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Must know

IASB issues amendments to IAS 19 – plan amendment, curtailment or settlement

Issue

On 7 February 2018, the IASB issued amendments to the guidance in IAS 19, 'Employee Benefits', in connection with accounting for plan amendments, curtailments and settlements.

The amendments require an entity:

- to use updated assumptions to determine current service cost and net interest for the remainder of the period after a plan amendment, curtailment or settlement; and
- to recognise in profit or loss as part of past service cost, or a gain or loss on settlement, any reduction in a surplus, even if that surplus was not previously recognised because of the impact of the asset ceiling.

Impact

Changes in the terms or membership of a defined benefit plan might result in a plan amendment or a curtailment or settlement. IAS 19 requires an entity to determine the amount of any past service cost, or gain or loss on settlement, by remeasuring the net defined benefit liability before and after the amendment, using current assumptions and the fair value of plan assets at the time of the amendment. Current service cost and net interest are usually calculated using assumptions determined at the beginning of the period.

However, if the net defined benefit liability is remeasured to determine past service cost or the gain or loss on settlement, current service cost and net interest for the remainder of the period are remeasured using the same assumptions and the same fair value of plan assets. This will change the amounts that would otherwise have been charged to profit or loss in the period after the plan amendment, curtailment or settlement, and it might mean that the net defined benefit liability is remeasured more often.

A plan amendment, curtailment or settlement might reduce or eliminate a surplus, which could change the effect of the asset ceiling. Past service cost, or a gain or loss on settlement, is calculated in accordance with IAS 19, and it is recognised in profit or loss. This reflects the substance of the transaction, because a surplus that has been used to settle an obligation or provide additional benefits is recovered. The impact on the asset ceiling is recognised in other comprehensive income, and it is not reclassified to profit or loss. The impact of the amendments is to confirm that these effects are not offset.

Who is affected

The amendments will affect any entity that changes the terms or the membership of a defined benefit plan such that there is past service cost or a gain or loss on settlement.

The amendments are applied prospectively to plan amendments, settlements or curtailments that occur after the beginning of the first annual reporting period beginning on or after 1 January 2019.

ESMA public statement on accounting by European listed entities for the recent US tax law changes

ESMA have highlighted that due to the short time frame within which companies have to prepare their estimates, taking account of the complex changes in tax law, it expects that those estimates will be subject to a higher than usual degree of estimation uncertainty than is usually the case and that measurement adjustments may be needed in subsequent periods as issuers get more accurate information.

Nevertheless, ESMA expects that issuers will be able to make a reasonable estimate of the material impacts of the Act. ESMA highlighted the disclosures required by IAS12 and also in respect of estimation uncertainty (IAS1 paragraph 122 and 125-129) as being of particular relevance in the circumstances.

See ESMA's public statement.

IFRS 9 impairment: intercompany loans in separate financial statements

At a glance

IFRS 9 introduces an 'expected loss' model for recognising impairment of financial assets held at amortised cost, including most inter-company loans receivable. This is different from IAS 39, which had an 'incurred loss' model, where provisions were recognised only when there was objective evidence of impairment.

This change of approach will require lenders of inter-company loans to consider forward-looking information to calculate expected credit losses, regardless of whether there has been an impairment trigger. In some cases, impairment losses might be recognised where none were previously.

Issue

IFRS 9 requires entities to recognise expected credit losses for all financial assets held at amortised cost, including inter-company loans from the perspective of the lender. IAS 39, the previous standard for assessing impairment of inter-company loans, had an incurred loss model.

This change of approach might result in impairment losses being recognised where none were previously.

However, it is expected that mana material impairment provision y inter-company loans within the scope of IFRS 9 might not require to be recognised, because:

- they are repayable on demand and the lender expects to be able to recover the outstanding balance of the loan if demanded;
- they are low credit risk, so 12-month expected credit losses can be calculated, which might not be material; or
- they have not had a significant increase in credit risk since the loan was first recognised, or have a remaining life of less than 12 months, so 12-month expected credit losses are calculated, which, as noted above, might not be material.

Where inter-company loans do not meet any of the three criteria above, lifetime expected credit losses will need to be calculated, which are more likely to give rise to a material impairment provision.

This In brief summarises our practical guidance in In depth 2018-02, 'IFRS 9 impairment practical guide: inter-company loans in separate financial statements', on how to apply IFRS 9's impairment requirements to inter-company loans.

