

PwC Nigeria IFRS Newsletter

June 2014



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Introduction

This newsletter highlights some of the current hot topics in the IFRS realm.

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IAS 26 – Accounting and reporting by retirement benefit plans

Overview

‘Pension schemes’ and ‘retirement benefit schemes’ are common place names for retirement benefit plans. These plans are arrangements whereby an entity provides benefits for employees on or after termination of service (either in the form of an annual income or as a lump sum) when such benefits, or the contributions towards them, can be determined or estimated in advance of retirement from the provisions of a document or from the entity’s practices.

These plans fall in either of two categories: defined contribution plans or defined benefit plans. Under the guidance of this standard, a retirement benefit plan is seen as being a reporting entity that is separate from the employers of the participants in the plan.

Defined contribution plans?

Defined contribution plans are retirement benefit plans under which amounts to be paid as retirement benefits are determined by contributions to a fund together with investment earnings thereon. The amount of a participant’s future benefits is determined by the contributions paid by the employer, the participant, or both, and the operating efficiency and investment earnings of the fund. An employer’s obligation is usually discharged by contributions to the fund. An actuarial valuation of the plan is not usually required at the end of the reporting period.

Defined benefit plans?

Defined benefit plans are retirement benefit plans under which amounts to be paid as retirement benefits are determined at the outset usually by reference to a formula usually based on employees’ earnings and/or years of service. The payment of promised retirement benefits depends on the financial position of the plan and the ability of contributors to make future contributions to the plan as well as the investment performance and operating efficiency of the plan. An actuarial valuation of the plan is usually required at the end of the reporting period.

Is a separate fund required?

Not usually a requirement in determining the accounting for the retirement benefit plan. Some companies’ retirement benefit plans may involve the creation of separate funds, which may or may not have separate legal identity and may or may not have trustees, to which contributions are made and from which retirement benefits are paid. This Standard applies regardless of whether such a fund is created and regardless of whether there are trustees.

Valuation of the plan assets

Retirement benefit plan investments are carried at fair value. Market value is fair value for marketable securities i.e. securities that are quoted on a recognized stock exchange market. Fair value is the price that would be received to

sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. If there are investments for which fair value estimations isn’t possible, a disclosure is made for this in the financial statements.

Practices in Nigeria

In Nigeria, companies provide retirement benefits to the employees under the gratuity schemes. These schemes would likely fall under a defined benefit plan as they are usually based on a percentage of the employee’s final salary on retirement. They are thus complex, and require an actuary to determine any defined benefit obligations arising as a result of this scheme.

Also, defined contribution plans that emerged from the Pensions Reform Act (PRA) of 2004, and specifies that a fixed percentage of total monthly emoluments are contributed by both the employer and employee, are accounted for under the guidance of IAS 26.

Challenges following IFRS adoption in Nigeria

On occasions, companies have set up a separate fund, under the directions of trustees. The relevant activities of these trust funds will have to be determined, as this might imply that the parent company (i.e. company who sets up the fund) might have to consolidate the trusts.

Also of a peculiar nature, are pension funds set up by the companies that own them for managing their employees’ pension plans in-house. They are referred to as closed pension fund administrators (CPFAs). The CPFAs manage the employees’ pension plan either directly or through a wholly owned subsidiary of the company dedicated exclusively for the management of such pension. A review of the relevant activities of these CPFAs would have to be carried out in order to determine whether they meet the criteria to be consolidated alongside the employer company’s financial statements, under the guidance of IFRS 10, ‘Consolidated Financial Statements’.

What do I have to disclose in the financial statements of a retirement benefit plan?

The following information is required to be disclosed:

- (a) a statement of changes in net assets available for benefits;
- (b) a summary of significant accounting policies; and
- (c) a description of the plan and the effect of any changes in the plan during the period.

IAS 38 – Intangible assets (amendment to amortization method)

Overview

Intangible assets are assets that are non-monetary in nature without physical substance. Examples include computer software, patents, and licenses. In order to reflect the depreciable amount of the assets through the period of its useful life, it is subject to amortization using a variety of methods.

What's new?

The International Accounting Standards Board (IASB) has issued an amendment to the standard in order to clarify when a method of amortisation based on revenue may be appropriate.

The IASB also clarified that revenue is generally presumed to be an inappropriate basis for measuring the consumption of the economic benefits embodied in an intangible asset. This presumption, however, can be rebutted in certain limited circumstances.

These are:

1. Where the intangible asset is expressed as a measure of revenue (for example, companies in the oil and gas industry, manufacturing and e-commerce); or
2. Where it can be demonstrated that revenue and the consumption of the economic benefits of the intangible asset are highly correlated.

Limitations in scope of the amendment

Most companies in Nigeria, amortize their intangible assets using any of the following methods: straight-line, reducing balance or units of production. This amendment will be of little concern to the existing preparers of their financial statements. The Amendment to IAS 38 should be applied prospectively for annual periods beginning on or after January 1, 2016.

