

# IFRS news

Emerging issues and practical guidance\*

Issue 81 – February 2010



## IAS 37 ED to bring significant change to size of provisions

The IASB has published revised proposals to amend the measurement of non-financial liabilities (formerly provisions) under IAS 37, 'Provisions, contingent liabilities and contingent assets'. The re-exposed proposals put forward a way of measuring provisions that is different from the method often used today. Some of these proposals are fundamental and could result in a significant increase to a provision. Steve Ralls of PwC's Global Accounting Consulting Services central team explains.

### Background

- The proposed amendments were originally published in 2005. Many of the proposals remain unchanged. However, those around measuring provisions have been re-addressed.
- Some of the proposals expected to feature in the revised standard could have significant impacts.
- Most entities will be affected.
- A draft standard is expected to be published in February this year; a new IFRS to replace IAS 37 is expected in the third quarter of 2010.

Management currently measures most provisions for an obligation to deliver a service (for example, a warranty service or an asset decommissioning obligation) at the cost that it expects to incur in fulfilling the obligation. The exposure draft (ED) proposes to measure a provision according to the value of the resources required.

There is diversity in practice around the costs included in a provision. Direct costs are usually included; indirect costs are sometimes not included; and the profit margin that would be charged by a contractor is rarely included. The ED aims to address this diversity, but the changes it proposes raise some significant issues.

The ED proposes four fundamental changes:

1. Removing the recognition requirement for an outflow of resources to be probable.
2. Removing the concept of contingent assets or liabilities.
3. Requiring re-measurement of provisions using an expected value model rather than the current best estimate approach.
4. Specifying what costs to include in the calculation of the provision.

The changes result from the proposed change in the measurement guidance and are addressed below.

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### 1. Removal of the requirement for an outflow of resources to be probable

IAS 37 currently requires a liability to be recognised when an obligating event has occurred and there is a probable outflow of economic benefits. 'Probable' is interpreted in practice as 'more than 50% likely to occur'. The proposals remove 'probability' from the recognition equation. Liabilities arising from an obligating event are all therefore recognised: the uncertainty of the outflow is included in the measurement criteria, by applying a probability assessment to a range of possible outcomes.

This change addresses the inconsistency between IAS 37 and other standards, such as IFRS 3, 'Business combinations', and IAS 39, 'Financial instruments: Recognition and measurement'; these standards do not apply a probability-of-outflows criterion to liabilities. In practice, this means that liabilities for which an outflow of economic benefits was assessed as not probable may now be recognised.

### 2. Removal of the concept of contingent assets or liabilities

The new standard will not address assets, and the concept of a 'contingent asset' will disappear. The removal of the recognition threshold for liabilities means that 'contingent liabilities', as we previously considered them, will also become a thing of the past. Contingent liabilities will continue to exist, but only in so far as the obligating event is considered unlikely to have occurred.

### 3. Re-measurement of provisions using an expected value model

The ED proposes that provisions should be measured at the present value of the amount an entity would rationally pay to be relieved of an obligation at the balance sheet date. Few provisions today are measured on a 'settlement' basis. Management estimates the costs it will incur in the future to satisfy the obligation and discounts these back to the balance sheet date.

The measurement method is proposed in the exposure draft as the "lowest of;

- *The present value of the resources required to fulfil the obligation;*
- *The amount the entity would have to pay the counterparty to cancel the obligation; and*
- *The amount the entity would have to pay a third party to transfer the obligation to that third party."*

Cancellation of obligations without settlement seldom occurs in practice. It is even rarer to find a market in which a transfer/ (sale) of the liability is possible to a third party. The lowest amount is likely to be the value of the resources required to fulfil the obligation. Many entities will therefore need to use the present value approach.

The present value approach measures the provision using the weighted average of all possible outcomes. This is rarely the

amount eventually paid but reflects the uncertainty inherent in the estimate. The provision is discounted using a rate that reflects the time value of money; then it is increased by adding a risk adjustment for any risks specific to the obligation that are not reflected in the expected value calculation.

### 4. Specifying what costs to include in the calculation of the provision

The Board expects that contractor prices will provide a more objective basis for assessing liabilities than internal estimates based on cost. By specifying the use of contractor prices as an overall objective, the amended standard may reduce the current diversity in practice. Detailed guidance on what costs to include is considered unnecessary. Where contractor prices are not available, the entity should use fully absorbed costs and a profit margin in the provision assessment.

