



IFRS news

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Alternative Performance Measures – better described as ‘profits before unfortunate debits’?

The use of Alternative Performance Measures (APMs) is widespread. A recent analysis of reporting practices in the UK FTSE 100 revealed a need for more transparency, especially under the light of the ESMA guidance applicable for all announcements after 3 July 2016. Jennifer Lau and Anna Schweizer from Accounting Consulting Services look into the details.

The good news first: Our [review](#) of all the FTSE 100 companies with year-ends from 1 April 2014 to 31 March 2015 revealed that most companies explain their APMs and reconcile these to GAAP measures. However, such reconciliations are not always easy to find.

Our [surveys](#) show that investors find APMs useful, but would like more transparency over the information disclosed. We expect increasing regulator scrutiny (not only in Europe) over the use and disclosure of APMs and that the [ESMA guidelines](#) will significantly impact the disclosure of APMs. Companies should now be thinking about what they need to do to publish transparent, unbiased and comparable information on their financial performance.

Key findings

Our key findings can be summarised as follows:

- 95% of the FTSE 100 adjust their GAAP profit numbers.
- Adjustments almost always have a favourable impact on profit.

- Companies commonly adjust for: acquired intangibles amortisation; asset impairment; interest, depreciation, amortisation and tax.
- Descriptions of reconciling items are often too broad to understand what they relate to.
- Inconsistencies as to where and how reconciliations are presented.

These findings may not surprise, but they do suggest more work is needed by companies to ensure they comply with the ESMA guidelines.

Use of adjusted profit measures

95% of the FTSE 100 disclose an adjusted profit number. There was a range of alternative terms used to describe the adjusted profit figure with the most popular being:

- Adjusted operating profit (39%)
- Adjusted PBT (35%)
- EBITDA/adjusted EBITDA (11%)

Such a variety of approaches, sometimes between competitors and industries, often



makes it difficult for readers to understand and compare APMs.

A review of the total number of adjustments showed that movements in aggregate for all companies with an APM went from a GAAP figure of roughly £119bn to £187bn. Of the 95 companies that presented an adjusted profit figure only 12 reported a number less than the original GAAP figure.

What is being adjusted?

A variety of terms is used to describe the adjustments from GAAP numbers to APMs. The most common adjustments relate to:

- acquired intangibles amortisation,
- asset impairment;
- interest, depreciation, amortisation and taxation;
- bank specific adjustments for those in the banking industry.

Although there are a large number of adjustments being made, the value of adjustments represents a small proportion in comparison to the overall value. For example, 10% of companies are adjusting for pension-related items and nearly 30% of companies are adjusting for acquisition-related costs yet these represent only 0.4% and 0.7% of the total value of adjustments. The question for companies to ask is whether these adjustments are material enough to be separately identified.

28% (£6bn) of adjustments remain uncategoryed because the descriptions provided were not adequate to assign the adjustment to a category.

Placement of the reconciliation

While most companies (98%) provided a reconciliation of the APM to GAAP, there was no consistency in where they were reported and in some circumstances they were reported in more than one place:

- Front half (45%),
- Face of the primary statements (37%),
- Notes to the financial statements (57%),
- Other sections (7%).

This is not a problem unless, as was the case with a few companies, there is a lack of signposting to where the reconciliation could be found.

ESMA guidance

The guidelines apply to APMs disclosed in regulated information published by issuers with securities traded on regulated markets. These include APMs presented in the ‘front half’ of annual reports and interim financial reports, but exclude financial information provided in the audited financial statements of the accounts. They also apply to APMs in other regulated information published by an entity such as management reports, prospectuses, or ad-hoc disclosures on financial earnings.

An APM is “a financial measure of historical or future performances, financial position, or cash flows, other than a financial measure defined or specified in the applicable financial reporting framework.”

Under the guidelines, issuers are required to:

- Define APMs in a clear and readable way and give meaningful labels (impairments and restructuring charges are ‘rarely ... unusual or non-recurring’).
- Reconcile APMs to the most directly reconcilable GAAP line item explaining material reconciling items.
- Explain the use of APMs so users understand relevance and reliability.
- Not display APMs with more prominence, emphasis or authority than GAAP measures.
- Present APMs with comparatives which also need to be reconciled.
- Define APMs consistently over time and justify any changes made.

Next steps

APMs continue to be a hot topic for many from regulators and investors right through to the media. Based on our findings we think that more work will need to be done by companies to make their reconciling items relevant, understandable and not misleading.



