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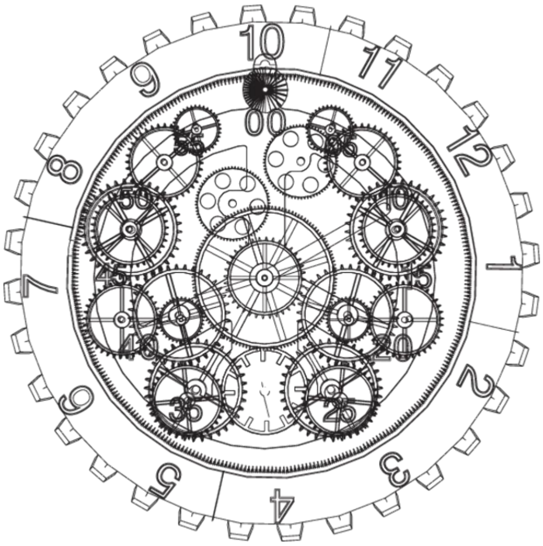

IFRS Newsletter
Bringing you the latest information on recent IFRS topics

We are pleased to welcome you to the first edition of our **IFRS Newsletter**.

Our aim is to keep you updated with all the latest news and developments on IFRS and financial reporting along with the potential impact they may have on your business.

In this issue we discuss:

- **New Standards** (IFRS 9, IFRS 15 & IFRS 16) – Disclosures in interim financial statements
- **IFRS 16** – Main Challenges
- **IFRS 17** – Second Transition Resource Group meeting discussing the implementation of IFRS 17 *Insurance Contracts*
- **IASB** issues a **Revised** ***Conceptual Framework***

We hope that you find our newsletter insightful and if you would like to discuss any of the

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topics covered, please do not hesitate to contact us.

Best regards

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Where can I go for more information?

This publication highlights just some of the recent IFRS topics that may be of interest to entities reporting under IFRS.

More detailed information can be found at www.iasplus.com

New Standards (IFRS 9, IFRS 15 & IFRS 16) – Disclosures in interim financial statements

Both IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers* are mandatorily effective for annual periods beginning on or after 1 January 2018. For many entities, the first financial statements reflecting adoption of these standards will be the interim report for the six months to June 2018. IFRS 16 *Leases* permits also early adoption in 2018 financial statements.

The detailed disclosure requirements of IFRS 9, IFRS 15 and IFRS 16 do not apply to interim financial statements prepared in accordance with IAS 34 *Interim Financial Statements*. However, IAS 34 does require disclosure of the effects of changes in accounting policy.

In particular, IAS 34 par16A(a) requires "*a statement that the same accounting policies and methods of computation are followed in the interim financial statements as compared with the most recent annual financial statements or, if those policies or methods have been changed, a description of the nature and effect of the change.*" Changes in accounting policy resulting from adoption of new accounting standards are subject to this requirement.

IAS 34 par15C also expresses a broader principle that "*when an event or transaction is significant to an understanding of the changes in an entity's financial position or performance since the last annual reporting period, its interim financial report should provide an explanation of and an update to the relevant information included in the financial statements of the last annual reporting period.*"

Determining the appropriate disclosures necessary to satisfy these requirements as well as investors' expectations of information on changes in, for example, reported revenue and profit will necessitate the application of **judgement** as the appropriate level of disclosure will differ depending on the extent and nature of the changes resulting from each new standard.

Entities should consider the need to provide the following information in their interim financial statements:

- **Description of the new accounting policies applied**
  For example:
  - In respect of IFRS 9: details on classification of each significant class of the entity's financial assets and how the expected credit loss model has been applied
  - In respect of IFRS 15: how the five-step model applies to each significant revenue stream, the identified performance obligations and timing of revenue recognition for each performance obligation (over time or at a point in time)
  - In respect of IFRS 16: how the revised definition of a lease applies to the entity's significant contracts

