IFRS update for the EU

June 2017

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1 Introduction

This IFRS for the EU update deals with the accounting changes that affect entities using IFRS as adopted in the European Union with an accounting period ending on 30 June 2017. It is based on the assumption that there is a 12 month accounting period. It does not deal with other information, such as information to be contained in a strategic report or directors' report for a UK company. It includes an annotated list of IASB pronouncements in issue but not in force at 30 June 2017 (but see below). This has been divided between those items which have been endorsed by the EU and those that have not. Where items have been endorsed they can be adopted early (subject to any limitation in the standard itself) and details of their effect must be disclosed. Where IFRS have not been endorsed they must not be adopted early in the EU.

This update is intended as a summary only, and is not intended to provide comprehensive guidance in respect either of changes that have taken place, or of standards or interpretations that have been issued but are not in force. It is intended to indicate whether a standard or interpretation is relevant or potentially relevant.

This update does not deal with the IFRS for SMEs, which is available for use by those entities based in jurisdictions which either do not specify the GAAP which must be applied or which have in fact adopted the IFRS for SMEs as an acceptable GAAP. It should be noted that the IFRS for SMEs has not been endorsed by the EC, and as a result cannot be used within the European Union.

This update also ignores IFRS 1 and consequently IFRS 14, and as a result does not deal with the issues faced by entities adopting IFRS for the first time with a period ending 30 June 2017. The update also deals only with annual financial statements, and therefore does not deal with the changes to IAS 34.

The IASB Practice Statement on Management Commentary has also been excluded, since it does not constitute an accounting standard.

Trivial changes to standards, which are simply consequential amendments as a result of changes to other standards, have similarly been ignored where they do no more than update references to, or descriptions of, the requirements of the standards which have been subject to the substantive change.

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2 Standards

2.1 IAS 1 – Presentation of Financial Statements

These amendments arise from the disclosure initiative and address a number of areas which include the disclosure of significant accounting policies, the application of materiality to financial statements, the presentation of sub-totals, information to be presented in the other comprehensive income section of the performance statement and the structure of the financial statements.

Entities are required to present significant accounting policies that form part of a complete set of financial statements, rather than a summary of significant accounting policies. It may appear that this change is likely to have little impact on entities, however the amendment requires that an entity consider the nature of its operations, and the policies that users of its financial statements would consequently expect to be disclosed for that type of entity. This will necessitate a review by entities of their accounting policies, to ensure they cover all significant areas.

The amendments clarify the application of materiality to the disclosures required by certain IFRSs. Such information need not be disclosed if the disclosure is not material to the entity: this principle would apply even where an IFRS sets out specific or 'minimum' disclosure requirements. Furthermore, when applying materiality and aggregating information in financial statements, an entity needs to consider all relevant facts and circumstances, so as not to obscure material information with immaterial information, or to avoid aggregating material items that have different natures or functions.

The amendments set out criteria that should be applied when sub-totals are presented in the statement of financial position and the performance statement or statements. Sub-totals must be clear and understandable, consistent from period to period, not be displayed with more prominence than sub-totals required by IFRS and should include line items that are recognised in accordance with IFRS.

The amendment also clarifies the presentation of other comprehensive income, which should be presented by nature, separately presenting an entity's share of its associates' or joint ventures' other comprehensive income. The disclosed categories of other comprehensive income are grouped by those items that are not subsequently reclassified to profit or loss, and those that may be subsequently reclassified to profit or loss.

The amendment provides various examples of the ordering or grouping of notes in the financial statements that ensure that the notes are presented in a systematic manner, but has eliminated any apparent requirement that there is a prescribed order of notes. This is the change which might impact entities the most, as entities will be able to re-order the notes according to their assessed relevance. For example, all notes based on an operating activity could be presented together. Alternatively, information with a similar measurement basis could be grouped together.

2.2 IAS 16 – Property, Plant and Equipment

There are two amendments to IAS 16. The first prohibits the use of a revenue-based method of depreciation.

For example, depreciating the asset based on revenue generated in the period as a proportion of total revenue expected to be generated by the asset is not a suitable method of depreciation given revenue is subject to other factors i.e. inflation or changes in sales volume and price. The amendment clarifies that those factors have no impact on the way the asset is consumed, but instead could indicate technological or commercial obsolescence of the asset that reflects a reduction of the future economic benefits of the asset. It is worth pointing out that some bases of depreciation, such as the unit of production method, are likely to be highly correlated with revenue. Nonetheless, they are not directly revenue based and will not be covered by the prohibition. They will continue to be allowed where they are an appropriate basis.

The second amendment defines and brings bearer plants into the scope of IAS 16 rather than IAS 41. Bearer plants are broadly those which are used in the production or supply of agricultural produce over more than one period and are unlikely to be sold as agricultural produce. An example would be a vine used in the production of grapes.

A bearer plant is similar to a manufacturing asset, since the only significant future economic benefits from bearer plants arise from selling the agricultural produce that they create. Hence, bearer plants meet the definition of property, plant and equipment in IAS 16. Bearer plants can be carried under the cost method or the revaluation method of accounting in accordance with IAS 16.

The produce growing on bearer plants will remain within the scope of IAS 41.

2.3 IAS 19 – Employee Benefits

The amendment to IAS 19 arises from the annual improvements projects, and clarifies the discount rate to be used in regional markets. The amendment clarifies that the discount rate to be used for post-employment benefit obligations must be assessed at a currency level and not a country/regional market level when determining the rate based on high quality corporate bonds or government bonds when there is no deep market in high quality corporate bonds in that currency. In practice, this is most likely to affect entities operating within a currency union, such as the Eurozone.

2.4 IAS 27 – Separate Financial Statements

The IAS 27 amendment addresses the measurement of investments in separate financial statements. It reinstates a previous option to allow an entity to measure its investments in subsidiaries, associates or joint ventures in the separate financial statements applying the equity method of accounting, this option is in addition to the cost and fair value method currently allowed. The accounting policy choice must be applied to each class of investment.

The amendment also clarifies that when an investor becomes or ceases to be an investment entity, such a change in accounting must start from the date the change in status occurs.

2.5 IAS 28 – Investments in Associates or Joint Ventures

The amendment clarifies the application of the consolidation exemption for investment entities, and is consistent with the amendments to IFRS 10.

The amendment makes clear that a parent entity is exempt from applying the equity method of accounting for an investment in associate or joint venture if the entity's ultimate or intermediate parent produces financial statements (consolidated or unconsolidated) that are available for public use and comply with IFRSs in which subsidiaries are consolidated or measured at fair value through profit or loss in accordance with IFRS 10. Previously, the ultimate or intermediate parent financial statements needed to be consolidated financial statements, which was inconsistent with the investment entity exemption, when the ultimate or intermediate parent is an investment entity applying the IFRS 10 consolidation exemption.

The standard has also been amended to extend the investment entity exemption to an investor that is not an investment entity itself but has an investment in an associate or joint venture that is an investment entity which has applied the consolidation exemption in IFRS 10. In such situations the investor may retain the fair value measurement applied by the investment entity associate's or joint venture's interest in subsidiaries. This amendment is useful as it would be impracticable for an investor to unravel the fair value through profit or loss accounting applied by the associate or joint venture and then consolidate their subsidiaries in order to apply the equity method of accounting in the investor's financial statements.

2.6 IAS 38 – Intangible Assets

The amendment to IAS 38 clarifies the suitability of using a revenue-based method of amortisation for an intangible asset.

The amendment is similar to that made to IAS 16, however the amendment to IAS 38 includes a rebuttable presumption that an amortisation method based on revenue generated is inappropriate, rather than a full prohibition. Revenue is usually subject to other factors i.e. inflation or changes in sales volume and price, which does not result in a suitable method of amortisation.

The presumption can be rebutted when:

- the use of the intangible asset is expressed as a measure of revenue (for example, a contract to use the intangible asset specifies a revenue threshold to be reached); or
- it can be demonstrated that there is a high correlation between revenue and the consumption of economic benefits of the intangible asset.

2.7 IAS 41 – Agriculture

Bearer plants have been taken outside of the scope of IAS 41. The changes made are dealt with above under the third amendment noted to IAS 16.

The produce growing on bearer plants will remain within the scope of IAS 41.

2.8 IFRS 5 – Non-current Assets Held for Sale and Discontinued Operations

The amendment clarifies the accounting for a change in a disposal plan from held for sale to held for distribution, or vice versa.

The amendment clarifies that when there is a reclassification of an asset (or disposal group) directly from held for sale to held for distribution to owners (or vice versa), then such a change should not result in a change in the measurement of the asset (or disposal group), in so far as the requirements to be held for sale or held for distribution are met. Such a change in classification does not result in a new plan of disposal and consideration would need to be given to whether the requirements for an extension to the normal 12 month period to complete the sale is appropriate.

The clarification also confirms that when the criteria for held for distribution are no longer met the accounting treatment is the same as for when the criteria for held for sale are no longer met.

2.9 IFRS 7 – Financial Instruments: Disclosures

The amendment clarifies the concept of continuing involvement in transferred financial assets for disclosure purposes.

Continuing involvement does not exist in a transferred financial asset when the entity does not have an interest in the future performance of the transferred financial asset, nor the responsibility to make payments in respect of the financial asset in the future.

The amendment clarifies the latter requirement relating to making a “payment” in respect of the financial asset. Payment in this context does not include cash flows of the transferred financial asset that are collected by the entity and remitted to the transferee.

