The Institute of Chartered Accountants of the Caribbean

IFRS Executive Update

June 28, 2013

Presenter - Peter Gittens

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AGENDA

Key Topics

IFRS 10 – Consolidated Financial Statements

IFRS 13 – Fair Value Measurement

IFRS for SMEs – Comprehensive Review Status

Executive Summary: Other Topics

IFRS 11 – Joint Arrangements

IFRS 12 – Disclosure of Interests in Other Entities

IAS 19R – Employee Benefits (Revised)

What’s to Come…

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IFRS 10 *Consolidated Financial Statements*

Effective January 1, 2013 – Retrospective
Early adoption permitted - must also apply IFRS 11 & 12.

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IFRS 10

- Objectives: single model for consolidation for all entities
  - Enhance disclosures for subsidiaries, joint ventures, associates, and structured entities
- Core principle:

> 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.

- Consolidate all controlled entities
- No 'bright lines' – consider all facts and circumstances

Assessing control: overview

Identifying activities

Activities

Identify which activities of the investee are considered to be the ‘relevant activities’; i.e., those that affect the investee‘s returns.

Evaluating power

Power

Determine which party, if any, has power; that is, having existing rights that give it the current ability to direct the relevant activities.

Assessing returns

Returns

Assess whether the investor is exposed, or has rights, to variable returns from its involvement with the investee.

Purpose and design

Continuous assessment

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Identifying relevant activities: overview

Identifying activities

Activities

Identify which activities of the investee are considered to be the 'relevant activities'; i.e., those that affect the investee's returns.

- Examples of activities that may affect investee's returns:
  - Determining or changing operating and financing policies
  - Making capital decisions
  - Appointing, remunerating and terminating employment of service providers or key management personnel
- If two investors both direct different relevant activities, one has to identify which investor can most significantly affect returns
- Shared power
- Purpose and design

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Example: Identifying relevant activities

- Investor C and D form an investee E (fund) to acquire, dispose and manage an investment property portfolio
- Investor C is responsible for acquisitions and disposals of the investment properties in the portfolio, whilst investor D is responsible for the management (e.g., maintenance and capital expenditures, customer management and rental collection) of the existing investment properties of E.
- The investment agreement states that E will hold no more than five properties at any one time, and indicates a planned internal rate of return (IRR) for each investment property and an overall planned minimum IRR of the fund.
- If an investment property of E achieves an IRR less than planned for three consecutive years, investor C is required to evaluate whether the property needs to be replaced considering the forecast of the respective investment property, the overall return of the portfolio of investment properties and available properties in the market. If C determines that the respective investment property has to be replaced, C can unilaterally initiate the disposal and the acquisition of a new investment property.

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Example: Identifying relevant activities - (cont'd)

Question:

What are the relevant activities & which relevant activity most significantly affects the returns of the investee?

Key points

- The level of activity associated with the acquisition and disposal of investment properties is based on the expected IRR of both the individual investment properties and the fund.
- If IRR levels are expected to be achievable and realistic on the properties initially acquired, then the level of acquisition and disposal activities would be low and the most relevant activity will therefore be the management of the investment properties.
- If the level of activities relating to acquisitions and disposals is high and is expected to remain high, this may indicate that the acquisitions and disposals of investment properties are the most relevant activity.
- Consider the purpose and design.

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Assessing power: overview

- Main aspects of power:
  - Power arises from rights.
  - Power is the current ability to direct and need not be exercised.
  - Power relates to direction of the relevant activities.
- Other considerations:
  - Evidence that the investor directed activities in the past is an indicator of power, but is not conclusive.
  - An investor that holds only protective rights cannot have power over an investee.

Evaluating power

Power

Determine which party, if any, has power; that is, having existing rights that give it the current ability to direct the relevant activities.

Assessing returns

Returns

Assess whether the investor is exposed, or has rights, to variable returns from its involvement with the investee.

