Deloitte.

IFRS in Focus

Closing Out 2017

Contents

For more information please see the following websites:

www.iasplus.com

www.deloitte.com

In this special edition of IFRS in Focus, we set out financial reporting issues that may be relevant for years ending on or after 31 December 2017 as a result of areas of regulatory focus, the current economic environment or changes in accounting standards.

Reporting financial performance

IAS 1 requires the presentation of only a few line items within the statement of profit or loss (revenue, finance costs and tax expense together with profits or losses arising from use of the equity method of accounting, the effect of discontinued operations and, when IFRS 9 is applied, various items relating to financial instrument accounting. Additional line items are permitted by paragraph 85 of IAS 1, provided that they are:

- comprised of line items made up of amounts recognised and measured in accordance with IFRSs;
- presented and labelled in a clear and understandable manner;
- consistent from period to period; and
- not displayed with more prominence than the line items required by IAS 1.

Additional line items are permitted, and should be presented, in light of the overarching principle that line items should be disaggregated when this provides additional material information to users of the financial statements.

In using such measures, it should be noted that:

- as discussed in paragraph BC56 of the Basis for Conclusions on IAS 1, a measure labelled as 'operating profit' should not exclude items such as inventory write-downs that would be generally understood as forming part of the entity's operations;
- gains and losses should not be offset unless permitted by IFRSs; and
- a clear accounting policy for the identification of such items should be provided.

The presentation of additional line items is also an area of regulatory focus and the views of relevant regulators should be considered in assessing whether a particular presentation is, or is not, acceptable. In particular, the presentation of 'underlying' or 'adjusted' profit figures is an area where regulatory requirements differ. If such a presentation is accepted, the approach to identifying items to be excluded from an adjusted profit figure should be even handed (with gains excluded as readily as losses), consistent from year to year and clearly disclosed (including an explanation of why it is believed necessary to adjust for certain items).

Non-GAAP financial measures

The use of 'non-GAAP' figures (sometimes referred to using other terms such as 'Alternative Performance Measures') outside the financial statements themselves has also been an area of regulatory concern in many jurisdictions around the world, with the International Organisation of Securities Commissions (IOSCO) publishing a Final Statement on Non-GAAP Financial Measures in 2016 which is summarised below.

IOSCO Statement on Non-GAAP Financial Measures

Scope – Applies to 'non-GAAP financial measures' being numerical measures of an issuer's current, historical or future financial performance, financial position or cash flow that is not a GAAP measure (defined as a measure determined pursuant to the issuer's financial reporting framework included in, for example, a press release or narrative section of an annual report).

Neither disclosures contained within the financial statements nor operating or statistical measures that are not financial measure are within the scope of the statement.

Defining the non-GAAP Financial Measure – The measure should be defined, explained (including a statement that it is not a standardised measure), clearly labelled and the reason for its use (including an explanation of why the information is useful to investors) explained.

Unbiased purpose – Non-GAAP measures should not be used to avoid the presentation of adverse information.

Prominence of presentation of GAAP measures – Non-GAAP measures should not be presented with more prominence than the most directly equivalent GAAP measure.

Reconciliation to comparable GAAP measures – A clear and quantitative reconciliation to the most directly equivalent GAAP measure should be provided.

Presentation consistently over time – Comparative values should be presented and non-GAAP measures generally presented consistently from year to year. Any changes to a non-GAAP measure (or cessation of use of a non-GAAP measure) should be explained with comparative figures adjusted accordingly.

Recurring items – In IOSCO's experience, there are rarely circumstances in which restructuring costs or impairment losses can be justified as being 'non-recurring', 'infrequent' or 'unusual'.

Access to associated information – Information supporting the use and calculation of non-GAAP measures should be readily available to users either by directly accompanying the measure or by a cross-reference to where the information is available.

Other regulators have their own requirements that limit (in some case more strictly than these guidelines) the use of such information. The guidance of the U.S. Securities and Exchange Commission on the use of non-GAAP measures, which is applicable to IFRS reporters', is covered in the Deloitte roadmap to non-GAAP financial measures, whilst the European Securities and Markets Authority has issued its own Guidelines on Alternative Performance Measures.

The Deloitte publication 'Alternative performance measures: A practical guide' provides additional guidance on the use of APMs, setting out what is considered best practice and providing real-life examples of how entities present such measures.

Accounting policies, judgements and estimates

A primary source of information enabling investors to understand the items in the financial statements is a clear description of the accounting policies applied in producing those numbers. IAS 1 *Presentation of Financial Statements* requires this to be supplemented by a discussion of:

- the most significant judgements made in applying those policies; and

- the major sources of estimation uncertainty (including assumptions made about the future) that have a significant risk of resulting in a material adjustment to the carrying amount of assets and liabilities in the next financial year.

A Deloitte 'IFRS in Focus' publication provides more detail on the disclosure of significant judgements and sources of estimation uncertainty.

An effective description of accounting policies should include clear, entity-specific discussion of the policies applied to material transactions and balances, covering ongoing elements of the business (for example, revenue and cost recognition policies for each revenue stream) as well as one-off transactions such as significant business combinations and, perhaps as importantly, should *exclude* irrelevant repetition of the requirements of accounting standards in respect of items that are not material to the entity.

