IFRS news

In this issue:

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Alternative Performance Measures – Under scrutiny by regulators

Companies using Alternative Performance Measures (APMs) should understand the new guidance issued by the European Securities and Markets Authority (ESMA) and the International Organisation of Securities Commissions (IOSCO) as well as applicable amendments to IAS 1. Annette Malsch from Accounting Consulting Services summarises the dos and don'ts and adds some practical examples.

European companies preparing annual or interim reports on or after 30 June 2016 must apply the latest IAS 1 amendments. These clarify the guidance around additional subtotals in the financial statements.

However, most companies (see our survey) disclose not only GAAP measures but also adjusted numbers – APMs. Many investors and other users of financial reports find APMs useful but would like more transparency over the information disclosed. Companies should consider the recently issued "ESMA Guidelines on Alternative Performance Measures" and the comparable IOSCO "Statement on Non-GAAP Financial Measures".

> An APM is "a financial measure of historical or future performances, financial position, or cash flows, other than a financial measure defined or specified in the applicable financial reporting framework."

IAS 1 amendments

The clarifications developed as part of the *Disclosure Initiative* are designed to further encourage entities to apply professional judgement and to improve the effectiveness of presentation and disclosure in financial reports. Additional line items, headings and subtotals shall be presented when such a presentation is relevant to an understanding of the entity's financial performance. This amendment clarifies the judgement required and recognises that it is not practical for the IASB to develop one comprehensive list of line items that are relevant to a user's understanding of financial statements of various industries.

Additional line items or subtotals that are labelled appropriately and do not contradict measures defined in IFRS might not be considered APMs. However, where a performance measure other than a sub-total is disclosed, and that measure is selective in the income and expenses included on a basis not commonly recognised in IFRS, it is likely to be considered an APM.

IOSCO guidance

The IOSCO guidance applies to any APM that an issuer discloses outside of the financial statements, such as press releases, Management's Discussion and Analysis, Operating and Financial Review, or any disclosure documents filed with securities regulators and stock exchanges.

Financial information provided within financial statements is explicitly excluded from the scope of the IOSCO statement. However, this does not mean that anything goes with APMs in the financial statements because the requirements of IAS 1 apply. A company that presents an APM in the MD&A and on the face of the primary financial statements must comply with both the IOSCO guidelines and IAS 1.

Regulators are expected to focus on APMs in their reviews of corporate reporting after 1 July 2016.

Guidance

IOSCO defines an APM (or non-GAAP financial measure) as a numerical measure of an issuer's current, historical or future financial performance, financial position or cash flow that is not a GAAP measure. The requirements for issuers are as follows:

- Define APMs in a clear way and give meaningful labels such that they are distinguished from GAAP measures.
- Explain the reason for presenting the APM, including an explanation of its usefulness to investors and for what additional purposes management might use the measure.
- Do not use APMs to avoid presenting adverse information to the market.
- Do not display APMs more prominently than GAAP measures, or confuse or obscure the presentation of GAAP measures.
- Reconcile APMs to the most directly reconcilable GAAP measure in the financial statements and explain the adjustments.
- Present APMs with comparatives.
- Present APMs consistently over time and explain any changes made and the reason for making them.
- Items such as restructuring costs or impairment losses should not be described as non-recurring, infrequent or unusual without sufficient explanation, given that they are in most cases reasonably likely to recur in the foreseeable future or have affected the entity in the recent past.
- Information that issuers provide regarding APMs should be readily and easily accessible to users of financial information.

The IOSCO guidance is very similar to the one issued by ESMA.

Examples

The following examples illustrate the application of the IOSCO and ESMA guidelines to the use of APMs in financial statements.

Labelling/comparatives

Case 1: A company presents in its income statement "*operating profit*" and "*normalised operating profit*", whereby the latter contains amortisation of intangibles, goodwill impairment, share-based payment expenses and inventory write-downs.

The presentation of "*normalised operating profit*" is unlikely to be acceptable. "*Operating profit*" should represent all activities that are normally be regarded as "operating". The exclusion of the aforementioned items could be misleading and may impair the comparability of the income statement as items of an operating nature were excluded from the results of operating activities.