Management should look at the proposals carefully, assess the impact and consider responding to the Board's proposals.

## Examples

### Warranty obligation

The obligation to replace a defective good under warranty for a new one, where that good is not unique and is sold to the public in large numbers, fits well into an expected value model. Historic failure and replacement rates are readily available, as is the market price of the good. However, if the obligation is only to repair the good, a market price for the repair may not be readily available, particularly if the goods are not routinely repaired. An assessment of both the costs and the profit margin that the entity would expect to receive in this situation is required to determine the value of the service and therefore the amount of provision.

### Asset decommissioning obligation

The obligation to remove an asset and decommission a site may fit well into an expected value model if there is a market in which entities provide decommissioning services. However, it does not fit so well when there is no market for decommissioning services and an entity must therefore undertake the decommissioning obligation itself. Management assesses both the costs and the profit margin to determine the value of the service and therefore the amount of the provision.

### Settling an obligation with cash

When the obligation is to pay cash – for example, to settle litigation – the amount will be the probability-weighted average of the expected cash payment plus any associated costs. This is likely to be a larger amount than the liability determined under the old standard. If the expected outflow was not probable, no provision may have been recorded.

### Binary obligations

The litigation example highlights a key problem. As the probability assessment has been removed from the recognition principle, those situations where there is a 'yes' or 'no' outcome to a liability will result in some provision being made. That litigation provision is unlikely to be the actual amount of cash that is paid out or the actual value of a service that has to be provided and it most certainly will not be no provision at all.



## Progress in long-awaited insurance contracts standard



Partner Gail Tucker and senior manager Dewald van den Berg in PwC's Accounting Consulting Services in the UK provide a summary of progress on the insurance contracts project.

The IASB is expected to issue an exposure draft on insurance contracts in May 2010 – a project that pre-dates the IASB itself. A final standard (scheduled for June 2011) will be welcomed by preparers and analysts in the insurance industry, given the diversity of accounting today (as noted in PwC's recent survey of insurance analysts *Making Sense of the Numbers*). A new standard in 2011 will enable preparers in the EU to consider the new requirements alongside the changes in Solvency II, which will affect insurers in 2012.

### Why has it taken so long?

The FASB joined this project in October 2008. Both boards have been discussing the proposals contained in the IASB's 2007 discussion paper on insurance contracts.

The discussions have been challenging, as many of the topics have parallels with other IASB projects such as revenue recognition, financial instruments and non-financial liabilities (IAS 37 amendments). The timetable has been subject to many delays as a result of these complexities and because the FASB has had less time to debate the issues. The Boards have started holding joint meetings, including additional meetings outside of the normal monthly schedule. This is to enable the exposure draft to be issued before three IASB board members retire in June 2010.

### What are the proposals expected to look like?

The 2007 discussion paper proposed a single 'current exit value' approach for valuing insurance contracts based on a

transfer notion to another party. The IASB has moved away from the current exit value notion. The Boards considered a number of measurement models. They have tentatively decided that the measurement should portray a current assessment of the insurer's obligation, using the following building blocks which are re-measured at each reporting date:

- The unbiased, probability-weighted average of future cash flows expected to arise as the insurer fulfils the obligation;
- The time value of money;
- A risk adjustment for the effects of uncertainty about the amount and timing of future cash flows; and
- An amount that eliminates any gain at inception of the contract.

There are still a number of important areas being discussed by the Boards before the exposure draft can be issued. Informal notes of the tentative decisions made at each board meeting (and *Making sense of the numbers* mentioned above) are available at [pwc.com/insurance](http://pwc.com/insurance) within the 'IFRS' pages.

### Next steps

The Boards have not yet discussed the scope of the standard. IFRS 4, 'Insurance contracts', defines an insurance contract as a contract where one party accepts significant insurance risk from another party. If this definition is not amended, companies other than insurers, such as service providers that issue fixed-price maintenance contracts, will need to follow the debate and consider the implications of this new model.

## Cannon Street Press

### IFRIC to clarify definition of vesting conditions in IFRS 2 amendment

The IFRIC is to clarify guidance on distinguishing between a service condition, a performance condition and a non-vesting condition. The agenda decision a lack of clarity in the definition of vesting conditions and in the amendment to IFRS 2, 'Share-based payment', on vesting conditions and

cancellations. This may result in divergent practices when distinguishing between vesting and non-vesting conditions. The IFRIC decided to add the issue to its agenda and will discuss it in its meeting next month.