The requirements for disclosure of critical judgements and of estimation uncertainty are separate and address distinct issues. In broad terms, a critical **judgement** is applied in *characterising* a transaction or item (for example, whether a debt restructuring is a modification or an extinguishment or which party was the acquirer in a business combination) whilst **estimation** uncertainty is concerned with the *value* of, for example, a provision for an uncertain tax position or the net realisable value of inventory. It is helpful to distinguish clearly between the two both in preparing and presenting useful disclosures.

It is also important to bear in mind that IAS 1 refers to the judgements that have had "the most significant effect" and to "major sources" of estimation uncertainty. A comprehensive discussion of a small number of issues that genuinely demanded management scrutiny in the current year is of more value than a superficial reference to many items which may have been relatively unproblematic. In respect of estimation uncertainties, it should also be noted that this disclosure requirements refers specifically to a risk of material adjustment **within the next financial year**. Information about longer term uncertainties might be useful as additional disclosure, but does not form part of this IAS 1 requirement.

Finally in respect of estimation uncertainties, the quantitative elements of the disclosures should not be overlooked, including the carrying amounts of the assets and liabilities in question, the sensitivity of balances to changes in estimates and, if an uncertainty is expected to be resolved within the next year, the range of possible outcomes.

IASB Practice Statement – Making Materiality Judgements

Changes to IAS 1 in 2014 re-iterated that the concept of materiality applies to disclosure in financial statements, meaning that even if a disclosure is required by a particular Standard, it need not be provided if immaterial. However, the consideration of materiality in financial statements, including what information should be excluded to avoid 'disclosure overload' remains a significant issue in financial reporting. Recognising this, in September 2017 the IASB issued a Practice Statement providing guidance on how to make materiality judgements in preparing financial statements. The guidance is non-mandatory and is available for immediate use.

The Practice Statement lays out a four-step process that could be helpful in framing a consideration of whether items are material, although it acknowledges that other methods may also be appropriate.

Step 1 – Identification of potentially material information, taking into account both the requirements of accounting standards and the information needs of primary users.

Step 2 – Assessment of whether this information is material through consideration of various quantitative and qualitative factors.

Step 3 – Organisation of information identified as material to communicate it effectively and efficiently.

Step 4 – An overall review of the draft financial statements to determine whether all material information has been identified as an item judged immaterial in isolation could be deemed material in the context of other information in a complete set of financial statements.

A Deloitte 'IFRS in Focus' publication provides more detail on the Practice Statement.

The impact of new accounting standards

As the significant new standards IFRS 15 *Revenue from Contracts with Customers* and IFRS 9 *Financial Instruments* are mandatorily effective for annual periods beginning on or after 1 January 2018, December 2017 annual reports will be published after the date of initial application of those standards. The effective date of IFRS 16 *Leases* (annual periods beginning on or after 1 January 2019) also draws closer. As such, the need for entity-specific, quantitative disclosure on the likely changes in accounting in line with the requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* intensifies and becomes an area of increasing regulatory focus. Indeed, regulators in many jurisdictions have expressed their expectations in this area and preparers should be aware of these in preparing 2017 annual reports.

As December 2017 annual reports will be issued after the effective date of IFRS 15 and IFRS 9 it might be expected that implementation analyses will be more advanced than was the case a year ago, allowing further elaboration and development of information provided in previous financial statements, including:

- Accounting policies to be applied, both on an ongoing basis and in respect of transition and the use of practical expedients.

- An explanation of the changes to amounts reported under existing standards, disaggregated as appropriate.

- The amount and nature of expected possible impacts compared to previously recognised amounts.

A clear description of new accounting policies is necessary to explain how for example, revenue accounting might change in respect of the principal-agent analysis or the basis for 'unbundling' elements of a contract and how the expected credit loss model of IFRS 9 might affect the recognition and measurement of impairment losses on financial assets.

When quantitative information is provided on the effect of a new standard, it should be disaggregated as appropriate (for example, information on the operating segments likely to be most affected could be useful to investors).

The effects of IFRS 15 and IFRS 9 can be many and varied depending on the precise nature of an entity's transactions. A suite of resources on each standard is available via www.iasplus.com, whilst your local Deloitte member firm can be contacted in respect of assistance with projects to implement new accounting requirements.

Recent developments on IFRS 9

As the effective date of IFRS 9 approaches, the IASB and IFRS Interpretations Committee have continued to discuss issues arising in the Standard's implementation.

One of these issues resulted in the publication in October 2017 of an amendment to the Standard *Prepayment Features with Negative Compensation*. This adjusts the 'solely payments of principal and interest' (SPPI) criterion to allow, in certain circumstances, for a feature in which a counterparty choosing to repay a loan early could receive (rather than, as is more usual, pay) compensation. Provided certain conditions are met, this will allow such loan assets, subject to the other criteria in IFRS 9, to be measured at amortised cost rather than at fair value.

