IFRS Global office
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IFRS in Focus
Closing out 2013

Contents

In this special edition of IFRS in Focus we set out financial reporting issues that may be relevant for years ending 31 December 2013 as a result of economic conditions, areas of regulatory focus or changes in accounting standards.

As noted in Deloitte's latest **Global Economic Outlook**, many of the world's larger economies are showing signs of steady recovery, with the International Monetary Fund (IMF) **predicting** annual growth of between 1% and 2% in each of the U.S., UK, Canada and Japan. However, sustaining this growth could be challenging; with concerns expressed over the continued uncertainty surrounding the U.S. federal budget and debt ceiling, the possibility of a property bubble developing in the UK and an impending sales tax increase in Japan.

Varied experiences are anticipated for countries within the Eurozone, with Northern Europe expected to show a low level of growth in 2013, whilst much of Southern Europe remains in recession.

The emerging markets that have been the engine for the world economy in recent years are expected by the **IMF** to show a similar level of growth in 2013 (for example 7.6% in China compared to 7.7% in 2012 and 3.8% in India compared to 3.2% in 2012) again, with challenges to face in sustaining that growth.

Of course, these headline figures mask a multitude of regions and industries experiencing their own levels of growth or decline. The picture is most definitely mixed.

Against this backdrop, preparers of financial statements will face a variety of challenges depending on the environment in which they operate. In addition, the implementation of a number of significant new accounting standards will require careful consideration and the application of significant judgements.

This special edition of IFRS in Focus highlights some of those considerations, together with areas likely to be focused on by regulators.

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Topical issues

Impairment of non-financial assets

Regulatory focus

Impairment remains a key area of focus for securities regulators across the world, as the following examples show:

- The European Securities and Markets Authority (ESMA) included impairment of non-financial assets as one of its enforcement priorities for 2013 financial statements, citing the continued effects of the financial crisis followed by an extended period of slow economic growth in Europe as implying that assets may continue to generate lower than expected cash flows. This followed an observation made in its survey on 2011 financial statements that the low level of impairment losses recognised by issuers might not be appropriate given the difficult economic circumstances at that time.
- The United Kingdom's Financial Reporting Council (FRC) noted in its 2013 annual report on corporate reporting that it continues to raise a number of questions in this area, citing in particular the 'heroic nature' of assumptions supporting a rapid turnaround in currently loss-making businesses.
- The Australian Securities & Investments Commission (ASIC) highlighted the importance of, amongst other things, the reasonableness of assumptions (including doubts raised by significant variances between prior period cash flow projections and actual results) and the identification of cash-generating units (CGUs) at an appropriate level.
- The Ontario Securities Commission published observations on the quality of asset impairment disclosures, identifying scope for improvement in descriptions of entities' CGUs, explanations of events and circumstances contributing to an impairment loss and explanations of the key assumptions and valuation approach used to determine recoverable amounts.

Discussions around impairment of non-financial assets often focus on the impairment of goodwill and intangible assets with an indefinite useful life arising from business combinations. In accordance with paragraph 10 of IAS 36, these assets need to be tested for impairment on an annual basis, irrespective of whether there is any indication of impairment.

Other assets are subject to an impairment review when there is an indication that an asset may be impaired. IAS 36 includes examples of internal (e.g., physical damage to an asset) and external (e.g., an entity's net assets exceeding its market capitalisation) information that indicate an asset may be impaired, but this is not an exhaustive list. Any indication that an asset's recoverable amount has declined to a significant degree such that it might be lower than its carrying amount would trigger a requirement to perform a full impairment review.

The recoverable amount is the higher of the asset's fair value less costs of disposal (determined in accordance with the requirements of IFRS 13 discussed below) and its 'value in use' (the present value of the future cash flows expected to be derived from an asset or cash-generating unit). Testing for impairment using a value in use approach involves a number of steps, with careful consideration needed at each stage of the process.

In particular, preparers should pay special attention to the following areas:

- The appropriate identification of CGUs. This is based on the generation of independent cash *inflows*; cost-sharing arrangements should not result in the identification of larger CGUs.
- The appropriate allocation of goodwill to CGUs or groups of CGUs. Goodwill may be allocated to a group of CGUs, but that group must be the lowest level at which goodwill is monitored for internal management purposes and must not be larger than an operating segment (as defined in IFRS 8) before any aggregation is applied for disclosure of segmental information. It is also important to remember that such an allocation does not mean that individual CGUs within that group no longer exist, in fact if there are indicators of an impairment at a CGU level IAS 36 requires a two-step approach, with the carrying amount of each CGU compared to its recoverable amount before the goodwill is added and the group of CGUs is tested again.
- The supportability of cash-flow projections. This is especially important when those projections differ from market expectations about the economy or industry in which the entity operates or when previous forecasts have differed from actual results.

- The consistency of projections with forecasts used for other purposes.

- The appropriateness of long-term growth and discount rates applied to the forecast cash flows. Application of the entity's overall weighted average cost of capital (WACC) to all CGUs (or groups of CGUs) may not be appropriate when the entity operates in a number of different markets. IAS 36 specifically mentions country risk in this context and this might be a significant consideration in the current economic environment as some economies show signs of growth whilst others continue to struggle.

Consistency of assumptions and forecasts

There are a number of areas in which forecasts of future performance affect financial statements (for example, goodwill impairment reviews, recognition of deferred tax assets, actuarial assumptions used in accounting for defined benefit plans, going concern considerations). Entities should apply the same assumptions in all such areas, or else have a clear rationale for divergence in assumptions.

