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# *Non-Executive Director Workshop*

Technical accounting update

24/25 January 2013



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## ***Setting the scene – the burning questions!***

US GAAP  
conversion  
they want

What is keeping the  
FRRP awake at  
night?

New UK GAAP -  
what will it mean to  
me?

big  
subjects  
completed?

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# ***Agenda***

1. What are the standard setters working on?
2. Common themes/issues - FRRP activity and hot topics
3. New standards and transition guidance
4. Update on significant IASB projects
5. The future of UK GAAP

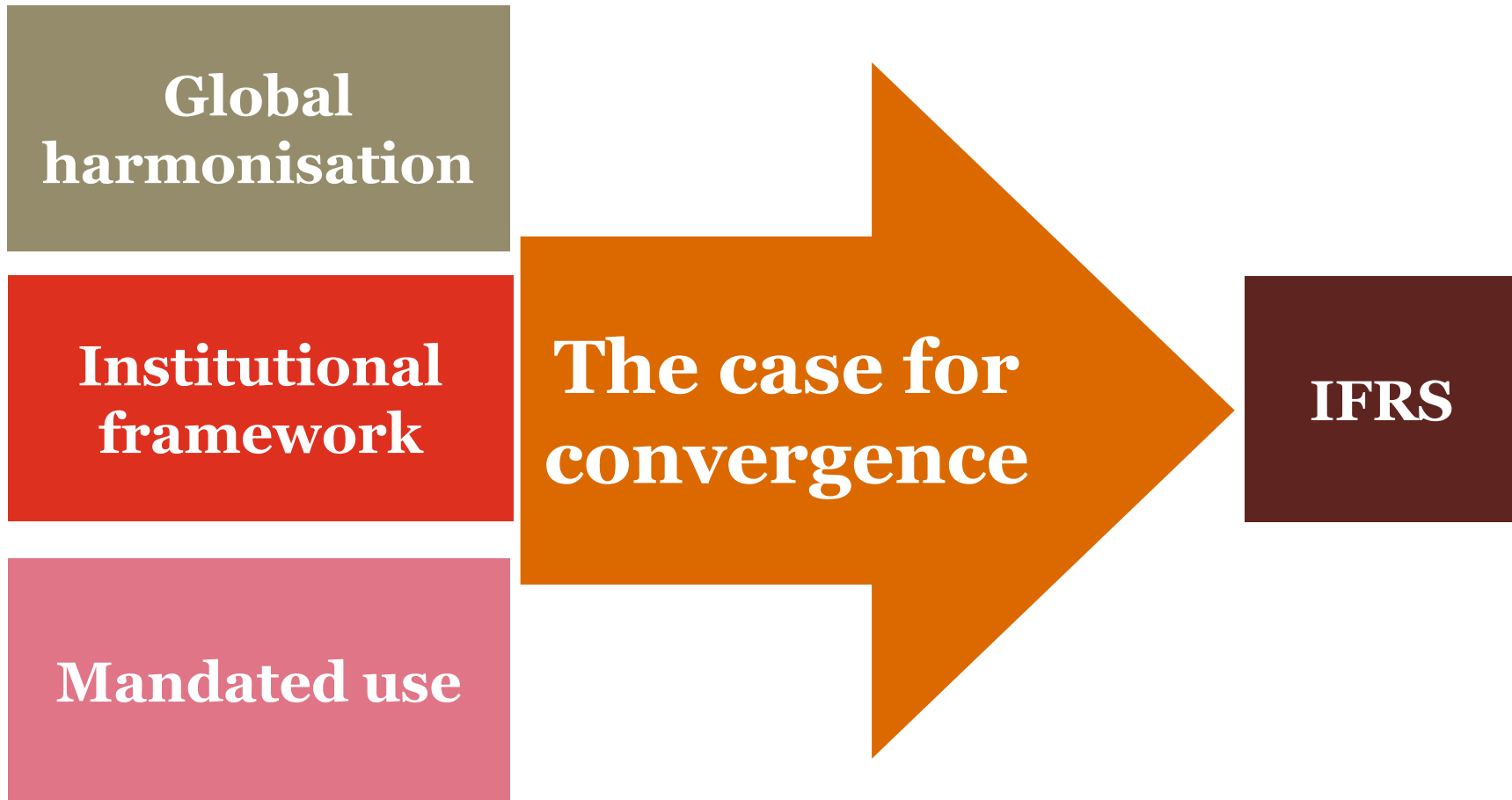
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*What are the standard setters  
working on?*

