

# A practical guide to new IFRSs for 2009

December 2008



IFRS technical publications



**IFRS manual of accounting 2009**

PwC's global IFRS manual provides comprehensive practical guidance on how to prepare financial statements in accordance with IFRS. Includes hundreds of worked examples, extracts from company reports and model financial statements.



**A practical guide to new IFRSs for 2009**

40-page guide providing high-level outline of the key requirements of new IFRSs effective in 2009, in question and answer format.



**A practical guide to capitalisation of borrowing costs**

Guidance in question and answer format addressing the challenges of applying IAS 23R, including how to treat specific versus general borrowings, when to start capitalisation and whether the scope exemptions are mandatory or optional.



**A practical guide to segment reporting**

Provides an overview of the key requirements of IFRS 8, 'Operating Segments' and some points to consider as entities prepare for the application of this standard for the first time. Includes a question and answer section. Also available: Eight-page flyer on high level management issues.



**A practical guide to share-based payments**

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High-level summary of the revised financial instruments standards issued in December 2003, updated to reflect IFRS 7 in September 2006. For existing IFRS preparers and first-time adopters.



**Financial reporting in hyperinflationary economies – understanding IAS 29**

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**IAS 39 – Achieving hedge accounting in practice**

Covers in detail the practical issues in achieving hedge accounting under IAS 39. It provides answers to frequently asked questions and step-by-step illustrations of how to apply common hedging strategies.



**IAS 39 – Derecognition of financial assets in practice**

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Guide aimed at finance directors, financial controllers and deal-makers, providing background to the standard, impact on the financial statements and controls, and summary differences with US GAAP.



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Outlines the disclosures required by all IFRSs published up to October 2008.



**IFRS for SMEs (proposals) – pocket guide 2007**

Provides a summary of the recognition and measurement requirements in the proposed 'IFRS for Small and Medium-Sized Entities' published by the International Accounting Standards Board in February 2007.



**IFRS pocket guide 2008**

Provides a summary of the IFRS recognition and measurement requirements. Including currencies, assets, liabilities, equity, income, expenses, business combinations and interim financial statements.



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**Illustrative interim financial information for existing preparers**

Illustrative information, prepared in accordance with IAS 34, for a fictional existing IFRS preparer. Includes a disclosure checklist and IAS 34 application guidance. Reflects standards issued up to 31 March 2008.



**Illustrative consolidated financial statements**

- Banking, 2006
- Corporate, 2008
- Insurance, 2006
- Investment funds, 2008
- Investment property, 2008
- Private equity, 2008

Realistic sets of financial statements – for existing IFRS preparers in the above sectors – illustrating the required disclosure and presentation.



**Share-based payment – a practical guide to applying IFRS 2**

Assesses the impact of the new standard, looking at the requirements and providing a step-by-step illustration of how to account for share-based payment transactions. June 2004.



**SIC-12 and FIN 46R – The substance of control**

Helps those working with special purpose entities to identify the differences between US GAAP and IFRS in this area, including examples of transactions and structures that may be impacted by the guidance.



**Understanding financial instruments – A guide to IAS 32, IAS 39 and IFRS 7**

Comprehensive guidance on all aspects of the requirements for financial instruments accounting. Detailed explanations illustrated through worked examples and extracts from company reports.



**Understanding new IFRSs for 2009 – A guide to IAS 1 (revised), IAS 27 (revised), IFRS 3 (revised) and IFRS 8**

Supplement to IFRS Manual of Accounting. Provides guidance on these new and revised standards that will come into force in 2009 and will help you decide whether to early adopt them. Chapters on the previous versions of these standards appear in the IFRS Manual (see above).

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# Introduction

This publication is a practical guide to the new IFRS standards and interpretations that come into effect in 2009. There has been little change to the body of IFRSs since European listed groups were required to apply the standards in 2005. This has been to allow for a period of 'bedding down'. Now this is over, the Board has issued a number of significant changes to take effect in 2009. It has published a number of new standards, interpretations and amendments to existing requirements arising from the 2008 annual improvements project.

The presentation of financial statements is overhauled by the revised IAS 1, 'Presentation of financial statements'. IAS 1R introduces a statement of comprehensive income with two optional formats and refers to the balance sheet and cash flow statement by different names: the 'statement of financial position' and 'statement of cash flows', respectively

The revised IAS 27, 'Consolidated and separate financial statements', and IFRS 3, 'Business combinations', have adopted a single consolidation model (the entity model). The revised standards introduce significant changes to the way in which consolidated financial statements are prepared. This has important implications for reported earnings pre- and post-acquisition and for the calculation of goodwill and non-controlling interests (the new name for minority interests); these can now be calculated using a full goodwill or a partial goodwill model. Management will need to consider the accounting for future business combinations carefully before structuring deals, as the way the transaction is undertaken could have a significant accounting impact.

The requirements concerning the disclosure of segmental information have been overhauled to bring them in line with US GAAP. The segments reported by many groups will change on adopting IFRS 8, 'Operating segments', as the standard adopts a 'through the eyes of management' approach. This requires disclosure of segment information that management uses to run the business. IFRS 8 also changes the level within the organisation at which impairment reviews are undertaken.

Other amendments and new requirements will impact some entities significantly. The revised IAS 23, 'Borrowing costs', now requires capitalisation of borrowing costs that finance the construction of qualifying assets, where previously there was a choice. The amendment to IFRS 1 and IAS 27 concerning the recognition of the cost of investment will help companies transitioning to IFRS. There are a number of technical changes relating to financial instruments, which need to be considered carefully, as some relax requirements and others restrict accounting treatments that have previously been acceptable. The change to IFRS 2, 'Share-based payment', narrows the definition of vesting conditions and will require restatement of many schemes when the standard is first adopted. IFRIC 15, 'Agreements for the construction of real estate', clarifies the contracts that will need to be accounted for in accordance with IAS 18, 'Revenue', and those that will need to apply IAS 11, 'Construction contracts'. This interpretation may have significant earnings implications, as the revenue recognition between the two standards can be quite different and will have wider implications than just for the real estate industry.

The IASB's 2008 improvements project has affected many of the standards. Some of the changes deal with inconsistency in terminology between the standards; others will impact certain entities and hence will need to be considered carefully.

The table below summarises the implementation dates for the new and amended IFRSs that are considered in more detail in the pages that follow.

Standard	Adopted by EU		Pg
<b>Changes apply from 1 October 2008</b>			
IFRIC 16, 'Hedges of a net investment in a foreign operation'		Early adoption is permitted.	38
<b>Changes apply from 1 January 2009</b>			
IAS 1 (revised), 'Presentation of financial statements'		Early adoption is permitted.	5
IFRS 8 'Operating segments'	✓	Early adoption is permitted.	20
IAS 23 (revised) 'Borrowing costs'		Prospective application, but can be adopted from a date before the effective date.	31
Amendment to IFRS 1 and IAS 27, 'Cost of an investment in a subsidiary, jointly controlled entity or associate'		Parts of the amendment can be applied early but possibly at different dates.	34
Amendments to IAS 32 and IAS 1, 'Puttable financial instruments and obligations arising on liquidation'		Early adoption is permitted.	37
Amendment to IFRS 2, 'Vesting conditions and cancellations'		Early adoption is permitted.	39
IFRIC 15, 'Agreements for the construction of real estate'		Early adoption is permitted.	41
Annual improvements – Part I			
IAS 1, 'Presentation of financial statements'		Early adoption is permitted.	47
IAS 16, 'Property plant and equipment'		Early adoption is permitted, but entities should also apply the related amendments in IAS 7, 'Statement of cash flows'.	45
IAS 19, 'Employee benefits'		With the exception of amendments to the guidance on curtailments and negative past services costs, which should be applied prospectively to any benefit changes occurring on or after 1 January 2009.	47
IAS 20, 'Government grants'		Prospective application to government loans received on or after 1 January 2009. Earlier application is permitted.	47
IAS 23, 'Borrowing costs'		Early adoption is permitted.	31
IAS 27, 'Consolidated and separate financial statements'		Prospective application from the date IFRS 5 was first applied. Early application permitted.	34
IAS 28, 'Investments in associates'		Early adoption is permitted, but entities should also apply the related amendments in IFRS 7, 'Statement of cash flows', and IAS 32, 'Financial instruments: Disclosure'.	46
IAS 31, 'Investments in joint ventures'		Early adoption is permitted, but entities should also apply the related amendments in IFRS7, 'Statement of cash flows', IAS 28, 'Investments in associates', and IAS 32, 'Financial instruments: Disclosure'.	46

Standard	Adopted by EU		Pg
<b>Changes apply from 1 January 2009</b>			
IAS 29, 'Financial reporting in hyperinflationary economies'		Early adoption is permitted.	46
IAS 36, 'Impairment of assets'		Early adoption is permitted.	46
IAS 38, 'Intangible assets'		Early adoption is permitted.	46
IAS 39, 'Financial instruments: Recognition and measurement'		Specifically, amendments to the guidance on fair value through profit or loss classification should be applied in the same manner as the 2005 fair value option amendment to IAS 39 was applied.	47
IAS 40, 'Investment property'		Prospectively from 1 January 2009. Earlier adoption only permitted if the relevant fair value information was determined at the earlier application date.	46
IAS 41, 'Agriculture'		Prospectively from 1 January 2009. Early adoption is permitted.	46
Annual improvements – Part II			
IFRS 7, IAS 8, IAS 10, IAS 18, IAS 20, IAS 34, IAS 40 and IAS 41		Amendments unlikely to affect the accounting treatment for most preparers.	48
<b>Changes apply from 1 July 2009</b>			
IAS 27 (revised), 'Consolidated and separate financial statements'		Early adoption is permitted. Cannot be adopted without IFRS 3 (revised).	8
IFRS 3 (revised), 'Business combinations'		Early adoption is permitted. Cannot be adopted without IAS 27 (revised).	8
Amendment to IAS 39, 'Eligible hedged items'		Early adoption is permitted.	36
Annual improvements – Part I			
IFRS 5, 'Non-current assets held for sales and discontinued operations'		Prospective application from the date IFRS 5 was first applied. Early application permitted if IAS 27 (as amended in May 2008) is also adopted.	45
IFRIC 17, 'Distributions of non-cash assets to owners'		Early adoption is permitted if IFRS 3 (revised), IAS 27 (revised) and IFRS 5 (amended) are also adopted.	43

# Presentation – IAS 1 (revised)

## Introduction

The IASB published IAS 1 (revised), 'Presentation of financial statements', in September 2007. The revision aims to improve users' ability to analyse and compare the information provided in financial statements.

IAS 1 (revised) requires, inter alia:

- Recognised income and expenses to be presented in a single statement (a statement of comprehensive income) or in two statements (an income statement and a statement of comprehensive income), separately from owner changes in equity. Components of other comprehensive income may not be presented in the statement of changes in equity. The statement of comprehensive income under the 'two-statement' approach is the same as the 'statement of recognised income and expense'. The statement of comprehensive income under the single statement approach is illustrated below; this example presents expenses by function, but entities may classify expenses by nature.
- Both the statement of comprehensive income and the statement of changes in equity to be included as primary statements (that is, they are components of a complete set of financial statements).
- The balance sheet to be referred to as the 'statement of financial position' and the cash flow statement is referred to as the 'statement of cash flows'.
- The components of other comprehensive income to be shown before tax, with the total tax on those components shown as a separate line item, as illustrated below, or net of tax. Whichever approach is adopted, entities are required to disclose the income tax related to each component of other comprehensive income either in the statement of comprehensive income or in the notes.
- Reclassification adjustments (that is, amounts reclassified to profit or loss in the current period that were recognised as other comprehensive income in previous periods) to be disclosed.
- Entities should present a statement of financial position (that is, a balance sheet) as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement or reclassifies items in the financial statements. Neither prior period adjustments nor restatements are illustrated in the financial statements below.

### Effective date

Annual reporting periods beginning on or after 1 January 2009. Earlier application is permitted, but local legal or regulatory requirements may restrict the ability of entities to early adopt.

### EU adoption status

Not adopted by the European Commission at the time of going to print.

The financial statements below show the presentation and additional disclosures that could be made on adopting IAS 1 (revised).

### Single statement, by function of expense

1(r)p81-83, 1(r)p103,1(r)p38 1p104		Note	Year ended 31 December	
			2008	2007
	<b>Continuing operations</b>			
1(r)p82(a)	Revenue	5	211,034	112,360
1(r)p103	Cost of sales		(77,366)	(46,682)
1(r)p103	<b>Gross profit</b>		<b>133,668</b>	65,678
1(r)p103	Distribution costs		(52,140)	(21,213)
1(r)p103	Administrative expenses		(28,778)	(10,426)
1(r)p103	Other income	26	1,900	1,259
1(r)p85	Other (losses)/gains – net	25	(90)	63
1(r)p85	Loss on expropriated land	27	(1,117)	–
1(r)p85	<b>Operating profit</b>		<b>53,443</b>	35,361
1(r)p85	Finance income	30	1,730	1,609
1(r)p82(b)	Finance costs	30	(8,173)	(12,197)
1(r)p85	Finance costs – net	30	(6,443)	(10,558)
1(r)p82(c)	Share of (loss)/profit of associates	8	(174)	145
1(r)p103	<b>Profit before income tax</b>		<b>46,826</b>	24,918
1(r)p82(d), 12p77	Income tax expense	31	(14,611)	(8,670)
1(r)p82(f)	Profit for the year from continuing operations		<b>32,215</b>	16,248
IFRS5p34, 12p81(b)	<b>Discontinued operations:</b>			
	Profit for the year from discontinued operations		<b>100</b>	120
1(r)p82(f)	<b>Profit for the year</b>		<b>32,315</b>	16,368
1(r)p82(g), 91(a)	<b>Other comprehensive income:</b>			
1(r)p82(g)	<b>Gains/losses recognised directly in equity</b>			
1(r)p82(g), 16p77(f)	Gains on revaluation of land and buildings	19	–	1,133
1(r)p82(g), 91(a) IFRS7p20(a)(ii)	Available-for-sale financial assets	19	560	123
IAS28p39, 1(r)p82(b)	Share of other comprehensive income of associates	19	(12)	(14)
1(r)p82(g), 19p93A	Actuarial loss on retirement benefit obligations		–	(705)
12p80(d)	Impact of change in Euravian tax rate on deferred tax	22	(10)	
1(r)p82(g), IFRS7p23(c)	Cash flow hedges	19	97	(3)
1(r)p82(g)	Net investment hedge	19	(45)	40
1(r)p82(g)	Currency translation differences	19	2,244	(156)
IFRS3p59	Increase in fair values of proportionate holding of YS Group (note 38)	19	850	–
	Income tax relating to components of other comprehensive income		(231)	(224)
	<b>Other comprehensive income for the year, net of tax</b>		<b>3,453</b>	194
1(r)p82(i)	<b>Total comprehensive income for the year</b>		<b>35,768</b>	16,562
1(r)p83(a)	<b>Profit attributable to:</b>			
1(r)p83(a)(ii)	Equity holders of the company		<b>29,767</b>	15,512
1(r)p83(a)(i)	Minority interest		<b>2,548</b>	856
			<b>32,315</b>	16,368
1(r)p83(b)	<b>Total comprehensive income attributable to:</b>			
1(r)p83(b)(i)	Equity holders of the company		<b>32,968</b>	15,746
1(r)p83(b)(i)	Minority interest		<b>2,800</b>	816
			<b>35,768</b>	16,562

## Earnings per share for profit attributable and profit from discontinued operations to the equity holders of the company during the year (expressed in C per share)

1(r)p81-83, 1(r)p103,1(r)p38 1p104	Note	Year ended 31 December		
		2008	2007	
<b>Basic earnings per share</b>				
33p66	From continuing operations	33	1.26	0.75
33p68	From discontinuing operations		0.01	0.01
			1.27	0.76
<b>Diluted earnings per share<sup>1</sup></b>				
33p66	From continuing operations	33	1.15	0.71
33p68	From discontinuing operations		0.01	0.01
			1.16	0.72

<sup>1</sup> EPS for discontinued operations may be given in the notes to the accounts instead of the face of the income statement.

