CIPFA Pensions Network:
Planning Ahead for 2013/14 and Beyond

Agenda

1. IFRS 10-12 Consolidated Accounts and Joint Arrangements
2. IFRS 13 Fair Value
3. New IASB standards in development:

   - Revenue Recognition

   - Leasing
4. FRS 9 Financial Instruments
5. Conclusions

IFRS 10 Consolidated Financial Statements

- IFRS 10 introduces the following revised definition of control together with accompanying guidance on how to apply it :

"An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee."

- The new definition uses the term 'returns' rather than 'benefits' to avoid giving the impression that only positive returns are of relevance.

IFRS 10 Consolidated Financial Statements

- In order to determine whether a reporting entity has control over another entity in which it has invested, the following three elements must always be present:

a) power over the investee

b) exposure, or rights, to variable returns from its involvement with the investee

c) the ability to use its power over the investee to affect the amount of the investor's returns.

IFRS 10 Consolidated Financial Statements

Examples of consolidation decisions that may change:

Large Minority Holdings

- control may exist where other shareholdings are widely dispersed, and an investor holds significantly more voting rights than any other shareholder or group of shareholders

Potential Voting rights

- under IFRS 10, potential voting rights may, in some circumstances, result in control even where they are not currently exercisable
- IFRS 10 considers a broader range of indicators on whether such rights are substantive

IFRS 10 Consolidated Financial Statements

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IFRS 10 Consolidated Financial Statements

- We expect that in most cases, conclusions as to what should be consolidated will be unchanged. In some circumstances, it will however change the composition of a group as a consequence of reassessment of which entities a parent company controls. In these cases the impact could be substantial.
- Effective for accounting periods beginning on or after 1/1/2014. Early adoption permitted.

IFRS 11 Joint Arrangements

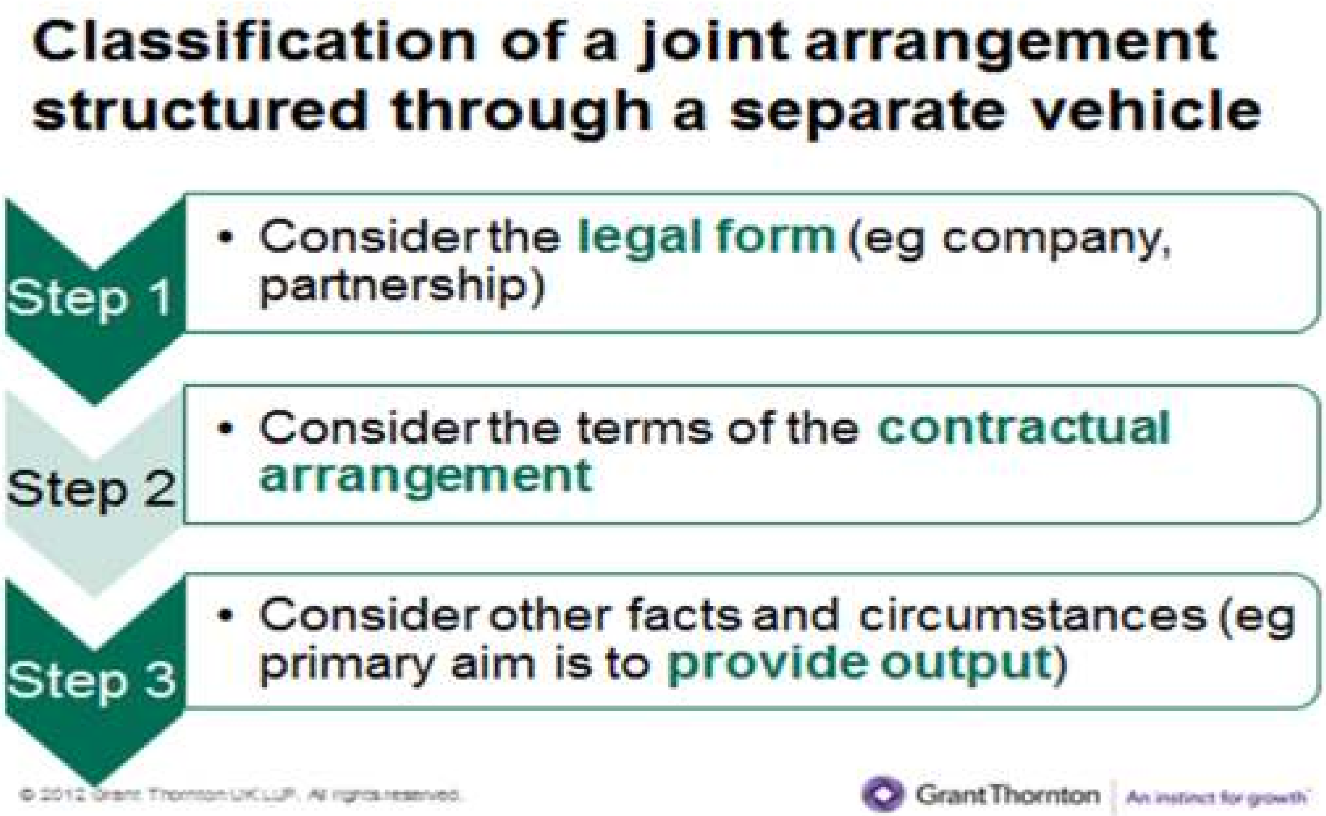
- IFRS 11 aims to improve on IAS 31 by establishing principles that are applicable to the accounting for all joint arrangements (a joint arrangement being an arrangement over which two or more parties have joint control).