## Beginners' guide: leasing

Peter Hogarth and Liza Therache in PwC's Accounting Consulting Services in the UK and France explain the basics of lease accounting and where the controversy lies.



"I can guarantee almost all of you here have never flown in a plane that has appeared in the airline's balance sheet. And the reason is they tend not to buy them, they lease them. And we all have leasing standards, and the great news is these leasing standards are perfectly harmonised world-wide. They are all absolutely useless. None of them work."<sup>1</sup>

*IASB Chairman, Sir David Tweedie, 15 August 2002*

Many entities across all business sectors lease assets. These range from substantial, high-value items (such as real estate, aircraft and ships) to everyday equipment (such as cars, computers and copiers). Most readers of this article at some time will have 'leased' a car or hotel room.

The decision of whether to 'lease or buy' that management often faces is based on many factors, such as available financing, tax structuring opportunities and other services that may be obtained alongside a lease. The risks and rewards associated with using somebody else's asset compared to outright ownership are also important. This analysis of risks and rewards also has accounting consequences, as will be explained later.

### What is a lease?

A lease is an agreement by which one party (the 'lessee') purchases the right to use an asset belonging to another party (the 'lessor') for an agreed period of time. Many leases are easy to identify. However, some may take the form of a purchase agreement for goods and services but contain a 'hidden' lease. Examples of these are some outsourcing contracts and take or pay arrangements, where the purchaser ('lessee') controls the use of the asset needed to provide or produce the purchased goods or services. The underlying principle is that if an arrangement has the substance of a lease, it should be accounted for as a lease.

### Are all leases the same?

Leases take many different forms. At one extreme is the rental of a car for a day; at the other, a complex arrangement for the lease of a machine for its entire useful life. Most leases lie somewhere in the middle.

The accounting for leases is driven by an analysis of who bears the risks and benefits of ownership of the leased asset. This analysis results in classification as a finance lease or an operating lease. If the lessee bears almost all of the risks and benefits, it is called a finance lease; otherwise it is called an operating lease.

The accounting treatment for the two different types of lease is very different. From the perspective of a lessee, finance leases are accounted for in a similar way to the outright purchase of the leased asset with deferred payment terms; operating lease rentals are recognised as expenses over the lease term, and no asset or liability is recorded. This is explored below.

The classification of a lease (that is, as an operating lease or a finance lease) should be determined at the beginning of the lease, based on the information available at that date. This is not subsequently amended for changes in estimates or circumstances. However, if changes (other than simple renewal) are made to the terms of the lease agreement, the revised lease should be regarded as a new agreement and its classification reconsidered.

### How to classify a lease?

The current lease accounting standard gives examples of indicators of when a finance lease transfers the risks and benefits of ownership of an asset to the lessee. These indicators all relate, directly or indirectly, to the value of the leased asset at the end of the lease term (the 'residual value risk'). Where the lessee bears the residual value risk, or if this risk is not significant, the lease is classified as finance lease. For example, a lease is usually classified as a finance lease when:

- the transfer of legal title to the lessee is expected at the end of the lease (automatically or through a purchase option);
- the lease term (which includes any optional extension period where the lessee is reasonably certain to lease the asset over the longer period) covers the major part of the economic life of the leased asset;
- the payments that the lessee is required to make to the lessor cover most of the value of the asset; or
- the asset is of a very specialised nature such that, in practice, no other party could use it at the end of the current lease.

In these situations, the lessor usually has little or no residual exposure to the leased asset itself, the rentals being set at such

<sup>1</sup> Sir David Tweedie is reported to have repeated this joke in every speech he has made since. The publisher would be interested to hear if anyone has heard Sir David make a speech since 2002 that does not include this joke (not including speeches made to the European Commission, where jokes are not appreciated).

a level as to cover its investment, together with its funding costs and a reasonable profit. The lessor's risk exposure would therefore be similar to that incurred in a financing transaction – that is, exposure to the credit risk of the lessee.