More guidance for banks on IFRS 9 impairment



The IASB issued its final version of IFRS 9 *Financial Instruments* in July 2014, but for banks this is not the end of the story. Hannah King from Accounting Consulting Services tells us about recent developments.

IFRS 9 introduces a new expected credit loss (ECL) approach to impairment provisioning for financial instruments: a radical move away from the current incurred loss model in IAS 39. Following the issue of IFRS 9, two bodies - the Basel Committee on Banking Supervision (the Committee) and the Enhanced Disclosure Task Force (EDTF) - have recently published guidance in respect of the ECL requirements in IFRS 9.

Both publications are aimed at large internationally active banks, but other large and more sophisticated banks may also find the additional guidance relevant.

Basel Committee Guidance on accounting for ECL for banks

In December 2015, the Committee issued its 'Guidance on credit risk and accounting for expected credit losses'. This sets out supervisory guidance on sound credit risk practices associated with the implementation and ongoing application of ECL accounting frameworks, such as that introduced in IFRS 9.

Notably, the Committee expects a disciplined, high-quality approach to assessing and measuring ECL by banks.

The Guidance discusses some of the areas requiring significant judgement involved in implementing the ECL requirements, as well as highlighting the need for good governance, controls, processes and disclosure.

Forward looking information

Amongst other things, the Committee emphasises the importance of including a wide range of relevant, reasonable and supportable forward-looking information,

including macroeconomic data, in a bank's accounting measure of ECL. In particular, banks should not ignore future events simply because they have a low probability of occurring or on the grounds of increased cost or subjectivity. This has particular relevance for one-off uncertain events, for example, a future vote on the UK leaving the European Union. However, the Committee does acknowledge that in certain exceptional circumstances, information about a future event may not be reasonable and supportable, in which case it should be excluded from the determination of ECL.

'Low credit risk' exemption

In the Committee's view, the use of the practical expedients in IFRS 9 should be limited for internationally active banks. This limitation includes restricting the use of the 'low credit risk' exemption for lending exposures (although there still may be some scope to use this exemption for securities).

Using the exemption in IFRS 9 negates the need to assess whether there has been a significant increase in credit risk since initial recognition for those financial instruments that are of low credit risk (for example, investment grade). Not being able to take advantage of the exemption could involve considerable more work and analysis.

EDTF IFRS 9 Impairment disclosure recommendations

In November 2015, the EDTF published a report 'Impact of Expected Credit Loss Approaches on Bank Risk Disclosures'. This recommends disclosures in banks' annual reports to help the market understand an ECL approach to impairment, such as that in IFRS 9.

Transition period from now to adoption

IFRS 9 comes into effect from 2018. The EDTF highlights that disclosures are needed in the transition period leading up to adoption of IFRS 9, starting with 31 December 2015 annual reports. As summarised in the diagram below, the EDTF recommends a gradual, phased approach to disclosures during this transition period. The EDTF suggests that initially the focus should be on qualitative disclosures. Quantitative information about the impact of IFRS 9 should follow, but at the latest in 2017 annual reports.

Ongoing 'permanent' disclosures

The EDTF also recommends disclosures that will apply on a permanent basis once IFRS 9 has been adopted and which go considerably further than those required by accounting standards. For example, the

EDTF recommends that banks offer sensitivity disclosures. These would show the key drivers of change in credit losses when they are meaningful and relevant to understanding material changes.

