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Closing Out 2016

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Deloitte's Global Economic Outlook provides views from Deloitte economists on the economic situation and outlook on the global economy. The report highlights the significant level of uncertainty that has emerged in 2016, notably following the result of the United Kingdom's referendum on membership of the European Union. As well as questions over Britain's future relationship with Europe and the wider world, this highlights more pervasive uncertainty over the future of globalisation and economic integration (for example, in respect of international trade agreements) which have arisen during, for example, the U.S. presidential campaign.

Issues arising in other jurisdictions include concerns over job creation levels in the U.S., deflationary pressures across the Eurozone and rising levels of corporate debt in China.

At a global level, commodity prices continue to be at historically low levels, with oil prices still well below the $100 per barrel levels of just a few years ago, despite some recovery in the second half of 2016. The outlook for oil and other commodities in 2017 and beyond remains unclear.

Preparers of financial statements may, therefore, face a variety of challenges depending on the environment in which they operate. In addition, the implementation of accounting standards will continue to require careful consideration and the application of significant judgement.

This special edition of IFRS in Focus highlights some of the above considerations, together with other issues relevant to December 2016 reporting such as potential areas of regulatory focus and developments in IFRSs.

Topical issues – reporting on the year to 31 December 2016

The impact of market volatility

The current range of political uncertainty has translated to volatility in international markets and to uncertainty in the prospects for the 'real' economy.

This volatility can have a number of direct and indirect effects on financial statements.

Currency exchange rates

The most striking effect of the Brexit vote on the markets has been a significant fall in the value of Sterling against other major currencies. This will have significant direct effects in terms of the level of gains and losses on the translation of Sterling balances into other currencies (or, for entities with a Sterling functional currency, of balances denominated in other currencies into Sterling) and the retranslation of foreign operations (again, either of Sterling operations into other presentational currencies or of operations with other functional currencies into Sterling).

For those purposes, it will be important to consider whether the use of an average rate for retranslation of either foreign currency transactions or the income and expenses of a foreign operation remains appropriate given the level of volatility in exchange rates or whether such an average needs to be adjusted to reflect the timing of transactions within the reporting period.

Given the potential significant increase in the size of foreign currency movements, it should also be considered whether that effect should be given additional prominence in reporting the results for the year. In addition, items which may previously have been small (such as the effect of exchange rate changes in cash and cash equivalents reported at the bottom of a statement of cash flows) could now be much larger and thus subject to additional focus.

Less directly, foreign currency movements could have an effect on, for example:

- the functional currency value of forecast cash flows included in impairment reviews under IAS 36 *Impairment of Assets*;
- the net realisable value of inventory expected to be sold for foreign currency;
- the effectiveness of some hedging relationships and hedge accounting disclosures (as investors in entities subject to significant foreign currency risk may take a greater interest in the extent and term of their hedging arrangements); and
- financial instrument risk disclosures. In particular, it may be necessary to reassess the level of exchange rate movement that is considered 'reasonably possible' for the purposes of the sensitivity analysis required by IFRS 7 *Financial Instruments: Disclosures*.

Foreign currency movements will, of course, also have direct business impacts (for example, on the cost of imports or the prices that can be charged for overseas sales). These effects should be considered in preparing, for example, cash flow forecasts for impairment or going concern review purposes.

Venezuela

A specific challenge in recent years has been the identification of a suitable rate for retranslating balances denominated in Venezuelan Bolivar and in reporting the results of Venezuelan operations, as Venezuela has imposed strict currency restrictions with different rates used for different purposes.

In the current year, it is expected that the 'Dicom' rate (introduced in March 2016 and, at the time of writing, standing at approximately 660 Bs.F./US$) will generally be used for retranslating both individual Bolivar balances and the results of Venezuelan operations as this will be the rate applicable to all but the most essential food and medicine transactions.

Interest rates

Prevailing interest rates in many jurisdictions are low, or even in some cases negative. As well as affecting the income or expense generated by lending or borrowing activities, market interest rates underpin the discounting applied across a variety of balances including:

- defined benefit obligations under IAS 19 *Employee Benefits*;
- valuation of a share option or other grant under IFRS 2 *Share-based Payments*;
- long-term provisions under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and
- a value in use calculation under IAS 36 *Impairment of Assets*.

Again, sensitivity disclosures may be needed where a change in interest rates could have a significant effect on, for example, headroom in an impairment review.

