IFRS news

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IASB exposes revised Conceptual Framework

The IASB issued its exposure draft on the conceptual framework. Maria Constantinou looks at this key proposal and potential impact on standard setting.

The IASB has issued its proposal to revise the Conceptual Framework (the "ED" or "the proposed Framework"). The primary purpose of the Framework is to assist the IASB by identifying concepts it will use when developing and revising standards. It will not be "GAAP".

What will change?

Nothing will change in the short term. A revised Framework will not automatically lead to changes in any particular standards. However, the Framework is sometimes used to interpret existing standards and develop accounting positions when no current standard is on point. With seemingly little immediate impact, will the majority of users and preparers get engaged or is it only "conceptual accounting thinkers" who are interested?

The Framework will not override any existing or new standard or interpretation, but the IASB should be making standard-setting decisions based on the new Framework going forward. The IASB may issue standards that are inconsistent with the Framework, but those instances should be rare. If it does occur, the proposal would be subject to the IASB's standard due process, and the departure from the Framework would be documented in that standard's Basis for Conclusions.

Why has the IASB focused on the Framework now? The project was designed to fill gaps, update, and clarify. Many believed that the existing guidance on recognition of assets and liabilities needed updating, and there is minimal guidance in the current Framework on measurement.

Chapters in the Framework

This table summarises some of the key proposed changes to the Framework.

Chapter	Proposed guidance
Objective	• Adds stewardship to the objective of general purpose financial reporting
Qualitative characteristics	• Explicit reference to substance over form • Reinstates prudence as a component of neutrality
Reporting entity	• Defines reporting entity, which may be one legal entity or more or a portion of a legal entity • Provides guidance for determining boundaries of reporting entities
Elements	• Refines the definitions of assets and liabilities • Defines income as an increase in assets or decrease in liabilities • Defines expense as a decrease in assets or increase in liabilities
Recognition	• Removes probability threshold • Adds recognition criteria
Derecognition	• Adds guidance on full derecognition, partial derecognition, and continued recognition
Measurement	• Mixed measurement model of both historical cost and current value measures
Presentation and disclosure	• Profit or loss is the primary performance indicator • Discussion of other comprehensive income (OCI); notes that its use should be limited

Objective

The objective of general purpose financial reporting is to provide financial information about the entity that is useful to investors, lenders, and other creditors in making decisions about providing resources to the entity. The proposed Framework gives greater prominence to the principle of stewardship within the objective.

Qualitative characteristics

Financial information is useful if it is relevant and representationally faithful. The proposed Framework includes an explicit reference to “substance over form” within the description of representationally faithful. Also, prudence (removed from the Framework in 2010) makes a come-back as a principle to help achieve neutrality.

The reporting entity

The proposed Framework defines a reporting entity as “an entity that chooses, or is required, to present general purpose financial statements”. The ED provides guidance on establishing the boundary of a reporting entity, which could include more than one legal entity or a portion of a legal entity.

This suggests that combined and/or carve-out financial statements are acceptable under the Framework. The ED, however, does not address when such financial statements would be appropriate. This topic continues to attract debate, but the IASB has not taken a stand in the ED and suggests that this is a standards level question. Is this the first sign that a standards-level project is on the horizon?

Elements of financial statements

The IASB proposes to refine the definitions of assets and liabilities, while retaining the existing definition of equity as the residual. It also includes the definitions of income and expenses, which continue to be defined in terms of increases and decreases in assets and liabilities.

What is a liability and when is it recognised has been a burning platform in accounting for some years. IFRIC 21 is a case in point.

The proposed definition of a liability includes the concept that the entity has "no practical ability to avoid" the obligation. The ED attempts to clarify "practical ability to avoid". For example, liquidating the entity, ceasing operations, or any alternative that causes significant business disruption or economic consequences that are "significantly more adverse" than the obligation would not be "practical".

Even with clarifications, questions will remain and conditional liabilities are certain to continute to attract debate.

Liability versus equity is a debate that sends conceptual accountants to separate corners. This distinction was intentionally not addressed in the ED as it would've undoubtedly delayed it. Instead, it is part of a research project that will surely be the subject of much conceptual debate.

Avoidance of this threshold question leaves many wondering if the proposed definition of a liability is sufficiently clear, as the most heated debate during development of the ED has been on making the cut between liability and equity.

Recognition and derecognition

The ED proposes revised criteria for recognition. It removes the concept of a probability threshold and adds provides criteria for recognising an asset or liability. They include: relevance, faithful representation, and cost/benefit. The cost/benefit consideration is meant to determine if measurement would be unusually difficult.