The appended decision tree and commentary will direct you to the relevant section of the In depth guidance, to assess whether a material impairment provision is required for your inter-company loans.

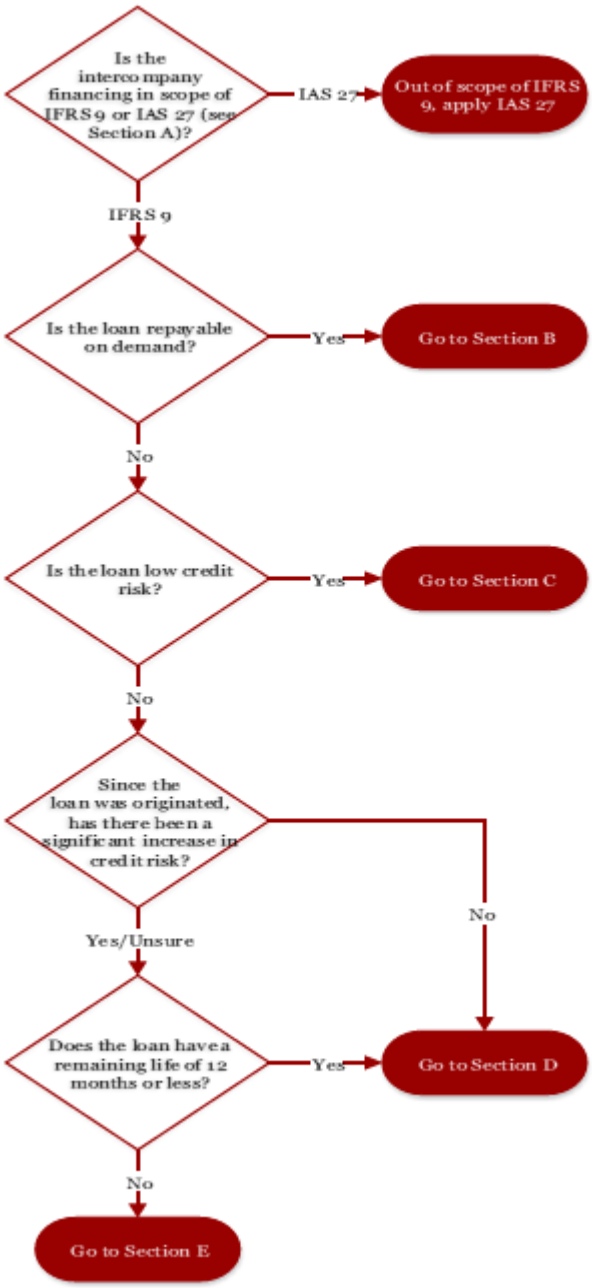
Irrespective of whether calculating expected credit losses for inter-company loans gives rise to a material impairment provision, entities will need to ensure that their approach and the relevant assumptions made are documented.

Where can further information be found?

PwC's In depth 'IFRS 9 impairment practical guide: inter-company loans in separate financial statements' provides guidance on IFRS 9's impairment requirements for inter-company loans.

Appendix – Decision tree and commentary

Use the following decision tree to direct you to the relevant section of the In depth, and commentary below, to determine if a material impairment provision is required:



In depth Section	Common Example	Commentary
Section A *Is the loan in the scope of IFRS 9?*	Lender accounts for the intercompany financing as an 'investment in subsidiary' under IAS 27. Borrower accounts for the financing received as a capital contribution.	• Inter-company financings that, in substance, form part of an entity's 'investment in a subsidiary' are not in IFRS 9's scope. Rather, IAS 27 applies to such investments. • An inter-company loan is outside IFRS 9's scope (and within IAS 27's scope) only if it meets the definition of an equity instrument for the subsidiary (for example, it is a capital contribution). • All loans to subsidiaries that are accounted for by the subsidiary as a liability are within IFRS 9's scope. • If the terms of an intra-group financing are clarified or changed on adoption of IFRS 9, careful analysis might be required.
Section B *Loan is repayable on demand*	Inter-company loan is repayable on demand. The borrower does not have sufficient available liquid assets to repay the inter-company loan if it was demanded at the reporting date. However, if the lender demanded repayment of the inter-company loan, it would allow the borrower to continue trading/sell its assets to fund repayment of the loan over a period of time, to maximise recovery of the loan.	• For loans that are repayable on demand, expected credit losses are based on the assumption that repayment of the loan is demanded at the reporting date. • If the borrower has sufficient accessible highly liquid assets in order to repay the loan if demanded at the reporting date, the expected credit loss is likely to be immaterial. • If the borrower could not repay the loan if demanded at the reporting date, the lender should consider the expected manner of recovery to measure expected credit losses. This might be a 'repay over time' strategy (that allows the borrower time to pay), or a fire sale of less liquid assets. • If the recovery strategies indicate that the lender would fully recover the outstanding balance of the loan, the expected credit loss will be limited to the effect of discounting the amount due on the loan (at the loan's effective interest rate, which might be 0% if the loan is interest free) over the period until cash is realised. If the time period to realise cash is short or the effective interest rate is low, the effect of discounting might be immaterial. If the effective interest rate is 0%, and all strategies indicate that the lender would fully recover the outstanding balance of the loan, there is no impairment loss to recognise.
Section C *Loan has low credit risk*	The borrower of the inter-company loan has a strong capacity to meet its contractual cash flow obligations in the near term. Any adverse changes in economic and business conditions in the longer term will not necessarily reduce the borrower's ability to repay the loan.	• A loan has low credit risk if the borrower has a strong capacity to meet its contractual cash flow obligations in the near term, and adverse changes in economic and business conditions in the longer term might, but will not necessarily, reduce the ability of the borrower to fulfil its obligations. • For loans that are low credit risk at the reporting date, IFRS 9 allows a 12- month expected credit loss to be recognised. • An external rating of 'investment grade' is an example of low credit risk. However, an intra-group loan should not be assumed to have the same rating as other instruments issued by the borrower (such as loans to third parties) without further analysis. • Low credit risk loans might have very low risk of default (or 'probability of default' (PD)).

In depth Section	Common Example	Commentary
		• A 'short-cut' can be used to determine if the expected credit loss on a low credit risk loan needs to be recognised. This short-cut assumes that the PD for the inter-company loan is that of the lowest investment grade (either BBB- or Baa3, depending on the credit ratings agency used) and the maximum possible loss in the event of a default (that is, the loan is fully drawn and no amount is recovered). If this results in an immaterial expected credit loss, no further work is required. If, however, this short-cut results in a material expected credit loss, further work will be required to estimate both the actual PD and the actual loss in the event of a default.
Section D *No significant increase in credit risk since the loan was originated, or remaining life is less than 12 months*	Inter-company loan is a 'quasi equity' loan and the lender is unable to determine that the loan is low credit risk. However, since the loan was first granted, there have not been any actual or expected significant adverse changes in the operating results of the borrower, nor any actual or expected significant adverse changes in the regulatory, economic or technological environments of the borrower. The inter-company loan is not 30 days past due.	• For loans where there has not been a significant increase in credit risk (that is, where they are in stage 1), a 12-month expected credit loss is recognised. • A similar short-cut could be used as for low credit risk loans to determine if the expected credit loss on a stage 1 loan is material. This short-cut assumes the maximum possible loss in the event of a default (that is, the loan is fully drawn and no amount is recovered). If, when the PD is applied to the outstanding balance of the inter-company loan, this results in an immaterial expected credit loss, no further work is required. If, however, this short-cut results in a material expected credit loss, further work will be required to estimate the actual loss in the event of a default.
Section E *Other intercompany loans*	Inter-company loan does not fall into any of the categories above (that is, it has had a significant increase in credit risk since it was first recognised).	• For loans that are in stage 2 or 3, a lifetime expected credit loss is recognised. • In measuring the expected credit loss, all reasonable and supportable information that is available without undue cost or effort should be considered. This includes both internal and external information, and information about past events, current conditions and forecasts of future economic conditions. • The effect of credit enhancements such as collateral, guarantees and letters of support should also be considered. Guarantees that are contractually enforceable have a greater effect than letters of support that are not. • Calculating lifetime expected losses can be complex. If support is required, consult with an IFRS 9 specialist.

Issue of the month

IFRS Blog: Accounting for Initial Coin Offerings

What is an initial coin offering?

When I first heard about an ICO ("Initial Coin Offering"), I said "are you sure you don't mean an IPO buddy?" After being told I needed to get with the times, I decided to keep quiet and do a bit of research to make sure I could still hang with the cool crypto kids.

