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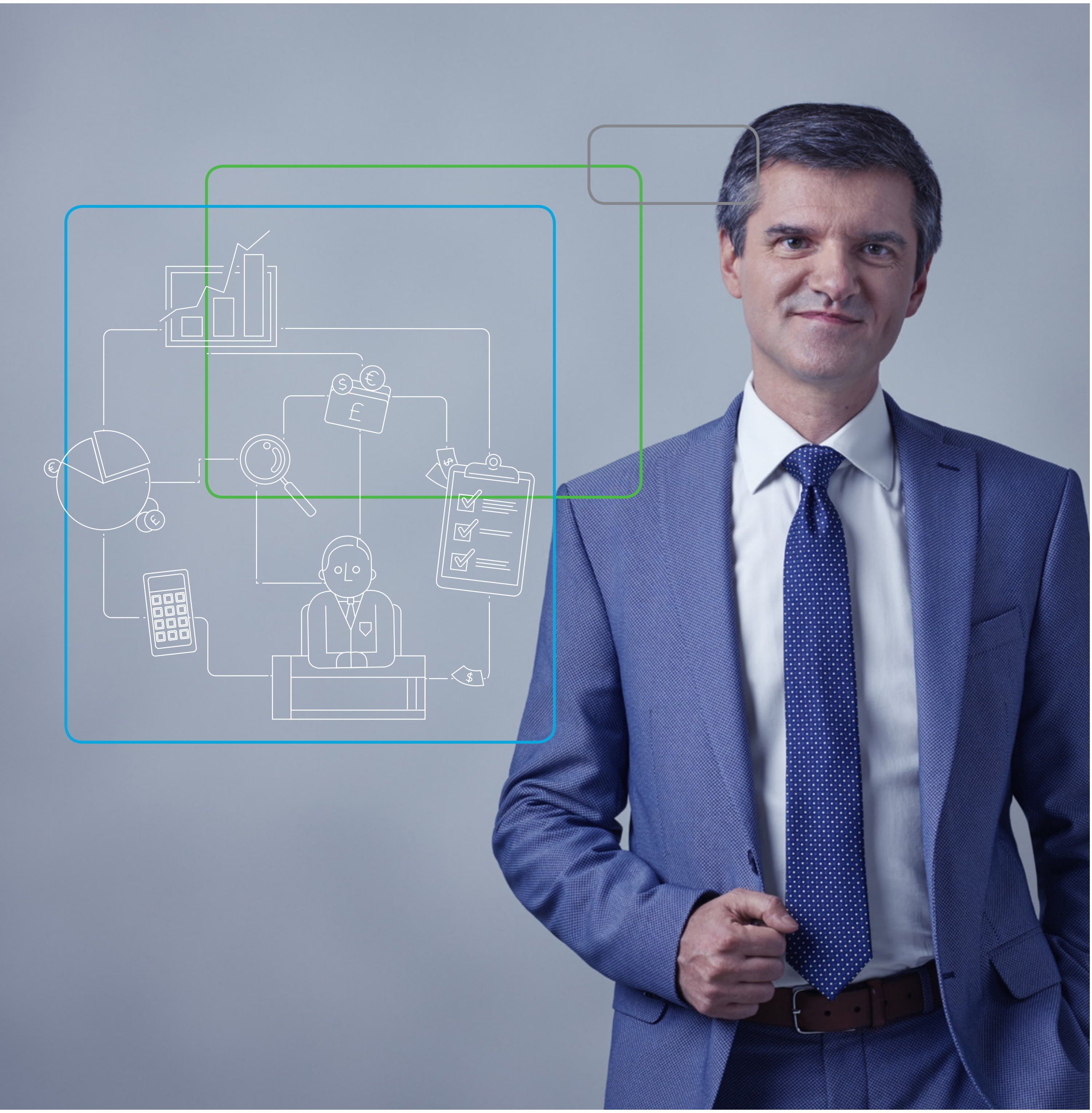

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WELCOME

In this issue we report on the IASB's endeavour to publish a new Conceptual Framework, which is approaching a successful completion. We reported on the inception of this project three years ago and we've kept an eye on its developments ever since, in the strong belief that the Conceptual Framework is a fundamental document that will shape our profession for the foreseeable future.

My conversation with Darrel Scott, member of the IASB, on the Conceptual Framework project proved to be much more than informative; providing instead inspiring insights into this important project.

As comprehensive as the Conceptual Framework is, one of the open questions it leaves, in its current form, refers to the distinction between liability and equity in certain specific cases. Hence, Anja Guenther and Anna Irrgang (from RSM Germany) have provided us with some valuable insights into the current requirements for distinguishing between equity and liabilities.

As is tradition, the last edition of the year hosts Joelle Moughanni's review of the pronouncements and amendments that are required to be adopted for the first time for 31 December year ends, as well as those that are available for early adoption.

The issue closes with RSM's response to recent comment letters as well as an example technical question and answer which arose in practice during the quarter.

We hope you will find this issue insightful and helpful.

Enjoy your reading!

