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IFRS news

In This Issue

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Investor expectations on new IFRS implementation

Marie Claire Tabone, Investor Engagement manager, shares insights on what investors expect companies to communicate when implementing new accounting standards .

Four new IFRS standards come into effect between 2018 and 2021, and companies will undoubtedly already be considering what accounting implications these new standards have on their business. They will also be assessing whether they need to implement new systems to capture the required information and whether contracts and maybe even staff behaviours need to change. The investment community will be very interested in how companies are approaching these new standards, especially if they are expected to have a material impact on an entity's financial statements. Investors will be looking at a company's disclosures and communications both in the run-up to implementation, and after the standard is adopted.

What can a company do to make communication of new standards relevant?

Early and transparent communication

Investors would like companies to communicate as early as possible to avoid 'surprises' and to be transparent about the changes. Those companies which communicate about the impact of a standard in advance of adoption are viewed positively by investors and seen as ahead of the curve. If the effect of a standard on the entity's accounts is material, it is particularly important to get that message to investors as soon as possible. The stock market does not like uncertainty and will try to fill in any gaps in information – therefore, companies should ensure they are the ones sending the messages about the effect on their company, and not letting the market guess. Besides information in financial statements and interim announcements, educational calls or presentations for analysts are also considered helpful.

Investors also want companies to be clear about differences between current practice and the new standard, and to either provide reconciliations of the differences or sufficient information to allow them to perform their own reconciliations. It is also important to distinguish between what has changed as a result of the new standard and what is due to the underlying economics of the business. News on poor performance should not be buried within disclosures and explanations or blamed on the new standard.

Improved disclosures

New accounting standards can also be seen as an opportunity to improve a company's disclosures. A company can replace old boilerplate disclosure with meaningful notes, including useful detail to allow investors to understand the figures. Investors do not appreciate the excuse of 'commercial sensitivity' for limited disclosures, and this should not act as a barrier to clarity, as they believe that competitors tend to be aware of such information already.

To further enhance their understanding, investors would like to ideally have at least three years of comparatives under the new standard in the first year of adoption. While this goes beyond standards' requirements, it will help investors understand the implications of the new standard and assess company performance. Such information should also be presented at segmental or divisional level, and not just for the group.

Other considerations

Investors do not look at a new accounting standard in isolation. They want to know what its tax impact is, and the cost of implementation. For example, how much will the company be spending on new software or employee training? Such information should be included in communications about the new standard.

Companies should keep in mind that:

- A new accounting standard can have a major impact on how investors perceive the performance of companies and even whole sectors, especially where they think the old standard is inadequate. If addressed properly, this could have a positive impact.
- Investors' view of a company is influenced by how it reacts to and implements a new standard – is management being transparent and proactive?
- If the standards have an impact on profitability, it will affect investment valuations and influence the analysis, and potentially the buy/sell recommendation on a company's shares.

IFRS 13 Fair Value gets a check-up

The IASB recently issued the Request for Information for IFRS 13 Fair Value, as a part of the Post-implementation Review. Tatiana Geykhman from Accounting Consulting Services provides the details behind the request

IFRS 13 Fair Value Measurement has been around for a number of years now and it is time for the IASB to do a health check through their Post-implementation Review process.

The standard is a single measurement framework for the fair value of both financial and non-financial instruments and includes additional disclosure requirements.

This article explores the findings from the initial assessment of the standard and where the IASB has focused the request.

Disclosures

Both users and preparers of financial statements are invited to express their views on the usefulness of fair value measurement disclosures.

Originally, the user community had asked the Board to require detailed disclosures for Level 3 fair value measurement. A level 3 measurement has significant unobservable inputs and therefore clear disclosure would enable transparency over inputs and techniques used.

In practice, IFRS users and other stakeholders observed that the current disclosure requirements can be burdensome. Disclosure can be generic and therefore add little value to the users of the financial statements. Preparers often aggregate information together to avoid having an entire appendix on fair value in the financial statements. This makes it harder to see what inputs are used in which model and where the model is the most sensitive.

*Measuring quoted investments (P*Q)*

P*Q (share price multiplied by quantity of shares) is a unit of account issue. The standard requires an entity to identify what they are measuring at fair value as one of the first steps in the measurement process. It would make sense to measure a holding of 100 listed shares at the share price multiplied by 100, the quantity. It gets more complicated where the unit of account is an investment in a subsidiary, associate or joint venture where an acquirer may pay more for a block in comparison to the price of one share.