## Income tax expense

### Tax effects of components of other comprehensive income

1(r)p90		Year ended 31 December					
		2008			2007		
		Before tax	Tax (charge) credit	After tax	Before tax	Tax (charge) credit	After tax
1(r)p90	Fair value gains:						
1(r)p90	– Land and buildings	–	–	–	1,133	(374)	759
1(r)p90	– Available-for-sale financial assets	560	(198)	362	123	(61)	62
1(r)p90	Share of other comprehensive income of associates (12)	–	(12)	(14)	–	(14)	
1(r)p90	Actuarial loss on retirement benefit obligations	–	–	–	(705)	211	(494)
1(r)p90	Impact of change in Euravian tax rate on deferred tax	–	(10)	(10)	–	–	–
1(r)p90	Cash flow hedges	97	(33)	64	(3)	–	(3)
1(r)p90	Net investment hedge	(45)	–	(45)	40	–	40
1(r)p90	Currency translation differences	2,244	–	2,244	(156)	–	(156)
IFRS3p59	Increase in fair values of proportionate holding of YS Group (note 38)	850	–	850	–	–	–
	<b>Other comprehensive income</b>	<b>3,694</b>	<b>(241)</b>	<b>3,453</b>	<b>418</b>	<b>(224)</b>	<b>194</b>

## Other reserves

### Components of other comprehensive income

1(r)p90		31 December	
		2008	2007
1(r)p90	Gain on revaluation of land and buildings	–	1,133
1(r)p90	Available-for-sale financial assets/associates:		
	Gains arising during the year	678	261
	Reclassification for gains included in profit or loss	(130)	(152)
		548	109
1(r)p90	Actuarial loss on retirement benefit obligations	–	(705)
1(r)p90	Cash flow hedges:		
	Gains arising during the year	368	300
	Reclassification to inventory	(151)	(67)
	Reclassification for gains included in profit or loss	(120)	(236)
		97	(3)
1(r)p90	Net investment hedge	(45)	40
1(r)p90	Currency translation differences	2,244	(156)
IFRS3p59	Increase in fair values of proportionate holding of YS Group (note 38)	850	–
	Income tax relating to components of other comprehensive income	(241)	(224)
	<b>Other comprehensive income</b>	<b>3,453</b>	<b>194</b>

# Consolidations – IFRS 3 (revised) and IAS 27 (revised)

## Introduction

The revised standard on business combinations was released in January 2008, accompanied by a revised standard on consolidated financial statements. They converge IFRS with US Accounting Standard SFAS 141 (revised), 'Business combinations', and SFAS 160, 'Noncontrolling interests in consolidated financial statements', respectively. The new standards are expected to add to earnings volatility, making earnings harder to predict. They are also likely to:

- Influence acquisition negotiations and deal structures in an effort to mitigate unwanted earnings impacts.
- Potentially impact the scope and extent of due diligence and data-gathering exercises prior to acquisition.
- Require new policies and procedures to monitor and determine changes in the fair value of some assets and liabilities.
- Call for the early input of accountants and lawyers, and expand the call for valuation expertise.
- Influence the 'how, when and what' of stakeholder communications.

The table below sets out the potential impact for gains and losses on day 1, measurement of assets and liabilities in the acquisition balance sheet and income statement volatility on day 2 and beyond.

	Impact on earnings at combination date	Impact on net assets/goodwill at combination date	Ongoing earnings impact
Share options given to seller		✓	✓
Existing interest held in target	✓	✓	
Earn-out paid in a fixed number of equity shares		✓	
Earn-out paid in cash or shares to a fixed amount		✓	✓
Transaction costs	✓	✓	
Full goodwill		✓	✓
Contingent liabilities		✓	✓
Settlement of pre-existing relationships	✓	✓	✓
Restructuring costs			✓
Indemnity from seller		✓	✓
Buying or selling minority interest			X <sup>1</sup>

<sup>1</sup>Transactions with minority interests resulted in income statement effects under IAS 27, depending on an entity's policy. There will be no effect on income under IAS 27 (revised).

### Effective date

Annual reporting periods beginning on or after 1 July 2009. Early adoption is permitted.

### EU adoption status

Not adopted by the European Commission at time of going to print.

# Questions and answers

1. Scope and applicability
2. Consideration
3. Goodwill and non-controlling interests
4. Asset and liability recognition
5. Other issues
6. IAS 27 (revised) – new proposals on minority interests and disposals

## 1. Scope and applicability

The business combinations standard represents some significant changes for IFRS. IFRS 3 (revised) is a further development of the acquisition model. The standard now applies to more transactions, as combinations by contract alone and combinations of mutual entities are brought into the standard's scope. Common control transactions and the formation of joint ventures remain outside the scope of the standard. The definition of a business has been amended slightly. It now states that the elements are 'capable of being conducted' rather than 'are conducted and managed'. This change is supplemented by a significant expansion of the application guidance. This may bring more transactions into acquisition accounting.

### 1.1 When will the new standard affect the financial statements?

IFRS 3 (revised) is applied prospectively to business combinations occurring in the first accounting period beginning on or after 1 July 2009. It can be applied early but only to an accounting period beginning on or after 30 June 2007. IFRS 3 (revised) and IAS 27 (revised) are applied at the same time. Retrospective application to earlier business combinations is not permitted.

As with other standards, IFRS 3 (revised) and IAS 27 (revised) cannot be applied by entities within the European Union until they are endorsed.

### 1.2 Has the scope of the standard changed?

Yes, it now includes combinations of mutuals and combinations by contract. This change in scope is not significant for many entities.

### 1.3 What about common control transactions?

Common control transactions remain outside the scope of the new standard. The IASB is starting a project on accounting for them, but a new standard is not expected soon. Entities choose a policy for such transactions. The most common are either applying IFRS 3 by analogy to other business combinations or using predecessor values by analogy to US and other GAAPs with similar frameworks. Entities should continue to use their existing policy for business combinations under common control.

## 2. Consideration

Consideration is the amount paid for the acquired business. Some of the most significant changes are found in this section of the revised standard. Individual changes may increase or decrease the amount accounted for as consideration. These affect the amount of goodwill recognised and impact the post-acquisition income statement. Transaction costs no longer form a part of the acquisition price; they are expensed as incurred. Consideration now includes the fair value of all interests that the acquirer may have held previously in the acquired business. This includes any interest in an associate or joint venture or other equity interests

of the acquired business. If the interests in the target were not held at fair value, they are re-measured to fair value through the income statement.

The requirements for recognising contingent consideration have also been amended. Contingent consideration is now required to be recognised at fair value even if it is not deemed to be probable of payment at the date of the acquisition. All subsequent changes in debt contingent consideration are recognised in the income statement, rather than against goodwill as today.

## **2.1 The selling-shareholders will receive some share options. What effect will this have?**

An acquirer may wish selling-shareholders to remain in the business as employees. Their knowledge and contacts can help to ensure that the acquired business performs well.

The terms of the options and employment conditions could impact the amount of purchase consideration and also the income statement after the business combination. Share options have a value. The relevant accounting question is whether this value is recorded as part of the purchase consideration, or as compensation for post-acquisition services provided by employees, or some combination of the two. Is the acquirer paying shareholders in their capacity as shareholders or in their capacity as employees for services subsequent to the business combination?

How share options are accounted for depends on the conditions attached to the award and also whether or not the options are replacing existing options held by the employee in the acquired business. Options are likely to be consideration for post-acquisition service where some of the payment is conditional on the shareholders remaining in employment after the transaction. In such circumstances, a charge is recorded in post-acquisition earnings for employee services. These awards are made to secure and reward future services of employees rather than to acquire the existing business.

## **2.2 Is it true that some business combinations will result in gains in the income statement?**

Yes, it is. Any previous stake is seen as being 'given up' to acquire the business. A gain or loss is recorded on its disposal. If the acquirer already held an interest in the acquired entity before acquisition, the standard requires the existing stake to be re-measured to fair value at the date of acquisition, taking any movement to the income statement (together with any gains previously recorded in equity that relate to the existing stake). If the value of the stake has increased, there will be a gain to recognise in the income statement of the acquirer at the date of the business combination. A loss would only occur if the existing interest has a book value in excess of the proportion of the fair value of the business obtained – and no impairment had been recorded previously. This loss situation is not expected to occur frequently.

The standard also requires any gain on a 'bargain purchase' (negative goodwill) to be recorded in the income statement. This is not a change from previous requirements.

## **2.3 Some of the payments for the business are earn-outs. How are these accounted for?**

It is common for some of the consideration in a business combination to be contingent on future events. Uncertainty might exist about the value of the acquired business or some of its significant assets. The buyer may want to make payments only if the business is successful. Conversely, the seller wants to receive full value for the business. Earn-outs are often payable based on post-acquisition earnings or on the success of a significant uncertain project.

The acquirer should fair value all of the consideration at the date of acquisition including the earn-out. If the earn-out is a liability (cash or shares to the value of a specific amount), any subsequent re-measurement of the liability is recognised in the income statement. There is no requirement for payments to be probable, which was the case under IFRS 3. An increase in the liability for strong performance results in an expense in the income statement. Conversely, if the liability is decreased, perhaps due to under-performance against targets, the reduction in the expected payment will be recorded as a gain in the income statement.

These changes were previously recorded against goodwill. Acquirers will have to explain this component of performance: the acquired business has performed well but earnings are lower because of additional payments due to the seller.

#### **2.4 Does it make a difference whether contingent consideration (an earn-out) is payable in shares or in cash?**

Yes, it does make a difference. An earn-out payable in cash meets the definition of a financial liability. It is re-measured at fair value at every balance sheet date, with any changes recognised in the income statement.

Earn-outs payable in ordinary shares may not require re-measurement through the income statement. This is dependent on the features of the earn-out and how the number of shares to be issued is determined. An earn-out payable in shares where the number of shares varies to give the recipient of the shares a fixed value would meet the definition of a financial liability. As a result, the liability will need to be fair valued through income. Conversely, where a fixed number of shares either will or will not be issued depending on performance, regardless of the fair value of those shares, the earn-out probably meets the definition of equity and so is not re-measured through the income statement.

#### **2.5 A business combination involves fees payable to banks, lawyers and accountants. Can these still be capitalised?**

No, they cannot. The standard says that transaction costs are not part of what is paid to the seller of a business. They are also not assets of the purchased business that are recognised on acquisition. Transaction costs should be expensed as they are incurred and the related services are received.

The standard requires entities to disclose the amount of transaction costs that have been incurred.

#### **2.6 What about costs incurred to borrow money or issue the shares used to buy the business. Do these also have to be expensed?**

No, these costs are not expensed. They are accounted for in the same way as they were under the previous standard.

Transaction costs directly related to the issue of debt instruments are deducted from the fair value of the debt on initial recognition and are amortised over the life of the debt as part of the effective interest rate. Directly attributable transaction costs incurred issuing equity instruments are deducted from equity.

## 3. Goodwill and non-controlling interests

The revised standard gives entities the option, on a transaction-by-transaction basis, to measure non-controlling interests (previously minority interest) at the value of their proportion of identifiable assets and liabilities or at full fair value. The first will result in measurement of goodwill little different from existing IFRS 3; the second approach will record goodwill on the non-controlling interest as well as on the acquired controlling interest. The 'bargain purchase' guidance remains the same with the requirement to recognise 'negative goodwill' immediately in the income statement.

### 3.1 Does the type of consideration affect how much goodwill is recognised?

No, it does not. Regardless of how payments are structured, the consideration is recognised in total at its fair value at the date of the acquisition. Paying the same amount in today's values in different ways will not make a difference to the amount of goodwill recognised.

The form of the consideration will not affect the amount of goodwill, but the structure of the payments will have a significant effect on the post-acquisition income statement.

Payments that are contingent and deemed to be part of the acquisition price will be measured at fair value and included in the business combination accounting on day one. Equity instruments that are contingent consideration are not subsequently re-measured. Debt instruments are subsequently re-measured through the income statement.

Changes in the carrying amount of contingent consideration will often not be offset by profits and losses of the acquired subsidiary. A substantial payment to the previous owners may be required if an in-process research and development (IPR&D) project meets key approval milestones. The successful IPR&D project may generate substantial profits over 20 years. The increased amounts due under the contingent consideration arrangement are likely to be recognised as an expense in the income statement before the project generates any revenue at all.

### 3.2 How is goodwill measured?

Goodwill continues to be a residual. It may well be a different residual under IFRS 3 (revised) compared to the previous standard. This is partly because all of the consideration, including any previously held interest in the acquired business, is measured at fair value. It is also because goodwill can be measured in two different ways.

The first approach is similar to the method under current IFRS: goodwill is the difference between the consideration paid and the purchaser's share of identifiable net assets acquired. This is a 'partial goodwill' method because the non-controlling interest is recognised at its share of identifiable net assets and does not include any goodwill. Goodwill can also be measured on a 'full goodwill' basis, described in the following question.