Dr Marco Mongiello ACA
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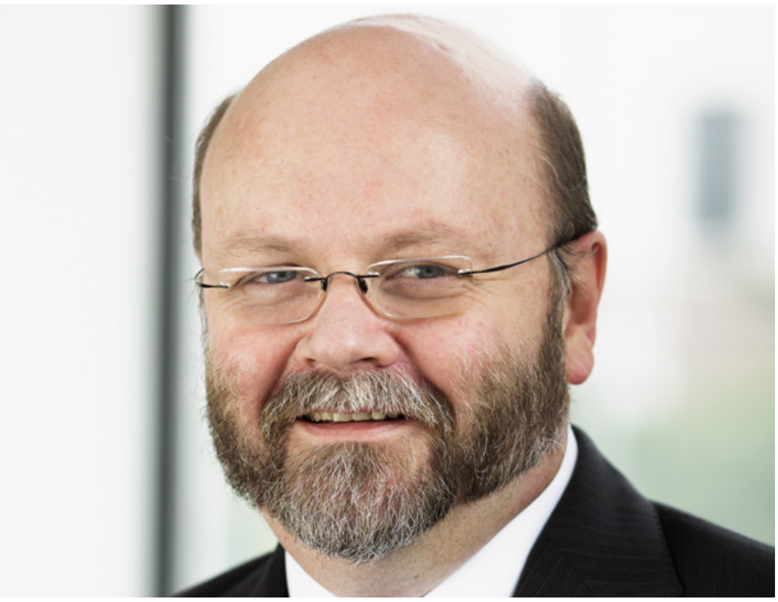
“WE REPORTED ON THE INCEPTION OF THIS PROJECT THREE YEARS AGO AND WE’VE KEPT AN EYE ON ITS DEVELOPMENTS EVER SINCE, IN THE STRONG BELIEF THAT THE CONCEPTUAL FRAMEWORK IS A FUNDAMENTAL DOCUMENT THAT WILL SHAPE OUR PROFESSION FOR THE FORESEEABLE FUTURE.”



Darrel Scott became a member of the IASB in October 2010, having previously been a member of the IASB's IFRS Interpretations Committee (IFRIC) and a member of the IFRS Foundation's Standards Advisory Council (SAC), now called the IFRS Advisory Council.

Prior to joining the IASB, Mr Scott was Chief Financial Officer of the FirstRand Banking Group, one of the largest financial institutions in South Africa. He had responsibility for both financial and regulatory reporting under respectively IFRS and the Basel II Accords. He is chairman of the IASB's SME Implementation Group.

A CONVERSATION WITH DARREL SCOTT ON THE CONCEPTUAL FRAMEWORK EXPOSURE DRAFT

by Marco Mongiello, Editor

In December 2012, we reported on the resumed Conceptual Framework project, in an interview with Stephen Cooper. Three years on, the project is moving toward a successful conclusion, with the comment period on its Exposure Draft closing in November of this year and the new Conceptual Framework expected to be published late next year. It seems, therefore, that this is the right time to touch base on the project and how it will affect accounting and reporting in the foreseeable future.

To this end, I had the privilege to meet Darrel Scott, member of the IASB, who shared his personal views on the Conceptual Framework project. Upon acknowledging that a sensitive and critical point raised by the previous article concerned the IASB's outreach in this project, Darrel starts off our conversation explaining that the project has attracted global interest. Darrel mentioned that the responses to the Conceptual Framework Discussion Paper included in excess of 220 comments letters and 140 meetings with IASB members and staff. Both letters and meetings were cross-national and cross-sector. It is also expected that the comments on the Exposure Draft currently published will create the same level of interest.

What is the reason for such a wide-spread interest in this project?

Even though it doesn't feel like the Conceptual Framework will affect preparers and users on a day-to-day basis, they know that it is going to influence decisions in accounting and reporting from now on. There are difficult debates to be had, of course, but even these contribute to a greater level of interest in the project. One of these difficult debates concerns the different views about what the Conceptual Framework should be. Some think that it should be an aspirational document, and by that I mean a document about where we would want the Standards to be if we were living in a perfect world. Others have the view that the document should prioritise real decisions the Board will have to make. A simple example of where the two approaches diverge is 'measurement': some believe that the IASB should aspire to a single measurement basis (usually 'fair value'). In practice, preparers and users often feel uncomfortable with applying 'fair value' in all circumstances, because in their view, it requires a greater level of judgement, does not always provide certainty and in many situations may not provide more relevant information. The Conceptual Framework Exposure Draft accepts the need for a mixed measurement approach and provides a framework for the decisions we will need to make in choosing which measurement base to use in any given circumstance. This is indicative of the Board's general view for the Conceptual Framework – we want it to be a practical tool that is useful to the Board when setting Standards, rather than a more aspirational document that the IASB may often choose to ignore.

Is this linked to the concept of 'prudence' that is reintroduced in the Exposure Draft?

Prudence came back into the picture for a different reason. The Exposure Draft, and the Discussion Paper before that, emphasise that information should be neutral and unbiased. We believe that prudence has a role to play in helping to make financial information neutral and unbiased – the meaning we give to the word is essentially "be more careful with your assessments when you are dealing with uncertainty". A concern we have heard though is that this is not a definition most people share, as they read 'prudence' as 'being conservative'. One of the reasons why the word 'prudence' is misinterpreted is that it is a loaded word with a long history in accounting. I suspect we may spend quite a bit of time in expressing our principle of prudence while trying not to use the word 'prudence'!