The standard is unclear whether to use P*Q or do a fair value measurement considering a control premium or a minority discount.

The IASB had previously issued an exposure draft on this issue but deferred this to the post implementation review when there was no clear answer.

Highest and best use

The highest and best use of a non-financial asset should be considered when measuring the asset's fair value, even if the current use is different.

Some stakeholders expressed concerns about applying this concept to groups of assets.

The stakeholders are invited to express their views as to how pervasive the highest and best use concept is and whether further support from the Board would be helpful.

Judgement

Use of judgement is required in applying IFRS in general, and IFRS 13 is not an exception.

Areas of significant judgement identified were whether:

- the market is active, and
- an input is a significant unobservable input.

The stakeholders are invited to describe the challenges in applying judgments and whether further support from the Board would be helpful.

What's next?

The deadline for submissions is 22 September 2017.

The Board is especially interested in practical experiences and illustrative examples. The Board will analyse submissions received and other information gathered to decide whether further guidance is needed.

IFRS 16 requires some variable lease payments to be excluded from the lessee's lease liability. Can Professor Lee Singh and his assistant Richard Brown help decide how to categorise and account for variable lease payments? Let's experiment!

The Leases Lab

Hypothesis

Lessees exclude all variable lease payments when calculating the lease liability.

Testing and analysis

IFRS 16 identifies three types of variable lease payments:

- Based on an index or rate
- Not based on an index or rate
- In-substance fixed payments.

Based on an index or rate

Examples of variable lease payments based on an index or rate include payments which change based on the inflation index or market rent reviews.

> Variable lease payments based on an index or rate are included in the lease liability because they are unavoidable from the perspective of the lessee.

The uncertainty relates only to the measurement of the liability but not to its existence.

Lessees calculate the lease liability on initial recognition using the index or rate at the commencement dateT do not estimate or forecast future changes to the cash flows from the inflation or rent reviews.

During the lease, when the lease payments change based on the index or rate, the lessee remeasures the liability based on the new payments.

Not based on an index or rate

Examples of variable lease payments not based on an index or rate include lease payments which are a percentage of turnover in a retail store or payments for exceeding a specified mileage with a motor vehicle.

> Variable lease payments not based on an index or rate are excluded from the lease liability because they are avoidable from the perspective of the lessee, assuming they are genuinely variable.

Examples of when the payments may not be genuinely variable include:

- If there is a contractual minimum, the minimum would be accounted for as a fixed lease payment.
- Payments that are initially variable but later become fixed are accounted for as fixed once they become fixed.
- If the payments are in-substance fixed (see next section).

Although variable lease payments which do not depend on an index or rate are excluded from the lease liability, the lessee needs to separately disclose the expense and the exposure to the variable payments in future.

In-substance fixed

In-substance fixed payments are payments that are structured to be variable but are not genuinely variable in substance.

> In-substance fixed lease payments are included in the lease liability because they are, in substance, unavoidable from the perspective of the lessee.

Examples of in-substance fixed payments include payments that are contingent on the asset being proven capable of operating.

Practical impact

In practice, accounting for variable lease payments may be more complex and judgemental.

Consider, for example, a retail lessee in a shopping mall (that has to open during mall opening hours and sell their products) with the following payment terms:

Payment terms	Type of variable payments
Pay 10% of their turnover as rent	The payments would be genuinely variable and not based on an index or rate.
Pay no rent unless turnover is over $1,000, in which case pay rent of $1,000,000 for that year	The payment of $1,000,000 would be in-substance fixed
Pay 50% of their turnover as rent up to $800,000 of rent per annum, then 20% of turnover up to $1,000,000 of total rent per annum and thereafter 5% of turnover	Significant judgement is needed to decide which amounts are in-substance fixed. The payments at 50% could be deemed in -substance fixed, depending on the specific circumstances of the lease. The payments at 5% could be deemed genuinely variable and not based on an index or rate. The payments at 20% are judgemental as to whether in substance they are unavoidable.

Conclusion

IFRS 16 identifies types of variable lease payments which are accounted for differently: some are excluded from the lessee's lease liability but others are included.

For some lease arrangements, deciding how to classify variable lease payments may require significant judgement.

For more information please see the IFRS 16 page of our website pwc.com/ifrs

You might also find our range of videos helpful.