Preparers should think about how this might affect past practice.

Case 2: A company presents its income statement as of 30 June 2016 (significantly shortened version) as follows:

	Before re-structuring expenses (k€)	Re-structuring expenses(k€)	**Total (k€)**
Revenue	2,000	-	2,000
Cost of sales	400	200	600
Gross profit	**1,600**	**200**	**1,400**
Other income	100	-	100
Operating profit	**1,700**	**200**	**1,500**

A multi-column format of the income statement is acceptable because it facilitates a better understanding of what management considers operating results to be, excluding exceptional items such as restructuring charges.

However, a corresponding presentation would be required for the comparative period presented. If each period contains similar restructuring expenses, management should consider whether those really are exceptional.

Explain the use

The company presenting the multi-column format of the income statement in case 2 above might use the following explanation in the notes:

"The company has adopted a columnar presentation for its consolidated income statement in order to separately identify results of restructuring activities, as the directors consider that this gives a better view of the underlying results of the ongoing business. The restructuring is a one-off event not expected to recur. The Company has adopted a policy of disclosing separately on the face of its consolidated income statement, within the column entitled "restructuring expenses", the effect of any components of financial performance regarding restructuring activities for which the directors consider separate disclosure would assist in a better understanding of the financial performance achieved."

Next steps

Non-GAAP measures, especially performance measures, continue to be a hot topic for regulators, investors and companies. Companies should consider the ESMA and IOSCO guidelines when presenting APMs.

What is a business?

Is the current definition of a business difficult to apply? The IASB has proposed some clarifications. Tatiana Geykhman from Accounting Consulting Services explains the proposed changes.

The IASB has proposed clarifications to the definition of a business in IFRS 3 *Business Combinations.*

The definition of a business affects the accounting not only for acquisitions but also for disposals, consolidation and other areas.

Why change the existing requirements?

The proposed amendments resulted from the Post-Implementation Review of IFRS 3. Respondents indicated it was difficult to apply the current definition as follows:

- Complex to assess the relevance of the processes acquired and the significance of processes missing;
- Little or no guidance on when an acquired set was not a business;
- "Capable of being conducted as a business" was not considered helpful;
- The guidance was not clear when the acquired set did not generate revenue;
- IFRSs do not define "market participant" and the same set might or might not be considered as a business by different market participants.

What is going to change?

The amendments are expected to add clarity to whether a transaction is classified as a business combination or as a purchase of assets.

Minimum requirements

An acquired set of activities and assets should include an input and a substantive process that together have the ability to contribute to the creation of outputs and be considered a business.

Was a substantive process acquired?

The proposed amendments provide a framework to evaluate whether a substantive process was acquired. There are two different sets of criteria to consider depending on whether the acquired activities and assets have outputs.

An acquired set of activities and assets that does not yet have outputs is only a business if it contains an organised workforce (input) capable of performing an acquired substantive process. The acquired substantive process should be critical to the ability to convert another acquired input into outputs. The impact of minor side processes is not critical.

When outputs are present, the acquired set is a business if there is either:

- A unique or scarce process or the process cannot be easily replaced, or;
- An organised workforce capable of performing an acquired substantive process.

An acquired contract is not a substantive process itself but it could be the basis for access to an organised workforce.

Ability to replace missing elements is no longer needed

The requirement that an acquired set is a business if market participants can replace missing elements and continue to produce outputs is removed.

Definition of outputs is narrowed

The proposed definition of output is *"the result of inputs and processes applied to those inputs that provide goods or services to customers, investment income (such as dividends or interest) or other revenue"*. The reference to the ability to reduce costs is removed. The proposed definition of outputs focuses on goods and services provided to customers.

Concentration of fair value guidance

An acquired set is not considered a business if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of assets.

Illustrative examples

Examples are added to illustrate the interpretation of the requirements.

Why is this important?

The proposed amendments will likely result in more acquisitions being classified as acquisitions of assets. This is likely to affect all industries, most significantly real estate, pharmaceutical, and oil and gas.