- **Transitional method adopted and any practical expedients used**

- **Key judgements and estimates applied**
  For example:
  - In respect of IFRS 9: assumptions made in expected credit loss model regarding future credit losses
  - In respect of IFRS 15: estimates regarding variable consideration and determination of stand-alone selling prices
  - In respect of IFRS 16: determination of the lease term and the discount rate

- **The quantitative effects**
  Entities should consider whether it is necessary to provide quantitative or qualitative information on the current interim period effect on financial statements due to changes in accounting policies resulting from adoption of new standards (for example, on revenue recognized in the interim period) in order to satisfy the requirement of IAS 34 par16A(a) regarding disclosure of "*the effect of the change*". In addition, whilst not directly applicable to interim financial statements, the transitional disclosures required in annual financial statements might be referred to in assessing whether additional quantitative disclosures should be provided. In particular, for financial institutions there may be an expectation from investors that the disclosure of the change in loss allowance from the application of IFRS 9, as required by IFRS 7 par.42P in annual financial statements, will also be made in the interim financial statements. Also, listed entities should consider that the European Securities and Market Authority (ESMA) expects that issuers applying IFRS 15 using the modified retrospective transition method will provide the disclosures required by IFRS 15.C8 in all interim periods that include the date of initial application of IFRS 15 (refer to ESMA's report "*Enforcement and Regulatory Activities of Accounting Enforcers in 2017*" issued on April 3rd, 2018).

- **Disclosure requirements added to IAS 34 on adoption of IFRS 15**
  Two specific disclosure requirements were added*;* significant impairment of contract assets and disaggregation of revenue (together with sufficient information to understand the relationship between that disclosure and revenue disclosed in a segmental analysis).

Overall, the extent of disclosures in interim financial statements will depend on each entity's circumstances and management will need to apply judgment to satisfy both IAS 34 requirements and investors/regulators expectations.

IFRS 16 – Main Challenges

IFRS 16 *Leases* was published in January 2016 and is effective for periods beginning on or after 1 January 2019, with earlier application permitted. IFRS 16 will have a significant impact to lessees, since most of the leases are coming onto the balance sheet. In particular, lessees will have to recognize a right-of-use asset and a lease liability for almost all leases (except for short-term leases and leases of low value assets). In the income statement, the straight-line operating lease expenses will be replaced with depreciation and front-loaded interest. For lessors, the finance and operating lease distinction as well as the accounting remains largely unchanged.

IFRS 16 is expected to bring broader implications. Lessees need to carry out an assessment of the accounting, systems' and other implications and develop a plan for successful transition to the new standard.

Accounting challenges

The **identification of leases**, the determination of the **lease term** and the **discount rate** are some of the areas that are expected to be quite challenging for lessees.

- **Identification of leases**: The new leasing standard introduces a new definition of a lease, which may lead to arrangements previously outside the scope of lease accounting now to be captured as leases and vice versa.

- **Lease term**: IFRS 16 has a similar definition of lease term to the existing standard, IAS 17 *Leases*. In particular, the lease term is defined as the non-cancellable period of a lease plus periods covered by an option to extend the lease or an option to terminate the lease if the lessee is reasonably certain to exercise the extension option or not to exercise the termination option. While IFRS 16 provides additional guidance to support entities assessing the reasonable certain criterion, the determination of the lease term remains quite challenging and management will need to apply considerable judgement in this area.

- **Discount rate:** Under IFRS 16, lease payments included in the lease liability should be discounted using the interest rate implicit in the lease, if this can be readily determinable; otherwise, the incremental borrowing rate shall be used. The interest rate implicit in the lease is the rate of interest that causes the present value of (a) the lease payments and (b) the unguaranteed residual value to equal the sum of (i) the fair value of the underlying asset and (ii) any initial direct costs of the lessor. The incremental borrowing rate is the rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment. Determining the rate implicit in the lease may be challenging in certain cases, for example property leases, as it requires knowledge of the underlying asset's residual value, and its fair value; information which may not be readily available to lessees. Whilst IFRS 16 provides an alternative in the incremental borrowing rate, determining this hypothetical rate may still present practical challenges and may require a considerable use of judgement.

