Grant Thornton

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Navigating the changes to International Financial Reporting Standards

A briefing for Chief Financial Officers

December 2013

Introduction

Overview
This publication is designed to give Chief Financial Officers a high-level awareness of recent changes to International Financial Reporting Standards that will affect companies' future financial reporting. It covers both new Standards and Interpretations that have been issued and amendments made to existing ones.

What's new in the 2013 edition
The December 2013 edition of the publication has been updated for changes to International Financial Reporting Standards that have been published between 1 December 2012 and 30 November 2013.

The publication now covers 31 March 2013, 30 June 2013, 30 September 2013, 31 December 2013 and 31 March 2014 financial year ends.

Contents
The table of contents on the next page lists all the changes covered in the publication, their effective dates, and the page in the publication on which the appropriate summary can be found.

How to use the publication
Identifying the changes that will affect you

The table of contents has been colour coded to help entities planning for a specific financial reporting year end identify:
- changes mandatorily effective for the first time
- changes not yet effective
- changes already in effect.

Where a change is not yet mandatorily effective for a particular year end, it may still be possible for an entity to adopt it early (depending on local legislation and the requirements of the particular change in concern).

Where a change has been made but an entity is yet to apply it, certain disclosures are required to be made under IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'. Disclosures required include the fact that the new or amended Standard or Interpretation is in issue but has not yet been applied, and known or reasonably estimable information relevant to assessing its possible impact on the financial statements in the period of initial application.

Identifying the commercial significance of the changes in the publication
For each change covered in the publication, we have included a box on its commercial implications. These sections focus on two questions:
- how many entities will be affected?
- what will be the impact on affected entities?

A traffic light system indicates our assessment of the answers to these questions.

Other Grant Thornton International publications
Where appropriate, references have been made to other Grant Thornton International publications that provide more detailed information. These publications can be obtained from your local IFRS contact.

Grant Thornton International Ltd
December 2013

Effective dates of new Standards

(based on Standards issued at 30 November 2013)

Standard	Title of Standard or Interpretation	Effective for accounting periods beginning on or after	Page ref	31 Mar 2013 year end	30 Jun 2013 year end	30 Sep 2013 year end	31 Dec 2013 year end	31 Mar 2014 year end
IFRS 7	Disclosures – Transfers of Financial Assets (Amendments to IFRS 7)	1 July 2011	5	effective for the first time			already in mandatory effect	already in mandatory effect
IFRS 1	Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters (Amendments to IFRS 1)	1 July 2011	6					
IAS 12	Deferred Tax: Recovery of Underlying Assets (Amendments to IAS 12)	1 January 2012	7		effective for the first time	effective for the first time		
IAS 1	Presentation of Items of Other Comprehensive Income (Amendments to IAS 1)	1 July 2012	8	not yet effective			effective for the first time	effective for the first time
IAS 19	Employee Benefits (Revised 2011)	1 January 2013	9		not yet effective	not yet effective		
IFRS Practice Statement	Management Commentary: A framework for presentation	no effective date as non-mandatory guidance	11					
IAS 27	Separate Financial Statements (Revised 2011)[1]	1 January 2013	13					
IAS 28	Investments in Associates and Joint Ventures (Revised 2011)[1]	1 January 2013	14					
IFRS 1	Government Loans (Amendments to IFRS 1)	1 January 2013	15					
IFRS 7	Disclosures – Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7)[2]	1 January 2013	16					
IFRS 10	Consolidated Financial Statements[1]	1 January 2013	17					
IFRS 11	Joint Arrangements[1]	1 January 2013	19					
IFRS 12	Disclosure of Interests in Other Entities[1]	1 January 2013	21					
IFRSs 10, 11 & 12	Transition Guidance (Amendments to IFRS 10, IFRS 11 and IFRS 12)[1]	1 January 2013	22					
IFRS 13	Fair Value Measurement	1 January 2013	23					
IFRIC 20	Stripping Costs in the Production Phase of a Surface Mine	1 January 2013	26					
Various	Annual Improvements to IFRSs 2009–2011 Cycle	1 January 2013	27					
IAS 32	Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32)[2]	1 January 2014	29				not yet effective	not yet effective
IFRS 10, 12 & IAS 27	Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)[1]	1 January 2014	30					
IFRIC 21	Levies	1 January 2014	32					
IAS 36	Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36)	1 January 2014	33					
IAS 39	Novation of Derivatives and Continuation of Hedge Accounting (Amendments to IAS 39)	1 January 2014	34					
IAS 19	Defined Benefit Plans: Employee Contributions (Amendments to IAS 19)	1 July 2014	35					
IFRS 9	Financial Instruments	to be determined	36					

[1] these changes (the 'consolidation package' and subsequent amendments to the transition requirements and for investment entities) are inter-related and entities are advised to assess their impact collectively

[2] the changes to IAS 32 and IFRS 7 dealing with offsetting are inter-related

The colour coding gives an indication of when the changes covered in the publication become effective in relation to the specific financial reporting year ends set out in the table.

Key: Change already in mandatory effect   Change effective for the first time   Change not yet effective

Disclosures – Transfers of Financial Assets (Amendments to IFRS 7)

'Disclosures – Transfers of Financial Assets (Amendments to IFRS 7)' amends the disclosures required under IFRS 7, to help users of financial statements evaluate the risk exposures relating to more complex transfers of financial assets and the effect of those risks on an entity's financial position.

The intention behind the amendments is to improve IFRS 7's existing disclosure requirements and reduce the differences with US GAAP disclosure requirements. The additional disclosures required are designed to provide information that enables users:

- to understand the relationship between transferred financial assets that are not derecognised in their entirety and the associated liabilities; and
- to evaluate the nature of, and risks associated with, any continuing involvement of the reporting entity in financial assets that are derecognised in their entirety.

For example, where a reporting entity has derecognised financial assets in their entirety but has continuing involvement in them, it has to disclose the amount that best represents the entity's maximum exposure to loss from its continuing involvement and how that amount has been determined. Similarly where an entity has transferred financial assets in such a way that part or all of the transferred financial assets do not qualify for derecognition, then it has to explain the nature of the risks and rewards and make certain quantitative disclosures.

IAS 39's actual derecognition requirements have not changed, as these were seen as having performed favourably during the financial crisis.

Transitional relief means that the disclosures required need not be provided for any period presented that begins before the date of initial application of the Amendments.

Commercial significance

Number of entities affected: Few

The additional disclosures introduced are aimed at addressing perceived weaknesses in the disclosure of more complex transfers of financial assets that were exposed during the financial crisis. Simple derecognition transactions should not be affected by the amendments, meaning most entities will be unaffected by them.

Impact on affected entities: Medium

Entities involved in complex transfers of financial assets (eg those involving securitisations of financial assets) will need to spend time in addressing the requirements of the new disclosures.

Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters (Amendments to IFRS 1)

In December 2010, the IASB published two limited amendments to IFRS 1 'First-time Adoption of International Financial Reporting Standards'. The amendments:

- remove certain fixed dates in the Standard
- introduce an additional exemption for entities emerging from a period of severe hyperinflation.

Removal of fixed dates

The first amendment replaces references to a fixed date of '1 January 2004' that were in IFRS 1 with references to 'the date of transition to IFRSs'.

The reason for the references to the fixed dates (contained in the financial instrument exception and the exemption in relation to the initial fair value measurement of financial instruments) was historic. They were introduced in advance of 2005, a time when many companies were adopting IFRS for the first time, and were intended to put first-time IFRS adopters in the same position as existing preparers at that time (who were able to benefit from certain transitional reliefs contained in IAS 39 'Financial Instruments: Recognition and Measurement'). As time has passed, however, the references to the 1 January 2004 date have become less relevant.

The amendment will provide relief for first-time adopters of IFRSs from having to reconstruct transactions that occurred before their date of transition to IFRSs.

Additional exemption after a period of severe hyperinflation

The second amendment to IFRS 1 provides guidance on how an entity should resume presenting financial statements in accordance with IFRSs after a period when the entity was unable to do so because its functional currency was subject to severe hyperinflation.

The amendment adds an exemption to the Standard under which such an entity may elect to measure its assets and liabilities at fair value, which could then be used as the deemed cost in its opening IFRS statement of financial position, presented on or after the functional currency normalisation date. This may lead to a comparative period of less than 12 months. The amendment is available to entities that are emerging from a period of severe hyperinflation, whether or not they had applied IFRSs prior to the severe hyperinflationary period.

Commercial significance

Number of entities affected: Few

The amendments to IFRS 1 are only relevant to those entities adopting IFRSs for the first-time (or resuming the application of IFRSs having been unable to do so as a result of severe hyperinflation). Furthermore the guidance on severe hyperinflation will impact a very narrow sub-section of those companies.

Impact on affected entities: Medium

The replacement of the fixed date for prospective application of some aspects of IAS 39 with the date of transition to IFRSs will reduce the cost and effort required to apply the detailed rules relating to some aspects of financial instrument accounting.

Although the additional guidance and exemption relating to severe hyperinflation will only impact a small number of entities globally, it provides much needed guidance and relief for those entities.

Together the amendments should help to ensure that entities applying IFRS for the first time will not face undue cost or effort on transition to IFRSs in particular circumstances.

Deferred Tax: Recovery of Underlying Assets (Amendments to IAS 12)

In December 2010, the IASB published some limited scope amendments to IAS 12 'Income Taxes'. These are relevant when an entity elects to use the fair value model in IAS 40 'Investment Property'.

