IFRS news

In This Issue

For further information or to subscribe, contact us at pwc.publications@lu.pwc.com or register online.

IFRIC 23 – Putting some certainty into uncertain tax positions

Ernesto Mendez highlights the key elements of IFRIC 23, the new interpretation on uncertain tax treatments.

The IFRS Interpretations Committee (IFRS IC) issued IFRIC 23, which clarifies how the recognition and measurement requirements of IAS 12 *Income taxes*, are applied where there is uncertainty over income tax treatments.

When does the Interpretation apply?

IAS 12, not IAS 37 *Provisions, contingent liabilities and contingent assets*, applies to accounting for uncertain income tax treatments. IFRIC 23 explains how to recognise and measure deferred and current income tax assets and liabilities if there is uncertainty over a tax treatment.

An uncertain tax treatment is any tax treatment applied by an entity where there is uncertainty over whether that approach will be accepted by the tax authority. For example, a decision to claim a deduction for a specific expense or not to include a specific item of income in a tax return is an uncertain tax treatment if its acceptability is uncertain under tax law. IFRIC 23 applies to all aspects of income tax accounting where there is an uncertainty regarding the treatment of an item, including taxable profit or loss, the tax bases of assets and liabilities, tax losses and credits and tax rates.

What is the unit of account?

Each uncertain tax treatment is considered separately or together as a group, depending on which approach better predicts the resolution of the uncertainty. The factors that an entity might consider to make this determination include:

1) how it prepares and supports the tax treatment; and
2) the approach that it expects the tax authority to take during an examination.

What should an entity assume about the examination of tax treatments by taxation authorities?

An entity is required to assume that a tax authority with the right to examine and challenge tax treatments will examine those treatments and have full knowledge of all related information. Detection risk is not considered in the recognition and measurement of uncertain tax treatments.

When should an entity account for any uncertain tax treatments?

If an entity concludes that it is probable that the tax authority will accept an uncertain tax treatment that has been taken or is expected to be taken on a tax return, it should determine its accounting for income taxes consistently with that tax treatment. If an entity concludes that it is not probable that the treatment will be accepted, it should reflect the effect of the uncertainty in its income tax accounting in the period in which that determination is made (for example, by recognising an additional tax liability or applying a higher tax rate).

How is the effect of uncertainty recognised?

The entity should measure the impact of the uncertainty using the method that best predicts the resolution of the uncertainty; either the most likely amount method or the expected value method.

The most likely amount method might be appropriate if the possible outcomes are binary or are concentrated on one value. The expected value method might be appropriate if there is a range of possible outcomes that are neither binary nor concentrated on one value. Some uncertainties affect both current and deferred taxes (for example, an uncertainty over the year in which an expense is deductible). IFRIC 23 requires consistent judgements and estimates to be applied to current and deferred taxes.

What about changes in circumstances?

The judgements and estimates made to recognise and measure the effect of uncertain tax treatments are reassessed whenever circumstances change or when there is new information that affects those judgements. New information might include actions by the tax authority, evidence that the tax authority has taken a particular position in connection with a similar item, or the expiry of the tax authority's right to examine a particular tax treatment. IFRIC 23 states specifically that the absence of any comment from the tax authority is unlikely to be, in isolation, a change in circumstances or new information that would lead to a change in estimate.

What about the disclosures?

There are no new disclosure requirements in IFRIC 23. However, entities are reminded of the need to disclose, in accordance with IAS 1, the judgements and estimates made in determining the uncertain tax treatment.

Effective date and transition

The Interpretation is effective for annual periods beginning on or after 1 January 2019. Earlier application is permitted. An entity can, on initial application, elect to apply this Interpretation either:

1)retrospectively applying IAS 8, if possible without the use of hindsight; or

2)retrospectively, with the cumulative effect of initially applying the Interpretation recognised at the date of initial application as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate).

IFRS 16 brings significant changes to accounting for lessees, but what extra information needs to be presented in the financial statements? Can Professor Lee Singh help you solve the disclosure problem? Let's experiment!

