IFRS news
August 2018

Must know

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Disclosures required in interim financial statements on the initial adoption of IFRS 15

At a glance

IFRS 15 is required to be applied for annual reporting periods beginning on or after 1 January 2018. Many entities will be required to issue interim financial statements under IAS 34, 'Interim Financial Reporting', before they issue their first annual financial statements applying IFRS 15.

Regulators, investors and other stakeholders might focus on disclosures related to the adoption of IFRS 15.

What disclosures are required in interim financial statements in the year in which IFRS 15 is adopted?

IFRS 15 made consequential amendments to IAS 34 that require disclosure of:

- the recognition or reversal of an impairment loss from assets arising from contracts with customers, as an additional example of the events and transactions for which disclosures would be required if they are significant; and
- the 'disaggregation of revenue from contracts with customers' required by paragraphs 114 to 115 of IFRS 15.

In addition to complying with these specific requirements in each interim report, entities should comply with paragraph 16A(a) of IAS 34, which requires a description of the nature and effect of any changes to their accounting policies and methods as compared with the most recent annual financial statements.

What is the impact and for whom?

The extent of the disclosures will depend on an entity's circumstances. Entities apply judgement to determine the extent of the disclosure, taking into consideration, for example:

- the requirements or expectations of local regulators: entities should consider any guidance issued by regulators that might require specific disclosures or information to be included in interim reports; some regulators might require all of the disclosures required in annual financial statements to be included in the interim report (for instance, the European Securities and Markets Authority has stated that it expects the disclosures required by paragraph C8 of IFRS 15 to be provided where the modified retrospective transition approach is adopted); and
- the significance of the changes: the extent of disclosures might vary depending on the effect on the financial statements of the initial adoption of IFRS 15; disclosures might be less extensive where the impact is not qualitatively or quantitatively material.

The disclosures might include:

- a description of the nature and effect of the change resulting from the new accounting policies (this disclosure is required by paragraph 16A(a) of IAS 34);
- the key judgements made by management in applying IFRS 15;
- details of the impact on the amounts presented in the interim financial statements, including earnings per share and the opening balance of retained earnings;

- the transition method selected, together with any transitional practical expedients applied (entities that elect to apply the modified retrospective transition approach should consider whether the requirements of paragraph C8 of IFRS 15 for annual financial statements could be used to explain the nature and effect of the change in accounting policy); and
- disclosures specific to the entity – entities should consider whether the requirements in paragraph 28 of IAS 8, which will be applicable for the annual financial statements, could be used to explain the nature and effect of the change in accounting policy when IFRS 15 is first applied.

Entities should also consider whether any of the detailed disclosures required by IFRS 15 in annual financial statements are useful to comply with the requirements of IAS 34, although these disclosures are not mandatory in interim reports.

Repeating disclosures in subsequent quarters

IAS 34 requires interim financial reports to provide an update from the most recent set of full financial statements. Interim financial reports should stand alone, and they should include all of the information necessary to comply with IAS 34.

Entities that are considering reducing the volume of disclosure about new standards in subsequent interim financial reports should consider the views of the relevant securities regulator, and they should ensure, as a minimum, that the disclosures explain the nature and effect of the changes in accounting policy and that quantitative disclosures are updated.

When does it apply?

IFRS 15 is applicable for annual reporting periods beginning on or after 1 January 2018. Any interim financial statements issued before the first annual financial statements applying IFRS 15 will need to consider the above guidance.

Disclosures required in interim financial statements on the initial adoption of IFRS 9

At a glance

IFRS 9, the new standard on financial instruments, is required to be applied for annual reporting periods beginning on or after 1 January 2018. Many entities will be required to issue interim financial statements under IAS 34, 'Interim Financial Reporting', before they issue their first annual financial statements applying IFRS 9.

Regulators, investors and other stakeholders might focus on disclosures related to the adoption of IFRS 9.

What disclosures are required in interim financial statements in the year in which IFRS 9 is adopted?

Unlike IFRS 15, IFRS 9 made no consequential amendments to IAS 34 to bring in specific new interim disclosure requirements. So the key requirement for interim reports is found in paragraph 16(a) of IAS 34, which states that an entity should provide *"a statement that the same accounting policies and methods of computation are followed in the interim financial statements as compared with the most recent annual financial statements or if those policies or methods have been changed, a description of the nature and effect of the change"* (emphasis added). Paragraph 6 of IAS 34 also states that the interim financial report is intended to provide an update on the latest complete set of annual financial statements and, accordingly, it focuses on new activities, events and circumstances.