Under IAS 12, the measurement of deferred tax liabilities and deferred tax assets reflects the expected manner of recovery of the underlying assets – in other words, whether an entity expects to recover an asset by using it, selling it or both. In some jurisdictions the tax rate or tax deductions differ between income generation and sales transactions. However, without specific plans for disposal of an investment property, it is difficult and subjective to estimate how much of its carrying amount will be recovered through cash flows from rental income and how much of it will be recovered through cash flows from selling the asset. This is particularly relevant when the property is measured using the fair value model in IAS 40 because the fair value adjustments often create substantial temporary differences.

Recovery through sale presumption

To provide a practical approach in such cases, the amendment introduces a presumption that an investment property is recovered entirely through sale. This presumption is rebutted if the investment property is held within a business model whose objective is to consume substantially all of the economic benefits embodied in the investment property over time, rather than through sale.

Consequential withdrawal of SIC-21 Income Taxes – Recovery of Revalued Non-depreciable assets

SIC-21 'Income Taxes – Recovery of Revalued Non-Depreciable Assets' addressed similar issues involving non-depreciable assets measured using the revaluation model in IAS 16 'Property, Plant and Equipment'. The consensus in SIC-21 required that, where tax law specifies a different tax rate on the sale of a revalued non-depreciable asset compared to the rate that applies to income from its use, then the former rate applies. This requirement has been incorporated (after excluding investment property from its scope) into IAS 12 as part of the amendments. SIC-21 has therefore been withdrawn.

Commercial significance

Number of entities affected: Few

The amendments will only affect those entities that hold investment property, apply the IAS 40 fair value model and are subject to particular tax regimes.

Impact on affected entities: Medium

The amendments should provide a practical and cost-efficient approach for measuring deferred tax assets and liabilities for fair-valued investment properties in jurisdictions in which rental income and capital gains or losses are taxed differently.

Presentation of Items of Other Comprehensive Income (Amendments to IAS 1)

In June 2011, the IASB published 'Presentation of Items of Other Comprehensive Income (Amendments to IAS 1)'.

The Amendments to IAS 1 do not address which items are presented in other comprehensive income (OCI) but do change the structure of their presentation.

The main change

The main change is a requirement for entities to group items presented in OCI into those that, in accordance with other IFRSs:

a) will not be reclassified subsequently to profit or loss

b) will be reclassified subsequently to profit or loss when specific conditions are met.

Effects of tax

There is no change to the existing option to present items of OCI either before tax or net of tax. However, if the items are presented before tax then the Amendments require the tax related to each of the two groups of OCI items noted above to be shown separately.

Other matters

The Amendments to IAS 1 reaffirm existing requirements that items in OCI and profit or loss should be presented as either a single statement or two consecutive statements.

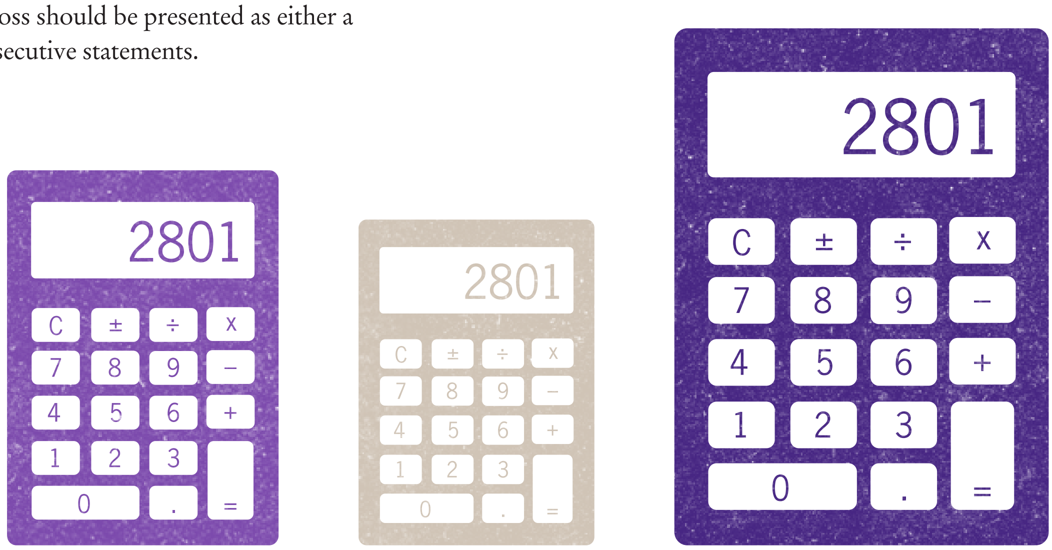
Commercial significance

Number of entities affected: Most

The amendments can be expected to affect many entities' financial statements.

Impact on affected entities: Low

The Amendments are limited to presentational changes. They should help provide readers with a clearer picture of items presented within OCI.



IAS 19 Employee Benefits (Revised 2011)

In June 2011, the IASB issued an amended version of IAS 19 'Employee Benefits', which changes the way defined benefit plans are accounted for. The amended version is intended to improve the recognition, presentation, and disclosure of defined benefit plans. It will have a particular impact on the amounts presented in profit or loss and other comprehensive income (OCI).

Major changes

The major changes made in the amended version of the Standard will result in:

- immediate recognition of all estimated changes in the cost of providing defined benefits and all changes in the value of plan assets. The various methods which allowed deferral of some of those gains or losses under the previous version of IAS 19, including the 'corridor' method, have been eliminated
- a new presentation approach that distinguishes the different types of gains and losses arising from defined benefit plans and requires that all gains and losses are presented in profit or loss apart from 'remeasurements' that are presented in OCI . The table sets out the changes in benefit costs which are to be presented separately under the new approach.

The previous IAS 19 option for entities to recognise in profit or loss all changes in defined benefit obligations and in the fair value of plan assets is eliminated.

IAS 19 Employee Benefits (Revised 2011)

Type of gain or loss	Recognition
service cost	in profit or loss
net interest on the net defined benefit liability or asset	in profit or loss
remeasurement of the defined benefit liability or asset	in other comprehensive income

One controversial change is that preparers will no longer be able to include the expected return on plan assets in profit or loss. The return on plan assets will instead represent interest, dividends and other income derived from the plan assets, together with realised and unrealised gains or losses on the plan assets, less certain costs. The change means that instead of crediting the expected return on pension plan assets separately and charging the calculated interest cost on the pension provision, the amended standard requires a charge or credit to be calculated by applying the market yield on a high quality corporate bond to the net pension deficit or surplus (in countries where there is no deep market in such bonds, market yields on government bonds should be used). This is likely to reduce the reported profit for many companies.

Other changes

In addition to these major changes, the amended version of IAS 19 makes changes to a number of other areas. These include:

- more closely aligning the accounting for plan amendments, curtailments, settlements, termination benefits and restructurings
- miscellaneous clarifications, including:
  - the classification of short-term and long-term employee benefits is based on the timing of expected settlement
  - the mortality assumptions used to determine the defined benefit obligation are the current estimates of expected mortality rates
  - the allocation of tax and administration costs between the costs of the plan and a reduction of plan assets
  - the impact of risk-sharing and conditional indexation features
- some matters that had been submitted to the IFRIC for interpretation (special wage taxes, treatment of employee contributions, pension promises based on performance hurdles, and settlements).

In addition to these changes, the amendments also introduce improved disclosures relating to the following areas:

- the characteristics of the company's defined benefit plans
- the amounts recognised in the financial statements
- risks arising from defined benefit plans
- participation in multi-employer plans.

Commercial significance

Number of entities affected: Some

The changes will affect those entities with defined benefit pension schemes. Other entities should not be significantly affected by the revised version of the Standard.

Impact on affected entities: High

The amendments can be expected to have a major impact on some entities. The elimination of the 'corridor' method that allowed some actuarial gains or losses to be deferred will be particularly significant, forcing companies to recognise the full pension scheme asset or deficit on balance sheet and adding to volatility in reported results. Separately the change in the way the return on plan assets is to be calculated is likely to reduce the reported profit for many of the companies affected.

Management Commentary: A framework for presentation

In December 2010, the IASB published its first IFRS Practice Statement 'Management Commentary – A framework for presentation'. The Practice Statement provides a broad, non-binding framework for the presentation of management commentary that relates to financial statements prepared in accordance with IFRSs.

The significance of management commentary

Management commentary is the term used to denote narrative reports that often accompany the financial statements. It is sometimes referred to by other names such as Management Discussion and Analysis or an Operating and Financial Review. Such reports provide users with:

- historical explanations of the amounts presented in the financial statements
- commentary on the entity's prospects and other information not presented in the financial statements
- a basis for understanding management's objectives and strategies.

The authority of the Practice Statement

The Practice Statement is not an IFRS and does not have the same authority as one. It does not mandate which entities are required to publish management commentary, how frequently they should do so or the level of assurance required. Instead the Practice Statement provides a broad, non-binding framework for the presentation of management commentary relating to IFRS financial statements.

The framework for preparation of management commentary

Under the Practice Statement, management commentary is aimed at the needs of the primary users of the financial statements (existing and potential investors, lenders and other creditors).