*1*

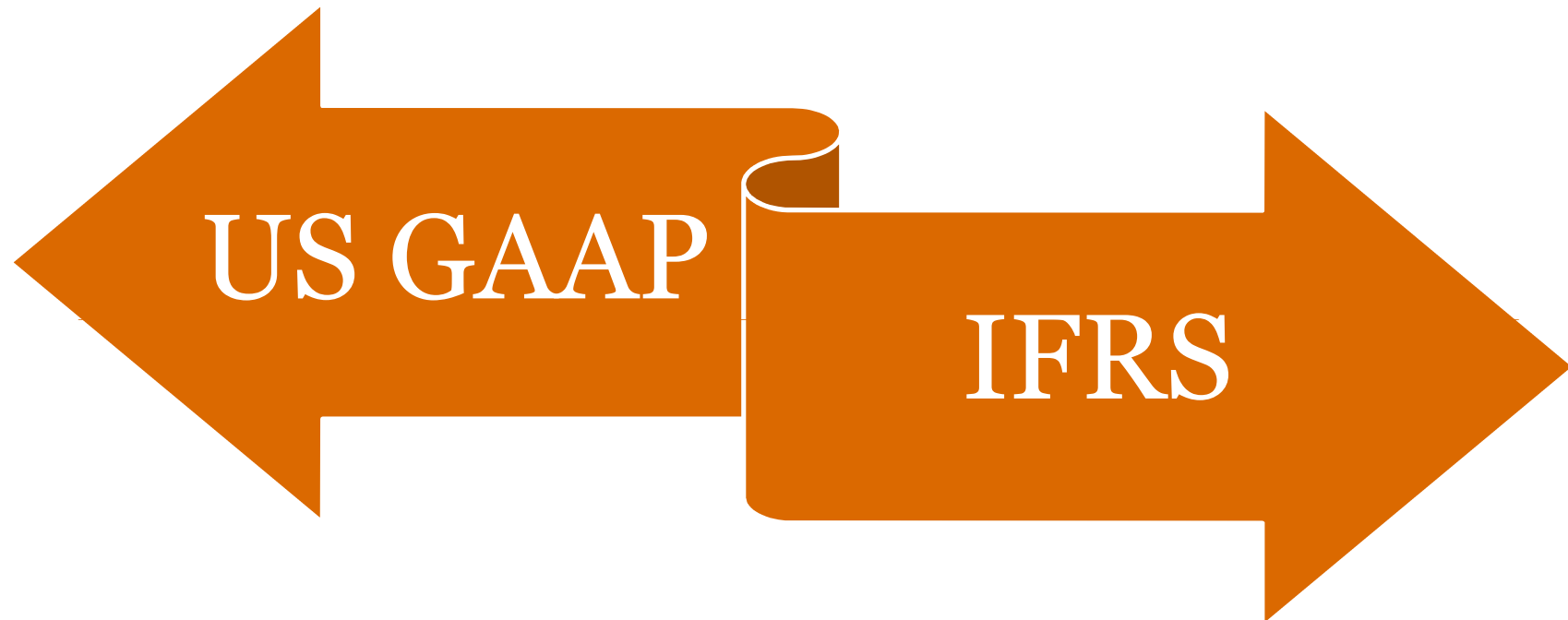
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## ***Financial reporting today***



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## ***IFRS and US GAAP convergence***



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## ***IFRS and US GAAP convergence***



**Will the US ever adopt IFRS?  
Will the two GAAPs gradually  
converge over an extended  
period?**



**Will the IASB now be free to  
take a different route from  
recent years?**



**What will be the nature and  
extent of the US's role in  
international standard setting  
in the future?**

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## ***IASB workplan update***

**The IASB current & future work  
programme...**



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## ***IASB's agenda consultation***

### **Agenda consultation – July 2011**

#### **Maintaining existing IFRS**

- Post-implementation reviews
- Interpretations/ implementation problems

#### **Developing financial reporting**

- Updating framework
- Researching strategic issues
- Finalising big four and moving on to other projects

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## ***What specifics could be on IASB's agenda?***

**Revenue**

**Leasing**

**Financial instruments**

**Insurance**

Debt/equity

Emissions trading

Equity  
accounting

Rate-regulated  
activity

Intangibles

Liabilities/provisions

Share-based  
payment

Income taxes

Discount rate

Agriculture

Business  
combinations –  
common control

Foreign currency

Post-employment  
benefits

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## *FRRP activity and hot topics*

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## ***Who are the FRRP and the Conduct Committee ?***

- Established as part of the FRC
- From July 2012 following reform now under direction of the Conduct Committee of FRC
- Review annual reports of public and large private companies
- Compliance with law and accounting standards

### **How do they work?**

Selection of accounts:

- risk based approach
- select from certain industries (“priority sectors”)
- complaints from the public

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## ***FRRP focus***

- Companies operating in specific market sectors
- Companies considered to face more risks due to difficult market conditions
- Challenge companies that provide “boiler plate” disclosures, particularly over disclosure of principal risks and uncertainties
- Focus on disclosures relating to significant judgements

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## ***2012 Annual Report***

- 326 sets of accounts reviewed
- 297 selected by FRRP
- 29 selected from complaints/referrals
- 130 approaches to companies
- 5 panel groups established in year to consider responses, all satisfactorily resolved
- No press notices issued in year to March 2012, one subsequently issued in August 2012 (Pendragon PLC)
- 7 panel references agreed with companies (published as a note to the accounts). Further 3 references subsequently agreed post March 2012

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## ***FRRP – Targeted reviews***

- General comments
- Directors' reports – business reviews
- Corporate Governance statements
- Half yearly financial reports
- Insurance company reports and accounts

