30% and based on previous experience, I know they'll do it – even without the Reindeer service option!"

"Does the extra fee meet the probable test for our US GAAP numbers, or highly probable, for the IFRS ones?" asked the Elf.

"Yes" said Santa, with a sly look into his desk drawer. "Er....it's probable or highly probable (um....delete as applicable) that a significant revenue reversal will not occur".

"Excellent!" said the Elf, "Because the Chief Operating Decision Maker, or Mrs Claus as I call her, has included that additional fee in the budget. By the way, what's this 'other income'?"

"Ah", said Santa, "I'm very pleased with that. You know that list I've checked, at least twice, of all the kids who are naughty and nice?"

"Yes," said the Elf, slowly.

"I've sold it!"

"What!? Who to?"

"That is classified! Let's just call them 'The Agency'. I got cash up front too, in return for a discount. I promised to keep the list updated for free for the next 10 years but that's easy."

The Elf paused, "It may be easy for you to do but the accounting isn't straight-forward. Revenue over 10 years and there's a significant financing component! Never mind, Santa, I'm here to keep your accounts 'elfy'!" he said with a grin.

"That's a joke isn't it?" said Santa. "Twice in five years – keep it up! Oh, and there's also the air resistance technology intellectual property I've licensed to Oxford University. The related experiments are going very well. The reindeer are literally flying around with a 50% reduction in air resistance thanks to their Teflon-like covering, although", he paused thoughtfully, "there are a few teething issues with braking. We've had a 400% increase in claims for wrecked chimneys. Anyway, we'll get a fee from the University for every product they sell using our intellectual property so we can recognise that revenue in the future – but only when they sell it! That's right, isn't it? The new standard has an exception from the need to recognise variable consideration regardless of how probable it is for sales-based royalties on licenses of intellectual property?"

“Yes,” said the Elf. “You’re reading from the accounting reference book inside your desk drawer again aren’t you? And on the topic of Reindeer, Mr Claus, sir, non-Human Resources have requested you stop singing ‘Rudolph the non-stick Reindeer’ as it is unsettling the workforce.”

“OK,” said Santa glumly.

“Any other material sources of income?” asked the Elf?

“Material?” responded Santa, “Well, I suppose dung is material!”

“That’s not quite what I meant but it is income,” said the Elf. “Revenue on delivery?”

“Yes” replied Santa, “although I’ve had a few complaints about the delivery method. Can’t get out of the habit, you see, and people are so unreasonable. I mean, every chimney needs a sack of dung from time to time?”

“Hmm,” said the Elf. “Any returns issues?”

“No,” said Santa, “they’ve not yet worked out where we live. And besides, although they are unaccountably a bit miffed, they still pay on time. I have a naughty and nice list remember!”

The Elf hesitated. “Santa, there’s one more thing. We get lots of revenue from disposals of surplus mince pies but none in relation to wine or other alcoholic drinks? Any particular reason?”

“Ah”, smiled Santa. “Well, the cards accompanying the mince pies and wine instruct me to ‘Have a Merry Christmas’. So I do. Ho ho ho!”

10 reminders for year-end reporting

A busy reporting season looms for many: here are 10 reminders to consider for 2014 annual financial statements and links to relevant practical guidance. For more details, see the latest IFRS quarterly update, which also includes a summary of new standards applicable for 2014.

Regulatory interest in impairment reviews

The economic environment has been challenging over the past few years and impairment continues to be an area of concern for regulators. Remember to look out for impairment triggers (both internal and external) and ensure that key assumptions align with the information available in the external market. Remember disclosures. Regulators have observed that the discount and terminal growth rates are often incorrectly identified as the only key assumptions and entities often forget to include disclosures of the ‘key assumptions’ on which the cash flow projections are based.

Consolidation and IFRS 10

Many in the EU will be adopting IFRS 10 for the first time in 2014. The transitional provisions are complex and need careful consideration. In cases where there is reclassification in the comparatives, a third balance sheet is needed in line with IAS 1. One area on which regulators focus is ‘de facto control’. This is the situation where an entity is controlled by voting rights, and an entity owning less than 50% of those voting shares is deemed to have control because it has the practical ability to direct the relevant activities. IFRS 10 provides clearer guidance on de facto control compared with IAS 27, but it remains a highly judgemental area.