Broader level considerations
IFRS 16 will also have an impact on lessees' **financial ratios** and clear communication will be required to explain the changes to stakeholders. EBITDA will be increased, net assets will be decreased and gearing will be increased. Also, the impact on the income statement, along with balance sheet becoming more asset rich, but also more heavily indebted, could impact compliance with **debt covenants** based on financial ratios. As a result, lessees may need to consider renegotiating their debt covenants with the banks.

Practicalities
Capturing all the necessary data required to implement the new standard and ensuring that it is a sufficiently robust basis for making material accounting entries is likely to be a considerable challenge and may require **significant resources**. Entities may need **to modify existing systems** or **move to new systems** for compliance with IFRS 16 requirements. In addition, entities will need to **review** and potentially to **modify** their **processes and internal controls** to comply with the new standard.

IFRS 17 – Second Transition Resource Group meeting discussing the implementation of IFRS 17 *Insurance Contracts*

The International Accounting Standards Board (IASB) issued IFRS 17 *Insurance Contracts* in May 2017. IFRS 17 sets out the requirements that a company should apply in reporting information about insurance contracts it issues and reinsurance contracts it holds.

IFRS 17 is effective from 1 January 2021, with earlier application permitted. IFRS 17 replaces the interim standard -IFRS 4 *Insurance Contracts*.

The IFRS 17 Transition Resource Group (TRG) is a discussion forum established by the IASB to support the implementation of IFRS 17 *Insurance Contracts*.

The second meeting of the TRG took place on 2 May 2018, discussing the following accounting issues:

- Combination of insurance contracts
- Risk adjustment for non-financial risk in a group of entities
- Cash flows within the contract boundary
- Boundary of reinsurance contracts held with repricing mechanisms
- Determining the quantity of benefits for identifying coverage units
- Implementation challenges outreach report
- Reporting on other questions submitted

* For more information on the issues discussed, please refer to the publication "*IFRS in Focus - Second Transition Resource Group meeting discussing the implementation of IFRS 17 Insurance Contracts*" that can be found in www.iasplus.com.

IASB issues a Revised *Conceptual Framework*

The IASB has issued a revised *Conceptual Framework*.

The main purpose of the Conceptual Framework is to guide the IASB when it develops International Financial Reporting Standards. The Framework can also be helpful for preparers and auditors when there are no specific or similar standards that address a particular issue.

The revised Framework became effective when it was published (on 29 March 2018). Given that some standards include references to the 1989 and 2010 versions of the Framework, the IASB has published a separate document *Updating References to the Conceptual Framework* which contains consequential amendments to affected standards so that they refer to the new Framework. These amendments are effective for annual periods beginning on or after 1 January 2020, with earlier application permitted. There is one exception. IFRS 3 Business Combinations states that, in a business combination, identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in the Framework. IFRS 3 refers to both the 1989 and 2010 Frameworks.

The definitions of asset and liability in those Frameworks are also in IFRS standards. The IASB decided not to amend IFRS 3 at this stage, considering that an item that meets the definition of an asset or liability when the new Framework is applied might need to be derecognized immediately because it does not meet the asset or liability definition in IFRS standards. The IASB will explore this issue in a separate narrow scope project.

Main changes and key concepts in the revised Framework:

- Reintroduces the terms stewardship and prudence.
- Introduces a new asset definition that focuses on rights and new liability definition that is likely to be broader than the definition it

replaces, but does not change the distinction between a liability and an equity instrument.

- Removes from the asset and liability definitions references to the expected flow of economic benefits. This lowers the hurdle for identifying the existence of an asset or liability and puts more emphasis on reflecting uncertainty in measurement.
- Discusses historical cost and current value measures and provides some guidance on factors to be considered when selecting a measurement basis for a particular asset or liability.
- States that the primary measure of financial performance is profit or loss, and that only in exceptional circumstances will the IASB use other comprehensive income and only for income or expenses that arise from a change in the current value of an asset or liability.
- Discusses uncertainty, derecognition, unit of account, the reporting entity and combined financial statements.

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