There is no criteria in the existing Framework on derecognition. The ED discusses full derecognition, partial derecognition, and continued recognition. It also provides guidance on the assets and liabilities retained after an event that led to derecognition. The ED concentrates on cases in which those two objectives are in conflict.

Measurement

This chapter calls for a mixed measurement model of two broad categories: historical cost and current value measures and notes which measurements to use in which circumstances.

Presentation and disclosure

A new chapter, presentation and disclosure, is where the term "profit or loss" makes its debut. Profit or loss is the primary performance indicator and the use of OCI is expected to be "limited". OCI is not mentioned in the current Framework.

Capital and capital maintence

This chapter describes two concepts of capital: financial and physical. The IASB carried it forward with minor changes for consistency in terminology.

Other related projects

The IASB has pushed the debate about liabilities versus equity into a research project on Financial Instruments with Characteristics of Equity (FICE). This is not the first incarnation of the FICE project. If completed, it could have several possible outcomes, including amending existing standards, the Conceptual Framework, or both. See update under "Cannon Street Press".

Next steps

Comments on the ED are due by 26 October 2015. The IASB proposes a transition period of approximately 18 months for the amendments with retrospective application in accordance with IAS 8.

Are you following the IFRS blog?

What do you think about prudence being reinstated in the Framework? Check out this blog by Peter Hogarth on the debate

Segment disclosures to bring more insight on the "management view"

Derek Carmichael, Global Accounting Consulting services looks at the changes proposed by the IASB in response to the Post Implementation Review (PIR) of IFRS 8 to increase value to users.

The IASB staff finally delivered their long-awaited proposals for improvements to respond to the feedback on the IFRS 8 PIR. The PIR was completed in July 2013 and as this was the first such review of its kind, many were curious about the nature of the response. Two years later, we have their proposals.

The proposals are not earth shattering but seek to address problem areas, particularly around consistency and aggregation. The IASB will also propose some new disclosure requirements.

Consistency of reporting

The IASB has proposed new guidance to encourage entities to use a consistent description of segments across all forms of reporting to investors.

There is no current requirement that other information that accompanies the financial statements (for example, the management discussion and analysis) be consistent with segments identified in the notes to the financial statements. This has come under challenge by regulators.

The objective of the segment disclosures is to present information at the level at which management makes operational decisions and assesses performance. Providing information differently within management commentary or presentations to investors raises questions as to whether the segment disclosures comply with the requirements of IFRS 8.

The new guidance does not introduce any new requirements. However, it will hopefully encourage preparers to ensure they have correctly identified the operating segments of the entity.

Chief operating decision maker

Additional guidance is also proposed to clarify that the Chief Operating Decision Maker (CODM) might be either an individual or a committee.
The guidance will emphasise that the CODM makes operating and strategic decisions. This is to address concerns that some might be incorrectly identifying an individual or committee as the CODM whose function is instead to perform a governance role (for example, a non-executive director).

A new requirement to disclose the nature of the CODM will also be introduced.

Similar economic characteristics

Aggregation of operating segments into reportable segments has been a difficult area in practice. One of the main challenges is assessing whether operating segments have similar economic characteristics given the minimal guidance in IFRS 8.

IFRS 8 notes as an example that "similar long-term average gross margins" would be expected for segments with similar economic characteristics. However, the IASB is concerned that some preparers used this as the sole test as to whether characteristics are similar. In addition, it was suggested during the meeting that similar gross margins are the effect of similar characteristics, rather than being a similar characteristic itself.

There is no clear consensus on how to address this issue. The IASB instructed the staff to propose some additional examples of similar characteristics for inclusion in the standard, with growth rates being one example suggested in the meeting.

More guidance on line items to be disclosed

IFRS 8 requires disclosure of specific line items for profit or loss, assets and liabilities.

Feedback from the PIR indicates that investors consider some additional line items to have special relevance for decision-making and allow investors to make comparisons between entities. Items identified include those that affect future cash flows, provide information on investing activities or are non-recurring, as well as items which are components of ratios or alternative performance measures (such as EBITDA).

The IASB decided not to mandate specific additional line items to be disclosed. Instead, additional guidance will be provided on what factors management should consider when deciding if other line items need to be disclosed.

Additional disclosure requirements

In addition to the new guidance noted above, the proposed narrow-scope amendments will include some new disclosure requirements:

- Interim reporting - When a reorganisation occurs, the proposals will require the first interim financial statements after the restructuring to restate comparative segment information for all interim periods for the preceding year. Therefore, an entity that reports quarterly and performs restructuring in the first quarter will be required to present restated comparative information for all three quarters in their first quarter reporting.