It is also important to ensure consistency between assumptions and forecasts included in narrative reporting and those used within financial statements.

Impairment of assets outside the scope of IAS 36

A number of non-financial assets fall outside the scope of IAS 36 because they are tested for impairment in a different way. These assets should not be overlooked in preparing financial statements and each of them may be affected by a difficult trading environment. For example, the net realisable value of inventory may fall or the generation of future profits necessary to recover a deferred tax asset may no longer be probable.

Impairment of financial assets

Financial assets not measured at fair value through profit or loss need to be considered for impairment in a different way to non-financial assets. The requirements of IAS 39 (or, when applied, IFRS 9) need to be considered carefully.

- Although many equity markets have shown gains in the past year, it is important to remember that equity investments classified as available-for-sale (AFS) under IAS 39 must be assessed for impairment at an individual level, rather than as part of a portfolio. Accordingly, entities will need to apply a consistent accounting policy to determine whether a fall in the value of an investment is 'significant' or 'prolonged' and, therefore, whether the investment is impaired. The observations of the IFRS Interpretations Committee made in respect of this requirement in July 2009 remain valid, namely:

  – that a fall in value that is *either* significant *or* prolonged results in an impairment, the standard cannot be read to mean that both are required;
  – a fall in value is assessed in absolute terms, a decline being in line with a general fall in market values does not make it any less significant;
  – a forecast recovery of value is not a relevant factor; and
  – foreign currency denominated equity securities should be assessed for impairment in the entity's functional currency, not in the currency of the equity.

- Assets measured at amortised cost should be assessed for the occurrence of events indicating that a loss has been incurred, including:

  – significant financial difficulty of the issuer or obligor;
  – a breach of contract, such as a default or delinquency in interest or principal payments;
  – it becoming probable that the borrower will enter bankruptcy or other financial reorganisation; and
  – the disappearance of an active market for that financial asset because of financial difficulties.

- Although they are financial assets, investments in subsidiaries, associates and joint ventures are only subject to the impairment requirements of IAS 39 when they are accounted for using that standard. When such investments are measured at cost or using the equity method of accounting they are subject to the requirements of IAS 36.

- Pending completion of the IASB's project on impairment of financial assets, the incurred loss model in IAS 39 continues to apply even for entities that have adopted IFRS 9.

Impairment disclosures

Amendment to IAS 36 on the disclosure of the recoverable amounts of cash-generating units (CGUs) containing goodwill or intangible assets with indefinite useful lives
Upon publication of IFRS 13, the IASB made a number of consequential amendments to other standards. One of these was to add to IAS 36 a requirement to disclose the recoverable amount (i.e., the higher of value in use and fair value less costs of disposal) of each CGU (or group of CGUs) to which a significant amount of goodwill (or intangible assets with indefinite useful lives) has been allocated. This requirement applied in all periods, not only when an impairment had occurred.

The addition of this requirement was inadvertent and the IASB has now amended IAS 36 accordingly. The amendment is not effective until 2014, but is available for early adoption.

Entities wishing to take advantage of this amendment in 2013 financial statements should note that they would also need to provide the additional disclosures required by the amendment on impairment losses resulting from measurement of recoverable amount at fair value less costs of disposal.

Informative disclosures are critical in providing users with an appropriate understanding of the judgements made in determining whether assets, financial or non-financial, are impaired and this has been an area of focus for regulators.

IAS 36 and IFRS 7 include detailed disclosure requirements for non-financial and financial assets respectively. It is important to give due focus to those that are intended to provide users with insight into the exercise undertaken and the key assumptions and judgements made. Regulators have indicated a particular focus on:

- the requirement in paragraph 134(d) of IAS 36 to describe the approach taken to determine the key assumptions used in a value in use calculation (including the period over which cash flows have been projected based on forecasts approved by management, the long-term growth rate applied beyond that period and the discount rate applied to forecast cash flows);
- the requirement in paragraph 134(f) of IAS 36 to provide a sensitivity analysis if a reasonably possible change in a key assumption would result in an impairment (such an assumption could be, for example, the margin achieved on sales as well as revenue growth or discount rate); and
- the requirements of IFRS 7 to disclose information about the credit quality of assets that are neither past due nor impaired and the factors considered in determining that financial assets are impaired.

These disclosures provide examples not only of specific areas of regulatory challenge, but also of broader issues that should be considered in preparing financial statements.

Disclosure of entity-specific information, disaggregated to an appropriate level
A narrow reading of IAS 36.134(d) might suggest that disclosure of single values for a forecast period, long-term growth rate and discount rate would be sufficient to meet this requirement. However, regulators have made clear that this is not the case and that information should be disaggregated to provide informative disclosures (for example, on the different discount rates applied to cash-generating units operating in different industries or different jurisdictions).

The requirement to describe management's approach to determining those key assumptions has been highlighted by several regulators as an area requiring entity-specific disclosures, rather than a boilerplate approach. This focus might equally be applied to disclosures of the factors considered in determining whether financial assets are impaired. Similar criticisms have been made in respect of, for example, the requirement in IFRS 3 to disclose the factors making up goodwill recognised in a business combination.

The supportability of assertions made in financial statements
If an entity does not consider that a reasonably possible change in a key assumption would result in an impairment loss, it might make a simple statement to that effect in its financial statements. However, entities should note that they may be called upon by a regulator to support such an assertion – ESMA, for example, has taken the view that such a statement is not sufficient when an entity does not have a large margin of headroom.

Reversal of impairment

As economies begin to recover and asset prices rise (in some markets at least), the issue of reversal of impairments recognised following the financial crisis might become significant. Again, the requirements to be considered differ depending on the nature of the asset.