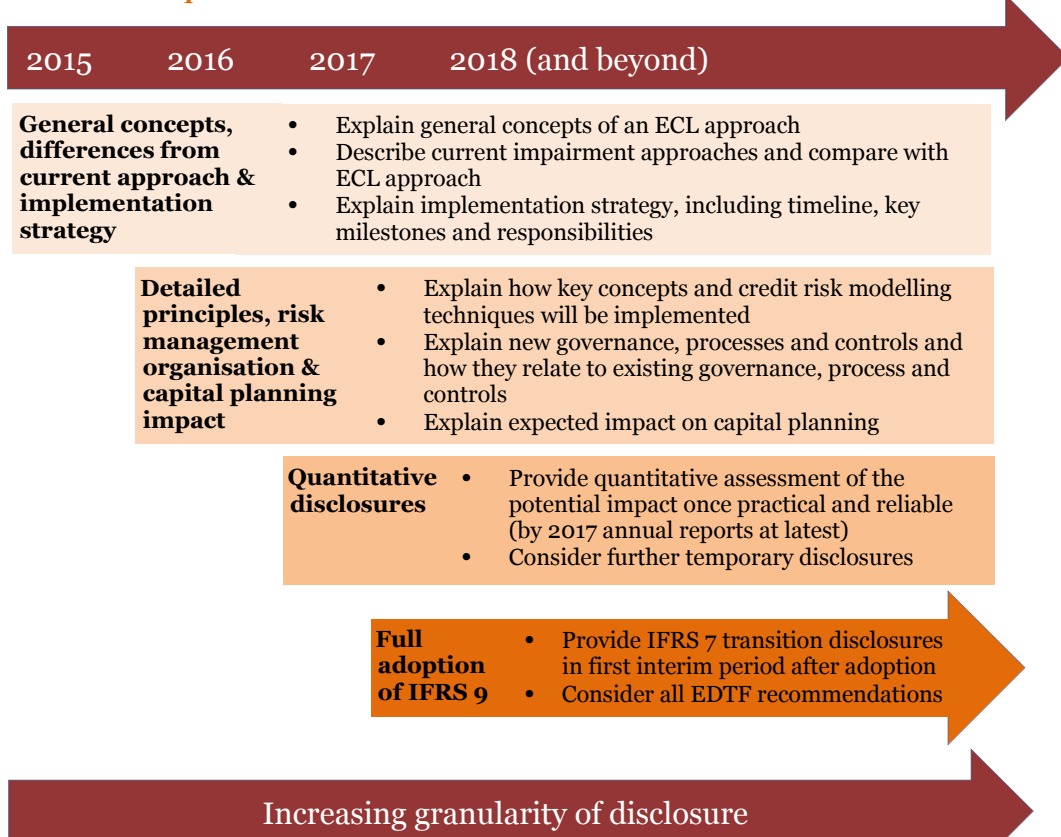
What's next?

Banks, in particular internally active banks and other large more sophisticated banks, should consider the implications of the Basel Guidance and the EDTF's disclosure recommendations. Banks should determine the extent to which the additional guidance applies and how they plan to incorporate it into their IFRS 9 implementation processes.

In doing so, banks will need to consider the views of their local regulator.

As well as the ongoing disclosure requirements post IFRS 9 implementation, banks should consider the transition disclosures needed now and up to the first period of adoption of IFRS 9.

Indicative timeline for implementing the EDTF disclosure recommendations in the transition period:



IAS 7 ‘net debt’ amendment: How to implement new guidance?



John Chan from Accounting Consulting Services brings us up to speed on the narrow-scope amendment to IAS 7 *Statement of cash flows* and shows how entities might fulfil the new disclosure requirement.

Borrowings form a major part of nearly every business and operation. Information about changes in borrowings helps users of financial statements evaluate the financial health of an entity.

Even though IAS 7 and IFRS 7 require some disclosures, users still remarked that they find it difficult to understand changes of borrowings across periods. The IASB has thus amended IAS 7 as part of its Disclosure Initiative to address those concerns.

What is the additional disclosure required?

Objective and scope

The objective of the revised disclosures is to help users evaluate changes in borrowings.

As neither borrowings nor ‘net debt’ are defined in IFRS, the IASB requires that the disclosures apply to *liabilities arising from financing activities*.

The disclosure requirements also apply to:

- Financial assets arising from financing activities (for example derivative assets that hedge long-term borrowings).
- Other assets and liabilities. Entities should also include other assets and liabilities that might be included in other categories within the cash flow

statement if that would meet the disclosure objective (for example, cash and cash equivalents and interest payments that are classified as operating activities).

Required disclosures

Entities should disclose changes of the items above arising from cash flows and non-cash changes (for example, acquisitions, disposals and exchange differences).

Disclosure format

The amendment does not mandate any specific format and management should consider the disclosure that best meets the objective based on their circumstances. Different ways of meeting the disclosure objective are described below.