The amendment provides examples of when continuing involvement exists in transferred financial assets when a servicing fee is paid to the entity and the fee is based on the amount or timing of cash flows collected on behalf of the transferee. In such situations the entity retains an interest in the performance of the transferred financial assets, hence continuing involvement exists.

2.10 IFRS 10 – Consolidated Financial Statements

The amendment clarifies the application of the consolidation exemption for investment entities.

The amendment makes clear that an investment entity parent is exempt from preparing consolidated financial statements if that investment entity’s ultimate or intermediate parent produces financial statements (consolidated or unconsolidated) that are available for public use and comply with IFRS. Previously the ultimate or intermediate parent financial statements needed to be consolidated financial statements, which was inconsistent with the investment entity exemption when the ultimate or intermediate parent is an investment entity applying the IFRS 10 consolidation exemption.

The amendment also clarifies that a subsidiary of an investment entity whose main purpose and activities are providing services that relate to the parent entity’s investment activities, must be consolidated by the investment entity parent.

2.11 IFRS 11 – Joint Arrangements

The standard has been amended to provide guidance on accounting for acquisitions of interests in joint operations that constitute a business in accordance with IFRS 3.

A joint operator that acquires an asset or group of assets in a joint operation that represents a business in accordance with IFRS 3 should apply the principles in IFRS 3 in accounting for business combinations to the acquisition. This will result in separate recognition of goodwill, if any arises on the acquisition. If the asset or group of assets acquired do not constitute a business then the principles of IFRS 3 are not applied.

The amendment also clarifies that a joint operator which increases its interest in an existing joint operation in which the operator retains joint control does not remeasure the previously held interest in the joint operation.

The amendment does not apply to the acquisition of an interest in a joint operation when the joint operation is under common control of the same ultimate controlling party or parties both before and after the acquisition.

The amendment provides principles akin to those applied in the acquisition of a subsidiary.

2.12 IFRS 12 – Disclosure of Interests in Other Entities

The standard has been amended as part of the IFRS 10 consolidation exemption for investment entities. The amendment ensures consistency with IAS 27, in that disclosure is to be provided in accordance with IFRS 12, when an investment entity measures all its subsidiaries in its financial statements at fair value through profit or loss in accordance with the IFRS 10 investment entity consolidation exemption.

3 Guidance in Issue but not in Force – EU Endorsed

3.1 Introduction

IAS 8 requires disclosure of guidance in issue but not in force. The minimum disclosure relates to guidance issued by the date of the statement of financial position, and with a potential effect.

The following guidance covers EU endorsed standards.

3.2 IAS 1 – Presentation of Financial Statements

IAS 1 has been amended as a consequence of the issue of IFRS 9 (as set out below). The main changes deal with the abolition of the available for sale category of financial assets, amend the presentation and disclosure of gains and losses arising on financial assets stated at amortised cost, and take account of the revised reclassification rules under IFRS 9 as compared with IAS 39. These changes take effect at the same time as IFRS 9 is applied.

3.3 IAS 39 – Financial Instruments: Recognition and Measurement

The major change to IAS 39 arises out of IFRS 9. The amendments primarily remove items from the scope of the standard, insofar as they are dealt with by IFRS 9. However, these changes apply only when IFRS 9 is adopted.

3.4 IFRS 7 – Financial Instruments: Disclosures

A major change to IFRS 7 arises out of IFRS 9. There are significant changes to the standard, reflecting the replacement of the four categories of financial asset under IAS 39 with the three under IFRS 9. All of the IFRS 7 disclosures by category of financial asset have had to be altered to reflect the new categorisation. There are also changes associated with the potentially different measurement bases applied by IFRS 9. IFRS 7 also has a number of disclosures which deal with the transition from IAS 39 to IFRS 9 for financial assets, and will be required only for the year of change.

3.5 IFRS 9 – Financial Instruments

The IASB has completed IFRS 9 Financial Instruments, the replacement for IAS 39, dealing with the classification, recognition and measurement, de-recognition, impairment and hedge accounting (except for macro hedging). IFRS 9 applies for accounting periods beginning on or after 1 January 2018, though as explained below, its transitional provisions are complex.

Macro hedging (described as dynamic risk management) is now being considered as a separate project, and a standard dealing with that matter will be issued in due course.

Objective and Scope

IFRS 9 has the objective of establishing principles for the financial reporting of financial assets and liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of the entity's future cash flows.

The scope of the standard is similar to that of IAS 39, however, there are some changes:

- it is now made clearer that the exclusion for forward contracts for business combinations applies only to such combinations which are within the scope of IFRS 3;
- loan commitments now fall within the scope of the impairment requirements (as well as the de-recognition requirements, which also applied under IAS 39); and

- entities may now, at inception, irrevocably designate a contract to buy or sell a non-financial item that would normally be excluded from the scope if this eliminates or reduces a recognition inconsistency (or accounting mismatch).

Recognition and De-recognition

IFRS 9 does not make any substantive changes to the IAS 39 requirements in respect of recognition and de-recognition of financial assets or liabilities, instead more disclosures are required by IFRS 7 on de-recognition.

Classification of Financial Assets

The four categories of financial asset set out in IAS 39 do not survive into IFRS 9. Instead there are three categories:

- at amortised cost;
- at fair value through other comprehensive income; and
- at fair value through profit or loss.

In deciding into which category a financial asset falls, the entity must take account of:

- the entity's business model for managing the financial assets; and
- the contractual cash flow characteristics of the financial asset.

Financial assets are measured at amortised cost if:

- the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Financial assets are measured at fair value through other comprehensive income if:

- the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

These requirements are based on the contractual rights to cash flows and the business model.

There is one exception to the second requirement, and an entity may make an irrevocable election at initial recognition for specific investments in equity instruments that would otherwise be measured at fair value through profit or loss to present subsequent changes in fair value in other comprehensive income. This election is not available if the investment is held for trading nor for contingent consideration payable by the acquirer in a business combination to which IFRS 3 applies.

Contractual Rights to Cash Flows

IFRS 9 defines interest widely and conceptually, rather than legalistically.

Interest means consideration for the time value of money and for the credit and other lending risks associated with the principal amount outstanding during a particular period of time, and includes a profit margin.

IFRS 9 contains considerable guidance dealing with the assessment as to whether payments represent payments of interest and principal.

For example, terms in contracts dealing with prepayment will still allow the asset to qualify if such terms mean any prepayment would substantially represent unpaid amounts of principal and interest on that principal, and can still include reasonable amounts of compensation for early termination.

Items are excluded where the contractual cash flows include, or are affected by, factors other than consideration for the time value of money and the credit risk associated with the principal amount outstanding during a particular period of time.

The Business Model

The business model is a more complex concept, and there is considerable guidance appended to the standard to deal with it. In broad terms, it represents the general approach that an entity takes to its portfolio of “debt” instruments.

The assessment of which business model is being applied needs to be based on observable data, such as business plans, remuneration arrangements, risk management practices, and amount and frequency of disposals, including in some cases the business rationale for those disposal.

Entities may have more than one business model, although in this case there would have to be a clear observable distinction between the relevant portfolios.

Other Financial Assets

All financial assets which do not fall into the first two categories must be stated at fair value through profit or loss.

There is an exception to this general rule. An item which would normally be stated at amortised cost under the requirements set out above may be designated as to be measured at fair value through profit or loss if doing so would eliminate or significantly reduce a measurement or recognition inconsistency (or “accounting mismatch”) that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases.

It should also be noted that IFRS 9 does not carry over the impracticability exemption of IAS 39 in relation to equity investments without a market price. This means that all equity investments must be stated at fair value.

Classification of Financial Liabilities

The requirements in respect of classification of financial liabilities of IAS 39 have, largely, been carried forward without change into IFRS 9.

However, consistent with the change in the treatment of unquoted equity investments dealt with above, the standard does change the treatment of derivative liabilities that are linked to, and must be settled by delivery of, unquoted equity instruments.

Under IAS 39, such instruments were potentially subject to an exemption on fair value measurement. That exemption does not survive.

The exceptions related to financial guarantee contracts and below-market loan commitments survive, with the only change (other than references to IAS 18 changing to IFRS 15) being that no reference is made to the amount that would be determined under IAS 37. Instead, these are subject to the impairment, or loss allowance, requirements set out in IFRS 9.

Entities will still have the option to designate liabilities that would otherwise have been stated at amortised cost, as at fair value through profit or loss. The conditions that must be satisfied to do this are substantively unchanged from those in IAS 39.

Embedded Derivatives

IFRS 9 has, with some rewording, basically taken the definition of an embedded derivative from IAS 39 without substantive change.

It does, however, change the accounting consequences of identifying embedded derivatives, quite substantially in some cases.

Where there is an embedded derivative then under this standard:

- if the host contract is an asset that falls within the scope of IFRS 9 then the embedded derivative is not separated but the entire contract is accounted for under IFRS 9. This will normally mean that the contract is stated at fair value, although there are exceptions;

- if the host is not an asset that falls within the scope of IFRS 9 then the requirements are unchanged from IAS 39, in terms of determining whether the embedded derivative needs to be separated from the host. If it does, then the resulting instrument should be classified according to IFRS 9 and the host should be accounted for in accordance with whatever is the applicable standard.

Reclassification of Financial Assets

Reclassification is allowed if, and only if, the entity changes its business model for managing financial assets, or specific portfolios of financial assets.

Where this occurs, the change in accounting treatment is applied on a prospective basis only, from the reclassification date. This is defined as the first day of the first reporting period following the change in business model that results in an entity reclassifying financial assets. There is no change to the treatment of any gains, losses or interest amounts that have previously been recognised.