### 3.3 What is 'full goodwill'?

Full goodwill means that the non-controlling (minority) interest is measured at fair-value, and goodwill is recognised in a business combination. Under IFRS 3, minority interest was recognised at the minority's share of net assets and did not include any goodwill. Full goodwill means that non-controlling interest and goodwill are both increased by the goodwill that relates to the non-controlling interest.

### 3.4 When can full or partial goodwill be recognised?

The standard gives a choice for each separate business combination. An acquirer may either recognise the non-controlling interest in the subsidiary at fair value, which leads to 100% of goodwill being recognised (full goodwill), or the acquirer can recognise the non-controlling interest measured at the non-controlling interest in net assets excluding goodwill. This leads to goodwill being recognised only for the parent's interest in the entity acquired, the same as under current IFRS 3 (partial goodwill).

This is one of the major differences with the US GAAP standard: under US GAAP, the non-controlling interest must be measured at fair value, and full goodwill is always recognised.

This choice only makes a difference in an acquisition where less than 100% of the acquired business is purchased. Few acquisitions of listed entities are for less than 100% of the equity shares. Business combinations where the entire business is acquired will result in goodwill being calculated in much the same way as it is under IFRS 3.

### 3.5 What is the effect of recognising full goodwill?

Recognising full goodwill will increase reported net assets on the balance sheet. The potential downside is that any future impairment of goodwill will be greater. Impairments of goodwill should not occur with greater frequency, as the current impairment test is adjusted for a less than wholly-owned subsidiary.

Measuring non-controlling interest at fair value may prove difficult in practice. However, goodwill impairment testing may be easier under full goodwill, as there is no need to gross-up goodwill for partially owned subsidiaries.

A company planning a cash buy-out of the non-controlling interest in a subsidiary at a future date may want to record non-controlling interest at fair value and recognise full goodwill in a business combination. If the non-controlling interest is later purchased, there will be a lower difference between the consideration paid for the non-controlling interest and its recorded value, and thus a smaller percentage reduction of equity.

## 4. Asset and liability recognition

The revised IFRS 3 has limited changes to the assets and liabilities recognised in the acquisition balance sheet. The existing requirement to recognise all of the identifiable assets and liabilities of the acquiree is retained. Most assets are recognised at fair value, with exceptions for certain items such as deferred tax and pension obligations.

### 4.1 Have the recognition criteria changed for intangible assets?

No, there is no change in substance. Acquirers are required to recognise brands, licences and customer relationships, amongst other intangible assets. The IASB has provided additional clarity that may well result in more intangible assets being recognised, including leases that are not at market rates and rights (such as franchise rights) that were granted from the acquirer to the acquiree.

### 4.2 What happens to the contingent liabilities of the acquired business?

Many acquired businesses will contain contingent liabilities – for example, pending lawsuits, warranty liabilities or future environmental liabilities. These are liabilities where there is an element of uncertainty; the need for payment will only be confirmed by the occurrence or non-occurrence of a specific event or outcome. The amount of any outflow and the timing of an outflow may also be uncertain.

There is very little change to current guidance under IFRS. Contingent assets are not recognised, and contingent liabilities are measured at fair value. After the date of the business combination contingent liabilities are re-measured at the higher of the original amount and the amount under the relevant standard, IAS 37. US GAAP has different requirements in this area.

Measurement of contingent liabilities after the date of the business combination is an area that may be subject to change in the future (see Q&A 5.1).

#### **4.3 If consideration paid and most assets and liabilities are at fair value, what does this mean for the post-combination income statement?**

Fair valuation of most things that are bought in a business combination already existed under IFRS 3. The post-combination income statement is affected because part of the 'expected profits' is included in the valuation of identifiable assets at the acquisition date and subsequently recognised as an expense in the income statement, through amortisation, depreciation or increased costs of goods sold.

A mobile phone company may have a churn rate of three years for its customers. The value of its contractual relationships with those customers, which is likely to be high, will be amortised over that three-year period.

There may be more charges in the post-combination income statement due to increased guidance in IFRS 3 (revised) on separating payments made for the combination from those made for something else. For example, guidance has been included on identifying payments made for post-combination employee services and on identifying payments made to settle pre-existing relationships between the buyer and the acquiree.

With contingent consideration that is a financial liability, fair value changes will be recognised in the income statement. This means that the better the acquired business performs, the greater the likely expense in profit or loss.

#### **4.4 Can a provision be made for restructuring the target company in the acquisition accounting?**

The acquirer will often have plans to streamline the acquired business. Many synergies are achieved through restructurings such as reductions in head-office staff or consolidation of production facilities. An estimate of the cost savings will have been included in the buyer's assessment of how much it is willing to pay for the acquiree.

The acquirer can seldom recognise a reorganisation provision at the date of the business combination. There is no change from the previous guidance in the new standard: the ability of an acquirer to recognise a liability for terminating or reducing the activities of the acquiree in the accounting for a business combination is severely restricted.

A restructuring provision can be recognised in a business combination only when the acquiree has, at the acquisition date, an existing liability, for which there are detailed conditions in IAS 37, the provisions standard.

Those conditions are unlikely to exist at the acquisition date in most business combinations. A restructuring plan that is conditional on the completion of the business combination is not recognised in the accounting for the acquisition. It is recognised post-acquisition, and the expense flows through post-acquisition earnings.

#### **4.5 What might adjust goodwill and over what period?**

An acquirer has a maximum period of 12 months to finalise the acquisition accounting. The adjustment period ends when the acquirer has gathered all the necessary information, subject to the one year maximum. There is no exemption from the 12-month rule for deferred tax assets or changes in the amount of contingent consideration.

#### **4.6 The seller will be giving an indemnity on a tax exposure. How will this be accounted for?**

An indemnity is a promise by the seller to reimburse the buyer for liabilities of uncertain amount or likelihood. The indemnity is recognised as an asset of the acquiring business. It is measured in the same way as the indemnified liability, and it is limited to the amount of the indemnified liability. This applies to all indemnities for specific contingencies or liabilities.

### **5. Other issues**

There is additional guidance on accounting for employee share-based payments in the revised standard. It provides additional guidance on valuation as well as determining whether replacement share awards are part of the consideration for the business combination or may be compensation for post-combination services.

The revised standard includes additional guidance with regard to contracts and arrangements of the acquired business at the balance sheet date. Leases and insurance contracts are assessed based on the facts at the time they were entered into (or subject to substantial modification). All other contracts are assessed for classification at the date of the acquisition.

Current guidance requires deferred tax assets of the acquired business that are not recognised at the date of the combination but subsequently meet the recognition criteria to be adjusted against goodwill. The revised standard will only allow adjustments against goodwill within the one-year window for finalisation of the purchase accounting.

#### **5.1 Are there any changes to deferred tax accounting?**

Yes. The main change relates to the recognition of acquired deferred tax assets after the initial accounting for the business combination is complete; this will have an impact on the income statement.

Adjustments to deferred tax assets will only affect goodwill if they are made within the 12-month period for finalising the business combinations accounting and if they result from new information about facts and circumstances that existed at the acquisition date. After the 12-month period, adjustments are recorded as normal under IAS 12, through the income statement or the statement of changes in equity, as appropriate.

#### **5.2 Is there more clarity around classification and reassessment of contracts and other arrangements?**

Yes, there is. IFRS 3 was silent on what to do with leases, purchase and sale contracts, insurance contracts and hedges. The new standard clarifies that all assessments such as the determination of, for example, embedded derivatives are made based on the facts at the date of the business combination. The only exceptions are leases and insurance contracts. These are generally assessed and classified based on conditions at the inception date of the contract.

#### **5.3 Will the financial statements grow through additional disclosures?**

The financial statements will be longer than before and even more detailed. An acquisitive company might be adding three pages per transaction.

Some of the new disclosure requirements are:

- the amount of acquisition-related costs expensed and the income statement line item in which that expense is reported;
- the measurement basis selected and the recognised amount of non-controlling interests in the acquiree;

- where non-controlling interest is measured at fair value, the valuation techniques and key model inputs used for determining that value;
- details of transactions that are separate from the acquisition of assets and assumption of liabilities in exchange for the acquiree;
- in a step acquisition, disclosure of the fair value of the previously held equity interest in the acquiree and the amount of gain or loss recognised in the income statement resulting from remeasurement; and
- information about receivables (fair value, gross contractual amounts receivable and best estimate of cash flows not expected to be collected at the acquisition date).

#### 5.4 Do previous transactions need to be restated?

No. Business combinations and transactions with minorities that occurred prior to the adoption of IFRS 3 (revised) and IAS 27 (revised) are not restated. The standards are to be applied prospectively to all transactions for which the transaction date is on or after the first accounting period beginning on or after 1 July 2009 or the date of early adoption, if elected.

Some future accounting related to previous business combinations will change once the standard is adopted. Deferred tax assets that are recognised relating to a previously acquired business will be accounted for under the new standard. Instead of affecting goodwill, they will be recognised in profit or loss (see Q&A 5.1). The purchase or sale of a non-controlling interest that existed at the date of adoption of IFRS 3 (revised) and IAS 27 (revised) may also be different (see Q&A 6.4).

#### 5.5 Are there more changes to come?

Possibly, although the timing of any change is uncertain. The IASB has added a project to its agenda to address the treatment of business combinations involving entities under common control.

The Fair Value Measurement Project (a discussion paper was released in December 2006) is still in progress and might affect the definition of fair value as currently contained in IFRS 3 (revised). There are other ongoing projects on some standards that are linked to business combinations (notably IAS 37 on provisions and IAS 12 on deferred tax) that may affect either the recognition or measurement at the acquisition date or the subsequent accounting.

## 6. IAS 27R – new proposals on minority interests and disposals

The revised consolidation standard moves IFRS to a mandatory adoption of the economic entity model. Current practice under IFRS is overwhelmingly the parent company approach. The economic entity approach treats all providers of equity capital as the entity's shareholders, even when they are not shareholders in the parent company. The parent company approach sees the financial statements from the perspective of the parent company shareholders.

A partial disposal of an interest in a subsidiary in which the parent company retains control does not result in a gain or loss but in an increase or decrease in equity under the economic entity approach. Purchase of some or all of the non-controlling interest is treated as a treasury transaction and accounted for in equity. A partial disposal of an interest in a subsidiary in which the parent company loses control but retains an interest (say an associate) triggers recognition of gain or loss on the entire interest. A gain or loss is recognised on the portion that has been disposed of; a further holding gain is recognised on the interest retained, being the difference between the fair value of the interest and the book value of the interest. Both are recognised in the income statement.

## **6.1 What happened to minority interest?**

All shareholders of a group – whether they are shareholders of the parent or of a part of the group (minority interest) – are providers of equity capital to that group. All transactions with shareholders are treated in the same way. What was previously the minority interest in a subsidiary is now the non-controlling interest in a reporting entity.

There is no change in presentation of non-controlling interest under the new standard. Additional disclosures are required to show the effect of transactions with non-controlling interest on the parent-company shareholders.

## **6.2 What happens if a non-controlling interest is bought or sold?**

Any transaction with a non-controlling interest that does not result in a change of control is recorded directly in equity; the difference between the amount paid or received and the non-controlling interest is a debit or credit to equity. This means that an entity will not record any additional goodwill upon purchase of a non-controlling interest nor recognise a gain or loss upon disposal of a non-controlling interest.

## **6.3 How is the partial sale of a subsidiary with a change in control accounted for?**

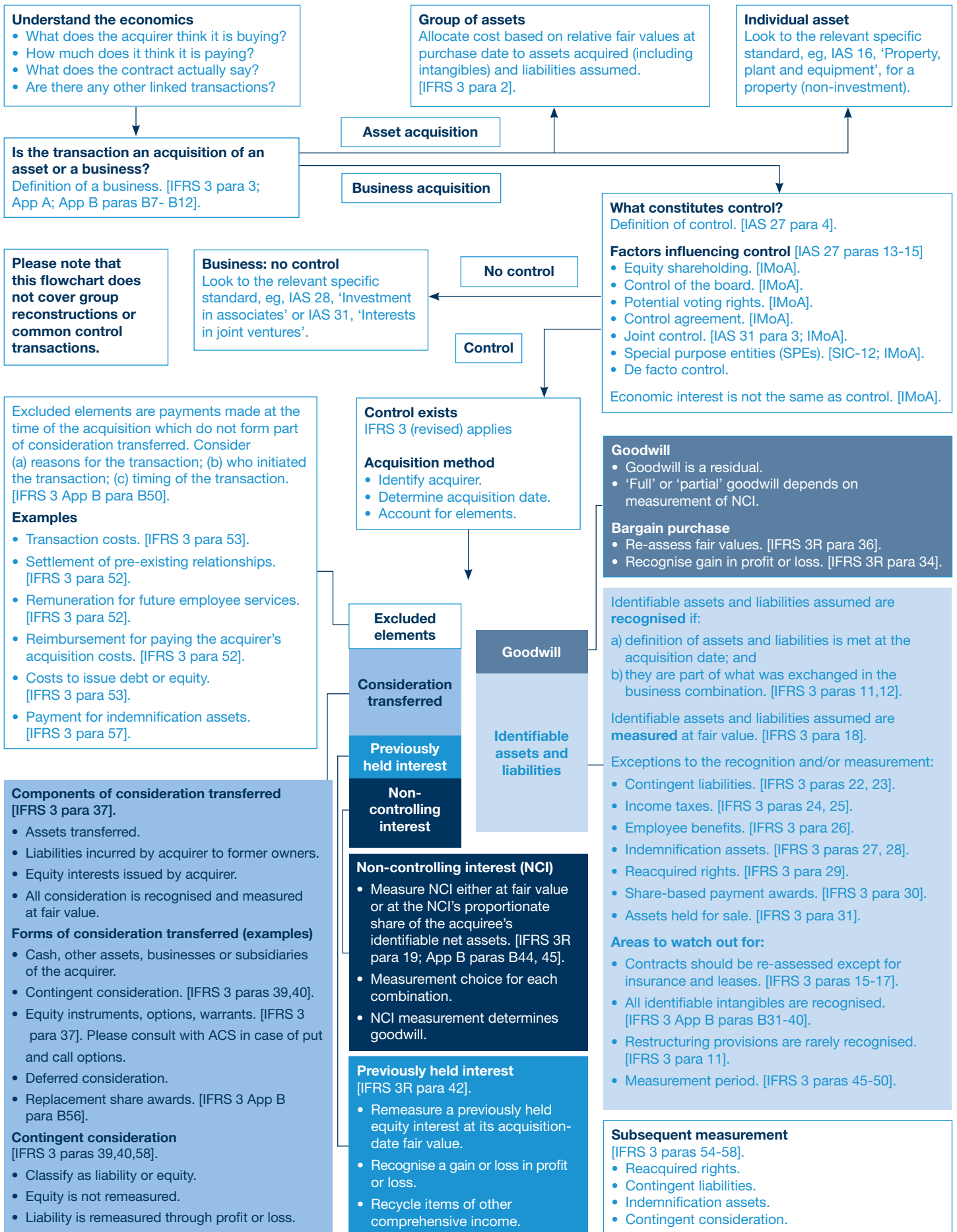
A group may decide to sell its controlling interest in a subsidiary but retain significant influence in the form of an associate, or retain only a financial asset. If it does so, the retained interest is remeasured to fair value, and any gain or loss compared to book value is recognised as part of the gain or loss on disposal of the subsidiary. Consistent with a 'gain' on a business combination (see Q&A 2.2), the standards take the approach that loss of control involves exchanging a subsidiary for something else rather than continuing to hold an interest.