The Basis for Conclusions on these amendments also provided clarification on an unrelated issue – that of accounting for a modification or exchange of a financial liability that is not significant enough to result in derecognition of the liability (and recognition of a new liability at its fair value). The Basis for Conclusions states that such a modification should be treated as a revision of estimated cash flows (resulting in an immediate gain or loss) rather than, as is the predominant treatment under IAS 39 *Financial Instruments: Recognition and Measurement*, the changes to cash flows being factored into the interest expense recognised over the remaining life of the liability.

Because the clarification of the accounting for modifications formed part of the Basis for Conclusions, rather than being an amendment to IFRS 9 itself, it should be applied on initial application of IFRS 9.

A Deloitte 'A Closer Look' publication provides more detail on the effect of IFRS 9 on the accounting for modifications of financial liabilities.

As the effective date of IFRS 16 is a year later, assessments of the impact of that standard are (unless an entity intends to adopt early) likely to be less well advanced and, therefore, entities are likely to be more limited in their ability to provide detailed, quantitative information on the impact of this standard. However, entities should to the extent that they are reasonably estimable, provide entity specific, qualitative disclosure. Furthermore, entities should be aware of the possibility of additional scrutiny of their operating lease commitments disclosure prepared under IAS 17 *Leases* as it is used as a guide to the likely impact of IFRS 16 and will (depending on the transition method selected) need to be reconciled to the lease liability recognised upon application of IFRS 16.

The need for governance and control over preparation of these disclosures should also not be overlooked. Although not yet reflected in the primary statements, this information is part of the financial statements and should be robust enough to be used for that purpose.

Statement of cash flows

The proper presentation of cash flows and related disclosures remain an area of regulatory focus, with issues raised on, amongst other things:

- The allocation of payments made for finance leases between repayment of capital (classified as financing cash flows) and interest (classified as operating or financing cash flows in line with the entity's policy for other interest payments). This will become relevant to more payments upon adoption of IFRS 16 when, subject to limited practical expedients, all leases will be treated as having a capital and an interest element.

- Payments such as acquisition expenses which might be thought of as relating to an investment but do not result in a recognised asset and, as such, should be classified as operating cash flows.

- The presentation and disclosure of factoring and reverse factoring transactions.

Amendments to IAS 7, requiring disclosure of changes in liabilities from financing activities (sometimes termed a 'gross debt reconciliation'), are effective for December 2017 year-ends. Presentation of a 'net debt reconciliation' is already common practice in some jurisdictions and one which remains acceptable, but previous adopted presentations should be reviewed to ensure they comply with the requirements of the amended standard – particularly that:

- They enable users to link items in the reconciliation to the statement of financial position and statement of cash flows.

- Non-cash changes and items that will result in a financing cash flow in the future are included in the reconciliation.

- Financial assets (for example, a derivative in an asset position that is designated as a hedge of a financial liability) are included in the reconciliation if they will give rise to financing cash flows.

Other disclosures supporting the statement of cash flows that continue to fall short of regulators' expectations include:

- Explanations of policies on the identification of cash and cash equivalents, including when applicable the reconciliation of the amounts with the equivalent items reported in the statement of financial position (for example, in respect of uncommitted bank facilities and cash pool facilities).

- 'Restricted cash' balances, which might be particularly relevant for groups operating in jurisdictions with controls over currency exchange or repatriation.

Business combinations

Business combinations are often very large, very complex transactions that can give rise to a variety of issues not encountered in other circumstances. Some of these issues are discussed below.

Identification of a business combination and of the acquirer

In characterising a transaction in which, by whatever means, one entity obtains control of another, it is first necessary to ask two questions:

- Is this a business combination?
- If so, which entity is the acquirer?

These questions are significant as they determine, firstly, whether the fair value exchange model of IFRS 3 (resulting in the recognition of assets and liabilities at fair value and of goodwill and the immediate expensing of transaction costs) applies, or whether a cost allocation approach (with no goodwill recognised and possible capitalisation of transaction costs) is appropriate and, if there is a business combination, which of the entities' assets and liabilities should be fair valued (the acquiree) and which should not (the acquirer). As such, insufficient consideration of these points can give rise to fundamentally incorrect accounting.

IFRS 3 provides guidance on both of these issues, but by means of a number of indicators that must be considered carefully.

Identification and valuation of intangible assets
Business combinations in which a large amount of goodwill is recognised, while few or no intangible assets are identified, are likely to attract regulatory attention.

IFRS 3 requires the recognition at fair value of intangible assets that are either separable (capable of being separated from the acquiree and monetised in some way) or that arise from contractual or legal rights. This results in the recognition of many assets (e.g. brands and customer relationships) that might not be recognised outside a business combination. Careful consideration of which assets should be identified is needed.

Once intangible (and, indeed, other) assets are identified, their fair value must then be determined in accordance with IFRS 13.

Business combinations and deferred tax
A common complication in the accounting for a business combination is the recognition and measurement of deferred tax balances. Amongst other things, it should be noted that:

- Deferred tax should not be recognised in respect of goodwill balances recognised in a business combination.

- For other assets and liabilities, the 'initial recognition exception' in IAS 12 *Income Taxes* does not apply to assets and liabilities recognised in a business combination, meaning that deferred tax will need to be recognised for both assets and liabilities recognised in the acquiree's financial statements and items (for example, some intangible assets) only recognised when a business combination occurs.