If the change is from amortised cost to fair value through profit or loss then fair value is determined as at the reclassification date and any difference between this amount and the previous carrying amount is taken immediately to profit or loss.

If the change is from fair value through profit or loss to amortised cost then the fair value at the reclassification date is taken to be the new gross carrying amount, that is, effectively the new gross cost for the purposes of determining amortised cost.

If the change is from amortised cost to fair value through other comprehensive income then fair value is determined as at the reclassification date and any difference between this amount and the previous carrying amount is taken immediately to other comprehensive income. No adjustment is made (as a result of this change in isolation) to the effective interest rate or measurement of expected credit losses.

If the change is from fair value through other comprehensive income to amortised cost then the reclassification is undertaken at fair value, but immediately adjusted for any gains and losses that have been previously been recognised in other comprehensive income. This should result in the asset being recorded at the same amount as if it had always been measured at amortised cost.

If the change is from fair value through profit or loss to fair value though other comprehensive income there is no adjustment to the carrying amount. However, the entity must then determine an effective interest rate and loss allowance, as this will be relevant on an ongoing basis.

If the change is from fair value through other comprehensive income to fair value through profit or loss there is no adjustment to the carrying amount. The cumulative gain or loss that has been recorded through other comprehensive income and accumulated in equity is reclassified to profit or loss as a reclassification adjustment under IAS 1.

Financial liabilities cannot be reclassified.

Gains and Losses

All gains or losses on assets and liabilities held at fair value are recognised in profit or loss, other than:

- gains and losses on items in a hedge relationship, where the hedge accounting rules require them to be recognised outside of profit or loss;

- gains and losses (other than dividends) on equity investments where the entity has made the irrevocable election to present in other comprehensive income subsequent changes in fair value;

- the amount of changes in the fair value of a liability measured at fair value which are attributable to changes in that liability's credit risk (which are shown within other comprehensive income); and

- in respect of assets carried at fair value through other comprehensive income, any changes in fair value that are not attributable to impairment, foreign exchange movements or the use of the effective interest method.

Where a financial asset is stated at amortised cost (and is not part of a hedging relationship) then gains or losses are recognised in profit or loss:

- on de-recognition;

- when the asset is impaired;

- if the asset is reclassified in accordance with the requirements set out above; or

- through the amortisation process.

If settlement date accounting is used then any value changes between trade date and settlement date are ignored, if the asset is measured at amortised cost. They are taken to profit or loss or other comprehensive income (in accordance with the normal rules) if the asset is measured at fair value.

Where a financial liability is stated at amortised cost (and is not part of a hedging relationship) then gains or losses are recognised in profit or loss:

- on de-recognition; and

- through the amortisation process.

Where a financial asset is treated at fair value through other comprehensive income then gains or losses are split between profit or loss and other comprehensive income, as set out above, during the life of the asset. On de-recognition, the cumulative gains or losses previously recognised in other comprehensive income are reclassified from equity to profit or loss.

Measurement

With one main exception, financial assets and liabilities are initially recorded at their fair value (at trade date, if relevant). In the case of items which will not be carried at fair value through profit or loss, this is then adjusted for directly attributable acquisition costs.

The main exception is trade receivables which do not contain a significant financing component, which are initially recorded at transaction price.

There is another, minor, exception where the transaction price does not equal the fair value (so called "day one" gains or losses). Where the fair value is evidenced by a level 1 input then it should be used for initial recording, giving rise to an immediate gain or loss. In all other cases, the difference is deferred, which means that in practice it is the transaction price that is used. This difference is then only recognised to the extent it arises from a change in a factor, including time, that a market participant would take into account in pricing the item.

After recognition, financial assets are carried at a value measured in accordance with their classification, as set out above. Impairment requirements also need to be reflected for items at amortised cost or at fair value through other comprehensive income.

Similarly, financial liabilities are measured in accordance with their classification.

The general rule is that the effective interest method is applied to the gross carrying amount of financial assets (i.e. ignoring impairment) but this does not apply to:

- purchased or originated credit-impaired assets; or

- assets that have become credit-impaired since recognition (unless and until there is objective evidence that the credit-impairment has reversed).

Where contractual cash flows are renegotiated or modified (and that does not result in de-recognition) the gross carrying amount is redetermined, including reflecting any costs or fees, and a profit or loss recognised.

Impairment

IFRS 9 moves to an expected loss model of accounting for impairments compared with IAS 39 incurred loss model.

Under the new model, expected credit losses are recognised from the point at which a financial asset is initially recognised. This applies to financial assets measured at amortised cost, lease receivables, contract assets, loan commitments, financial guarantee contracts and financial assets measured at fair value through other comprehensive income. The difference is that, in the final case, the loss allowance is recognised in other comprehensive income and is not reflected directly in the balance sheet as it is incorporated in the fair value of the asset.

For the purposes of dealing with expected credit losses, financial assets fall into three categories:

- trade receivables, contract assets and lease receivables (although this involves a policy choice for longer term trade receivables and contract assets, and for all lease receivables);
- purchased or originated credit-impaired assets; and
- all other financial assets (including trade, contract and lease receivables where the entity has decided not to apply the simplified approach) as well as financial guarantee contracts and loan commitments.

When dealing with impairment the standard deals with two bases for determining losses. The first is lifetime expected credit losses. This is, in effect, a reasonable estimate of the losses that might be expected to arise on an instrument, or a portfolio of instruments, over its whole life.

The second is 12-month expected credit losses, that is a portion of the lifetime expected credit losses that result from default events on a financial instrument that are possible within the 12 months after the reporting date.

For trade receivables and contract assets that do not contain a significant financing component entities are always required to measure their allowance account as lifetime expected credit losses.

The same applies to trade receivables and contract assets that do contain a significant financing element, and to lease receivables, although in these cases that is a policy choice. (The choice can be made separately for each class, and indeed separately for operating and finance lease receivables.)

For all other financial assets, as well as financial guarantee contracts and loan commitments apart from those which were credit impaired at origination or acquisition, the approach depends on whether the credit risk has increased significantly since original recognition or not.

If it has, then the entity must measure the allowance account based on lifetime expected credit losses.

If it has not, then the entity must measure the allowance account based on 12-month expected credit losses.

For financial assets which were credit impaired at origination or acquisition, the allowance account must always be based on lifetime expected credit losses. This applies even if there is an improvement such that the asset is no longer considered to be credit-impaired.

Deciding whether there has been a significant increase in credit risk, is not always going to be an easy exercise and requires judgement. The determination must be made by comparing the risk of default at the reporting date with the risk at the recognition date, taking into account all reasonable and supportable information that is available without undue cost or effort. It should be noted that credit risk must be assessed without regard to collateral.

Regardless of the period covered by the allowance account, credit losses should be measured by reference to:

- an unbiased and probability-weighted amount determined by evaluating a range of possible outcomes;
- the time value of money; and
- reasonable and supportable information available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

Normally, the maximum period that needs to be considered, which is relevant only when dealing with lifetime expected credit losses, is the maximum contractual period including contractual extension periods. The exception is where an arrangement includes both drawn and undrawn elements, when the period covered by undrawn amounts may also need to be taken into account.

Hedge Accounting

IFRS 9 contains hedge accounting conditions that are more liberal than those of IAS 39. Whilst hedge accounting remains optional, the simplicity that IFRS 9 introduces is likely to extend its use.

However, entities have an option, they could apply IFRS 9 hedge accounting requirements or continue to apply existing IAS 39 hedge accounting requirements as the project on macro hedge accounting has not been completed.

It should be noted that IFRS 9 does not deal with macro hedge accounting, and the relevant requirements of IAS 39 will continue to apply to such arrangements, pending a new standard dealing with this issue.

IFRS 9 allows an entity to apply hedge accounting where it designates a hedging relationship between a hedging instrument and a hedged item that meets all the qualifying criteria:

- the relationship consists only of eligible hedging instruments and eligible hedged items;
- there is formal designation and documentation at inception which includes the risk management objectives and strategy, identifies the relevant items, identifies the relevant risks and explains how hedge effectiveness will be determined; and
- the hedge meets the effectiveness requirements, meaning there is an economic relationship between the hedged item and hedging instrument, the effect of credit risk does not dominate value changes arising, and the hedge ratio is the same as that arising from the quantities hedged and used for hedging.

A qualifying hedging instrument can be a derivative measured at fair value through profit or loss or a non-derivative instrument measured at fair value through profit or loss unless it is a financial liability for which the amount of its change in fair value attributable to changes in the credit risk is presented in other comprehensive income.

For a hedge of foreign currency risk the hedging instrument cannot be an equity instrument for which an entity has elected to present changes in fair value in other comprehensive income.

Only contracts with a party external to the entity can be designated as hedging instruments.

Generally, an item can be a hedging instrument only in its entirety, but there are exceptions and a hedging instrument may be:

- a portion of the entire instrument (e.g. 75%);
- the intrinsic value of an option, i.e. not its time value; or
- the spot element of a forward contract.

(There are separate detailed rules on accounting for hedges where these exclude the time value of options or the forward element of forward contracts, including foreign currency basis spreads.)

A hedging instrument may also be a group of instruments (or parts of instruments, as above) even where some risks are offset within that grouping. However, a net written option cannot qualify unless it is being used to hedge a purchased option.