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Assessing returns

- Can be positive, negative or both
- Examples:
  - Dividends, distributions of economic benefits, changes in value
  - Remuneration, fees, residual interests, tax benefits
  - Synergistic returns, saving costs, economies of scale
- Returns that appear 'fixed' may actually be 'variable'
  - Bond with 'fixed' interest payments – exposed to credit risk
  - Fixed fee for managing investment – exposed to performance risk
- Exposure to returns is an indicator of control:
  - Greater the exposure → greater incentive to obtain power

Assessing returns

Returns

Assess whether the investor is exposed, or has rights, to variable returns from its involvement with the investee.

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Power with less than majority of voting rights

- An investor may have the power to direct the relevant activities with less than half of the voting rights.
- All facts and circumstances must be considered:
  - Contractual arrangements with other shareholders
  - Contractual rights arising from other arrangements
  - The investor's voting rights: size of the investor's holding of voting rights relative to the size and dispersion of other vote holders (de facto control)
  - Potential voting rights held by the investor and other parties

If it is not clear from considering these factors that the investor has power, the investor does not control the investee.

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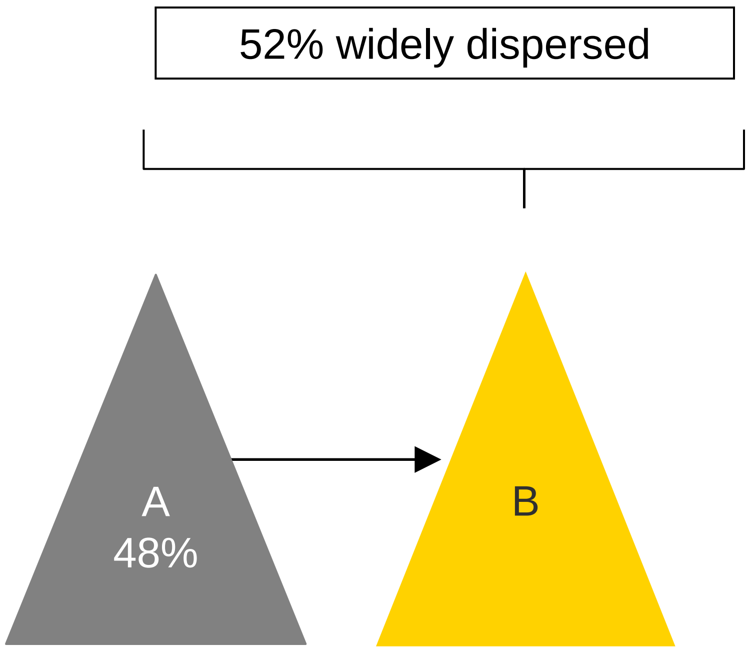
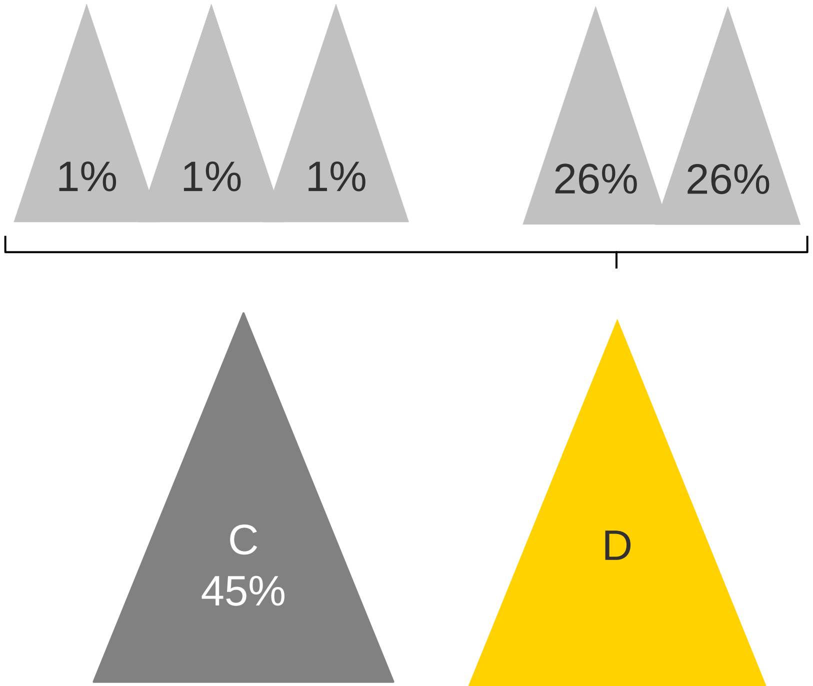
Assessing power – Power with less than majority of voting rights