Will prudence affect the application of existing Standards?

Yes, it will. Prudence as we suggest articulating it applies to every instance where an entity is assessing a requirement of IFRS under conditions of uncertainty. That suggests it will have an effect on any existing standard where this type of assessment is required. In addition, some also think it will affect the way the Board sets standards. A good example of how some would think about this latter effect is IFRS 15 *Revenue from Contracts with Customers*, which in general, requires measurement of revenue as the amount you expect to receive. However, the standard also requires that where there is a significant chance that that amount will reverse, you should not record anything until the uncertainty has been resolved. This is caution in the face of uncertainty and some see this as the consequence of applying prudence.

So with all these changes, should we expect even bulkier annual reports?

I hope not. When we set out on the Conceptual Framework project, we expected to touch on presentation and even perhaps disclosure themes. We decided early on though that disclosure should become a project in its own right. Historically, disclosures are often done on a check-list basis. When the IASB set out its required disclosures, preparers often present exactly those items, without questioning if the information they provide is actually relevant. This can have the consequence that preparers include information that is not relevant, while sometimes excluding information that is relevant. So, our disclosure project sets out to provide a set of principles we think preparers should think about. The question we want preparers to ask is: 'does this disclosure help the users of the accounts to understand more about my business?' And we go a step further: not only should preparers critically consider the list of items we provide, but if there are further ones that we have not thought about, preparers should report them.

A second aspect of the project is that we encourage preparers to think of the financial statements as communication documents. This is a way for them to communicate with their users. Currently, companies often organise their financials based on historical reasons; which is why you'll find notes following no particular order. This project will encourage preparers to think about the relevance of information and how to effectively communicate that information. The path we are heading down suggests we are not going to dictate a certain format, because we do not want to interfere with preparers' ability to communicate.

A third aspect is a re-focus on 'materiality', which has over time become very quantitatively expressed, e.g. more than 5% of assets or more than 1% of income. This was never the intention. Materiality is about considering information that influences the decision making of users of the financial statements. We are in the process of issuing non-mandatory guidance which we hope will help stakeholders better understand how to apply materiality.

This complements an important amendment we issued last year to IAS 1 *Presentation of Financial Statements*, which makes it clear that companies do not need to disclose information that is not material even where it is required by specific standards.

A lot of the discussions we have had under the disclosure project are about emphasising existing IFRS rather than re-writing it. We are already getting some feedback that this has started to put a bit of 'creative juice' in companies' processes. We may not have seen any material changes in the financial statements as yet, but hopefully they will come.

Preparers and auditors need guidance, though, to apply the principles and respectively produce and inspect the financial statements.

That's a great point. By taking away the check-list we remove the unnecessary disclosure, but we immediately elevate the level at which disclosure decisions are made. It is not about ticking the box, but rather about making judgement calls. This cannot be done by the most junior accountant or auditor, but will not require the most senior either.

I would imagine that operating accountants and auditors will first have to sit with the company's senior management and explore the most important events and decisions that happened in the company, and how to disclose them. Then a judgement will have to be taken on each element of reporting, to see if it is really material. That said, judgement will be more on an exceptional basis; having gone through the check-list, what are the things that have to come out?

This sounds consistent with the new emphasis given to the concept of company's stewardship in the Conceptual Framework Exposure Draft.

Yes, financial statements are there to provide information that is useful to users when making decisions about whether to provide resources to an entity. As part of this, users will need to evaluate the entity's prospects for future cash flows and how effective management has been at managing assets in the past, because that would provide an indication of how effective it will be in the future. Better management manages the same assets better. Giving more prominence to the notion of stewardship acknowledges the fact that one cannot make resource allocation decisions without understanding how management is likely to manage assets in the future.

This has to do with a company's corporate governance, too...

From our perspective, 'stewardship' is about 'how well managers have managed assets in the past, in order to give the user information about how they are likely to manage those assets in the future'. It isn't our intention that 'stewardship' should address corporate governance considerations per se. However, I do think this complements corporate governance thinking, even if this was not what we set out to do. We restrict our considerations to financial reporting, but we do engage with the International Integrated Reporting Council (IIRC) and other authorities.[1]

[1]EDITOR'S NOTE: SEE ARTICLE ON IIRC IN APRIL 2015

You mentioned the importance of presentation of statements in the Conceptual Framework project. Is this going to impact the use of the Statement of Other Comprehensive Income(OCI)?

OCI has proved to be useful in the past when setting standards, but we are also aware that we perhaps haven't been clear enough about when and how it is used and consequently it is misunderstood by many, including users and preparers. We have found it challenging to articulate what we are trying to achieve with OCI. The principle in the Conceptual Framework is that income and expenses should always go to the statement of profit or loss. Profit or loss is clearly considered the primary source of information about performance of an entity. Some movements in the balance sheet are not perceived by some as performance and so, it is argued, should not affect the P&L.