Rather than mandating the inclusion of certain information, the Practice Statement establishes a principles-based framework for preparing management commentary. Management should present commentary that is consistent with the following principles:

- to provide management's view of the entity's performance, position and development
- to supplement and complement information presented in the financial statements.

In relation to supplementing and complementing the financial statements, management commentary should, in addition to discussing the factors which have led to the amounts presented in the current financial statements, discuss forward-looking information. The Practice Statement acknowledges however that the extent of forward-looking information will be influenced by the regulatory and legal environment within which the entity operates.

Elements of management commentary

Being principles-based, the Practice Statement acknowledges that the particular focus of management commentary will depend on the facts and circumstances of the entity in concern. It does however indicate that management commentary should include information on the following elements:

- the nature of the business (eg the entity's main markets, its main products or services, the legal and regulatory environment)
- management's objectives and its strategies for meeting those objectives
- the entity's most significant resources, risks and relationships
- the results of operations and prospects (eg financial and non-financial performance and targets)
- the critical performance measures and indicators that management uses to evaluate the entity's performance against stated objectives.

It is hoped that the flexibility afforded by the Practice Statement's principles-based approach should reduce the risk of 'boilerplate'-type disclosure.

Commercial significance

Number of entities affected: Some

Many companies prepare management commentary. The Practice Statement is non-binding however, so companies do not need to apply it unless mandated by the relevant jurisdictional authority.

Impact on affected entities: Low

The Practice Statement represents high-level, principles-based guidance. It should contribute to improved Management Commentary, particularly in those jurisdictions that do not already have well developed requirements in this area. It is however non-binding guidance, not having the same authority as an IFRS.

IAS 27 Separate Financial Statements (Revised 2011)

IAS 27 (Revised) 'Separate Financial Statements' was published in May 2011 along with IFRS 10 'Consolidated Financial Statements' , IFRS 11 'Joint Arrangements', IFRS 12 'Disclosure of Interests in Other Entities' and IAS 28 (Revised) 'Investments in Associates and Joint Ventures'. Together these Standards form a comprehensive package dealing with group issues and off-balance sheet activity.

The changes made to IAS 27 (Revised) 'Separate Financial Statements' are consequential changes arising from the publication of the new IFRSs. The main change is that IAS 27 (Revised) will now solely address separate financial statements, the requirements for which are substantially unchanged from the previous version of the Standard.

Commercial significance

Number of entities affected: Some

Companies preparing separate financial statements will fall under the scope of the revised Standard.

Impact on affected entities: Low

The changes made are consequential changes arising from the publication of IFRSs 10, 11 and 12. The requirements for separate financial statements are substantially unchanged from the previous version of the Standard.

IAS 28 'Investments in Associates and Joint Ventures' (Revised 2011)

IAS 28 (Revised) Investments in Associates and Joint Ventures was published in May 2011 along with IFRS 10 'Consolidated Financial Statements', IFRS 11 'Joint Arrangements', IFRS 12 'Disclosure of Interests in Other Entities' and IAS 27 (Revised) 'Separate Financial Statements'. Together these Standards form a comprehensive package dealing with group issues and off-balance sheet activity.

Prior to the publication of this package of new Standards, the accounting for joint ventures was addressed solely by IAS 31 'Interests in Joint Ventures'. Following the publication of the new Standards, an entity should now apply IFRS 11 to determine the type of joint arrangement in which it is involved.

Consequential changes have been made to the scope of IAS 28 so that once an entity has determined that it has an interest in a joint venture, it accounts for it using the equity method in accordance with IAS 28 (Revised).

The mechanics of equity accounting set out in the revised version of IAS 28 remain the same as in the previous version.

Commercial significance

Number of entities affected: Some

Those companies that have investments in associates and joint ventures will be affected by the revised version of the Standard.

Impact on affected entities: Low

Changes to the scope of IAS 28 have been made as a result of the publication of IFRSs 10, 11 and 12. The requirements on how to apply equity accounting are unchanged from the previous version of the Standard.

Government Loans – Amendments to IFRS 1

'Government Loans – Amendments to IFRS 1' provides relief for first-time adopters of IFRSs from the retrospective application of the requirements of IAS 20 'Government Grants' on government loans. IAS 20 requires government loans to be measured at fair value on initial recognition, with the corresponding benefit of a below-market interest rate being accounted for as a government grant.

Under the Amendments, a first-time adopter:

- classifies government loans received as a financial liability or as equity in accordance with IAS 32 'Financial Instruments: Presentation'
- measures government loans at the date of transition to IFRSs at their previous GAAP carrying value, and subsequently applies IFRS 9 'Financial Instruments' or IAS 39 'Financial Instruments: Recognition and Measurement'
- applies IAS 20 to government loans received originated after the date of transition.

Despite these requirements, an entity may apply the requirements in IFRS 9 and IAS 20 retrospectively to any government loan originated before the date of transition to IFRSs, provided that the information needed to do so had been obtained at the time of initially accounting for that loan.

Commercial significance

Number of entities affected: Few

The Amendments to IFRS 1 are only relevant to those entities applying IFRSs for the first-time. Furthermore the guidance on government loans that carry a below-market interest rate will only affect a narrow sub-section of those companies.

Impact on affected entities: Low

The Amendments provide the same relief to first-time adopters of IFRSs as is available to existing IFRS preparers when first applying IAS 20's requirements on government loans. Prior to the Amendments a first-time adopter that received a government loan with a below-market interest rate before its transition date needed to estimate the fair value of that loan retrospectively which would require the use of hindsight.

Disclosures – Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7)

The publication of 'Disclosures – Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7)' was influenced by the outcome of the joint project between the IASB and the US Financial Accounting Standards Board (FASB) on offsetting. The IASB and the FASB had originally intended to introduce common offsetting requirements for IFRSs and US GAAP. In the end, however, the two Boards decided to maintain their respective offsetting models (subject, for the IASB, to the limited clarifications described in page 34). While they were unable to achieve convergence on common offsetting requirements, they noted that requiring common disclosures would be helpful for users of financial statements.

Accordingly, qualitative and quantitative disclosures have been added to IFRS 7 relating to gross and net amounts of recognised financial instruments that are (a) set off in the statement of financial position and (b) subject to enforceable master netting arrangements and similar agreements, even if not set off in the statement of financial position. The required disclosures should be provided retrospectively.

Commercial significance

Number of entities affected: Few
The increased disclosure requirements will mainly affect financial institutions that enter into high volumes of trades with the same counterparty that are subject to master netting and similar arrangements.

Impact on affected entities: Medium
While the change affects neither recognition or measurement, entities affected will need to spend time in addressing the requirements of the new disclosures.

IFRS 10 Consolidated Financial Statements

IFRS 10 'Consolidated Financial Statements' was published in May 2011 along with IFRS 11 'Joint Arrangements', IFRS 12 'Disclosure of Interests in Other Entities', IAS 27 (Revised) 'Separate Financial Statements' and IAS 28 (Revised) 'Investments in Associates and Joint Ventures'. Together these Standards form a comprehensive package dealing with group issues and off-balance sheet activity.

Summary

IFRS 10 Consolidated Financial Statements

- supersedes IAS 27 'Consolidated and Separate Financial Statements' and SIC-12 'Consolidation – Special Purpose Entities'
- changes the definition of control and applies it to all investees to determine the scope of consolidation
- has the potential to affect the outcome of many borderline and judgemental control assessments
- expected to lead to few changes for conventional group structures based on majority share ownership
- where such a change does arise, however, the impact could be very significant.

Background to the project

IFRS 10 is in part a response to the financial crisis. Prior to its publication, consolidation has been addressed by IAS 27 'Consolidated and Separate Financial Statements' and SIC-12 'Consolidation – Special Purpose Entities'. There is some tension between these pronouncements, with IAS 27 focusing mainly on control through powers such as voting rights, and SIC-12 focusing more on exposure to risks and rewards of the investee.

IFRS 10 aims to address these concerns with a new, principle-based, definition of control that will be applied to all types of investee to determine which are consolidated.

The new definition of control

IFRS 10 introduces the following revised definition of control together with accompanying guidance on how to apply it.

"An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee."

In order to determine whether a reporting entity has control over another entity in which it has invested, the following three elements must always be present:

a) power over the investee
b) exposure, or rights, to variable returns from its involvement with the investee
c) the ability to use its power over the investee to affect the amount of the investor's returns.

The new definition uses the term 'returns' rather than 'benefits' to avoid giving the impression that only positive returns are of relevance. In addition, the new definition focuses more specifically on the decisions that affect the level of returns and whether the investor controls those decisions. As a result, the decision whether to consolidate or not will need to be reconsidered in many borderline scenarios (see table).

In contrast to IAS 27 and SIC-12, which resulted in different criteria for determining control being applied to special purpose vehicles, IFRS 10's requirements will apply to all types of potential subsidiary.

For more information on this Standard, please refer to our Special Edition of IFRS News 'New consolidations standards'.

Examples of consolidation decisions that may change

Decision	Change
Special purpose vehicles	• exposure to risks and rewards is only an indicator of control under IFRS 10. It does not on its own lead to consolidation. This is a change from the requirements of SIC-12 • IFRS 10 requires a more specific identification of the decisions that have the greatest effect on returns, and who takes them • this change may impact on the consolidation decision for entities that were previously within the scope of SIC-12
Large minority holdings	• control may exist where other shareholdings are widely dispersed, and an investor holds significantly more voting rights than any other shareholder or group of shareholders
Potential voting rights	• under IFRS 10, potential voting rights may, in some circumstances, result in control even where they are not currently exercisable • IFRS 10 considers a broader range of indicators on whether such rights are substantive
Delegated power	• new guidance in IFRS 10 on principals and agents may impact on consolidation decisions • investment and asset managers in particular may be affected

Effective date and transition

The new Standards are effective for annual periods beginning on or after 1 January 2013. Certain transition provisions exist.