- IFRS 11 replaces IAS 31's three categories of 'jointly controlled entities', 'jointly controlled operations' and 'jointly controlled assets' with two new categories – 'joint operations' and 'joint ventures'.

IFRS 11 Joint Arrangements

- a joint operation is a joint arrangement whereby the parties that have joint control of the arrangement (ie joint operators) have *rights to the assets, and obligations for the liabilities, relating to the arrangement*.
- a joint venture is a joint arrangement whereby the parties that have joint control of the arrangement (ie joint venturers) have *rights to the net assets of the arrangement.*

IFRS 11 Joint Arrangements



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IFRS 11 Joint Arrangements

<u>Examples of possible conditions that may indicate an arrangement is a joint operation:</u>

- the activities of an arrangement are primarily designed for the provision of output to the parties
- the parties are substantially the only source of cash flows contributing to the continuity of the operations of the arrangement.

IFRS 11 Joint Arrangements

- Joint venturer recognises its interest in a joint operation by proportionate consolidation. ie the joint venturer recognises its share of the assets, liabilities, income and expenses of the joint operation
- Joint venturer recognises its interest in a joint venture by using equity accounting (same as accounting for associates under IAS 28)

IFRS 11 Joint Arrangements

- A party that participates in, but does not have joint control of, a joint venture accounts for its interest in the arrangement in accordance with IAS 39 'Financial Instruments', unless it has significant influence over the joint venture, in which case IAS 28 applies
- Effective for accounting periods beginning on or after 1/1/2014. Early adoption permitted.

IFRS 12 Disclosure of Interests in Other Entities

IFRS 12 complements the other new Standards by:

- integrating and making consistent the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities
- providing transparency about the risks to which a reporting entity is exposed from its involvement with structured entities (the financial crisis of 2008/9 had exposed this area as a weakness in financial reporting).

IFRS 12 Disclosure of Interests in Other Entities

The Standard establishes disclosure objectives according to which an entity discloses:

• significant judgements and assumptions (and changes) made by the reporting entity in determining whether it controls another entity

• the interest that the non-controlling interests have in the group's activities

• the effect of restrictions on the reporting entity's ability to access and use assets or settle liabilities of consolidated entities

IFRS 12 Disclosure of Interests in Other Entities

- the nature of, and changes in, the risks associated with the reporting entity's interests in consolidated structured entities, joint arrangements, associates and unconsolidated structured entities.
- Effective for accounting periods beginning on or after 1/1 2014, early adoption permitted

IAS 27 Separate Financial Statements (Revised 2011)

- The changes made to IAS 27 (Revised) 'Separate Financial Statements' are consequential changes arising from the publication of the new IFRSs. The main change is that IAS 27 (Revised) will now solely address separate financial statements, the requirements for which are substantially unchanged from the previous version of the Standard

IAS 28 Investments in Associates and Joint Ventures (Revised 2011)

- Consequential changes have been made to the scope of IAS 28 so that once an entity has determined that it has an interest in a joint venture, it accounts for it using the equity method in accordance with IAS 28 (Revised).
- The mechanics of equity accounting set out in the revised version of IAS 28 remain the same as in the previous version.

IFRS 13 Fair Value Measurement - Scope

- In general, IFRS 13 applies when another IFRS requires or permits fair value measurements – either in the primary statements themselves or in the footnotes (including ‘fair value-based’ measurements). In other words it explains **how** to measure fair value rather than when to.