Reversal of impairment of non-financial assets

Firstly, and most simply, it should be remembered that IFRSs do not permit the reversal of an impairment of goodwill to be recognised under any circumstances.

In contrast, impairments of other non-financial assets within the scope of IAS 36 must be reversed when there is objective evidence that the previously recognised impairment loss has decreased. Indicators of such a decrease mirror the indicators for impairment stated by IAS 36 but it is not necessary for an indicator of reversal to be the mirror of the indicator that led to the initial impairment. It is important to note that reversal of an impairment loss does not arise simply due to the passage of time resulting in the discounted value of future cash inflows increasing. An increase in those cash inflows (due to improved revenue forecasts), reduced forecast cash outflows (due to, for example, revised actuarial assumptions applied to a defined benefit obligation) or a decrease in the discount rate to be applied is necessary.

Once a possible reversal has been identified, a test of the asset (or CGU's) recoverable amount is conducted in the same way as for an impairment review and any reversal recognised accordingly. Reversal of an impairment can only increase the carrying amount of an asset to the value it would have had absent the original impairment, taking into account any additional depreciation or amortisation that would have been recognised without the original impairment.

Reversal of impairment of financial assets

In respect of reversal of impairment, equity investments classified as AFS are similar to goodwill in that reversal is not permitted. Subsequent to an impairment loss, any increase in value is recognised in other comprehensive income (OCI) not in profit or loss.

Impairments of AFS debt investments and of assets measured at amortised cost should be reversed if an increase in value (for an AFS investment) or decrease in impairment loss (for an asset measured at amortised cost) can be related objectively to an event that occurred after the impairment was recognised.

Similar to non-financial assets, reversal of impairment of a financial asset cannot result in the entity making a 'net profit'. Reversal of impairment of an AFS debt instrument recognised in profit or loss is limited to the impairment previously recognised in profit or loss. Similarly, reversal of impairment of an asset measured at amortised cost cannot result in the carrying amount of the asset exceeding its value had the impairment not occurred.

Presentation of impairment reversals

In addition to the recognition and measurement of impairment reversals, it is important to consider their presentation in profit or loss. This presentation would usually be expected to be in the same line in profit or loss as the original impairment.

Management commentary

Another area coming under increasing scrutiny by users and by regulators is the narrative element of financial statements. The narrative section of an annual report (MD&A, business review, operating and financial review etc.) should, together with the financial statements, tell a coherent and consistent story of the entity's performance and position. In the UK, for example, this has been codified in law with the directors of listed companies required to assert explicitly that the annual report as a whole is 'fair, balanced and understandable', whilst in the U.S. SEC Commissioner Elisse B. Walter gave **a speech** highlighting the importance of the MD&A telling "the whole story", the bad parts as well as the good.

At a basic level, this highlights the need for consistency between narrative and financial reporting. Are the operating segments identified under IFRS 8 the same as the businesses discussed in the MD&A? Are the intangible assets recognised as part of a business combination consistent with discussion on the strategy behind that acquisition?

As shown by Deloitte in the United Kingdom's most recent study of financial reporting, 'A New Beginning', more sophisticated preparers are going further to provide a single narrative with clear links between financial and non-financial information. As initiatives such as the International Integrated Reporting Council's framework for Integrated Reporting develop, this approach might be expected to become more common.

In this context, the importance of the requirements in IFRSs to provide explanations in the notes supporting the financial statements should not be overlooked. The following requirements are of particular relevance.

- Where appropriate, accounting policy disclosures should provide entity-specific information rather than a simple repetition of requirements from accounting standards. This is particularly relevant in explaining revenue recognition policies as well as in other areas (for example, as noted above, a policy on what constitutes a 'significant' or 'prolonged' fall in value of an AFS equity investment).

- The requirements of IAS 1 to disclose information about assumptions made on significant areas of estimation uncertainty and judgements made in the application of accounting policies. Again, these disclosures are more valuable if they include information specific to the entity.

- The requirements of IAS 8 to provide information on the effect of new accounting standards applied in the year and on standards in issue but not yet effective. This will be relevant in the current year given the significance of IFRS 13, IAS 19(2011) and the 'package of five' standards on interests in other entities.

'Boilerplate' disclosures
A number of regulators have expressed dissatisfaction with the use of 'boilerplate' disclosures that provide little information about the reporting entity itself. The above are examples of where this practice should be avoided if possible.

Business combinations and continuing employment

A common feature of business combinations in certain industries is for the previous owners of the acquiree to remain within the business and to receive further payments depending on the performance of that business and sometimes, on their continued employment.

In the January 2013 IFRIC Update, the IFRS Interpretations Committee observed that an arrangement in which contingent payments are automatically forfeited if employment terminates would lead to a conclusion that the arrangement is compensation for post-combination services rather than additional consideration for an acquisition, unless the service condition is not substantive.

Based on this observation, all amounts due under such an arrangement will be recognised as an employee benefit cost subsequent to the business combination, rather than as part of the consideration for that business combination.

Other issues arising in an uncertain economic environment

As the economic environment continues to be uncertain, with some jurisdictions remaining in recession, the following issues will continue to be relevant to some entities.

Going concern

For many entities, particularly those operating in industries or jurisdictions experiencing weak or negative growth, going concern will continue to be an area requiring careful consideration.