### Accounting for an operating lease

The substance of an operating lease is that the lessee makes a series of payments for the right to use an asset. The lessee does not bear the risks or enjoy the benefits of ownership of the leased asset, so the asset is not recognised on the lessee's balance sheet. Similarly, the lessee does not recognise a liability for its obligation to make rental payments. The arrangement is instead regarded as an uncompleted contract, committing the lessor to make the asset available for use in the future in return for payment. Described in this way, an operating lease resembles a service contract, and the accounting is similar. A rental expense is recognised evenly over the lease term.

### Accounting for a finance lease

The substance of a finance lease is similar to the outright purchase of an asset with deferred payment terms. The lessee bears the risks and enjoys the benefits of ownership of the leased asset, so the asset is recognised on the lessee's balance sheet. It is then accounted for in a similar way to other owned assets.

A liability is also recognised, representing the amount the lessee is committed to pay. This liability is treated in a similar way to a borrowing; this means that the amount recognised at the beginning of the lease takes account of the time value of money; it is measured at the present value of the payments that the lessee is required to make to the lessor over the lease term. The interest rate used in this calculation (called the 'interest rate implicit in the lease') should be the rate that makes the following equation work:

Present value of lease payments + residual value of the leased asset at the end of the lease	=	Current fair value of the leased asset + any initial direct costs incurred by the lessor
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This is not only complex but requires information that the lessee may not know (such as the residual value at the end of the lease term or the costs incurred by the lessor). A lessor might make this information available, but if not, the lessee should use the rate that it would have to pay on a similar lease or borrowing (called the 'lessee's incremental borrowing rate')

The above equation means that the present value of the lease payments should never exceed the leased asset's fair value. Where this happens, it may suggest that an incorrect interest rate is being used. The accounting standard therefore requires the leased asset and lease liability to be measured initially at the

lower of the present value of the lease payments and the fair value of the leased asset.

The payments in future periods are not described as rental but are treated as a combination of principal and interest on the outstanding liability. At the same time, the carrying amount of the leased asset is reduced (depreciated). Finance leases, unlike operating leases, result in two different types of expense – depreciation and interest.

### Example

An entity has leased an asset for two years. It is required to pay the lessor C100 at the end of each year.

If the lease is an operating lease, the total rental of C200 is recognised evenly over the lease term. An expense of C100 is therefore recognised each year.

If the lease is a finance lease, the accounting is more complex. First, the interest rate implicit in the lease needs to be estimated. In order to do this, the lessee would need to establish the fair value of the asset, its residual value at the end of the lease and the amount of any initial costs incurred by the lessor. The lessee might be able to get hold of this information from the lessor, or it may have to use its own incremental borrowing rate. For the purpose of this example, assume a rate of 10% is appropriate.

The present value of the lease payments at the beginning of the lease is C174 (calculated as  $C100/1.1 + CU100/1.1^2$ ). Provided this does not exceed the fair value of the leased asset, it is the amount at which the leased asset and lease liability are recognised.

In the first year, the lessee makes a payment of C100 and recognises interest on its liability of C17 (that is, 10% of C174). It also recognises depreciation of the leased asset, resulting in an expense of C87 (that is,  $174 \times \frac{1}{2}$ ). The total expense in the first year is therefore C104; the carrying amount of the leased asset is reduced to C87; and the carrying amount of the lease liability is reduced to C91 (that is, C174 plus interest of C17 less payment of C100).

Initial recognition of asset	174	Initial recognition of liability	174
Depreciation in year 1	(87)	Interest in year 1	17
	<u>87</u>	Repayment	(100)
			<u>91</u>

In the second year, the lessee again makes a payment of C100 and recognises interest on its liability of C9 (that is, 10% of C91). It also recognises depreciation of C87 on the leased asset. The total expense in the second year is therefore C96.

Asset at start of year 2	87	Liability at start of year 2	91
Depreciation in year 2	(87)	Interest in year 2	9
	<u>—</u>	Repayment	(100)
			<u>—</u>

The key accounting differences between an operating lease and a finance lease are as follows:

Operating lease	Finance lease
<ul style="list-style-type: none"> <li>• No asset or liability recognised</li> <li>• Expense in the form of rental</li> <li>• Expense recognised evenly over the lease term</li> </ul>	<ul style="list-style-type: none"> <li>• Asset and liability recognised</li> <li>• Expense in the form of depreciation and interest</li> <li>• Total expense tends to be higher in earlier years and lower in later years</li> </ul>

### The future

The existing lease accounting standard, with its two types of lease (operating and finance), has been strongly criticised. Many

leases are clearly of one type or the other, but some have features that could support either classification. This judgement has important accounting consequences, as described above. Some consider that this reduces comparability and transparency for investors; users regularly adjust the financial statements in order to take into account operating leases (considered as a form of 'off balance sheet financing').