A qualifying hedged item can be a recognised asset or liability, an unrecognised firm commitment, a forecast transaction which is highly probable, or a net investment in a foreign item. The hedged item can be a single item, a group of items (if they meet certain criteria) and can also be a component of such an item or group of items. The hedged item must be reliably measurable.

A hedged item (other than for a net investment in a foreign operation) must be in relation to a party external to the reporting entity, although IFRS 9 makes clear that this can also be a subsidiary in the group accounts of an investment entity if that subsidiary is carried at fair value. There is also an exception for intragroup monetary items where exchange gains or losses would not be fully eliminated on consolidation.

A hedged item will generally be an item in its entirety, but it can also be a component of an item if that component is:

- a specified part of the total amount of an item;
- one or more contractual cash flows; or
- changes in fair value or cash flows that can be attributed to a specific risk or risks and that are separately identifiable and reliably measurable. This can include a one-sided risk, i.e. a risk that relates only to movements above or below a specified variable.

There is an exception to the general rules in that where an entity used a credit derivative that is measured at fair value through profit or loss to manage the risk associated with a credit exposure it can designate the instrument giving rise to that exposure (or the appropriate proportion of it) as measured at fair value through profit or loss, so long as:

- the party giving rise to the credit exposure is the same as the reference entity of the credit derivative; and
- the seniority of the instrument giving rise to the credit exposure matches that of the instruments that can be delivered in accordance with the credit derivative.

This exception can be applied even to exposures that are not within the scope of IFRS 9, including those which may not be recognised, such as loan commitments on arm’s length terms.

For the purpose of hedge accounting there are three types of hedging relationship:

- fair value hedges;
- cash flow hedges; and
- hedges of a net investment in a foreign operation.

A hedge of the foreign currency risk of a firm commitment may be accounted for as either a fair value hedge or as a cash flow hedge.

Fair value hedges are accounted for by:

- recognising the gain or loss on the hedging instrument in profit or loss (unless the hedged item is an equity instrument where the entity has elected to recognise fair value changes in other comprehensive income, in which case the change in fair value on the hedging instrument also goes to other comprehensive income);
- and, as appropriate:
  - adjusting the carrying amount of the hedged item, where that item is recognised, reflecting the movement in profit or loss (unless the hedged item is an equity instrument where the entity has elected to reflect movements in other comprehensive income); or
  - recognising an asset or liability, with the movement going to profit or loss, for the cumulative hedging gain or loss if this relates to an unrecognised firm commitment.

Where the hedged item is a financial instrument recognised at amortised cost, the cumulative hedging gain or loss must itself be amortised, based on a recalculated effective interest rate.

Where the hedged item is a financial instrument recognised at fair value through other comprehensive income the same procedure is basically applied, except that it is the amount of the cumulative gain or loss previously recognised that must be amortised and not the carrying amount.

Cash flow hedges are initially accounted for by:

- creating a cash flow hedge reserve which is adjusted to the lower of:
  - the cumulative gain or loss on the hedging instrument; and
  - the cumulative change in fair value of the hedged item;
- recognising the effective portion of the gain or loss on the hedging instrument in other comprehensive income; and
- recognising the ineffective portion (if any) of the gain or loss on the hedging instrument in profit or loss.

Subsequently, the amount that has been built up in the cash flow hedge reserve is:

- transferred directly to the initial carrying amount of the asset or liability where:
  - a hedged forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability; or
  - a hedged forecast transaction for a non-financial asset or non-financial liability becomes a firm commitment for which fair value hedge accounting is applied;
- reclassified to profit or loss in the same period or periods during which the hedged expected future cash flows affect profit or loss, for other cash flow hedges; and
- reclassified immediately to profit or loss if all or part of a loss is not expected to be received.

Similar rules apply where a cash flow hedge ceases to qualify. If the cash flow is still expected to occur then the balance is spread forward and if the cash flow is not expected to occur then it is reclassified immediately to profit or loss.

Hedges of a net investment in a foreign operation are initially accounted for in the same way as cash flow hedges. The cumulative gain or loss accumulated in equity is reclassified to profit or loss on disposal or partial disposal of the foreign operation.

If a hedging relationship ceases to meet the effectiveness requirement but the risk management objective remains the same, the hedge ratio should be adjusted so that it meets the qualifying criteria again.

Hedge accounting must be discontinued only when the hedging relationship ceases to meet the qualifying criteria. This includes instances when the hedging instrument expires or is sold, terminated or exercised. The standard notes that expected rollovers, and the replacement of instrument counterparties as result of changes in law or regulations including other changes consequential on this, are not treated as expirations or terminations.

IFRS 9 also deals with the option to designate a credit exposure as measured at fair value through profit or loss.

Transitional Provisions

While IFRS 9 is a fairly straightforward standard, its transitional provisions are complex.

The basic requirement is that IFRS 9 is to be applied retrospectively, but there is a very wide range of exceptions to this general principle. In particular, there is no requirement to restate prior periods. Indeed, prior periods may only be restated where it is possible to do so without the use of hindsight. Where this cannot be done, or an entity has chosen not to do it, the retrospective effect is reflected by adjustment to opening retained earnings, or other category of equity as appropriate.

The date of initial application is now defined as the beginning of the first reporting period in which the entity adopts this IFRS. There is no longer an option to adopt the standard from a date which is not the beginning of an accounting period. However, and very unusually, it is possible for an entity to have more than one date of initial application.

The following summary deals only with some of the transitional provisions.

At the date of initial application, an entity has to determine whether assets should be treated as at amortised cost or at fair value through other comprehensive income based on the situation at that date. It does not need to consider the business model that had previously been applied. Once determined, the treatment is applied retrospectively.

Where it is impracticable (as defined in IAS 8) to determine the impact of the time value of money (due to, for example, a mismatch between the rate basis and the tenor) or the significance of a prepayment feature then that issue can be ignored, and the cash flows should be assessed without regard to that feature for the purposes of classification and measurement at initial recognition.

If an entity measures a hybrid contract at fair value but had not previously done so, then the fair value of the hybrid contract in the comparative reporting periods shall be the sum of the fair values of the components (i.e. the non-derivative host and the embedded derivative) at the end of each comparative reporting period if the entity restates prior periods. The difference between this sum and the fair value of the hybrid contract at the date of initial application is adjusted through opening retained earnings (or other equity account) of the relevant period.

An entity can choose to designate a financial asset as at fair value through profit or loss, or an equity instrument as at fair value through other comprehensive income, if it meets the normal conditions at the date of initial application. It then applies this treatment retrospectively. It does not matter whether the conditions would have been met at the date of original recognition.

Similarly, entities must revoke designation of financial assets at fair value through profit or loss if they do not meet the normal IFRS 9 conditions at the date of initial application, and may revoke this designation even if they do, if they were classified under this category under IAS 39. This is then applied retrospectively.

The same principle is also applied to liabilities, so, on the basis of conditions at the date of initial application, entities:

- may designate liabilities as at fair value through profit or loss if they meet the normal IFRS 9 conditions;
- must revoke that designation if they do not meet the normal IFRS 9 conditions, even if they previously met the conditions under IAS 39; and

- may revoke the designation even if they continue to meet the conditions.

These changes are also applied retrospectively.

If it is impracticable (as defined in IAS 8) for an entity to apply the effective interest method retrospectively, the entity treats:

- the fair value of the financial asset or the financial liability at the end of each comparative period presented as the gross carrying amount of that financial asset or the amortised cost of that financial liability if the entity restates prior periods; and

- the fair value of the financial asset or the financial liability at the date of initial application as the new gross carrying amount of that financial asset or the new amortised cost of that financial liability at the date of initial application.

If an entity previously accounted for an investment in an equity instrument, or a derivative linked to an equity instrument, at cost (where so allowed by IAS 39) then it must be measured at fair value at the date of initial application, and the difference recognised in opening retained earnings (or other component of equity).

In principle, the impairment requirements should be applied, although this is subject to the point above that retrospective treatment may amount to restating opening balances.

However, if without undue cost or effort, an entity can assess whether there was a significant increase in credit risk between the date of recognition (or origination for loan commitments and financial guarantee contracts) under the normal rules then it will apply those rules, retrospectively. If it cannot, then it must recognise a loss allowance based on lifetime expected credit losses at the date of initial application unless (or until) the instrument has low credit risk.

The transitional provisions in relation to hedge accounting are unusual, in that they allow entities to continue to use the IAS 39 requirements to its hedge arrangements, not just extant ones but also future ones.

Where this option is taken all further comments on transition re hedge accounting are not relevant.

Where this option is not taken, hedge accounting is applied prospectively from the date of initial application, with the qualifying criteria having to be met at this date.

Where a hedge relationship qualified for hedge accounting under IAS 39, and qualifies under IFRS 9, after taking account of rebalancing, this is considered to be a continuing hedge relationship.

Where an entity does move from IAS 39 to IFRS 9, whether initially or in the future, it should cease to apply the old standard and start to apply the new standard at the same time. It must use the hedge ratio under IAS 39 as the starting point for any rebalancing under IFRS 9, with any resultant gain or loss being taken to profit or loss.

Whilst the hedge accounting rules are basically applied prospectively, there are exceptions, and:

- accounting for the time value of options should be applied retrospectively if, under IAS 39, only the change in an option’s intrinsic value was designated as a hedging instrument in a hedging relationship; and

- an entity may apply the accounting for the forward element of forward contracts retrospectively if, under IAS 39, only the change in the spot element of a forward contract was designated as a hedging instrument in a hedging relationship. This election must be made for all affected forward contracts.