## **6.4 How does the new standard affect transactions with previously recognised non-controlling interests?**

An entity might purchase a non-controlling interest recognised as part of a business combination under the previous version of IFRS 3 – that is, where only partial goodwill was recognised. Alternatively, an entity might recognise partial goodwill under the new IFRS 3 (revised) and might purchase a non-controlling interest at a later date.

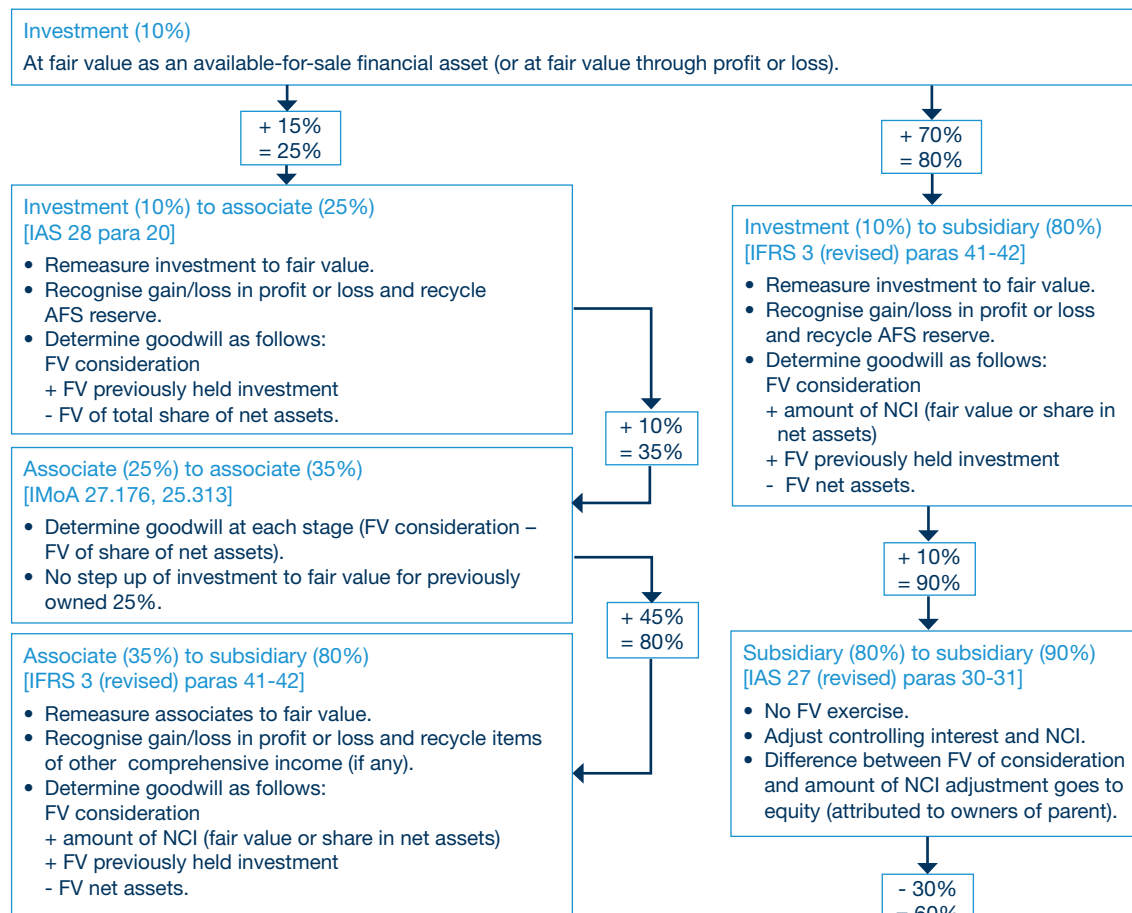
In both cases, no further goodwill can be recognised when the non-controlling interest is purchased. If the purchase price is greater than the book value of the non-controlling interest, this will result in a reduction in net assets and equity. This reduction may be significant.

# Principles of business combinations

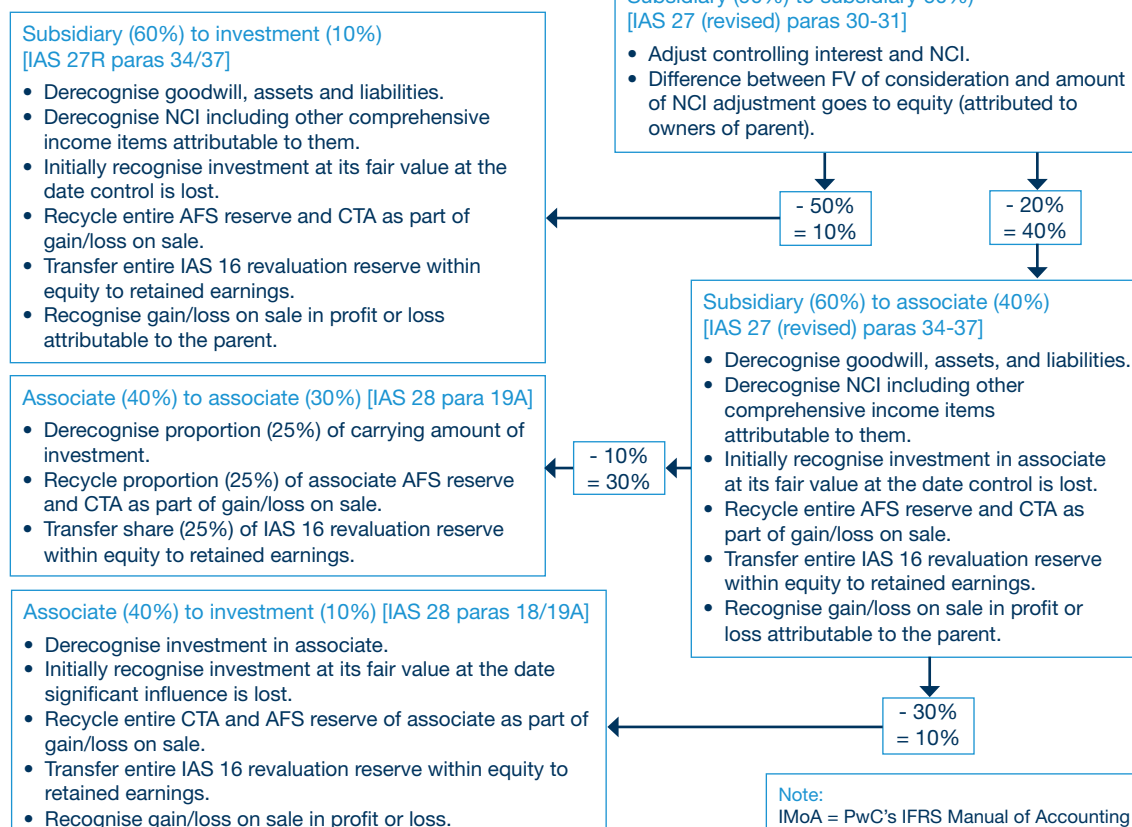


# Step acquisitions and disposals

## Step acquisitions



## Step disposals



# Segment reporting – IFRS 8

## Introduction

IFRS 8 replaces IAS 14, ‘Segment reporting’. It converges IFRS with US Accounting Standard SFAS 131, ‘Disclosure about segments of an enterprise and related information’.

The key principle behind IFRS 8 is that the disclosures will enable users to evaluate the nature and financial effects of the business activities in which it engages and the economic environment in which it operates.

IFRS 8 applies to entities whose equity or debt securities are publicly traded or that issue equity or debt securities in a public market (as with IAS 14) and to entities who file (or are in the process of filing) financial statements with a regulatory organisation for purposes of issuing securities in a public market.

Operating segments under IFRS 8 are components that engage in business activities that may earn revenues or incur expenses, whose operating results are regularly reviewed by the chief operating decision maker (CODM) and for which discrete financial information is available. The CODM is the person/function who/which allocates resources and assesses the performance for the entity.

Reported information under IFRS 8 is based on information that management uses to run the business and not on the financial information presented in the consolidated financial statements, as under IAS 14. It is therefore possible for the segment disclosures to be presented on a basis different from that of the financial statements. However, there is a requirement for this to be reconciled.

### **Effective date**

Annual reporting periods beginning on or after 1 January 2009. Early adoption is permitted.

### **EU adoption status**

Not adopted by the European Commission at time of going to print.

# Questions and answers

1. Identifying operating segments
2. Aggregating and reporting segments
3. Segment disclosures
4. Other matters for consideration

## 1. Identifying operating segments

### 1.1 Can the chief operating decision maker be a group of individuals?

Yes. The CODM may be an individual or a group of individuals. A business activity usually has a unit manager who is directly accountable to, and maintains regular contact with, an individual or group of individuals to discuss operating activities, financial results, forecasts, or plans for the business activity. The CODM is that individual or group of individuals that is responsible for the allocation of resources and assessing the performance of the entity's business units.

### 1.2 Is the CODM always the highest level of management at which decisions are made?

Typically, yes. In almost every organisation, decisions about the entity's resource allocation and the assessment of the performance of the entity's businesses are made at the highest level of management.

Judgement is required in this area. The CODM will vary from entity to entity, and it may be the chief executive officer, chief operating officer, senior management team or in some jurisdictions, the board of directors. We believe that a supervisory board function that simply approves management's decisions would not be the CODM, as it does not allocate resources.

### 1.3 Can a head office function be an operating segment?

Yes. A head office function that undertakes business activities (for example, a treasury operation that earns interest income and incurs expenses) may be an operating segment as long as its revenues earned are more than incidental to the entity's activities, and discrete financial information is reviewed by the CODM.

A head office function (such as accounting, information technology, human resources and internal audit) that earns revenue that is purely incidental to the entity's activities is not an operating segment and not part of one of the reportable segments. Such functions should be reported in the reconciliation of the segment totals as 'other reconciling items'.

### 1.4 Does a component meet the definition of a segment if the CODM reviews revenue-only information?

In most cases, no. For most entities, the review of revenue-only data is not sufficient for decision-making related to resource allocation or performance evaluation of a segment.

Only in rare cases where product sales or service provisions involve minimal costs is the revenue-only data representative of the results. The review of the revenue-only data by the CODM may be sufficient in these rare cases to conclude that the business activity falls within the definition of an operating segment.

### **1.5 Is a segment balance sheet necessary to conclude that discrete financial information is available?**

No. We believe that in many cases the requirement for discrete financial information can be met with operating performance information only, such as revenue and gross profit by product line.

### **1.6 Can vertically integrated operations and cost centres that earn no revenues be classified as an operating segment?**

Yes. IFRS 8 defines an operating segment as a 'component of an entity that engages in business activities from which it may earn revenues and incur expenses'. This recognises that not all business activities earn revenues.

### **1.7 Can a research and development function be an operating segment?**

Yes, as long as discrete information is reviewed by the CODM. Typically, an entity's R&D function is a vertically integrated operation (see question 1.6), in which the R&D activities serve as an integral component of the entity's business. The definition of operating segment envisages that part of an entity that earns revenue and incurs expenses relating to transactions with other components of the same entity may still qualify as an operating segment even if all of its revenue and expenses derive from intra-group transactions.

Where entities allocate entity-wide R&D costs into the business activities for which the R&D is specifically being performed, the R&D function will be considered a separate operating segment as long as the CODM separately reviews discrete R&D activity and data. It will not be a separate segment if the CODM does not review discrete financial data for the criteria.

### **1.8 Can a discontinued operation be an operating segment?**

Yes. A discontinued operation can meet the definition of an operating segment if:

- it continues to engage in business activities;
- the operating results are regularly reviewed by the CODM; and
- discrete financial information is available to facilitate the review.

### **1.9 Are activities conducted through proportionally consolidated joint ventures or associates considered under the definition of operating segment?**

We believe that where (1) a company manages its joint-venture operations or associates separately and (2) the criteria for identifying operating segments in (a)-(c) of IFRS 8 para 5 are met, the joint-venture operations qualify as an operating segment. The asset and profit/loss information (reported to the CODM) regarding the joint-venture or associate's activities that comprise the segment are disclosed. The external reporting of the joint-venture activities may be on a proportionate consolidation basis or a full consolidation basis. If the full financial results are reviewed by the CODM, the total of all segments' financial amounts should be reconciled to the corresponding amounts reported in the consolidated financial statements, so appropriate eliminations should be reflected in the reconciling column for amounts reported in excess of those amounts reflected in the consolidated financial statements. For example, an associate's revenue information is not included in the revenue amount reported in the consolidated financial statements. An elimination of the revenue amount disclosed for the associate should be reflected as a reconciling item.

## 1.10 A CODM may receive multiple levels of information. How are operating segments determined?

IFRS 8 para 8 states that the following factors should be considered when an entity is determining the set of components that constitutes its operating segments:

- The nature of business activities of each component. To the extent that the higher-level segment information is represented by components that contain dissimilar business activities, while the lower level components contain similar business activities, the lower level components may be more representative of the company's operating segments.
- The existence of managers responsible for each component. It is likely that those components that have individuals responsible for the components' results (such as a segment manager, business-unit CFO, or vice president) and who are directly accountable to, and maintain regular contact with, the CODM to discuss operating activities, financial results, forecasts, or plans for the segment, are an entity's operating segments. Segment managers may be responsible for more than one operating segment. IFRS 8 para 9 states that generally, if there is only one set of components for which segment managers are held responsible, that set of components constitutes the operating segments.
- The information provided to the board of directors. The information provided to the company's board of directors, when not considered to be the CODM, may indicate the level at which (1) overall performance is assessed and (2) decisions are made about resource allocation to different areas of an entity's business.