As always, care should be taken in applying the right discount rate to the right item as IFRSs do not apply the same approach across all balances. For example, a high quality corporate bond yield used for IAS 19 *Employee Benefits* purposes may differ from a cost of borrowing used in determining a weighted average cost of capital for use in an impairment calculation.

In terms of presentation, it should be noted that in January 2015 the IFRS Interpretations Committee published an agenda decision stating that negative interest on a financial asset should be presented in a suitable expense category rather than interest income as it does not meet the definition of revenue.

Commodity prices

Commodity prices have remained low throughout 2016, this has a direct impact in the extractives industry, particularly in respect of impairment of assets including exploration and evaluation costs capitalised under IFRS 6 *Exploration for and Evaluation of Mineral Resources*, which requires assessment for impairment in specific circumstances such as a decision to discontinue exploration.

Again though, the impact can be felt more widely including, for example, by entities such as airlines with oil being a key part of their costs. For all entities affected, commodity prices may be a factor in, for example:

- impairment reviews;
- the valuation of assets acquired in a business combination; and
- the fair value of derivatives (either stand alone or embedded in other contracts) linked to commodity prices.

Disclosing the effect of judgement, risk and uncertainty

When reporting in uncertain times, it becomes particularly important to provide users of an annual report with appropriate insight into the risks and uncertainties facing an entity and the judgements that have been made inpreparing financial information.

A primary source of information on which judgements are to be made is the disclosure of accounting policies, this should be sufficiently specific and granular to enable users to understand the choices and judgements made by the entity and the financial information provided in an annual report overall. For example, it should be made clear how the sources of income described elsewhere in the annual report (such as in the description of the entity's business model) are addressed by revenue recognition policies. This is particularly important in explaining when revenue is recognised in complex circumstances such as long-term contracts and sales of 'bundled' goods or services.

The completeness of accounting policy disclosures should also be considered, as particularly when dealing with a significant 'one off' transaction such as the transfer of a business to an associate or an issue that has arisen for the first time (for example, a pension surplus in a scheme previously always in deficit). It is easy, while focusing on developing a proper accounting treatment, to overlook the need to properly disclose that new accounting policy.

This information is supplemented by the disclosures required by IAS 1 *Presentation of Financial Statements* on critical judgements and sources of estimation uncertainty. Again, these should be clear and entity specific.

In particular, the quantitative elements of disclosures on estimation uncertainty should not be overlooked, with paragraph 125 of IAS 1 requiring disclosure of the nature and carrying amount of assets and liabilities for which estimation uncertainty gives rise to a significant risk of material adjustment in the next financial year. The Standard provides a number of examples of disclosures that might, alone or in combination, fulfil these requirements:

- the nature of the assumption or other estimation uncertainty;
- the sensitivity of the carrying amounts of assets and liabilities to the methods, assumptions and estimates used in calculating those amounts;
- if resolution of an uncertainty is expected in the next financial year, that fact and the range of reasonably possible outcomes; and
- if an uncertainty remains unresolved, an explanation of any changes made to past assumptions.

IFRSs also include specific requirements for disclosure on assumptions used and uncertainties arising in specific areas, including:

- assumptions and sensitivities applying to unobservable 'Level 3' inputs to fair value measurement;

- key assumptions used in estimating the recoverable amounts of cash-generating units (or, for goodwill testing, groups of cash-generating units) subject to impairment testing. When relevant, these should include assumptions underpinning detailed cash flow forecasts (for example, revenue or margin growth, foreign exchange rates and commodity prices) as well as factors such as terminal growth and discount rates that are used to convert those forecasts to a value in use or fair value; and
- sensitivities to reasonably possible changes in key assumptions that would give rise to impairment.

Reporting financial performance and the use of 'non-GAAP' measures

IFRSs currently require the presentation of line items for revenue, total profit or loss and certain specific line items in between (for example, finance costs). Inclusion of other subtotals is permitted by IAS 1 *Presentation of Financial Statements*, but figures often presented as the primary measure of an entity's performance (for example, operating profit) are not defined. In the absence of such requirements in IFRSs, regulators have focused their attention on the appropriate reporting of financial performance.

The amendments made to IAS 1 as part of the IASB's Disclosure Initiative (mandatorily effective for periods beginning 1 January 2016) do introduce rigour to the presentation of subtotals in the statement of profit or loss, requiring that they:

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

Expanding on these basic requirements, it should be noted that:

- 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;
- care should be taken in labelling items as 'exceptional' or 'non-recurring' and when excluding them from a subtotal presented in the financial statements. In particular:
  - items that affected past periods or are expected to affect future periods can rarely be labelled as 'nonrecurring';
  - gains and losses should not be offset unless permitted by IFRSs;
  - the approach to identifying 'exceptional' or 'non-recurring' items 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); and
  - a clear accounting policy for the identification of such items should be provided.