IFRS 12 disclosures

IFRS 12 aims to enable users to understand the interests that NCI has in a group’s activities. An entity will need to provide disclosures when NCI in a subsidiary is material. An entity should apply judgement to determine whether summarised financial information disclosed about a sub-group of a subsidiary that has material NCI is based on the consolidated information of the sub-group or disaggregated further to present information about individual subsidiaries with material NCIs. This was confirmed by the IFRS IC in September 2014. See more details at [IFRSs 10 and 12 - Questions and answers](#).

Measurement of joint operations

Measurement of a joint operation is largely unaddressed in IFRS 11, and as such, some diversity in practice has developed. This is an area of recent focus of the IASB and an amendment to IFRS 11 was issued in 2014. The amendment requires all of the principles of IFRS 3 to be applied to transactions where an investor obtains an interest in a joint operation that constitutes a business. The guidance is mandatory from January 2016. See [In depth Measurement of joint operations: Reading between the lines](#) for more insight.

Accounting for other admin costs under IAS 19 revised

Under IAS 19R, costs associated with the management of plan assets are deducted from the return on plan assets. Other administration expenses associated with the provision of employee benefits are recognised within operating results when the services are received. See [Practical Guide](#) for other reminders about employee benefits accounting for year-end.

Industry specific tariff and IFRIC 21

Industry-specific 'taxes' or 'levies' continue to be a popular way for governments to increase tax revenues. Tariffs not based on taxable profit are accounted for under IAS 37 rather than IAS 12. The IC issued IFRIC 21, an interpretation of IAS 37 which sets out guidance for recognising an obligation to pay a levy that is not income tax. IFRIC 21 could result in recognition of a liability later than previously, particularly for levies triggered by circumstances on a specific date. See [In depth, IFRIC 21 Levies](#) for more details.

Supplier financing arrangements

There has been an increase in questions around the accounting for supplier financing arrangements. Such arrangements raise the question of whether the trade payables that are the subject of the supplier financing should be derecognised and replaced by a bank borrowing. The accounting for supplier finance arrangements will depend on the exact facts and circumstances.

Debt restructuring

There is an increase in questions on the restructuring of issued debt instruments, for example loan facilities or bond financing. Some key areas to consider are:

- IAS 39 requires assessment of whether the new and old debt have substantially different terms when the exchange or modification is with same borrower / lender. If substantially different, the transaction is accounted for as an extinguishment.
- A non-bank entity may use a bank as an intermediary, for example, to buy back the original bonds and place the modified bonds with investors. A key consideration is whether the bank is acting as an agent or as principal, which is highly judgmental.

Cash pooling arrangements

Many groups have cash pooling arrangements. [IAS 32 offsetting guidance](#) applies to these arrangements and was recently amended (effective 1 January 2014) to clarify when an entity has a legally enforceable right of set-off. These arrangements take various forms including notional sweeping arrangements when no cash is swept but interest is earned on the net position. In these cases, offsetting is not appropriate as there is no actual sweep and no intention to offset the cash positions. It is important to understand the operational and contractual arrangements when assessing these arrangements.

Externally imposed capital requirements

IAS 1 requires an entity to disclose whether it complied with any relevant externally imposed capital requirements and, if not, the consequences of non-compliance. This includes capital requirements/limits established through contractual relationships – for example, with banks. Some regulators have observed that such disclosure is a significant area of information for users, particularly when assessing going concern.

Cannon Street Press

Investment Entities: IFRS 10 and IAS 28 amendments

The IASB published amendments to IFRS 10, IFRS 12 and IAS 28. The amendments clarify the application of the consolidation exception for investment entities and their subsidiaries.

The amendments to IFRS 10 and IAS 28 (2011) are effective from 1 January 2016. Earlier application is permitted.

Exception from preparing consolidated financial statements

The amendments to IFRS 10 clarify that the exception from preparing consolidated financial statements is available to intermediate parent entities which are subsidiaries of investment entities. The exception is available when the investment entity parent measures its subsidiaries at fair value. The intermediate parent would also need to meet the other criteria for exception listed in IFRS 10.