We believe entities should consider qualitative factors in addition to those outlined above in determining the operating segments. These should include an assessment of whether the resultant operating segments are consistent with the core principle of IFRS 8 and whether the identified operating segments could realistically represent the level at which the CODM is assessing performance and allocating resources. We would also expect the identified operating segments to be consistent with other information the entity produces, such as press releases, interviews with management, company websites, management discussions and other public information about the entity.

## 1.11 An entity is structured in a matrix style, where the CODM reviews two overlapping sets of financial information. How are the operating segments determined?

IFRS 8 para 10 addresses the issue of matrix structures. It uses the example of an entity where some managers are responsible for product and service lines worldwide, whereas other managers are responsible for specific geographical areas.

The CODM reviews the operating results of both sets of components, and discrete financial information is available for both. In this situation, the entity should determine which set of components constitutes the operating segments, taking account of what the users of the financial statements would need to know in order to evaluate the entity's business activities and the environment it operates in.

Matrix-structured entities use judgement to determine their operating segments. Such entities should consider the importance of the factors that have led to the matrix structure. For example, if an entity's priority is to increase total sales, market share and geographic spread, the most relevant information for shareholders would be based on geographic markets. An entity that aims to improve the sales of individual products, with a CODM that believes that improving and maintaining product quality is the key to achieving this, might conclude that the most relevant information for shareholders would be based on products.

This approach would be acceptable under IFRS 8 if:

- the entity can sufficiently support the basis for how it determined its segments; and
- the entity's basis for determining segments enables users of its financial statements to evaluate its activities and financial performance, and the business environment it operates in.

## 2. Aggregating and reporting segments

### 2.1 If operating segments are based on geography rather than products or services, can they still be aggregated?

Yes, as long as the individual country segments have similar economic characteristics and are similar in each of the other areas set out in IFRS 8 para 12.

The requirement for segments to have similar economic characteristics may be difficult to overcome when combining individual countries. This is because the individual countries need to have similar economic conditions, exchange control regulations, and underlying currency in order for them to have similar economic characteristics.

Even when aggregation of geographic segments is permitted, IFRS 8 para 33 requires the separate disclosure of revenues and assets for each material foreign country. This disclosure allows users of the financial statements to assess the dependence of entity's on customers based in one particular country.

### 2.2 Can a company aggregate start-up businesses with mature businesses?

Yes. One of the objectives of requiring disclosures about segments is to help users assess the future prospects of an entity's business. Segments with similar economic characteristics often exhibit similar long-term financial performance. To the extent that the future financial performance (including the competitive and operating risks) of the start-up businesses is expected to be similar to that of a company's mature businesses, the economic characteristics requirement for aggregation might be satisfied.

### 2.3 Can two similar operating segments be combined despite having different long-term average gross margins?

Yes. Management should consider all relevant factors and determine whether the economic characteristics of its segments are similar.

IFRS 8 states that similar long-term average gross margins for two operating segments are expected if their economic characteristics are similar. However, other performance factors such as trends in sales growth, returns on assets employed and operating cash flow may also be considered by management to assess whether segments have substantially similar economic characteristics.

When management reviews financial performance measures and compares segments, it should consider not only the quantitative results, but also the reasons why the results are similar or dissimilar before reaching a conclusion about whether the economic characteristics are similar/dissimilar. The basis for conclusions states that, 'separate reporting of segment information will not add significantly to an investor's understanding of an enterprise if its operating segments have characteristics so similar that they can be expected to have essentially the same future prospects'. We consider these comments regarding aggregation to be consistent with the core principle of IFRS 8. Entities should ensure their facts and circumstances support aggregation.

Management should be aware that:

- An entity that cannot demonstrate 'similar economic characteristics' cannot rely on the other criteria in IFRS 8 para 12 to aggregate operating segments. This is a high hurdle.
- It is important to consider a variety of factors, such as trends in growth of the products, gross margins and management's long-term expectations for the product lines.
- Several years of both historical and future financial performance should be considered.
- Segment reporting should be consistent with other public information and disclosures, such as websites and other financial information presented outside of the financial statements.
- Management should document its conclusion that segments are economically similar.

#### **2.4 How should an entity perform the 10% test when each of its operating segments reports different measures of segment profitability and segment assets?**

Where segments report different measures of segment profitability, assets and liabilities, a consistent measure should be developed for the purposes of assessing the 10% test. This measure should be used regardless of whether the CODM uses that measure when evaluating the segments' performance.

#### **2.5 How should an entity identify its reportable segments under IFRS 8 para 13(b) when it has both profit- and loss-making segments?**

Where an entity is applying the 10% test to segment results, the entity is required to ascertain whether the absolute amount of its reported profit or loss is 10% or more of the greater, in absolute amount, of:

- (a) the combined reported profit of all operating segments that did not report a loss; and
- (b) the combined reported loss of all operating segments that reported a loss.

#### **2.6 Can information about non-reportable operating segments be combined and disclosed in an 'all other' category, together with items which reconcile the segment information to the statutory information?**

No. IFRS 8 para 16 requires all non-reportable operating segments and other business activities to be combined and disclosed in an 'all other' category on a stand-alone basis. The disclosure of 'other reconciling items' should be presented separately in the reconciliation of segment totals to the consolidated financial statement totals.

#### **2.7 Can a company aggregate an 'immaterial non-reportable' segment with a reportable segment, even though the aggregation criteria under IFRS 8 para 12 have not been met?**

No. Two or more operating segments may only be combined if all of the aggregation criteria are met. An exception to this is IFRS 8 para 14, which allows the aggregation of two or more immaterial non-reportable segments (that is, operating segments that do not meet the 10% quantitative threshold) where the operating segments have similar economic characteristics and share a majority of the five aggregation criteria.

In an example where an entity has identified two operating segments – one is a reportable segment and the other is a non-reportable segment – it may treat the immaterial non-reportable segment in one of the following ways (assuming the 75% test in IFRS 8 para 15 is met):

- include the segment in an ‘all other’ category;
- voluntarily report the segment separately; or
- if applicable, aggregate the segment with other non-reportable segments in accordance with IFRS 8 para 14.

## **2.8 When applying the 75% test under IFRS 8 para 15, should the next largest operating segment always be selected?**

No. The entity should select the next most meaningful operating segment.

The next most meaningful operating segment may be the next largest in terms of revenue, but it need not be. Entities should consider both quantitative and qualitative factors when determining which segment would be most useful to users of financial statements. For example, an entity may select a small segment in terms of revenue contribution because it is a potential growth segment, which is expected to contribute materially to group revenue in the future.

Immaterial segments can only be aggregated with material segments if aggregation is consistent with the core principle, are economically similar, and meet all of the aggregation criteria in IFRS 8 para 12.

## **3. Segment disclosures**

### **3.1 Where the CODM is provided with more than one measure of segment profitability, what measure of segment profitability should be reported?**

When more than one measure of profitability is provided to the CODM, the measure most relied upon by the CODM for assessing performance and deciding on the allocation of resources should be disclosed. When two or more measures are equally relied upon by the CODM, the measure most consistent with those used in measuring the corresponding amounts in the entity’s financial statements should be used.

Additional disclosure may need to be made in some circumstances.

### **3.2 What measure should be reported when the asset information reported to the CODM is limited or not reviewed at all?**

IFRS 8 para 25 states that only those assets that are included in the measure of the segment’s assets that are used by the CODM should be reported.

Non-current assets by geographical area are also required to be disclosed (IFRS 8, para 33(b)) even if such information is not reviewed by the CODM.

### **3.3 Do the measures of profit or loss and assets and liabilities presented for each operating segment comply with the IFRS accounting policies used in the consolidated financial statements?**

No. IFRS 8 para 25 requires the information presented to be on the same basis as it is reported internally, even if the segment information does not comply with IFRS or the accounting policies used in the consolidated financial statements.

Examples of such situations include segment information reported on a cash basis (as opposed to an accruals basis), and reporting on a local GAAP basis for segments that are comprised of foreign subsidiaries.

Although the basis of measurement is flexible, IFRS 8 para 27 requires entities to provide an explanation of:

- the basis of accounting for transactions between reportable segments;
- the nature of any differences between the segments' reported amounts and the consolidated totals. For example, those resulting from differences in accounting policies and policies for the allocation of centrally incurred costs that are necessary for an understanding of the reported segment information. The nature of any changes from prior periods in the measurement methods and the effect of those changes should also be disclosed; and
- the nature and effect of any asymmetrical allocations to reportable segments. For example, an entity might allocate depreciation expense to a segment without allocating the related depreciable assets to that segment.

In addition, IFRS 8 para 28 requires reconciliations between the segments' reported amounts and the consolidated financial statements.

### **3.4 Where the CODM only receives information with respect to the entity's cash flows (that is, the CODM receives no profit or asset information), what should that entity disclose in its segmental disclosure?**

The entity should only disclose information that is used by the CODM to evaluate segment results and allocate resources; therefore the entity should disclose the cash-flow information and then reconcile these cash flows to the entity's total revenues, profit or loss before tax and total assets.

### **3.5 When should an entity consider and review its segment reporting?**

There is no specific guidance in IFRS 8 on what changes trigger a change in the reportable operating segments. Changes in the CODM and/or the information provided to and reviewed by the CODM for the purposes of evaluating performance and allocating resources would impact the identified operating segments. Therefore, at each reporting date management should consider whether the current operating segment disclosure continues to be appropriate.

Determining operating segments is an area of significant judgement and scrutiny, so it is important that entities consider how internal organisational change will impact the identification and measurement of their operating segments.

Management should consider the following when determining its operating segments:

- Who is the CODM and what is reviewed by the CODM?
- Has the CODM changed (that is, have reporting lines changed)?
- How has the CODM reporting package changed?
- Has the organisational chart changed (that is, acquisition/disposal of business activities)?
- Has the person the CODM meets with changed?
- Have there been any changes in the budgeting process, or level at which budgets are set?
- What is the company communicating to external parties such as investors, creditors and customers?

Situations that may impact identified operating segments:

- Entering a new line of business.
- Line of service versus geography (that is, a company has hired a new CEO and the internal reporting structure is changing from a model of geographical reporting to that of product line reporting).
- New system and reporting tools (that is, implementation of a new system that includes various reporting tools has enabled the entity to report on and manage its business activities differently).

### **3.6 Is restatement of segment information required when a reorganisation causes the composition of reportable segments to change?**

Yes. An entity that changes the structure of its internal organisation in a manner that causes the composition of its reportable segments to change should restate the corresponding information for earlier periods (including interim periods), unless the information is not available and the cost to develop it would be excessive.

Management should determine, for each disclosure item, whether the information is available and if not, whether the cost to develop it would be excessive. This means that an entity's disclosures may consist of some comparatives that have been restated and some that have not; disclosures to this effect should be made.

### **3.7 Is restatement of segment information required when there is a change in the measure of segment profit or loss?**

No. IFRS 8 only requires restatement (if practicable) when there has been a change in the composition of the segments resulting from changes in the structure of an entity's internal organisation. Although restatement is not required, we believe it might be preferable to show all segment information on a comparable basis to the extent it is practicable to do so. If prior years' information is not restated, IFRS 8 para 27(e) nonetheless requires disclosure of 'the nature of any changes from prior periods in the measurement methods used to determine reported segment profit or loss and the effect, if any, of those changes on the measure of segment profit or loss'.

### **3.8 What is the definition of 'material' where an entity is required to disclose separately material revenues and material non-current assets from an individual foreign country?**

IFRS 8 does not define the term 'material' for the purpose of determining whether an individual country's revenue or non-current assets should be separately disclosed.

The entity should consider materiality from both quantitative and qualitative perspectives. When considering materiality quantitatively, the standard uses the threshold of 10% or more in determining whether an operating segment is a reportable segment. Therefore, it may be appropriate to apply the same test to determine whether an individual country's revenue or assets are material for the purpose of separate disclosure.

We believe the materiality test should be applied by comparing the country's revenue or assets to total entity external revenue or assets (including the country of domicile) rather than comparing those figures to the relevant totals of foreign countries' revenues and assets (excluding the country of domicile).

## 4. Other matters for consideration

### 4.1 The impact of IFRS 8 on accounting for impairment of assets

The release of IFRS 8 has required a consequential amendment to IAS 36, 'Impairment of assets'. IAS 36 required goodwill acquired in a business combination to be allocated to existing cash-generating units of the acquiring entity. The amendment to IAS 36 states that each cash-generating unit or group of cash-generating units to which the goodwill is allocated should not be larger than an operating segment determined in accordance with IFRS 8.

Consequently, all entities should consider whether their cash-generating units are in line with this amendment ahead of impairment reviews.