The Leases Lab

Hypothesis

Changes in accounting for lessees are the only new requirements introduced by IFRS 16. Disclosure guidance remains the same

Testing and analysis

IFRS 16 requires lessees to recognise a right-of-use asset and lease liability for nearly all leases. The standard contains enhanced disclosure guidance to provide further information on these assets and liabilities and includes certain specific requirements.

A lessee shall disclose:

- Additions, depreciation charge and carrying amount at the end of period for right-of-use assets by class of asset;
- A maturity analysis of lease liabilities;
- Interest expense on lease liabilities;
- Expense for variable lease payments not included in lease liabilities;
- Expense relating to short-term leases and to low value leases;
- Total cash outflow for leases; and
- Gains or losses arising from sale and leaseback transactions.

There are also disclosure requirements in respect of leases for which recognition exemptions have been taken, both for the cost incurred in the period and future commitments.

The standard also requires entities to disclose future cash outflows to which a lessee is potentially exposed but which have not been included in the lease liability. This includes variable lease payments, extension and termination options and residual value guarantees. This is part of a requirement to disclose additional qualitative and quantitative information on leasing activities, which also includes providing restrictions or covenants imposed by leases.

Transition

IFRS 16 allows two different approaches to transition: 'fully retrospective' or 'simplified approach'. The standard contains specific disclosure requirements for the latter approach.

Practical impact

The requirement to provide a reconciliation of operating lease commitments previously disclosed under IAS 17 and lease liabilities initially recognised under IFRS 16 provides additional focus on the accuracy of prior disclosures.

There might be some valid reasons for reconciling items, such as new liabilities arising from application of the standard, reassessment of contracts as service agreements or adjustments from treatment of extension and termination options. Entities will want to ensure a reconciling item is not a correction of prior period disclosures.

Identification of the discount rate used to measure the lease liability is an area which might pose challenges for some entities. The disclosure requirements for transition will make this a visible number to users of the financial statements.

The requirements to disclose current costs from (and potential future exposure to) variable lease payments will also provide additional visibility to users, even when they are not included in the measurement of the lease liability.

Conclusion

IFRS 16 not only has a significant accounting impact, but contains extensive new guidance on disclosures—with more information being provided to users than before.

Lessees should ensure that preparation of disclosure forms part of the implementation plan for the new standard. This is also the moment to re-assess the current reporting of operating lease commitments under IAS 17 is accurate!

A lessee shall disclose information about initial application:

- Weighted average incremental borrowing rate applied to lease liabilities recognised at the date of initial application ('DIA');
- Explanation of any difference between operating lease commitments applying IAS 17 at end of the reporting period immediately preceding DIA and lease liabilities recognised at DIA; and
- Use of one or more of the available practical expedients.

Want to know more on disclosure? Our new [Illustrative financial statements] contains an appendix with example IFRS 16 disclosures.

For discount rates, you might find our [new video] helpful.

Scene 4, Take 1: Demystifying IFRS 9 for Corporates: Factoring and business model

Holger Meurer, Financial instruments expert, explains how factoring can affect the measurement of receivables

LIGHTS, CAMERA, ACTION!

Dear Corporate,

The classification and measurement of financial assets under IFRS 9 is determined based on two criteria:

- the **business model** within which the entity holds the asset (business model test), and
- the **cash flows** arising from the asset (SPPI test, that is, the financial asset gives rise to cash flows that are solely payments of principal and interest).

This article takes a closer look at the first criterion.

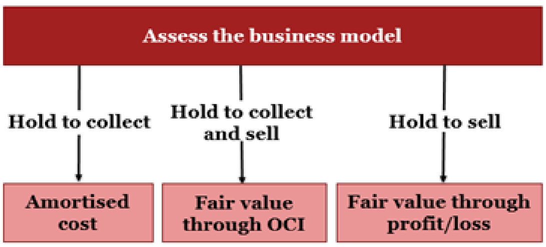
Business model test

The business model test will determine the classification of financial assets that pass the SPPI test.