A simple example is a car manufacturer with a single factory. It makes money producing and selling cars, it doesn't make money selling its factory, and probably wouldn't be able to continue in business if it did sell it. The current value of the factory may be decision-useful but reporting changes in that value as performance seems, to many, to distort the evaluation of the actual performance. It is that dividing line that we have tried to articulate with the Conceptual Framework: we think P&L should be about performance and if something does not help in understanding performance of the entity, there may be a reason for putting it into the OCI. We think that there are very few circumstances when this might be the case and the Conceptual Framework sets out to limit the use of OCI. From the outreach I've done, I believe people are comfortable with the overall idea of performance, but are uncomfortable with us not defining what we mean by the term.

I am sure that the greater stability that the Conceptual Framework is bringing will be greatly appreciated. Preparers and users may be concerned about possible further changes to the Framework, though.

The Conceptual Framework should be a very stable document. We are likely to revisit the distinction between equity and liability[2] in the medium term, but apart from that, I would expect it to be relatively stable for at least ten to 15 years. Although individual standards do sometimes contradict the Conceptual Framework, the Framework still plays a significant role in keeping the body of IFRS standards consistent, and that can only be achieved if the framework is stable.

Editor: Never have I seen the principles of accounting coming to life as in this conversation. I realised that they are indeed the DNA of accounting and ensure that financial statements are informative and useful documents. One could argue that the Conceptual Framework was long due... the positive aspect is that it is now within reach of becoming the ontological core of international accounting. Quite a historical moment for us accountants!

[2] EDITOR'S NOTE: SEE NEXT ARTICLE IN THIS ISSUE.

LIABILITY OR EQUITY? – CLASSIFICATION UNDER IAS 32

By Anja Guenther and Anna Irrgang, RSM Germany

Basic classification principles

To give a true and fair view of an entity's financial results and position, it is necessary to classify all financing arrangements in equity or debt – based on the true substance of the arrangements. The classification as either a financial liability or as equity is important as it has a direct effect on an entity's reported results and financial position. A liability classification typically results in any payments on the instrument being treated as interest and charged to earnings – directly affecting the entity's ability to pay dividends to its shareholders. An equity classification avoids this negative impact on profit – any consideration received is added directly to equity while any consideration paid is deducted directly from equity. It also results in the instrument being outside of the scope of IAS 39, thus avoiding the complicated ongoing measurement requirements of that standard.

IAS 32 *Financial Instruments: Presentation* not only contains the accounting requirements for the presentation of financial instruments [for scope exceptions refer to IAS 32.4], particularly the classification of such instruments into financial assets, financial liabilities and equity instruments – it also provides guidance on the classification of related interests, dividends and gains and losses as well as the offsetting of financial assets and financial liabilities.

IAS 32.11 defines a financial instrument as "any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity". The issuer shall classify the instrument (or if necessary its component parts) on initial recognition as either a financial liability or equity instrument. According to IAS 32.15, the substance of the contractual arrangement and its definition rather than its legal form, governs its classification in the entity's statement of financial position (substance over form principle).

The instrument is an equity instrument if the following requirements are fulfilled:

- The instrument includes no contractual obligation (IAS 32.16 (a)):
  - To deliver cash or another financial asset to another entity; or
  - To exchange financial assets or liabilities with another entity under conditions that are potentially unfavourable to the issuer.
- If the instrument will or may be settled in the issuer's own equity instruments, it is (IAS 32.16 (b)):
  - A non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or
  - A derivative that will be settled by the issuer exchanging a fixed amount (of cash/ financial assets) for a fixed number of its own equity instruments.

Contractual obligation to deliver cash or another financial asset

The existence of a contractual obligation is affirmed even in cases where it is only indirectly established through its terms and conditions (IAS 32.20), where the entity does not have an unconditional right to avoid delivering cash or another financial asset to settle (with few exceptions), where the entity has no ability to satisfy the contractual obligations (IAS 32.19(a)) or where contingent settlement provisions exist that depend on the (non-) occurrence of uncertain future events that are beyond the control of the issuer and the holder of the instrument, unless not genuine or only settled in the event of liquidation of the issuer (IAS 32.25).

The following example illustrates the existence of a contractual obligation based on an indirect obligation to pay dividends:

Entity A issues a financial instrument containing the condition that A has to transfer a property to the holders of the instrument if A fails to make the dividend payments on the instrument.

Although there is no direct contractual obligation to pay the dividends, the entity is indirectly obliged. If the entity can avoid a transfer of cash or another financial asset only by settling the non-financial obligation, the instrument is classified as a financial liability (see IAS 32.20(a)).

Another example shows the effects of redeemable shares:

Entity A issues 1,000 shares with a par value of 100 CU (Currency Unit). The holder of the shares has the option to require A to redeem the shares at par at any given time.

These shares are classified as financial liability. The entity has no ability to avoid the obligation to redeem the shares for cash when the holder exercises the option. If only entity A had the option to redeem the shares, these would have been classified as equity.

Instruments settled in an entity's own equity instruments

Certain conditions need to be fulfilled to classify an instrument as equity if the instrument will or may be settled in the issuer's own equity instruments (IAS 32.16 (b)). The standard distinguishes between 'non-derivatives' and 'derivatives'.

Non-derivative settleable

Apply the 'fixed test'

Derivatives settleable

Apply the 'fixed for fixed test'

The following examples demonstrate the requirements and differences:

'Fixed-test' for non-derivatives

Entity A issues a non-interest bearing bond amounting to 5,000 CU that will be settled by delivering a fixed number of its own equity instruments (e.g. 20 shares).