### 4.2 Segment reporting in the separate company statements of listed subsidiaries

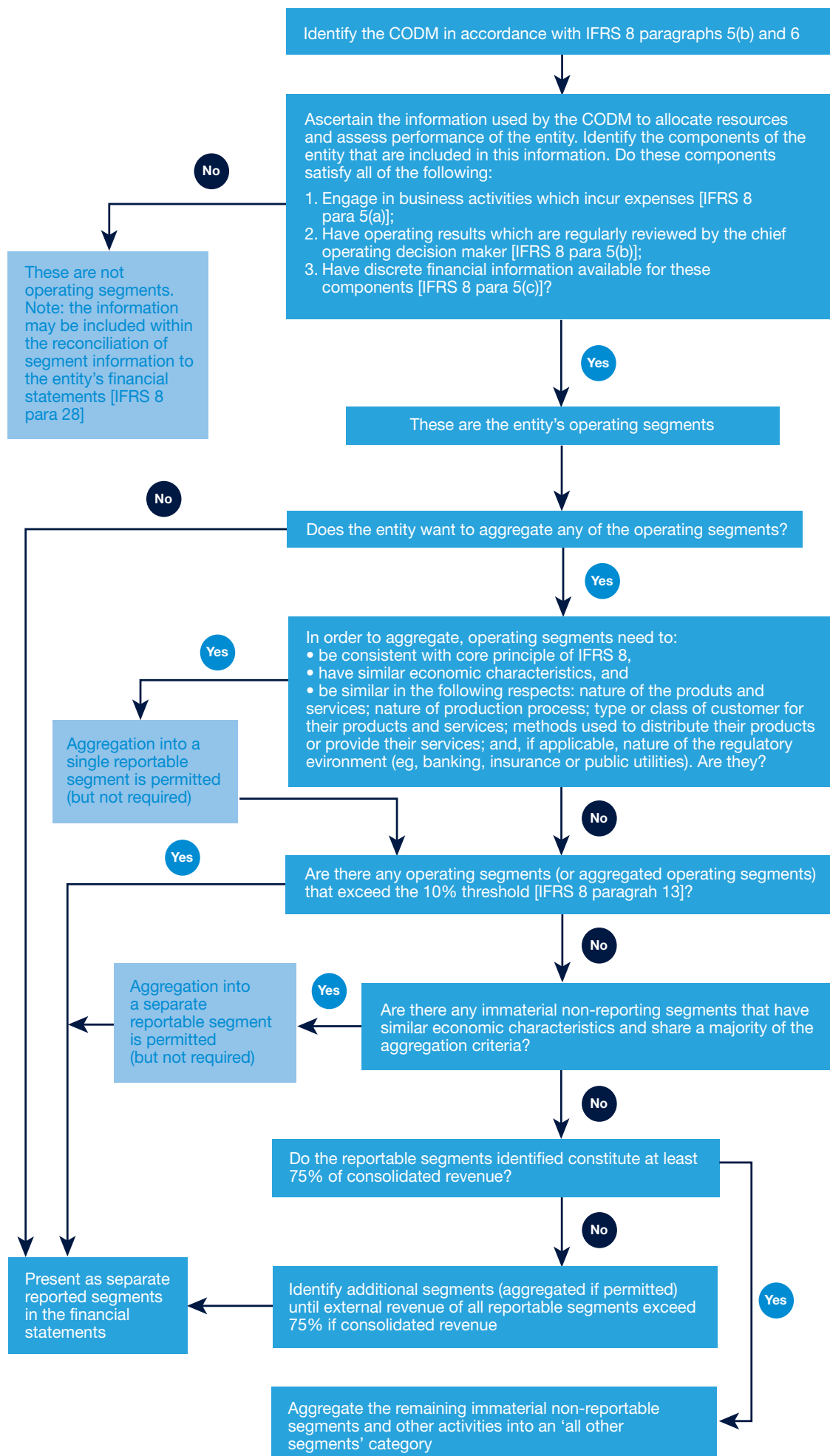
Listed subsidiaries are required to present segment information. The listed subsidiary would need to analyse its segments in the same manner as the parent company. This would include identifying its CODM, determining its operating segments based on its CODM's review and disclosure of its reportable segments in accordance with IFRS 8. We expect the separate subsidiary's reportable segments will not be consistent with the parent company's disclosures of the activities of the listed subsidiary, in many cases. It would not be uncommon for the listed subsidiary's reportable segments to be more detailed than the corresponding segment disclosures in the parent company financial statements.

### 4.3 Convergence with US standard SFAS 131

IFRS 8 is almost identical to SFAS 131. There are still some minor differences between the standards, which are outlined in the basis for conclusion within IFRS 8.

### 4.4 What's in the pipeline?

The International Accounting Standards Board has indicated that the scope paragraph of IFRS 8 is likely to be amended upon finalisation of the IFRS standard for small and medium-sized entities ('IFRS for private entities'). The intention is that IFRS 8 will apply to all entities that have public accountability. This means that IFRS 8 would have to be applied whenever an entity has to apply full IFRS and is not able to use the 'IFRS for private entities'.



# Borrowing costs – IAS 23 (revised)

## Introduction

The main change in IAS 23 (revised), 'Borrowing costs', from the previous version is the removal of the option of immediately recognising as an expense borrowing costs that relate to qualifying assets that take a substantial period of time to get ready for use or sale. IAS 23 (revised) requires capitalisation of these borrowing costs, whereas previously there was a choice of capitalisation.

The new standard is expected to improve financial reporting in three ways:

- The cost of an asset will in future include all costs incurred in getting it ready for use or sale.
- Comparability is enhanced because one of the two accounting treatments that previously existed for those borrowing costs is removed.
- The revision to IAS 23 achieves convergence in principle with US GAAP.

### Effective date

Reporting periods beginning on or after 1 January 2009. Early adoption is permitted if disclosed.

### EU adoption status

Not adopted by the European Commission at the time of going to print.

## Does IAS 23 (revised) apply to qualifying assets existing at the transition date?

No. IAS 23 (revised) applies to qualifying assets for which the commencement date for capitalisation is on or after the effective date. It does not affect qualifying assets for which the commencement date for capitalisation is earlier than the effective date. However, management can decide to designate any date before the effective date and apply IAS 23 (revised) to borrowing costs relating to all qualifying assets for which the commencement date for capitalisation is on or after that date.

The commencement date for capitalisation is the date when the entity first meets all of the following conditions:

- It incurs expenditures for the asset.
- It incurs borrowing costs.
- It undertakes activities that are necessary to prepare the asset for its intended use or sale.

**A qualifying asset is an asset that ‘necessarily takes a substantial period of time to get ready for its intended use or sale’. Is there any bright line for determining the ‘substantial period of time’?**

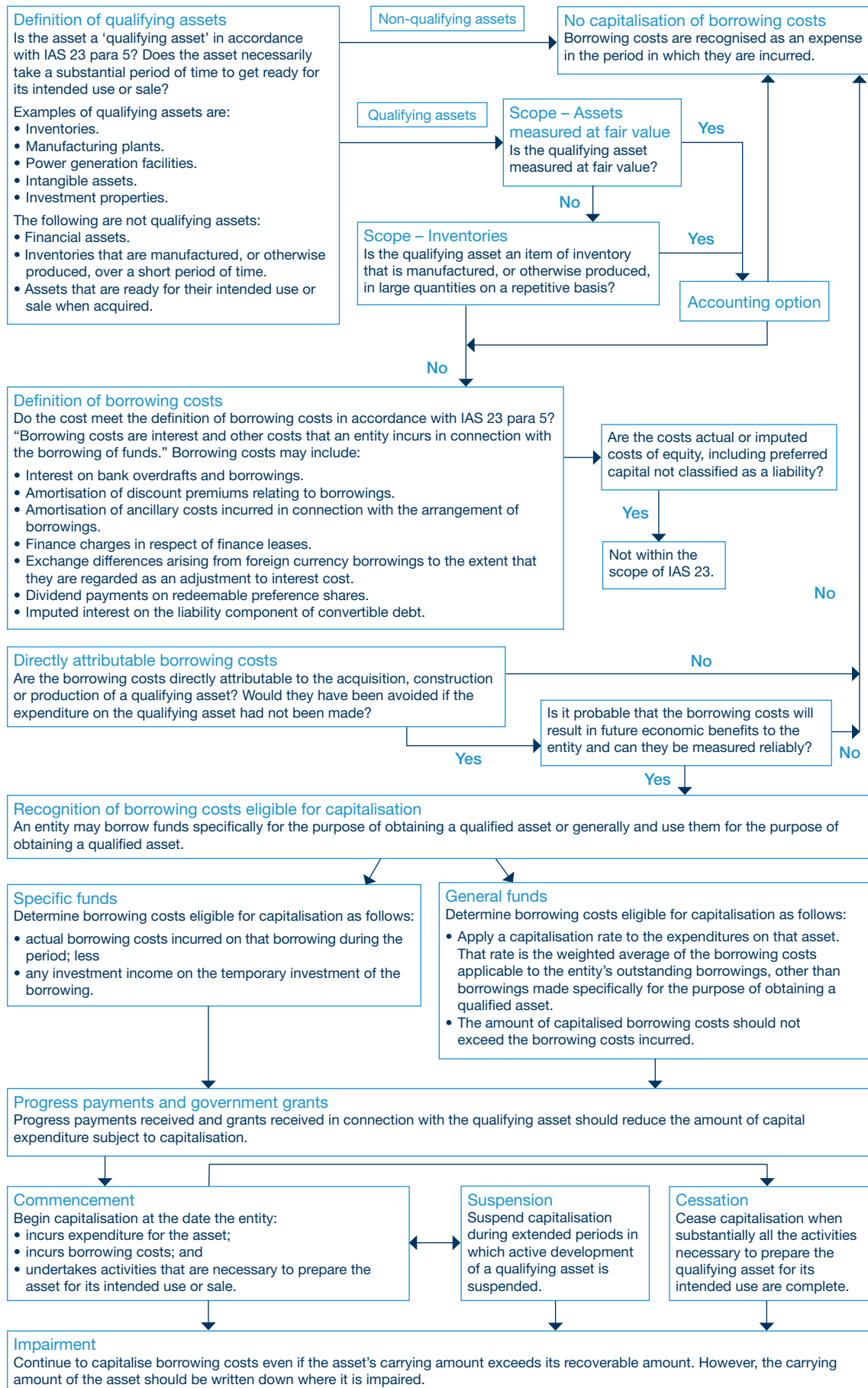
No. IAS 23 (revised) does not define ‘substantial period of time’. Management exercises judgement when determining which assets are qualifying assets, taking into account the nature of the asset. An asset that normally takes more than a year to be ready for use will usually be a qualifying asset. Once management chooses the criteria and type of assets, it applies this consistently to those types of asset.

Management discloses in the notes to the financial statements, when relevant, how the assessment was performed, which criteria were considered and which types of asset are subject to capitalisation of borrowing costs.

**Can borrowing costs incurred to finance the production of inventories that have a long production period, like wine or cheese, be capitalised?**

Yes. IAS 23 (revised) does not mandate capitalising borrowing costs for inventories that are manufactured in large quantities on a repetitive basis, but allows it as long as the production cycle takes a ‘substantial period of time’, as with wine or cheese. The choice to capitalise borrowing costs on those inventories is an accounting policy choice; management discloses it when material.

# Quick guide to applying IAS 23 revised



# Cost of investment – amendments to IFRS 1 and IAS 27

## Introduction

The amendments to IFRS 1, 'First-time adoption of IFRS', and IAS 27, 'Consolidated and separate financial statements', bring three major changes:

- The cost of a subsidiary, jointly controlled entity or associate in a parent's separate financial statements, on transition to IFRS, is determined under IAS 27 or as a deemed cost. Deemed cost is either fair value or the carrying amount under the previous accounting practice.
- Dividends from a subsidiary, jointly controlled entity or associate are recognised as income. There is no longer a distinction between pre-acquisition and post-acquisition dividends.
- The cost of the investment of a new parent in a group (in a reorganisation meeting certain criteria) is measured at the carrying amount of its share of equity as shown in the separate financial statements of the previous parent.

### Effective date

Reporting periods beginning on or after 1 January 2009. Early adoption is permitted if disclosed.

### EU adoption status

Not adopted by the European Commission at the time of going to print.

## What was the reason for the amendment?

The main reason for the amendment is to facilitate the transition to IFRS without significantly reducing the benefits of those statements. IAS 27 requires an entity to account for its investments at cost or in accordance with IAS 39 in its separate financial statements. For those accounted for at cost, a parent entity could only recognise income from the investment to the extent that distributions were received from post-acquisition earnings. Distributions in excess of post-acquisition earnings were recognised as a reduction to the cost of the investment.

Prior to the amendment, IFRS 1 required retrospective application of this method of calculating cost, which was often cumbersome to reconstruct for investments that had been held for several years. With the amendments, a first-time adopter can use a deemed cost, which may be the previous GAAP carrying amount.

## If dividends are recognised as income and not as a reduction to the cost of the investment, is there risk of impairment?

IAS 36 has been amended to identify circumstances when a dividend payment requires impairment testing. These circumstances include:

- dividends exceeding the total comprehensive income (under IAS 1(revised)) of the subsidiary, jointly controlled entity or associate in the period the dividend is declared; or
- the carrying amount of the investment in the separate financial statements exceeding the carrying amount in the consolidated financial statements of the investee's net assets, including goodwill

## How will this alleviate 'dividend trap' issues?

Prior to the amendment, dividends from pre-acquisition earnings were recognised as a reduction of the cost of an investment. Because they were not recognised as profits by the parent, they were not available for further distribution. Under the new standard, dividends are credited to income and available for distribution, subject to there being no impairment and subject to local legal requirements.

# Financial instruments

## Hedging of portions of financial instruments – IAS 39 amendment

### Introduction

The IASB issued an amendment to IAS 39, 'Eligible hedged items', on 31 July 2008. The amendment makes two changes:

- It prohibits designating inflation as a hedgeable component of a fixed rate debt.
- In a hedge of one-sided risk with options, it prohibits including time value in the hedged risk. This change precludes a treatment that PwC had previously considered acceptable. Hedging strategies involving options should be re-assessed immediately to minimise the effect on comparatives arising from the retrospective application from 1 July 2009.

#### Effective date

Reporting periods beginning on or after 1 July 2009. It should be applied retrospectively.

#### EU adoption status

Not adopted by the European Commission at the time of going to print.

### **If management issued inflation linked debt, can it hedge the inflation component?**

Yes, the contractually specified inflation component of an inflation linked debt can be designated as a hedged item in a cash flow or fair value hedge.

### **If management uses options to hedge forecast sales in foreign currency, can it still designate them as hedges of one-sided risk?**

Yes, options may be designated as hedges of one-sided risk – for example, the foreign exchange risk that forecast sales in foreign currency will be worth less in functional currency of the entity.

### **Can these options be perfectly effective hedging instruments?**

No. The amendment clarified that only the intrinsic value of the purchase options can be designated as a hedging instrument. Changes in the time value of the options will be posted to profit or loss account.

### **What should management do if it designated the full fair value of the options as hedging instruments in the past?**

Management should re-designate such options in new hedged relationships on an intrinsic value basis prospectively as soon as possible. If a calendar year end entity re-designates its options before 31 December 2008, there will be no effect on the comparatives when it adopts the amendment in the year ending 31 December 2010.

# Puttable financial instruments and obligations arising on liquidation – amendments to IAS 32 and IAS 1

## Introduction

The IASB issued an amendment to IAS 32, 'Financial instruments: Presentation', on 14 February 2008. The amendment introduces a limited exception to the principles in IAS 32 for certain puttable financial instruments and certain instruments containing obligations arising on liquidation. Where such instruments meet the strict criteria set out in the amendment, they are classified as equity, rather than financial liabilities, despite the contractual obligation to deliver cash or another financial asset. This amendment has a restricted scope; however, it is likely to have a significant impact on the financial statements of those entities to whom it does apply. It prohibits designating inflation as a hedgeable component of a fixed rate debt.

