IFRS News

Emerging issues and practical guidance*

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Amendments to IFRS 1 and IAS 27

The amendments to IFRS 1 and IAS 27 are expected to simplify the preparation of separate financial statements on first-time adoption and eliminate potential dividend traps. Alla Saltykova and Milan Zeleny explain.

The amendments bring three major changes:

- The cost of a subsidiary, jointly controlled entity or associate on transition to IFRS is determined under IAS 27 or as a deemed cost;
- 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; and
- The cost of the investment of a new parent in a group is measured at the carrying amount of its share of equity as shown in separate financial statements of the previous parent.

New exemption in IFRS 1

The new exemption facilitates the transition to IFRS and importantly on separate financial statements – an area that does not often get attention from the Board. The exemption is available for investments in a subsidiary, jointly controlled entity or associate. It can be used if such investments are carried at cost in the separate financial statements.

A first-time adopter can use cost as determined in accordance with IAS 27 or at deemed cost. Deemed cost is determined as at the transition date as either fair value of the

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Welcome to IFRS News – relaunched

This month marks six years – that's 64 issues – of *IFRS News*. The use of IFRS continues to spread around the globe, and the standards themselves grow and change every year. We have taken this opportunity to re-launch *IFRS News* with a new design and a small change in emphasis. We plan to bring you an increased focus on the practical issues surrounding the application of IFRS, as well as covering breaking news from the IASB. We will feature more Q&As and practical examples, as requested by you, our readers. Thank you to all of those who participated in our recent survey. We hope you like the new approach. Feedback is always welcome.

Mary Dolson
Global ACS business combinations topic team leader and publisher of *IFRS News*

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investment as at that date under IAS 39 or the previous GAAP carrying amount at that date. Determining cost in accordance with IAS 27 is seldom an attractive option, as the entire track record of the subsidiary would have to be 'reconstructed' under IFRS.

The exemption is available on an investment-by-investment basis for all investments accounted for at cost in the separate financial statements. Some additional disclosures are required if the exemption is used.

Practical insights

Use of the exemption relieves the first time adopter of the requirement to:

- measure the investment at its fair value as at the date of acquisition of the investment;
- go back to the date of acquisition of the investment and recognise income from the investment only to the extent the entity received distributions from post-acquisition profits; and
- recognise distributions received in excess of post-acquisition profits as a reduction of the cost of investment.

Dividend amendments

Dividends from a subsidiary, jointly controlled entity or associate are now recognised as income in the separate financial statements of the parent.

Previously the accounting treatment of dividends was driven by the definition of the cost method in IAS 27. Dividends from post-acquisition retained earnings were recognised as income; dividends in excess of such profits were considered a recovery of an investment and a reduction of the cost of the investment.

There is an amendment to IAS 36 to reduce the risk that an investment might be overstated. It identifies circumstances when dividend payment requires impairment testing of the investment. This includes dividends exceeding the total comprehensive income of the subsidiary, jointly controlled entity or associate in the period the dividend is declared or if the carrying amount of the investment in separate financial statements exceeds the carrying amount in the consolidated financial statements of the investee's net assets, including goodwill.

Practical insights

The amendment removes the need to differentiate between post and pre-acquisition retained earnings. It simplifies accounting and bookkeeping for both existing preparers and first-time adopters.

It also removes the automatic link between the payment of dividends from pre-acquisition retained earnings and return of investment. Instead it treats the receipt of dividends as a recovery of the investment.

Reorganisations/the cost of investment in the separate financial statements of the new parent

The amendment clarifies the accounting for the formation of a new parent for an existing group when there are no changes of substance.

A new parent that adopts the cost model to account for the investment in the original parent, measures the cost of the investment at the carrying amount of its share of equity items in separate financial statements of the original parent at the date of reorganisation.

The amendment suggests that there are no changes of substance from a reorganisation when all of the following conditions are met:

- the new parent gets control of the original parent by issuing equity instruments in exchange for existing equity instruments of the original parent;
- the assets and liabilities of the new group and the original group are the same immediately before and after the reorganisation; and
- the owners of the original parent before reorganisation have the same absolute and relative interests in the net assets of the original group and the new group immediately before and after the reorganisation.