Alternative: Settlement will be by delivering shares to the fixed value of 5,500 CU.

The instrument is classified as equity due to the number of shares to be delivered having been fixed upfront. According to the alternative, the entity uses its own shares as a currency, and therefore the financial instrument is classified as a financial liability (variable number of equity instruments).

'Fixed for fixed test' for derivatives

Entity A issues a share option that gives the counterparty the right to buy a fixed number of the entity's shares for a fixed amount of cash.

The instrument is classified as equity due to the fixed number of its own shares for a fixed amount of cash. The option fails the test when it is agreed over a variable number of shares for a fixed price. In those cases, the option will be accounted for as a derivative in accordance with IAS 39.

Concerning what exactly is a 'fixed' amount of cash in relation to a foreign currency due to the possibility of exchange rate fluctuations, the Standard clarifies that an issue of rights, options and warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments, if and only if the entity offers the rights pro rata to all of its existing shareholders. To this day, no broader amendment to IAS 32 has been made so that, for classification purposes only, a fixed amount of foreign currency would be treated as a fixed amount of cash.

Accordingly, a derivative contract which involves an entity delivering a fixed number of its own equity instruments in exchange for a fixed amount of foreign currency fails the 'fixed for fixed' test and will be classified as a liability.

Compound financial instruments

Compound instruments are those non-derivative instruments that possess both equity and liability characteristics. In order to recognise the substance of such instruments, IAS 32.28 requires the issuer to separate the equity and liability components on initial recognition – a process sometimes referred to as 'split accounting'. In practice, this is done by first determining the fair value of the instrument as a whole as well as the fair value of the liability component. The equity component is then determined as the difference between the two fair values, as demonstrated in the following example:

Entity A issues 1,000 convertible bonds at par value of 2,000 CU each. The bonds have a three year term and an interest rate of 5% that is paid annually in arrears. The bonds are convertible at the option of the holder, at any time until maturity, at a rate of 250 ordinary shares per bond. The current market interest rate of similar bonds without the conversion feature is 8% per annum.

- Present value of principal payable at the end of three years: 1,587,664*
- Present value of interest payable for three years: 257,710**
- **Total liability component as of issuing date: 1,845,374**
- Proceeds of issue: 2,000,000
- Residual – equity component: 154,626

* 2m discounted at 8% for three years
** 100,000 discounted at 8% for each of the three years

It is a common misconception that a convertible bond is always a compound financial instrument. In fact, a convertible bond will only qualify as a compound instrument where the component relating to conversion satisfies the requirements of the 'fixed for fixed' test.

On the date of conversion, the carrying amount of the liability is reclassified to equity. If the entity changes the terms of the conversion to induce an early conversion (prior to maturity), IAS 32.AG32 et seq. provides additional guidance and the difference between the fair value of the share compensation is recognised as a loss in profit or loss.

Puttable instruments/obligations arising on liquidation

Exceptional classification guidelines exist for the following instruments:

- Puttable financial instruments (IAS 32.16A f.)
- Instruments imposing an obligation to deliver a pro rata share of the net assets only in liquidation (IAS 32.16C f.)

These exceptions to the basic principles set out in IAS 32 were introduced in 2008, to address the problem that some partnerships or co-operatives showed no equity, as the issued shares (holder receiving an equity-like return) allow the holder to redeem the instrument for cash. Applying the aforementioned basic principles to the financial instruments of partnerships and co-operatives may result in a classification as liability and therefore resulting in no equity. The exceptions contain a set of criteria leading, if criteria are fulfilled, to an equity classification of the instruments that would otherwise be classified as a liability.

Outlook

IAS 32 remains one of the most complex standards. The classification by an issuer of financial instruments requires an economic analysis of the contractual obligations. The identification of substance is often challenging and may result in a classification differing from the desired legal form. The classification of issued financial instruments is very important to preparers and users as it has a direct effect on the entity's financial results and position, and therefore on covenants, ratings, etc.

As a response to criticisms that IAS 32 was both difficult to apply and can result in inappropriate classification of some financial instruments, the "Financial Instruments with Characteristics of Equity" project was identified as one of the priority research projects and reactivated by the IASB in 2012 focusing on classification difficulties under the current requirements.

The time has come for our annual rendezvous to take stock of the latest developments in IFRS financial reporting requirements. This article provides a high level overview of new and amended standards and interpretations that need to be considered for financial reporting periods ending on 31 December 2015, with the objective of highlighting key aspects of these changes.[3]