These exceptions apply only to those hedging relationships that existed at the beginning of the earliest comparative period or were designated thereafter.

Entities must also apply the rules on change of counterparty included in IFRS 9.

There are also various transitional provisions to deal with those entities which have already adopted previous versions of IFRS 9.

3.6 IFRS 15 – Revenue from Contracts with Customers

IFRS 15 *Revenue from Contracts with Customers*, will replace the extant revenue recognition standards IAS 18 and IAS 11 and related IFRIC interpretations, including IFRIC 13, IFRIC 15, IFRIC 18 and SIC 31. It will not apply to certain forms of revenue covered by other standards, such as revenues under lease contracts or revenues under insurance contracts. IFRS 15 applies to accounting periods starting on or after 1 January 2018. As described below, the standard provides some transitional relief on initial application.

The standard has been developed to provide a comprehensive set of principles in presenting the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer. For many entities revenue recognition will not change, however more guidance now exists on contracts with multiple performance obligations.

The standard is based around five steps in recognising revenue:

1. Identify the contract with the customer – the contract must be approved by the parties and should have commercial substance. The parties to the contract should also be able to identify their rights regarding the goods or services to be transferred, and the payment terms in relation to those goods or services. It must also be probable that consideration will be received for the goods or services transferred.

   Contracts with the same customer can be combined if specific criteria are met, for example the contracts are negotiated as a package, the amount of consideration is linked to the performance of another contract, or goods or service are a single performance obligation.

2. Identify the performance obligations in the contract – these are distinct goods or services that are to be transferred to the customer. A good or service is distinct if the customer can benefit from the good or service either on its own or with other resources that are readily available to the customer and if the promise to transfer the good or service is separately identifiable from other promises in the contract. A good or service is still likely to be separately identifiable if it has a functional dependence on another, but not if this relationship has a 'transformative' effect.

3. Determine the transaction price – based on the contract terms the transaction price should be determined. The transaction price is the amount that the entity expects to receive in exchange for transferring promised goods or services to a customer. The amount should exclude those collected on behalf of third parties (such as sales taxes). Contract price can include both fixed and variable consideration.

   An entity is required to estimate variable consideration to which it will be entitled to either using an expected value approach (sum of probability weighted amounts) or the most likely amount (single amount). Variable consideration is only included in the transaction price if it is highly probable that a significant reversal of the consideration will not occur. Reassessment of the variable consideration is required at the end of each reporting period.

   Contracts may include significant financing components and non-cash consideration. A contract with a financing component is discounted using a discount rate that reflects the credit characteristics of the customer. The effects of financing are presented separately from revenue from customers. Any non-cash consideration received is measured at the fair value of the non-cash consideration.

4. Allocate the transaction price – the transaction price should be allocated to each performance obligation identified in step 2, based on the relative stand-alone selling prices of each distinct good or service, or an estimate of such a price if the price is not observable.

   If the customer receives a discount, the discount is allocated to those performance obligations to which it relates, which could either be all or some of the performance obligations. A similar approach is applied to allocating variable consideration.

5. Recognise revenue when a performance obligation is satisfied – a performance obligation is satisfied when the customer obtains control of the good or service. At the inception of the contract the entity must establish if the performance obligation is to be satisfied over time or at a point in time.

   An entity that satisfies a performance obligation over time, recognises revenue over time when the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs; or where the entity's performance creates or enhances an asset that the customer controls; or where the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date (for example, an incomplete voyage in a voyage charter).

The standard also provides specific principles to apply in the following areas:

- Contract modifications that have been approved by both parties are accounted for as a separate contract when the modification results in distinct additional promised goods or services and the increase in price reflects the stand-alone selling prices of the additional goods or services. In all other cases the contract modification could either be accounted for as a termination of the original contract and the creation of a new contract, or as part of the original contract or a combination of both depending on the facts and circumstances.

- Contract costs that are incremental in obtaining a contract with a customer are recognised as an asset if the entity expects to recover the costs, for example sales commission. The asset is then amortised systematically over the period the entity transfers the goods or services to the customer. IAS 36 should be applied in assessing the impairment of the asset when certain conditions are met that are outlined in IFRS 15.

- The standard provides specific guidance on accounting for refunds and warranties. Warranties are considered to be one of two types. A warranty that can be purchased separately is a distinct service and treated as a separate performance obligation. A warranty for example required by law or a typical one year manufacturer's warranty in the UK, is not likely to be treated as a separate performance obligation and therefore warranty accounting would fall within the scope of IAS 37.

As with most new standards the disclosure requirements are set around disclosure principles. The disclosure principles for the standard include disclosing the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers, by providing qualitative and quantitative information. Entities will find that the level of disclosures required by the standard will increase from what they currently provide.

Entities will need to consider all the requirements in the standard to determine if any change to the recognition of revenue is required. For many entities there will be little change in the recognition of revenue. However, for those where there is a change, the standard provides some transitional relief when first applied. An entity has one of two options:

- Retrospective application for the period immediately preceding the date of initial application. However no adjustment is required for any contract that began and ended in the same reporting period, and the standard does not apply to contracts that were completed at the beginning of the earliest period presented. Where a contract has been completed and was subject to variable consideration, an entity can use the transaction price at the date the contract was completed (i.e. hindsight is used) rather than estimating the variable consideration for the prior period. Where performance obligations remain outstanding, amounts and details of when the remaining performance obligations are expected to be recognised for periods presented before the date of initial application do not need to be provided; or

- Retrospective application with the cumulative effect of applying the standard recognised at the date of initial application within opening retained earnings. Therefore the standard only applies to contracts that are incomplete at the date of initial application. Additional disclosures are required when this approach is adopted.

After the standard was issued in 2014, a number of clarifications were published by the IASB in April 2016, with an effective date the same as for the original standard itself. It should be noted that these

clarifications have not yet been formally endorsed for application in the EU, although it is anticipated that they will be, and with the same effective date.

4 Guidance in Issue but not in Force – Not EU Endorsed

4.1 Introduction

The following guidance covers standards issued or amended by IASB, but where the EU has not yet endorsed the changes.

Strictly, there is no requirement to comment on the implications as they are not "in issue" for EU entities. However, it would be considered best practice to do so, especially in light of the European Securities and Markets Authority (ESMA) enforcement decision published in October 2013 against a company for not having disclosed the material impact of standards that had not been EU endorsed.

No implementation dates have been given, as these are not known until the EU endorses the changes.

4.2 IAS 7 – Statement of Cash Flows

This amendment arises from the disclosure initiative. On initial application, comparative information does not have to be provided.

Changes in liabilities arising from financing activities will need to be analysed between five categories:

- changes from financing cash flows;
- changes due to obtaining or losing control of a subsidiary or other business;
- the effect of changes in foreign exchange rates;
- fair value changes; and
- other changes.

Liabilities arising from financing activities are those for which cash flows have been or will be classified as arising from financing activities in the cash flow statement. The disclosure requirements can also apply to financial assets, if the cash flows arising from them are also so classified.

4.3 IAS 12 – Income Taxes

This clarification is intended to reduce diversity in practice in the accounting for deferred tax assets arising on unrealised losses. On initial application, an election can be made to recognise any change in opening equity, for the earliest period presented, in retained earnings or another appropriate component of equity, rather than across equity components.

The amendments clarify that in order to compute a temporary difference, the carrying amount is compared to its tax base. In doing so, the entity should not consider how the related assets will be recovered (such as through sale), or the probability that any resulting deferred tax asset will be recoverable.

The amendments also clarify that the estimation of taxable profit, against which deferred tax assets can be utilised, is a separate step. If it is considered probable that an asset will be realised at more than its carrying amount, this is reflected in the entity's estimate of future taxable profit. The tax deduction arising from the reversal of deferred tax assets will not be included in the estimated future taxable profit which is used to evaluate whether those assets are recoverable.

4.4 IAS 28 – Investments in Associates or Joint Ventures

These amendments arise from the annual improvements project.

Under IAS 28, when an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, such an entity may elect for measurement at fair value through profit or loss in accordance with IFRS 9. This first amendment confirms that the election should be made separately for each associate or joint venture at the date of its initial recognition.

Furthermore, IAS 28 permits an entity, which is not itself an investment entity, but has an interest in an associate or joint venture that is an investment entity, to retain, when applying the equity method, the fair value measurement applied by the investment entity associate or joint venture to the investment entity associate's or joint venture's interest in subsidiaries. The second amendment confirms that this is done via a separate election for each investment entity associate or joint venture at the latest of the date on which:

(a) the investment entity associate or joint venture is initially recognised,

(b) the associate or joint venture becomes an investment entity; or

(c) the investment entity associate or joint venture first becomes a parent.

4.5 IAS 40 – Investment Property

The amendments to IAS 40 clarify the requirement to transfer a property to or from investment property when (and only when) there is a change in use. The amendments state that the property should meet (or cease to meet) the definition of investment property, and there should be evidence of the change in use (which means more than management's intention alone). The list of required indicators of a change in use in paragraph 57 of IAS 40 are now reclassified as examples.

At the date of initial application of the amendments, reporting entities are required to reassess the classification of property, and where reclassifications are made, certain accounting and disclosure requirements apply. Furthermore, the amendments are applied prospectively, with retrospective application permitted only if this is possible without the use of hindsight.

4.6 IFRS 2 – Share-Based Payment

There are a number of changes and clarifications affecting IFRS 2.

There are various clarifications emphasising that vesting conditions, other than market conditions, are taken into account in determining the number of instruments expected to vest and not in determining the values of the individual instruments.