What is the impact and for whom?

The extent of the disclosures will depend on an entity's circumstances. Entities apply judgement to determine the extent of the disclosure, taking into consideration, for example:

- the requirements or expectations of local regulators: entities should consider any guidance issued by regulators that might encourage or require specific disclosures or information to be included in interim reports; some regulators might require a subset of the disclosures required in annual financial statements to be included in the interim report; and
- the significance of the changes: the extent of disclosures might vary depending on the effect on the financial statements of the initial adoption of IFRS 9; for instance, in the banking sector, some entities might choose to include more information on expected credit losses, due to the significance of the impact on their financial statements; disclosures might be less extensive where the impact is qualitatively or quantitatively lower.

The disclosures might include:

- a description of the nature and effect of the change resulting from the new accounting policies (this disclosure is required by paragraph 16A(a) of IAS 34), including the new accounting policies themselves;
- the key judgements made by management in applying IFRS 9 (such as those when applying the business model test for classification and measurement or assumptions made in incorporating forward-looking information into expected credit loss calculations);
- details of the impact on the amounts presented in the interim financial statements, including earnings per share and the opening balance of retained earnings;

- the disclosures in paragraphs 42L and 42P of IFRS 7 which set out some of the quantitative and qualitative disclosures which are required in the annual financial statements where IFRS 9 is applied for the first time; and
- disclosures specific to the entity – entities should consider whether the requirements in paragraph 28 of IAS 8, which will be applicable for the annual financial statements, could be used to explain the nature and effect of the change in accounting policy when IFRS 9 is first applied.

Entities should also consider whether any of the other detailed disclosures required by IFRS 7 in annual financial statements are useful to comply with the requirements of IAS 34, although such disclosures are not mandatory in interim reports.

In addition, appropriate disclosures should be given about other aspects not discussed above that are necessary for a user to understand the impacts at transition, the reasons for those impacts and the key judgements that will impact the financial statements going forward.

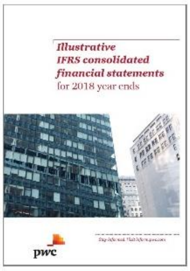
Repeating disclosures in subsequent quarters

IAS 34 requires interim financial reports to provide an update from the most recent set of full financial statements.

Interim financial reports should stand alone, and they should include all of the information necessary to comply with IAS 34. Entities that are considering reducing the volume of disclosure about new standards in subsequent interim financial reports should consider the views of the relevant securities regulator, and they should ensure, as a minimum, that the disclosures explain the nature and effect of the changes in accounting policy and that quantitative disclosures are updated.

When does it apply?

IFRS 9 is applicable for annual reporting periods beginning on or after 1 January 2018. Any interim financial statements issued before the first annual financial statements applying IFRS 9 will need to consider the above guidance.



Available now: ***Illustrative IFRS consolidated financial statements for 2018 year ends***

This publication presents the sample annual financial reports of a fictional listed company, VALUE IFRS Plc. It illustrates the financial reporting requirements that would apply under IFRS as issued at 31 May 2018. Supporting commentary is also provided.

IFRS 9 disclosures by banks in 2018 interim reporting and transition documents

At a glance

Before banks issue their first annual financial statements applying IFRS 9, many will issue interim financial statements under IAS 34. Some also plan to issue a separate transition document to help users better understand the impacts of IFRS 9 at, and beyond, adoption. This reporting is likely to receive a lot of focus from investors, regulators and other key stakeholders.

Given the lack of prescriptive guidance on what banks should include in these documents, judgement will be required. A key point is that many of the transition disclosures required by IFRS 7 in annual financial statements will be relevant. Other key considerations include the level of granularity provided and how any interim financial reporting or transition document interacts with other communications on IFRS 9.

What disclosures are required by banks ?

Unlike IFRS 15, IFRS 9 made no consequential amendments to IAS 34 'Interim Financial Reporting' to bring in specific new interim disclosure requirements.

In assessing the appropriate extent of disclosure, a number of factors are likely to be relevant. In particular, regulators may have expectations on the extent and nature of disclosures considered appropriate. In addition, the extent of the disclosures should be proportionate to the impact of IFRS 9 adoption.

For example, if the impact of adoption is not significant in monetary terms, or is restricted to a small number of financial statement line items, extensive disclosure may not be warranted.

When considering the appropriate extent of disclosure, the potential future impacts of IFRS 9 should be considered, as well as the impact at the time of adoption. The extent of disclosures expected of larger, more sophisticated banks is also likely to be greater than for smaller, simpler banks.