Example 1 – A has power

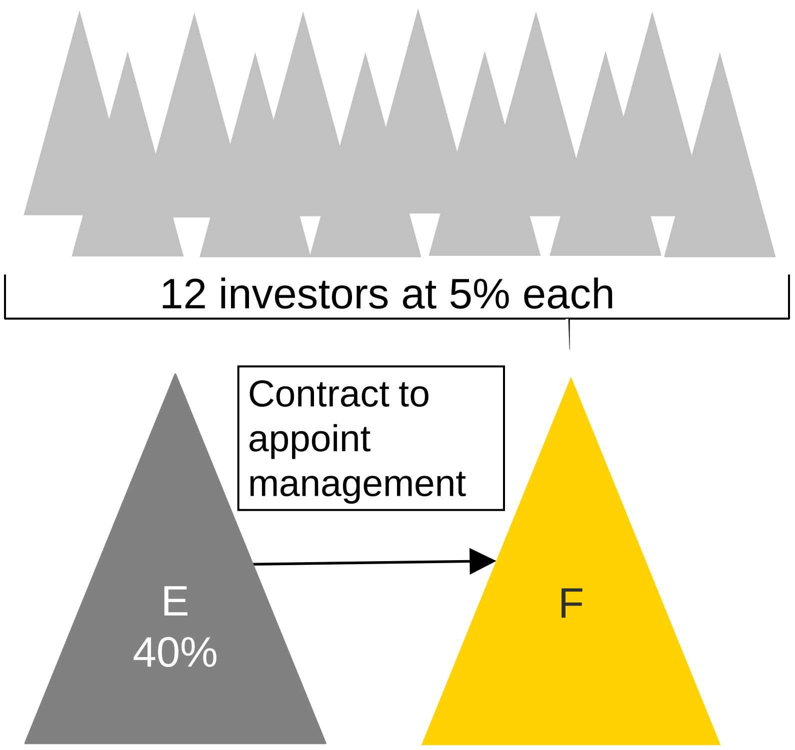


Example 2 – C does not have power

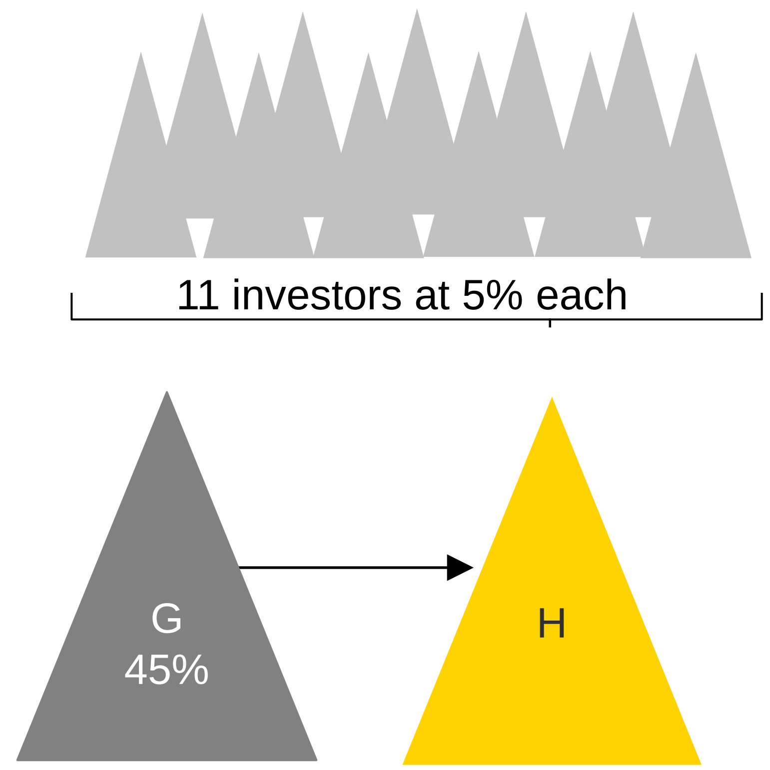


Assessing power – Power with less than majority of voting rights (cont.)