The tax and cash flow effects of any 'exceptional' items should also be clearly presented.

Regulatory guidance on 'non-GAAP' measures and ESMA guidelines on 'Alternative Performance Measures'

The concerns discussed above were amongst those driving various regulators to issue guidance on the use of performance measures other than those required by IAS 1. Notably, the International Organisation of Securities Commissions (IOSCO) published in June 2016 its Final Statement on Non-GAAP Financial Measures, establishing a frame of reference for the use of non-GAAP financial measures, and the European Securities and Markets Authority (ESMA) issued Guidelines on Alternative Performance Measures (APMs) that apply to financial APMs disclosed in regulated information (defined in EU-law as information made available to the market in accordance with the requirements of the Transparency Directive and the Market Abuse Regulation) and to prospectuses published on or after 3 July 2016.

As can be seen below, the IOSCO and ESMA guidance is very similar in most respects.

IOSCO Statement on Non-GAAP Financial Measures	ESMA Guidelines on Alternative Performance 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). Disclosures contained within the financial statements are not within the scope An operating or statistical measure that is not a financial measure is not within scope.	**Scope** – Applies to 'Alternative Performance Measures' being financial measures of historical or future financial performance, financial position or cash flows other than a financial measure defined or specified in the applicable financial reporting framework. APMs disclosed in financial statements are not within the scope of guidelines. The guidelines are also not applicable to: • physical or non-financial measures; • information on major shareholdings, acquisitions or disposals of own shares and total number of voting rights; or • information to explain compliance with the terms of an agreement (such as a lending covenant) or legislative requirement (such as the basis of calculating directors' remuneration).
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.	**Presentation** and **Explanation on the use of APMs** – A clear and readable definition of APMs should be provided. APMs should also be given meaningful labels reflecting their content and basis of calculation. The use of APMs should be explained to allow users to understand their relevance and reliability.

IOSCO Statement on Non-GAAP Financial Measures	ESMA Guidelines on Alternative Performance Measures
Unbiased purpose – Non-GAAP measures should not beused to avoid the presentation of adverse information.	Presentation – Overly optimistic or positive labels for APMs should not be used. *In addition, ESMA's common enforcement priorities state that "when including in the financial statements measures of performance not defined in IFRS Standards, issuers should ensure that those measures are calculated and presented in an unbiased fashion (e.g. issuers should not eliminate, remove or omit only negative aspects or items of their performance)."*
Prominence of presentation of GAAP measures – Non-GAAP measures should not be presented with more prominence than the most directly equivalent GAAP measure.	**Prominence and presentation of APMs** – APMs should not be displayed with more prominence, emphasis or authority than, or distract from, measures directly stemming from financial statements.
Reconciliation to comparable GAAP measures – A clear and quantitative reconciliation to the most directly equivalent GAAP measure should be provided.	**Reconciliations** – Each APM should be reconciled to its most directly reconcilable item in the financial statements.
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 figure adjusted accordingly.	**Comparatives** and **Consistency** – APMs should be presented consistently from period to period with comparative information provided. Any changes to the definition or calculation of an APM (or cessation of use of an APM) should be explained, with restated comparative figures provided.
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'.	**Presentation** – Items should not be mislabelled as nonrecurring, infrequent or unusual. For example, items that affected past periods and will affect future periods (such as restructuring costs or impairment losses) will rarely be considered as non-recurring, infrequent or unusual.

IOSCO Statement on Non-GAAP Financial Measures	ESMA Guidelines on Alternative Performance Measures
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.	**Compliance by reference** – Disclosure principles in the guidelines may be replaced by a direct reference to other documents previously published which contain disclosures on APMs and are readily and easily accessible to users.

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.

In respect of the reporting of performance in annual financial statements more generally, it should be noted that:

- The requirement of IFRS 8 Operating Segments that segmental information be presented 'through the eyes of management' means that this information (in terms of the segments presented and measures disclosed) should be consistent with the presentation used in, for example, a management report or press release. Care should also be taken in presenting the reconciliations of total segmental figures to corresponding entity amounts and disclosing judgements made in aggregating operating segments.
- In presenting items of other comprehensive income, IAS 1 *Presentation of Financial Statements* now requires a distinction to be drawn between items that may subsequently be reclassified to profit or loss and those that will not, including for an entity's share of OCI of an associate or joint venture. An indirect effect of this guidance is clarity on the calculation of the gain or loss on disposal of a subsidiary, associate or joint venture as 'recyclable' items will be included in that calculation whilst 'non-recyclable' items will not. Additionally, the level of disaggregation of items of OCI required to provide material information to users should be considered.
- The calculation of EPS is often complex, particularly when it is affected by items such as share options and convertible bonds. Care should be taken in both performing these calculations and in providing the associated disclosures required by IAS 33 *Earnings Per Share* – for example, reconciling the weighted average number of shares used to calculate basic and diluted EPS.