Subsidiaries which act as an extension of an investment entity

The amendments to IFRS 10 clarify that an investment entity should consolidate a

subsidiary which is not an investment entity and which provides services in support of the investment entity's investment activities, such that it acts as an extension of the investment entity. However, the amendments also confirm that if the subsidiary is itself an investment entity, the investment entity parent should measure its investment in the subsidiary at fair value through profit or loss. This approach is required regardless of whether the subsidiary provides investment-related services to the parent or to third parties.

Equity accounting for investments in associates and joint ventures

The amendments to IAS 28 allow an entity which is not an investment entity, but has an interest in an associate or joint venture which is an investment entity, a policy choice when applying the equity method of accounting. The entity may choose to retain the fair value measurement applied by the investment entity associate or joint venture, or to unwind the fair value measurement and instead perform a consolidation at the level of the investment entity associate or joint venture.

IAS 1 narrow scope amendments

The IASB issued amendments to IAS 1 as part of its Disclosure Initiative. They are effective from 1 January 2016.

Materiality

An entity should not reduce understandability by aggregating or disaggregating information in a manner that obscures useful information, for example, by aggregating items that have different characteristics or disclosing a large amount of immaterial detail.

When management determines an item is material, IAS 1 requires assessment of which specific disclosures (set out in the relevant standard) should be presented, and whether additional information is necessary to meet the needs of users or the disclosure objectives of that standard.

Disaggregation and subtotals

The amendments address additional subtotals in the statement of financial position or the statement of profit or loss and other comprehensive income. IAS 1 specifies what additional subtotals are acceptable and how they are presented.

Additional subtotals should:

- be comprised of items recognised and measured in accordance with IFRS;
- be presented and labelled in a manner that makes the components of the subtotal clear and understandable;
- be consistent from period to period; and
- not be displayed with more prominence than the subtotals and totals specified in IAS 1.

Additional subtotals must be reconciled to the subtotals and totals required by IAS 1.

Notes

Management should consider understandability and comparability when it determines the order of the notes. An entity is not required to present the notes to the financial statements in a particular order. An entity might, for example, present more significant notes first, or present linked areas sequentially. Such flexibility, which is already permitted by IAS 1, may allow for management to provide further insight about the entity.

Proposed narrow scope amendments to IFRS 2

The **exposure draft**, 'Classification and measurement of share-based payment transactions' issued by the IASB in November, brings together a collection of three proposed amendments to IFRS 2. These proposed amendments were initially discussed by the IFRS Interpretations Committee. The exposure draft is open for comment until 25 March 2015.

The proposals provide guidance on:

- the accounting for the effects of vesting conditions on the measurement of a cash-settled share-based payment;

IASB proposed amendments to IAS 7

The IASB has proposed amendments to IAS 7 on the presentation of a reconciliation of liabilities relating to financing activities and disclosure of restrictions on the use of cash and cash equivalents. The **exposure draft** is open for comment until 17 April 2015.

The ED proposes to add a disclosure requirement to IAS 7 for reconciliation of cash flows arising from financing activities (as reported in the statement of cash flows excluding contributed equity) to the corresponding liabilities in the opening and closing statement of financial position.

The proposals were issued in response to requests from investors to introduce a requirement that entities must disclose net

Disclosure of accounting policies

The amendments clarify how to identify a significant accounting policy by removing unhelpful examples from IAS 1.

OCI arising from investments accounted for under the equity method

IAS 1 requires that the share of other comprehensive income arising from investments accounted for under the equity method is grouped based on whether the items will or will not subsequently be reclassified as profit or loss. Each group should then be presented as a single line item in the statement of other comprehensive income.

- the classification of share-based payment transactions with net settlement features (for example, where an employer settles a share based payment transaction by issuing a net number of shares to the employee and paying cash to the tax authority) and
- the accounting for a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled.

debt reconciliation. The IASB's proposal draws upon the existing guidance on the statement of cash flows as 'net debt' is not defined in the IFRS. Some of the required information is already available elsewhere in the financial statements; however, the impact of foreign exchange movements, non-cash items, and business combinations is not always disclosed separately

The amendments also propose disclosure of restrictions that affect the decisions of an entity to use cash and cash equivalents, including tax liabilities that would arise on the repatriation of foreign cash and cash equivalent balance.

Know your IFRS ‘ABC’: V is for ‘Vesting conditions’



John Chan from PwC’s Accounting Consulting Services looks at the revised vesting condition definition and related accounting implications.