However, it would generally be expected that the IAS 34 requirements could be met by disclosing:

- New accounting policies - a statement of the new policies required by IFRS 9 in the first set of interim reporting, given these will not have been disclosed in previous financial statements or interim reports. As well as explaining the new expected credit loss impairment and classification & measurement models, disclosure should be provided of relevant policy choices that have been applied. Examples might include whether or not:
    - the low credit risk exemption has been applied;
    - the 30 / 90 days past due presumptions have been rebutted as an indicator of significant increase in credit risk / credit impairment respectively; and
    - comparative amounts have been restated.
- Classification and measurement changes - quantitative and qualitative disclosures of the changes to classification and measurement arising from the adoption of IFRS 9 will be key to users' understanding of the interim reporting. These aspects of disclosure are discussed in more detail in IFRS 7 paras 42I, 42J, 42L and 42O.

In addition to the business model and SPPI tests, changes may arise from modification gains and losses on financial assets recognised in accordance with paragraph 5.4.3 of IFRS 9 and similar effects from modified financial liabilities as clarified by the IASB in BC 4.253 of the October 2017 amendment to IFRS 9.

- Impairment provision reconciliation - the reconciliation of the closing IAS 39 impairment provision to the opening IFRS 9 provision (as per IFRS 7 para 42P) will help users to understand the adoption impacts of IFRS 9, as well as start developing expectations of how different portfolios might be affected by IFRS 9 from period to period.

To enable users to understand why the movements have arisen, this should be accompanied by qualitative information explaining the main reasons for the changes. A related disclosure likely to be a key focus of analysts will be the percentage of loans reported at transition as stage 1 / 2 / 3 / purchased or originated credit-impaired and the ECL provision coverage for each.

- Key judgements - a key focus of readers will naturally be those areas that mattered most in implementing IFRS 9 and where the greatest judgement was required. Areas likely to be most relevant for ECL, where most analyst comment and industry debate has focused, include: the criteria for identifying a significant increase in credit risk, how forward looking information has been incorporated (including the use of multiple macro-economic scenarios), the lives used for revolving credit facilities such as overdrafts and credit cards and the definition of default.

When any of these areas are not a key judgement for a bank, it may nonetheless help users if this is stated explicitly in disclosures. This will avoid the risk that users look to disclosures made by peer banks on these judgements and mistakenly assume they also apply to the bank in question. Key judgements relating to classification and measurement should also not be overlooked. These may include, for example, a judgement on whether prepayment features in a material portfolio of loans do not only provide 'reasonable additional compensation' and so prevent measurement at amortised cost, or a judgement on the level of sales considered consistent with a Hold To Collect business model.

- Other relevant disclosures – appropriate disclosures should be given about other aspects not discussed above that are necessary for a user to understand the impacts at transition, the reasons for those impacts and the key judgements that will impact the financial statements going forward.

Other factors that may be relevant

When designing disclosures for IAS 34 interim reporting there a number of other factors that may be relevant. These are discussed below. It may also be helpful for banks to liaise with investors and analysts, so their views can be taken account of when designing these disclosures.

Timing

- Cumulative disclosure over time - some banks that produce quarterly interim reporting may wish to provide progressively more disclosure over the course of the first year of application. Whilst this may help users to focus initially on the most important aspects of IFRS 9, banks should ensure they can justify why any additional disclosures only provided later in the year were not necessary in the first interim reporting, in order for users to have sufficient understanding of the impacts of adoption.

- Early involvement of auditors - to avoid surprises, auditors should be involved early in the process of designing IAS 34 interim reporting and any Transition document. Even where auditors do not provide any report on IAS 34 interim reporting, to the extent the disclosures provided are intended to be consistent with year-end IFRS 7 disclosures that *will* be subject to audit, obtaining the auditor's views will avoid potential issues later in the annual reporting cycle.

Comparatives

- Structure of notes - depending upon the balance sheet line items a bank uses, there may be line items that are only applicable in the prior year but not the current year, and vice versa. One example would be where a bank used 'Available for Sale assets' as a line item in the comparative year under IAS 39. For such items, even if there is a current year IFRS 9 line item which is considered very similar (e.g. Assets at Fair Value Through Other Comprehensive Income), it would not be appropriate in the supporting note disclosures to analyse the two amounts in adjacent columns of the same table. Therefore, thought should be given to the layout and ordering of the notes disclosures in such cases.

