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IFRS Center of Excellence (CoE) Newsletter

Dear all,

Welcome to this edition of the IFRS Newsletter prepared by the Deloitte Luxembourg IFRS Centre of Excellence. We are happy to update you on IFRS matters we found relevant.

IFRIC proposed changes relating to the taxation: Uncertainty over Income Tax Treatments

IFRIC previously published the draft Interpretation to provide guidance when there is uncertainty over income tax treatments.

This came as a response to the question when the recognition of a current tax asset is appropriate, if tax laws require an entity to make an immediate payment in respect of a disputed amount.

Even though IAS 12 Income Taxes provides guidance on this matter, diversity in practice for various issues in circumstances in which there is uncertainty in the application of the tax law exists.

IAS 12 does not provide specific guidance on how uncertainty about a tax treatment should be reflected in the accounting for income tax. Consequently, the Interpretations Committee proposed its view on the matter.

The Interpretations Committee noted that the Interpretations would not explicitly address interest and penalties related to uncertain tax positions and will therefore consider them separately at a future meeting.

This draft Interpretation does not change any existing requirements in IAS 12. An entity shall recognise and measure a current or deferred tax asset or liability by applying the requirements of IAS 12. However, this shall be based on taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates that are determined in accordance with this draft Interpretation if there is uncertainty over income tax treatments. If an entity concludes that it is probable that the taxation authority will accept an uncertain tax treatment, or group of uncertain tax treatments, it shall determine the taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates consistently with the tax treatment used or planned to be used in its income tax filings. If an entity concludes that it is not probable that the taxation authority will accept an uncertain tax treatment, or group of uncertain tax treatments, it shall reflect the effect of uncertainty in determining the related taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates.

If an uncertain tax treatment affects both deferred tax and current tax, an entity shall make consistent estimates and judgements for both. For example, an uncertain tax treatment may affect both taxable profits used to determine the current tax and tax bases used to determine deferred tax.

International Practice Task Force

The task force discussed the three-year cumulative inflation rates for certain countries. Those countries with three-year cumulative inflation rates exceeding 100% are considered as being in a state of hyperinflation. The following countries are considered highly inflationary: Malawi, South Sudan, Sudan, Venezuela and Ukraine. We are focusing on the two last countries.

Ukraine:

As per reported data in the October 2016 World Economic Outlook (hereafter WEO) report, the three-year cumulative inflation rate through the end of 2015 amounted to 80% and was expected to amount to 102% by the end of 2016. This cumulative inflation is primarily caused by a spike in inflation reported in 2015 of 43%. It is likely that Ukraine will cease being considered highly-inflationary by the end of 2017.

Argentina:

As reported in the October 2016 WEO report, the three-year cumulative inflation rate is projected to be 105% at the end of 2016. The WEO report does not provide inflation data for 2015 or 2016. This is due to changes made by the Argentinian government that took office in December 2015, in relation to how the consumer price index is recorded. The task force recommended that registrants closely monitor all inflation data and conditions in Argentina throughout 2017 to determine if Argentina should be considered highly inflationary.

IAS 1 Disclosure Initiative

Disclosures have significant importance as they provide information about the key judgements and estimates made when providing financial statements. IAS 1 provides two distinct requirements in relation to these judgements and estimates made by management which have the most significant effect on the amounts recognized in the financial statements. The two requirements in IAS 1 differ in regard to the exercise of judgement. IAS 1.122 simply concerns the disclosure of judgements that do not involve estimates. IAS 1.125 requires disclosure on the assumptions made by the entity on the future and other sources of estimation uncertainty. Importantly IAS 1 requirements are only concerned with complex or subjective judgements that have a significant effect on amounts recognized; and assumptions and other sources of estimated uncertainty which cause a significant risk of material adjustment to the carrying amounts of assets/liabilities within the year. Disclosures are often best presented as a separate note or separate section of note. Clear headings should be used. Examples of areas where judgements may arise that fall under requirements of IAS 1.122 include: revenue recognition and lease classification. Examples of areas where disclosure may be necessary under IAS 1.125 include: measurement of obligations for long-term employee benefits such as pensions.