Example 3 – E has power



Example 4 – not conclusive



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Delegated rights – link between power and returns

More likely principal	More likely agent
Broad scope of decision-making powers	Narrow scope of decision-making powers
Removal rights Large number of parties	Removal rights Single party or small number of parties
Remuneration not commensurate with services provided	Remuneration is commensurate with services provided
Greater exposure to variability of returns from all interests	Little exposure to variability of returns from all interests

Decision-maker

Based on considering all factors, rather than a single factor

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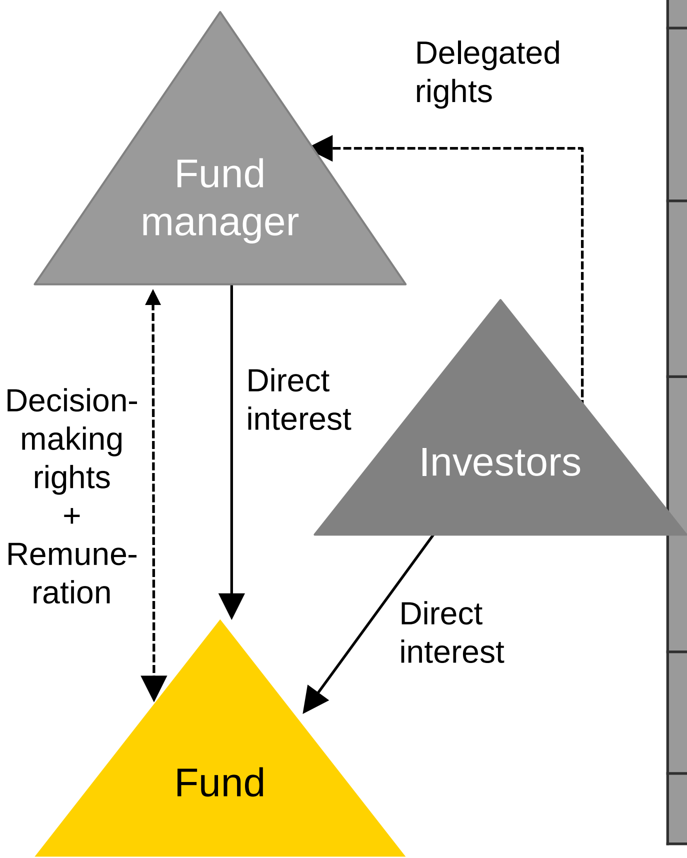
Delegated rights: examples



	Example 1	Example 2	Example 3
Decision-making scope	Broad discretion	Broad discretion	Broad discretion
Rights held by other investors	Simple majority, for cause	**Simple majority, for cause**	**Independent board, for any reason**
Remuner-ation	1% of NAV 20% of profits if hurdle rate achieved	1% of NAV 20% of profits if hurdle rate achieved	1% of NAV 20% of profits if hurdle rate achieved
Other interests	2% direct interest	**20% direct interest**	**20% direct interest**
Conclusion	Agent	**Principal**	**Agent**

Business impact

- Judgement required to assess which party has control over another entity, based on facts and circumstances – **no 'bright lines'**
- May result in changes to the entities being consolidated and will impact key metrics of financial performance:
  - Assessment of impact on debt covenants and management remuneration
  - Communication with stakeholders
- Consideration of new guidance when new arrangements are negotiated or existing ones are modified
- Additional procedures required to assess control on a continuous basis (information gathering regarding investee and behaviour of other shareholders)

Local impact – Look out for...

Re-assess for potential consolidation:

- Substantial and significant holdings < 50%
- Special Purpose Entities
- Employee profit share plans (IAS 19 & IFRS 2)
- Sponsored Funds (e.g. mutual funds)

IFRS 13
Fair Value Measurement

Effective January 1, 2013
Early adoption permitted – Prospective.