# ***Important disclosure considerations***

**Business reviews –balanced and consistent with back half disclosures. Include both good and bad news**

**Principal risks and uncertainties – mitigating actions to reduce risks**

**Accounting policies not specific – particularly revenue recognition**

**Significant judgements and estimates generic – need to be specific**

**Classification of cashflows – (operating versus investing/ financing)**

**Income taxes– deferred tax asset and liability recognition**

**Impairment of assets – significant assumptions require disclosure**

**FRRP Interest in Pension restructuring arrangements**



# ***FRRP priority sectors for 2012/2013***



**Support  
services**

**Priority  
sectors  
2012/2013**



**Commercial  
property**



**Retail**

## Common themes/issues

### FRRP findings

- Accounting policies – particularly revenue
- Judgements and assumptions
- Statement of cash flows
- Income taxes
- Impairment of assets

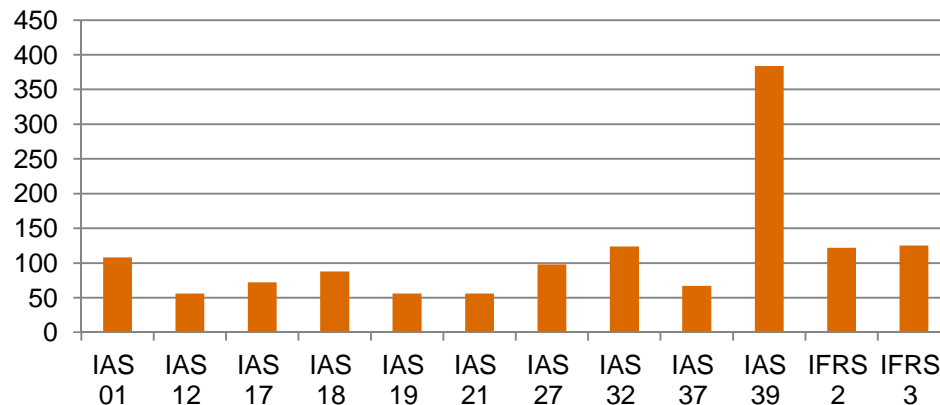
### FRRP 2012/13 focus

- Commercial property
- Retail
- Support services

### AIU

- Goodwill assumptions
- Revenue Recognition

Number of queries by Standard



#### KEY:

IAS 1	Presentation of financial statements
IAS 12	Income taxes
IAS 17	Leases
IAS 18	Revenue
IAS 19	Employee benefits
IAS 21	The effects of changes in foreign exchange rates
IAS 27	Consolidated and separate financial statements
IAS 32	Financial instruments: Presentation
IAS 37	Provisions, contingent liabilities and contingent assets
IAS 39	Financial instruments: Recognition and Measurement
IFRS 2	Share-based payment
IFRS 3	Business combinations

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*New standards and transitional  
guidance*

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# ***New and amended Standards***

## **Effective for periods beginning on or after 1 January 2012**

IAS 12 – Income Taxes

IFRS 7 Financial instruments: Disclosures – Transfers of financial assets

IFRS 1 – First time adoption of IFRS

## **Standards to consider for early adoption**

IAS 1 – Presentation of financial statements

IFRS 7 – Financial Instruments: Disclosure

IFRS 9 – Financial Instruments

IFRS 10, IFRS 11, IFRS 12 – the consolidation ‘pack’

IFRS 13 – Fair Value

IAS 19 – Employee benefits

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## ***IAS 12 – Income Taxes***

- Introduces rebuttable presumption of sale
- Fully retrospective application on adoption
- Effective 1 January 2012 (1/1/2013 in EU)
- Expected manner of recover difficult to ascertain



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# ***IFRS 7 - Financial instruments: Disclosures***

## Transfers of financial assets

- Greater disclosure of transferred financial assets.
- The amendment has different disclosure requirements for transferred assets that are:

**Not** derecognised  
in their entirety

Derecognised in  
their entirety

*Effective for periods beginning on or after 1 July 2011*

# ***Standards to consider for future periods***

The major new standards and amendments issued recently are:

IAS 1 – Presentation of financial statements\*

**1 July 2012**

IFRS 7 – Financial Instruments: Disclosure\*

IFRS 10 – Consolidated financial statements^

IFRS 11 – Joint arrangements^

IFRS 12 – Disclosure of interests in other entities ^

IFRS 13 – Fair value measurement\*

IAS 19 (amendment) – Employee benefits\*

**1 January  
2013**

IFRS 9 – Financial Instruments

**1 January 2015**

**EU Endorsed\* (^2014)**

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## ***New consolidation standard – IFRS 10***

- Changes definition of control; core principle unchanged
- Same criteria for all entities to determine control; no distinction for SPEs
  - Focus on power and variable returns before control is present
  - Voting or contractual rights are evidence of power
  - ‘De facto’ notion more firmly defined
  - Power is continually assessed
  - Intended temporary control does not prevent consolidation
- Effective date – 1 January 2013



## ***Who will these changes affect?***

Generally the changed definition of control will not affect the scope of consolidation for most corporates. The main impact will be felt by:

### **Investment managers**

New guidance as to whether the manager exercises control as a principal or agent:

- Scope of decision making authority
- Rights held by other parties
- Nature of remuneration
- Exposure of the manager to variability from other interests

### **Entities with SPEs**

SIC-12 is being withdrawn by IFRS 10 so entities with SPEs should revisit their consolidation decisions in light of the new guidance

### **Investment Companies**

Scoped out of IFRS10

Investments held at Fair Value through P&L

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## ***IFRS 10***

### ***Application guidance – Structured entities***

- Consider
  - Purpose and design
  - Involvement in design of investee
  - Contractual arrangements closely-related to investee
  - Rights contingent upon particular circumstances
  - Commitment to ensure investee operates
  - Other facts and circumstances

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## ***IFRS 10***

### ***Example – Structured entities***

- Investee is held by various investors.
- Investee holds only receivables.
- Investee's activity is to pass on interest/principal.
- Defaulting receivables are managed by investor A.
- Only relevant activity is managing defaulting receivables.