- In measuring such balances, care should be taken in determining the tax base of an asset or liability, which depending on local tax law may remain at its previous value or be reset to a different value as a result of the business combination.

- The assessment of whether a deferred tax asset should be recognised should be made at the level of the enlarged group. This (again depending on local tax law) can result in recognition of assets not previously recognised by the acquiree (because, for example, tax losses could now be utilised against profits elsewhere in the group).

Consideration vs remuneration
It is often the case, particularly in the acquisition of an owner-managed business, for one or more shareholders of an acquiree to continue as employees of the enlarged group after the business combination has completed. In such cases, it becomes important to determine whether payments due or equity to be issued to those people are:

- consideration for the business combination (in which case a liability or equity is recognised at the date of acquisition, with only, when applicable, subsequent movements in value subsequently recognised in profit or loss); or

- remuneration for post-combination employment (in which case no liability or equity is recognised at the date of acquisition, with the payments recognised in profit or loss in full as an employee cost over the related service period).

Paragraphs B54-B55 of IFRS 3 provide guidance on making this judgement, but should be read in light of the January 2013 agenda decision by the IFRS Interpretations Committee that contingent payments which are automatically forfeited if employment terminates are remuneration for post-combination services. In applying that guidance it should be noted that:

- The 'forfeited if employment terminates' criterion is applied strictly, with neither similar payments to exiting shareholders nor a low probability of the employee departing being grounds to override it.
- A thorough analysis of 'good leaver' and 'bad leaver' provisions is necessary, most importantly in determining what payments would be forfeited in a 'normal' departure of the employee of their own volition.
- Proper disclosure of the accounting policies applied to these potentially large and unusual transactions, together with judgements applied in their application, is important.

Bargain purchases

In most business combinations, the value of consideration paid by the acquirer exceeds the fair value of the acquiree's identifiable net assets, resulting in (subject to adjustments in respect of non-controlling interests and previously held equity interests in the acquiree) the recognition of goodwill.

However, in the rare circumstances of a 'bargain purchase' this relationship is reversed, resulting in the recognition of an immediate gain in profit or loss but only after a reassessment of whether all relevant assets and liabilities have been identified and whether the fair values of all relevant items have been appropriately determined.

It is important that such a reassessment is performed robustly and if it is finally determined that a bargain purchase has occurred, that appropriate disclosure is provided on how assets and liabilities were reassessed and why a bargain purchase arose (sometimes due to the requirements of IFRS 3 to measure certain assets and liabilities at other than fair value).

In instances where more than one business combination has been undertaken in the year, care should be taken before concluding that aggregation of the disclosures is appropriate as IFRS 3 requires each material business combination to be disclosed separately.

Transactions not addressed by IFRS 3

Given the range and complexity of business combination transactions, it is perhaps unsurprising that IFRS 3 does not address every possible variant that arises in practice. Notably, the Standard:

- Excludes from its scope the accounting for business combinations under common control (BCUCC), with no other IFRS specifically addressing such transactions.
- Does not address the treatment of a Mandatory Tender Offer (MTO) under which law or regulation requires an acquirer to offer to purchase shares held by remaining non-controlling interests.

An accounting policy for BCUCC is often developed, using the hierarchy in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, by reference to other accounting frameworks, accounting literature and accepted industry practices, taking into account the expectations of investors and regulators in relevant jurisdictions. As a result, diversity continues to exist in accounting for such transactions.

The IASB currently has a research project on the accounting for Business Combinations under Common Control, with a discussion paper due for publication in the second half of 2018.

The IFRS Interpretations Committee discussed the issue of MTOs in March 2013, no final conclusions were reached but the Committee highlighted the need to determine whether either a contractual financial liability (as defined in IAS 32 *Financial Instruments: Presentation*) or an onerous contract (in the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*) arise in the circumstances of a particular MTO.

In both cases, it is important that an accounting policy is applied consistently between transactions and is properly disclosed.

The importance of disclosure
Given the complexity of many business combination transactions and the level of judgement required in measuring resulting assets and liabilities, proper disclosure becomes particularly important.

Amongst other things, clear disclosure should be provided on:

- Business combinations for which the accounting is incomplete at the end of the reporting period in which the combination occurred. In those circumstances, IFRS 3 requires disclosure of the fact that provisional values have been used, why that is the case, the provisional amounts used and any adjustments recognised during the up to 12 month 'measurement period' permitted by the Standard.

- The combined group's revenue and profit or loss had the business combination been completed as of the start of the financial year.

- Assumptions and sensitivities in fair value measurements. For example, contingent consideration based on an entity's future performance is required to be measured at fair value on an ongoing basis and is likely to fall into 'Level 3' of the fair value hierarchy, requiring detailed disclosures under IFRS 13 *Fair Value Measurement*.

Defined benefit pension schemes
Defined benefit pension schemes are a complex area of accounting, giving rise to a surplus or deficit figure that is in fact the net of:

- The obligation to pay benefits to members, measured using the projected unit credit method.

- Plan assets, measured at their fair value.

- The effect of IAS 19's 'asset ceiling', a function of the refunds or reductions in future contributions available to the employer.