IFRS 9 makes a distinction between three different business models:

- **Hold to collect**: The entity holds the financial assets in order to collect the contractual cash flows.
- **Hold to collect and sell**: The entity holds the financial assets for both selling and collecting contractual cash flows.
- **Hold to sell**: The entity holds the financial assets with an intention to sell them before their maturity.

The business model test drives the accounting treatment as follows:



It can be challenging, in practice, to determine the business model. The entity must take into account a range of factors including the historical frequency, timing and value of sales, the reason for the sales and expectations of future sales.

Factoring

Corporates often enter into factoring arrangements where they sell receivables to a third party and transfer substantially all the related risks and rewards. Factoring arrangements will affect the business model in which the receivables are held:

The business model will not be 'hold to collect' but, depending on how regularly receivables are sold, either 'hold to collect and sell' or 'hold to sell'. In both cases, the receivables have to be measured at fair value.

Conclusion

The classification and measurement of financial assets under IFRS 9 is based not only on the cash flows arising from the asset, but also on the business model in which they are held. Factoring of receivables may impact the business model assessment and result in measuring at fair value.

Practical advice:

If an entity factors only some of its receivables (for example, only those due from certain customers) it may be able to sub-split its portfolio of receivables.

The business model for the sub-portfolio containing the factored receivables will be 'held to sell'. The business model for the sub-portfolio containing the remaining receivables will be 'held to collect'.

CUT!!!

Our full range of IFRS 9 content and videos can be found here.

IFRIC Rejections Supplement-IAS 37

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

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 37 as per below.

IAS 37 is seldom discussed at the Interpretations Committee (IC). The following handful of agenda decisions were developed in recent years.

Deposits on returnable containers

Entities often distribute products in returnable containers. Such entities collect a deposit for each container and are obliged to refund the deposit once the container is returned. The IC concluded that:

The refund of the deposit transaction is an exchange of non-financial asset for cash if the containers are derecognised as part of the initial sale transaction. The refund is at the discretion of the customer and is therefore not in the scope of IAS 32 but rather in the scope of IAS 37 as a rebate liability.

If the containers are not derecognised as part of the initial sale transaction, then the customer's only right is the right to refund, in which case it is in the scope of IAS 32.

Divergence in practice was considered unlikely to be significant and the issue was not added to the agenda.

Measurement on liabilities arising from emission trading schemes

The IC was asked to clarify whether the measurement of a liability arising from emissions trading should reflect the current values of allowances at the end of each reporting period if IAS 37 was applied. This was the basis required by IFRIC 3 which has been withdrawn.

The issue was seen as too broad to conclude on and thus the IC did not add this to its agenda.

Inclusion of own credit risk in the discount rate

The IC was asked whether 'the risks specific to the liability' in IAS 37 suggests that an entity's own credit risk should be excluded from adjustments to the discount rate used to measure liabilities.

Common practice, per the IC, is to exclude own credit risk, as it is viewed as a risk of the entity rather than a risk specific to the liability. The IC decided that the question would be better addressed as part of the Board's project to replace IAS 37 and did not add the issue to its agenda.

The IFRS 15 Mole

PwC revenue specialist Ruth Preedy investigates how to account for licenses under IFRS 15 with the help of the Mole

Suspects

A licence arrangement establishes a customer's rights to an entity's intellectual property (IP) and the entity's obligations to provide those rights. Common licences include patents, software, motion picture, and trademarks.

Incident description

Management should assess whether the contract includes a license that is distinct and therefore treated as a separate performance obligation.

The nature of the license will need to be determined if a license is distinct.

A licence might be bundled with other goods or services and therefore it is harder to identify if the licence is a separate performance obligation. Where the license is the predominant feature of the bundle, the bundle is treated as a licence.

Facts

IFRS 15 refers to two types of licence: right of access and right to use. A license is a right of access if:

- the contract requires, or the customer reasonably expects, that the entity will undertake activities that significantly affect the IP to which the customer has rights;
- the rights granted by the licence directly expose the customer to any positive or negative effects of the entity's activities identified above; and
- those activities do not result in the transfer of a good or service to the customer as those activities occur.