Convergence

The business combination requirements are substantially converged between IFRS and US GAAP. Comments received by the FASB on a similar post-implementation review reflected similar difficulties in applying the existing definition of a business. The FASB issued a proposal to revise the definition of a business in November 2015. The amendments proposed by both Boards are based on substantially converged tentative conclusions, although there are minor differences in how the amendments are phrased.

What's next?

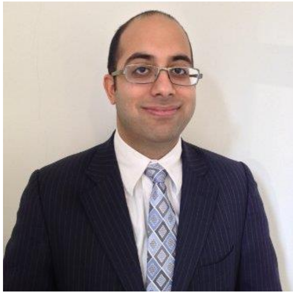
The comment period on the proposed amendments lasts until 31 October 2016. See here for the full text of the Exposure Draft.

Have you seen the latest PwC IFRS blogs

Saad Siddique and Anna Schweizer discuss the accounting for income tax

Jessica Taurae discusses the impact of the EU referendum result on financial reports

Ten reminders for interim reporting*



The interim reporting season has arrived for many. Saad Siddique from Accounting Consulting Services summarises the key items to consider for 2016 interim financial statements.

Impact of the UK referendum on EU membership	The UK voted to leave the EU ("Brexit") on 23 June 2016. This decision will likely affect both UK businesses and those investing or working in the UK. There are a number of financial reporting issues to consider: • IFRS 7 Risk disclosures relating to financial instruments • IAS 1 disclosures around uncertainty and sensitivity • IAS 36 Impairment assessments – is Brexit an impairment trigger? • IAS 19 Plan assets are likely to have reduced in value See the PwC In Brief on Brexit for further details.
Impairment triggers and reviews	The global economy continues to face uncertainties or volatility arising from a range of events such as falling oil or commodity prices and reduced demand from China, to name but a few. Some of these issues may have been present at the interim balance sheet date and therefore should be considered when making forward-looking statements or forecasts. Impairment reviews and going concern assessments rely heavily on future cash flows. Companies should assess whether those cash flows remain achievable and reasonable in light of the uncertainties in the market, as this is a key area of regulator and auditor focus.
Business combinations in the period	Interim reporting is usually condensed, however, one of the key requirements of IAS 34 is to ensure significant events and transactions are disclosed so that users are aware of major changes. For any business combination in the period, the full disclosure requirements of IFRS 3 should be included in the interim reporting. Additionally, if any acquisitions have occurred after the reporting date but before the issue of the interim financial statements, there are still a number of disclosures required, which are often omitted.
Newly effective amendments and standards	Interim reporting is often the first time that recently effective standards and amendments affect the financial statements. Therefore, it is important that the interim reporting includes the impact of adopting these changes. For periods starting on or after 1 January 2016, entities will need to apply all of the relevant 2012-2014 Annual Improvements. Read on for more details on the IAS 1 amendments resulting from the Disclosure Initiative. Find full details of all changes in New IFRS for 2016.