Early application of IFRS 10 is possible only if the other new Standards in the package (IFRS 11, IFRS 12, IAS 27 (Revised) and IAS 28 (Revised)) are also adopted at the same time.

Commercial significance

Number of entities affected: Most

All companies with significant involvement in other entities will need to consider the requirements of the new Standard.

Impact on affected entities: Medium

We expect that in most cases, conclusions as to what should be consolidated will be unchanged. In some circumstances, it will however change the composition of a group as a consequence of reassessment of which entities a parent company controls. In these cases the impact could be substantial.

IFRS 11 Joint Arrangements

IFRS 11 'Joint Arrangements' was published in May 2011 along with IFRS 10 'Consolidated Financial Statements', IFRS 12 'Disclosure of Interests in Other Entities', IAS 27 (Revised) 'Separate Financial Statements' and IAS 28 (Revised) 'Investments in Associates and Joint Ventures'. Together these Standards form a comprehensive package dealing with group issues and off-balance sheet activity.

Entities with interests in joint arrangements will need to consider the new terminology and classification requirements of IFRS 11. Where proportionate consolidation has been used in the past under IAS 31, entities will often need to switch to equity accounting.

Summary

IFRS 11 Joint Arrangements

- supersedes IAS 31 'Interests in Joint Ventures'
- introduces two accounting categories whose applicability is determined based on the substance of the joint arrangement
- eliminates the option of using proportionate consolidation for joint ventures
- eliminates IAS 31's 'jointly controlled operations' and 'jointly controlled assets' categories
- many of the arrangements that would have been classified under those categories will fall into the newly defined category 'joint operation'.

IFRS 11 has been issued with the intention of addressing two perceived deficiencies in IAS 31 'Interests in Joint Ventures':

- that the legal form of the arrangement was the critical determinant of the accounting
- that an entity had a choice of accounting treatment for interests in jointly controlled entities (proportionate consolidation or equity accounting).

IFRS 11 aims to improve on IAS 31 by establishing principles that are applicable to the accounting for all joint arrangements (a joint arrangement being an arrangement over which two or more parties have joint control).

IFRS 11 replaces IAS 31's three categories of 'jointly controlled entities', 'jointly controlled operations' and 'jointly controlled assets' with two new categories – 'joint operations' and 'joint ventures'.

- a joint operation is a joint arrangement whereby the parties that have joint control of the arrangement (ie joint operators) have rights to the assets, and obligations for the liabilities, relating to the arrangement.
- a joint venture is a joint arrangement whereby the parties that have joint control of the arrangement (ie joint venturers) have rights to the net assets of the arrangement.

Entities that have previously been classified as jointly controlled entities under IAS 31 (ie joint ventures that were structured through a separate legal entity) will more usually be classified as 'joint ventures' under IFRS 11.

In limited circumstances a jointly controlled entity under IAS 31 will however be classified and accounted for as a 'joint operation' – broadly when the venturers have rights and exposure to the underlying assets and liabilities. This determination requires an assessment of the legal form of the vehicle, other contractual arrangements and other facts and circumstances (such as whether the activities of the arrangement are primarily designed for the provision of output to the venturers).

Effective date and transition

The new Standards are effective for annual periods beginning on or after 1 January 2013. Certain transition provisions exist.

Early application of IFRS 11 is possible only if the other new Standards forming part of the package (IFRS 10, IFRS 12, IAS 27 (Revised) and IAS 28 (Revised)) are also adopted at the same time.


Grant Thornton
IFRS News
Special Edition

For more information on this Standard, please refer to our Special Edition of IFRS News 'New consolidations standards'.

Commercial significance

Number of entities affected: Some

IFRS 11 can be expected to affect many entities operating in the extractive industries, property and construction sectors where joint ventures and other joint arrangements are common. It may of course have a significant effect on individual companies in other industries.

Impact on affected entities: High

IFRS 11 eliminates the use of proportionate consolidation for joint ventures. This will be a significant presentational change for the many venturers that chose this accounting policy under IAS 31. Although net assets will not be affected, the removal of that method of accounting will affect individual balance sheet and performance ratios.

IFRS 12 Disclosure of Interests in Other Entities

IFRS 12 'Disclosure of Interests in Other Entities' was published in May 2011 along with IFRS 10 'Consolidated Financial Statements', IFRS 11 'Joint Arrangements', IAS 27 (Revised) 'Separate Financial Statements' and IAS 28 (Revised) 'Investments in Associates and Joint Ventures'. Together these Standards form a comprehensive package of material dealing with group issues and off-balance sheet activity.

Unlike the other Standards mentioned above, entities are encouraged by the IASB to provide some or all of IFRS 12's disclosure requirements early even if they choose not to early adopt the entire package.

Summary

IFRS 12 Disclosure of Interests in Other Entities

- combines the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities within a comprehensive disclosure standard
- provides more transparency on 'borderline' consolidation decisions
- enhances disclosures about unconsolidated structured entities in which an investor or sponsor has involvement
- will help investors to assess the extent to which a reporting entity has been involved in setting up special structures and the risks to which it is exposed as a result.

IFRS 12 complements the other new Standards by:

- integrating and making consistent the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities
- providing transparency about the risks to which a reporting entity is exposed from its involvement with structured entities (the financial crisis of 2008/9 had exposed this area as a weakness in financial reporting).

The Standard establishes disclosure objectives according to which an entity discloses:

- significant judgements and assumptions (and changes) made by the reporting entity in determining whether it controls another entity
- the interest that the non-controlling interests have in the group's activities
- the effect of restrictions on the reporting entity's ability to access and use assets or settle liabilities of consolidated entities
- the nature of, and changes in, the risks associated with the reporting entity's interests in consolidated structured entities, joint arrangements, associates and unconsolidated structured entities.

Commercial significance

Number of entities affected: Most

Most entities can expect to be affected by the new disclosure requirements of IFRS 12. Parent companies whose subsidiaries have non-controlling interests and businesses that operate through so-called structured entities are likely to be especially affected.

Impact on affected entities: High

IFRS 12 specifies minimum disclosures that an entity must provide. Some of this information will be new and its preparation will require planning. System modifications and enhancements may be required to address the change in guidance and to provide the necessary information for the new disclosure requirements.

Transition Guidance – Amendments to IFRS 10, IFRS 11 and IFRS 12

In June 2012, the IASB published 'Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance – Amendments to IFRS 10, IFRS 11 and IFRS 12' (the Amendments) with the primary intention of clarifying the transitional guidance in IFRS 10 'Consolidated Financial Statements'. In addition, it includes some related changes to IFRS 11 'Joint Arrangements' and IFRS 12 'Disclosure of Interests in Other Entities'.

The amendments to IFRS 10

IFRS 10 contains transition guidance that is intended to achieve limited retrospective application of IFRS 10. The Amendments clarify this transition guidance, explaining that the 'date of initial application' in IFRS 10 means 'the beginning of the annual reporting period in which IFRS 10 is applied for the first time'.

In doing so, the IASB has amended the transition guidance to confirm that an entity is not required to apply IFRS 10 retrospectively:

- if the consolidation conclusion reached at the date of initial application of IFRS 10 is the same as when applying IAS 27 'Consolidated and Separate Financial Statements' and SIC-12 'Consolidation – Special Purpose Entities'
- to interests in investees that were disposed of during a comparative period in such a way that consolidation would not occur in accordance with either IAS 27/SIC-12 or IFRS 10 at the date of initial application.

The Amendments also:

- clarify how an investor would adjust comparative period(s) retrospectively if the consolidation assessment at the date of initial application is different under IFRS 10 compared to IAS 27/SIC-12
- provide additional transition relief by limiting the requirement to present adjusted comparatives to the period immediately preceding the date of initial application. Presentation of adjusted comparatives for earlier periods is allowed but not required.

The amendments to IFRS 11 and IFRS 12

The Amendments also make changes to IFRS 11 and IFRS 12 which:

- provide similar relief from the presentation or adjustment of comparative information for periods prior to the immediately preceding period
- provide additional relief by removing the requirement to present comparatives for the disclosures relating to unconsolidated structured entities for any period before the first annual period for which IFRS 12 is applied.

Commercial significance

Number of entities affected: Some

The additional transitional relief relating to the presentation of adjusted comparative information will affect a relatively narrow group of entities where the adoption of IFRS 10 results in a change to previous consolidation conclusions.

The changes to the other parts of the transition guidance will have a wider impact on entities but are more in the nature of clarifications rather than fundamental changes.

Impact on affected entities: Medium

The provision of additional transitional relief relating to the presentation of adjusted comparative information will be a useful simplification for those entities affected by it.

IFRS 13 Fair Value Measurement

IFRS 13 'Fair Value Measurement' (IFRS 13) was published in May 2011. Prior to its publication, the guidance on fair value was distributed across many IFRSs, with some containing quite limited guidance while others contained extensive guidance that was not always consistent. IFRS 13 has been developed to remedy these problems.