The more substantive changes deal with tax liabilities and schemes that change from cash settled to equity settled.

Where a tax obligation falls on the employee on a share based payment some schemes allow or require the issuing entity to withhold the number of instruments equal in value to the tax liability and pay that value, usually in cash, to the tax authority on behalf of the individual. This is described in IFRS 2 as a net settlement feature. In such a case, the entity will be required to classify the entire scheme as equity-settled, notwithstanding that there will be an element of cash payment. The payment made is deducted from equity, except in relation to any amount that is in excess of the fair value of the equity instruments withheld. The new exception does not apply to any arrangements where the entity is not required to pay over the tax obligation. There is also new disclosure associated with this exception, and companies should disclose an estimate of the future tax payments they are expecting to make.

Where a cash settled scheme is converted to an equity settled scheme:

- the new equity settled scheme is measured by reference to the value of the arrangement at the date of change, although spread from the date at which goods or services started to be received (which will usually be the grant date of the original scheme). This will involve an adjustment to equity;
- the previous liability for the cash settled scheme is derecognised;

- any difference between the liability under the old scheme and the amount recognised in respect of the new scheme is recognised in profit or loss;
- if the vesting period has changed then the adjustment must also reflect the amended period.

An identical treatment must also be applied if an equity settled scheme is identified as a replacement for a cash settled scheme, rather than a modification of the scheme. Finally, this treatment must be applied even if the change takes place after vesting of the cash settled scheme.

4.7 IFRS 4 – Insurance Contracts

The amendments to IFRS 4 address concerns over the impact of IFRS 9 where this will be implemented before IFRS 17, which replaces IFRS 4. Preparers may adopt one of two approaches, designed to supplement the existing provisions in IFRS 4 which aim to tackle temporary volatility:

Overlay approach – on transition to IFRS 9, preparers which issue insurance contracts have an option to recognise in other comprehensive income, rather than profit or loss, the volatility which could arise by applying IFRS 9 before the revised IFRS 4 becomes effective.

Total comprehensive income is consequently the same as if IFRS 9 was applied without the overlay approach, and the carrying amounts of all financial assets are determined in accordance with IFRS 9. The overlay approach is applied retrospectively, although comparative information is only restated if restatement is applicable on applying IFRS 9. Unlike the deferral approach below, there is no fixed maximum period for applying the overlay approach, although it will cease to apply once the replacement for IFRS 4 becomes effective.

Deferral approach – alternatively, preparers whose activities are predominantly connected with insurance can opt to defer the adoption of IFRS 9 for three years, instead continuing to apply IAS 39 for accounting periods beginning before 1 January 2021.

These options are available for both insurers, and issuers of a financial instrument that contains a discretionary participation feature. The timelines set out above are those set out by the IASB, and are subject to EU endorsement.

Overlay approach

The overlay approach is adopted when the reporting entity first applies IFRS 9 (or adopts certain IFRS 9 presentation requirements for gains and losses on financial liabilities – the ‘own credit’ requirements). It is adopted on an instrument-by-instrument basis - an asset qualifies for the approach if it is:

- measured at fair value through profit or loss under IFRS 9, but would not have been so measured in its entirety under IAS 39; and
- held in respect of an activity within the scope of IFRS 4.

Once the overlay approach has been adopted, it can only be applied to an asset on initial recognition, or when the asset starts to be held in respect of an activity within the scope of IFRS 4. In the latter case, the fair value at the date of application becomes its deemed amortised cost.

The difference between the amount reported in profit or loss under IFRS 9, and the amount which would have been reported under IAS 39, is reclassified between profit or loss and other comprehensive income (as an item that will subsequently recycled to profit or loss). The amount involved is presented separately in both profit or loss and OCI. As a result, the IAS 39 outcome is ‘overlaid’ to what would have been reported under IFRS 9. By implication, the overlay approach is only available where an entity adopts IFRS 9.

The overlay approach is applied to an asset until it is de-recognised, unless it ceases to be held in respect of an activity within the scope of IFRS 4, or the reporting entity elects to cease adopting the overlay method generally.

Deferral approach

In order to adopt the deferral approach, a preparer must not have previously applied IFRS 9 (other than certain presentation requirements for gains and losses on financial liabilities – the ‘own credit’ requirements), and its activities must be predominantly connected with insurance at the annual reporting date that immediately precedes 1 April 2016. Thereafter, there are provisions for reassessing whether the entity remains eligible for the deferral, and an entity is able to make an irrevocable election to adopt IFRS 9 after a period of applying the deferral.

Disclosures

A reporting entity adopting the deferral approach will explain how it concluded that it qualified to take this option, either at the outset, or as the result of a re-assessment. There are similar disclosure requirements where a reporting entity concludes that its activities are no longer predominantly connected with insurance. There are also a number of detailed disclosure requirements, which are intended to enable an insurer applying the deferral approach to be compared with those which have not done so. In determining the disclosures required, an entity can use the transitional provisions in IFRS 9 (taking the first annual period beginning on or after 1 January 2018 as the application date for this purpose).

Where the overlay approach is adopted, the entity discloses the basis for designating financial assets for this approach, along with the carrying amounts of assets involved (by class of asset). Disclosure requirements also include the effect on profit or loss and other comprehensive income of applying the overlay approach, and of new designations or de-designations.

4.8 IFRS 12 – Disclosure of Interests in Other Entities

This minor amendment arises from the annual improvements project. It clarifies that, except for the requirements to disclose summarised financial information, the requirements of IFRS 12 apply to interests (or a portion thereof) in a subsidiary, joint venture or associate that is classified (or included in a disposal group that is classified) as held for sale in accordance with IFRS 5 *Non-current Assets held for Sale and Discontinued Operations*.

4.9 IFRS 16 – Leases

With the introduction of IFRS 16 the changes for lessors, and for lessees under current finance leases, will be limited, but the standard will significantly affect the financial statements of lessees under what are currently treated as operating leases.

Some matters have been carried across without substantive amendment from IAS 17:

- the definition of a lease (although some clarification has been provided on whether a contract conveys the right to use a particular asset and to benefit from its use);
- the definition of the lease term (although examples have been added to clarify the application of the requirements in relation to optional extension and termination clauses, and there is more guidance on changes in the lease term);
- the requirement to split contracts which contain a lease between their lease and service elements (although if this is too complex, entities are allowed to treat the whole contract as though it were a lease, so long as it is not an embedded derivative and there is some quite pointed guidance on ensuring that the split is based on market values and not by reference to the nominal contractual terms);
- the treatment of leases which also qualify as investment properties under IAS 40;the basic accounting treatment for leases previously classified as finance leases, both for lessors and lessees; and
- the distinction between finance and operating leases for lessors.

The key change is that, with a few exceptions, lessees under current operating leases will be required to:

- record a liability for the payments under the lease; and
- record a right of use asset.

This is similar in principle to the previous accounting treatment for finance leases, with all its attendant implications of front loading charges and changing gearing ratios.

There are minor changes to the scope of the standard, with specific reference to the exclusion of leases that fall within the scope of IFRIC 12 or licences of intellectual property granted by lessors that fall within the scope of IFRS 15.

Of greater importance are two optional exemptions from the requirement to account for a right of use asset and related lease obligation being:

- leases of one year or less that do not contain a purchase option; and
- leases of low value assets, such as PCs and some items of office furniture.

The short-term exemption must be adopted, if at all, by class but the low value exemption is available on an asset by asset basis.

Whilst IFRS 16 contains no reference to amounts, the Basis for Conclusions lets slip that the IASB had in mind an amount of $5,000 when discussing the low value exemption, so no doubt many will try to apply this as a bright line. To avoid abuse, to qualify for the exemption assets must be capable of use on their own, or in combination with other assets that are readily available to the entity, the value must be based on the asset when new and the lease cannot be a head lease of an asset intended to be sub-leased.

Where either of these exemptions is taken the accounting treatment will not change from that previously applied to operating leases.

There are some changes to the basis of calculations in respect of leases. This means that, even though, as noted above, the basic treatment of leases that would always have been treated as finance leases is not changing, the numbers may not be quite the same.

The basic rule remains that the lease payments should be discounted at the interest rate implicit in the lease or, where this is not known to the lessee, then the lessee's incremental borrowing rate. This amount then provides the liability, whilst the asset starts from this figure to which may be added the present value of any restoration costs and any incremental costs in entering the lease, as well as any lease payments made prior to commencement of lease, minus any lease incentives already received. One thing that will be a little more challenging in respect of those leases that would previously have been treated as operating leases is that it will not usually be possible to "sense check" the asset value arising to the fair value of the asset as a whole, which could broadly be done for finance leases under IAS 17.

What may change, for more complex leases, are the payments included. As before these include fixed amounts, options expected to be exercised, and expected amounts of residual value guarantees from the lessee, but they must now also include two types of variable payment: those based on an index or rate (such as a measure of inflation) and 'in-substance fixed' payments (where practically or economically, the payment is unavoidable). Payments based on other variables are excluded, and recognised in profit or loss as incurred (for example, an amount equal to a set percentage of sales actually made). Variable payments based on an index or rate are initially measured using the index or rate at the commencement date of the lease. Subsequent changes are accounted for when the lease payment itself changes. Such variable payments were not treated consistently under IAS 17, and therefore the impact of the change to IFRS 16 will depend on what policies entities previously adopted.