The impact of new accounting standards

A number of significant new Standards have recently been issued by the IASB, but are not yet mandatorily effective. The requirements of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors to provide disclosures on the likely effects of those Standards on an entity's future financial statements are of particular interest to investors and are an area of heightened regulatory focus.

IFRS 15 *Revenue from Contracts with Customers*

IFRS 15 will have a significant effect across a wide variety of entities, particularly those providing bundles of multiple goods and services and those engaged in long-term contracts.

Entities expecting little impact on their revenue recognition policies in adopting IFRS 15 should still be aware that collecting the data required to make a full assessment of their contracts and to prepare the additional disclosures required by IFRS 15 could present a significant challenge.

IFRS 9 *Financial Instruments*

The impact of IFRS 9 will be felt most keenly in the financial services sector, in particular due to the need to develop systems to transition from the incurred loss model applied under IAS 39 *Financial Instruments: Recognition and Measurement* to financial assets to the expected loss model required by IFRS 9. Entities in other sectors should not, however, overlook the effect that this might have on, for example, the measurement of impairment of trade receivables.

In a European context, ESMA has published a public statement detailing its expectations of disclosure of the likely effect of IFRS 15 and a similar statement on IFRS 9. These statements illustrate an expectation of increasing levels and detail of disclosure as the effective date of these standards approaches. For 2016 annual financial statements, the statements encourage:

- a detailed description and explanation of how the key concepts included in the new standards (for example, the identification of performance obligations for each revenue stream under IFRS 15 and the modelling techniques used to estimate expected credit losses under IFRS 9) will be implemented and, where relevant, how this differs from the entity’s current accounting policies;
- an explanation of the timeline for implementing IFRS 15 and, where available, IFRS 9, including which transitional provisions the entity expects to use; and
- if known or reasonably estimable, a quantification of the possible impact of the application of IFRS 15 and IFRS 9. If the quantitative effect is not reasonably estimable, additional qualitative information to provide an understanding of the magnitude of the expected impact on the financial statements and, in respect of IFRS 9, on capital planning.

Regulators elsewhere have also highlighted the need for entity-specific information on the effects of IFRS 15 and IFRS 9.

IFRS 16 *Leases*

The effective date of IFRS 16 is a year later than that for IFRS 15 and IFRS 9, so disclosure of its likely effect might be expected to be less detailed at this stage (although it should be noted that entities, most likely lessors, intending to early adopt IFRS 16 to coincide with the effective date of IFRS 15 might need to be further progressed in their considerations). However, one item that may require further attention in 2016 is the disclosure of lease commitments already required under IAS 17 Leases. Not only is this likely to be a user’s starting point for assessing an entity’s likely level of exposure to IFRS 16, it is also (depending on the transition method selected) required to be reconciled to the lease liability recognised when IFRS 16 is first applied. As such, the accuracy of this disclosure is likely to be subject to additional scrutiny.

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.

Distinguishing equity and financial liabilities

The distinction between debt and equity has long been one of the more complex aspects of financial reporting, as evidenced by the volume of queries on the matter submitted to the IFRS Interpretations Committee and the long gestation period of the IASB's project on Financial Instruments with Characteristics of Equity (FICE).

In approaching a debt/equity assessment, it is important to bear in mind the overriding principles underpinning the distinction drawn in IAS 32 *Financial Instruments: Presentation*.

Unconditional right to avoid delivering cash or another financial asset

The primary distinguishing feature of an equity instrument is that it gives the issuer the unconditional right to avoid having to deliver cash or another financial asset in settlement. If the contractual terms of the instrument contain provisions that can compel the issuer to deliver cash or another financial asset then the instrument is (at least in part) a financial liability.