- Income statement impact - where a bank does not restate prior year amounts under IFRS 9, which is likely to be common, and the comparative income statement remains under IAS 39, it may be difficult for users to grasp what effect IFRS 9 may have on future income statements. Whilst unlikely to be a widespread practice, banks may therefore choose to present additional information indicating what the prior year income statement might have looked like under IFRS 9.

This would be non-IFRS information which therefore falls within the scope of the ESMA guidelines on alternative performance measures (APMs) for EU entities, or potentially other similar guidance in other jurisdictions. Even where such guidelines do not exist, good practice would be to explain the reason for presenting these non-IFRS amounts, to clearly define and appropriately describe the amounts presented. As an alternative method of helping users compare the income statement year-on-year, if a bank were to voluntarily present 2018 amounts prepared under IAS 39 then similar considerations for APMs would apply.

Other considerations

- Level of granularity - in the first annual financial statements applying IFRS 9 it will be necessary to provide disclosures under IFRS 7 separately for each class of financial instrument. Earlier reporting would therefore be expected to align to these classes, but may not need to be as granular, if for example such detail would be excessive in the context of IAS 34 interim reporting or a Transition document.

Therefore, even if some information has already been published elsewhere by a bank, for example in a Transition document, it would not be appropriate to incorporate that information into IAS 34 interim reporting via cross-reference. Instead, the relevant information for the purposes of the IAS 34 interim reporting not previously included in the annual financial statements should be repeated in the IAS 34 document.

- Other market communications - banks may issue other external communications on IFRS 9 to the market, such as via investor presentations. Such other information is generally issued as it is considered relevant to understanding the impact of IFRS 9. Accordingly if it is not included in IAS 34 interim reporting, management should be clear why it is not considered relevant for that purpose.
- Standalone document - IAS 34 interim reporting can build upon, and cross- reference to, information contained in previously issued annual financial statements. However, it otherwise needs to be a standalone document.

Entities that are considering reducing the volume of disclosure about new standards in subsequent interim financial reports should consider the views of the relevant securities regulator, and they should ensure, as a minimum, that the disclosures explain the nature and effect of the changes in accounting policy and that quantitative disclosures are updated.

Impact beyond IFRS - although not required by IFRS, a key focus of many users will be the impact IFRS 9 has on banks' regulatory capital position.

- Where the regulatory capital regime is still evolving, any disclosure of the regulatory impact should be accompanied by appropriate explanation of any related uncertainties and assumptions used.
- Where capital disclosures address the anticipated effects of IFRS 9 under both transition rules and the 'end state' rules applicable once transitional rules no longer apply, these different measures should be clearly distinguished. Where IFRS 9 will impact other key performance indicators (KPIs) used by a bank in its external reporting, discussion and quantification of these impacts may also be helpful for users.

IAS 29 becomes applicable in Argentina

At a glance

IAS 29, 'Financial reporting in hyper-inflationary economies', should be applied by entities with a functional currency of the Argentine peso for accounting periods ending after 1 July 2018; and it should be applied as if the economy had always been hyper-inflationary.

What is the issue?

Inflation in Argentina has been high for several years, and local inflation data has not been reported consistently. After several months of declining inflation, inflation has increased significantly in early 2018. The three-year cumulative inflation rate, using different combinations of retail price indices, has exceeded 100% for several months, and it is now increasing. Local forecasts suggest that three-year cumulative retail price inflation at the end of 2018 will be around 120%. Three-year cumulative inflation using the wholesale price index has now exceeded 100%, and it is unlikely to fall significantly below 100% in 2019.

The qualitative indicators are still mixed; however, taking into account the recent developments, including the devaluation of the currency, they do not contradict the conclusion that Argentina is now a hyper-inflationary economy for accounting purposes.

What is the impact and for whom?

Argentina should be considered a hyper-inflationary economy for accounting periods ending after 1 July 2018. Paragraph 4 of IAS 29 states that it is preferable for all entities that report in the currency of a hyper-inflationary economy to apply the standard at the same date. Therefore, IAS 29 should be applied by all entities with a functional currency of the Argentine peso from that date, and it should be applied as if the economy had always been hyper-inflationary.

IAS 29 requires financial statements of an entity whose functional currency is the currency of a hyper-inflationary country to be restated into the current purchasing power at the end of the reporting period. Therefore, transactions in 2018 and non-monetary balances at the end of the period should be restated to reflect a price index that is current at the balance sheet date.

The comparatives and the opening statement of financial position at the beginning of the earliest period presented should also be restated to reflect a price index that is current at the balance sheet date. Entities are not required to present an additional balance sheet as at the beginning of the preceding period.