Does A have power before receivables default?

Yes.

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## *Significant IASB projects*

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# *Revenue recognition project*

## ***Why is a new revenue standard needed?***

### **IFRS**

Dual model – different accounting for goods/ services and construction contracts  
Standards are old and contain little basis for the conclusions

### **New [draft] standard**

Single model for all revenue contracts  
Convergence between IFRS US GAAP

### **US GAAP**

Over 200 separate pieces of revenue guidance  
Some aspects are very rules driven  
Lack of consistency across industries



## ***Scope – Revenue from contracts with customers***

**Revenue** is income from ‘ordinary activities’

A **contract** has rights and obligations between two or more parties

A **customer** receives a good or service

- Who is a customer?
- What is scoped out?
  - Leases, insurance, financial instruments, certain guarantee contracts and certain nonmonetary exchanges
- Contracts with elements in multiple standards
  - Evaluate under other standards first

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## ***The 5-step model***

Step 1: Identify the contract with the customer

Step 2: Identify the separate performance obligations in the contract

Step 3: Determine the transaction price

Step 4: Allocate the transaction price

Step 5: Recognise revenue when a performance obligation is satisfied



## ***Industry implications***

<b>Industry</b>	<b>Potential issues</b>
Telecommunications	Allocation of consideration
Construction	Continuous transfer
Retail	Vouchers and loyalty programmes
Manufacturing	Volume rebates
Pharmaceuticals	Sales based royalties
Entertainment & Media	Licences
Contract services	Unit of account
Aerospace & defence	Separation of performance obligations

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## ***Topics re-deliberated in 2012***

***Identifying  
separate  
performance  
obligations***

***Performance  
obligations  
satisfied over  
time***

***Accounting for  
licences***

***Onerous  
performance  
obligations***

***‘reasonably  
assured’  
constraint on  
recognition of  
variable  
consideration***

***Collectability***

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## ***Next steps***

Several key issues still to be discussed

*Allocation of  
transaction  
price*

*Contract costs*

*Time value of  
money*

*Disclosures*

## ***Business impacts***

### ***Financial ratios impacted***

- Possible impact on contracts under IAS11 – limitation of applicability of PoC method
- Shifts in timing of revenue recognition in multiple-element contracts
- Shifts within income statement due to expanded definition of performance obligations

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# *Leasing project*

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## ***High level comparison between current leasing standard and current leasing proposal***

- **What is a lease?**
  - Revised analysis to determine whether a contract is a service arrangement or a lease
- **Lessee accounting**
  - All leases to be recognised on the balance sheet
  - Retains a dual model for income statement recognition with a new bright line
- **Lessor accounting**
  - Retains a dual model for balance sheet and income statement
  - Current operating lease accounting is retained
- **Other changes**

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## ***Key aspects of re-deliberations***

***Definition of a lease (distinguishing a lease from a service)***

***Lessee: expense recognition***

***Lessor accounting***

***Lease term***

***Variable lease payments***

## ***Key aspects of re-deliberations***

### ***Definition of a lease (distinguishing a lease from a service)***

- A contract must meet both the following conditions.:
  - (a) specified asset – the fulfillment of the contract depends on providing an identifiable (either explicitly or implicitly) asset;  
and
  - (b) the contract transfers the right to control the use of the specified asset for a period of time



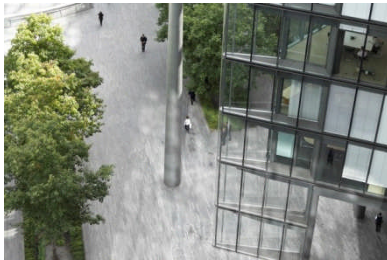
## ***Lessee accounting: The new ‘bright-line’***

***Principle: Does the lessee ‘consume’ more than an insignificant portion of the underlying asset?***

***Yes – front end load expenses***

***No – straight line***

Rebuttable presumptions/practical expedients



Rebut the presumption of insignificant consumption if:

Lease term major part of economic life of underlying asset or  
PV of fixed lease payments substantially all FV of underlying asset

Rebut the presumption of more than insignificant consumption if:

Lease term insignificant portion of economic life of underlying asset  
or

PV of fixed lease payment insignificant part of FV of underlying asset



***Straight-line***

**‘Bright-line’**

***Front end load***

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## ***Key aspects of re-deliberations***

### ***Lease term***

- Lease term: non-cancellable period for which the lessee has contracted with the lessor to lease the underlying asset, together with any option to extend or terminate the lease when there is a significant economic incentive for an entity to exercise an option to extend the lease, or for an entity not to exercise an option to terminate the lease

## ***Key aspects of re-deliberations***

### ***Variable lease payments***

- Lease payments that vary with usage or performance (such as distance driven by a car or sales through a retail store) should not be included in the measurement of assets and liabilities
- Measurement includes lease payments that are in substance fixed lease payments but are structured as variable payments
- Include lease payments that depend on an index or rate, but ongoing discussion