As a result, even when the statement of financial position shows a small (or even nil) net position, that can result from two or three very large offsetting balances subject to future changes arising from different risks and uncertainties. This, in conjunction with the complexity of some pension arrangements (either the plan itself, or the employer's strategy to fund it), means that effective disclosure of the arrangement and of the judgements applied in accounting for it is important to investors.

IAS 19 includes many disclosure requirements in respect of defined benefit schemes (for example, a reconciliation of opening and closing amounts for each of the three balances above and a description of the rules and regulatory framework under which the plan operates). However, when a defined benefit scheme is material to the financial statements high quality financial reporting requires consideration of what detail is needed to **fulfil the purpose of each disclosure**, particularly in respect of the amount, timing and uncertainty of future cash flows.

- **At a minimum**, IAS 19 requires disclosure of the expected contributions to be paid in the next accounting period. A fuller understanding of the funding arrangements affecting future contributions can be provided by disclosure of:
  - Expected contributions for subsequent years, distinguishing between deficit remedy payments and payments relating to current service.
  - The system for revision of contribution levels, often as part of a funding valuation exercise.
  - Any interdependencies between pension contributions and other transactions. For example, it can be the case that, to ensure plan members are not disadvantaged, increased levels of dividend payments require an increase in contributions to an entity's pension scheme.
- A sensitivity analysis is required for each significant actuarial assumption (e.g. discount rate, inflation forecast and mortality rates). In uncertain times, the level of variation in these amounts that is deemed '**reasonably possible**' should be reassessed at each reporting date.
- **Asset-liability matching strategies** (for example, longevity swaps) are becoming more common and more complex. Effective disclosure includes not just the existence of such arrangements but also of the underlying nature of such instruments and the means by which they are valued.

In respect of plan assets more generally, an appropriate level of disaggregation (beyond simply quoted and unquoted assets) can provide valuable insight into a plan's investment strategy and the risks to which it is exposed.

Due to the requirements of IAS 19 and of IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* in respect of the effect of the asset ceiling and the complexity of many funding requirements, a significant level of judgement can be required in determining whether a net surplus (or, indeed, liability for a minimum funding requirement) should be recognised. In circumstances where this is relevant, a clear description (as per paragraph 122 of IAS 1) of the judgements made in respect of this accounting requirement should be provided. This will often need to cover the assessment of **trustees' rights** to either enhance members' benefits or wind up the plan before making any payment back to the employer.

Discount rate in a country that has adopted another country's currency

The June 2017 IFRIC Update reported an agenda decision by the IFRS Interpretations Committee on the determination of a discount rate for defined benefit obligations in a country that has adopted another currency as its official or legal currency (the question submitted to the Committee was in respect of Ecuador where the U.S. dollar is used).

In determining an appropriate discount rate, it is first necessary to consider whether there is a deep market in high quality corporate bonds. If so, the yield on such bonds is used as a discount rate. If not, a government bond yield is used.

The Committee concluded that the consideration of whether there is a deep market in high quality corporate bonds should be made at a *currency* level, not limited to the *country* in which the entity operates. As such, an entity will need to assess whether there is a deep market in high quality corporate bonds denominated in their currency in other jurisdictions and only if this is not the case revert to use of a government bond yield.

Reporting the effects of income tax

The reporting of income tax remains an area of high focus, both from the point of view of quality reporting on, for example, the effects of uncertain tax positions and possible future changes to an entity's effective tax rate, but more generally as a result of regulatory and media scrutiny of entities' tax affairs.

Many generic elements of quality financial reporting are relevant to income tax. For example:

- **Accounting policies** related to tax should be clear, specific to the entity's circumstances and should address all key issues including the recognition and measurement of uncertain tax positions, if relevant.

- Income tax is a common source of **estimation uncertainty**, particularly in respect of uncertain tax positions to be disclosed in accordance with IAS 1. Significant risks of material adjustment in the next financial year should be disclosed, including quantitative information such as sensitivities or ranges of possible outcomes. The possibility of material adjustments in later periods is also valuable information which could be included in, for example, the tax note.

- If the annual report includes a **narrative on performance in the year** such as an MD&A or operating review, this should include appropriate discussion of tax, particularly on variances in and expectations of the effective tax rate.

The effective tax rate reconciliation required by IAS 12 should also be prepared carefully so that it provides clear information about the key factors affecting the effective tax rate and its sustainability in the future. This can be achieved by describing the nature of reconciling items and why they have arisen and by distinguishing clearly between significant one-off or unusual items and those that are expected to recur. In addition, care should be taken over the treatment of 'prior year' tax adjustments in terms of whether they represent a change of estimate to be accounted for in the current year or an error in the previous year's tax accounting that, if material, may need to be adjusted retrospectively.

Interest and penalties relating to income taxes

The September 2017 IFRIC Update reported an agenda decision by the IFRS Interpretations Committee on the treatment of interest and penalties charged by a tax authority for late payment of an income tax liability. The Committee concluded that the determination of whether such a cost is within the scope of IAS 12 *Income Taxes* (and, as a result, presented within the tax line in profit or loss) or IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* (and, as a result, presented as an operating or finance cost) is not an accounting policy choice but should be considered based on the circumstances in which the interest or penalty arose.