Depending on the terms of an instrument, assessing against this criterion may not be straightforward. It is important to note that:

- An ability to refuse to make a payment (for example of a dividend or upon redemption of the instrument) must be a feature of the instrument itself. External factors that may affect the entity's ability to fulfil a contractual obligation, such as the availability of distributable reserves, are not part of the debt/equity analysis.
- Contingent settlement provisions (conditions that require payments to be made in the event of the occurrence, or non-occurrence, of an event outside the control of both the issuer and holder of the instrument) give rise to a liability unless the requirement is not genuine or occurs only upon liquidation of the issuer.
- Economic compulsion which might lead an entity to make a payment when it is not contractually obliged to do so (for example, a 'dividend blocker' that means a dividend cannot be paid on ordinary shares without payment of a dividend on a preference share) does not itself create a financial liability. However, disclosure of such terms may be appropriate in explaining the judgements made in classifying an instrument as equity.

Settlement in an issuer's own equity instruments and the 'fixed for fixed' criterion

A contract is not an equity instrument solely because it may, or will, result in the delivery of the issuer's own equity instruments. For the instrument to be equity, the delivery must be of a fixed number of equity instruments in exchange for a fixed amount of cash or another financial asset. This is often referred to as the 'fixed for fixed' criterion, designed to ensure that instruments in which an entity's own shares are used as 'currency' to settle an obligation are classified as liabilities.

Assessment of this criterion can often be complex, it is important to note for example that 'fixed amount of cash' refers to also being fixed in the issuer's functional currency. A contract allowing, for example, an issuer with Sterling functional currency to deliver a fixed number of its shares to settle a Euro denominated liability would not qualify for equity classification.

The 'fixed for fixed' criterion is particularly important in assessing the classification of compound instruments such as convertible bonds and of derivatives over the issuer's own equity instruments (for example, a call option to purchase ordinary shares).

Exceptions to the rules

Each of the principles above is, however, subject to tightly defined exceptions within IAS 32.

- An obligation to redeem an instrument for a pro rata share of the entity's net assets does not result in classification as a liability if strict criteria are met, amongst them that the instrument in question is subordinate to all other classes of instrument issued by the entity.
- The 'fixed for fixed' criterion is set aside in the specific circumstance of a rights issue in which equity instruments will be issued for a fixed amount of foreign currency cash.

As can be seen from the above, this determination can be both highly complex and sensitive to sometimes subtle distinctions in the terms of an instrument. As such, this is an area in which proper disclosure is important, specifically:

- the accounting policy applied when assessing whether an instrument qualifies as debt or equity should be properly disclosed and applied consistently;
- the requirements of paragraph 122 of IAS 1 *Presentation of Financial Statements* to disclose the judgements made in applying accounting policies may be relevant; these should include the main characteristics (e.g. par value, interest and step-up clauses, coupon payment terms, triggering events for any payments, key contract dates, conversion or call and put options) of the instrument(s) in question; and
- paragraph 17 of IFRS 7 *Financial Instruments: Disclosures* has a specific requirement to disclose the existence of derivatives with interdependent values which are embedded in a compound instrument.

Material balances or amounts in the statement of comprehensive income relating to a significant class of capital instrument (for example, the profit or loss effect of an instrument requiring mandatory payments based on an entity's profits) might also be a candidate for separate presentation in the primary financial statements (as described in the amendments to IAS 1 made as part of the IASB's Disclosure Initiative). Similarly, disaggregation in the statement of cash flows and disclosure in the notes to the financial statements of distributions to holders of instruments other than ordinary shares that are classified as equity could provide clarity on the effect of such instruments.

Reporting the effects of income tax

Tax may be a complex area, especially for larger, multi-national and more complex groups, and reporting of income tax often involves the exercise of significant judgement and estimation. These factors, combined with increased regulatory and media scrutiny of companies' tax affairs, mean that the demand for transparency in annual reports about a company's approach to tax, its tax strategy and policies, significant risks arising from tax and the accounting for, and disclosure of, tax is ever growing.

In a number of ways, the accounting for and disclosure of income tax is a prime example of the wider issues highlighted in this publication. For example:

- **Accounting policies** related to tax should be clear, specific to the group's circumstances and should address all key issues including the recognition and measurement of uncertain tax positions, if relevant. To be meaningful to users of the annual report, generic descriptions and boilerplate should be avoided.
- Income tax is a common source of **estimation uncertainty**, particularly in respect of uncertain tax positions. The disclosure requirements of IAS 1 *Presentation of Financial Statements* in this respect, particularly if there is a significant risk of material adjustment in the next financial year, should be applied carefully and should include quantitative information, such as sensitivities or ranges of possible outcomes.
- When the risk of material adjustment in the next year is not significant, income tax should not be described as a key source of estimation uncertainty. However, companies should make disclosures where material adjustments are expected beyond the next financial year to ensure transparent and meaningful information is provided to users of the annual report. This disclosure could, for example, be included in the tax note.
- The effects of income tax should be appropriately reflected in **reporting financial performance**. For example, a policy on presentation of 'exceptional' or 'non-recurring' items should cover the reporting of tax gains and losses in respect of reporting the tax effect of other 'exceptional' or 'non-recurring' items.