# ***Business impacts***

## ***Financial ratios impacted***

- B/S expansion
- Expense recognition pattern
- EBITDA
- Covenants

## ***Systems/controls evaluation***

- System-based record-keeping
- Changes in estimate

## ***Functional areas impacted***

- Accounting/reporting
- Tax
- Treasury

## ***Other***

- Lease vs buy decisions
- Contingent rent clauses
- Sale-leaseback transactions

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# *Financial instruments project*

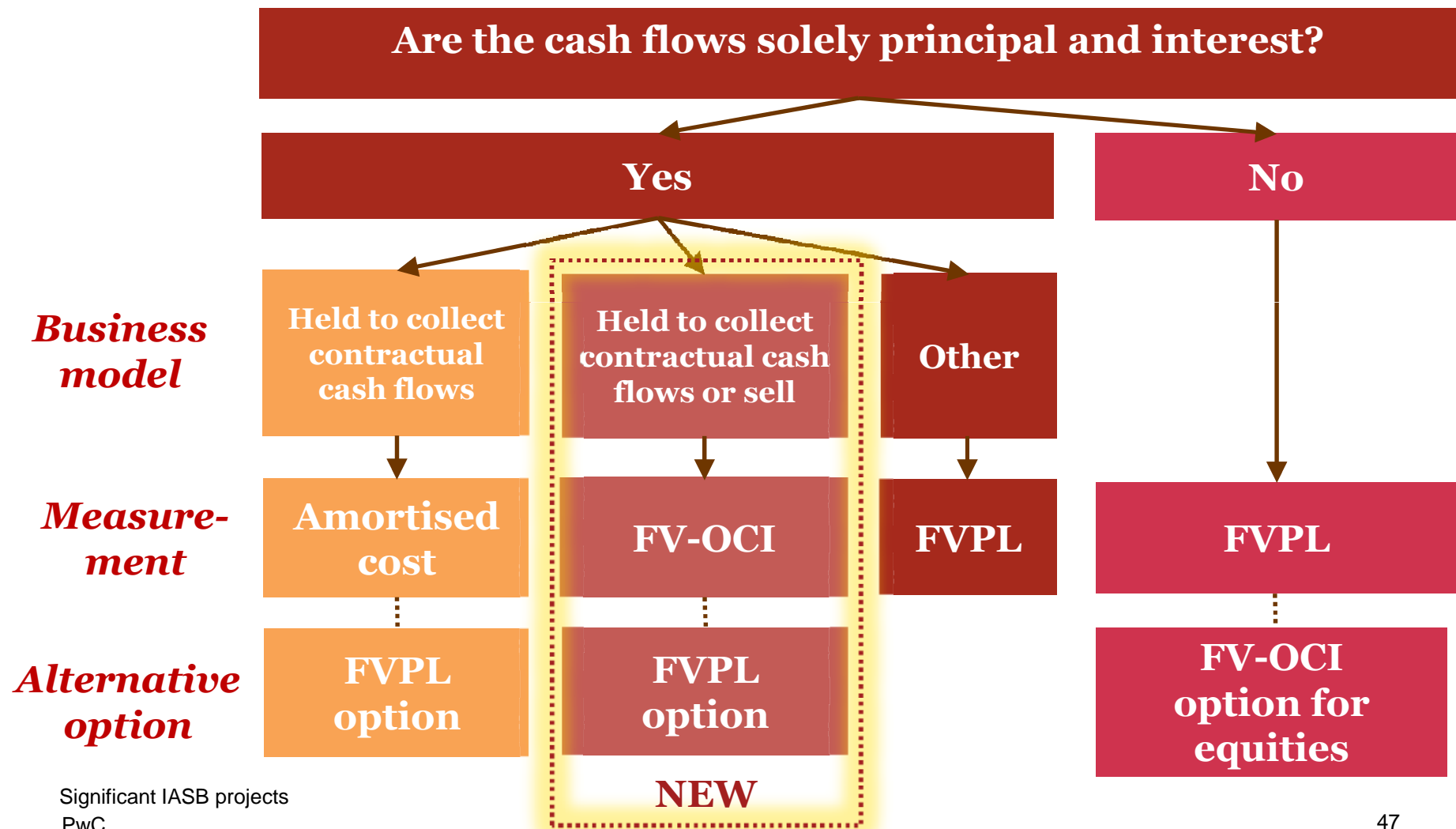
## Overview of phases and status of the project

Phase	Status
Classification and measurement	<p><b>Financial assets</b></p> <ul style="list-style-type: none"> <li>IFRS 9 published November 2009.</li> <li>Limited modifications to IFRS 9 exposure draft expected Q4 2012 (“IFRS 9 R”)</li> </ul> <p><b>Financial liabilities</b></p> <ul style="list-style-type: none"> <li>IFRS 9 published October 2010</li> </ul>
Impairment	<p><b>Expected-loss impairment model</b></p> <ul style="list-style-type: none"> <li>A further exposure draft is expected Q4 2012</li> </ul>
Hedge accounting	<p><b>General hedging</b></p> <ul style="list-style-type: none"> <li>Review draft published September 2012.</li> <li>Final standard expected Q4 2012</li> </ul> <p><b>Macro hedging</b></p> <ul style="list-style-type: none"> <li>Discussion paper expected H1 2013</li> </ul>