Assessment of going concern will include consideration of whether the entity has access to sufficient cash to meet its needs for the foreseeable future (defined in IAS 1as at least 12 months from the reporting date). This access to cash may be in the form of borrowing facilities (in which case the entity will need to consider whether it will meet any conditions (e.g. loan covenants) attached to those facilities) or from other sources such as a planned equity issue (in which case the entity will need to consider the likelihood of success of such an issue). However, the considerations are not limited to liquidity risks. Any other available information that may affect the entity's ability to continue as a going concern will also need to be considered.

The need for proper disclosure of the judgements made around going concern (either as a critical judgement disclosed in accordance with IAS 1 or to comply with jurisdictional requirements on going concern or principal risks facing the business) should also be considered. Regulators such as the Australian Securities & Investment Commission (ASIC) have stated their intention to focus on the need for such disclosures.

Classification of liabilities as current or non-current

As well as having a major impact on going concern assessments, failure to comply with loan covenants will affect the classification of loans subject to such a covenant.

Preparers facing such a situation should bear in mind that if a lender has the ability at the year end to demand repayment of a liability within 12 months of the reporting date, that liability is classified as current even if the lender subsequently chooses to waive that right. Disclosure of expected difficulties in meeting covenants may also be necessary in the context of a going concern assessment.

Financial risk disclosures

The requirements of IFRS 7 to disclose details of credit, liquidity and market risk remain an area of focus for regulators, with ESMA focusing on:

- clear and transparent disclosures for each of assets neither past due nor impaired, assets past due but not impaired and assets individually determined to be impaired;
- an unambiguous description of the accounting policy applied to collective impairment assessments for financial assets;

> It should be noted that these requirements of IFRS 7 apply to all financial assets subject to credit risk, including trade receivables as well as loan assets held by a financial institution.

- sufficiently granular liquidity risk disclosures, in particular the disclosure of an appropriate number of time bands in maturity analyses; and
- availability and/or restrictions on assets that could be used for supporting liquidity needs.

New accounting standards and amendments mandatorily effective for years ending 31 December 2013

Further detail on the new and revised standards discussed below is available at:
http://www.iasplus.com/en/tag-types/global-publications/ifrs-in-focus-newsletters

IFRS	Effective for annual periods beginning on or after	Application
IFRS 13 *Fair Value Measurement*	1 January 2013	Prospective Application
'The package of five' • IFRS 10 *Consolidated Financial Statements* • IFRS 11 *Joint Arrangements* • IFRS 12 *Disclosure of Interests in Other Entities* • IAS 27 *Separate Financial Statements* (as revised in 2011) • IAS 28 *Investments in Associates and Joint Ventures* (as revised in 2011)	1 January 2013*	Retrospective application, with specific transitional provisions (amended by *Amendments to IFRS 10, IFRS 11 and IFRS 12 Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance*).
IAS 19 *Employee benefits (2011)*	1 January 2013	Retrospective application, with specific transitional provisions
Amendments to IFRS 1 *Government Loans*	1 January 2013	Retrospective application
Amendments to IFRS 7 *Disclosures – Offsetting Financial Assets and Financial Liabilities*	1 January 2013	Retrospective application
Amendments to IAS 1 *Presentation of Items of Other Comprehensive Income*	1 July 2012	Retrospective application
Annual Improvements to IFRSs 2009-2011 Cycle	1 January 2013	Retrospective application
IFRIC 20 *Stripping costs in the production phase of a surface mine*	1 January 2013	This Interpretation should be applied to production stripping costs incurred on or after the beginning of the earliest period presented, with specific transitional provisions.

* For entities applying IFRS as adopted for use in the European Union, application of 'the package of five' is for annual periods beginning on or after **1 January 2014**. Early application is permitted only if all five standards are applied.

IFRS 13 *Fair Value Measurement*

IFRS 13 establishes a single framework for measuring fair value where that is required or permitted by other standards. As such, its scope is broad including, for example investment properties, biological assets and intangible assets as well as all types of financial instruments.

The IFRS 13 framework is based on a single definition of fair value, being "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." This might be characterised as an 'exit value' approach to fair value.

In applying this definition, IFRS 13 requires a number of other concepts to be incorporated:

- The unit of account for measuring fair value (i.e., at an individual asset or liability or groups of assets or liabilities level) should be consistent with the unit of account applied by the standard requiring or permitting the use of fair values.

Unit of account for equity investments

The determination of the unit of account for financial assets that are investments in subsidiaries, joint ventures and associates measured at fair value is currently included as an item on the IASB's work programme, with an exposure draft scheduled for the first quarter of 2014.

This question becomes relevant when such an investment is measured at fair value, for example when the recoverable amount of the investment is estimated based on fair value less costs of disposal for the purposes of impairment testing, and the investee in question has shares quoted in an active market (i.e., with a 'Level 1' price available).

Prior to the conclusion of that IASB project, it is possible to view the unit of account to be the investment as a whole and thus to justify an adjustment to a fair value measurement based on the product of a quoted price per share and the number of shares held (often referred to as 'P x Q') to reflect the premium that would be paid for control, joint control or significant influence over an investee. It should be noted that any such adjustment would be unobservable (i.e., a 'Level 3' input). If significant, this would result in the entire fair value measurement being categorised as 'Level 3' and, therefore, in a requirement to provide the additional disclosures stipulated by IFRS 13 with regard to Level 3 fair value measurement (for example, a description of the valuation process and inputs used and of sensitivity to changes in the unobservable input used).

Other quoted equity investments that are measured at fair value in accordance with either IFRS 9 or IAS 39 are not the subject of these discussions. For such assets the unit of account is viewed as the individual share and no adjustment should be made to a 'Level 1' share price.