You, like me, might need a crash course in ICOs. Here's my layman's take on them. An ICO is a combination of crowd funding with blockchain. A group of people put together a white paper requesting funding for an innovative idea (often an eCommerce platform), describing the business model, and explaining what investors might get if they choose to invest.

Investors are 'issued' with a digital coin (based on blockchain technology) if they decide to take part in the ICO. They typically pay in cash or in another cryptourrency. The digital coins detail who the investors are and the white paper explains what benefits holding the digital coins will provide. ICOs are relatively new and their terms and conditions can vary significantly. Some digital coins give the investors access to a portion of the benefits from the underlying venture or activity. For example, it might be a portion of the fee that a developed platform charges on each transaction or maybe a discount on those fees for the coin holder.

The benefits of the digital coins are unlikely to be access to the future profits of the venture (like a normal share), but rather give the coin holder access to free or discounted goods that are the output of the activity or venture. And some ICOs provide no benefit other than that the initial digital coins are issued at a discount to the expected issue price of future coins. If the venture is successful, the investors can sell their digital coins to other parties, , and pocket the appreciation. However, if the developers don't manage to finalise their idea, often there is no obligation to refund any funding to the investors.

So what are the accounting issues?

Unsurprisingly IFRS isn't designed with blockchain business models in mind. Here are a couple of the juiciest problems that are keeping me awake at night:

1. Is it a barter arrangement for the issuer (developer) and the investor? How should the developers account for the initial issuance of the digital coins? The developers are often receiving a cryptocurrency (rather than traditional currency) in exchange for issuing the digital coins. That seems like a barter arrangement, i.e. a digital coin for some cryptocurrency. This might allow the developer to determine the value of consideration by reference to the spot value of the cryptocurrency that they receive. But it doesn't help decide what to do with the credit.

2. If ICOs are a capital raising, are they debt or equity? Many digital coins do not give the holder a right to any residual interest in the platform or the entity that issued the coins, nor do they generally give the holder the ability to vote on any decisions relating to the operating activities of the platform. However, the digital coins generally last as long as the underlying activity exists and give their holders special benefits that others do not enjoy. They don't seem to meet the definition of equity, but it does feel in many cases like the holders are entitled to benefits into perpetuity, much like a share. What about those coins that entitle the holder to a portion of every transaction fee? Does the entity have a contractual obligation to make a stream of payments in perpetuity? Or even a constructive obligation? If so, does the entity need to recognise a liability for the present value of all the future expected transaction fees to be paid to coin holders when the coins are issued. Interesting recognition and measurement issues:– good luck with that.

3. If not debt or equity under IAS 32, what else? The developer has promised to develop the proposed platform and provide discounts or other benefits in exchange for consideration; but the investor has no right to a refund if the developer fails. Is this in the scope of IFRS 15? There seems to be a contract as defined by IFRS 15 and an implied obligation to develop and maintain the platform and maybe provide other benefits.

4. If in the scope of IFRS 15, how many performance obligations are there? What are the promises in the contract, if the ICO consideration is deferred revenue? Is the promise to build a platform and make it available and provide benefits for as long as the platform exists. Are these distinct? IFRS 15 requires an allocation of the consideration based on relative stand-alone selling prices. What is the relative stand-alone selling price of an untested IT platform and VIP access to that platform indefinitely? Even if an entity could allocate, the access to the platform is indefinite or as long as the platform operates. We are left trying to work out how to recognise an obligation to provide access indefinitely? – I think I'd have more luck trying to guess the price of Bitcoin in a year's time!

Conclusion

I don't know what the answers at this stage, but I do think this is an area that needs focus from regulators, standard setters and auditors if we're going to try and provide users with useful information. Is it time to think about an ICO for a platform that will solve by consensus all the difficult accounting problems in the world – subscribe now, tokens are limited.

This week's guest blogger is Gary Berchowitz, PwC Partner.

Connect with him on LinkedIn.

Cannon Street press

The February 2018 IASB Update has been published and the work plan updated.

The topics, in order of discussion, were:

- Disclosure Initiative: Principles of Disclosure
- Primary Financial Statements
- Dynamic Risk Management
- Business Combinations under Common Control
- Research Programme
- Insurance Contracts
- Discussion Papers and Exposure Drafts
- Rate-regulated Activities

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