Practical insights

The amendment applies when a new parent is established below the existing shareholders for an existing group or entity. The old parent and the new parent may or may not be under common control of the shareholders. For example, the new parent may be established by legal advisers to be ready for use when the shareholders agree to a reorganisation but do not establish common control by contract. The shareholders may vote to insert the new parent over the existing parent. The application of carry-over basis is not optional when the three criteria of a reorganisation having no changes of substance and the cost method is used.

Effective date

The new exemption to IFRS 1 is applied for annual periods beginning on or after 1 January 2009, with earlier application permitted.

The amendment on dividends is applied prospectively from 1 January 2009, with application permitted. Where amendments on dividends are applied for an earlier period, the related amendments to IAS 18, IAS 21 and IAS 36 are applied at the same time.

The amendment on reorganisation is applied prospectively to reorganisations occurring in annual periods beginning on or after 1 January 2009. The amendment can be applied retrospectively from a specific reorganisation, and all later reorganisations are restated.

Milan Zeleny

Alla Saltykova

Practical guidance on financial reporting for oil & gas and utilities companies

The second wave of transition to IFRS – Canada, China, India, Korea and the US among others – is under way. PwC has published two volumes of practical guidance on financial reporting in energy and utilities under IFRS. The guides provide practical help to continuing users of IFRS as well as transitioning companies in both industries. *Financial Reporting in the Oil and Gas Industry* and *Financial Reporting in the Utilities Industry* complete the three-volume set that was launched by *Financial Reporting in the Mining Industry* published in June last year. The guidance highlights the key issues faced by entities operating in these sectors as they apply IFRS, include a comparison of IFRS and US GAAP requirements and a look forward at new standards that will have a big impact on companies in the sector.

The topics addressed are those that arise frequently in practice, including for example, the application of IAS 39 to commodity contracts for utility entities and accounting for business combinations in the upstream oil industry.

The publications also identify and comment on proposed and actual changes in IFRS such as the impacts of the new business combinations standard, the Extractive Activities project (see box below), the Joint Arrangements exposure draft (ED 9) and the IASB's new project on emissions trading schemes.

"As with earlier publications", said Norbert Schwieters, co-chair of the firm's Global Utilities IFRS Group, "PwC aims at being ahead of a new wave of transitions in the energy industry. The publications will be welcomed by companies on their way into IFRS accounting."

The publications were launched at a roundtable in London, attended by representatives of over 20 energy and utilities companies from eight countries. The afternoon sessions gave attendees the opportunity to participate in discussions on emerging issues for either oil and gas or utilities.

The publications are available for download from **www.pwc.com/energy**. Contact **mark.king@uk.pwc.com** (energy) and **norbert.schwieters@de.pwc.com** (utilities) for further information on PwC IFRS services.

IASB Extractive Activities project

The Board has a research project, considering the different accounting alternatives for reserves and resources, and other associated accounting issues. Further details, including an estimated timetable for the project, can be found in the PwC pamphlet *Need to Know* (published in March 2008), available from www.pwc.com/energy.

Conceptual framework moves forward

The Board has published two consultation documents on the proposed improved conceptual project:

- an exposure draft of Chapter 1, The Objective of Financial Reporting, and Chapter 2, Qualitative Characteristics and Constraints of Decision-useful Financial Reporting Information; and
- a discussion paper, 'Preliminary Views on The Reporting Entity'.

Qualitative characteristics of financial reporting information

The board seeks views on its proposals for the qualitative characteristics of information provided by financial reporting and constraints on the provision of that information.

The exposure draft proposes that the objective of financial reporting is to provide financial information that is useful to present and potential equity investors, lenders and other creditors in making decisions in their capacity as capital providers. It also presents an description of 'faithful representation', one of the qualitative characteristics that financial information should have if it is to provide a useful basis for economic decisions.