The views of local regulators should also be taken into account in considering an accounting policy other than 'P x Q' for fair value measurement of investments in subsidiaries, joint ventures and associates. For example, the French Autorité des Marchés Financiers (AMF) **has called on entities** facing this issue to present and explain the unit of account used.

- For non-financial assets, fair value is based on the 'highest and best use' of that asset, regardless of whether the entity chooses to use the asset in a different way.

Highest and best use differing from current use

The highest and best use of an asset may differ from its current use in the context of a business combination. When the acquiree has an asset that the acquirer does not intend to use (for example, a patent for a product it does not intend to manufacture) it is clear that the fair value of this asset must still reflect the optimal use of the asset by a market participant. It cannot be assigned a value of nil due to the acquirer's future intentions.

The use of investment property should also be considered because a property's current use may differ from its highest and best use if, for example, that use differs from current market assessments of the most profitable use for land in the area.

- 'Non-performance risk' (the risk that a party to the item will not perform under its obligations) must be incorporated into the valuation of both assets and liabilities.

Credit risk in derivative valuations

When determining the fair value of derivatives, it is common for a starting point to be derived based on forecast expected cash flows discounted at a 'risk free' rate. However, to incorporate non-performance risk as required by IFRS 13, it is necessary to adjust this value to reflect the risk of default by each party to the contract. Such an adjustment may commonly be required to valuations provided by a bank for over the counter (OTC) derivatives as these may not include the effect of non-performance risk.

An adjustment to counterparty credit risk is often referred to as a credit valuation adjustment (CVA), with own credit risk reflected through a debit valuation adjustment (DVA).

- The fair value of a liability is based on the concept of a transfer value, rather than settlement value.
- The valuation assumes that the asset is sold or the liability transferred in the principal (or most advantageous) market to which the entity has access.

If the price for an asset or liability can be observed directly, this value is determined to be fair value. If not, the standard discusses three widely used valuation techniques, with entities required to use a technique consistent with one or more of these approaches.

The market approach	The cost approach	The income approach
A valuation approach that uses prices and other relevant information generated by market transactions involving identical or comparable assets, liabilities or a group of assets and liabilities such as a business.	A valuation technique that reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).	Valuation techniques that convert future amounts (e.g., cash flows or income and expenses) to a single current (discounted) amount. The fair value measurement is determined on the basis of the value indicated by current market expectations about those future amounts.

IFRS 13 requires extensive quantitative and qualitative disclosures about the techniques used to determine fair values and the inputs to those techniques. This includes disclosing the level within the fair value hierarchy within which fair value measurements are categorised.

The fair value hierarchy

The fair value hierarchy should be a familiar concept to those used to dealing with financial instruments, because IFRS 7 already requires financial instruments measured at fair value to be categorised in this way. IFRS 13 extends this requirement to all assets and liabilities that are either measured at fair value or for which fair value is disclosed.

The fair value hierarchy categorises inputs to a valuation based on how observable they are, from Level 1 (quoted, unadjusted prices in active markets for identical assets or liabilities that the entity can access at the measurement date) to Level 3 (unobservable inputs for the asset or liability). The entire asset or liability is classified at the lowest level of any input that is significant to the measurement of that item.

Additional disclosures on valuation processes and sensitivities to unobservable inputs are required for all assets and liabilities categorised as 'Level 3'.

Application of IFRS 13 may be challenging, as entities will need to evaluate whether current valuation methodologies for fair value measurements comply with the requirements of the standard and to exercise care in providing suitable disclosure of valuation exercises undertaken. For a non-financial asset, this will require consideration of whether the methodology previously applied is consistent with one of the three approaches (market, cost and income) described in IFRS 13 and where the inputs used fall within the fair value hierarchy. In particular, management forecasts of future income and expenses would not be observable by an external party and would, as a result, be classified as 'Level 3' inputs.

The requirements of IFRS 13 to use inputs higher in the fair value hierarchy when available and to provide additional disclosures on 'Level 3' valuations might be mistaken as indicators that these valuations are considered unreliable. This is not, in fact, the case. Rather, they are less *observable* than 'Level 1' or 'Level 2' inputs, with additional disclosures intended to provide users with insight into a valuation using data that would otherwise be unavailable to them.

Due to its scope and complexity and the level of disclosure required, IFRS 13 is likely to be an area of regulatory focus when it is first adopted.

ESMA **has stated** that fair value measurement and disclosure are amongst its priorities for 2013 financial statements – highlighting in particular the need for care in incorporating non-performance risk into valuations, identifying the appropriate unit of account and providing appropriate disclosures.

IFRS 10 *Consolidated Financial Statements*

IFRS 10 replaces the requirements previously included in IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation – Special Purpose Entities* on when and how to consolidate an investee over which the entity has control. It makes no changes to the mechanics of consolidation, or to the accounting for a loss of control or a change in stake in a subsidiary (the 'how') but does change the requirements for identification of a subsidiary (the 'when').

IFRS 10 provides a single basis for consolidation for all entities, regardless of the nature of the investee and that basis is control. The definition of control includes three elements:

1. power over an investee;
2. exposure or rights to variable returns of the investee; and
3. the ability to use power over the investee to affect the investor's return.

Power exists when the investor has existing rights that give it the current ability to direct the 'relevant activities' that significantly affect the investee's returns. Power most commonly arises through voting rights granted by equity instruments, but it can also arise through other contractual arrangements (for example potential voting rights derived from share options or a contract to manage the investee's activities). The second criterion refers to an exposure to variable returns from an investee which could be either positive or negative. The third criterion focuses on the interaction between power and exposure, since an investor must have not only power but also the ability to use that power to affect its returns from the investee.