IFRS KEY CONSIDERATIONS FOR CLOSING OUT 2015

by Joelle Moughanni, RSM

Pronouncements mandatory for the first time in closing out 2015 year-end accounts[4]
Amendment to IAS 16 – Revaluation method: proportionate restatement of accumulated depreciation
The amendment clarifies how the gross carrying amount and the accumulated depreciation are treated where an entity uses the revaluation model.
Amendments to IAS 19 – Defined benefit plans: employee contributions
The amendments clarify the requirements that relate to how contributions from employees or third parties that are linked to service should be attributed to periods of service. In particular, contributions that are independent of the number of years of service (e.g. contributions that are a fixed percentage of the employee's salary, a fixed amount throughout the service period or dependent on the employee's age) can be recognised as a reduction in the service cost in the period in which the related service is rendered, instead of attributing them to the periods of service.
Amendment to IAS 24 – Key management personnel
The amendment clarifies how payments to entities providing management services are to be disclosed.
Amendment to IAS 38 – Revaluation method: proportionate restatement of accumulated amortisation
The amendment clarifies how the gross carrying amount and the accumulated amortisation are treated where an entity uses the revaluation model.
Amendment to IAS 40 – Clarifying the interrelationship with IFRS 3 when classifying property
The amendment clarifies the application of IFRS 3 and IAS 40 in respect of acquisitions of investment property. IAS 40 assists preparers to distinguish between investment property and owner-occupied property, then IFRS 3 helps them to determine whether the acquisition of an investment property is a business combination.
Amendment to IFRS 3 – Scope exceptions for joint ventures
The amendment clarifies that IFRS 3 excludes from its scope the accounting for the formation of any joint arrangement in the financial statements of the joint arrangement itself.
Amendments to IFRS 8 – Aggregation and reconciliation
The amendments require disclosure of the judgements made by management in applying the aggregation criteria to operating segments, and clarify that reconciliations of the total of the reportable segments' assets to the entity's assets are required only if the segment assets are reported regularly.
Amendment to IFRS 13 – Scope of paragraph 52 (portfolio exception)
The amendment clarifies that the portfolio exception in IFRS 13 which allows an entity to measure the fair value of a group of financial assets and financial liabilities on a net basis applies to all contracts (including non-financial) within the scope of IAS 39/ IFRS 9.

[3] This article reflects pronouncements issued up to 30 September 2015. When entities prepare financial statements for the year ending 31 December 2015, they should also consider and disclose the potential impact of the application of any new or amended standard or interpretation issued by the IASB before the financial statements are authorised for issue.

[4] Unless mentioned otherwise, all the new or amended pronouncements require retrospective application, sometimes with transitional provisions.

Pronouncements available for early application in closing out 2015 year-end accounts[5]
Amendments to IAS 1 – Disclosure initiative
The amendments – applicable to annual periods beginning on or after 1 January 2016 – clarify guidance on materiality and aggregation, the presentation of subtotals, the structure of financial statements and the disclosure of accounting policies.
Amendments to IAS 16 – Clarification of acceptable methods of depreciation
The amendments – applicable prospectively to annual periods beginning on or after 1 January 2016 – add guidance and clarify that the use of revenue-based methods to calculate the depreciation of an asset is not appropriate because revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits embodied in the asset.
Amendments to IAS 16 and IAS 41 – Agriculture: bearer plants
The amendments – applicable to annual periods beginning on or after 1 January 2016 – define bearer plants as living plants which are used solely to grow produce over several periods and usually scrapped at the end of their productive lives (e.g. grape vines, rubber trees, oil palms), and include them within IAS 16's scope while the produce growing on bearer plants remains within the scope of IAS 41.
Amendment to IAS 19 – Discount rate: regional market issue
The amendment – applicable to annual periods beginning on or after 1 January 2016 – clarifies that the high quality corporate bonds used in estimating the discount rate for post-employment benefits should be denominated in the same currency as the benefits to be paid.
Amendments to IAS 27 – Equity method in separate financial statements
The amendments – applicable to annual periods beginning on or after 1 January 2016 – reinstate the equity method option allowing entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements.
Amendment to IAS 34 – Disclosure of information 'elsewhere in the interim financial report'
The amendment – applicable to annual periods beginning on or after 1 January 2016 – clarifies what is meant by the reference in the standard to 'information disclosed elsewhere in the interim financial report', and requires a cross-reference from the interim financial statements to the location of that information.
Amendments to IAS 38 – Clarification of acceptable methods of amortisation
The amendments – applicable prospectively to annual periods beginning on or after 1 January 2016 – add guidance and clarify that revenue is generally presumed to be an inappropriate basis for measuring the consumption of the economic benefits embodied in an intangible asset; however, this presumption can be rebutted in certain limited circumstances.
Amendments to IFRS 5 – Changes in methods of disposal
The amendments – applicable prospectively to annual periods beginning on or after 1 January 2016 – add specific guidance when an entity reclassifies an asset (or a disposal group) from held for sale to held for distribution to owners, or vice versa, and for cases where held-for-distribution accounting is discontinued.
Amendments to IFRS 7 – Servicing contracts
The amendments – applicable to annual periods beginning on or after 1 January 2016 – add guidance to clarify whether a servicing contract is continuing involvement in a transferred asset.

[5] Unless mentioned otherwise, all the new or amended pronouncements require retrospective application, sometimes with transitional provisions.

IFRS 9 – Financial Instruments

This standard will replace IAS 39 (and all the previous versions of IFRS 9) effective for annual periods beginning on or after 1 January 2018. It contains requirements for the classification and measurement of financial assets and financial liabilities, impairment, hedge accounting and derecognition.