*and entities with 2016 year-ends

Seasonality and cyclicality	Some businesses have cash flows and revenues that are seasonal or cyclical, often in industries that are weather dependent or areas such as retail that have peak periods. IAS 34 requires that commentary on the seasonality or cyclicality of operations is included in the interim financial reporting. This requirement is not always a priority of management but helps users to gain a better understanding of the nature of the business.
Financial instrument disclosures	Another common omission from interim financial reporting is the various financial instrument disclosures from IFRS 7 and IFRS 13 required by IAS 34 para 16A(j). These include details of level three fair value measurements such as effect on the P&L in the period, the valuation methodology and inputs. Other disclosures include transfers between fair value levels as well as comparisons between fair and carrying values.
Presentation and classification in cash flow statements	Cash flow statements continue to be an area of concern for regulators due to recurring errors emerging. The classification of an item as an operating, financing or investing activity can require judgement. Examples of frequent errors include: • Purchases of own shares classified as an investing activity instead of a financing activity; • Transaction costs incurred in a business combination classified as investing rather than operating; • Loans to related parties classified as financing instead of investing; and • Non-cash items being included in the cash flow statement incorrectly also remains an issue.
Interim tax calculations	Tax calculations for interim reporting are based on the expected tax rates for the full year after forecasting full year profit or loss, claims, credits and reliefs. That calculated rate then applies to the interim profit or loss. However, when determining the expected year-end tax rate, any tax laws or rates that have not been substantively enacted by the interim balance sheet date (even if they will be during the rest of the period) should not be taken into consideration.
Disclosure initiative	The amendment to IAS 1 for the IASB Disclosure Initiative is now effective. The key changes include: • Materiality – information should not be over aggregated or disaggregated such that it becomes obscured; • Subtotals – the guidance now explicitly permits subtotals such as operating profit or PBIT (profit before interest and taxes). Other subtotals can be included as long as they are made up of IFRS items and labelled appropriately without undue prominence. • Notes – IAS 1 gives clearer guidance on notes to the financial statements. There is no prescribed order for these to be presented. Management should ensure the presentation is understandable and comparable.
Sale and lease back transactions	As entities look to raise finance in different ways, there is a rise in sale and leaseback arrangements. It is important to consider the substance of such transactions. There may be terms that indicate that these are in effect collateralised borrowings rather than leases. If the majority of the risks and rewards of the asset have not transferred on the "sale" this may be a loan.

Amendments to IFRS 2

Are you looking to understand the new IFRS 2 amendments? Here is a quick summary of the main changes. Ernesto Mendez from Accounting Consulting Services explains them in short.

The IASB issued amendments to IFRS 2 on 20 June 2016. The amendments provide additional guidance on the accounting for cash-settled share-based payments and add an exception that provides equity-settled accounting where the settlement of share-based payment awards is split between equity instruments issued to the employee and a cash payment to the tax authorities.

Measurement of cash-settled share-based payments

Even though IFRS 2 refers to "fair value", share-based payments are scoped out of IFRS 13 *Fair value measurement*. IFRS 2 provides guidance on the measurement of equity-settled awards that makes clear why "grant date fair value" is not in accordance with IFRS 13. However, before these amendments there was divergent practice on the measurement of liabilities for cash-settled awards.

The amendment clarifies that the fair value of a cash-settled award is determined on a basis consistent with that used for equity-settled awards. That is, market-based performance conditions and non-vesting conditions are reflected in the "fair value", but non-market performance conditions and service conditions are reflected in the estimate of the number of awards expected to vest.

Modification of cash-settled awards

IFRS 2 did not include guidance on how to account for a modification from cash-settled to equity-settled.

The accounting for the modification of cash-settled awards and equity-settled awards is very different. This means that where a modification changes both the classification and value of an award, the outcome would be different depending on the order in which you apply the changes.

The amendment requires the liability to be trued-up for any change in value through the income statement before reclassifying the accrued liability to equity. The post modification expense is then based on the modification date fair value, in the same way as the expense for an award that has always been equity-settled is based on the grant date fair value.

Awards with net settlement features

In many territories an employer is required to withhold tax when settling a share-based payment award and pay the tax on behalf of the employee. IFRS 2 would bifurcate such an award into a cash-settled component for the tax payment and an equity-settled component for the net shares issued to the employee. The amendment adds an exception that requires the award to be treated as equity-settled in its entirety. The cash payment to the tax authority is treated as if it was part of an equity settlement. The exception would not apply to any equity instruments that the entity withholds in excess of the tax obligation.

The cash payment to the tax authority might be much greater than the expense that has been recognised for the share-based payment. The amendment says the entity should disclose an estimate of the amount it expects to pay to the tax authority in respect of the withholding tax obligation where it is necessary to inform users about the future cash flows.

There is no income statement impact on transition as a result of any reclassification from liability to equity in respect of "net settled awards"; the recognised liability is reclassified to equity without any adjustment.

Next steps

The amendments are effective from 1 January 2018 with early adoption permitted. The transition provisions in effect specify that the amendments apply to awards that are not settled at the date of first application or to modifications that happen after the date of first application, without restatement of prior periods.

The amendments can be applied retrospectively, provided this is possible without hindsight and the retrospective treatment is applied to all of the amendments.