Ilaria Evans, Financial instruments expert, considers a simpler approach to credit losses for trade receivables

Scene 5, Take 1: Demystifying IFRS 9 for Corporates: Provisions matrix

LIGHTS, CAMERA, ACTION!

Dear Corporate,

Impairment is one of the biggest changes of IFRS 9 and it is a complex area. Impairment must be based on forward-looking information as well as past experience and current expectations. Most companies will need to collect new information and apply significant judgement.

This article explores, the use of a provision matrix, one of the practical expedients allowed by IFRS 9 for calculating expected credit losses on trade receivables.

Step 1 – Define a period of sales and bad debts relating to those sales

The first step when using a provision matrix is to define an appropriate period of time to analyse the proportion of trade receivables written off as bad debts. This period should be sufficient to provide useful information. Too short might result in information that is not meaningful. Too long might mean that changes in market conditions or the customer base make the analysis no longer valid. In the example we have selected one year. The overall receivables were CU 10,000 and the receivables ultimately written off were CU 300 in that period.

Step 2 – Calculate payment profile of the debtors

In step 2 we determine the amount of receivables outstanding at the end of each time bucket up until the point the bad debt is written off. The ageing profile calculated in this step is critical for the next step when calculating default rate percentages.

Step 2: Calculate payment profile of the debtors

Total sales (CU):	**10 000**	**Total paid:**	**Ageing profile of sales (step 3):**
Paid in 30 days:	(2 000)	(2 000)	8 000
Paid between 30 and 60 days:	(3 500)	(5 500)	4 500
Paid between 60 and 90 days:	(3 000)	(8 500)	1 500
Paid after 90 days:	(1 200)	(9 700)	**300** [written off]

Step 3 – Calculate the historical default loss percentage

The receivables are analysed in time buckets in step 3 to calculate the historical default loss percentage. The debtors ultimately written off of CU 300 are applied to each time bucket .

Step 3: Calculate the historical default loss percentage
[Use ageing of payments determined in step 2 / credit loss on all sales]

	Current sales	**Sales payments outstanding after 30 days**	**Sales payments outstanding after 60 days**	**Sales payments outstanding after 90 days**
Ageing profile of sales [1]	10 000	8 000	4,500	1,500
Loss: [2]	300	300	300	300
Default rate: **[2]/[1]**	**3%**	**3.75%**	**6.67%**	**20%**

Step 4 – Adjust the loss percentage for forward looking information

This is likely to be the most judgemental step in the process. The key to adjusting the historical default loss percentage is to understand what drives the level of bad debts in the specific debtors' book. For example where a company is selling to retail customers, the default rate might correlate with unemployment.

Step 4: Adjust the loss percentage for forward looking information

Consider changes in:
- Economic, regulatory, technological environment e.g. industry outlook, GDP, employment, politics
- External market indicators
- Customer base

Assumptions:
- Economic down turn/higher unemployment rates forecast
- Assume the same payment profile and sales as initially
- Loss adjusted from 300 to 400 as a result

	Current sales	Sales payments outstanding after 30 days	Sales payments outstanding after 60 days	Sales payments outstanding after 90 days
Ageing profile of sales [1]	10 000	8 000	4,500	1,500
Loss: [2]	400	400	400	400
Default rate: **[2]/[1]**	**4%**	**5%**	**8.9%**	**27%**

Step 5 – Calculate the expected credit loss using the default rates determined in step 4

Finally take the default rates from step 4 and apply them to the actual receivables at the period end for each of the time buckets. There is a credit loss of CU12 in the example illustrated.

Step 5: Calculate the expected credit loss using the default rates determined above

	Total	Current [0 – 30 days]	30 -60 days	60 -90 days	After 90 days
Trade receivable balances at year end: [1]	140	50	40	30	20
Default rate: [2]		4%	5%	8.9%	27%
Expected credit loss: **[1] x [2]**	**CU 12**	**CU 2**	**CU 2**	**CU 2,7**	**CU 5,3**

Conclusion

- IFRS 9 has new complex impairment requirements that are likely to result in larger, more volatile bad debt provisions.
- A provision matrix is a simplification for companies to calculate the expected credit loss .
- There is no prescribed method for the provision matrix, but the two key factors to are that as debts get older they are more likely not to pay, and to include forward looking information.