The IASB and the FASB are working on a joint project, with the aim of issuing a new standard in 2011. They propose to eliminate the distinction between operating leases and finance leases; lessees would treat all leases in a manner similar to finance leases today. All leases would therefore be 'on-balance sheet'. This seems a fitting response to one famous critic of the current model (see quote on page 4).

## An IFRS year in review

Accounting technical partners ('GACS' – Global Accounting Consulting Services in PwC) are keen observers of and participants in the standard setting process. Many spend as much time thinking about what's coming in IFRS as advising on what today's standards say. 2009 is a year that many might want to forget – those involved in accounting standards may well be among them.

We asked the three global topic team leaders in PricewaterhouseCoopers' Global Accounting Consulting Services to reflect on the year that was, what change is coming in 2010 and finally what they would like the standard setter to do. The three topical areas are: financial instruments ('FI' – including leasing and real estate), business combinations ('BC' – all non-financial assets, business combinations, joint ventures, equity accounting and consolidations) and revenue, liabilities and other ('RLO' – everything to do with presentation, deferred tax, employee benefits, provisions, revenue recognition, etc).

### How would you sum up the standard setting activity in your area in 2009?

*John Althoff (FI):* Intense. We had the challenging combination of a lot of proposals (DPs and EDs – see box on p8) and short comment periods in which to respond. The IASB and FASB were given a mandate to 'fix' accounting for financial instruments, and they were to do it quickly and ideally on a converged basis. In a perfect world, you would approach the accounting for a broad area such as financial instruments in a methodical way with the goal of delivering a single comprehensive package. Instead, what we got was probably the opposite of that: a piecemeal approach where different pieces were separately debated and exposed for comment in

compressed timeframes. Having politicians interested in the outcome and weighing in with their viewpoints on the best accounting has added an interesting dimension to what some think is an otherwise dull world of standard setting.

*Mary Dolson (BC):* Waiting. We seemed to spend the year waiting for a joint venture standard, then waiting for a consolidation standard – like buses in a London snowstorm neither ever appeared. We also spent the year waiting for the changes to the business combinations and consolidation standards to become effective for our calendar year companies. We had plenty of work to do anyway in looking at impairments of goodwill, intangibles and fixed assets – both the impairments that were recorded and the might-have-been impairments that weren't recorded. We had a year to bed down the adoption of IAS 23 (revised) but it was a very quiet year for 'new GAAP'.

*Tony Debell (RLO):* Unfinished. None of the major projects – see box on p8 – have been finalised; all are still at the discussion and drafting stages. And the outlook will be the much same for this year. We have possibly had the opposite of the financial instruments experience – too much time for discussion. However, we also have the sense that projects aren't being approached in a holistic way.

### What are you expecting from the IASB in 2010 in the way of standard-setting activity?

*FI:* Again, intense, or do I have to use a different word?! There are more EDs on their way, with quick turnaround likely. We will probably see EDs on the classification and measurement of financial liabilities and hedge accounting for financial instruments at the end of the first quarter, along with a request for views on the FASB proposed package for financial

instrument classification, measurement, impairment and hedge accounting. In the second quarter, we can probably look forward to EDs on debt versus equity classification, leases, derecognition, insurance and hedge accounting for non-financial items. If all goes well, we should see final standards addressing financial instrument classification, measurement, impairment and hedge accounting by the fourth quarter, as well as fair value measurement.

BC: We're still expecting the joint venture standard and the consolidation standard. The JV standard is more likely to appear, but we'd be surprised to see it in Q1 as the IASB website predicts. We think they're still drafting, and at this point, that would make it a challenge for the end of March. The consolidation standard has become a convergence project with the FASB – so I wouldn't stand out in the cold and wait for that one. It may appear as a 2010 Christmas gift though. I think the Thursday before Christmas is a working day this year. The fair value measurement standard falls in the FI area (see above), although it has a big impact on non-financial asset measurement as well.