Cannon Street Press

Insurance contracts

The IASB discussed issues arising from the drafting of the forthcoming standard.

Level of aggregation for the measurement of the contractual service margin: The objective shall be that the contractual service margin at the end of a reporting period represents the profit for the future services to be provided for a group of contracts.

Changes in the carrying amount of the contractual service margin (CSM) for insurance contracts without direct participation features: The Board tentatively decided to revise the guidance on changes in the fulfilment cash flows that relate to future service (adjusting the CSM) and current and past service (not adjusting the CSM).

Presentation and disclosure: The IASB tentatively decided upon a number of presentation requirements related to aggregation of data and disclosure requirements.

Reinsurance contracts and the scope of the variable fee approach: The Board tentatively decided that an entity should not apply the variable fee approach to reinsurance contracts issued or reinsurance contracts held.

Previously held interests

The IASB has published proposed amendments to IFRS 11. The amendments are intended to clarify the accounting for a transaction in which an entity obtains joint control or control of a business that is a joint operation.

- Obtaining joint control is not viewed as a business combination achieved in stages. It follows that previously held interest in the joint operation is not remeasured.
- A transaction in which an entity obtains control of a business where it previously had joint control is a business combination achieved in stages. The previously held interest is remeasured at fair value.

These amendments are expected to change existing practice around moving from joint control to control. Comments are due by 31 October 2016.

IAS 12 Income Taxes: Presentation of income tax consequences arising from dividends

The IASB discussed a recommendation from the IC to clarify the circumstances to which the presentation requirements relating to tax consequences arising from dividends apply.

The Board agreed that an entity should apply the presentation requirements to all income tax consequences of dividends. The Board also tentatively decided to include the proposed amendment in the next cycle of annual improvements (2015–2017).

Conceptual Framework:

Definitions of income and expense

The Board tentatively decided to confirm the definitions of income and expenses proposed in the Exposure Draft.

Information about financial performance

The Board tentatively decided that:

- The statement of profit or loss (P&L) shall be described as the primary source of information about an entity's financial performance. Income and expenses should be included in the P&L for the period unless the relevance or faithful presentation provided in the P&L for the period would be enhanced by including a change in current value of an asset or a liability in other comprehensive income (OCI). A decision about including income and expenses in OCI can be made only by the Board in setting standards.
- Income and expenses included in OCI should be recycled when doing so would enhance the relevance or faithful representation of the information in the P&L for that period. However, they may not be recycled if,

for example, there is no clear basis for identifying the period in which recycling should occur or the amount that should be recycled.

- The IASB also tentatively decided to remove the statement in the ED that an inability to identify a clear basis for recycling may indicate that such income or expenses should not be included in OCI.

The PwC leases lab

This month Professor Lee Singh explores the world of systems and processes with the help of his assistant Alexander Woodford.

Hypothesis

For lessees, IFRS 16 is just an accounting change; it will not require major changes to systems or processes.

Testing and analysis

Today, many entities might not require robust processes or systems for the accounting for leases, other than those relating to initial classification and disclosures.

The new standard will change this for a number of reasons:

- There is an increased focus on the dividing line between leases and service contracts requiring consistent judgement when considering the definition of a lease.
- The volume of leases and number of data points needed to implement the new standard might require contract management systems.
- Remeasurement of leases will be required when certain changes in estimates occur, or where lease payments change due to an index or rate.

Many lessees currently use spreadsheets to manage their leases. Existing lease accounting systems are based on IAS 17 and will need to be modified to accommodate the new standard. Software developers are working on designing systems to fully meet the needs of this new standard, but a number of these are not yet up and running. Many systems also focus only on real estate leases or equipment leases but not both.

In addition, the integration of any new systems with existing accounting systems will require consideration.

Processes and controls might need to be designed from scratch to ensure proper management and accounting of all lease agreements. These need to address initial and subsequent measurement, as well as to monitor events both in and outside of the lessee's control that may trigger accounting adjustments.

Conclusion

The new standard will require greater oversight over lease accounting and contract management due to the sensitivity between leases and service contracts, and its remeasurement principles. Lessees need to act now to improve systems and processes in order to be ready as there could be lots to do.