The new Standard:

- explains how to measure fair value by providing a new definition and introducing a single set of requirements for (almost) all fair value measurements
- clarifies how to measure fair value when a market becomes less active
- improves transparency through additional disclosures.

IFRS 13 applies to both financial and non-financial items but does not address or change the requirements on when fair value should be used.

The table summarises the main requirements of the new Standard.

Summary of IFRS 13's requirements

Requirement	Significance
Scope	• addresses all fair value and 'fair value-based' measurements (except those in IFRS 2 and IAS 17) • covers both financial and non-financial items • fair values that are required to be disclosed in the notes are also captured
Definition of fair value	• an exit value-based approach • emphasis on market participants • excludes entity specific factors • a transaction or entry price may not necessarily represent fair value eg where related parties are involved or a transaction takes place under duress
Fair value measurement	• transactions are assumed to take place in the principal (or most advantageous) market • for non-financial assets, the highest and best use of the asset is considered • guidance is provided for measuring the fair value of a liability in the absence of an active market for the liability • adjustments for premiums and discounts must be consistent with the unit of account, blockage factors should not be reflected
Valuation techniques	• entities are required to maximise the use of relevant observable inputs and minimise the use of unobservable inputs • a three-level fair value hierarchy gives the highest priority to quoted prices in active markets (Level 1) and lowest priority to unobservable (Level 3) inputs

Summary of IFRS 13's requirements

Requirement	Significance
Disclosures	• fair value hierarchy disclosures are required for financial and non-financial items measured at fair value and for which fair value is disclosed • disclosure requirements are greater for Level 3 fair value measurements
Effective date	• annual periods beginning on or after 1 January 2013 • earlier application is permitted • prospective application

Scope of IFRS 13

In general, IFRS 13 applies when another IFRS requires or permits fair value measurements – either in the primary statements themselves or in the footnotes (including 'fair value-based' measurements). In other words it explains how to measure fair value rather than when to.

The definition of fair value

IFRS 13 defines fair value as 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 (ie an exit price).

The Standard clarifies that fair value is based on a transaction taking place in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market. The principal market is the market with the greatest volume and level of activity for the asset or liability.

Having established the basic context in which fair value is to be determined, IFRS 13 then goes into further depth, considering:

- the characteristics of the asset or liability
- application to non-financial assets
- application to liabilities and own equity.

The characteristics of the asset or liability

Under IFRS 13, characteristics of an asset or liability are taken into account in fair value estimates if they are:

a) a characteristic of the asset or liability in question (rather than a characteristic of the entity that holds the item)
b) they would influence market participants' pricing decisions.

The Standard indicates that this will result in some cases in an adjustment being made to observable market inputs (eg a control premium when measuring the fair value of a controlling interest) but only when this is consistent with the unit of account. Questions have been raised as to what is the appropriate unit of account in certain scenarios, and the IASB is currently discussing this matter. Pending clarification of this matter by the IASB, regulators have indicated that they expect issuers to disclose clearly their analysis regarding the unit of account.

Application to non-financial assets

IFRS 13 states that a fair value measurement of a non-financial asset takes into account the highest and best use of the asset. To be relevant, the highest and best use of a non-financial asset must be:

- physically possible
- legally permissible
- financially feasible.

Application to liabilities and own equity

Measuring fair value can be problematic for liabilities and an entity's own equity instruments due to quoted prices for the transfers of such items not being available. To overcome this problem, IFRS 13 states that fair value shall be measured from the perspective of a market participant that holds the identical item as an asset. Where this is not possible, IFRS 13 requires an entity to use a valuation technique from the perspective of a market participant that owes the liability or has issued the claim on equity.

Non-performance risk

The fair value of a liability should reflect the effect of non-performance risk which includes, but is not limited to, an entity's own credit risk. This is particularly relevant to entities that have entered into derivatives transactions. For a liability related to a derivative financial instrument, the fair value should incorporate changes in non-performance risk (Debit Valuation Adjustments or DVAs) in order to take account of the entity's own credit risk.

There should also be proper recognition of counterparty credit risk (Credit Valuation Adjustments or CVAs) when determining the fair value of financial instruments and providing relevant disclosures.

Regulators have noted that they expect issuers to provide an appropriate level of transparency on the methodologies used, and when the amounts are significant, on the effects of counterparty credit risk on measurement of the fair value of assets and non-performance risk on the measurement of the fair value of liabilities.

Fair value hierarchy

IFRS 13 establishes a fair value hierarchy under which the inputs to valuation techniques used to measure fair value are categorised into three levels. This requirement, which had previously applied only to financial instruments, is aimed at increasing consistency and comparability when measuring fair value and making related disclosures. The three levels of the hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly
- Level 3 inputs are unobservable inputs for the asset or liability.

For more information on this Standard, please refer to our Special Edition of IFRS News 'IFRS 13 Fair Value Measurement'.

Disclosures

IFRS 13 introduces a comprehensive disclosure framework for fair value measurements. This framework is intended to help users of financial statements assess the valuation techniques and inputs used to develop those measurements.

The disclosures required are affected by the fair value hierarchy discussed above, with increased disclosure requirements applying to the lower levels of that hierarchy.

Commercial significance

Number of entities affected: Most

Even entities largely unaffected by IFRS 13's valuation guidance are likely to be affected by its extensive disclosure requirements.

Impact on affected entities: Medium

For many entities, IFRS 13 will not actually change fair values significantly, as much of the new guidance is intended to be consistent with common valuation practices. However, its impact will ultimately depend on the items being fair valued and the techniques currently used. For example, if a company includes 'blockage' adjustments when valuing a large shareholding, then IFRS 13 may well make a difference.

IFRIC 20 Stripping Costs in the Production Phase of a Surface Mine

IFRIC 20 'Stripping Costs in the Production Phase of a Surface Mine' sets out authoritative guidance on accounting for costs incurred by mining companies in removing waste materials to gain access to mineral ore deposits ('stripping costs'). The Interpretation is narrowly focused on surface mines, not underground mines, and on extracting mineral ore such as coal, not oil and gas.

In a surface mine, stripping activities can result in two benefits for a mining company: usable ore that can be used to produce inventory and improved access to further quantities of material that will be mined in future periods.

Accounting requirements

Under IFRIC 20, the accounting treatment of stripping costs depends on whether the related activity results in inventory production or in improved access to ore deposits. In summary:

- IAS 2 'Inventories' applies if the benefits from the activity are realised through inventory production
- costs incurred on improving access to ore deposits are recognised as a 'stripping activity asset' if certain conditions are met. This asset is treated as an addition to, or as an enhancement of, an existing asset. The stripping activity asset's classification as a tangible or intangible asset reflects that of the existing asset
- costs incurred on dual purpose activities are allocated to the different elements on a relevant production measure basis.

IFRIC 20 includes more guidance on the asset recognition conditions, cost allocation and on the initial and subsequent measurement of stripping activity assets.

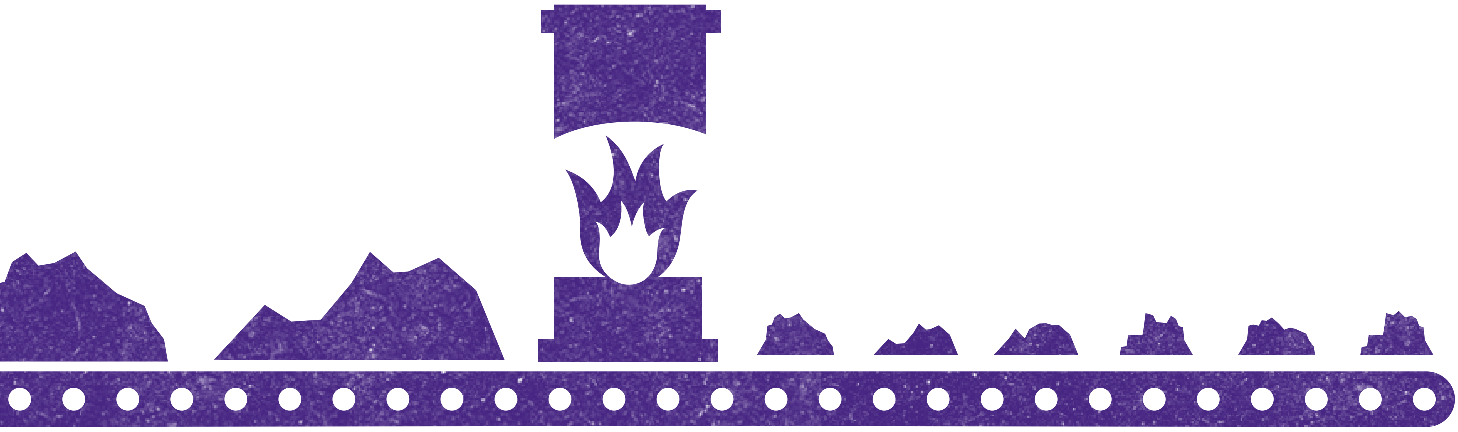
Commercial significance

Number of entities affected: Few

The Interpretation is very narrowly focused. Only mining entities that have surface mines will be affected.

Impact on affected entities: Medium

IFRIC 20 has been introduced to address diversity in practice over how mining companies treat stripping costs. As a result, some companies that have previously expensed those costs may now need to capitalise them. Other companies who have previously capitalised them may find that their policies do not meet IFRIC 20's criteria for capitalisation.