This judgement should be based on whether interest and/or penalties can be seen as forming part of a larger tax position (for example, if interest or penalties are accepted as a cost of delaying payment to avoid prejudicing the overall tax position).

Regardless of the judgement reached, information about material interest and penalties should be disclosed.

Uncertain tax positions

IFRIC Interpretation 23 *Uncertainty over Income Tax Treatments* was published in 2017 and whilst it is not mandatorily effective until 2019 the conclusions it reaches are consistent with and do not add to already effective accounting standards. As such, they provide an appropriate approach to dealing with uncertain tax positions that can be applied immediately.

In brief, its conclusions are as follows:

- Uncertainties in income tax liabilities or assets should be reflected in recognising a tax liability or asset only when payment or recovery becomes probable.

- Judgement is required in identifying the unit of account to be applied in making this judgement (i.e. whether there is a single tax uncertainty or group of related uncertainties).

- Full 'detection risk' (i.e. all relevant information being available to the tax authorities) is assumed in making these judgements.

To the extent that preparers' current practices are inconsistent with the conclusions above, they should, as discussed above in the context of IFRS 9, IFRS 15 and IFRS 16, provide disclosure on the likely effects of applying IFRIC 23.

Recognition of deferred tax assets

IAS 12 requires entities to recognise a deferred tax asset derived from deductible tax differences and unused tax losses (even if the entity is currently loss making) over and above the level of deferred tax liabilities relating to the same taxation authority and taxable entity provided that it is probable that the entity will generate future taxable profits to utilise the benefit from them. In many cases, the assessment as to whether the entity will generate future taxable income involves the use of significant judgement, for example the time period considered (which should be based on the facts and circumstances of the entity rather than an arbitrary limit), tax planning strategies, impact of future contracts etc.

Entities are required to disclose the judgements made and evidence that supports the recognition of those deferred tax assets. For example, where an entity is loss making, disclosure of the evidence over the availability of future profits to support a deferred tax asset is required.

Reforms to the U.S. Tax Code

On 2 December 2017, the Tax Cuts and Jobs Act was passed by the United States Senate. The bill includes a suite of amendments to the Internal Revenue Code, including a reduction in corporate tax rate from a maximum of 35% to a flat 20% rate.

The changes included are complex and, as a result, their effect will differ depending on each entity's circumstances. At the time of writing, the bill had not been approved by the President and it was not clear whether this would occur during 2017 (resulting in substantive enactment of those changes and, therefore, changes to recognised tax balances).

Entities affected by the U.S. tax regime should consider any accounting or disclosure impacts of these changes on their 2017 annual reports. Deloitte in the United States is monitoring the progress of the bill and will be providing updates via www.usgaapplus.com.

Impairment reviews

The performance and disclosure of impairment reviews remains an area of regulatory challenge. In addition to the annual review required for goodwill and intangible assets with indefinite useful lives, it is first necessary to consider what impairment reviews are necessary by considering whether indicators of impairment exist. It is also a requirement of IAS 36 *Impairment of Assets* that for assets previously impaired (other than goodwill, for which an impairment can never be reversed) an assessment is made of whether that impairment may no longer exist and, therefore, that review for reversal of impairment should be made. A critical part of this assessment is determining the level at which an impairment review should be performed, which can be at:

- The level of an **individual asset**, if that asset's recoverable amount can be determined.

- If that is not possible, because the asset's value-in-use cannot be estimated as close to its fair value less costs of disposal and it does not generate cash inflows that are largely independent of those from other assets, at the level of a **cash-generating unit** (being the smallest identifiable group of assets that generates largely independent cash inflows).

- Only for impairment reviews of goodwill, at the level of a **group of cash-generating units** that represents the lowest level (not larger than an operating segment as defined in IFRS 8) at which goodwill is monitored for internal management purposes.

It should be noted that this assessment will be largely fact based, in particular that the identification of a cash-generating unit should be based on an objective assessment of whether there is significant interdependence between cash inflows from one asset or location and from another. The level at which the entity monitors its business is only relevant to the grouping of cash-generating units for the purposes of goodwill testing.

Once it is determined that an impairment (or reversal) review should be performed and the individual asset, cash-generating unit or group of cash-generating units to which goodwill is allocated has been identified, it is important to consider carefully all inputs into a calculation of either value-in-use or fair value less costs to sell. For both, this can be based on a discounted cash flow calculation, in which case both cash flow forecasts and the discount rate(s) then applied to them will need to be assessed. An appropriate discount rate should also be applied to each cash-generating unit (or group of cash-generating units) rather than the same rate being applied across an entity. Assumptions used in applying, for example, a market or cost approach to determining fair value will also need to be considered carefully.

In terms of disclosure, the following should be considered:

- Key assumptions behind value-in-use calculations (not restricted to discount and terminal growth rates), IAS 36 *Impairment of Assets* requires disclosure of the approach to determining those assumptions should be disclosed.

- A quantified sensitivity analysis is required when a reasonably possible change in assumptions would result in impairment of goodwill.