Reporting entity concept

The discussion paper sets out the boards' preliminary views on the reporting entity concept and related issues. These views are:

- a reporting entity is a circumscribed area of business activity of interest to present and potential equity investors, lenders and other capital providers;
- control is the basis for determining the composition of a group reporting entity; and
- consolidated financial statements should be prepared from the perspective of the group reporting entity.

The IASB and the FASB invite comments on both documents by 29 September 2008.

Chile moves to full IFRS

Chile is going for a gradual convergence to full IFRS over a three-year period from 2009 to 2011. Banks and major listed companies will have to present IFRS information as early as 2009; other companies will have more time to get up to speed. Sergio Tubio and Fernando Orihuela, IFRS partners in Chile, describe the IFRS adoption process in the first Latin American country going for full IFRS.

What's the adoption time line for Chile?

The SVS, the Chilean securities exchange regulator, announced in 2004 that public companies will be required to present full IFRS financial statements from 2009. At the same time, the Chilean professional body announced the conversion of Chilean GAAP to IFRS, also for 2009. Since then, regulators, the profession and representatives from different industries have been working closely to get a consensus on the strategic approach to IFRS convergence in Chile.

The SVS announced last year a gradual adoption plan – see timeline on p5.

Are there specific requirements for banks and insurance companies?

Insurance companies in Chile are also regulated by the SVS. Insurance companies are required to present full IFRS financial statements in 2010 – see timeline on p5.

In 2007, the Superintendence of Financial Institutions issued a circular requiring banks and other financial institutions to adopt IFRS on 1 January 2009, with certain exceptions, including:

- provisions – banks must provide for credit risk based on prudential requirements including expected losses on loans commitments; for example, off balance contingent risk such as authorised credit limits or letter of credits not yet negotiated; and
- fair value option – banks are not allowed to designate assets or liabilities as FVTPL.

Banks that are subsidiaries of entities regulated by the SVS will have to reconcile to full IFRS in their financial information for consolidation purposes.

What about non-listed companies?

The Chilean professional body is in the process of issuing a set of new accounting standards replicating the IFRSs, known as NIIFCH ('NIIF' is the Spanish translation of 'IFRS'). There should be no changes to the IFRSs as issued by IASB. The objective of its work is just to translate the latest version of the international standards, including local expressions and terminology, so that the new standards can be understood by the profession. However, bases for conclusion and application guidance will not be translated but incorporated into the new Chilean standards as references.

The new NIIFCHs are scheduled to be formally issued this month. Entities may apply them for reporting periods beginning on 1 January 2009. They will be mandatory for every Chilean entity, for both consolidated and stand-alone financial statements, some time between 2009 and 2011.

How involved are boards of directors and corporate governance bodies in the transition process?

Regulators seek to have company directors deeply involved in the transition process. In particular, they were required to approve the company's strategy and detailed plan for transitioning to IFRS before in April 2008.

A draft circular issued by the SVS requires directors to consider the actions and measures that management has taken in determining the main accounting policies and the transition adjustments. The directors' discussions have to be documented.

Are companies required to tell the market the expected effects of adopting the new accounting framework?

Yes, major listed companies that elect to present full IFRS financial statements in 2009 will be required to present a reconciliation of the opening balance as of 1 January 2008.

Will Chile achieve full convergence to IFRS?

Full convergence is the spirit behind the Chilean transition to IFRS. However, given the gradual approach to IFRS adoption, and given that not all the regulators require full IFRS, different accounting frameworks will coexist for a period of time.

In addition, although banks are required to apply all the IFRSs, certain exceptions introduced by the regulator mean that banks will not achieve full convergence.

Will the tax requirement change to accommodate to the new IFRS figures?

This is probably the most significant implementation issue to be considered when defining the company's IFRS transition strategy. Tax law and requirements will not change. Therefore, companies will have to apply IFRS in their financial statements but will have to keep separate records in order to arrive to the tax figures. For example, a company that changes its fixed assets' useful lives and stops reflecting the effects of inflation in its non-monetary assets for financial reporting purposes will