The application of IFRS 10 requires significant judgement in a number of areas as follows:

- Identification of an investee's 'relevant activities'. This may be particularly challenging in the context of a 'special purpose entity' that has activities with a limited scope.

- Consideration of whether the investor has the practical ability to exercise a right (i.e., whether the right is substantive), or whether a right is 'protective' (i.e., designed only to protect the interests of the investor, but not to give power over the investee).

- Assessment of whether an investee has the practical ability to direct relevant activities unilaterally even though it does not have the majority of voting rights (this is sometimes referred to as 'de facto control').

- Determination of whether a decision maker is acting on its own account (as 'principal') or on behalf of another party (as 'agent'). This consideration may arise in a number of circumstances, including the fund management industry.

IFRS 10 requires investors to make a balanced assessment of all relevant factors and to reassess the conclusion whenever facts and circumstances indicate that there are changes to any element of control, with consolidation of an investee commencing or ceasing whenever control is obtained or lost.

Investment entities

Following amendments to IFRS 10, an investment entity is required to measure its interests in subsidiaries at fair value through profit or loss.

To qualify as an investment entity strict criteria have to be met. An investment entity is required to:

- obtain funds from one or more investors for the purpose of providing them with professional investment management services;
- commit to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and
- measure and evaluate performance of substantially all of its investments on a fair value basis.

This amendment is not effective until 2014, but entities that believe they meet the definition of an investment entity may wish to adopt it early to avoid the necessity of adopting IFRS 10 (with potential changes in which investees are consolidated), only to switch to a fair value approach a year later.

IFRS 11 *Joint Ventures*

IFRS 11 deals with the identification of and accounting for a joint arrangement – defined as ‘an arrangement of which two or more parties have ‘joint control’. Joint control is further defined as ‘the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.’ Control in this definition has the same meaning as in IFRS 10.

Once a joint arrangement has been identified, it must be classified as either a ‘joint venture’ or a ‘joint operation’.

Type of joint arrangement	Features	Accounting under IFRS 11
Joint venture	Joint venturers have rights to the *net assets* of the arrangement.	Equity method of accounting – proportionate consolidation is not allowed.
Joint operation	Joint operators have rights to the assets and obligations for the liabilities of the arrangement.	Each joint operator recognises its assets and liabilities (including its share of assets and liabilities held or incurred jointly) and its revenue and expenses (including its share of revenue from sales made by the joint operation and of expenses incurred jointly).

Classification as a joint operation reflects an economic reality that the assets and liabilities of the joint operation are, in effect, assets and liabilities of the joint operators. This will be the case when the joint arrangement is not conducted through a separate vehicle, but joint operation classification may also result when the existence of such a vehicle is overcome as a result of:

- the legal form of the separate vehicle not conferring separation between the parties to the vehicle and its assets and liabilities;
- the terms of the contractual arrangement governing the joint arrangement specifying that the parties have rights to its assets and obligations for its liabilities; or
- other facts and circumstances demonstrating that the arrangement’s activities primarily aim to provide the parties with an output (giving rights to the arrangement’s assets) and that the arrangement depends on the parties on a continuous basis for settling its liabilities (giving obligations for those liabilities).

‘Other facts and circumstances’ in this context will most frequently mean a contractual obligation for the parties to purchase substantially all of a joint arrangement’s output.

IFRS 12 *Disclosure of interests in other entities*

IFRS 12 consolidates the requirements for disclosures in respect of subsidiaries, joint arrangements, associates and unconsolidated structured entities into a single standard. As well as aggregating the existing disclosure requirements in respect of such interests, it introduces additional requirements.

Unconsolidated structured entities

'Unconsolidated structured entities' is a new term referring to an entity in which a reporting entity has an interest (but not control) and that have been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity. These might commonly be referred to as 'special purpose entities'.

IFRS 12 requires disclosure of information enabling an understanding of the nature and extent of the reporting entity's involvement with such entities and the risks arising from that involvement.

The new requirements extend the scope of disclosures on interests in other entities in a number of significant ways, including:

- information about the significant judgements and assumptions made in applying IFRS 10 and IFRS 11 (for example, explaining how an entity has determined that it has control over an investee despite having a minority of the voting rights or that it has determined that a joint arrangement structured through a separate vehicle should be classified as a joint operation);
- additional information on the nature of a non-controlling interest in the entity's subsidiaries (including the name and summarised financial information of each subsidiary with a material non-controlling interest); and
- summarised financial information about each material joint venture and associate.

The disclosure requirements are extensive and significant effort may be required to accumulate the necessary information.

IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*

The revised versions of IAS 27 and IAS 28 comprise the requirements for separate financial statements and for accounting for associates and joint ventures. IAS 28 makes changes to the mechanics of equity accounting in limited circumstances such as changes in ownership interest and plans to dispose of a portion of an investment in an associate or joint venture.

The 'package of five' is likely to be an area of regulatory focus as it introduces a number of new judgements to the preparation of financial statements, together with a requirement to disclose the basis for the conclusions reached.

IAS 19 *Employee benefits (2011)*

The amendments to IAS 19 change the accounting for defined benefit plans and termination benefits. The most significant change relates to the accounting for changes in defined benefit obligations and plan assets. The amendments require the recognition of changes in defined benefit obligations and in fair value of plan assets when they occur, and hence eliminate the 'corridor approach' permitted under the previous version of IAS 19 and accelerate the recognition of past service costs. The amendments require all actuarial gains and losses to be recognised immediately through other comprehensive income so that for the net pension asset or liability recognised in the consolidated statement of financial position reflects the full value of the plan deficit or surplus.