- The reasons for significant changes in, for example, discount rates compared to previous years should also be explained.

Capital management disclosures

In fulfilling the requirements of paragraph 134 of IAS 1, 'boilerplate' capital management policies and unclear explanations of objectives, policies and processes for managing capital should be avoided. This can be an issue in particular for entities that are subject to externally imposed capital requirements, who should consider carefully how they manage capital and the role that regulatory capital requirements play in that management.

'Brexit' and 2017 annual reports

Given its economic significance and range of possible effects on businesses both in the UK and those with an interest in the UK economy (through for example a UK subsidiary, or British customers or suppliers) many entities have already begun to discuss the possible effects of 'Brexit' within their corporate reporting. To date, this has primarily been reported in relatively general terms, noting that it is still too early to measure the longer term effects on particular businesses.

It is important, however, that as the landscape develops entities continue to refine their analysis of the potential impacts and, as they do so, continue to provide more detailed and more entity-specific discussion of these impacts in their corporate reporting. Such a discussion could be included in an entity's narrative reporting as part of, depending on the requirements applicable in its jurisdiction, a discussion of the entity's business model or the risks which it faces. When relevant, effects of 'Brexit' that an entity might already be experiencing in discussions of performance in 2017 should also be included in discussing an entity's performance in 2017.

Within the financial statements themselves, such uncertainties could be relevant to disclosure of sources of estimation uncertainty and to the parameters of 'reasonably possible' changes used in sensitivity analyses of fair value measurements, market risks (for example, foreign currency rates) on recognised financial assets and liabilities and impairment reviews.

As noted in a Deloitte IFRS in Focus the triggering of 'Article 50' did not constitute substantive enactment of any changes to existing tax law, meaning that current and deferred tax should be measured based on the basis of that existing law.

As with other economic events, changes in tax law should be accounted for when they occur rather than being anticipated based on an expectation of possible future change. Tax accounting is, however, unusual in that a change in tax law applies to all entities simultaneously, and thus provides a single 'trigger point' for changes in tax accounting. Other accounting that may occur, directly or indirectly, as a result of 'Brexit' are likely to be more entity-specific, resulting from events or decisions particular to an individual entity: for example, a restructuring provision will be recognised when the entity's plans have reached the point at which the criteria in IAS 37 have been met.

Climate related financial risks disclosures

In June 2017, the Task Force on Climate-related Financial Disclosures (TCFD), a body set up by the Financial Stability Board, published its final recommendations for effective disclosure of climate-related financial risks.

The TCFD recommends inclusion in mainstream corporate reporting of information on:

- An entity's governance structure in respect of climate-related risks and opportunities.
- The actual and potential impacts of changes in climate on business, strategy and financial planning. This is expected to take into account a scenario of a 2°C increase in global temperatures.
- How the organisation identifies, assesses and manages climate-related risks.
- The metrics and targets used in assessing and managing climate-related risks and opportunities.

Over 100 CEOs of large, multi-national organisations have publicly stated their support for the TCFD's initiative and urged other entities to support better disclosures of climate-related risks and opportunities.

A Deloitte 'IFRS in Focus' publication provides more detail on TCFD's recommendations.

New and revised IFRSs mandatorily effective for years ending 31 December 2017

Further detail on the new and revised standards discussed below is available at:

http://www.iasplus.com/en/tag-types/global/newsletters/ifrs-in-focus

IFRS
Amended Standards:
Amendments to IAS 12 – Recognition of Deferred Tax Assets for Unrealised Losses
Amendments to IAS 7 – Disclosure Initiative
Amendment to IFRS 12 issued in the Annual Improvement Cycle 2014-2016

Amendments to IAS 12 *Income Taxes* – Recognition of Deferred Tax Assets for Unrealised Losses

The amendments to IAS 12 clarify that unrealised losses on debt instruments measured at fair value for financial reporting purposes but at cost for tax purposes can give rise to a deductible temporary difference and how such a temporary difference should be assessed in determining whether a deferred tax asset should be recognised.

Amendments to IAS 7 *Statement of Cash Flows* – Disclosure Initiative

The amendments to IAS 7 require disclosure of both cash and non-cash changes in liabilities arising from financing activities (being liabilities for which cash flows were, or future cash flows will be, classified as being from financing activities).

Amendments to IFRS 12 Disclosure of *Interests in Other Entities* issued in the Annual Improvements Cycle 2014-2016

The amendments to IFRS 12 introduced in the 2014-2016 annual improvement cycle clarify that all requirements of that Standard (other than those covered by an existing exemption from disclosure of summarised financial information on interests in subsidiaries, joint ventures and associates) apply to interests classified as held for sale or discontinued operations in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

IFRS Interpretations Committee agenda decisions in 2017

Along with its activity developing formal interpretations of IFRSs and proposing that the IASB make amendments to Standards, the IFRS Interpretations Committee regularly publishes summaries of issues that it has decided not to add to its agenda, often accompanied by a discussion of the accounting issue submitted.

Whilst the commentary included in an agenda decision is not formally part of IFRSs, it is an important source of guidance that should be carefully considered when selecting a suitable accounting policy. In many jurisdictions there is an expectation from regulators that agenda decisions will be considered.