Another change is that IFRS 16 covers changes in lease arrangements in greater depth and far more clearly than IAS 17. These changes can arise due to a reassessment (based on contractual clauses already in the lease) or modification (which involves a re-negotiation between the lessee and lessor). Depending on the nature of the change, reassessments can result in a revision to the discount rate, and a re-measurement of the lease liability results in corresponding adjustment to the right of use asset.

A modification may or may not change the scope of a lease. For example, a negotiation to lease extra space in a building can be contrasted with a negotiated reduction in payments where market conditions have deteriorated. Broadly, modifications result in a re-measurement of the lease liability and an adjustment to the right-of-use asset, except in one case. A separate lease contract is accounted for where the scope of the lease is increased, and the change to the consideration paid is commensurate with the stand-alone price for the increase. There may well be judgement required here, as ‘commensurate’ does not mean ‘equal’, as certain adjustments can be taken into account (such as the lessor’s lower costs when dealing with an existing lessee, as opposed to finding a new lessee).

For lessors, a modification of an operating lease will be accounted for as a new lease. A modification of a finance lease is treated as a separate lease if the same criteria are met as for lessees above. If not, the treatment depends on whether the modification would have resulted in either an operating or finance lease, had it been in effect at the inception of the lease.

There are substantially more disclosure requirements than under IAS 17. Unlike some other aspects of the new standard, these will affect every entity involved in leasing, whether as lessor or lessee and whether lease were previously classified as finance or operating.

There are some transitional provisions. In particular:

- determinations of whether a contract contained a lease under IFRIC 4 do not need to be reconsidered;
- for operating leases for lessees a simplified method can be applied such that rather than full retrospective adjustment an entity can treat leases in place at the date of initial application as though they were entered into at that date, taking account only of payments to be made after that date and allowing other simplifications, such as the use of hindsight and of a portfolio basis;
- where an operating lease has less than a year to run at the date of initial application it can be treated as a short-term lease, without reference to its full term; and
- neither lessees nor lessors with finance leases at the date of initial application need restate the relevant amounts, even if they are affected by the changes in relevant lease payments.

There are also specific transitional provisions dealing with sub-leases and previous sale and leaseback transactions. The standard also points out that if an entity had previously accounted for an asset or liability arising from a favourable or unfavourable operating lease acquired in a business combination then that asset or liability must be eliminated, with a corresponding adjustment to the right of use asset.

4.10 IFRS 17 - Insurance Contracts

Overview and scope

This standard replaces IFRS 4, which was intended as an interim solution and permitted a variety of accounting practices. IFRS 17 establishes a single model for the recognition, measurement presentation and disclosure of insurance contracts, rather than adopting different models according to product type. This model is intended to reflect the fact that key attributes of insurance contracts are that they combine features of both a financial instrument and a service contract, and can generate cash flows which vary substantially over a long period. The entities within the scope of IFRS 17 are those that issue insurance contracts, issue or hold reinsurance contracts, or issue investment contracts with a discretionary participation feature, as long as insurance contracts are also issued.

The general model set out in the standard uses current assumptions when estimating the amount, timing and uncertainty of future cash flows, taking into account market interest rates and the impact of policyholder options and guarantees. There is an explicit measure of the cost of risk (the uncertainty), whilst estimates make as much use as possible of observable information. Measurement reflects the time value of money, with discount rates reflecting the characteristics of the contract.

The profit on sale of insurance contracts is aggregated in groups of similar contracts and deferred at the outset as a liability. The profit is then recognised systematically over the period of cover after any adjustments are made for changes in the cash flow assumptions relating to each group of contracts.

Deferred acquisition costs are taken into account in the initial measurement of the insurance contract, rather than being accounted for and released separately.

A simplified version of the general model called the Premium Allocation Approach (PAA) can be adopted, where certain criteria are met. PAA offers simplification when measuring the liability for remaining coverage, but not for incurred claims. It is likely to be adopted for many non-life insurance contracts, such as home contents insurance, where the coverage period is one year or less. Another impact of this will be that for the majority of short-term contracts (such as annual home insurance), it will not be necessary to compute CSM (see below) and profit will be recognised as the premium is allocated on a time basis.

A contract may have components which are within the scope of another standard. IFRS 17 has criteria to establish when these components should be separated out, including that they should be distinct from the insurance element. Components could include an embedded derivative or investment component (which are subject to IFRS 9), or a sale of a non-insurance good or service (which are subject to IFRS 15).

Certain insurance contracts provide services for a fixed fee. One example of these is breakdown cover for a domestic appliance, for which the compensation is the repair service and the insurance risk is the frequency of breakdown of the appliance. The issuer may elect to apply IFRS 15 instead to these contracts, so long as the price is not set on the basis of a risk assessment of an individual customer, the compensation is through the provision of services rather than cash payments and the insurance risk mainly arises from the customer's use of the service rather than uncertainty over the cost of the service. The election is on a contract-by-contract basis, and is irrevocable.

As described below, the requirements of IFRS 17 are modified for investment contracts with a discretionary participation feature ('direct par contracts'). Such contracts are a financial instrument, and do not entail a transfer of significant insurance risk. They are only within the scope of IFRS 17 if their issuer also issues insurance contracts.

Recognition

Insurance contracts will be aggregated into portfolios, which comprise policies that are subject to similar risks (for example, due to the type of cover) and are managed together. Each portfolio should be divided into groups, which include at a minimum, those onerous at initial recognition, those that at initial recognition have no significant chance of becoming onerous, and other contracts. A group cannot consist of contracts issued over a year apart, and once the groups have initially been established, they are not subsequently reassessed. There is a similar grouping process for reinsurance contracts, based on whether the purchaser has a net gain on recognition (as opposed to the criterion of whether a contract may be onerous).

Groups of contracts are recognised from the earliest of the start of cover, the due date of the first payment from the policyholder, or when the group becomes onerous.

Measurement

A group of contracts is measured as the sum of its fulfilment cash flows ('FCF') and the contractual service margin ('CSM'). FCF consists of estimated future net cash flows, adjusted for the time value of money, the financial risks of future cash flows and non-financial risk (reflecting the compensation needed for bearing the associated uncertainty).

For reinsurance contracts, the estimates also include the risk of non-performance by the reinsurer. The estimated adjustment for non-financial risk represents the transfer of risk from the holder of the reinsurance contract to the reinsurer.

The cash flow estimates should be current and reflect all information reasonably available to the entity. The discount rate used will reflect, in addition to the time value of money, the characteristics of the cash flows and the liquidity characteristics of the contracts. In both cases, estimates of market variables should be consistent with observable market prices. Cash flows should be measured by group of contracts, although it is also possible to estimate them at a higher level and then allocate the cash flows across individual groups of contracts.

CSM is the profit which is a component of the carrying amount of the asset or liability for a group of insurance contracts. This profit will be recognised in the Statement of Comprehensive Income as services are provided in the future. The intention of the standard is that the profit from a group of insurance contracts is recognised over the period of cover, and as the reporting entity is released from risk (whilst losses are recognised immediately). The total CSM cannot be negative, as this indicates that the group is onerous. It is set at an amount which on initial recognition of the group, results in no income or expense arising from the initial FCF, the derecognition of any asset or liability recognised for acquisition cash flows, and the cash inflows and outflows arising from the group's contracts at that date.

For reinsurance contracts, the CSM is determined similarly on initial recognition, but for reinsurance, the CSM represents the net gain or loss on the purchase of the reinsurance. This gain or loss is deferred, unless a net loss relates to events that occurred before purchasing the reinsurance contract, in which event it is expensed immediately.

A contract is onerous at initial recognition if the total of the FCF, any previously-recognised acquisition cash flows and any cash flows arising from the contract at that date is a net outflow. The liability for the group of contracts will be the FCF and the CSM will be zero. To achieve this position, a loss is recognised in profit or loss for the net outflow, which takes account of the FCF.

At the end of subsequent reporting periods, the entity determines the liability for remaining coverage (comprising FCF relating to future services, and CSM yet to be earned) - 'A', and for incurred claims (comprising the FCF relating to past service, and taking into account claims incurred but not yet reported) - 'B'. The carrying amount of the group of contracts is adjusted to the sum of A plus B.

In general, changes relating to past service are recognised in profit or loss, whilst those relating to future service adjust the CSM. The changes in A and B above, recognised separately, determine the insurance revenue and expenses. Insurance revenue is the reduction in A due to service provided in the reporting period. Insurance service expense comprises losses on groups of onerous contracts and reversal of such losses (arising from A) and the increase in liability due to claims or expenses incurred (B) along with the effect on FCF of these incurred claims and expenses. Both revenue and insurance service expense exclude any investment components.

Insurance finance income or expense arises from both A and B and represents the change in the carrying amount of the group of contracts that arises from the time value of money (and changes therein) and the effect of changes in assumptions relating to financial risk. Such changes would, however, be dealt with through an adjustment to the CSM where a group of contracts has direct participating features.

Reinsurance contracts are subsequently accounted for similarly to direct insurance contracts under the general model. However, changes in the reinsurer's risk of non-performance are reflected in profit or loss, rather than via an adjustment to the CSM.

It will also be necessary to make a make a charge to profit or loss when a group of contracts subsequently becomes onerous or more onerous. Once the onerous amount previously recognised has been reversed (via insurance service expense, as above) it will be possible to recognise revenue and increases in CSM.