- IFRS 9 requires all recognised financial assets to be subsequently measured at amortised cost or fair value (through profit or loss or through other comprehensive income), depending on their classification by reference to the business model within which they are held and their contractual cash flow characteristics. Specifically, debt investments that are held within a business model whose objective is to collect the contractual cash flows and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortised cost at the end of each accounting period. All other debt investments and equity investments are measured at their fair value at the end of each accounting period.
- For financial liabilities, the most significant effect of IFRS 9 relates to cases where the fair value option is applied: the amount of change in fair value of a financial liability designated as at fair value through profit or loss that is attributable to changes in the credit risk of that liability (the 'own credit risk') is recognised in other comprehensive income (with no subsequent reclassification to profit or loss), unless this creates an accounting mismatch.
- For the impairment of financial assets, IFRS 9 introduces an 'expected credit loss' model based on the concept of providing for expected losses at inception of a contract; it is no longer necessary for a credit event to have occurred before a credit loss is recognised.
- For hedge accounting, IFRS 9 introduces a substantial overhaul allowing financial statements to better reflect how risk management activities are undertaken when hedging financial and non-financial risk exposures. Key changes from the IAS 39 model include increased eligibility of hedged items and of hedging instruments, more flexibility in demonstrating a hedging relationship such as removal of quantitative thresholds for hedge effectiveness, and expanded disclosures.
- The derecognition provisions are carried over almost unchanged from IAS 39.

Amendments to IFRS 10 and IAS 28 – Sale or contribution of assets between an investor and its associate or joint venture

The amendments – applicable prospectively to annual periods beginning on or after 1 January 2016 – address a current conflict between the two standards and clarify that the gain or loss should be recognised fully when the transaction involves a business, and partially if it involves assets that do not constitute a business.

Amendments to IFRS 10, IFRS 12 and IAS 28 – Investment entities: applying the consolidation exception

The amendments – applicable to annual periods beginning on or after 1 January 2016 – clarify the application of the consolidation exception for investment entities and their subsidiaries.

Amendments to IFRS 11 – Accounting for acquisitions of interests in joint operations

The amendments – applicable prospectively to annual periods beginning on or after 1 January 2016 – require an acquirer of an interest in a joint operation in which the activity constitutes a business (as defined in IFRS 3) to apply all of the business combinations accounting principles and disclosure in IFRS 3 and other IFRSs, except for those principles that conflict with the guidance in IFRS 11. The amendments apply both to the initial acquisition of an interest in joint operation, and the acquisition of an additional interest in a joint operation (in the latter case, previously held interests are not remeasured).

IFRS 14 – Regulatory Deferral Accounts

This interim optional standard – pending the outcome of the IASB's comprehensive project on rate-regulated activities – is applicable to annual periods beginning on or after 1 January 2016 and only by first-time adopters of IFRSs who apply IFRS 1 and conduct rate-regulated activities. Entities in the standard's scope are permitted to continue to account, with some limited changes, for regulatory deferral accounts in accordance with their previous GAAP, both on initial adoption of IFRS and in subsequent financial statements.

IFRS 15 – Revenue from Contracts with Customers

The new standard – effective for annual periods beginning on or after 1 January 2018[6] – replaces IAS 11, IAS 18 and their interpretations (SIC-31 and IFRIC 13, 15 and 18). It establishes a single and comprehensive framework for revenue recognition to apply consistently across transactions, industries and capital markets, with a core principle (based on a five-step model to be applied to all contracts with customers), enhanced disclosures, and new or improved guidance (e.g. the point at which revenue is recognised, accounting for variable consideration, costs of fulfilling and obtaining a contract, etc.).

[6] The IASB issued on 11 September 2015 an amendment deferring by one year the effective date of the new revenue Standard (initially set to 1 January 2017).

WE COMMENTED ON IASB'S RECENT PROPOSALS FOR:

DEFERRAL OF EFFECTIVE DATE OF IFRS 15

What is the current status of the project?

The Exposure Draft ED/2015/2 Effective Date of IFRS 15 *(Proposed amendments to IFRS 15)* ("the ED"), issued on 19 May 2015, aims at deferring the effective date of IFRS 15 *Revenue from Contracts with Customers* by one year, i.e. to annual periods beginning on or after 1 January 2018 (early application would continue to be permitted), mainly because of a subsequent Exposure Draft of targeted amendments to IFRS 15 – ED/2015/6 issued on 30 July 2015 – which clarifies some of its requirements and adds illustrative examples to aid implementation. Comments on the ED were requested by 3 July 2015.

On 22 July 2015, the IASB confirmed the one-year deferral of the effective date of the new revenue Standard – still to be issued formally as an amendment to IFRS 15 – thus giving entities more time to implement it in view of the forthcoming clarifications, and keeping the effective date aligned with US GAAP.

What did RSM say on the ED?

We supported the proposal to defer the mandatory effective date of IFRS 15 so that entities would be required to apply the Standard for annual periods beginning on or after 1 January 2018, rather than being required to apply it for annual periods beginning on or after 1 January 2017, with early application still permitted.

We were of the opinion that a one-year deferral would improve the quality of implementation, particularly when entities have to make pervasive changes to their information systems (the delay in the publication of the Standard having absorbed some of the implementation time the entities were expecting to have). Also, this additional time would allow entities to take into account upon implementation the forthcoming amendments and clarifications to the Standard as planned by the Board. In addition, in a context where the FASB is also proposing to postpone the effective date of Accounting Standards Update No. 2014-09 *Revenue from Contracts with Customers* (Topic 606), we encourage retaining an aligned effective date in order to maintain comparability between entities applying IFRS or US GAAP.