The licence is accounted for as right to use license if the above criteria are not met. The recognition of revenue then follows the nature of the licence:

1) **Right of access** licences provide access to an entity's IP over time and revenue is recognised over time. Management should select an appropriate measure of progress to determine the pattern of recognition. A straight-line approach is often an appropriate method, however, there could be circumstances where the nature of the IP or the related activities indicate that another method of progress would better reflect the transfer to the customer.
2) **Right to use** licences that provide a right to use an entity's IP are performance obligations satisfied at the point in time. Management should determine when control of the license is transferred and recognise revenue at that date.

Management will need to apply judgement to assess whether the entity's activities will significantly affect the IP. This considers how the IP provides a benefit to the customer. If the benefit is derived from the form or functionality of the IP, only activities that change that form or functionality will significantly affect the IP. IP that has significant stand-alone functionality, for example music or motion pictures, derives a substantial portion of its benefit from that functionality. However, when the benefit is obtained from something other than the form and functionality of the IP, an entity's activities might significantly affect the IP. For example, an entity's activities to support or maintain a brand name will significantly affect the IP.

Recommendations

The nature of that IP is critical for revenue recognition. This is a difficult assessment. Consideration of how the customer benefits from the IP is probably a good starting point.

Further investigations

There is an exception for the recognition of revenue of sales- or usage-based royalties promised in exchange for a licence of IP. We will consider this in future investigations.

Cannon Street Press

Editors choice

Definition of a business

The Board continued discussing comment letters received on the definition of a business. The Board tentatively decided to:

- Clarify the definition of a business is met when the acquired process impacts the creation of output significantly.
- Reaffirm that the possibility of a market participant to replace missing elements will no longer be considered when assessing if an acquired group of assets is a business, as it is not part of what is being acquired.
- Clarify that, if the acquired group of assets creates output, even if the acquirer does not intend to use it for the creation of output, that which is being acquired would still be a business.

The Board tentatively decided to clarify that 'other revenue' in the definition of output includes revenue and income both in and out of the scope of IFRS 15. The Board also tentatively decided to amend the definition of output in the definition of a business in Appendix A to ensure internal consistency in the standard and remove the statement that a set of assets and activities in which goodwill is present is presumed to be a business.
The Board will discuss a comparison of the FASB and IASB amendments at a future board meeting.

Other Highlights

IFRS Maintenance

IAS 8 *Accounting policy changes resulting from IC agenda decisions*

IC agenda decisions are not authoritative standard setting therefore do not have transition requirements. Many regulators require that IC agenda decisions are followed and entities are encouraged to make a voluntary change in policy under IAS 8 where the change results in 'helpful, informative, and persuasive information'. Currently, a voluntary change in accounting policy is applied retrospectively unless it is impractical to do so. The Board tentatively decided to amend IAS 8 to lower the impracticability threshold for retrospective application of voluntary changes in accounting policies from agenda decisions. The proposed threshold would include a consideration of the benefits and costs of applying the change retrospectively.