Disclosure examples

Reconciliation table

The amendment suggests a reconciliation between the opening and closing balances of the items above would meet the disclosure requirement. This may be the best way of meeting the disclosure objective where entities have several different items to be disclosed or where non-cash changes arise from different transactions or events. A tabular reconciliation could look as follows:

	At 1 January 20x7	Cash flows	Non-cash changes				At 31 December 20x7	
			Acquisition	Interest accretion	Foreign exchange movement	New leases		Fair value change
	'000	'000	'000	'000	'000	'000	'000	
(1) Short-term bank borrowings	10,000	(300)	-	-	-	-	9,700	
Long-term bank borrowings	22,000	500	3,000	-	3,000	-	28,500	
Other long-term borrowings	1,000	(400)	-	-	-	-	600	
Finance lease liabilities	3,000	(250)	-	200	-	500	3,450	
Interest payable	456	(2,100)	-	2,500	-	-	856	
Assets held to hedge long-term borrowings	(300)	150	-	-	-	(40)	(190)	
	36,156	(2,400)	3,000	2,700	3,000	500	(40)	42,916
(2) Cash and cash equivalents (other than bank overdraft)	(30,000)	300	-	-	250	-	-	(29,450)
(2)(3) Bank overdraft	2,100	(200)	-	-	-	-	-	1,900
Cash and cash equivalents	(27,900)	100	-	-	250	-	-	(27,550)
	8,256	(2,300)	3,000	2,700	3,250	500	(40)	15,366

⁽¹⁾ The amendment requires that the link between the reconciliation and the balances and amounts presented in balance sheet and cash flow statement is explained. Management should consider the balance sheet and disclosure objective when deciding how much detail to disclose.

⁽²⁾ The amendment requires separate disclosure of changes in assets and liabilities classified in financing activities from changes on other assets and liabilities included in other categories.

⁽³⁾ The example assumes that the bank overdraft is repayable on demand and forms an integral part of the entity's cash management.

Narrative descriptions

Narrative disclosures might be appropriate when there are only few items to be disclosed or where there are limited non-cash changes, for example:

During the year ended 31 December 20x7, the non-cash changes on long-term bank borrowings amounted to USD 3 million arising from unrealised foreign exchange differences.

Other insights

Some preparers may already make similar disclosures in accordance with local guidance or on a voluntary basis. Such existing disclosures may not fully align with the revised requirements, so management should examine the items included in the disclosures for completeness, proper

segregation of other assets and liabilities and linkage to the balance sheet and cash flow statement.

Effective date and transition

The amendment is effective for annual periods beginning on or after 1 January 2017. Earlier application is permitted. When an entity first applies the amendment, it is not required to provide comparative information in respect of preceding periods.

Who is affected?

The amendment will affect every entity preparing IFRS financial statements. However, the information required should be readily available. Preparers should consider how to best present the additional information explaining the changes in liabilities arising from financing activities.

Cannon Street Press

Insurance contracts

The IASB instructed the staff to start the balloting process. The IASB will discuss the effective date and any sweep issues that

arise in the drafting process at a future meeting. The final standard is expected around the end of 2016.

Goodwill and Impairment

The IASB continued its discussions. No decisions were made. The IASB will continue its discussions at future meetings

and consider the steps it needs to take before holding further discussions with the FASB.

Measurement of interests in associates and joint ventures

The IASB discussed the IC's request for input on whether long-term interests that in substance form part of the net investment in an associate or joint venture should be tested for impairment by applying IAS 28, IFRS 9 or a combination of both.

interests that are included in the net investment.

The IASB supported the IC's continued discussion of the issue and noted the possibility that the IC might develop an interpretation to clarify the type of

The IASB agreed that such long-term interests would be recognised and measured by applying the requirements of IFRS 9. The IASB further agreed that entities would apply the impairment requirements of IFRS 9 and IAS 28 when assessing the net investment. Feedback from the IASB will be provided to the IC at a future meeting.

Non-current liabilities: conditions that are tested after the end of the reporting period

The IASB considered how its proposals in the ED *Classification of Liabilities* should be applied when conditions in the lending agreement are tested or reviewed after the end of the reporting period. The Board tentatively decided that:

affect classification even in cases where the conditions are tested subsequent to the year-end;

- compliance with any conditions in the lending agreement is assessed as at the reporting date;
- the proposed amendment to the Standard should include the requirement that compliance with a condition as at the end of the reporting period should determine whether a right subject to that condition should

- when an agreement includes a periodic review clause and the right to defer settlement is subject to the lenders review, the entity has a right to defer settlement only up to the date of the periodic review.

At a future meeting, the staff will present analysis that examines the guidance with respect to the transfer of equity as a means of settlement and that confirms the Board's proposals by using specific examples raised in the comment letters.