**Effective date 2015**  
**Endorsement timetable uncertain**

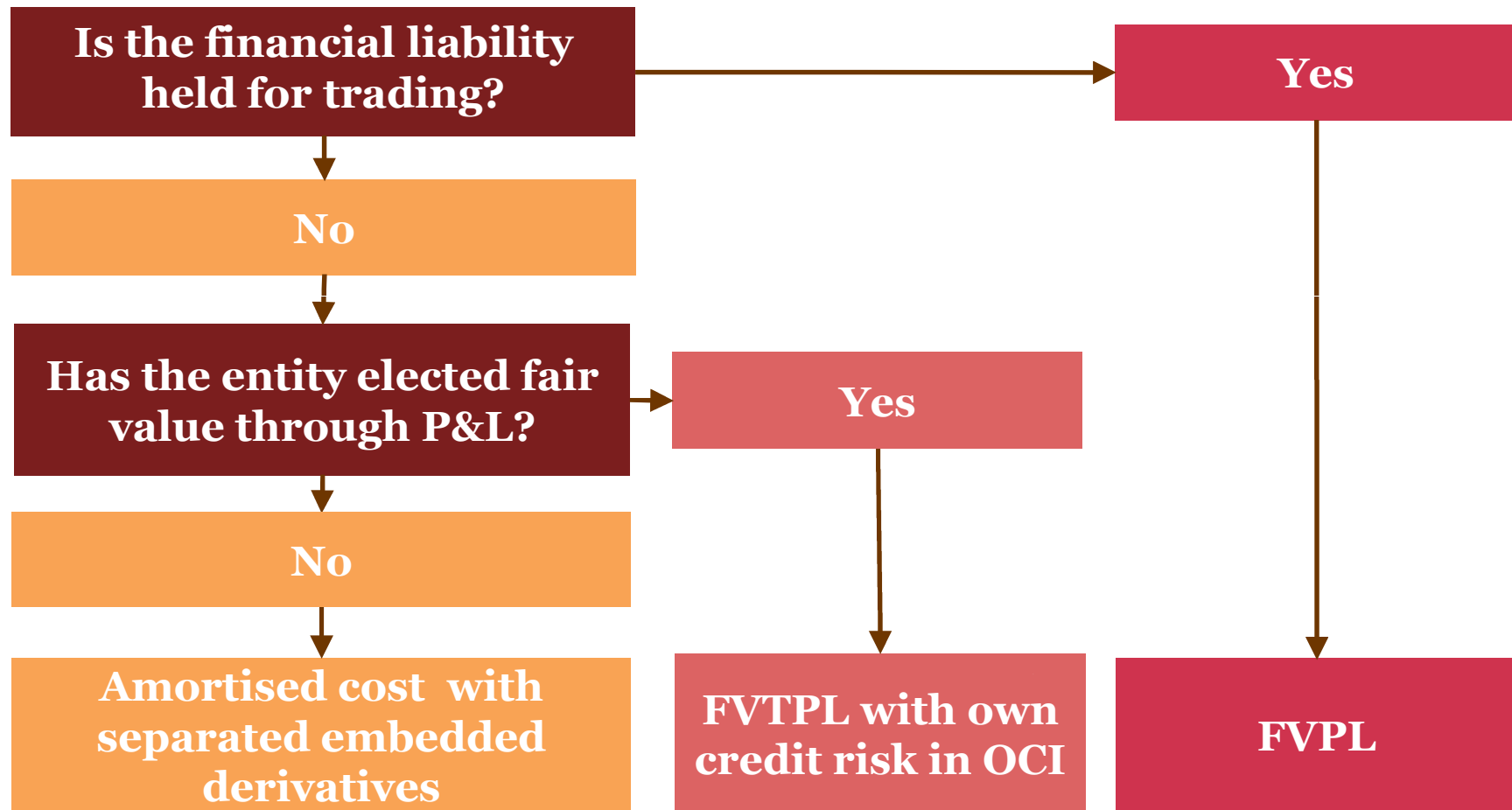
# ***IFRS 9 classification and measurement model***