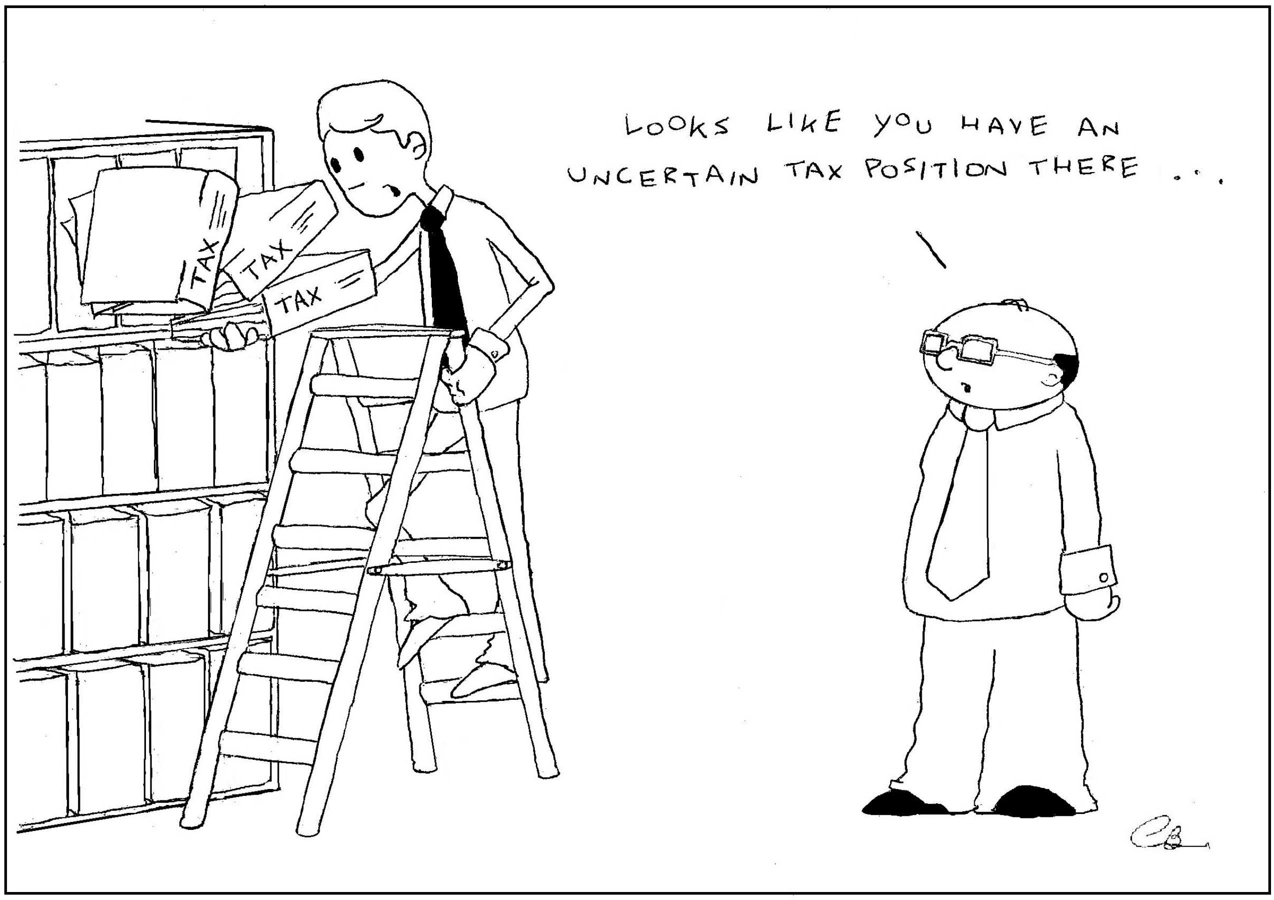
Standard Setting Projects

Rate regulated

The Board considered examples that demonstrate the operation of a possible accounting model for activities subject to 'defined rate regulation.' The examples show how the model would recognise a regulatory asset or regulatory liability, and a related regulatory adjustment in the profit or loss. The Board considered the timing and amount of the initial adjustment, and the pattern and timing of the reversal.

These are the editor's top picks from the June Board meeting. For a comprehensive list of all discussions, visit the IASB website www.IFRS.org

The bit at the back ...



For further help on IFRS technical issues contact:	
Marc Minet, Partner Commercial and Industrial Companies, IFRS Leader marc.minet@lu.pwc.com +352 49 48 48 2120	Fabrice Goffin, Partner Technical Advices and Banking fabrice.goffin@lu.pwc.com +352 49 48 48 2155
Kenneth Iek, Partner Real Estate kenneth.iek@lu.pwc.com +352 49 48 48 2278	Michael Delano, Partner Asset Management michael.delano@lu.pwc.com +352 49 48 48 2109
Marc Voncken, Partner Insurance marc.voncken@lu.pwc.com +352 49 48 48 2461	Philippe Förster, Director IFRS, IFRS training and Treasury philippe.foerster@lu.pwc.com +352 49 48 48 2065