IFRIC 12 – Service Concession Arrangements (SCAs)

Overview

Service Concession Arrangements are agreements in which the private sector provides utilities to the public, on behalf of a public entity or the government. These agreements are also commonly called 'Public-Private Partnerships' (PPPs) or 'Build, Operate and Transfer' (BOTs) within Nigeria.

Why are they popular?

In developing countries like Nigeria, operations and maintenance of public infrastructure such as road networks, airport terminals, electricity supply, are vested in the government. In recent times especially in situations where the population outweighs the infrastructure, and with governments struggling to bridge this gap, invitations are extended to private sector companies, to partner with them, to provide these critical services to the population.

What features are common to a service concession arrangement?

Some common features include:

- The grantor is a public sector entity, including a governmental body, or a private sector entity to which the responsibility for the service has been devolved;
- The operator is responsible for at least some of the management of the infrastructure and related services and does not merely act as an agent on behalf of the grantor;
- The contract sets the initial prices to be levied by the operator and regulates price revisions over the period of the service arrangement; and
- The operator is obliged to hand over the infrastructure to the grantor in a specified condition at the end of the period of the arrangement, for little or no incremental consideration irrespective of which party initially financed it.

How do we account for the transaction?

Depending on the terms of the agreement, the government (usually referred to as the grantor), details in the contract, the rights of the private sector partner (referred to as the operator), to either the receipts of income streams from the government in form of cash, or a right to operate the facilities for an agreed period of time earning its revenues from charging the users of this service through this right or a combination of both.

Understanding these options determines the accounting.

In the first instance, the right to cash would mean accounting for the transaction, under the financial instruments standard (IAS 39). This means that under the guidance of IAS 39, the operator will recognise this right as a financial asset, as it is in effect, a right to receive cash or other financial asset.

In the second instance, the right to charge users of the service, would mean accounting for the transaction, under the intangible assets standard (IAS 38). This means that under the guidance of IAS 38, the operator will recognise this right as an intangible asset, as it is a non-monetary asset without physical substance, and amortise over its useful life.

In the third instance, it will entail accounting for the transaction under both IAS 39 and IAS 38. Where there is a combination where consideration is received partly in the form of cash and partly in the form of an intangible asset, this is referred to as a bifurcated model (a model consisting of 2 parts) as the operator receives a fixed amount from the grantor and a right to charge users over the term of the arrangement.

Illustrative example

Road Networks Ltd. has been granted a concession arrangement by the Lagos State Government (LASG), for the construction and maintenance of a major road. The company will be responsible for the construction of the road infrastructure. The terms of the contract states that the company can charge users for the right to use the road during the duration of the contract term of 10 years.

In this example, Road Networks Ltd. must account for revenue and costs relating to the construction phase of the concession arrangement in accordance with IAS 11, 'Construction contracts' by reference to the stage of completion.

The construction costs are accumulated and accumulation ceases once the road network is completed. These costs are then recognized as an intangible asset in the statement of financial position (derived from the right to charge users toll for using the completed roads) as consideration for the construction of the road network. This consideration received or receivable differs in nature from the asset to be delivered (network of roads), and as such, this consideration shall be recognized at its fair value.

This intangible asset is then amortised on a straight line basis over the 10 year period in which it is expected to be available for use by Road Networks Ltd.

The revenues from the tolling arrangement where road users pay for the service at the same time as they receive them i.e. when they use the road, is recognized when Road Networks Ltd collects the tolls.

What has changed?

Not a lot as the IFRIC has pretty much stayed the same, from inception. However, the Financial Accounting Standards Board (FASB), in looking at new ways to streamline its requirements in line with IFRSs, as part of its ongoing convergence project, has issued an update that seeks to provide guidance on the accounting treatment of such agreements, by precluding arrangements that fall into this category from treatment as a lease agreement for companies that report under US-GAAP.

Asides this, companies should also consider the potential impacts of the new revenue standard, IFRS 15, Revenue from contracts with customers, which comes into effect for reporting periods beginning on or after 1 January 2017.

IFRS 15 will apply to all contracts entered into with customers with the company. A customer is a party that contracts with the company to obtain goods or services that are the output of the company's ordinary activities. Thus, contracts under SCA's will have to be reviewed in order to ascertain whether they fall under the scope of the standard and might significantly change the way and timing of revenue recognition under each identifiable customer contractual relationships.

The standard will also require extensive disclosures around revenue that has been recognised, and revenue that is expected to be recognised in the future from existing contracts. It would also require that quantitative and qualitative information be provided about the significant judgments and changes in those judgments that management made to determine revenue that is recorded within a particular reporting period.

How PwC can help

PwC has vast experience in applying the IFRS requirements across a wide range of businesses and sectors. We can help you consider the impact on your business not only from an accounting, tax, and legal point of view, but also the impact on your systems and processes.



PwC helps organisations and individuals create the value they're looking for. We're a network of firms in 157 countries with more than 184,000 people who are committed to delivering quality in assurance, tax and advisory services. Find out more by visiting us at www.pwc.com.

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