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Fair value measurement

- Clarifies definition of fair value
- Single framework for <u>how</u> to measure fair value
  - Does not change <u>when</u> fair value is used
- Increases disclosures about fair value measurements
- Applies to financial and non-financial assets and liabilities
- Applies to recurring and non-recurring measurements

Fair value: 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 (an exit price)

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Fair value measurement
What changed and who is affected?

What changed?

- Clearly an exit price
- Use principal market
- Highest and best use for non-financial assets
- Fair value of liabilities and equity instruments considered from perspective of market participants who hold as assets
- No blockage discounts
- More disclosures for non-financial assets

Who is affected?

- Entities that use fair value model for investment property
- Entities that revalue PP&E or intangible assets
- Entities with biological assets or agricultural produce
- Entities with financial instruments

Example: Highest & best use vs. current use

An entity acquires land in a business combination. The land is currently developed for industrial use as a site for a factory. The current use of the land is presumed to be its highest and best use, unless market or other factors suggest a different use. Nearby sites have recently been developed for residential use as sites for high-rise apartment buildings.

On the basis of that development and recent zoning and other changes to facilitate that development, the entity determines that the land currently used as a site for a factory could be developed as a site for residential use, because market participants would take into account the potential to develop the site for residential use when pricing the land.

Example: Highest & best use vs. current use

The highest and best use of the land would be determined by comparing both of the following:

(a) The value of the land as currently developed for industrial use (i.e. the land would be used in combination with other assets, such as the factory, or with other assets and liabilities);

(b) The value of the land as a vacant site for residential use, taking into account the costs of demolishing the factory and other costs (including the uncertainty about whether the entity would be able to convert the asset to the alternative use) necessary to convert the land to a vacant site (i.e. the land is to be used by market participants on a stand alone basis);

The highest and best use would be determined based on the higher of those values.

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Disclosures: Principles

- Disclose information that helps users to assess:
  - For assets and liabilities that are measured at fair value on a recurring or non-recurring basis after initial recognition, valuation techniques and inputs used to develop those measurements
  - For recurring fair value measurements using significant unobservable inputs (Level 3), the effect of measurements on profit or loss or other comprehensive income for the period
- Fair value disclosures are required to be made separately for each class of assets and liabilities
- Present quantitative disclosures in a tabular format unless another format is more appropriate

Business impact

- Consider whether entity has appropriate expertise, processes, and systems
  - Significant increase in required disclosures for non-financial instruments that are measured at fair value (e.g., investment property and PP&E measured using fair value)
- If IFRS 13 will change amount recognised, consider:
  - Covenant compliance
  - Remuneration plans
  - Shareholder communications

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Local impact – Look out for...

- Consider implications of the standard for all assets and liabilities measured at FV, but pay special attention to:
  - Property, plant and equipment (revaluation method);
  - Investment property;

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SME Comprehensive Review & RFI Proposals

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General

- Request for additional guidance/basis of conclusions for characteristics of entities without public accountability
- Staff recommendation that there is no change relating to clarification of use by not-for-profit entities
- Recommendation on how to deal with changes to full IFRSs

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Changes proposed

The IASB tentatively decided:

- the main changes in certain new and revised Standards should be considered for incorporation in the IFRS for SMEs: (IAS 1, IAS 32, IFRIC 19, amendments to IFRS 1, severe hyperinflation and removal of fixed dates for first-time adopters and government loans);
- certain changes to annual improvements should be considered for incorporation in the IFRS for SMEs: (IFRS 1, IAS 1, IAS 16, IAS 32);
- to incorporate guidance to help SMEs apply the ‘undue cost or effort‘ exemption (used in several Sections of the IFRS for SMEs);
- to add guidance in Section 9.16 on the preparation of consolidated financial statements if group entities have different reporting dates, but continue to require uniform reporting dates to be used unless it is impracticable to do so;