Multinational companies that have subsidiaries with the Argentine peso as their functional currency should consider paragraph 43 of IAS 21, which requires the financial statements of a subsidiary entity that has the functional currency of a hyper-inflationary economy to be restated in accordance with IAS 29 before being included in the consolidated financial statements. Comparative amounts presented previously in a stable currency are not restated.

Entities are not required to apply IAS 29 for periods ending 30 June 2018. Entities might consider describing the situation in Argentina, and the potential impact of hyper-inflation accounting in future periods, when preparing the financial statements for periods ended 30 June 2018.

PwC in the US has issued 'Monitoring inflation in Argentina - US In brief' to explain the conclusions that should be followed by entities with a functional currency of the Argentine peso that report under US GAAP.

When does it apply?

IAS 29 should be applied to entities with a functional currency of the Argentine peso from periods ending after 1 July 2018, and it should be applied as if the economy had always been hyper-inflationary.

Issues of the month

IFRS 9 - Why be sensitive about sensitivities?

After four long years, pens have finally started to go down on the IFRS 9 transition. Despite expectations to the contrary, provisions have been relatively stable so far (save for transition adjustments), thanks in large part to stable economic outlooks. Nevertheless, analysts, regulators and others are already asking 'what if' questions, seeking to understand the new approach and its inherent sensitivities. So far, we've seen few such disclosures - probably due to first-mover reluctance, post-transition exhaustion and uncertainty about what disclosures might actually be meaningful. Even so, it wouldn't be our approach. Here's why…

Two things are critical when thinking about what disclosures to provide – firstly, how IFRS 9 came to be, and secondly, why they're required to begin with. On the former, the new expected loss model is meant to provide an earlier warning to financial statement users about management's perception of changes in the risks underlying the portfolio by reflecting them in impairment provisions on a forward looking basis each period. On the latter, IFRS requires disclosure of information about the assumptions about the future and other major sources of estimation uncertainty. This is so as to help users to understand the imprecision in an estimate, its sources and the possible magnitude of any change in the estimate within the next financial year. While much of this disclosure is naturally qualitative, the standard gives examples that make it difficult to argue that qualitative disclosures alone are sufficient. What quantitative disclosure to provide is a matter of judgment, though they may often include a range of possible outcomes. Think of it as laying out management's view of the fairway.

Some argue that sensitivities that show the effect of changing only one economic variable would be misleading since there would never be an isolated change in one variable without corresponding changes in others (in the real world, that is). We agree. Indeed, the real world is complicated and so coming up with meaningful sensitivities won't be easy. There is no 'magic bullet'. That said, something is likely better than nothing. So, what then? One approach might include showing your math, or summarized versions of it. Expected losses are probability-weighted estimates that already contemplate multiple alternative outcomes, so, you could provide those outcomes, the probabilities assigned to them and the expected losses (i.e. unweighted) were they to arise. Remember too that sensitivities should consider all variables, not just macroeconomic ones. There are two key advantages to presenting this information – that it doesn't require additional analysis, and that (hopefully) it aligns with information that's already being prepared and reviewed internally by management and audit committees. On the other hand, a significant disadvantage of this approach is that disclosing scenarios might be misleading if they aren't reasonably possible of occurring in the coming year. The math is only half the story too. Like most aspects of IFRS 9, the models themselves are extremely complicated (even for those who built them), so ensuring you tell the whole story – including the methodology applied and its limitations, will be key.

Why take the leap now? For starters, because there's safety in transparency. As we often hear from our own clients, bad news might not be avoidable – surprises usually are. During the financial crisis, fingers pointed quickly at shortcomings in disclosures and accounting, so better to build the ark before the storm. Remember too that these disclosures take time to assess, debate, develop and embed (not to mention, audit).

For those who wait to find out what others are doing, it may be too late by the time they see.

This month's guest blogger is Chris Wood, Banking Partner and IFRS 9 specialist, connect with him on LinkedIn here.

Contacts

For further help on IFRS technical issues, contact:
Andri Stavrou: Tel: +30 210 687 4703
andri.stavrou@gr.pwc.com

Financial instruments
Kyriaki Plastira: Tel: +30 210 687 4425
kyriaki.plastira@gr.pwc.com

Business combinations
Iliana Kostoula: Tel: +30 210 687 4044
iliana.kostoula@gr.pwc.com

Liabilities, revenue recognition and other areas
Vart Kassapis: Tel: +30 210 687 4757
vart.kassapis@gr.pwc.com

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