Another significant change to IAS 19 relates to the presentation of changes in defined benefit obligations and plan assets with changes being split into the following components.

- Service cost – recognised in profit or loss and includes current and past service cost as well as gains or losses on settlements.
- Net interest – recognised in profit or loss and calculated by applying the discount rate at the beginning of the reporting period to the net defined benefit liability or asset at the beginning of each reporting period.
- Remeasurement – recognised in other comprehensive income and comprises actuarial gains and losses on the defined benefit obligation, the excess of the actual return on plan assets over the change in plan assets due to the passage of time and the changes, if any, due to the impact of the asset ceiling.

As a result, profit or loss will no longer include an expected return on plan assets. Instead, finance income on the plan assets is recognised as part of the net interest cost. Any actual return above or below the imputed finance income on plan assets is recognised as part of remeasurement in other comprehensive income.

Fair value of plan assets

Although the disclosure requirements of IFRS 13 do not apply to defined benefit plans, the measurement of plan assets at fair value does fall within the scope of that standard. Entities should consider whether their methodology for determining the fair value of plan assets, particularly those that do not have a quoted price, complies with the new requirements. This may necessitate the gathering of additional information to assess the methods used to determine fair value.

Net interest is calculated using a high quality corporate bond yield. For plans with a significant amount of assets, this will generally result in a reduction in the entity's profit as the expected return on assets (calculated using a typically higher rate) is replaced by a net interest figure.

Discount rate

The identification of a suitable high quality corporate bond (HQCB) yield for use in discounting defined benefit obligations has been a challenging issue for some time, particularly in regions such as the Eurozone where the population of AAA and AA-rated bonds fell following the financial crisis. The revised version of IAS 19 neither changes this concept nor offers additional guidance on how a suitable discount rate may be determined.

The IFRS Interpretations Committee has discussed this issue a number of times and in November 2013 issued an agenda decision stating the following:

- 'high quality' as used in paragraph 83 of IAS 19 reflects an absolute concept of credit quality and not a concept of credit quality that is relative to a given population of corporate bonds;
- a reduction in the number of HQCB should not result in a change to the concept of high quality;
- an entity's methods and techniques used for determining the discount rate so as to reflect the yields on HQCB would not be expected to change significantly from period to period;
- the discount rate applied to a defined benefit obligation is typically a significant actuarial assumption which should be disclosed in accordance with paragraphs 144-145 of IAS 19; and
- the identification of the HQCB population used as a basis to determine the discount rate requires the use of judgement and may often have a significant effect on the entity's financial statements. This would require disclosure in accordance with paragraph 122 of IAS 1.

This issue continues to be an area of focus for capital markets regulators, with ESMA **stating** that it expects rates for AA and AAA-rated bonds to continue to be used where they have been used previously and the AMF **stating** that companies should not change their current practices because there is a deep market in HQCB in the euro area.

Employee contributions to defined benefit plans

In November 2013, IAS 19 was amended to clarify the accounting for contributions made to a defined benefit plan by employees or third parties. The amendments permit contributions that are independent of the number of years of service to be recognised as a reduction in the service cost in the period in which the service is rendered, instead of allocating the contributions to periods of service using the projected unit credit method.

The amendments are effective from 1 July 2014 with earlier application permitted.

Amendments to other IFRSs

Amendments to IFRS 1 *Government Loans*

The amendments provide relief to first-time adopters of IFRSs by amending IFRS 1 to allow prospective application of IAS 39 or IFRS 9 and paragraph 10A of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* to government loans outstanding at the date of transition to IFRSs.

Amendments to IAS 32 and IFRS 7 *Offsetting Financial Assets and Financial Liabilities* and the related disclosures

The amendments to IAS 32 clarify existing application issues relating to the offsetting requirements. Specifically, the amendments clarify the meaning of 'currently has a legally enforceable right of set-off' and 'simultaneous realisation and settlement'.

The amendments to IFRS 7 require entities to disclose information about rights of offset and related arrangements (such as collateral posting requirements) for financial instruments under an enforceable master netting agreement or similar arrangement.

Amendments to IAS 1 *Presentation of Items of Other Comprehensive Income*

The amendments to IAS 1 require additional disclosures to be made in the other comprehensive income section such that items of other comprehensive income are grouped into two categories:

- items that will not be reclassified subsequently to profit or loss; and
- items that may be reclassified subsequently to profit or loss when specific conditions are met.

Income tax on items of other comprehensive income is required to be allocated on the same basis.

Annual Improvements to IFRSs 2009-2011 Cycle

The Annual Improvements include amendments to five IFRSs which have been summarised below:

Standard	Subject of amendment	Details
IFRS 1 *First-time Adoption of International Financial Reporting Standards*	Repeated application of IFRS 1	The amendments clarify that an entity may apply IFRS 1 if its most recent previous annual financial statements did not contain an explicit and unreserved statement of compliance with IFRSs, even if the entity applied IFRS 1 in the past.
	Borrowing costs	The amendments clarify that borrowing costs capitalised under previous GAAP before the date of transition to IFRSs may be carried forward without adjustment to the amount previously capitalised at the transition date.
IAS 1 *Presentation of Financial Statements*	Clarification of the requirements for comparative information	The amendments to IAS 1 clarify that an entity is required to present a statement of financial position as at the beginning of the preceding period (a 'third balance sheet') only when the retrospective application of an accounting policy, restatement or reclassification has a material effect on the information in that statement of financial position and that notes beyond those specifically required by IAS 8 are not required to accompany the third statement of financial position.
IAS 16 *Property, Plant and Equipment*	Classification of servicing equipment	The amendments clarify that spare parts, stand-by equipment and servicing equipment should be classified as property, plant and equipment when they meet the definition of property, plant and equipment in IAS 16 and as inventory otherwise.
IAS 32 *Financial Instruments: Presentation*	Tax effect of distribution to holders of equity instruments	The amendments clarify that income tax on distributions to holders of an equity instrument and transaction costs of an equity transaction should be accounted for in accordance with IAS 12.
IAS 34 *Interim Financial Reporting*	Interim financial reporting and segment information for total assets and liabilities	The amendments clarify that the total assets and total liabilities for a particular reportable segment would be separately disclosed in interim financial reporting only when the amounts are regularly provided to the chief operating decision maker and there has been a material change from the amounts disclosed in the last annual financial statements for that reportable segment.