Annual Improvements to IFRSs 2009-2011 Cycle

Published in May 2012, 'Annual Improvements 2009-2011 Cycle' is a collection of amendments to IFRSs resulting from issues that were discussed by the IASB during the project cycle for making annual improvements that began in 2009, and which were subsequently included in an Exposure Draft published in June 2011. The IASB uses the Annual Improvements process to make necessary, but non-urgent, amendments to IFRSs that will not be included as part of any other project.

A summary of the issues addressed is given in the table:

Summary of Annual Improvements to IFRSs 2009-2011 Cycle

Standard affected	Subject	Summary of amendment
IFRS 1 'First-time Adoption of International Financial Reporting Standards'	Repeated application of IFRS 1	• addresses the question of whether IFRS 1 can be applied more than once • clarifies that in a situation where an entity readopts IFRSs, it can elect to either apply IFRS 1 or apply IFRSs retrospectively in accordance with IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' as if the entity had never stopped applying IFRSs.
	Borrowing costs	Addresses situations where an entity chooses to apply IFRS 1's exemption from the requirements of IAS 23 'Borrowing Costs', clarifying that: • borrowing costs that were capitalised before the date of transition in accordance with previous GAAP should be carried forward in the opening statement of financial position • borrowing costs incurred after the date of transition in relation to qualifying assets under construction at the date of transition should be accounted for in accordance with IAS 23 • where a first-time adopter chooses to apply the requirements of IAS 23 from a date earlier than the date of transition, it should account for borrowing costs in accordance with IAS 23 on or after the earlier date selected.
IAS 1 'Presentation of Financial Statements'	Clarification of the requirements for comparative information	The amendment covers two issues: 1) Opening statement of financial position • addresses the comparative requirements for the opening statement of financial position when an entity changes accounting policies, or makes retrospective restatements or reclassifications, in accordance with IAS 8 • clarifies that the appropriate date for the opening statement of financial position is the beginning of the preceding period. Related notes to this opening statement of financial position are no longer required to be presented. 2) Comparative information beyond minimum requirements • addresses whether an entity should be required to present a complete set of financial statements when it provides financial statements beyond the minimum comparative information requirements (ie additional comparative information) • clarifies that additional financial statement information need not be presented in the form of a complete set of financial statements for periods beyond the minimum comparative requirements. Any additional information presented should however be presented in accordance with IFRSs and the entity should present comparative information in the related notes for that additional information.

Summary of Annual Improvements to IFRSs 2009-2011 Cycle

Standard affected	Subject	Summary of amendment
IAS 16 'Property, Plant and Equipment'	Classification of servicing equipment	• addresses a perceived inconsistency in the classification requirements for servicing equipment which had led some to think that servicing equipment used during more than one period would be classified as part of inventory • the amendment clarifies that items such as spare parts, stand-by equipment and servicing equipment shall be recognised as property, plant and equipment when they meet the definition of property, plant and equipment. If they do not meet this definition they are classified as inventory.
IAS 32 'Financial Instruments: Presentation'	Tax effect of distribution to holders of equity instruments	• addresses perceived inconsistencies between IAS 12 'Income Taxes' and IAS 32 with regards to recognising the consequences of income tax relating to distributions to holders of an equity instrument and to transaction costs of an equity transaction • clarifies that the intention of IAS 32 is to follow the requirements in IAS 12 for accounting for income tax relating to distributions to holders of an equity instrument and to transaction costs of an equity transaction. IAS 12 requires the recognition of the income tax consequences of dividends in profit or loss except to the extent that the tax arises from a business combination or from a transaction which is recognised outside profit or loss (either in other comprehensive income or directly in equity).
IAS 34 'Interim Financial Reporting'	Interim financial reporting and segment information for total assets and liabilities	• clarifies the requirements on segment information for total assets and liabilities for each reportable segment to enhance consistency with the requirements in paragraph 23 of IFRS 8 'Operating Segments' • The amendment clarifies that the total assets and liabilities for a particular reportable segment are required to be disclosed if, and only if: a) a measure of total assets or of total liabilities (or both) is regularly provided to the chief operating decision maker; and b) there has been a material change from those measures disclosed in the last annual financial statements for that reportable segment.

Commercial significance

Number of entities affected: Few

The amendments make changes to relatively narrow areas within IFRSs.

Impact on affected entities: Low

The IASB's Annual Improvements process addresses non-urgent, but necessary minor amendments to IFRSs. By nature then, their commercial significance can be expected to be low.

The guidance on the repeated application of IFRS 1 will be useful in a situation such as where an entity was previously required to apply IFRSs in order to meet listing requirements but then delists and no longer presents financial statements in accordance with IFRSs. In a subsequent reporting period, the entity relists, or its local jurisdiction's requirements change from national GAAP to IFRSs, requiring it to present its financial statements in accordance with IFRSs again. The amendment to IFRS 1 clarifies that such an entity will be able to choose to apply IFRS 1.

Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32)

'Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32)' adds application guidance to IAS 32 to address inconsistencies in applying the criteria for offsetting financial assets and financial liabilities. Two areas of inconsistency are addressed by the amendments.

The first relates to the meaning of 'currently has a legally enforceable right of set-off'. The IASB has clarified that a right of set-off is required to be legally enforceable in the normal course of business, in the event of default and in the event of insolvency or bankruptcy of the entity and all of the counterparties. The right must also exist for all counterparties.

The second area relates to gross settlement systems, such as clearing houses, used by banks and other financial institutions. There had been diversity in practice over the interpretation of IAS 32's requirement for there to be 'simultaneous settlement' of an asset and a liability in order to achieve offsetting.

The IASB has clarified in the amendments the principle behind net settlement and included an example of a 'gross settlement system' with characteristics that would satisfy the IAS 32 criterion for net settlement.

These Amendments were made in conjunction with additional disclosures in IFRS 7 on the effects of rights of set-off and similar arrangements (see page 20).

Commercial significance

Number of entities affected: Few

The first amendment deals with quite a narrow set of transactions, while the second amendment will mainly be of interest to major financial institutions that enter into high volumes of derivative transactions using a centralised counterparty such as a clearing house.

Impact on affected entities: Medium

The first amendment is a clarification of the meaning of 'currently has a legally enforceable right of set-off' rather than a substantial change. The second will lead to a change in practice for some financial institutions who routinely use gross settlement systems as part of their operations. For entities that do need to change their offsetting practice (from net to gross or vice versa) the impact on reported financial position could be material.

Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)

Many commentators have long held the view that consolidating the financial statements of an investment entity and its investees does not provide the most useful information. Consolidation makes it more difficult for investors to understand what they are most interested in – the value of the entity's investments.

The IASB has been influenced by these arguments. On 31 October 2012 it published 'Investment Entities – Amendments to IFRS 10, IFRS 12 and IAS 27' (the Amendments). The Amendments define an investment entity and provide detailed application guidance on that definition. Entities that meet the definition are required to measure investments that are controlling interests in another entity (in other words, subsidiaries) at fair value through profit or loss instead of consolidating them. The Amendments also introduce new disclosure requirements for investment entities.

The table summarises the key features of the Amendments:

The amendments at a glance

	Summary
Who's affected?	Entities that: • meet the new definition of 'investment entity' • hold one or more investments that are controlling interests in another entity
What is the impact?	Investment entities will: • no longer consolidate investments that are controlling interests in another entity • make additional disclosures about these investments
Other key points	• a non-investment parent entity that controls an investment entity will continue to consolidate its subsidiaries (the consolidation exemption does not 'roll up') • an investment entity's service subsidiaries (subsidiaries that are not 'investments') will continue to be consolidated • if an investment entity has no non-investment subsidiaries it presents separate financial statements as its only financial statements
When are the changes effective?	• annual periods beginning on or after 1 January 2014 • early application permitted

Definition of an 'investment entity'

An investment entity is an entity that:

a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services (investment services condition)
b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both (business purpose condition)
c) measures and evaluates the performance of substantially all of its investments on a fair value basis (fair value condition).

Typical characteristics

In assessing whether it meets the definition an entity shall consider whether it has the following typical characteristics of an investment entity:

a) it has more than one investment
b) it has more than one investor
c) it has investors that are not related parties of the entity
d) it has ownership interests in the form of equity or similar interests.

Accounting requirements for an investment entity

The Amendments do not set out a comprehensive accounting framework for investment entities – they are instead limited to an exception from consolidation of investments in certain subsidiaries. The Amendments also affect the separate financial statements of an investment entity (if these are prepared). The key changes are shown in the table:

Accounting requirements for investment entities

	Summary
Accounting for subsidiaries held as investments	• subsidiaries held as investments are measured at fair value through profit or loss in accordance with IFRS 9 'Financial Instruments' instead of being consolidated. This accounting is mandatory not optional • IFRS 3 'Business Combinations' does not apply to the obtaining of control over an exempt subsidiary • the consolidation exception also applies to controlling interests in another investment entity
Accounting for service subsidiaries	• an investment entity is still required to consolidate subsidiaries that provide services that relate to its investment activities • IFRS 3 applies on obtaining control over a service subsidiary
Accounting in separate financial statements	• an investment entity's fair value accounting for its controlled investees also applies in its separate financial statements • if the consolidation exception applies to all an investment entity's subsidiaries throughout the current and all comparative periods (ie it has no services subsidiaries) its separate financial statements are its only financial statements

Disclosures

The Amendments introduce customised disclosure requirements in IFRS 12 'Disclosure of Interests in Other Entities' relating to an investment entity's subsidiaries that are no longer consolidated. Most existing disclosures in IFRS 12 cease to apply, either because they are specifically dis-applied or because they are not relevant to subsidiaries that are not consolidated (such as summarised financial information and information about non-controlling interests).