Practical application

Lessees might also want to use the new standard as an opportunity to improve their systems and processes. This is especially true for those currently using spreadsheets, as under the new standard these might contain incomplete data or not be cost-efficient and could lead to errors feeding into financial reporting. Lessees will also need to identify data and system gaps, and the required changes to IT environments on a timely basis.

See more of the Professor's analysis of the commercial and practical impact of IFRS 16 Leases in IFRS 16: The leases standard is changing. Are you ready?

IFRIC Rejections in short - IAS 21

Maria Opazo of Accounting Consulting Services examines the practical implications of IC rejections related to IAS 21.

Looking for an answer? Maybe it was already addressed by the experts.

The Interpretations Committee (IC) regularly considers anywhere up to 20 issues at its periodic meetings. A very small percentage of the issues discussed result in an interpretation. Many issues are rejected; some go on to become an improvement or a narrow scope amendment. The issues that are not taken on to the agenda end up as "IFRIC rejections", known in the accounting trade as "not an IFRIC" or NIFRICs. The NIFRICs are codified (since 2002) and included in the "green book" of standards published by the IASB although they technically have no standing in the authoritative literature. This series covers what you need to know about issues that have been "rejected" by the IC. We go standard by standard and continue with IAS 21 as per below.

IAS 21 is applied on the accounting for foreign currency transactions, on the conversion of profit and loss and financial position of foreign businesses and the conversion of the entity's profit and loss and financial position to presentation currency.

IAS 21 related issues tend to appear occasionally on the IC's agenda. Over the years a number of issues have been rejected, some of which we explain in more detail in the following article.

Exchange rates (April 2003)

The IC discussed which exchange rate should be used when there is more than one available. The IC agreed that the standard was clear: when several exchange rates are available, the rate used is that at which the future cash flows represented by the transaction or balance could have been settled if those cash flows had occurred at the measurement date.

Determination of functional currency (March 2010)

A series of primary and secondary indicators should be considered when identifying the functional currency of an entity. However, this principle led to difficulties when considering the relative importance given to each indicator for the entities concerned, especially for investment entities.

The IC emphasised that the following factors mentioned in the standard should be considered on a holistic basis:

- The main economic environment in which it operates.
- The currency that influences sale prices.
- The currency that influences labour and other pertinent costs.
- Other factors, such as the currency in which the company is financed and the currency in which receipts from operating activities are usually retained

The IC concluded that since this assessment required the application of a high degree of judgment, issuing an interpretation would not solve this issue.

Repayments of investments and foreign currency translation reserve (September 2010)

The IC discussed the guidance on the reclassification of the foreign currency translation reserve (FCTR) when a repayment of a foreign currency occurs. Reduction could be due to a reduction in an investor's percentage equity ownership in the investee (relative reduction) or an absolute reduction in the investment (e.g. repayment of quasi-equity loans or dividend distribution, which might no impact in the proportionate equity ownership percentage)

The IC recognised that different interpretations could lead to diversity in practice. However, it decided not to add the issue to its agenda because it considered that no timely consensus would be reached. The IC recommended the IASB to consider this issue within a broad review of IAS 21 as a potential item for its post-2011 agenda

Our point of view is that both relative and absolute concept of reduction in ownership interest can lead to partial disposal. A policy choice exists (relative, absolute or both concepts) and should be applied consistently.

Foreign exchange restrictions and hyperinflation (November 2014)

Due to the economic environment in Venezuela (strict foreign exchange controls in combination with several official exchange rates that may not fully reflect the local rate of hyperinflation), the IC received an enquiry about the following issues concerning the companies that hold investments or subsidiaries in that country:

- Which rate should be used to translate an entity's net investment in the foreign operation when there are several exchange rates available?
- Which rate should be used under a longer-term lack of exchangeability?

In relation to the first issue, the IC observed that predominant practice is to apply the principle in IAS 21: the rate to be used is that at which the future cash flows or balance could have been settled if those cash flows had occurred at the measurement date. Regarding the second issue, the IC observed that a longer-term lack of exchangeability is not addressed by the guidance in IAS 21.However, as addressing this subject requires a broader project the IC rejected the issue.