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Changes proposed

- To amend the criteria in Section 11.9 to clarify that loans payable in a foreign currency and loans with standard loan covenants will usually be basic financial instruments accounted for at amortised cost in accordance with Section 11 Basic Financial Instruments;
- To include an 'undue cost or effort' exemption to the requirement to recognise intangible assets separately in a business combination;
- to add specific guidance in Section 19.14 for the measurement of employee benefit arrangements and deferred taxes when allocating the cost of a business combination;
- to add an exemption in Section 22.8 for equity instruments issued as part of a business combination of entities or businesses under common control;

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Changes proposed

- to add an exemption in Section 22.17 for distributions of a non-cash asset ultimately controlled by the same parties before and after distribution;
- to revise the definition of ‘related party‘ to be consistent with IAS 24 Related Party Disclosures (2009) and add the definition ‘close members of the family of a person‘;
- to clarify the accounting requirements for entities involved in extractive activities; and
- to include an ‘undue cost or effort‘ exemption from measurement of investments in equity instruments at fair value in Section 11 and Section 12 Other Financial Instruments Issues.

Other Proposals

- Use of recognition and measurement provisions in full IFRSs for financial instruments – recommendation to wait until post-implementation review of IFRS 9 and IAS 39 fallback to be ultimately removed
- Income tax – revise chapter to be consistent with IAS 12
- Amortisation of goodwill and intangibles – management to make estimate, but it is not to exceed 10 years
- Presentation of share subscriptions receivable – delete paragraph
- Continuation of Q&A process
- Minor wording changes

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IFRS 11 *Joint Arrangements*

Effective January 1, 2013 – Retrospective
Early adoption permitted - must also apply IFRS 10 & 12.

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Joint arrangements

IAS 31

Jointly controlled operations
Recognise its assets, liabilities, expenses, and its share of income

Jointly controlled assets
Recognise its assets, liabilities, revenue, and expenses, and/or its relative shares thereof

Jointly controlled entities
Equity method or proportionate consolidation

Joint Ventures

IFRS 11

Joint operations
The parties with joint control have rights to the assets and obligations for the liabilities of the arrangement

Recognise its assets, liabilities, revenue, and expenses, and/or its relative shares thereof

Joint ventures
The parties with joint control have rights to the net assets of the arrangement.

Equity method

Joint Arrangements

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IFRS 12 *Disclosure of Interests in Other Entities*

Effective January 1, 2013 – Retrospective
Early adoption permitted - must also apply IFRS 10 & 11.

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IFRS 12

- Integrates disclosures for subsidiaries, joint arrangements, associates and structured entities into a single standard
- Disclosures should enable users to understand:
  - Nature of, and risks associated with, interests in other entities
  - Effects of those interests on financial position, financial performance, and cash flows

IFRS 12

- Main changes to disclosure requirements
  - Significant judgements and assumptions regarding whether an entity has control (and changes thereto)
  - Summarised financial information for:
    - Subsidiaries that have NCI that is material
    - Joint ventures
    - Associates
  - Nature and risks related to structured entities
    - Consolidated and unconsolidated

IAS 19 *Employee Benefits* Revised

Effective January 1, 2013 – Retrospective (with certain exceptions)
Early adoption permitted.

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Employee benefits
Main proposals and business impact

Immediate recognition

Corridor approach removed

- Recognise changes in value of pension assets and liabilties as they occur
- Higher volatility in net assets for entities that applied the corridor approach and for those with unvested past service costs

Removing expected returns

Post-employment benefits

- Service costs and net interest income (expense) recorded in P&L, remaining changes through OCI
- Expected returns are no longer recognised in P&L

New distinction

Short-term employee benefits

- Benefits classified as short-term based on expected timing of settlement
- Reclassification of some short-term employee benefits to other long-term employee benefits

Change in recognition

Termination benefits

- Termination benefits (outside of a wider restructuring) recognised only when the offer cannot be withdrawn
- Potentially later recognition for some termination benefits (outside of a wider restructuring)

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Post-employment benefits
No presentation options

Service cost
•Current service costs
•Past service costs
•Gains or losses on non-routine settlements

Net interest
•Product of net pension liability or asset and discount rate used to measure the obligation