Disclosure Initiative - Background

The Disclosure initiative consists of a number of implementation (first two) and research projects. These are:

- Materiality Practice Statement: considers how materiality is applied in practice in IFRS financial statements.
- Definition of Materiality: aims to redefine definition of materiality and clarify its clarifications.
- Principles of Disclosure: aims to develop a set of principles for disclosure that could form the basis of a Standards-level project.
- Standards-level review of disclosures: aim is to develop a drafting guide for the Board to use when setting

disclosure requirements in new and amended Standards.

Next steps

A Discussion Paper has been issued by the IASB as part of its Disclosure Initiative. The IASB aims to identify steps which will facilitate improvement of the quality of information available to users of financial reports. The Board is focusing on the areas of:

A) Effective communication;
B) Where to disclose information;
C) The fair presentation of non-IFRS specified performance measures in the financial statements;
D) Identifying which accounting policies should be disclosed and where;
E) Centralized disclosure objectives.

Expected Credit Loss calculation

IFRS 9 highlights that the point-in-time probability of default should be used in the ECL calculation.

For calculating the regulatory probability of default the 12-month expected credit losses used which is based on the "throughout the cycle" probability of default. In contrast, the IFRS 9 probability of default is a point-in-time probability and do not contain adjustment for prudence.

However, many Banks are planning to use the Basel II internal ratings- based (IRB) capital models to manage the calculation and use them as a starting point. Adjusting the IRB to be used for IFRS 9 is challenging (significant changes must be done), is complex and will require the use of judgement.

ESMA recent activities update

Below we have summarized certain the topics we found interesting for IFRS users throughout the practice as per the Enforcement and Regulatory Activities of Accounting Enforcers in 2016 the European Securities and Markets Authority (ESMA) published on 10 April 2017:

- Impact of the financial markets conditions on financial statements
- Statement of cash flows and related disclosures
- ESMA Statement on implementation of IFRS 9 and IFRS 15

Impact of the financial markets conditions on financial statements

Impairment of assets

As per the Standard the entities had to perform an impairment test disclosed the discount rate applied to the cash flow projections which is required when the cash generating unit (CGU) tested for impairment includes goodwill or intangible assets with indefinite useful life.

ESMA highlighted if the issuers that disclose the discount rate as a key assumption, they need to provide sufficient disclosures on the management approach to determine the value of the discount rate and a sensitivity analysis to a variation in the discount rate for each significant CGU or group of CGUs. However, the European enforcers identified that the range of the disclosed sensitivities were not reasonable and highlighted the importance to select the reasonable range for preparing the sensitivity analysis.

Countries with multiple exchange rates, cash restrictions and other countries at risk

Based on IAS 1 Presentation of Financial Statements (para 125 to 129), ESMA expressed its expectation that issuers with significant exposure to a country at risk, in which more than one foreign exchange rate exists, should provide information about the exposure. Furthermore, issuers should provide the foreign exchange rate and an analysis of the main judgements used (e.g. the judgements made and the reasons for selecting one specific foreign exchange rate rather than another), as well as a sensitivity analysis where relevant.

ESMA also highlights that the Financial Statements' issuers with material exposure to a specific country at risk and/or exchange rate risk were exposed to countries with restrictions should provide sufficient information on the extent of these restrictions in the Financial Statement. The countries most mentioned were Greece, Russia and Venezuela, where also certain capital controls apply. In these cases the issuer should disclose sufficient information about the nature and extent of significant cash and cash equivalents held but not available to the group due to restrictions.

Statement of cash flows and related disclosures

The statement of cash flows is a key element in analysing an entity's performance and allows users to assess the ability of an issuer to generate cash and consider its reliance on new financing. However, in significant cases the enforcers identify issues in the application of the IAS 7 Statement of Cash Flows.

The IFRS IC determined that in order to meet the requirements of IAS 34 Interim Financial Reporting (para 10,15 and 25) a condensed statement of cash flows should include all information that is relevant to understand the entity's ability to generate cash flows and the entity's needs to utilise those cash flows. Also noted that it did not expect that a three-line presentation alone would meet the requirements in IAS 34.

ESMA also enforces, that based on IAS 1 Presentation of Financial Statements (para 125 to 129) where the classification of cash flows involves judgement, the entities should provide information on the classification together with the reasoning.
European Common Enforcement Priorities (ECEP) statement mentions examples of cash flows where classification requires judgement such as cash flows of an operator in a service concession agreement, cash payments for deferred or contingent considerations arising from a business combination or cash flows from interest and dividends.