VIEW THE FULL COMMENT LETTER HERE

WE COMMENTED ON IASB'S RECENT PROPOSALS FOR:

AMENDMENTS TO CLASSIFICATION OF LIABILITIES IN IAS 1

What is the current status of the project?

The Exposure Draft ED/2015/1 *Classification of Liabilities (Proposed amendments to IAS 1)* ("the ED"), issued on 10 February 2015, aims at clarifying the criteria for classification of a liability in an entity's financial statements as either current or non-current. In particular, classification should be based on the entity's rights that are in existence at the end of the reporting period. Comments on the ED were requested by 10 June 2015.

What did RSM say on the ED?

Overall, we agreed with the IASB's objective to clarify the existing classification principles for liabilities in IAS 1 by removing inconsistencies in the terms used and making it explicit that only rights in existence at the reporting date should affect the classification. The proposed amendments are thus likely to result in greater consistency in practice when classifying liabilities as either current or non-current.

However, we were concerned that the current drafting might lead to unintended contradictory outcomes. For example, in a situation where a liability can be settled, at the option of the lender, either in cash in five years or by transferring a variable number of the entity's equity instruments within twelve months, it is unclear how the following two requirements would interact:

(a) current unchanged guidance in IAS 1.69(d), which stipulates that 'terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification'; and

(b) the proposed additional wording in IAS 1.69 which states that 'for the purposes of classification as current or non-current, settlement of a liability refers to the transfer to the counterparty of cash, equity instruments, other assets or services that results in the extinguishment of the liability'.

Under (a) above, the liability would be classified as non-current (the option to settle in shares being disregarded for classification purposes), whereas it would be regarded as current under (b) since the entity does not have a right to defer settlement of the liability for at least twelve months after the reporting period (if the holder exercises the option).

Therefore, we recommended that the last sentence of paragraph 69(d) 'Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification' be deleted.

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WE FOCUSED ON:

DISTINGUISHING A BUSINESS COMBINATION FROM AN ASSET ACQUISITION

What is the issue?

Company ABC recently received regulatory approval for a highly specialised device. ABC has not yet started selling the device but has already contracted with a third party to manufacture it. ABC employs research and development, regulatory and sales personnel who are focused on the approved device.

Company XYZ purchases the approved intellectual property related to the device from ABC and also assumes the manufacturing agreement with the third party, but does not hire any people from ABC because it already has its own sales force and management team.

XYZ is seeking advice for determining whether the acquisition should be accounted for as a business combination or an asset acquisition, as well as understanding how significantly the accounting for a business combination varies from the accounting for an asset acquisition.

What is the proposed solution?

Based on the facts above, Company XYZ most likely acquired a business. This is because it purchased the inputs in the form of the intellectual property rights to an approved highly specialised device. Such rights inherently include a process for replicating the device design. XYZ is not acquiring a manufacturing facility, but it assumed the third party manufacturing agreement, which gives it the process needed to manufacture the device. Although it did not hire any of ABC's employees, XYZ and other market participants in the highly specialised device sector have existing workforces with the technical, regulatory and sales and marketing capabilities necessary to produce and sell outputs from the acquired rights to the device.

In fact, arrangements that on the surface appear to convey only assets – such as this acquisition of intellectual property – include other elements that, for accounting purposes, may mean they meet the definition of a business.

To assist XYZ in determining whether it has acquired a business, it is helpful to consider the definition of a business provided by IFRS 3 Business Combinations:

"A business is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants. A business consists of inputs and processes applied to those inputs that have the ability to create outputs. Although businesses usually have outputs, outputs are not required for an integrated set to qualify as a business. However, a business need not include all of the inputs or processes that the seller used in operating that business if market participants are capable of acquiring the business and continuing to produce outputs, for example, by integrating the business with their own inputs and processes."

The table on the following page highlights the most common accounting differences between a business combination and an asset acquisition under IFRS.

DIFFERENCE	BUSINESS COMBINATION (IFRS 3)	ASSET ACQUISITION (OTHER IFRSS)
Intangible assets and goodwill	▪ Intangibles are recognised at fair value if they meet the identifiable criteria. ▪ Goodwill is recognised as a separate asset.	· Only other intangibles are recognised, not goodwill. · Any excess consideration transferred over the fair value of the net assets acquired is reallocated to the identifiable assets based on their relative fair value.
Contingent consideration	· Recognised at acquisition-date fair value. · Subsequent measurement at fair value (except equity); changes in fair value are recorded through profit or loss.	Recognised when probable and reasonably estimable.
Acquired contingencies	If fair value is determinable, recognised at fair value at acquisition date or during the measurement period; otherwise, recognised when probable and reasonably estimable.	Recognised only if probable and reasonably estimable.
Deferred taxes	Deferred tax recognised on temporary differences relating to assets acquired and liabilities assumed with an offsetting entry to goodwill.	Initial recognition exemption applies and recognition of deferred tax is unlikely.
Transaction costs	Expensed as incurred.	Intangible assets and goodwill.

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