Check this out !! Our full range of IFRS 9 content and videos can be found here

Jonas Molini of Accounting Consulting Services examines the practical implications of IC rejections related to IAS 38.

IFRIC Rejections - IAS 38

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 38 as per below.

IAS 38 prescribes the accounting treatment for intangible assets that are not dealt with specifically in another Standard.

Over the years, a number of issues have been rejected, some of which we explain in more detail below.

Amortisation method (January 2010)

The IC received requests for guidance on the meaning of 'consumption of economic benefits' when determining the appropriate amortisation method for an intangible asset with a finite useful life.

IAS 38 paragraph 98 states that 'the method used is based on the expected pattern of consumption of the expected future economic benefits embodied in the asset...' Some members of the IC believed that an interpretation could assist in reducing diversity in practice, while others considered that any guidance would be in the nature of application guidance. The IC noted that the determination of the amortisation method is therefore a matter of judgement.

The IC concluded that it would not be able to reach a consensus on the issue on a timely basis and decided not to add the issue to its agenda.

The IASB later clarified that the use of revenue-based amortisation is presumed to be inappropriate, because revenue reflects factors other than the consumption of the economic benefits embodied in the asset. This presumption can be rebutted only in the limited circumstances included in IAS 38 paragraph 98A.

Variable payment for asset purchase (March 2016)

The Interpretations Committee received a request to address the accounting for variable payments to be made for the purchase of an item of property, plant and equipment or an intangible asset that is not part of a business combination.

The IC observed significant diversity in practice but concluded that the issue is too broad to be addressed within the confines of existing IFRS Standards and did not add this issue to its agenda.

Two approaches are observed in practice: the first is a cost accumulation model, whereby all further consideration is added, when incurred, to the cost of the asset initially recorded. The second approach is a financial liability model, with any re-measurements of the related liability and any additional payments recognised in the income statement. Both approaches to accounting for variable payments are acceptable. This is a policy choice that should be applied consistently to all similar transactions and appropriately disclosed.

Summary of other IAS 38 rejections

Topic	Summary of the conclusion
Costs of acquiring or developing content for electronic databases (February 2002)	The IC did not address these issues because SIC-32 and IAS 38 provide sufficient guidance.
Subscriber acquisition costs (November 2004)	The IC did not add this to their agenda because the IASB was considering this as part of its Revenue project.
Regulatory assets *(August 2005)*	The IC concluded that the special regulatory asset model of SFAS 71 could not be used without modification, as the recognition criteria in SFAS 71 were not fully consistent with the recognition criteria in IFRS.
Service concessions *(November 2005)*	The IC agreed that there is not relief from the IAS 8 hierarchy for service concessions. Capitalisation of interest after construction is completed is not therefore permitted in either the tangible or intangible asset model.
Classification and accounting for SIM cards *(November 2006)*	The IC declined to take this item on its agenda as it was similar to the subscriber acquisitions costs, which they also declined to take on their agenda.
Regulatory assets and liabilities (March 2009)	The IC decided not to add this issue to its agenda as it would be picked up in the IASB's rate-regulated project.
Accounting by a real estate developer for sales costs during construction *(May 2009)*	Accounting for selling costs is addressed in a number of IFRSs. The IC concluded that because the accounting for such costs varies depending on specific facts and circumstances, it would not reach a conclusion and did not add this issue to the agenda.
Compliance costs for 'REACH' Regulation (July 2009)	The IC received a request to add an item to its agenda on the treatment of costs incurred to comply with the requirements of the European Regulation concerning the Registration, Evaluation, Authorisation and Restriction of Chemicals ('REACH'). The IC did not add the issue to the agenda as they concluded the guidance in IAS 38 was sufficient.
Regulatory assets and liabilities (November 2012)	This issue was deferred into the IASB's rate regulated project.

The IFRS 15 Mole

Katie Woods, revenue specialist, investigates how to determine whether revenue should be accounted for at a point in time or over time under IFRS 15 with the help of the IFRS 15 Mole

Suspects

Revenue from a contract with a customer is either recognised at a point in time or over time. Making this determination depends on when control of the good or service is transferred to the customer.

Incident description

Will the timing or revenue recognition change with the application of IFRS 15? In practice, following the control principle can mean that revenue from the sale of goods currently recognised at a point in time might be recognised over time recognition.