Modifications to the general model

I Variable Fee Approach

This general model is modified for insurance contracts with direct participation features (which involve investment returns as well as cover for insured risk), in order to reflect more closely the economic substance of these direct par contracts. In order to meet the definite of a direct par contract under IFRS 17, a contract must meet three criteria. Firstly, the contract terms include participation by the policyholder in a share of a clearly–identified pool of items. Secondly, it is anticipated that the policyholder will be paid a substantial share of the fair value returns from the items, and thirdly, a substantial part of the cash flows expected to be paid to the policyholder will vary with the cash flows arising from the items.

The variation of the general model for direct par contracts is known as the variable fee approach (VFA). The insurer has an obligation to pay to the policyholder the underlying items less a variable fee (comprising the insurer’s share of the fair value of the underlying items, less amounts payable that do not vary according to the underlying items such as contract expenses).

After initial recognition, the CSM is measured differently under the VFA compared to the general model. Broadly, the CSM varies according to the entity’s share of profits arising from the performance of the underlying investments. The CSM is not adjusted for changes in the obligation to pay amounts to policyholders based on fair values as this does not relate to future service.

II Premium Allocation Approach

The premium allocation approach (PAA) represents a simplified method of measuring the liability for remaining coverage of a group of contracts, as long as, at initial recognition, it can reasonably be expected that this approximates the general model, or the coverage period of each contract in the group is one year or less. PAA is not a permissible method for a group expected (at inception) to display significant changes in its FCF before a claim is incurred. It is likely to be widely adopted to measure non-life insurance contracts.

Under PAA, the initial liability for remaining coverage comprises the premiums received at initial recognition, less any insurance acquisition cash flows. In determining the subsequent amount of the liability, the initial amount is adjusted for premiums subsequently received (less insurance acquisition cash flows), plus amortisation of acquisition cash flows, less the amount for coverage provided in the period (which is recognised as insurance revenue) and any investment component paid or transferred to the liability for incurred claims.

When applying PAA, a choice can be made to recognise insurance acquisition cash flows as an expense when incurred, as long as the coverage period at initial recognition is no more than one year.

In the case of non-life insurers, the adoption of PAA for short-term contracts is likely to be similar to the current accounting method adopted. For longer-term contracts, it may be necessary to measure a sample using both the general model and PAA in order to establish whether the latter is a reasonable approximation of the former.

The simplified PAA approach cannot be applied when measuring the liability of a group of contracts for incurred claims measured under the general model, although no discounting is required where it is expected that the balance will be paid or received within one year of incurring the claim. Similarly, for contracts with a significant financing component, the liability for remaining coverage does not have to be discounted if on initial recognition, the time between providing each tranche of coverage and the due date of the related premium is expected to be less than one year.

Modifications to contracts

Where a contract is substantively modified, according to the criteria in the standard, it is de-recognised and the modified contract is recognised as a new contract. A modification is substantive if any of the following conditions are met:

(a) If, had the modification been included at inception of the contract, there would have resulted one of the following:
    i. Exclusion from the scope of the standard;
    ii. Unbundling of different embedded derivatives;
    iii. Redefinition of the contract boundary; or
    iv. Reallocation to a different group of contracts; or
(b) The original contract met the definition of a direct par contract, but this is not the case for the modified contract (or vice versa); or
(c) PAA was originally applied, but the modification means that the contract is no longer eligible for it.

Presentation

In the statement of financial position, the balances of insurance and reinsurance contracts are presented separately. Within these two groups, the contracts that are assets and those which are liabilities are presented separately.

The two key headings in the statement of financial performance are the insurance service result being insurance revenue, less insurance service expense, and the insurance finance income or expense, which are described above. The results arising from insurance contracts are presented separately to those arising from reinsurance contracts, and any investment element is excluded.

The greatest change in income presentation arising from the standard is likely to that affecting life insurers, who will no longer recognise as revenue the premiums receivable. Revenue will now be represented by changes in the calculation of the liability for remaining coverage.

An entity can choose whether to include all of insurance income finance or expense in profit or loss, or to disaggregate the total between profit or loss and OCI. Under the general model, any insurance finance income or expense presented in OCI will be released to profit or loss over the duration of the contracts, so that profit or loss reflects a systematic allocation of the total. When the group of contracts is de-recognised, any amounts remaining in OCI are reclassified to profit or loss.

Under the VFA model, where the entity holds the underlying items under direct par insurance contracts, disaggregation is a means of dealing with accounting mismatches. What is presented in profit or loss as insurance finance income or expense is an amount that eliminates the accounting mismatches with the finance income or expenses arising on the underlying items. On de-recognition of the group of contracts, amounts still in OCI will remain there.

An insurance contract is a monetary item, so the exchange differences are recognised according to where the related change is recognised (i.e. either in profit or loss, or OCI).

Disclosure

IFRS 17 requires extensive disclosure of information concerning the amounts recognised, judgements made and the insurance and financial risks (and how these are managed) arising from insurance contracts, and the impact of regulatory requirements. Detailed guidance is provided on how to determine the level of detail and emphasis appropriate to meet this overall disclosure objective. Information can be aggregated (for example by geographical area) and disaggregated to meet the requirement of not obscuring relevant information, either by aggregating items with different characteristics, or by providing a large amount of insignificant detail.

The disclosure guidance covers the detailed content of information to be provided in reconciliations and a tabular format, the analysis of insurance revenue, insurance finance income or expenses and the impact on the statement of financial position and future profit or loss. Fewer specific disclosures are set out for groups of contracts to which the PAA approach is applied. There are specific disclosures for contracts with direct participation features, such as the fair value of the underlying items.

Conforming amendments have been made to IAS 1 Presentation of Financial Statements, to add in the disclosures required by IFRS 17 in the primary financial statements.

Disclosures covering transition include the impact of the adoption of the modified retrospective and fair value approaches, which are described below.

Effective date and transition

The standard is effective for reporting periods beginning on or after 1 January 2021, with earlier adoption permitted so long as IFRS 9 and IFRS 15 are also adopted.

Application of IFRS 17 is retrospective, or where this is impracticable, a modified retrospective or fair value approach may be adopted. The modified retrospective approach involves using information available without undue cost or effort to apply the retrospective approach, applying hindsight where this is the only practical source of information. The fair value approach involves taking the fair value of a group of contracts at transition date and the FCF at that date. The difference is the CSM at transition date.

Entities already applying IFRS 9 have the option to re-designate and reclassify retrospectively financial assets in respect of activities connected with contracts within the scope of IFRS 17. They also have a choice as to whether to restate IFRS 9 comparatives.

4.11 IFRIC 22 - Foreign Currency Transactions and Advance Consideration

This Interpretation applies to a foreign currency transaction (or part thereof) when an entity recognises a non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration before the entity recognises the related asset, expense or income (or part of it), at which point the non-monetary asset or liability is de-recognised.

The Interpretation states that the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration. If there are multiple payments or receipts in advance, the entity shall determine a date of the transaction for each payment or receipt of advance consideration.

The Interpretation is limited to advance payments or receipts that give rise to an asset or liability which is non-monetary. It is consistent with the treatment of non-monetary assets and liabilities applying paragraph 23(b) of IAS 21, because a reporting entity does not subsequently update the translated amounts of such items.

There are also some exceptions. The Interpretation does not apply when an entity measures the related asset, expense or income on initial recognition either at fair value (the exchange rate used is that applicable at the date the fair value is measured), or at the fair value of the consideration paid or received at a date other than the date of initial recognition of the non-monetary asset or non-monetary liability arising from advance consideration (for example, the measurement of goodwill applying IFRS 3 *Business Combinations*). Furthermore, an entity is not required to apply this Interpretation to income taxes or insurance contracts (including reinsurance contracts) that it issues, or reinsurance contracts that it holds.

4.12 IFRIC 23 – Uncertainty over Income Tax Treatments

This interpretation addresses concerns that whilst IAS 12 specifies how to account for current and deferred tax, it does not cover how to reflect the effects of uncertainty. It may, for example, be unclear how tax law applies in a particular situation, or whether an entity’s treatment will be accepted by the tax authorities.

Where it is considered not probable that an uncertain tax treatment will be accepted, the financial statements should reflect either the most likely outcome or the expected value (being a probability-weighted range of outcomes), as appropriate. This is not a choice, but depends on whether the issue itself is likely to be binary or concentrated on a single value or that there are a number of realistic possibilities.

Consistent estimates and judgements should be made in respect of both current and deferred tax, and this accounting treatment applies both to the amount of tax payable, and the associated interest and penalties.

If there is more than one uncertainty, it will be necessary to consider whether it is appropriate to consider them together (maybe mirroring how they are likely to be examined by the tax authorities). The entity should assume that the tax authorities will look at all information which they have a right to examine, and will have complete related information.

When facts and circumstances change or new information is received, the effect should be treated as change in accounting estimate in accordance with IAS 8. If the change occurs after the end of the reporting period, the reporting entity should apply IAS 10 to assess whether it is an adjusting or non-adjusting event.

Disclosures are based on the existing requirements in IAS 1 and IAS 12. These include the judgements, assumptions and estimates made. An entity might conclude that it is probable that an uncertain tax treatment will be accepted by the tax authorities. In this case, having accounted for taxation consistently with the treatment planned to be used in its tax filings, the entity also considers whether the potential effect of the uncertainty should be disclosed as a tax-related contingency.

IFRIC 23 is effective for accounting periods starting on or after 1 January 2019, with earlier application permitted. The Interpretation should be applied retrospectively, if this is possible without the use of hindsight. Otherwise, the cumulative effect is adjusted via opening balances at the start of the period in which the Interpretation is applied, and without restating comparative figures.

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