Financial Instruments with characteristics of equity

The IASB discussed the further developments of the three approaches it has identified as possible ways of improving IAS 32 *Financial Instruments*. The IASB's discussions focused on the presentation of sub-classes of liabilities

including presenting income and expense from particular type of liabilities, and the attribution of profit or loss and other comprehensive income to sub-classes of equity. No decisions have been made.

IFRIC Rejections in short - IAS 16

Tatiana Geykhman of Accounting Consulting Services examines the practical implications of IC rejections related to IAS 16.

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 16 as per below.

IAS 16 covers recognition, measurement, and disclosure of property, plant and equipment (PPE). Nine matters related to IAS 16 have resulted in an agenda rejection by the IC.

Depreciation

A number of issues have been submitted to the IC on the acceptable methods of depreciation.

Production method (May 2004)

The IC considered the so-called production method of depreciation. An example is the use of the road that is expected to increase over time. The IC considered whether this method could be used for an asset whose benefits were not consumed directly through use. The IC rejected the issue and deferred this to the Board. The units of production method results in a charge based on the expected use or output. It can be used where this method reflects the expected pattern of consumption of the future economic benefits embodied in the asset.

Interest method (November 2004)

The IC also rejected a submission asking about the interest method of depreciation. Under this method, the depreciated amount of an asset reflects the present value of future net cash flows expected from it, and thus the asset would be treated similarly to a receivable.

The IC noted that the depreciation method should reflect the manner in which future economic benefits of the asset are consumed. For example, straight-line depreciation would be the most appropriate

method where a road is used equally over time.

Revenue-based methods

IAS 16 establishes the principle for the basis of depreciation as being the expected pattern of consumption of the future economic benefits of an asset. In the case of a toll road, consumption might be low in the early periods and high in later periods. The IC discussed in November 2011 and March 2012 whether a unit of production method (expected use or output) might be more appropriate to reflect the pattern of consumption of the expected future economic benefits and suggested a clarification of IAS 16 and IAS 38.

The IASB then clarified that the use of revenue-based methods to calculate depreciation of an asset is presumed to be an inappropriate basis, because revenue reflects factors other than the *consumption* of the economic benefits embodied in the asset. In May 2014 the IASB amended IAS 16 and IAS 38. These amendments are effective for annual periods beginning on or after 1 January 2016.

Cost of testing (July 2011)

The IC was asked to clarify what could be viewed as sales proceeds from testing an asset. The submission considered an industrial group consisting of several autonomous plants in a jurisdiction subject to local regulation. The regulation required a 'commercial production date' to be identified for the industrial complex as a whole. The submission asked whether the proceeds from the plants already in operation could be offset against the costs of

testing the plants that are not yet available for use.

The IC noted that the cost of testing and proceeds from testing should be determined separately for each PPE item. The IC thought

that the IAS 16 guidance is sufficient to determine when a PPE item is available for use and to distinguish proceeds that reduce costs of testing an asset from revenue from production. Diversity in practice was not expected.

Summary of IAS 16 rejections

Topic	Summary conclusion
Depreciation of fixed assets (May 2004)	The IC considered the use of the production method of depreciation for an asset not consumed directly in relation to the level of use. An example is the use of a road that is expected to increase over time. The IC believed this was a conceptual area and recommended that the Board consider this topic as part of the Concepts project.
Depreciation of assets under operating leases (November 2004)	The IC concluded that the use of interest method of depreciation is not appropriate. Under this method, the depreciated amount of an asset reflects the present value of future net cash flows expected from it.
Revaluation of investment properties under construction (November 2006)	Following the recommendation from the IC, the Board amended IAS 16 and IAS 40 in May 2008 to state that investment property under construction should be accounted for under IAS 40.
Sale of assets held for rental (May 2007)	The IC received a question on presentation of gains or losses where an entity holds assets for rental and sells these assets afterwards. Following this submission, the Board amended IAS 16 in May 2008, clarifying that proceeds from the sale of assets held for rental should be recognised as revenue under IAS 18. The Board concluded that gross presentation would better reflect the ordinary activities for entities that routinely sell PPE items held for rental.
Disclosure of idle assets and idle construction in progress (May 2009)	As IAS 16 encourages, but does not specifically require, disclosure of temporarily idle assets and construction in progress, the IC was asked to clarify the expected extent. The IC concluded that on the basis of the IAS 1, the requirement to disclose additional information that is relevant to an understanding of the financial statements, no additional guidance is needed.
Cost of testing (July 2011)	The IC considered whether the proceeds from plants already in operation could be offset against the costs of testing plants that are not yet available for use provided all plants belong to the same industrial group. The IC rejected the issue on the basis that IAS 16 provides sufficient guidance to identify the date at which an item of PPE is 'available for use' and, therefore, to distinguish proceeds that reduce costs of testing an asset from revenue from commercial production.
Purchase of right to use land (September 2012)	The IC was asked to clarify the accounting for the purchase of a right to use land, and rejected the issue based on the fact pattern being territory specific. Notwithstanding the IC observed that the existence of an indefinite period does not prevent the 'right of use' from qualifying as a lease in accordance with IAS 17.