Effective date and transition

The Amendments are effective for annual periods beginning on or after 1 January 2014. This is one year later than the 1 January 2013 effective date of IFRS 10, but the IASB has permitted early adoption in order to allow investment entities to apply the Investment Entities amendments at the same time they first apply the rest of IFRS 10.

Commercial significance

Number of entities affected: Some

The Amendments affect qualifying investment entities. Private equity organisations, venture capital organisations, pension funds, sovereign wealth funds and other investment funds are likely to be particularly interested in the Amendments.

Impact on affected entities: High

The consolidation exception will have a huge impact on affected entities and, if adopted early, could spare them from much of the time and effort they would otherwise need to spend on reassessing their control conclusions under IFRS 10's new requirements.


IFRS News
Special Edition

For more information on the amendments, please refer to our Special Edition of IFRS News 'A consolidation exception for investment entities'.

IFRIC 21 Levies

IFRIC 21 'Levies' considers how an entity should account for liabilities to pay levies imposed by governments, other than income taxes, in its financial statements. A number of new levies were raised following the global financial crisis, particularly on banks. However, IFRIC 21 also applies to several more established types of non-income tax: for example certain property, environmental and payroll taxes (excluding social security contributions or similar taxes within the scope of IAS 19 'Employee Benefits'). As levies and taxes are not based on taxable profits, they fall outside the scope of IAS 12 'Income Taxes' and are therefore accounted for under IAS 37 'Provisions, Contingent Liabilities and Contingent Assets'.

IFRIC 21 addresses the accounting for a liability to pay a levy that is within the scope of IAS 37, in particular when an entity should recognise a liability to pay a levy. It also addresses the accounting for a liability to pay a levy whose timing and amount is certain.

Under IFRIC 21, the obligating event that gives rise to a liability to pay a levy is the activity that triggers the payment of the levy, as identified by the legislation. For example, if the activity that triggers the payment of the levy is the generation of revenue in the current period and the calculation of that levy is based on the revenue that was generated in a previous period, the obligating event for that levy is the generation of revenue in the current period. Where the activity that triggers the payment of the levy occurs over a period of time, the liability to pay a levy is recognised progressively. For example, if the obligating event is the generation of revenue over a period of time, the corresponding liability is recognised as the entity generates that revenue.

IFRIC 21 also clarifies that an entity does not have a constructive obligation to pay a levy that will be triggered by operating in a future period as a result of the entity being economically compelled to continue to operate in that future period. This can lead to accounting outcomes that some find counter-intuitive for levies that are measured by reference to current period activities but are triggered only if the entity continues to operate on a specified date in a future period.

IFRIC 21 is to be applied retrospectively.

Commercial significance

Number of entities affected: Some

The Interpretation will affect entities that are subject to levies which are not based on taxable profits. As noted above, it will apply to many different types of levy and non-income tax. That said, it is expected to change current practice mainly in cases when the relevant legislation identifies a trigger date in a future accounting period but the amount payable is based on current period activity.

Impact on affected entities: Medium

IFRIC 21 will result in some levies being recognised as expenses on a specific date rather than over an accounting period.

Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36)

'Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36)' addresses the disclosure of information about the recoverable amount of impaired assets if that amount is based on fair value less costs of disposal.

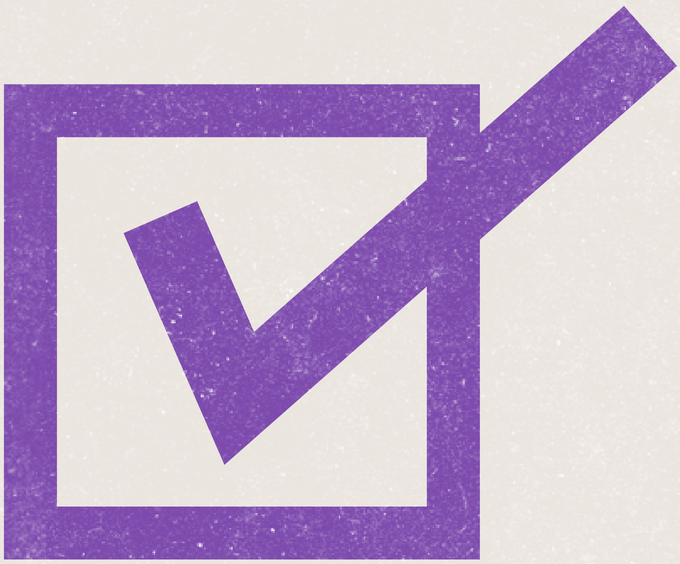
When developing IFRS 13 'Fair Value Measurement', the IASB decided to amend IAS 36 'Impairment of Assets' to require disclosures about the recoverable amount of impaired assets. The IASB noticed however that some of the amendments made in introducing those requirements resulted in the requirement being more broadly applicable than the IASB had intended. The Amendments to IAS 36 therefore clarify the IASB's original intention that the scope of those disclosures is limited to the recoverable amount of impaired assets that is based on fair value less costs of disposal.

The Amendments to IAS 36 should be applied retrospectively for annual periods beginning on or after 1 January 2014. Earlier application is permitted provided the entity has already adopted IFRS 13.

Commercial significance

Number of entities affected: Some
The Amendments will be relevant in situations where the recoverable amount of an impaired asset is based on fair value less costs of disposal.

Impact on affected entities: Low
The Amendments to IAS 36 are uncontroversial in nature.



Novation of Derivatives and Continuation of Hedge Accounting (Amendments to IAS 39)

'Novation of Derivatives and Continuation of Hedge Accounting (Amendments to IAS 39)' provides relief from discontinuing hedge accounting when the novation of a derivative designated as a hedging instrument meets certain criteria.

In 2009, the Group of Twenty Finance Ministers and Central Bank Governors (G20) made a decision that standardised 'over the counter' (OTC) derivatives should be cleared through a central counterparty (CCP). Following that decision a number of jurisdictions have introduced legal or regulatory requirements that OTC derivatives have to be novated to a CCP. The European Market Infrastructure Regulation in the European Union is one such example.

The Amendments to IAS 39 will allow hedge accounting to continue in a situation where a derivative, which has been designated as a hedging instrument, is novated to effect clearing with a central counterparty as a result of laws or regulation, if specific conditions are met.

The Amendments to IAS 39 should be applied retrospectively. Similar relief has been included in IFRS 9 'Financial Instruments'.

Commercial significance

Number of entities affected: Few

The Interpretation will only affect entities that have elected to use hedge accounting under IAS 39 and who find that a derivative used as a hedging instrument is novated to a central counterparty due to the introduction of a new law or regulation.

Impact on affected entities: High

The amendments are significant as affected entities would otherwise have had to discontinue hedge accounting which would in turn have led to increased profit or loss volatility.

Defined Benefit Plans: Employee Contributions (Amendments to IAS 19)

'Defined Benefit Plans: Employee Contributions (Amendments to IAS 19)' makes narrow scope amendments to IAS 19 'Employee Benefits' which:

- clarify the requirements on how contributions from employees (or third parties) that are linked to service should be attributed to periods of service when accounting for post-employment defined benefit plans
- permit a practical expedient if the amount of the contributions is independent of the number of years of service.

Background

Prior to the publication of IAS 19 (Revised 2011), it was common practice for entities to deduct employee contributions to defined benefit plans from service cost in the period in which the service was rendered. IAS 19 (Revised 2011) however requires contributions that are linked to service to be attributed to periods of service as a reduction of service cost (ie as a negative benefit). Concerns were raised however about the complexity of this requirement when it was applied to simple contributory plans.

The Amendments to IAS 19

The IASB has responded to these concerns by both clarifying the requirements of IAS 19 and introducing a practical expedient to the Standard.

The practical expedient

The practical expedient applies where the amount of contributions from employees or third parties is independent of the number of years of service, and permits an entity to recognise such contributions as a reduction in the service cost in the period in which the related service is rendered, instead of attributing the contributions to the periods of service.

Examples of contributions that are independent of the number of years of service include those that are a fixed percentage of the employee's salary, a fixed amount throughout the service period or dependent on the employee's age.

The clarification of the requirements of IAS 19

Separately the IASB has clarified that if the amount of the contributions from employees or third parties is dependent on the number of years of service, then an entity shall attribute the contributions to periods of service using the same attribution method required by IAS 19.70 for the gross benefit (ie either using the plan's contribution formula or on a straight-line basis).

IAS 19.93 had previously caused confusion by stating that contributions from employees or third parties in respect of service are attributed to periods of service as a negative benefit in accordance with IAS 19.70, and then stating that the net benefit is attributed in accordance with IAS 19.70.

Commercial significance

Number of entities affected: Some

The Interpretation will only affect entities with defined benefit pension schemes.

Impact on affected entities: Medium

The introduction of the practical expedient for accounting for certain contributions from employees or third parties should alleviate the need for complex calculations, and disruption to established practices, in relation to straightforward employee contributions to defined benefit plans.