ESMA encouraged issuers to present a breakdown of the changes in working capital if it is subject to significant variations from the comparative reporting period.

ESMA expects the substance of supplier chain financing (called reverse factoring) arrangements to be analyzed, too. It noted that it would be important to assess whether the related trade payables should be reclassified as financial liabilities towards banks and whether the cash flows should be presented as operating or as financing cash flows.

ESMA Statement on implementation of IFRS 9 and IFRS 15

ESMA published two Statements on the implementation of new standards issued by the IASB, one related to IFRS 15 and one related to IFRS 9. Due to the significant impact and importance of these two standards, ESMA highlighted and enforced again in these statements the need for timely preparation and implementation.

In the two statements, ESMA expects the entities will be ready when the new requirements become mandatorily applicable and that they are providing relevant disclosures on the expected impact. ESMA expects that as the implementation of the two standards progresses, information about their impact should become more reasonable estimable and issuers will be able to provide progressively more entity-specific qualitative and quantitative information about the application of these two standards. In order to help and assist the Financial Statements issuers, the two statements also provide an illustrative timeline and good practices of disclosures.

ESMA expects that these two statements will be taken into account by issuers and reflected in the 2017 annual and interim financial statements. ESMA, together with National Competent Authorities (NCAs), will monitor the level of transparency, how the entities are disclosing information in their financial statements regarding the implementation of the two standards, the changes in accounting policies resulting from its implementation and the relevant information to assess the possible impact on the issuers' financial statements in the initial period of application.

Further information in these above- mentioned topics (ESMA updates):

- ESMA Enforcement and Regulatory Activities of Accounting Enforcers in 2016- published as at 10 April 2017

Projects of the IASB

The following projects are accepted by IASB or still under discussion in the period between April and June 2017:

Insurance Contracts

The Board received an update on the strategy for supporting implementation of IFRS 17 *Insurance Contracts*. The Board plans to issue IFRS 17 in the second half of May 2017. Further information on how it will support implementation will be provided following the issuance of the Standard.

Fees included in the '10 percent' test for the purpose of derecognition

The Board considered the proposed amendment which will say when carrying out the "10 per cent" test for assessing whether to derecognise a financial liability, an entity includes only fees and paid or received between the entity and the lender, including fees paid or received by either the entity or the lender on the other`s behalf.

The Board tentatively decided:

a. to propose the amendment to IFRS 9 as part of the next Annual Improvements Cycle; and
b. to propose that an entity apply the amendment only to modifications or exchanges of financial liabilities that occur on or after the beginning of the annual reporting period in which the entity first applies the amendment.

Amendments to IAS 19 and IFRIC 14

The Board agreed on the transition requirements for the amendments to IAS 19 and IFRIC 14. The Board tentatively decided that:

a. an entity should apply the amendments to IFRIC 14 retrospectively (with an exemption for adjustments to the carrying amount of assets outside the scope of IAS 19);
b. an entity should apply the amendments to IAS 19 prospectively to plan events occurring on or after the effective date; and
c. the amendments should provide no transition relief for first-time adopters.

Amendments to IFRS 3 and IFRS 11

The amendments to IFRS 3 Business Combinations would clarify that when an entity obtains control of a business that is a joint operation, the entity applies the requirements for a business combination achieved in stages, including remeasuresing its previously held interests in the joint operation at fair value.

The amendments to IFRS 11 Joint Arrangements would clarify that when an entity obtains joint control of a bus

iness that is a joint operation, the entity does not remeasure previously held interests in that business.

The Board tentatively decided to finalise the amendments to IFRS 3 and IFRS 11 with no substantive changes. The Board tentatively decided to clarify in the amendments to IFRS 3 that when an entity obtains control of a business that is a joint operation, it remeasures its overall previously held interest in that business.

Definition of a Business

The Board discussed the comments received on the proposal to consider a set of activities and assets acquired not to be a business if a concentration exists. A concentration would exist if the fair value of the gross assets acquired is concentrated in a single asset or group of similar assets. This proposal is sometimes called the 'screening test'.

The Board tentatively decided to:

- make the screening test optional on a transaction-by-transaction basis. This would allow entities the flexibility to assess whether a substantive process has been acquired if this assessment would be more efficient or result in a conclusion that better reflects the economics of a particular transaction.