In 2017, the following agenda decisions have been published by the Committee.

March IFRIC Update	IFRS 10 – Investment entities and subsidiaries
	IAS 12 – Deferred taxes when acquiring a single-asset entity that is not a business
	IAS 28 – Fund manager's assessment of significant influence
	Commodity loans
June IFRIC Update	IAS 19 – Discount rate in a country that has adopted another country's currency
	IAS 32 – Centrally cleared client derivatives
	IAS 33 – Tax arising from payments on participating equity instruments
	IAS 41 – Biological assets growing on bearer plants
September IFRIC Update	IFRS 1 – Subsidiary as a first-time adopter
	IFRS 9 – Financial assets eligible for the election to present changes in fair value in other comprehensive income
	IAS 12 – Interest and penalties relating to income taxes
	IAS 38 – Goods acquired for promotional activities
November IFRIC Update	IFRS 3 – Acquisition of a group of assets

New and revised IFRSs available for early adoption in years ending 31 December 2017

Paragraph 30 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires entities to consider and disclose the potential impact of new and revised IFRSs that have been issued but are not yet effective. As discussed above, the sufficiency of these disclosures (particularly as they relate to IFRS 15 on revenue and IFRS 9 on financial instruments) is a current area of regulatory focus.

The list below reflects a cut-off date of 30 November 2017. The potential impact of the application of any new and revised IFRSs issued by the IASB after that date but before the financial statements are issued should also be considered and disclosed.

Consideration should always be given to the effect of any local endorsement or other regulatory or legal processes on an entity's ability to early adopt an IFRS.

IFRS	Effective date
New Standards	
IFRS 9 – Financial Instruments	1 January 2018 *
IFRS 15 – Revenue from Contracts with Customers	1 January 2018
IFRS 16 – Leases	1 January 2019
IFRS 17 – Insurance Contracts	1 January 2021
Amended Standards	
Amendments to IFRS 10 and IAS 28 – Sale or Contribution of Assets between an Investor and its Associate or Joint Venture	The IASB decided in December 2015 to defer indefinitely the effective date of these amendments.
Clarifications to IFRS 15 Revenue from Contracts with Customers	1 January 2018
Amendments to IFRS 2 – Classification and Measurement of Share-based Payment Transactions	1 January 2018
Amendments to IFRS 4 – Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts	1 January 2018
Amendments to IFRS 1 and IAS 28 issued in the Annual Improvement Cycle 2014-2016	1 January 2018
Amendments to IAS 40 – Transfers of Investment Property	1 January 2018
Amendments to IFRS 9 – Prepayment Features with Negative Compensation	1 January 2019
Amendments to IAS 28 – Long-term interests in Associates and Joint Ventures	1 January 2019
IFRIC Interpretations	
IFRIC 22 – Foreign Currency Transactions and Advance Consideration	1 January 2018
IFRIC 23 – Uncertainty over Income Tax Treatments	1 January 2019

* For periods beginning before 1 January 2018, previous versions of IFRS 9 may be adopted provided the relevant date of initial application is before 1 February 2015.

The clarifications to IFRS 15 issued in April 2016 addressed a number of issues highlighted by discussions of the IASB and FASB's joint Transition Resource Group (TRG) for Revenue Recognition. Details of the group's discussions can be found here.

A similar group, the IFRS Transition Resource Group for Impairment of Financial Instruments (ITG) has been instigated by the IASB to discuss issues arising from the expected loss-based impairment model of IFRS 9. Details of this group's discussions can be found here.

A Transition Resource Group for Insurance Contracts has also been set up following publication of IFRS 17 with meetings scheduled to commence in 2018.

Key contacts

Global IFRS Leader
Veronica Poole
ifrsglobalofficeuk@deloitte.co.uk

IFRS centres of excellence

Americas		
Canada	Karen Higgins	ifrs@deloitte.ca
LATCO	Miguel Millan	mx-ifrs-coe@deloittemx.com
United States	Robert Uhl	iasplus-us@deloitte.com
Asia-Pacific		
Australia	Anna Crawford	ifrs@deloitte.com.au
China	Stephen Taylor	ifrs@deloitte.com.cn
Japan	Shinya Iwasaki	ifrs@tohmatsu.co.jp
Singapore	James Xu	ifrs-sg@deloitte.com
Europe-Africa		
Belgium	Thomas Carlier	ifrs-belgium@deloitte.com
Denmark	Jan Peter Larsen	ifrs@deloitte.dk
France	Laurence Rivat	ifrs@deloitte.fr
Germany	Jens Berger	ifrs@deloitte.de
Italy	Massimiliano Semprini	ifrs-it@deloitte.it
Luxembourg	Eddy Termaten	ifrs@deloitte.lu
Netherlands	Ralph Ter Hoeven	ifrs@deloitte.nl
Russia	Maria Proshina	ifrs@deloitte.ru
South Africa	Nita Ranchod	ifrs@deloitte.co.za
Spain	Cleber Custodio	ifrs@deloitte.es
United Kingdom	Elizabeth Chrispin	deloitteifrs@deloitte.co.uk

Designed and produced by The Creative Studio at Deloitte, London. J14455