- Reconciliations – IFRS currently requires reconciliations between the total of segment revenue, profit or loss, assets and liabilities and the corresponding total within the financial statements. There are concerns that some investors could not understand how reconciling amounts related to an individual segment. The proposed amendments will require a fuller explanation of the nature of reconciling items, including those items not allocated to a specific segment.

What is next?

The staff will draft narrow-scope amendments to IFRS 8 based on the decisions at the May meeting with publication of an exposure draft expected by September.

EFRAG to EC: IFRS 9 will need close in-play monitoring

European financial reporting group says assessment of IFRS 9 is qualitative, not quantitative, but urges implementation without delay.

The European Financial Reporting Advisory Group (EFRAG) has issued draft advice to the European Commission, supporting the majority of the IFRS 9 (Financial Instruments) standard and encouraging the European Union to adopt it without delay. But, crucially, EFRAG says that its draft recommendations are based on less than full quantitative assessments.

After examining the standard, EFRAG concluded that it was conducive to the European good and would bring improvements to financial reporting, but added that its effects would need monitoring closely to "identify any unforeseen or unanticipated consequences".

Basis of conclusions

In its letter to the European Commission, the group set out the basis on which it had come to those conclusions. EFRAG considered whether the standard would improve financial reporting; whether it would trigger implementation costs that outweighed its potential benefits; whether the current lack of convergence with US GAAP would render EU businesses less competitive than their US counterparts; whether the standard would have an impact on economic growth – positive or negative; how the standard would interact with the future standard on insurance contracts coming from the IASB and whether companies should be able to early-adopt the standard.

Improving financial reporting

The group concluded that the standard would bring improvements to financial reporting, particularly regarding the impairment of financial assets and hedge accounting. They also asserted that it would likely bring significant implementation costs, but these would be outweighed by the long-term benefits derived from the standard. They also argued that IFRS 9 would not put EU businesses in a less competitive position than US businesses and in some cases might actually provide an advantage to investors in EU businesses because of its emphasis on credit deterioration and slightly wider scope than US GAAP.

On the matter of the standard's effect on economic growth, EFRAG noted that its conclusion was not substantiated sufficiently with quantitative analysis, but added that such analysis would be hard to come by until the standard had enjoyed a little time as implemented. The group concluded that there were too many factors in play to make a decision one way or another.

At the Commission's request, EFRAG did consider the interaction of IFRS 9 and the future insurance contracts standard and said that there was a strong case for the EC to ask the IASB to defer IFRS 9, but for insurance businesses only, and that it should be applicable without delay to all other businesses. They also recommended that those who wish to should be allowed to adopt the standard early.

But the group finished its letter with the warning that its draft conclusions were not based on as much quantitative analysis as they would like and that the standard would require much in-play monitoring and possible remedies. EFRAG offered its services in this regard.

This article is courtesy of PwC World Watch Magazine. For more articles like this, see link.

This article has been revised to clarify that the EFRAG position on endorsement is still in the form of a draft, pending consultation.

Cannon Street Press

Clarification to IFRS 15

The IASB discussed the guidance in IFRS 15 on determining whether an entity is a principal or agent in response to issues identified by Revenue Transition Resource Group (TRG).

The IASB tentatively decided to propose clarification to IFRS 15 and illustrative examples on how the control principle applies to services. The IASB tentatively decided not to amend the standard to provide further guidance the indicators of whether an entity is a principal or agent or on how to identify the specified goods or services to which the principal agent guidance applies. The IASB will however propose changes to the examples to illustrate these principles.

The IASB is expected to discuss these issues again at a future joint board meeting with the FASB.

Disclosure Initative

The IASB continued discussion on the Principles of Disclosure project as part of its Disclosure Initiative. The IASB discussed the following:

Amendments to IAS 8

The IASB reviewed suggestions by the Italian standard-setter (OIC) about possible amendments to IAS 8 to clarify the definition of accounting policies and changes in accounting estimates and the related disclosure requirements. No decisions were made.

Accounting policies

The IASB tentatively decided to include more guidance on determining how and when accounting policies should be disclosed. They will not propose additional guidance on making the policies more entity specific. This will be included in a general disclosure Standard or through education material.

Presentation – face versus notes

The IASB tentatively decided that more guidance on presentation in the primary financial statements versus the note will be addressed as part of a separate project on Performance Reporting. The potential need for explicit references in existing standards will be addressed as part of the Disclosure Initiative's Standards-level Review of Disclosures project.