### Effective date

Retrospective application for accounting periods beginning on or after 1 January 2009. Earlier adoption is permitted.

### EU adoption status

Not adopted by the European Commission at time of going to print.

## What instruments may be affected by the amendment?

The amendment applies to certain financial instruments issued by an entity that give the investor the right to get its capital back from the issuing entity for cash or another financial asset:

- at the investor's option (for example, units in some investment funds);
- automatically on the occurrence of a specified event, (for example on the retirement of a partner in a partnership or a member of a co-operative); or
- on liquidation of a limited life entity (for example limited life partnerships used in the private equity industry) or when liquidation is at the option of the investor.

To be classified as equity, such instruments must meet the strict criteria set out in the amendment. For example, one requirement is that the instrument holder is entitled to a pro rata share of net assets on liquidation, which could be indicative of an equity like return.

## What is the impact of the amendment?

For those, relatively few, entities that are affected by the amendment, the impact on both the income statement and the balance sheet can be significant. For example, some entities that do not have any equity before the amendment may now have equity.

## Can a puttable instrument held by third parties be classified as equity under the amendment in both the subsidiary's financial statements and its group's consolidated financial statements?

No. A puttable minority interest that is classified as equity in the subsidiary is always treated as a liability.

# Hedges of a net investment in a foreign operation – IFRIC 16

The IFRIC published IFRIC 16, 'Hedges of a net investment in a foreign operation', on 3 July 2008. The interpretation clarifies the following in respect of net investment hedging:

- The risk being hedged should relate to differences in functional currency between any parent (including an intermediate parent) and its subsidiary. The hedged risk cannot relate to the group's presentation currency.
- Hedging instruments may be held anywhere in the group (apart from the subsidiary that itself is being hedged).

Most hedging strategies used in practice will continue to be permitted by the interpretation. Most entities will not, therefore, face any changes from applying it.

## **Effective date**

Reporting periods beginning on or after 1 October 2008. Early adoption is permitted.

## **EU adoption status**

Not adopted by the European Commission at the time of going to print.

# Share-based payment – IFRS 2

## Introduction

IFRS 2, 'Share-based payment', was amended by the IASB on 17 January 2008. The amendment narrows the definition of vesting conditions. The standard previously stated that vesting conditions included service and performance conditions, implying that other conditions not listed could also meet the definition. The standard after the amendment clarifies that vesting conditions are limited only to service and performance conditions. This might seem to be a very minor amendment, but it can have some significant consequences.

### Effective date

Reporting periods beginning on or after 1 January 2009. Early adoption is permitted.

### EU adoption status

Not adopted by the European Commission at the time of going to print.

## What was the reason for the amendment?

The main reason for the amendment was to clarify the accounting for Save As You Earn (SAYE) schemes which are particularly prevalent in the UK. Employees in SAYE schemes are required to put some of their salary aside every month so that it may be used at the end of the scheme to purchase shares at a discounted price. Alternatively, the employee may choose repayment plus interest. A question was raised over what happens when an employee decides to stop saving.

## How does it impact the accounting for SAYE schemes?

Before the amendment, the failure to save could have been seen as a failure to satisfy a vesting condition resulting in the reversal of any charge previously recorded in the company's income statement. The amendment clarifies that the requirement to save is not a vesting condition; the failure to save now results in a cancellation and an acceleration of the charge.

## If certain conditions are no longer vesting conditions, how are they reflected in the income statement charge?

All non-vesting conditions, as well as market vesting conditions, are accounted for within the grant date fair value. In the case of SAYE schemes, the grant date fair value will be reduced when compared to the treatment prior to the amendment, as this will now reflect management's assessment of employees who are expected to cease saving.

## What other share-based payment awards are likely to be affected by the amendment?

- Matching share schemes (where employees are awarded or purchase shares and are promised more provided they do not sell their initial holding during a specified period), because the requirement not to sell the original holding is no longer a vesting condition.

- Non-compete agreements attached to share awards are also likely to be affected, because the condition of not working for a competitor can no longer be seen as a vesting condition.
- Awards that lapse on a change of control because the condition of the company remaining in its current ownership is not a vesting condition under the amendment.
- Black Economic Empowerment (BEE) transactions in South Africa, and similar schemes elsewhere in the world, where an entity has issued its shares to another body corporate beneficially owned by a certain group of people in order to comply with legislation. Such awards usually require no services to be provided by the BEE entity, but the number of shares awarded will depend on some profit measure of the entity issuing its shares at a future date. The profit measure condition will no longer be seen as a vesting condition following this amendment.

### **How does management calculate the fair value impact arising from the amendment?**

Valuation guidance is contained in Appendix B to IFRS 2. It may be necessary to obtain more detailed guidance from a valuation expert.

### **How will this amendment affect share-based payment awards already in issue?**

The amendment is fully retrospective; all affected awards will need to be restated as if the amendment had always applied.

### **Will management need to restate all share-based payment awards?**

No, not all awards will be affected by the amendment, and some entities will have interpreted the original standard in the narrower sense already. However, it is likely that the majority of entities with awards containing conditions that are not service or performance related will have applied a wider interpretation in the past, and will have to restate on adoption of the amendment.

# Construction contracts – IFRIC 15

## Introduction

IFRIC 15 was issued July 2008 in response to concerns over diversity in practice regarding revenue recognition for real estate construction agreements.

The interpretation provides guidance on determining whether an agreement is within the scope of IAS 11, 'Construction contracts', or is for the sale of goods under IAS 18, 'Revenue'.

### Effective date

Annual reporting periods beginning on or after 1 January 2009. Early adoption is permitted.

### EU adoption status

Not adopted by the European Commission at the time of going to print.

## Will the interpretation only impact the real estate industry?

No. Many entities might assume that the interpretation will not apply or will have minimal impact to their current revenue recognition model.

The interpretation clearly does apply directly to entities that enter into agreements for the construction of real estate. However, as the basis for conclusions indicates, the guidance may be applied by analogy to industries other than real estate.

We expect that other industries in which entities apply IAS 11 to the construction of complex machinery and equipment may be affected.

## When might this interpretation have an impact?

Entities that have previously recognised revenue from construction activities under IAS 11 will be most significantly affected if IFRIC 15 clarifies that their arrangements are more appropriately accounted for under IAS 18.

## How does an entity determine whether to apply IAS 11 or IAS 18?

This will depend on the terms of the agreement and all the surrounding facts and circumstances. Judgement will be required with respect to each agreement. The interpretation sets out the following guidance in determining which standard would apply:

- **IAS 11:** IAS 11 applies when an agreement meets the definition of a construction contract. The interpretation clarifies that when a buyer is able to specify the major structural elements of design, either before or during construction, the agreement meets the definition of a construction contract.
- **IAS 18:** An agreement is for the sale of goods when the buyer has only limited ability to influence the major structural elements of design, either before or during construction. In addition, an entity that is responsible only for the assembly of materials supplied by a customer, but not the acquisition of the related materials, generally applies the guidance in IAS 18 for sale of services. Conversely, if an entity is responsible for assembly and the related acquisition of materials, the guidance in IAS 18 for the sale of goods would apply.

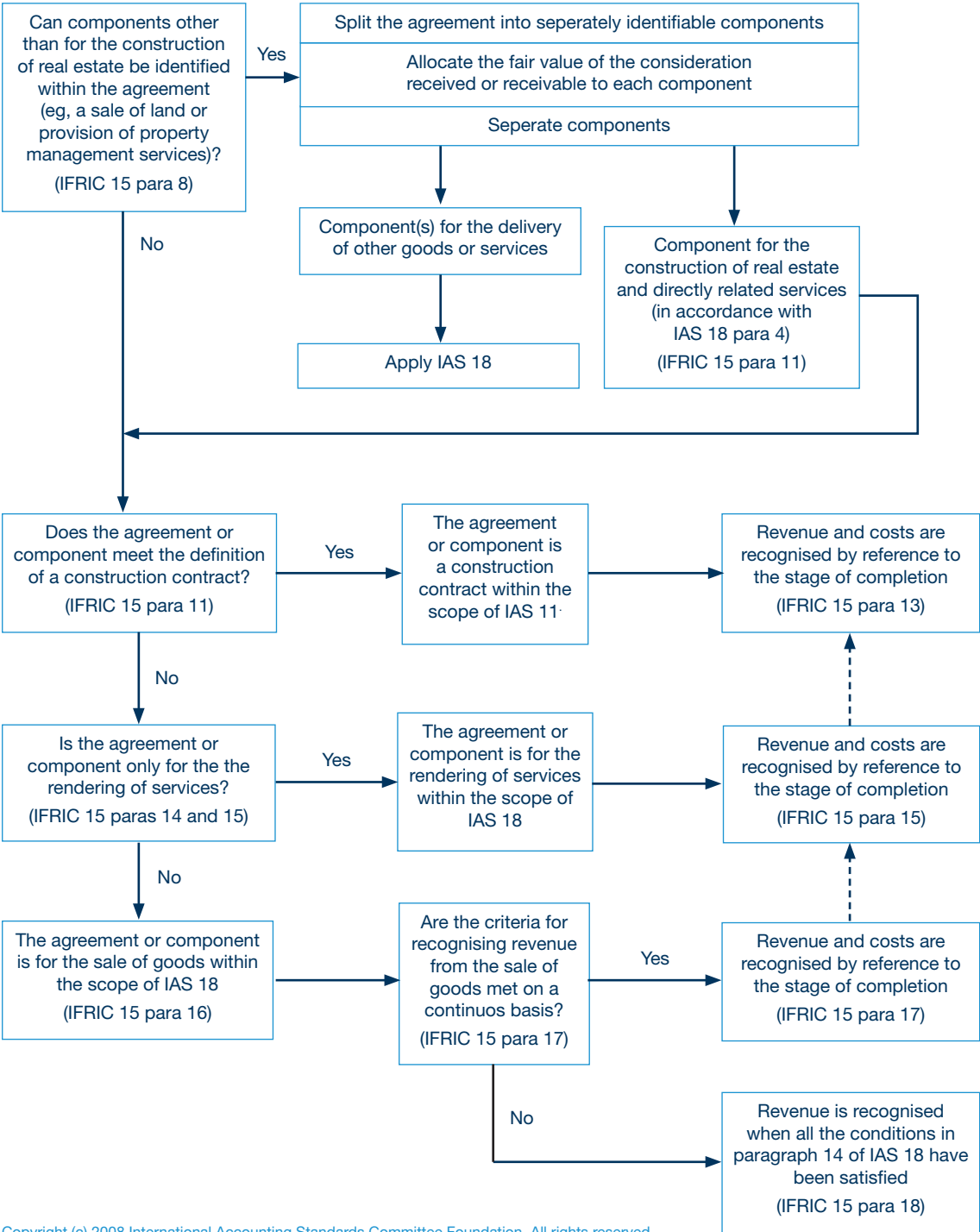
## What will the accounting be if the contract is within IAS 18's scope?

Where applying IFRIC 15 causes an entity to conclude that IAS 18 is the appropriate revenue recognition guidance to follow, further consideration is necessary.

The interpretation introduces a 'continuous transfer' revenue recognition concept for the sale of goods where, provided certain criteria are met, revenue may be recognised using the percentage-of-completion method.

Key criteria in applying the continuous transfer model include whether the entity can demonstrate that the significant risks and rewards of ownership transfer to the buyer on a continuous basis and that the entity retains neither continuing managerial involvements nor effective control over the goods sold. The interpretation's basis for conclusions makes it clear that such agreements might not be encountered frequently in practice.

## Analysis of a single agreement for the construction of real estate



# Distributions of non-cash assets to owners – IFRIC 17

## Introduction

IFRIC 17, 'Distributions of non-cash assets to owners' was issued on 27 November 2008 to clarify how an entity should measure distributions of assets other than cash made as a dividend to its owners. The current standards do not specifically address this issue.

The four main clarifications are:

- A dividend payable should be recognised when appropriately authorised and no longer at the entity's discretion.
- Where an owner has a choice of a dividend of a non-cash asset or cash, the dividend payable is estimated considering both the fair value and probability of the owners selecting each option.
- The dividend payable is measured at the fair value of the net assets to be distributed.
- The difference between fair value of the dividend paid and the carrying amount of the net assets distributed is recognised in profit or loss.

Additional disclosures are required if the net assets being held for distribution meet the definition of a discontinued operation under IFRS 5, 'Non-current assets held for sale and discontinued operations'.

### Effective date

Annual reporting periods beginning on or after 1 July 2009. Early adoption is permitted if disclosed. The entity would then also be required to early adopt IFRS 3 (revised), 'Business combinations', IAS 27 (revised), 'Consolidated and separate financial statements', and IFRS 5 (amended), 'Non-current assets held for sale and discontinued operations'.

### EU adoption status

Not adopted by the European Commission at the time of going to print.

## What is the scope of the interpretation?

IFRIC 17 applies to pro rata distributions of non-cash assets, but does not apply to common control transactions.

## When does an entity recognise a liability for a dividend payable?

An entity recognises a liability for a dividend payable when the dividend is authorised and no longer at the discretion of the entity. This date will vary by jurisdiction, so the IFRIC further clarified this point in the interpretation.

IFRIC 17 states this is the date:

- 'When declaration of the dividend, eg by management or the board of directors, is approved by the relevant authority, eg the shareholders, if the jurisdiction requires such approval, or
- When the dividend is declared, eg by management or the board of directors, if the jurisdiction does not require further approval.'

This might have implications for the legality and hence timing of distributions in certain countries. Where the dividend payable is recorded before the non-cash asset is distributed, the liability is recognised at fair value and the non-cash asset continues to be carried at book value before settlement. This might arise, for example, where the liability is recognised before a period end and the payment is made in the following period.

### **When does an entity recognise a receipt of a dividend?**

IFRIC 17 does not deal with the receipt of dividends, but dividend income is recognised when the shareholder's right to receive payment is established in accordance with IAS 18, 'Revenue'. Determining when a right to receive payment has been established will vary from one jurisdiction to another. However, the accounting for the receipt of dividends should mirror the accounting in the paying entity. The dividend received is therefore recorded at fair value.

# Annual improvements project 2008

## Introduction

The IASB published its first annual improvements project in May 2008. The table below identifies the more significant changes to the standards and the implications for management.

### Effective date

Amendments that are categorised as those unlikely to have much impact have an effective date of periods beginning on or after 1 January 2009. All other amendments, with the exception of one, will be effective for periods beginning on or after 1 January 2009. Early adoption is permitted. However, not all amendments will require retrospective application and a number provide for prospective application.