More specific to tax is the requirement of IAS 12 *Income Taxes* to disclose an effective tax-rate reconciliation to explain the relationship between the total tax expense and profit before tax for the year. This reconciliation should provide clear information about the key factors affecting the effective tax rate and its sustainability in the future, including the nature of reconciling items and why they have arisen, distinguishing clearly between significant oneoff or unusual items and those that are expected to recur. This enhances the predictive value of disclosures and helps in assessing the sustainability of the effective tax rate.

Tax payments on financial instruments classified as equity

The presentation (in profit or loss or directly in equity) of the tax effects of dividend payments has been a topic of recent discussion by the IFRS Interpretations Committee, specifically on the question of whether the income tax consequences of such a payment should be characterised as relating to the past generation of profit (and, as a result, presented in profit or loss) or to distributions to owners (and, as a result, presented in equity).

The June 2016 IASB Update notes a tentative decision by the Board to amend IAS 12 *Income Taxes* to clarify that the presentation requirements of paragraph 52B apply to all income tax consequences of dividends. Subject to certain specific exceptions, this would mean presentation in profit or loss.

Whilst these proposals are still some way from completion (an exposure draft is expected to be issued in January 2017), it may be appropriate to disclose separately any material income tax effects of dividends to allow users to gauge the possible impact of any future change in classification.

Uncertain tax positions

The accounting for and disclosure of uncertain tax positions is a recurring theme in the issues noted above, particularly in relation to reporting on risks and estimates.

The draft Interpretation issued by the IFRS Interpretations Committee in October 2015 is expected to be finalized in 2017. However, the key conclusions included in that draft can already be used as a basis for addressing this issue:

- 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.

In terms of disclosure, the draft Interpretation proposes no specific additional requirements but the disclosure considerations above (e.g. disclosure of estimation uncertainties under IAS 1 *Presentation of Financial Statements* and provision of appropriately granular information in the tax charge reconciliation) will frequently be relevant to uncertain tax positions. Paragraph 88 of IAS 12 also specifies that disclosure of tax-related contingent assets and liabilities is required under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

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 support the recognition of those deferred tax assets. For example, where a company is loss making, disclosure of the evidence over the availability of future profits to support a deferred tax asset is required.

Base Erosion and Profit Shifting

The OECD and the G20 project on 'Base Erosion and Profit Shifting' ('BEPS') was initiated in 2015 to address perceived inequalities and inconsistencies in the global tax landscape. This had resulted in a 15-point action plan to modernise the principles underlying today's international tax landscape and to develop a consistent framework for countries to base their tax legislation upon.

Core principles of the project are:

- the elimination of tax mismatches such that all income is taxed;
- the alignment of profits with value creation;
- the increase of transparency with tax authorities; and
- the implementation of change in a coordinated fashion.

While some of the proposals will be seen as increasing tax risk and bringing greater complexity, ultimately having a consistent tax platform is important to global businesses.

Similarly, the European Commission is launching initiatives to address tax evasion and tax fraud with the focus on improving tax transparency and creating a fairer tax environment within the European Union.

During 2016, individual territories have started to frame their responses to the BEPS initiative, including announced and enacted legislative changes in the UK and Australia.

These initiatives highlight the importance that companies should give to consideration of risks relating to tax as these can have significant effects on the recognition and measurement of tax balances.

Other topics

Offset of assets and liabilities and cash pooling arrangements

The March 2016 IFRIC Update included the output from the IFRS Interpretations Committee's discussions on a question of whether regular (but not at the reporting date) physical transfers of cash into a netting account would be sufficient to fulfil the 'intention to settle net' criterion in IAS 32 Financial Instruments: Presentation for offsetting assets and liabilities (in this case, cash in some bank accounts and overdrafts in others), with the Committee concluding that it would not.

The question was asked in the context of an arrangement whereby subsidiaries of a group each had legally separate bank accounts with regular physical transfers made into a central 'netting' account. However, such a transfer was not made at the reporting date and at that date the group expected that individual subsidiaries will use their bank accounts before the next net settlement date, by placing further cash on deposit or by withdrawing cash to settle other obligations.