They identified, however, the following disclosure requirements contained in IAS 1 and IFRS 12 that are applicable when the exchange rates impact is significant for understanding the entity's financial performance:

- Disclosure of significant accounting policies and judgements,
- Disclosure of sources of estimation uncertainty that have a significant risk of resulting in a material adjustment within the next financial year, and
- Disclosure about the nature and extent of significant restrictions on an entity's ability to access or use assets and to settle liabilities.

Summary of IAS 21 rejections

Topic	Summary conclusion
The effects of changes in foreign exchange rates (April 2003)	If more than one exchange rate is available, IAS 21 requires that entities use the rate at which the future cash flows represented by the transaction or balance could have been settled, if those cash flows had occurred at the measurement date.
Translation of assets and liabilities at the transaction date (October 2004)	The IC discussed whether a specific exception should be granted to first time adopters to permit entities to translate all assets and liabilities at the transition date exchange rate rather than applying the functional currency approach in IAS 21. The IC agreed that the position under IFRS 1 and IAS 21 was clear and that there was no scope for an interpretation on this topic that would provide any relief.
Determination of functional currency of an investments holding company (March 2010)	The IC received a request for guidance on whether the underlying economic environment of subsidiaries should be considered in determining, in its separate financial statements, the functional currency of an investment holding company. The indicators mentioned in the standard should be applied on a holistic basis. This assessment requires a high degree of judgement.
Repayments of investments and foreign currency translation reserve (September 2010)	The IC c considered that different interpretations could lead to diversity in practice in the application of IAS 21 on the reclassification of the foreign currency translation reserve when repayment of investment in a foreign operation occurs. However, the IC did not think that it would be able to reach a consensus on the issue on a timely basis and thus rejected this issue.
Foreign exchange restrictions and hyperinflation (November 2014)	The IC observed that a longer-term lack of exchangeability is not addressed by the guidance in IAS 21, and so it is not entirely clear how IAS 21 applies in such situations. However, as addressing this issue might require a broader project the IC decided not to take this issue onto its agenda.

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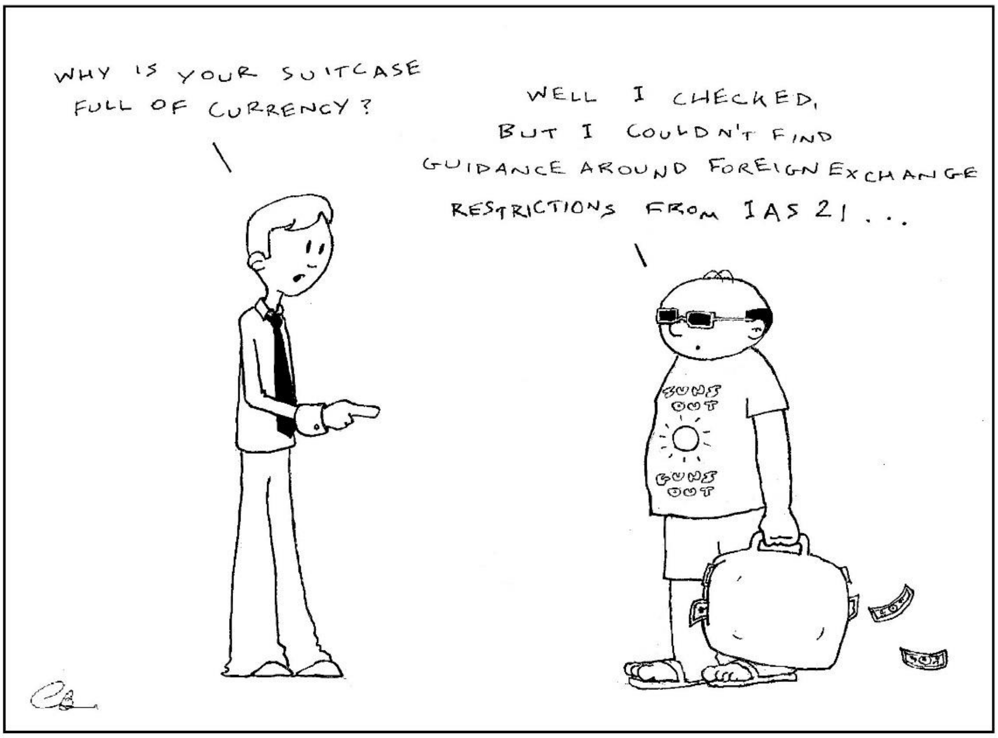
The bit at the back…