Facts

The concept of revenue being recognised over time or at a point in time is not new, however the principles and guidance in IFRS 15 are different. An entity first considers whether it satisfies the criteria to recognise revenue over time, and if not, revenue is recognised at a point in time.

The same criteria are applied to goods and to service arrangements. One of the following criteria need to be satisfied for over time recognition:

1. The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs.
   In a service contract, for example, a cleaning contract, the customer immediately benefits from the performance obligation being satisfied. An indication of this is where no re-performance is required if another entity was to fulfil the remaining performance obligations to the customers. This is the case for a significant portion of service contracts - but not all of them.

2. The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced.
   This criterion applies in situations where the customer controls what the entity is producing while it is being produced, for example building a house on the customer's land.

3. The entity's performance does not create an asset with an alternative use to the entity, and the entity has an enforceable right to payment for performance completed to date.

a) Alternative use
Not creating an asset with an alternative use would occur if the entity is unable, because of contractual restrictions or practical limitations, to redirect the asset for another use, for example, make something else with it or to sell to another customer.

b) Enforceable right to payment
There is a need to determine whether the entity would have an enforceable right to demand payment if the customer cancelled the contract. An entity's right to payment does not have to be a present unconditional right. This does not include situations such as breach of contract or non-performance .The right to payment should reflect the selling price of the goods or services provided to date, not compensation for costs incurred to date or potential loss of profit if the contract is terminated.

Recommendations

The contract is key. Looking at what the customer has the right to, either to benefit from a service straight away or make substantive decisions during the development and build of a particular good, is likely to lead to an overtime model.

Further investigations

Do not assume that if revenue is spread under existing GAAP, it will be spread under IFRS 15. There are many cases where recognition will change.

Cannon Street Press

Editors choice

Modification of financial liabilities – IFRS 9 accounting change confirmed

The Board confirmed the accounting for modifications of financial liabilities under IFRS 9 at the July Board. They confirmed that when a financial liability measured at amortised cost is modified without this resulting in derecognition, a gain or loss should be recognised in profit or loss. The gain or loss is calculated as the difference between the original contractual cash flows and the modified cash flows discounted at the original effective interest rate.

This will impact all preparers, particularly those applying a different policy for recognising gains and losses today. Many preparers under IAS 39 did not recognise a gain or loss at the date of modification of a financial liability. Instead, the difference between the original and modified cash flows was amortised over the remaining term of the modified liability by re-calculating the effective interest rate. This will need to change on transition to IFRS 9 because the accounting will change

Other Highlights

Standard Setting Projects

Insurance

After publication of IFRS 17, Insurance Contracts, the IASB members and Staff met investors and analysts to discuss feedback on the standard. The IASB Staff presented to the July Board a summary of those discussions. Investors and analysts welcomed a number of developments that IFRS 17 brings such as more clarity about sources of profits from insurance contracts from disclosures of contractual service margin (unearned profit) and risk adjustment for non-financial risks, consistency of revenue recognition policies with other industries and considering time value of money for incurred claims. Investors and analysts expressed concerns about expected remaining inconsistency in accounting for insurance contracts due to significant judgements involved in measurement and choices available under IFRS 17.

Publications from the Board

Proceeds before Intended Use exposure draft (ED)

The Board recently issued an ED to propose amendments to IAS 16 Property, plant, and equipment. The amendments prohibit deducting from the cost of a PPE item any proceeds from selling the items produced while that asset is not yet available for intended use. These proceeds should instead be recognised in profit or loss together with the costs of producing these items.

The amendments clarify the meaning of 'testing whether the asset is functioning properly' to be assessing the technical and physical performance of the asset, but not the financial performance.