A Discussion Paper is expected in the second half of 2015.

FICE research project

The IASB "relaunched" its research project on Financial Instruments with Characteristics of Equity. The project was added to the agenda in response to the IASB's decision to remove the distinction between liabilities and equity from the scope of the Conceptual Framework project (page 1).

The IASB staff presented an update on the project and outlined two types of accounting challenges identified:

- Conceptual - These are challenges with the underlying rationale of, and approach to, the distinction between liability and equity in IAS 32 and in the Conceptual Framework.
- Application - Challenges with the application of the requirements in IAS 32, such as the "fixed for fixed" condition, contingent features beyond the control of the entity and counterparty and the lack of guidance on accounting for transactions within equity.

The starting point will be to address the identified accounting challenges from the point of view of the existing requirements of IAS 32 and, to the extent relevant, other IFRSs. The IASB will bring the project back in future meetings.

NIFRICS by the numbers; IFRS rejections in brief starting with IAS 1

Ernesto Mendez of Global Accounting Consulting Services examines the practical implications of IFRIC rejections related to IAS 1.

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 new series will cover what you need to know about issues that have been "rejected" by the IC. We go standard by standard and start with IAS 1 as per below.

IAS 1 is all about presentation – that is, the form, order and structure of the financial statements. Your first reaction may be that there is minimal room for interpretation in this area, but apparently not. There have been more than 10 NIFRICs specifically attributed to IAS 1. Most were related to current versus non-current classification. This article focuses on current versus non-current but also includes a table of all NIFRICs on IAS 1 as categorised by the IASB.

Current or non-current troubles

Normal operating cycle (June 2005)

The IC was asked whether the requirement in IAS 1 to classify an asset as current when it is expected to be settled in the entity's normal operating cycle is applicable only if an entity has a predominant operating cycle. This is particularly relevant for conglomerates which, on a narrow reading of IAS 1, might require an entity to fall back on classifying based on a twelve-month cycle.

The IC's view is that the reference to the normal operating cycle should be read in both the singular and the plural. If an entity holds inventories with different cycles, and it is material to users' understanding, classification is assessed by aggregating similar items as required by IAS 1.

Convertible instruments (November 2006)

The IFRIC was asked about classification of the liability component of a convertible loan. The instrument has two components—equity (the holders' right to convert) and liability (the issuer's obligation to deliver cash). How should the liability component be classified in the issuer's balance sheet given it may be "paid" in shares of the issuer and not cash?

Some asserted that the liability component is best presented as non-current. However others thought that it was current as there is no unconditional right to defer settlement for at least 12 months after reporting period. Settlement of a liability is not confined to delivery of cash or other assets.

The IFRIC concluded that standard setting action was required. The result was an annual improvement that the terms of a liability that could result in its settlement by the issue of equity instruments at the option of the holder does not affect its classification.

"Held for trading" derivatives (May 2007)

The IC was asked whether derivatives that are classified as "held for trading" in accordance with IAS 39 should be classified as current or non-current. Such derivatives may be settled more than a year after the reporting date. IAS 39 described recognition and measurement, but not balance sheet classification. Consequently, there was diversity of views; one that the held-for-trading classification is solely for measurement purposes and a second that financial liabilities classified as held for trading must be presented as current.
The IC decided not to take the issue on to its agenda but in response, the IASB clarified

IAS 1 by removing the implication that financial instruments classified as held for trading in accordance with IAS 39 are always required to be presented as current.

Callable term loan (November 2010)