Picture this. You turn on your laptop one morning and receive an email message from your CEO addressed to all employees, “Win 100 ordinary shares of the company by accurately picking the 2018 World Cup winning team!” All of your colleagues are wild with excitement, but one department is just sitting in the corner scratching their heads; it must be the accountants. They are wondering how to account for this “gamble” initiated by their boss.

One of the accountants believes this should be accounted for as a share-based payment in accordance with IFRS 2. Another agrees but wonders if it is a vesting condition or market condition. Finally, the technical geek of the technical geeks announces that this definitely falls into the trap of the revised definition of vesting condition published by the IASB in its Annual Improvements last December.

Let’s re-cap some basics before applying them in practice for the case above.

The basics

What is a vesting condition?

A vesting condition is a condition that determines whether the entity receives the services that entitle the counterparty to receive cash, other assets or equity instruments of the entity, under a share-based payment arrangement. A vesting condition is either a service condition or a performance condition.

Service condition

It is usually straightforward to determine whether a service condition has been fulfilled. The condition is met if the employee or service provider has rendered the services to the entity for the specified period of time.

The employee or service provider will fail to satisfy this condition if the required service is not provided during the vesting period.

Performance condition

While the standard continues to define performance condition as including a service condition, the latest definition emphasises that the achievement of the performance target has to be within the service period. Therefore, any performance target to be satisfied after the specified service period would be regarded as a non-vesting condition.

In addition, a performance target has to be linked to operations or activities of the entity or some part of it, including its fellow group members or individual employees.

What does the revised definition mean in practice?

Let’s re-examine the “gamble” mentioned at the beginning of this article. What questions should the accountants ask themselves before determining the appropriate accounting?

Q1. Is there any specified service period?

A: The first and simplest question would be whether the employee is required to complete a specified service period. If no service is needed, the “gamble” would never qualify as a performance condition under IFRS 2. So if the employees have to stay with the company until the World Cup finals, then the condition does define the length of the service period.

Q2. Assuming the employee is required to provide a service for a specified period, would the gamble qualify as a performance condition?

A: One might have argued before the amendment that the gamble is a performance condition which defines the vesting period. The Annual Improvement clarifies that a performance target is defined by reference to the entity's own operations (or activities) or the price (or value) of its equity

In our case, the gamble has nothing to do with the operations or activities of the entity (even if the entity is one of the major organisers of the event). This means that this is a non-vesting condition.

Why the above is important to know after all?

If a condition is a vesting condition (service or a performance condition) and not a market performance condition (see below), these features only affect the assessment of the number of equity instruments expected to vest in the future. The features are not included in the measurement of the fair value of the instrument granted.

Any condition (performance target) that does not qualify as a performance condition defined above would be regarded as a non-vesting condition. Such conditions are incorporated in the fair value measurement of the equity instruments granted.

Let's get back to our example. If we assume that the employees are required to work for the company until the World Cup finals, the transaction will be accounted for as a share based payment under IFRS 2 and the gamble represents a non-vesting condition.

In our case, management would need to assess the fair value of the possible World Cup champions by taking into account various factors, including but not limited to the quality and performance of individual players, each team as a whole and even luck" etc. This can prove to be highly subjective and complex to derive. This condition is considered along with any

other assumptions required to value the share including the business value of the company.

What other areas might you need to know?

'Market' performance condition

There is no substantial change to the general definition of a market condition. It refers to a performance condition upon which the exercise price, vesting or exercisability of an equity instrument depends that is related to the market price (or value) of the entity's equity instruments. Such conditions affect the fair value measurement of the share-based payment, just like non-vesting conditions.

If an award had a condition based on the a particular share price index and the entity is one of the components of that index, some might argue that this should be regarded as a performance condition. The performance of the entity's share price will affect the index and the employee has to work until the index level is achieved.

However, the IASB confirmed that a share market index is a non-vesting condition because such an index not only reflects the performance of the entity in question, it also reflects the performance of other entities outside the group.

This is the case even where the entity's share price makes up a substantial part of the share market index. The same rationale applies.

Fellow group members

The IASB has also provided a clearer definition of performance condition. The Annual Improvement also clarifies a performance target can be defined by the price (or value) of the equity instruments of another entity in the same group. This amendment is consistent with the guidance for share-based payment transactions among group entities.

The bit at the back.....



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