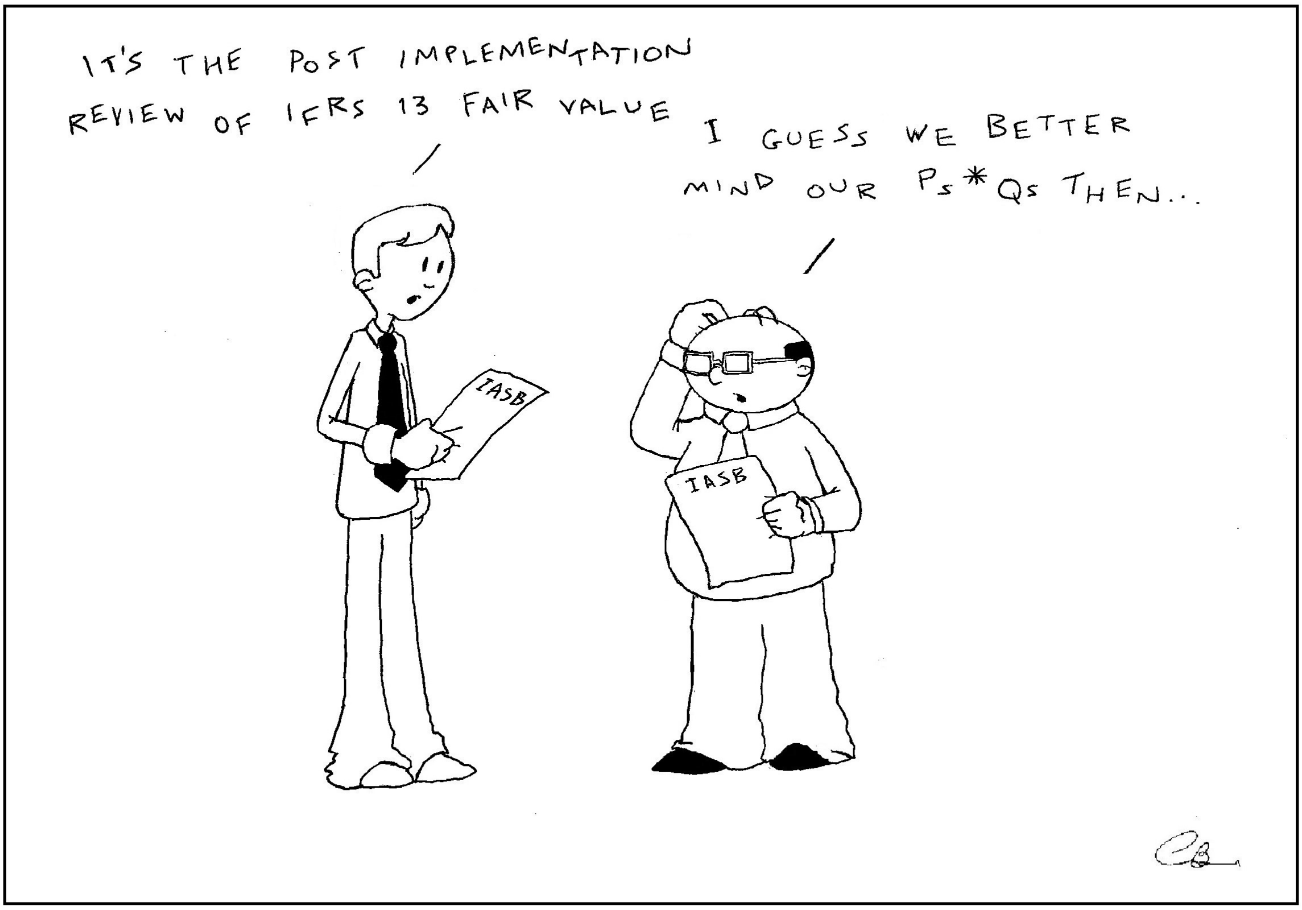
The effective date is not yet determined. Amendments are expected to be applied retrospectively to those PPE items become available for intended use on or after the beginning of the earliest period presented in the financial statements. Early adoption is expected to be permitted.

These are the editor's top picks from the July Board meeting and IASB publications. For a comprehensive list of all discussions visit the IASB website www.IFRS.org

Technical Accounting Bingo

It's facts and circumstances specific	*I would analogise to…*	*It's in the scope of IFRS 2*	*Let's go back to T accounts*	*It's in the basis of conclusion somewhere*
It's a policy choice	*The accounting policies are boiler plate*	*That topic is deferred into the equity accounting project*	*Have you read the contract?*	*The conceptual framework is very clear on this point*
There is diversity in practise	*Impair it now*	*That is not what the IASB meant to write*	*No really it's in the scope of IFRS 2*	*We can exclude that, it's non-core, non-recurring non-*
Does that reflect the true economic substance of the	*It's impractical*	*That would represent undue cost and effort*	*I'm sure US GAAP is different*	*Isn't that in IAS 1*
Book the liability	*It's not material*	*Of course it's a defined benefit plan*	*Have you discussed that with the financial instrument*	*That is what the standard says…*

The bit at the back ...



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