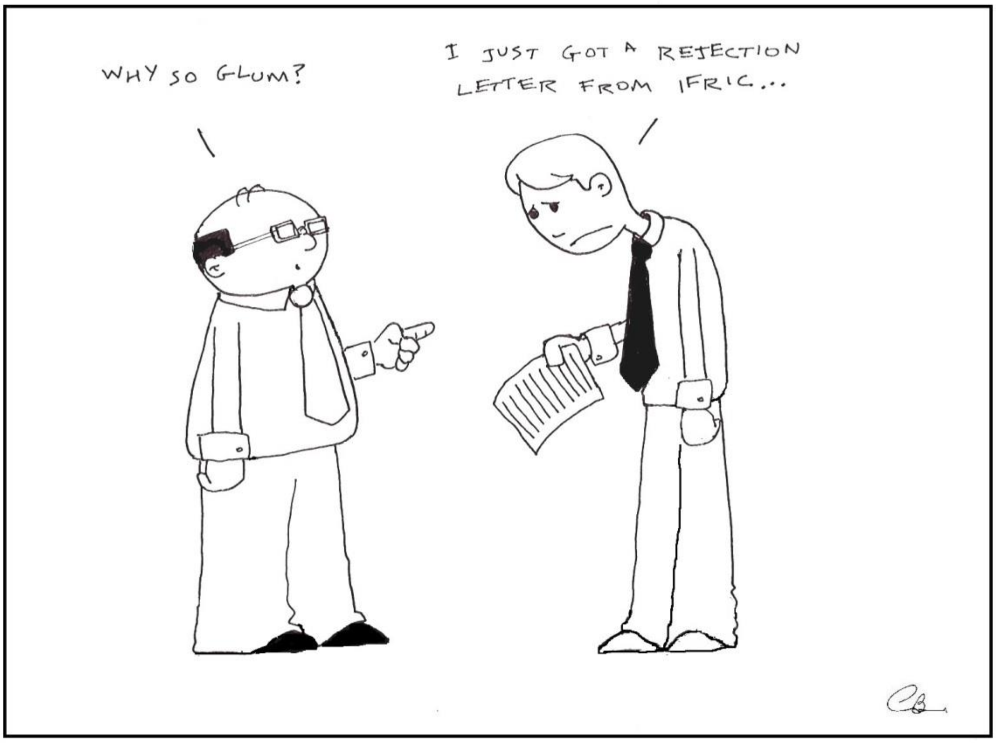
The IC was also asked about classification of of a liability that is not scheduled for repayment in twelve months, but callable by the lender at any time. The IC did not take the issue on the agenda, observing that IAS 1 requires current classification if the entity does not have the unconditional right at the reporting date to defer settlement for at least twelve months after reporting period. The counterparty has the right to call for payment at any time thus the unconditional right to defer settlement does not exist.

Summary of IAS 1 rejections

Topic	Summary conclusion
Operating and ordinary activities (Feb 2003)	The IC discussed whether additional guidance is needed on which items should be excluded from operating and ordinary activities. The references were eventually deleted but income statement presentation continues to get attention through the IASB's research project on Performance Reporting.
Normal operating cycle (Jun 2005)	The IC looked at the classification of assets (e.g. inventories) when there is no predominant operating cycle. They clarified that if an entity holds inventories with different cycles, classification is assessed by aggregating similar items. See further discussion above.
Comparatives for prospectuses (Jun 2005)	The IC considered requirements for comparatives in response to perceived practical problems for prospectuses in certain jurisdictions. They believed that the issue arose from a difference of approach between IAS 1 and regulatory requirements and thus, concluded that it could not be resolved by an interpretation.
Convertible instruments (Nov 2006)	The IFRIC was asked about classification of the liability component of a convertible loan. The submission resulted in annual improvement to clarify that the terms of a liability that could result in its settlement by the issue of equity instruments at the option of the holder does not affect its classification. See further discussion above.
"Held for trading" derivative (May 2007)	The IC was asked about the classification of "held for trading" derivatives. The IASB clarified IAS 1 by removing the implication that financial instruments classified as held for trading are always presented as current. See further discussion above.
Disclosure about going concern (Jul 2010/Jul 2014)	The IC twice considered disclosures related to material uncertainties about going concern. The IC rejected the issue in 2010 but suggested in 2014 that IAS 1 should be clarified. The IASB decided against amending IAS 1. The IC finally issued an agenda rejection noting that the general disclosure requirements in IAS 1 should be considered when there is a significant judgment in concluding on going concern.
Encouraged versus required disclosures (Sept. 2010)	The IC recommended that the IASB review all disclosures encouraged (but not required) to either confirm that they are required or eliminate them. The IASB did not add this issue to the Annual Improvements project as it would be covered by a separate project on disclosure principles. See disclosure initiative on page 7.
Callable term loan (Nov 2010)	The IC observed that if the counterparty has the right to call for payment of a loan at any time, the unconditional right to defer settlement does not exist and thus, the loan should be classified as current. See further discussion above.
Presentation of non-income taxes (Jul 2012)	The IC looked at the presentation in the income statement of production-based royalty payments. The IC rejected the issue noting that the relevant tax rules determine what meets the definition of an income tax and that royalty payments should not be presented as income tax, unless in the scope of IAS 12.
Issues related to the application of IAS 1 (May 2014)	The IC received a request to clarify the application of certain IAS 1 requirements including expenses by function, additional line items or columns and the application of materiality. The IC rejected the issue but a number of the items were addressed through narrow scope amendments to IAS 1 issued in December 2014.

Please refer to the following link for more information.

The bit at the back...



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