In these circumstances, there is not an intention to settle the specific balances (i.e. the cash or overdraft as at the reporting date) net and therefore the criteria for offset are not met.

Entities seeking to achieve offset of cash and overdraft balances should consider whether their current practices in terms of the timing of 'sweeps' into a central account are consistent with the Committee's conclusion.

Pension schemes

An exposure draft from June 2015 proposed changes to IAS 19 *Employee Benefits* and IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* including a clarification to IFRIC 14 specifying that when assessing whether a surplus (or liability for a minimum funding requirement) should be recognised, amounts assessed as available to the entity through future refunds should not include amounts that other parties (typically a trustee) can use to enhance members' benefits without the entity's consent.

At its September 2016 meeting, the IFRS Interpretations Committee recommended that the IASB finalise the proposed amendments. Although not yet finalised, these proposals should be considered in making disclosures on the significant judgements made in assessing the rights of trustees over any surplus assets in a defined benefit scheme.

In addition, as the funding of pension obligations becomes more sophisticated, for example by use of longevity swaps, proper disclosure of an entity's funding strategy including how fair values for such assets have been determined has become increasingly important.

New and revised IFRSs mandatorily effective for years ending 31 December 2016

IFRS
New Standards:
IFRS 14 – Regulatory Deferral Accounts
Amended Standards:
Amendments to IFRS 10, IFRS 12 and IAS 28 – Investment Entities: Applying the Consolidation Exception
Amendments to IAS 27 – Equity Method in Separate Financial Statements
Amendments to IAS 1 – Disclosure Initiative
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IFRS 14 – Regulatory Deferral Accounts[1]

IFRS 14 is available only to first-time adopters of IFRSs who recognised regulatory deferral account balances under their previous GAAP and permits those entities to continue (with limited changes) their previous GAAP accounting for rate-regulated activities, although with separate presentation of balances and items of income and expense arising from that accounting.

IFRS 14 is intended as an interim solution pending completion of the IASB's more comprehensive project on rate-regulated activities.

Amendments to IFRS 10, IFRS 12 and IAS 28 – Investment Entities: Applying the Consolidation Exception

The amendments clarify that:

- The exemption from preparing consolidated financial statements in IFRS 10 (and from applying the equity method in IAS 28) is available to subsidiaries whose ultimate or intermediate parent is an investment entity that measures the subsidiary at fair value through profit or loss.

[1] The EU has decided not to endorse this standard for use in the European Union as very few European companies would fall within its scope. As such, the option to retain previous GAAP accounting on transition to IFRSs is not available to entities required to apply EU-endorsed IFRSs.

- The requirement in paragraph 32 of IFRS 10 for an investment entity to consolidate a subsidiary that provides it with investment-related services does not apply to subsidiaries that are themselves investment entities.
- In applying the equity method to an associate or joint venture that is an investment entity, a non-investment entity investor may retain the fair value measurement applied by its associate or joint venture in calculating its share of profit or loss.

Amendments to IAS 27 – Equity Method in Separate Financial Statements

The amendments to IAS 27 allow entities to apply the equity method, as described in IAS 28 *Investments in Associates and Joint Ventures*, to investments in subsidiaries, joint ventures and associates in their separate financial statements. The previous options of accounting at cost or in accordance with IFRS 9 (or, for entities that have not yet applied IFRS 9, IAS 39) remain and the same method must be used for all investments in the same category.

Amendments to IAS 1 – Disclosure Initiative

The amendments to IAS 1 provide clarifications in a number of areas:

- Materiality and Aggregation – an entity should not obscure useful information by aggregating or disaggregating information and materiality considerations apply to the primary financial statements, notes and specific disclosure requirements of other IFRSs.
- Statement of financial position and statement of profit or loss and other comprehensive income – the line items specified in IAS 1 can be disaggregated or aggregated if this is relevant to an understanding of the entity's financial position or performance. Guidance is also provided on the use of subtotals in the financial statements.
- Presentation of other comprehensive income ('OCI') – the entity's share of OCI of associates and joint ventures should, as for its own OCI, be separated into items that will or will not be reclassified subsequently to profit or loss.
- Notes to the financial statements – entities have flexibility in designing a suitable structure for the notes.