### EU adoption status

Not adopted by the European Union at the time of going to print.

Standard	Amendments	Practical implications	Effective date
IFRS 5, 'Non-current assets held for sale and discontinued operations' (and consequential amendment to IFRS 1, 'First-time adoption')	<ul style="list-style-type: none"> <li>All of a subsidiary's assets and liabilities are classified as held for sale if a partial disposal sale plan results in loss of control.</li> <li>If the subsidiary described above is a disposal group meeting the definition of a discontinued operation, the relevant disclosures should be made.</li> <li>A consequential amendment to IFRS 1 states that these amendments are applied prospectively from the date of transition to IFRSs.</li> </ul>	<ul style="list-style-type: none"> <li>Classify as held for sale where a partial disposal results in loss of control. An entity that holds an interest of 51% in a subsidiary, sells 2% of its holding and loses control should follow IFRS 5.</li> <li>All assets and liabilities are classified as held for sale, not just the portion disposed of.</li> <li>Continuing involvement after partial disposal does not prevent classification as a discontinued operation. Partial disposal previously not accounted for under IFRS 5 will now fall within the scope of IFRS 5. Classify as held for sale where a partial disposal results in loss of control. An entity that holds an interest of 51% in a subsidiary, sells 2% of its holding and loses control should follow IFRS 5.</li> </ul>	Periods beginning on or after 1 July 2009 with prospective application from the date IFRS 5 was first applied. Early adoption permitted only if IAS 27 (as amended in May 2008) is also early adopted.
IAS 16, 'Property, plant and equipment' (and consequential amendment to IAS 7, 'Statement of cash flows')	<ul style="list-style-type: none"> <li>Entities whose ordinary activities comprise renting and subsequently selling assets present proceeds from the sale of those assets as revenue.</li> <li>The carrying amount of the asset is transferred to inventories when the asset becomes held for sale.</li> <li>A consequential amendment to IAS 7 states that cash flows arising from purchase, rental and sale of those assets are classified as cash flows from operating activities.</li> <li>Wording of definition of recoverable amount has been aligned with IAS 36, 'Impairment of assets'</li> </ul>	<ul style="list-style-type: none"> <li>Proceeds received from subsequent sale of such assets are presented gross as revenue following the amendment; the current standard requires net proceeds to be reported as other income/expense.</li> <li>IFRS 5 does not apply when the asset is transferred to inventories. This may result in a gross-up in revenue and expenses and a switch from investing cash flows to operating cash flows.</li> </ul>	Periods beginning on or after 1 January 2009. Early adoption permitted, but management should apply related amendments to IAS 7.
IAS 23, 'Borrowing costs'	<ul style="list-style-type: none"> <li>The definition of borrowing costs has been amended. Interest expense is calculated using the effective interest method defined in IAS 39.</li> </ul>	<ul style="list-style-type: none"> <li>The amendment eliminates inconsistency of terms between IAS 39 and IAS 23.</li> </ul>	Periods beginning on or after 1 January 2009.
IAS 27, 'Consolidated and separate financial statements'	<ul style="list-style-type: none"> <li>Where an investment in a subsidiary that is accounted for under IAS 39 is classified as held for sale under IFRS 5, IAS 39 (as opposed to IFRS 5) would continue to be applied.</li> </ul>	<ul style="list-style-type: none"> <li>Investments accounted for under IAS 39 in the separate financial statements of a parent are classified as held for sale. IFRS 5 only applies to investments in subsidiaries that are held at cost.</li> </ul>	Periods beginning on or after 1 January 2009 with prospective application from the date IFRS 5 was first applied.

Standard	Amendments	Practical implications	Effective date
IAS 28, 'Investments in associates' (and consequential amendments to IAS 32, 'Financial instruments: Presentation' and IFRS 7, 'Financial instruments: Disclosures')	<ul style="list-style-type: none"> <li>Where an investment in associate is accounted for in accordance with IAS 39 only certain (rather than all) disclosure requirements in IAS 28 need to be made in addition to disclosures required by IAS 32/IFRS 7.</li> <li>An investment in associate is treated as a single asset for the purposes of impairment testing.</li> <li>Any impairment loss is not allocated to specific assets included within the investment, for example, goodwill.</li> <li>Reversals of impairment are recorded as an adjustment to the investment balance to the extent that the recoverable amount of the associate increases.</li> </ul>	<ul style="list-style-type: none"> <li>Disclosure is significantly reduced.</li> <li>This amendment clarifies and potentially simplifies the accounting for impairment losses.</li> </ul>	Periods beginning on or after 1 January 2009. Early adoption is permitted, but management should also apply its related amendments in IFRS 7, IAS 28 and IAS 32.
IAS 29, 'Financial reporting in hyperinflationary economies'	<ul style="list-style-type: none"> <li>Amended guidance to reflect the fact that a number of assets and liabilities are measured at fair value rather than historical cost.</li> </ul>	<ul style="list-style-type: none"> <li>Achieves consistency with guidance in other standards.</li> </ul>	Periods beginning on or after 1 January 2009.
IAS 31, 'Interests in joint ventures (and consequential amendments to IAS 32 and IFRS 7)	<ul style="list-style-type: none"> <li>Where an investment in joint venture is accounted for in accordance with IAS 39, only certain (rather than all) disclosure requirements in IAS 31 need to be made in addition to disclosures required by IAS 32/IFRS 7.</li> </ul>	<ul style="list-style-type: none"> <li>Disclosure is significantly reduced.</li> </ul>	Periods beginning on or after 1 January 2009. Early adoption is permitted, but management should also apply its related amendments in IFRS 7, IAS 28 and IAS 32.
IAS 36, 'Impairment of assets'	<ul style="list-style-type: none"> <li>Where fair value less costs to sell is calculated on the basis of discounted cash flows, disclosures equivalent to those for value-in-use calculation should be made.</li> </ul>	<ul style="list-style-type: none"> <li>The amount of disclosure required when using fair value less costs to sell to calculate the recoverable amount has been increased.</li> </ul>	Periods beginning on or after 1 January 2009.
IAS 38, 'Intangible assets'	<ul style="list-style-type: none"> <li>An asset may only be recognised in the event that payment has been made in advance of obtaining right of access to goods or receipt of services.</li> <li>Advertising and promotional activities includes mail order catalogues.</li> <li>Deletion of wording that states that there is 'rarely, if ever' support for use of a method that results in a lower rate of amortisation than the straight line method.</li> </ul>	<ul style="list-style-type: none"> <li>Eliminates diversity in practice.</li> <li>Expenses incurred in printing mail order catalogues, for example, are recognised once the catalogues are printed and not when they are distributed to customers.</li> <li>Eliminates a potential interpretation that the unit of production method is prohibited.</li> <li>Amortisation method reflects the expected pattern of consumption of economic benefits of the asset.</li> </ul>	Periods beginning on or after 1 January 2009.
IAS 40, 'Investment property' (and consequential amendments to IAS 16)	<ul style="list-style-type: none"> <li>Property that is under construction or development for future use as investment property is within the scope of IAS 40.</li> <li>Where the fair value model is applied, such property is, therefore, measured at fair value.</li> <li>Where fair value of investment property under construction is not reliably measurable, the property is measured at cost until the earlier of the date construction is completed or the date at which fair value becomes reliably measurable.</li> </ul>	<ul style="list-style-type: none"> <li>More property under construction will be shown at fair value rather than cost.</li> </ul>	Prospective application for periods beginning on or after 1 January 2009. Earlier adoption only permitted if the relevant fair value information was determined at the earlier application date.
IAS 41, 'Agriculture'	<ul style="list-style-type: none"> <li>Use of a market-based discount rate where fair value calculations are based on discounted cash flows.</li> <li>Removal of the prohibition on taking into account biological transformation when calculating fair value.</li> </ul>	<ul style="list-style-type: none"> <li>Post-tax rates are more easily available in the market place for estimating fair value. The change also simplifies the calculation of discounted cash flows.</li> <li>Market participants assume normal biological transformation; this is therefore taken into account when calculating fair value using a discounted cash flow model.</li> </ul>	Prospective application for periods beginning on or after 1 January 2009.

<b>Liabilities</b>			
IAS 19, 'Employee benefits'	<ul style="list-style-type: none"> <li>• A plan amendment that results in a change in the extent to which benefit promises are affected by future salary increases is a curtailment.</li> <li>• An amendment that changes benefits attributable to past service gives rise to a negative past service cost if it results in a reduction in the present value of the defined benefit obligation.</li> <li>• Definition of return on plan assets amended to state that plan administration costs be deducted in the calculation of return on plan assets only to the extent that such costs have been excluded from measurement of the defined benefit obligation.</li> <li>• The distinction between short term and long term employee benefits is now based on whether benefits are due to be settled within or after 12 months of employee service being rendered.</li> <li>• Deletion of guidance that states IAS 37, 'Provisions, contingent liabilities and contingent assets' requires contingent liabilities to be recognised.</li> </ul>	<ul style="list-style-type: none"> <li>• A number of clarifications in definitions and eliminations of inconsistencies should ease application of the standard.</li> <li>• Makes IAS 19 and IAS 37 consistent.</li> </ul>	Periods beginning on or after 1 January 2009 with the exception of amendments to the guidance on curtailments and negative past service costs, which should be applied prospectively to any benefit changes occurring on or after 1 January 2009
IAS 20, 'Accounting for government grants and disclosure of government assistance'	<ul style="list-style-type: none"> <li>• The benefit of a below-market rate government loan is measured as the difference between the carrying amount in accordance with IAS 39 and the proceeds received.</li> <li>• The benefit is accounted for in accordance with IAS 20.</li> </ul>	<ul style="list-style-type: none"> <li>• Entities are required to quantify and report the benefits.</li> </ul>	Prospective application to government loans received on or after 1 January 2009.
<b>Financial assets and liabilities</b>			
IAS 39, 'Financial instruments: Recognition and measurement'	<ul style="list-style-type: none"> <li>• Clarification that it is possible for there to be movements into and out of the fair value through profit or loss category where: <ul style="list-style-type: none"> <li>– A derivative commences or ceases to qualify as a hedging instrument in cash flow or net investment hedge.</li> <li>– Financial assets are reclassified following a change in policy by an insurance company in accordance with IFRS 4.</li> </ul> </li> <li>• The definition of financial asset or financial liability at fair value through profit or loss as it relates to items that are held for trading is amended. This clarifies that a financial asset or liability that is part of a portfolio of financial instruments managed together with evidence of an actual recent pattern of short-term profit-taking is included in such a portfolio on initial recognition.</li> <li>• Removal of a segment as an example of what may be considered a party external to the reporting entity.</li> <li>• When remeasuring the carrying amount of a debt instrument on cessation of fair value hedge accounting, the amendment clarifies that a revised effective interest rate (calculated at the date fair value hedge accounting ceases) are used.</li> </ul>	<ul style="list-style-type: none"> <li>• Clarification makes it possible to have movements into or out of the fair value through profit or loss category after initial recognition.</li> <li>• The amendment addresses these interpretations by clarifying that reclassifications are not permitted, but there may be changes in circumstance that lead to the commencement or cessation of fair value through profit or loss measurement.</li> <li>• The guidance on designating and documenting hedges states that a hedging instrument needs to involve a party external to the reporting entity.</li> <li>• IAS 39 currently cites a segment as an example of a reporting entity.</li> <li>• Deletion of this example is a result of this being inconsistent with IFRS 8, 'Operating segments' which requires disclosure based on information reported to the chief operating decision maker.</li> <li>• This addresses a current inconsistency as to whether the original or a revised effective interest rate is applied. It clarifies that the revised effective interest rate is applied.</li> </ul>	Periods beginning on or after 1 January 2009. Specifically, amendments to the guidance on fair value through profit or loss classification should be applied in the same manner as the 2005 fair value option amendment to IAS 39 was applied.
<b>Financial statement presentation</b>			
IAS 1, 'Presentation of financial statements'	Clarification that some rather than all financial assets and liabilities classified as held for trading in accordance with IAS 39 are examples of current assets and liabilities respectively.	Financial assets and liabilities that are classified as held for trading are classified as current or non-current in accordance with IAS 1.	Periods beginning on or after 1 January 2009.

# Amendments that are unlikely to affect the accounting treatment for most preparers

## **IFRS 7, 'Financial instruments: Disclosures'**

The amendment addresses a potential conflict between the implementation guidance in IFRS 7 and guidance contained in IAS 1. The current wording in paragraph IG13 of IFRS 7 could suggest that an entity is permitted to present total interest income and expense as a net amount within finance costs. In contrast, IAS 1 would preclude interest income and expense being reported in this way. Accordingly, the guidance in paragraph IG13 has been amended to remove the possibility for such an interpretation.

## **IAS 8, 'Accounting policies, changes in accounting estimates and errors'**

The amendment clarifies that guidance that is not an integral part of a standard is intended to assist entities in application of standards rather than containing requirements that must be followed.

## **IAS 10, 'Events after the reporting period'**

The amendment reinforces existing guidance that a dividend declared after the reporting date is not a liability of an entity at that date given that there is no obligation at that time.

## **IAS 18, 'Revenue'**

The amendment replaces the term 'direct costs' with 'transaction costs' in respect of costs incurred in originating a loan. This achieves consistency with IAS 39.

## **IAS 20, 'Accounting for government grants and disclosure of government assistance' and IAS 29, 'Financial reporting in hyperinflationary economies'**

The terminology in both these standards has been amended in order to achieve consistency with other standards. For example, in IAS 20, references to 'taxable income' have been replaced with 'taxable profit or loss'.

## **IAS 34, 'Interim financial reporting'**

The standard currently states that basic and diluted earnings per share must be presented in an interim report. The amendment clarifies that this is only the case when the entity is within the scope of IAS 33, 'Earnings per share'.

## **IAS 40, 'Investment property'**

An amendment to the guidance on investment property held under a lease clarifies that if a valuation obtained for such an investment property is net of all expected payments, any recognised lease liability must be added back in order to determine the carrying amount of the investment property under the fair value model. A further amendment also brings wording included in the standard on changes in accounting policy in line with IAS 8.

## **IAS 41, 'Agriculture'**

The standard currently refers to 'point-of-sale costs'. Given that this term is not used in any other standard, the amendment replaces this term with 'costs to sell'. There are also resulting consequential amendments to IAS 2, IAS 36 and IFRS 5 to update references in those standards. A further amendment results in a minor change to examples of agricultural produce.

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