- confirm that the screening test is determinative. This means that if an entity chooses to apply the screening test and concludes that the transaction is an asset purchase (concentration exists), it should not carry out further assessment that might change that conclusion. If no concentration exists, the entity then should assess whether it has acquired a substantive process.

- exclude deferred tax balances and goodwill resulting from deferred tax adjustments from the screening test.

- clarify that guidance on 'a single asset' for the screening test also applies when one of the acquired assets is a right-of-use asset, as described in IFRS 16 *Leases*.

- to assess whether assets are 'similar' for the screening test, the nature of each single asset, the risk associated with it and creating outputs from the assets should be considered.

- clarify the interaction with existing guidance and the Board believes that the existing guidance is also applicable for the screening test. They recommended that the Board clarify that the proposed guidance on what assets may be considered a single asset or a group of similar assets does not modify the existing guidance in IAS 16, IAS 38 and IFRS 7.

During the June 2017 meeting, the Board further continued to discuss on the definition of Business.

The following was tentatively decided:

- that a business an acquired set of activities and assets must include an input and a substantive process that together are required to contribute significantly to the ability to create outputs.;
- to amend the definition of “output” by removing the reference to the ability to reduce costs and clarifying that “other revenues” means other income arising from contracts that are within the entity`s ordinary activities but are outside the scope of IFRS 15 Revenue from contracts with customers;
- if an acquired set of assets generated revenues before the acquisition but not after the acquisition, that set of assets is regarded as creating outputs;
- to add illustrative examples to help with determining what is considered a business;
- that an entity would not be required to the apply the amendments to the transactions which were occurring before the effective date of the amendments;

- to remove the statement that a set of assets and activities in which goodwill is present is supposed to be a business;
- the presence of more than an insignificant amount of goodwill may be an indicator that an acquired process is substantive.

The Board decided to discuss during the next meeting a comparison between the FASB Accounting Standards Update 2017-01 Clarifying the definition of Business and the draft amendments to IFRS 3.

Amendments to IAS 28- Long-term interests in associates and joint ventures

The Board considered the comments on the proposed amendments to IAS 28 Investments in Associates and Joint Ventures which would clarify that IFRS 9 Financial Instruments applies to long-term interests in associates or joint ventures. Long-term interests are interests to which the equity method is not applied, but that, in substance, form part of the net investment in an associate or joint venture. The proposed amendments were included in the Exposure Draft Annual Improvements to IFRS Standards 2015–2017 Cycle.

The Board also tentatively decided to finalize the proposed amendments to IAS 28 and clarify that an entity applies requirements in IFRS 9 to long-term interests before applying the loss allocation and impairment requirements in IAS 28 and in applying IFRS 9, the entity does not take account of any adjustments to the carrying amount of long-term interests that result from application of IAS 28. The Board also finalized the amendment to develop material that includes an example illustrating how the requirements in IAS 28 and IFRS 9 interact with respect to long- term interests.

Leases- Implementation update

The Board received an update on implementation support for IFRS 16 Leases. The update includes information about support activities and their reach; queries received from stakeholders, and planned future activities. The Board still continue to monitor the implementation of IFRS 16.

Goodwill and impairment

The Board discussed possible simplifications to the impairment test in IAS 36 Impairment of Assets. The Board will continuously simplify and improvement of the application of the impairment test in IAS 36 without loss of information to users of financial statements and improve the quality of information provided to users without imposing costs that might outweigh any benefits.

IAS 8 Accounting policies, changes in accounting estimates and errors- Accounting policy changes resulting from agenda decisions

The main point during the June 2017 meeting that the Board discussed how to address the challenges arising from the requirements in IAS 8 for voluntary changes in accounting policies. The discussion was covering whether the standard should provide further exceptions in IAS 8 for retrospective application of voluntary changes in accounting policies, either for all voluntary changes in accounting policies or only for those changes that results from agenda decisions.

The Board also tentatively decided to amend IAS 8 to lower the impracticability threshold regarding the retrospective application of voluntary changes in accounting policies. The amended threshold would take into consideration the benefits and the costs of applying the change retrospectively.

The final decision has been postponed for the next meeting.

For questions related to this and other IFRS topics, please contact the **IFRS Center of Excellence**.

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