New Interpretation

IFRIC 20 *Stripping Costs in the Production Phase of a Surface Mine*

IFRIC 20 applies to waste removal costs that are incurred in surface mining activity during the production phase of the mine ('production stripping costs'). The Interpretation specifies that the costs from this waste removal activity ('stripping') which provide improved access to ore are recognised as a non-current asset ('stripping activity asset') when certain criteria are met, whereas the costs of normal ongoing operational stripping activities are accounted for in accordance with IAS 2 *Inventories*. The stripping activity asset is accounted for as an addition to, or as an enhancement of, an existing asset and classified as tangible or intangible according to the nature of the existing asset of which it forms part.

New and revised IFRSs available for early application in years ending 31 December 2013

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.

The list below reflects a cut-off date of 30 November 2013. The potential impact of the application of any new and revised IFRSs issued by the IASB after 30 November 2013 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.

New Standards and interpretations	Effective for annual periods beginning on or after	Application
IFRS 9 *Financial Instruments*	1 January 2017*	Retrospective application, with specific transitional provisions
IFRIC 21 *Levies*	1 January 2014	Retrospective application
Amendments to IFRS 10, IFRS 12 and IAS 27 *Investment Entities*	1 January 2014	Retrospective application, with specific transitional provisions
IAS 32 *Offsetting Financial Assets and Financial Liabilities*	1 January 2014	Retrospective application
IAS 36 *Recoverable Amount Disclosures for Non-Financial Assets*	1 January 2014	Retrospective application
IAS 39 *Novation of Derivatives and Continuation of Hedge Accounting*	1 January 2014	Retrospective application with specific transition provisions

* Upon publication of the general hedge accounting element of IFRS 9, the mandatory effective date of 1 January 2015 was removed from the Standard. At its November 2013 meeting, the IASB tentatively decided that the mandatory effective date of IFRS 9 will be no earlier than annual periods beginning on or after 1 January 2017.

IFRS 9 Financial Instruments

The comprehensive project to replace IAS 39 was instigated in response to the global financial crisis and was split into a number of phases. At the current time, some of these phases have been completed and are available for early adoption, some have not.

Completed phase	Principal changes compared to IAS 39	Notes
Classification and measurement (issued November 2009, amended October 2010)	• All financial assets measured at either amortised cost or fair value. • Debt assets classified depending on their contractual terms and business model of the holder. • Equity investments measured at fair value, with an irrevocable election at initial recognition to present movements in fair value in OCI instead of profit or loss. • Movements in fair value of financial liabilities designated at fair value through profit or loss due to own credit risk recognised in OCI.	Limited amendments due for finalisation in the first half of 2014.
General hedge accounting (issued November 2013)	• Increased eligibility of hedging instruments. • Increased eligibility of hedged items. • Accounting for the time value component of options and forward contracts with less volatility in profit or loss. • Qualifying criteria for applying hedge accounting, IFRS 9 employs a more principle based approach. • Modification and discontinuation of hedging relationships. • Increased disclosures on hedge accounting.	Entities that adopt IFRS 9 (as amended in November 2013) can choose an accounting policy of either adopting the new IFRS 9 hedge accounting model now or continuing to apply the hedge accounting model in IAS 39 for the time being. However, the new hedge accounting model cannot be adopted by an entity that has not adopted the classification and measurement requirements of IFRS 9.

In respect of the IASB's ongoing work on financial instruments:

- development of its model for impairment of financial assets continues. Finalised requirements to be included in IFRS 9 are due in the first half of 2014; and

- its project on macro hedging (now decoupled from IFRS 9) is ongoing, with a discussion paper due early in 2014.

Preparers of financial statements should be aware of the status of these projects in considering any potential early application of IFRS 9.

IFRIC 21 Levies

IFRIC 21 defines a levy as a payment to a government for which an entity receives no specific goods or services. A liability is recognised when the obligating event occurs. The obligating event is the activity that triggers payment of the levy. This is typically specified in the legislation that imposes the levy.

Amendments to IAS 36 – Recoverable amount disclosures for non-financial assets

The amendments:

- remove the requirement to disclose the recoverable amount of a cash-generating unit (or group of cash-generating units) to which a significant amount of goodwill or intangible assets with indefinite useful lives has been allocated in periods when no impairment or reversal has been recognised (this requirement having been inadvertently introduced as part of consequential amendments on the introduction of IFRS 13); and

- introduce additional disclosure requirements in respect of assets for which an impairment has been recognised or reversed and for which the recoverable amount is determined using fair value less costs of disposal.

Amendments to IAS 39 on novation of derivatives

The amendment allows the continuation of hedge accounting (under IAS 39 and the IFRS 9 chapter on hedge accounting) when a derivative is novated to a clearing counterparty and certain conditions are met.

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