RLO: There is nothing new in the pipeline for this year that will be mandatory. The projects mentioned above will be debated and finalised, but nothing new is expected to be added to the Board's agenda. Preparers will have a challenge digesting what has been issued so far. We're all just relieved we don't have the new model for deferred tax, although we understand that IASB is considering some limited amendments to IAS 12 to address current practice issues. This brief quiet period will also be welcomed by the first-time adopters.

#### What's the big thing that will be 'newly applicable' (mandatory) in 2010 in your area?

FI: Although there will be some relatively minor amendments and narrow IFRIC issues applicable in 2010, none of the big ticket financial instruments standards will be mandatory this year. IFRS 9 is available for early adoption outside of the EU, but it is hard to say how many companies will be interested until they see the complete financial instruments package from the IASB in the fourth quarter.

BC: Finally, something for business combinations. IFRS 3 (revised) is applicable from 1 January 2010 for all calendar-year entities, and then lastly 31 March 2010 for those fiscal year ends – prospectively to transactions occurring after that date. The June and September year ends were swept up last year by the revised standard. Of course, the revisions to the consolidation standard around accounting for non-controlling interest are applicable at the same date. The presentation

aspects of IAS 27 (revised 2008) are retrospective, but the measurement aspects are largely prospective.

Both of these are convergence projects, and the US has been applying them for a year now. It has given us some insights into the issues and helped us prepare our IFRS clients for what's coming. Income statement volatility is looking like the biggest challenge from the changes in IFRS 3; it is a further iteration of the acquisition approach but not a radical change. Moving to the economic entity approach under IAS 27 is a bigger conceptual change, as minority shareholders are now treated as equity participants. We may see big debits and credits moving through equity, particularly as there are no transition provisions for first-time adoption.

RLO: We don't expect there to be any significant new guidance that is mandatory in 2010. The biggest projects that might be finalised in 2010, but mandatory in later years, will be the amendments to the guidance for provisions, the statement of comprehensive income, and the revisions to the accounting for termination benefits. The IFRIC has also decided to address the definitions of vesting and non-vesting conditions in IFRS 2.

#### Wave your magic wand and change one big thing and one small thing in IFRS. What are they?

FI: My big wish is so big that I'll forego my small wish: for the FASB and IASB to work at the same pace on the same projects drawing the same conclusions so they all apply at the same time. I'm talking complete convergence.

BC: The big thing would be to decide what equity accounting is and then sort out the standard on that basis. Is it fundamentally a financial asset or is it a 'collapsed consolidation'? This is particularly important, as the changes we're expecting from the new JV standard will widen the use of equity accounting. The small thing – can we call things by the old fashioned and simple names – so 'income statement', balance sheet, minority interest and perhaps even 'negative goodwill' instead of 'excess of the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed over the consideration transferred'.

RLO: I tried to settle on one big thing but I'm stuck on three, so I'm ignoring the guidance in the question. 1. For regulators and standard setters only to go public on the decisions that have legal standing, and not to issue their unauthorised views, which muddy the waters and do not help the debate. 2. A consistent model for recognising, measuring and derecognising credits that can be applied to revenue and liabilities. 3. A simplified model for deferred taxes that properly reflects the underlying economics.

## IASB activity in 2009\*

### Final standards

Amendments to IFRIC 14 IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction	<ul style="list-style-type: none"> <li>Published: November 2009</li> <li>Effective date: Annual periods beginning on or after 1 January 2011</li> <li>EU endorsement status: Not yet endorsed.</li> </ul>
IFRS 9, 'Financial instruments'	<ul style="list-style-type: none"> <li>Published: November 2009</li> <li>Effective date: Annual periods beginning on or after 1 January 2013</li> <li>EU endorsement status: Not yet endorsed</li> </ul>
Amendment to IAS 24, 'Related party disclosures'	<ul style="list-style-type: none"> <li>Published: November 2009</li> <li>Published: November 2009</li> <li>Effective date: Annual periods beginning on or after 1 January 2011</li> <li>EU endorsement status: Not yet endorsed</li> </ul>
Amendment to IAS 32 on classification of rights issues	<ul style="list-style-type: none"> <li>Published: 8 October 2009</li> <li>Effective date: Annual periods beginning on or 1 February 2010</li> <li>EU endorsement status: Not yet endorsed</li> </ul>
Amendment to IFRS 2, Share-based payment – Vesting conditions and cancellations	<ul style="list-style-type: none"> <li>Published: 18 June 2009</li> <li>Effective date: Annual periods beginning on or after 1 January 2010</li> <li>EU endorsement status: Not yet endorsed</li> </ul>
Amendments to IFRS 2 and IFRIC 11 'Share based payments – group cash settled	<ul style="list-style-type: none"> <li>Published: June 2009</li> <li>Effective date: 1 January 2010</li> <li>EU endorsement status: Not yet endorsed</li> </ul>
Amendments to IFRIC 9 and IAS 39 on embedded derivatives	<ul style="list-style-type: none"> <li>Published: March 2009</li> <li>Effective date: 30 June 2009</li> <li>EU endorsement status: 27 November 2009</li> </ul>
Amendments to IFRS 7, 'Financial instruments: Disclosures'	<ul style="list-style-type: none"> <li>Published: March 2009</li> <li>Effective date: 1 January 2009</li> <li>EU endorsement status: 27 November 2009</li> </ul>
IFRIC 18, 'Transfers of assets from customers'	<ul style="list-style-type: none"> <li>Published: January 2009</li> <li>Effective date: Transfers of assets from customers received on or after 1 July 2009, although EU endorsed from annual periods beginning on or after 31 October 2009</li> <li>EU endorsement status: Endorsed 27 November 2009</li> </ul>