## **Financial assets (including IFRS 9R)**



# ***IFRS 9 classification and measurement model***

## **Financial liabilities**





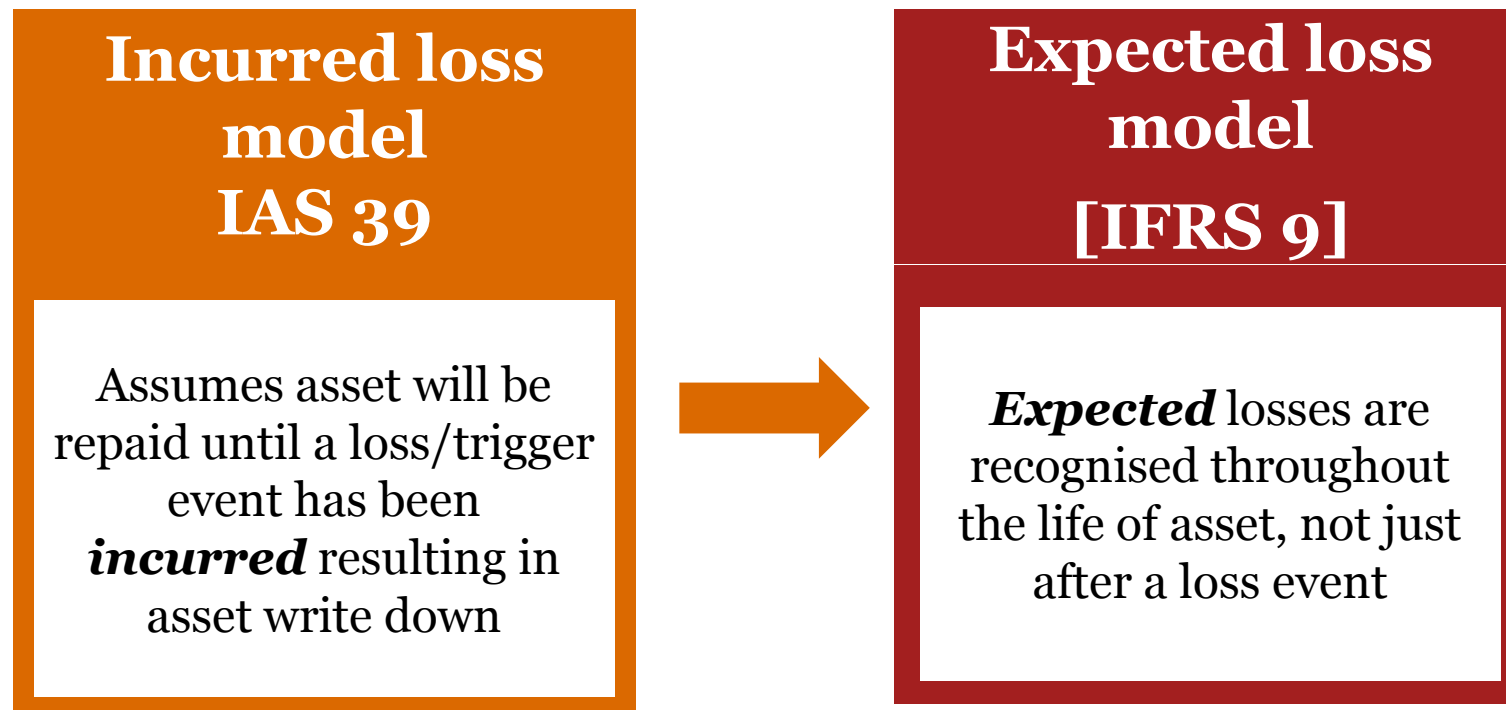
# ***IFRS 9 Classification and measurement***

What has changed? A comparison to IAS 39

Area	IAS 39	IFRS 9	IFRS 9 R
<b>FV-OCI category</b>	Available for Sale (FVOCI) for equity and debt investments (with recycling)	FVOCI only for elected equity investments (only dividends recognised in P&L)	AS IFRS 9 plus FVOCI required for certain debt investments (with recycling)
<b>Cost exemption</b>	Equity investments at cost	Cost exemption removed	
<b>Impairment</b>	Impairment for AFS equities	No impairment for equities (as FVPL or due to lack recycling on FVOCI for equities)	
<b>Embedded derivatives</b>	Separated if not closely related (unless hybrid measured at FV)	No bifurcation for financial assets - hybrid contract to be classified in its entirety	
<b>FVPL option on liabilities</b>	FV changes in P&L	FV changes relating to own credit risk in OCI (no recycling)	

## ***Impairment tentative decisions***

Moving from incurred loss to expected loss model



# ***Impairment tentative decisions***

“Three bucket” model

	<b><i>Bucket 1</i></b>	<b><i>Bucket 2 (grouped assets)</i></b>	<b><i>Bucket 3 (individually assessed assets)</i></b>
<b><i>Scope</i></b>	All loan assets with no /insignificant deterioration of credit quality since initial recognition; or it is not reasonably possible there will be a loss	Transfer loans to bucket 2/3 if:  1) more than an insignificant deterioration in credit quality  +  2) Reasonably possible that some contractual cash flows may not be collected	
<b><i>Impair- ment</i></b>	Recognition of expected lifetime loss for loans where loss is probable within next 12 months	Immediate recognition of expected lifetime loss	

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## ***Impairment tentative decisions***

### Trade and lease receivables

#### **Simplified approach**

- Measure lifetime expected losses at expected present value of all cash shortfalls over life of asset (as per bucket 2/3)
- Provides relief as entity not required to track credit deterioration through the “three-bucket” model for disclosure purposes
- Short term trade receivables (simplified approach required)
- Long term trade receivables & lease receivables (simplified approach on election, otherwise apply general three bucket model)

#### **Practical expedient**

- For trade receivables a provision matrix could be used to estimate expected credit losses
- Short term trade receivables measured initially at the transaction price (i.e. the invoice amount in many cases)

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## ***IFRS 9 Hedge accounting – general hedging***