Disclosure of borrowing costs for assets under the revaluation model (May 2014)	For PPE carried at fair value, the capitalisation of borrowing costs is not required. The IC confirmed that as part of the requirement to disclose the amount at which such assets had been carried under the cost model includes the disclosure of capitalised borrowing costs.
Accounting for core inventories (November 2014)	The IC was asked to clarify whether 'core inventories' should be accounted for under IAS 2 or under IAS 16. The IC observed that what might constitute 'core inventories' and how they are accounted for, could vary between industries. The IC noted that it did not have clear evidence that the differences in accounting were caused by differences in how IAS 2 and IAS 16 were being applied and removed this issue from its agenda.

The leases library



Reception

In brief

A summary introduction to the new standard

Reference section

In depth

A detailed look at the requirements of the new standard, with practical examples of the application of key principles

Critical analysis

IFRS blog

PwC's dedicated IFRS blog discusses and debates the hot topics in IFRS and leasing

Media

Webcast

Patrina Buchanan (IASB), Derek Carmichael and Jay Tahtah (PwC) discuss the highlights of the new standard

Interview on the practical impacts of IFRS 16

Jay Tahtah talks to Derek Carmichael about practical implications on companies of the new standard

Recommended reading

Are you ready?

A look at the impact on systems, processes and reporting

Specialist subjects

In the spotlight: Key questions to think about for individual industries, including **Retail & consumer** and **Real estate**.
New arrivals expected soon!

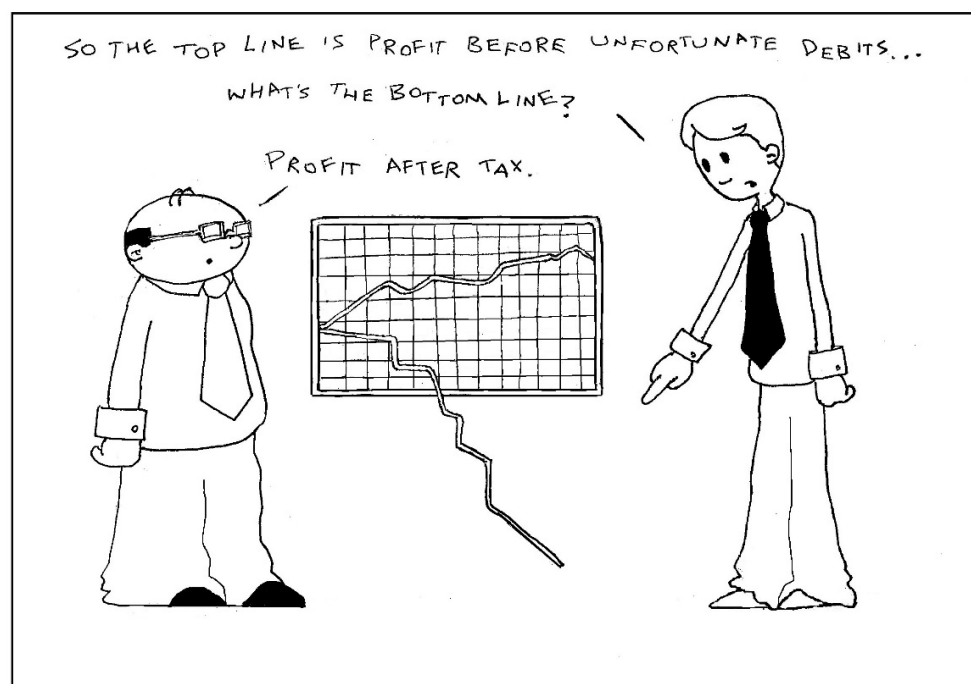
And opening in next month's IFRS News:



The leases lab!

by **Derek Carmichael**

The bit at the back.....



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