### Exposure drafts

Amendment to IAS 37 on liabilities	<ul style="list-style-type: none"> <li>Published: January 2010</li> <li>Comment period ends: 12 April 2010</li> </ul>
Limited exemption from comparative IFRS 7 disclosures for first-time adopters (proposed amendment to IFRS 1)	<ul style="list-style-type: none"> <li>Published: November 2009</li> <li>Comment period ends: 29 December 2009</li> </ul>
Financial instruments: Amortised cost and impairment	<ul style="list-style-type: none"> <li>Published: November 2009</li> <li>Comments period ends: 30 June 2010</li> </ul>
D25, 'Extinguishing financial liabilities with equity instruments'	<ul style="list-style-type: none"> <li>Published: July 2009</li> <li>Comment period ends: 5 October 2009</li> </ul>
Rate regulated activities	<ul style="list-style-type: none"> <li>Published: July 2009</li> <li>Comments period ends: 20 November 2009</li> <li>Standard expected: 2010</li> </ul>
Fair value measurement	<ul style="list-style-type: none"> <li>Published: May 2009</li> <li>Comments period ends: 28 September 2009</li> <li>Standard expected: 2010</li> </ul>
Amendments to IFRS 5 (discontinued operations)	<ul style="list-style-type: none"> <li>Published: September 2008</li> <li>Comments period ends: 23 January 2009</li> <li>Standard expected: Q1 2010</li> </ul>
Amendments to IAS 39 and IFRS 7 on derecognition	<ul style="list-style-type: none"> <li>Published: March 2009</li> <li>Comments period ends: 31 July 2009</li> <li>Standard expected: First half of 2010</li> </ul>
Income taxes	<ul style="list-style-type: none"> <li>Published: March 2009</li> <li>Comments period ends: 31 July 2009</li> <li>Standard expected: First half of 2010</li> </ul>

### Discussion papers

Credit risk in liability measurement	<ul style="list-style-type: none"> <li>Published: 18 June 2009</li> <li>Comments period ends: 1 September 2009</li> <li>Standard expected: 2011</li> </ul>
Leases	<ul style="list-style-type: none"> <li>Published: March 2009</li> <li>Comment period ends: 17 July 2009</li> </ul>
Revenue	<ul style="list-style-type: none"> <li>Published: December 2008</li> <li>Comment period ends: 19 June 2009</li> </ul>
Presentation	<ul style="list-style-type: none"> <li>Published: October 2008</li> <li>Comment period ends: April 2009</li> </ul>

\* Not a definitive list



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## Some of the issues regulators will be focusing on in December 2009 reports

### What is the issue?

In the next reporting season, regulators around the world will be focusing on a number of the financial reporting issues that have surfaced as a result of the changed economic conditions.

This edition of *IFRS in brief* addresses six of the likely areas of focus and shares PwC's insight on each.

Impact on profit and loss	✓
Impact on balance sheet	✓
Impact on disclosures	✓
Impact on stakeholder communication	✓

### Who does it impact?

All entities that submit financial statements to a regulator, particularly those currently preparing December 2009 reports.