### Overview of proposed changes

***Hedge effectiveness  
testing***

***Hedged items: Risk  
components of non-  
financial items***

***Use of options***

***Net positions***

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# *The future of UK GAAP*

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## ***“New UK GAAP”***

- Replaces the existing UK GAAP guidance (FRS, SSAP, UITF) with a single standard – ‘FRS 102’
- Based on the IFRS for SMEs as developed by the IASB but amended to bring this more in line with the current UK GAAP
- Inclusion of accounting options currently available under existing UK GAAP e.g. capitalisation of development costs, revaluation of PPE

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## ***Overview of the new FRS 102***





## ***Revised framework***

Reporting	Can use		
Groups listed on regulated markets	EU-adopted IFRS		
Other reporters, except as below	EU-adopted IFRS	FRS 102	
Small companies (as defined by company law)	EU-adopted IFRS	FRS 102	FRSSE

## ***Revised framework***

Reporting	Can use		
Groups listed on regulated markets	EU-adopted IFRS		
Other reporters, except as below	EU-adopted IFRS	FRS 102	
qualifying entities	or FRS 101 (ie RDF)	or FRS 102 RDF	
Small companies (as defined by company law)	EU-adopted IFRS	FRS 102	FRSSE
qualifying entities	or FRS 101 (ie RDF)	or FRS 102 RDF	

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## ***Key differences between existing UK GAAP and FRS102***

***Financial  
instruments***

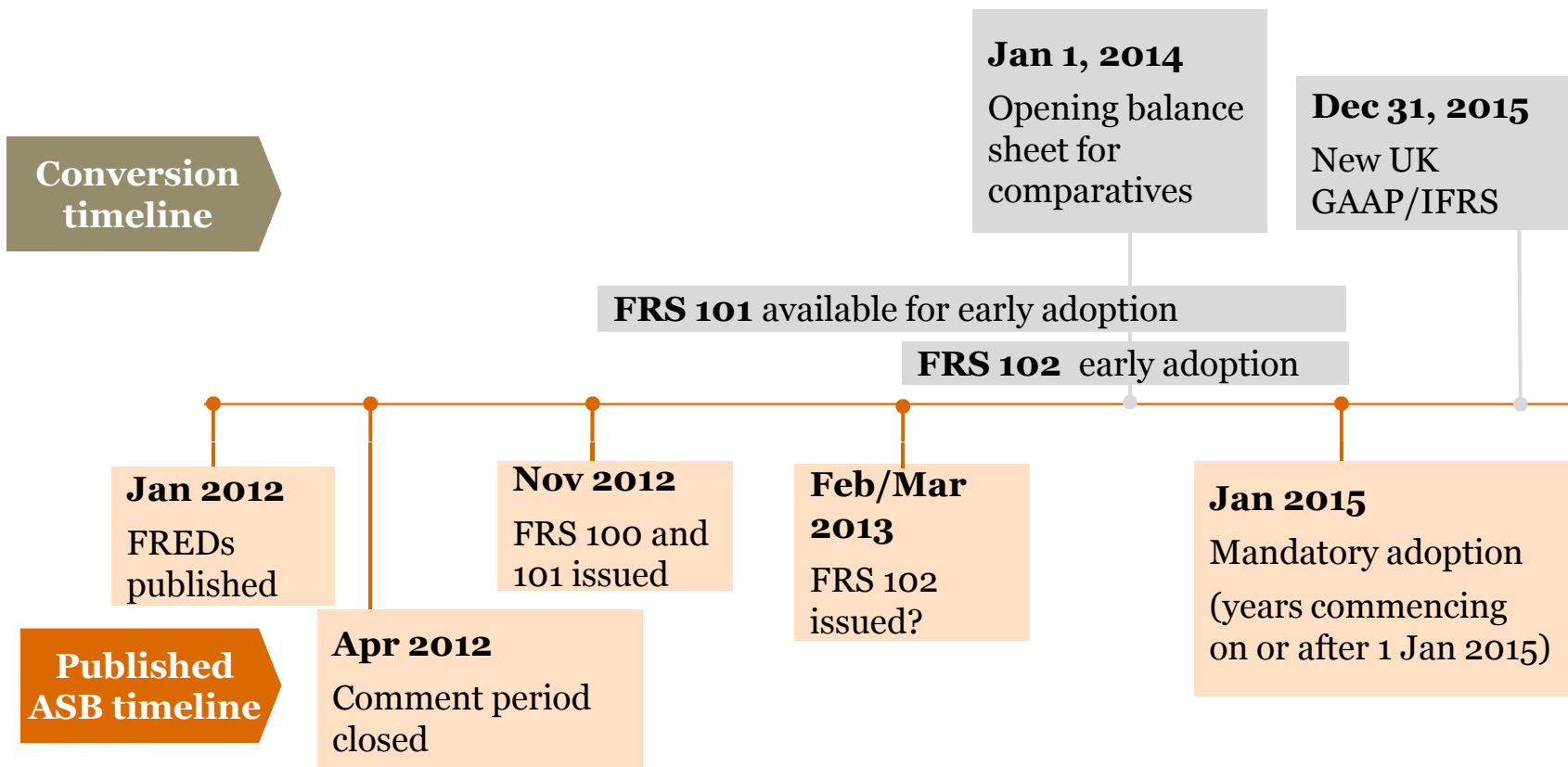
***Deferred  
tax***

***Defined benefit  
pension plans***

***Business  
combinations***

***Investment  
property***

## *Anticipated adoption timeline*



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# *Thank you*

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