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Appendix

Impact of UK referendum result on financial reporting

Issue

Now that the UK has voted to leave the EU, there will be a protracted period of negotiation and many months of uncertainty as the detailed political and legal issues are worked out and the real impact of leaving unfolds. It will be at least two years, probably longer, before the UK actually leaves the EU.

This uncertainty will inevitably affect all UK businesses and those that do business or invest in the UK. There has been an immediate impact on the financial markets, both in the UK and overseas, with the pound significantly weakening against other currencies and share prices fluctuating as the markets react to the decision.

For entities that are reporting either full year or interim results on or after 30 June, there is a need to consider a number of accounting and reporting issues. The In brief below provides an overview of some potential issues and the relevant guidance under IFRS.

Some further reading and watching on "Brexit"

The PwC Corporate Reporting Blog: Brexit and the EU audit reform

The recording from our webcast

SME growth strategies in a post Brexit world

The impact on financial services

The economic implications of Brexit

Potential consequences for the airline industry

Potential consequences for the energy industry

Impact

Risk and uncertainty

Whilst it is impossible to predict the impact on the economy in the coming years, there could be significant impairment, going concern and/or capital issues to consider. An immediate impact of volatile currency markets is that import costs into the UK could increase, which could be relevant for impairment and going concern judgements. Entities in the UK or those who trade with the UK will likely have to reassess their trading outlook once there is more clarity on the impact of the decision, as the impact could be substantial.

Risk disclosures (operational and financial) will undoubtedly need to take account of the volatility in financial markets. IFRS 7 requires a company to disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the reporting date. [IFRS 7 para 31]. This includes both quantitative and qualitative disclosure of market, credit and liquidity risks, with the market risk disclosure being broken down into interest rate risk, currency risk and other price risk.

Sensitivity calculations and related disclosures will also be affected. IAS 1 requires disclosure about "sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation, including the reasons for the sensitivity", along with, "Explanation of changes made to past assumptions concerning those assets and liabilities, if the uncertainty remains unresolved". [IAS 1 para 129]. Both of these requirements are clear that any assumptions and related sensitivity calculations should be clearly disclosed.

IAS 34 has additional disclosure requirements for interim financial reporting which should be considered. An entity is required to disclose "changes in the business or economic circumstances that affect the fair value of the entity's financial assets and financial liabilities." [IAS 34 15B(h)].

Impairment testing

One of IAS 36's indicators of impairment is "significant changes with an adverse effect ... in the technological, market, economic or legal environment". [IAS 36 para 12(b)]. While it might be too early to conclude whether the impact is "adverse", in the short term many entities will need to consider whether the vote does increase the risk of impairment.

For the purposes of impairment testing for non-financial assets, there are a number of areas to consider. Firstly, for value in use calculations, the present value of future cash flows denominated in a foreign currency must be translated to the entity's functional currency at the spot rate of exchange at the date of the calculation. Over time, any significant swings in the foreign exchange rate could lead to impairment indicators in future accounting periods which would lead to additional forecasts being prepared to support current asset values.

Secondly, companies may need to reconsider cash flows that are included in the forecast. Although there will be a period of time before the impact of the leave vote is known, the sales and cost projections may well need to be updated to reflect any initial impact on demand and supply of the products or services underlying the cash flows. Further, companies should also consider any impact on determining the discount rate used for impairment testing.

IAS 39 similarly notes that "objective evidence of impairment for an investment in an equity instrument includes information about significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the issuer operates". [IAS 39 para 61]. Companies should therefore also consider impairment of financial assets and whether there has been a significant decline in the fair value of an investment in an equity instrument below cost.