### What are likely areas of focus?

#### Issue: Going concern

Directors should be mindful of the entity's 'going concern' assumption and whether it remains appropriate at reporting date. Issues of liquidity and debt restructuring, and the ability of the entity to raise new funds should be considered when making this assumption. Consideration should also be given to future compliance with debt covenants.

#### PwC insight: Explain how 'significant uncertainties' will be mitigated

A number of entities disclosed significant uncertainty over their ability to continue as a going concern in the June 2009 reporting season. To help users of the financial statements understand the financial position, management should disclose how it plans to mitigate the circumstances surrounding the significant uncertainty. For example, an entity that is uncertain about its ability to refinance might disclose that it is currently renegotiating its banking covenants in order to maintain its existing line of credit.

#### Issue: Impairment of assets

Regulators continue to emphasise that an entity's impairment review process should be robust and transparent to ensure that investors can be confident in the reported value of assets.

In particular, entities should ensure that:

- The discount rates and growth rates used in the value-in-use calculation are realistic and supportable;
- Forecast periods of greater than five years are adequately explained; and
- A sensitivity analysis is disclosed, which includes any changes in management's key assumptions.

#### PwC insight: Impairment remains an issue at December

Economic indicators may appear more favourable now than at June 2009, but management should still be mindful of impairment indicators in the December 2009 period. For example, in Australia the continuing strength of the Australian dollar may give rise to an impairment indicator for entities with foreign currency cash flows. When translating foreign currency cash flows, management should ensure the foreign exchange rate is appropriate. Where the value-in-use calculation is the basis to determine the recoverable amount, the foreign exchange rate should be the 'spot rate' at reporting date. In contrast, a forward rate that is based on market evidence should be used where a discounted cash flow calculation has been applied to estimate the fair value of an asset.

## Issues regulators will focus on in December 2009 reports... cont'd

### Issue: Determining fair value

Regulators are likely to focus on how fair value is being determined for a range of assets. For example, some regulators have indicated that in the June 2009 reporting season a number of entities that held investment property didn't disclose the methods and assumptions that management used to determine their fair value. Further, some entities operating in inactive markets that carried their financial assets at fair value did not determine the fair value using the maximum amount of market information available. Entities should also be clear about when it is and isn't appropriate to carry intangible assets at fair value.

### PwC insight: Intangible assets should rarely be carried at fair value

Accounting standards are strict in this area. Intangible assets can only be re-valued where there is an active market for the assets, such that there are willing buyers and sellers for the asset and those assets are homogenous with prices available to the public. It is rare for intangible assets to meet this criteria in our experience. To justify why intangible assets have been carried at fair value, some entities cite the presence of broker quotes and prices in trade journals as evidence that prices are available to the market. However, these prices are often open to negotiation (in contrast to stock market prices, which are non-negotiable), making them a negotiated price rather than the market price.

### Issue: Off-balance sheet arrangements

Regulators around the world have indicated that financial reports imply off-balance sheet arrangements, but these arrangements are not being adequately disclosed in financial reports.

### PwC insight: Consider consolidation of special purpose entities

Although an entity may not be a subsidiary under the provisions of IAS 27, 'Consolidated and separate financial statements', it may be a controlled special purpose entity (SPE), which should be consolidated under SIC 12, 'Consolidation – Special purpose entities'. To help determine which party has control over an SPE, management should consider the substance of the SPE and its relationship to the various parties that participate in it. For example, on which party's behalf are the SPE's activities conducted?; which entity controls the decision-making process?; and which entity has the right to obtain the risks and benefits of the SPE's activities?

### Issue: New financial instruments disclosures

Regulators will expect to see entities fully disclose the extent of their financial instruments in line with IFRS 7. For example, that disclosure will include:

- Full explanation of the risks associated with financial instruments.
- A comprehensive sensitivity analysis to market risks.
- An ageing analysis of financial assets that are past due but not impaired.
- An analysis of impaired financial assets.

### PwC insight. New fair value hierarchy

Entities preparing annual financial statements at December 2009 should be aware of the revised requirements under IFRS 7. For example, all financial instruments measured at fair value in the balance sheet should be classified into a new three-level fair value hierarchy. We expect the new hierarchy to increase the disclosure requirements for those entities with instruments in the level 3 category, which are measured primarily using management's estimates and assumptions. For more information, download PwC's 'Fair's fair' publication from [www.pwcinform.pwc.com](http://www.pwcinform.pwc.com)