Remeasurements
•Actuarial gains and losses
•Return on plan assets*
•Effects of changes in asset ceiling*
**excluding amounts recorded as net interest*

Recognised in:

Profit or loss

OCI*

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Post-employment benefits
Net interest income (expense) - example

Assumptions at beginning of the annual period:

Fair value of plan assets	CU 300	(expected return - 8%)
Defined benefit obligation	CU 320	(discount rate – 5%)
Net pension liability	CU 20	

Note: excludes impact of contributions and benefit payments made during the period

Current IAS 19

Expected return – CU 24
*(300 * 8%)*
DB interest cost - CU 16
*(320*5%)*

Net (income) CU 8

IAS 19 Revised

Net interest expense – CU 1
*(20 * 5%)*

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Post-employment benefits
Disclosure objectives for DB plans

Objectives of DB disclosures

- Explain characteristics and associated risks
- Identify and explain related amounts recorded (e.g., reconciliations)
- Describe potential impacts on amount, timing and uncertainty of future cash flows (e.g., sensitivity analysis)

Key considerations

- Level of required detail
- Emphasis on the various requirements
- Aggregation/disaggregation of disclosures
- Potential for additional information

Accounting impact

- Significant impact on accounting, however little impact on processes, data and information systems
  - Possible exceptions:
    - Entities affected by new requirements for distinguishing short-term and long-term employee benefits
    - Requirements for additional disclosures (e.g., quantitative sensitivity of the DBO, separate impact of demographic and financial assumptions)

Local impact – Look out for...

- Entities with a defined benefit plan;
- Entities that currently use the ‘corridor approach’ or account for actuarial gains & losses through P&L;
- Where there is a difference in the actuarial assumptions for ERPA and discount rate – likely P&L impact;

What’s to Come...

IASB Work Plan as of 21 June 2013

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Timeline for financial instruments projects

	2009 2010	2011	2012	2013 Q1	2013 Q2	2013 Q3	2013 Q4	Effective Date
IFRS 9 *Financial instruments* (replacement of IAS 39)								
Classification and measurement	IFRS							2015?
Mandatory effective date of IFRS 9 and transition disclosures		IFRS						2015?
Classification and measurement *(limited amendments – comments due 28 Mar 2013)*			ED			R		2015?
Impairment *(Comments due 5 July 2013)*	ED	SD		ED		R		?
General hedge accounting	ED		RD			IFRS		2015?
Accounting for macro hedges								
Macro hedging						DP		?
Other financial instruments projects								
Offsetting disclosures (*amendments to IFRS 7)*		IFRS						2013
Offsetting *(amendments to IAS 32)*		IFRS						2014
Novation of derivatives and continuation of hedge accounting (amendments to IAS 39 and IFRS 9) – comments due 2 Apr 2013					Target IFRS			2014?

Note: DP: discussion paper | SD: supplementary document | ED: exposure draft | RD: review draft | IFRS: final standard | R: Re-deliberations

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Timeline for other selected IASB projects

	2009 2010	2011	2012	2013 Q1	2013 Q2	2013 Q3	2013 Q4	Effective Date
Consolidation, joint arrangements & related disclosures								
Consolidated financial statements , joint arrangements and related disclosures *(IFRS 10, IFRS 11 and IFRS 12)*		IFRS						2013
Transition Guidance *(amendments to IFRS 10)*		ED	IFRS					2013
Consolidation - Investment entities *(amendments to IFRS 10, IFRS 12 and IAS 27)*		ED	IFRS					2014
Other projects								
Fair value measurement *(IFRS 13)*		IFRS						2013
Leases	ED				ED		R	?
Revenue recognition	ED	New ED	R			IFRS		?
Insurance contracts	ED				ED		R	?
Defined Benefit Plans: Employee Contributions (*amendments to IAS 19- comments due 25 July 2013)*					ED		IFRS	?
Conceptual framework					DP			

Note:	DP: discussion paper	SD: supplementary document	ED: exposure draft	RD: review draft	IFRS: final standard	R: Re-deliberations

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Questions?

Thank You!