Amendments to IFRS 5, IFRS 7, IAS 19 and IAS 34 issued in the Annual Improvements Cycle 2012-2014

The amendments introduced in the 2012-2014 annual improvement cycle were:

- IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* – Changes in methods of disposal: Clarifies that reclassification of an asset or disposal group directly from being held for sale to being held for distribution to owners (or vice versa) is considered a continuation of the original plan of disposal and that the accounting requirements for a change to a plan of sale (or to a plan of distribution to owners) do not apply.
- IFRS 7 *Financial Instruments: Disclosures* – Servicing contracts and applicability of the amendments to IFRS 7 to condensed interim financial statements: Provides additional guidance on determining whether servicing a transferred financial asset constitutes 'continuing involvement' for the purposes of IFRS 7's disclosure

requirements and disclosures on offsetting are not, as a matter of course, required in condensed interim financial statements.

- IAS 19 *Employee Benefits* – Discount rate: regional market issue: Clarifies that the basket of high quality corporate bonds used to determine a discount rate for defined benefit obligations, along with the depth of the market for such bonds, should be assessed at a currency, rather than national, level.
- IAS 34 *Interim Financial Reporting* – Disclosure of information 'elsewhere in the interim financial report': Clarifies that, to be considered part of interim financial statements, information provided elsewhere must be incorporated by cross-reference and be available to users on the same terms as the interim financial statements and at the same time.

Amendments to IAS 16 and IAS 38 – Clarification of Acceptable Methods of Depreciation and Amortisation

The amendments prohibit the use of a revenue-based depreciation method for property, plant and equipment and introduces a rebuttable presumption that such a method is not appropriate for calculating the amortization of an intangible asset. This presumption can be rebutted only if the intangible asset is expressed as a measure of revenue or if revenue and consumption of the intangible asset are highly correlated.

Amendments to IFRS 11 – Accounting for Acquisitions of Interests in Joint Operations

The amendments clarify that the principles of business combination accounting set out in IFRS 3 *Business Combinations* should be applied to the acquisition of an interest in a joint operation whose activity constitutes a business.

Amendments to IAS 16 and IAS 41 – Bearer Plants

The amendments define a 'bearer plant' as a living plant that is used in the production or supply of agricultural produce, is expected to bear produce for more than one period and has a remote likelihood of being sold as agricultural produce except for incidental scrap sales.

The amendment includes such plants within the scope of IAS 16, to be measured either at depreciated cost or revalued through other comprehensive income.

Produce growing on bearer plants remains, however, within the scope of IAS 41 to be measured at fair value less costs to sell with changes in that value recognised in profit or loss.

IFRS Interpretations Committee agenda decisions in 2016

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, with the European Securities and Markets Authority (ESMA), for example, publicly stating an expectation to this effect.

In 2016, the following agenda decisions have been published by the Committee.

January IFRIC Update	IFRS 5 – To what extent can an impairment loss be allocated to non-current assets within a disposal group?
	IFRS 5 – How to present intragroup transactions between continuing and discontinued operations
	IFRS 5 – Other various IFRS 5-related issues
	IFRS 9 – Transition issues relating to hedging
	IFRS 11 – Remeasurement of previously held interests
	IAS 12 – Recognition of deferred taxes for the effect of exchange rate changes
	IAS 39 – Separation of an embedded floor from a floating rate host contract in a negative interest rate environment
March IFRIC Update	IFRS 9 – Determining hedge effectiveness for net investment hedges
	IAS 16 and IAS 38 – Variable payments for asset purchases
	IAS 32 – Classification of liability for a prepaid card in the issuer's financial statements
	IAS 32 – Offsetting and cash-pooling arrangements
May IFRIC Update	IFRS 9 and IAS 39 – Derecognition of modified financial assets
	IAS 20 – Accounting for repayable cash receipts
	IAS 36 – Recoverable amount and carrying amount of a cash-generating unit
July IFRIC Update	IFRS 11 and IFRS 10 – Accounting for loss of control transactions
	IFRIC 12 – Payments made by an operator to a grantor in a service concession arrangement

September IFRIC Update	IFRIC 12 – Service concession arrangements with leased infrastructure
November IFRIC Update	IAS 12 – Expected manner of recovery of intangible assets with indefinite useful lives
	IAS 32 – Written put options over non-controlling interests to be settled by a variable number of the parent's shares

New and revised IFRSs available for early application in years ending 31 December 2016

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) is a current area of regulatory focus.

The list below reflects a cut-off date of 31 October 2016. 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
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.
Amendments to IAS 12 – Recognition of Deferred Tax Assets for Unrealised Losses	1 January 2017
Amendments to IAS 7 – Disclosure Initiative	1 January 2017
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

*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.

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.

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