IFRS 9 Financial Instruments

The first phase of IFRS 9 'Financial Instruments' (IFRS 9) was published in November 2009 in reaction to the financial crisis and will eventually replace IAS 39 'Financial Instruments: Recognition and Measurement' in its entirety.

Structure

In order to allow for the IASB's phased approach to the completion of the overall project, IFRS 9 is structured in terms of chapters.

When first published in November 2009, IFRS 9 addressed only the classification and measurement of financial assets. It has however been subsequently changed on a number of occasions, notably October 2010 when requirements for classifying and measuring financial liabilities and derecognising financial assets and financial liabilities were added, and in November 2013 when requirements on hedge accounting were introduced. The requirements relating to these areas are discussed in greater detail below.

A new chapter on expected credit losses (impairment) is expected in the first half of 2014 along with some amendments to the Standard's classification and measurement requirements. Amendments made in November 2013 withdrew the Standard's 1 January 2015 mandatory effective date (a new date will be decided upon when the project is closer to completion). In the meantime however, companies can (subject to local law) early adopt it in its current state.

Classification and measurement of financial assets

The classification and measurement of financial assets was one of the areas of IAS 39 that received the most criticism during the financial crisis. In publishing IFRS 9, the IASB therefore made a conscious effort to reduce the complexity in accounting for financial assets. The following table summarises some of the simplifications that have been made:

Simplifications compared to IAS 39

	IFRS 9 treatment	IAS 39 treatment
Measurement categories	• Two categories*: – fair value – amortised cost *An Exposure Draft published in November 2012 proposes introducing a third category of fair value through other comprehensive income.	• Four categories: – fair value through profit or loss – held to maturity – amortised cost – available for sale
Impairment	• One impairment method	• Different impairment methods apply to: – financial assets carried at amortised cost – financial assets carried at cost – available for sale financial assets
Embedded derivatives	• For (asset) host contracts within the scope of IFRS 9, IFRS 9's application requirements are applied to the combined (hybrid) instrument in its entirety	• Complex rules determine whether the embedded derivative needs to be separated from the host contract

For more information on the classification and measurement requirements of this Standard, please refer to our Special Edition of IFRS News 'IFRS 9 Financial Instruments' which can be obtained from your local IFRS contact. Please note that this newsletter does not take account of any potential changes to the Standard which may arise from the proposals in the IASB's November 2012 Exposure Draft 'Classification and Measurement: Limited Amendments to IFRS 9'.

Classification and measurement of financial liabilities

In October 2010, the IASB amended IFRS 9 to incorporate requirements on the classification and measurement of financial liabilities. Most of IAS 39's requirements have been carried forward unchanged to IFRS 9. Changes have however been made to address issues related to own credit risk where an entity takes the option to measure financial liabilities at fair value.

Majority of requirements retained

Under IAS 39 most liabilities are measured at amortised cost or bifurcated into a host instrument measured at amortised cost, and an embedded derivative, measured at fair value.

Liabilities that are held for trading (including all derivative liabilities) are measured at fair value. These requirements have been retained.

Own credit risk

The requirements related to the fair value option for financial liabilities have however been changed to address own credit risk. Where an entity chooses to measure its own debt at fair value, IFRS 9 now requires the amount of the change in fair value due to changes in the entity's own credit risk to be presented in other comprehensive income. This change addresses the counterintuitive way in which a company in financial trouble was previously able to recognise a gain based on its theoretical ability to buy back its own debt at a reduced cost.

The only exception to the new requirement is where the effects of changes in the liability's credit risk would create or enlarge an accounting mismatch in profit or loss, in which case all gains or losses on that liability are to be presented in profit or loss.

In November 2013, the IASB amended IFRS 9 to allow these changes to be applied in isolation without the need to change any other accounting for financial instruments.

Elimination of the exception from fair value measurement for certain derivative liabilities

The new version of IFRS 9 also eliminates the exception from fair value measurement for derivative liabilities that are linked to and must be settled by delivery of an unquoted equity instrument. Under IAS 39, if those derivatives were not reliably measurable, they were required to be measured at cost. IFRS 9 requires them to be measured at fair value.

Derecognition of financial assets and financial liabilities

In October 2010, the requirements in IAS 39 related to the derecognition of financial assets and financial liabilities were incorporated unchanged into IFRS 9.

The IASB had originally envisaged making changes to the derecognition requirements of IAS 39. In the summer of 2010, however, the IASB revised its strategy, having concluded that IAS 39's requirements in this area had performed reasonably during the financial crisis. IAS 39's derecognition requirements have therefore been incorporated into IFRS 9 unchanged, while new disclosure requirements were instead issued in October 2010 as an amendment to IFRS 7 'Financial Instruments: Disclosures'.

Hedge accounting

In November 2013, the IASB published Chapter 6 of IFRS 9 'Hedge Accounting'.

IAS 39's hedge accounting requirements had been heavily criticised for containing complex rules which either made it impossible for entities to use hedge accounting or, in some cases, simply put them off doing so. As an example, hedge effectiveness was judged on both a prospective and a retrospective basis, with a 'bright-line' quantitative range of 80-125% being used to assess retrospective effectiveness on a quantitative basis. Anything outside this range resulted in the discontinuance of hedge accounting, leading to profit and loss volatility.

In part this complexity was a reflection of the fact that the hedge accounting requirements were an exception to IAS 39's normal requirements. There was however also a perception that hedge accounting did not properly reflect entities' actual risk management activities, thereby reducing the usefulness of their financial statements. IFRS 9's new requirements look to rectify some of these problems, aligning hedge accounting more closely with entities' risk management activities by:

- increasing the eligibility of both hedged items and hedging instruments
- introducing a more principles-based approach to assessing hedge effectiveness.

As a result, the new requirements should serve to reduce profit or loss volatility. The increased flexibility of the new requirements are however partly offset by entities being prohibited from voluntarily discontinuing hedge accounting and also by enhanced disclosure requirements. The table gives a highly summarised view of the new requirements.

Simplifications compared to IAS 39

Features	Key points
Objective of the Standard	• to better align hedging from an accounting point of view with entities' underlying risk management activities
Similarities with IAS 39	• hedge accounting remains an optional choice • the three types of hedge accounting (fair value hedges, cash flow hedges and hedges of a net investment) remain • formal designation and documentation of hedge accounting relationships is required • ineffectiveness needs to be measured and included in profit or loss • hedge accounting cannot be applied retrospectively
The major changes	• increased eligibility of hedged items • increased eligibility of hedging instruments and reduced volatility • revised criteria for hedge accounting qualification and for measuring hedge ineffectiveness • a new concept of rebalancing hedging relationships • new requirements restricting the discontinuance of hedge accounting

Effective date and transition disclosures

In December 2011, the IASB deferred the mandatory effective date of IFRS 9 from 1 January 2013 to 1 January 2015. In November 2013, the IASB went one step further, deciding to remove the 1 January 2015 mandatory effective date altogether in order to provide sufficient time for entities to make the transition to the new requirements. The IASB will decide upon a new date when the entire IFRS 9 project is closer to completion. Entities may still apply IFRS 9 immediately if they choose to however.

For more information on IFRS 9's hedge accounting requirements, please refer to our Special Edition of IFRS News 'IFRS 9 Hedge accounting' which can be obtained from your local IFRS contact.

Advantages and disadvantages of early adoption of IFRS 9

Advantages

- reduced complexity in accounting for financial assets as a result of having only two measurement categories (note however that a third category of fair value through other comprehensive income is likely to be introduced as a result of proposals in the Exposure Draft 'Classification and Measurement: Limited Amendments to IFRS 9', published November 2012)
- improved ability to align accounting with the company's business model for managing financial assets
- gives a (one-off) opportunity to reclassify financial assets on initial adoption (assuming all the criteria are met)
- only one set of impairment rules needs to be considered, with no separate impairment assessment (or losses) for investments in equity instruments
- simplified accounting for and valuation of financial instruments containing embedded derivatives in asset host contracts
- enables hedge accounting to be aligned more closely with entities' risk management activities
- avoids counter-intuitive results arising from changes in own credit risks where the option to measure financial liabilities at fair value has been taken
- greater flexibility on date of initial application for early-adopters.

Disadvantages

- need to re-evaluate the classification of all instruments within the scope of IAS 39, with consequent implications for system changes
- restricted ability to reclassify financial instruments on an ongoing basis
- inability to voluntarily discontinue hedge accounting
- inability to assess the overall impact of the IASB's overhaul until the remaining phases are complete
- the possibility of change to IFRS 9 as a result of decisions made in later phases

Commercial significance

Number of entities affected: Most

Because the definition of a financial instrument is so wide, most companies can expect to be affected. Even companies with relatively simple debtors and creditors should consider the changes. In addition, the greater alignment of IFRS 9's hedge accounting requirements with entities' risk management practices may encourage entities who engage in economic hedging to also apply hedge accounting.

Impact on affected entities: High

The new Standard, with its reduced number of measurement categories, should help to reduce the complexity in accounting for financial instruments. In the short-term however, it may lead to far reaching changes, with companies needing to re-evaluate the classification of all instruments within the scope of IAS 39.

In addition to the impact on a company's financial position and reported results, changes to information systems may well need to be made.

Companies considering adopting the Standard should also be aware that there is a risk of increased application problems arising from the project being divided into various phases.

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