IFRS 13 Fair Value Measurement – Definition of Fair Value

- IFRS 13 defines fair value as 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 (ie an exit price).
- The Standard clarifies that fair value is based on a transaction taking place in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market. The principal market is the market with the greatest volume and level of activity for the asset or liability.

IFRS 13 Fair Value Measurement – Application to Non-financial Assets

- IFRS 13 states that a fair value measurement of a non-financial asset takes into account the highest and best use of the asset.
- To be relevant, the highest and best use of a non-financial asset must be:
  - physically possible
  - legally permissible
  - financially feasible

IFRS 13 Fair Value Measurement – Fair Value Hierarchy

- IFRS 13 establishes a fair value hierarchy under which the inputs to valuation techniques used to measure fair value are categorised into three levels. The three levels of the hierarchy are as follows:
- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly
- Level 3 inputs are unobservable inputs for the asset or liability.

IFRS 13 Fair Value Measurement – Disclosures

- IFRS 13 introduces a comprehensive disclosure framework for fair value measurements. This framework is intended to help users of financial statements assess the valuation techniques and inputs used to develop those measurements.
- The disclosures required are affected by the fair value hierarchy discussed above, with increased disclosure requirements applying to the lower levels of that hierarchy.
- Applies for accounting periods beginning on 1/1/2013. Early adoption permitted

Revenue Recognition – New IASB Standard

- IASB developing a new standard " Revenue from contract with customers"
- Original Exposure Draft June 2010
- Revised Exposure Draft November 2011
- Standard expected in Ist Half of 2013
- Applicable for accounting periods beginning on or after 1st July 2015 (to be confirmed)

Revenue Recognition - Steps in revenue recognition

1. Identify the contract
2. Identify the separate performance obligations
3. Determine transaction price
4. Allocate transaction price to separate performance obligations
5. Recognise revenue when (or as) the entity satisfies a performance obligation

Revenue Recognition - Steps in revenue recognition

1 Identify the contract:

- identify the bundle of contractual rights and obligations to which an entity would apply the revenue model

2 Identify separate performance obligations:

- promises to transfer goods or services
- in case of multiple obligations - account separately for those that are distinct

Revenue Recognition - Steps in revenue recognition

3 Determine the transaction price:

- Determine the amount of consideration that an entity expects to be entitled to in exchange for promised goods or services

4 Allocate transaction price to separate performance obligations

- Allocate to each separate performance obligation the amount to which the entity expects to be entitled

Revenue Recognition - Steps in revenue recognition

5 Recognise revenue when (or as) the entity satisfies a performance obligation

- To recognise revenue when (or as) the entity satisfied a performance obligation by transferring a promised good or service (ie when the customer obtains control)

Lease Accounting – New IASB Standard in Development

- Lessee accounting - recognise:

- Right of use asset and Lease Liability
- Initial recognition – Present value of lease payments

- All leases within scope will be ON balance sheet.

- service element of contracts outside scope

- Some exemptions from the on balance sheet model:

- short term leases
- leases where assets incidental to contract

Lease Accounting – New IASB Standard in Development

There will be two models for expense profile

1 The Interest and Amortisation Approach (I&A)

2 Single Lease Expense Approach (SLE)

Two types of leased asset:

1 property

2 non property

Lease Accounting – New IASB Standard in Development

Lessor Accounting

- Where the lessor transfers significant risks or benefits, the derecognition approach would apply, whereby all or part of the underlying asset would be derecognised and a right to receive lease payments recognised as an asset

Lease Accounting – New IASB Standard in Development

- Where the lessor retains exposure to significant risks or benefits of the underlying asset, the performance obligation approach would apply.
- The underlying asset would be retained on the lessor's balance sheet. An asset would be recognised for the right to receive lease payments and a liability would be recognised for the obligation to permit the lessee to use the asset.
- The net total of the three items would be presented as a single amount in the balance sheet, with disclosure of the components of that amount

IFRS 9 Financial Instruments

- Classification and measurement – liabilities. Complete October 2010
- Derecognition – Complete October 2010
- Impairment – second ED expected 2013
- Hedge accounting – standard expected in 2013
- EU have not approved pending completion of IAS 39 replacement project

Conclusions

- Continued impact of new IFRSs
- Further modifications to standards just issued, eg exemption from consolidation for investment entities, new "fair value through OCI" assets, etc
- Revenue and Leasing standards both likely to be fundamental
- IASB working on its Conceptual Framework
- Preparers need to keep abreast with developments.