Grant Thornton

Accounting

News

Discussion

IFRS technical updates

April - October 2021

This newsletter highlights amendments, proposed amendments, and decision points to IAS and IFRS that have been released from April 2021 to October 2021.

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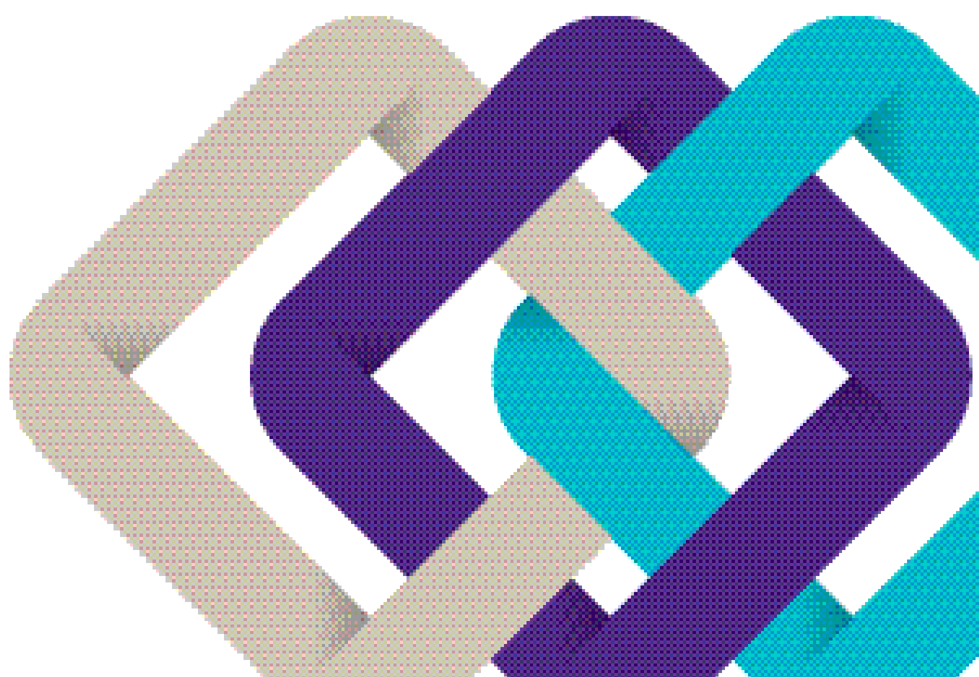


Amendment to IAS 12 Income Taxes

Deferred tax related to assets and liabilities arising from a single transaction

Prior to the amendment, there was uncertainty about the exemption applied to some transactions like leasing and decommissioning obligations as entity recognised both asset and liability. This gave rise to equal amounts of deductible and taxable temporary differences on initial recognition.

The amendment clarifies that the exemption does not apply. Companies are required to recognise deferred tax on such transactions, where equal amounts of deductible and taxable temporary differences arise on initial recognition. The amendment will help to reduce diversity in the reporting of deferred tax on leases and decommissioning obligations.

Deferred tax assets shall be recognised to the extent that:

- it is probable that taxable profit will be available against which the deductible temporary difference can be utilised
- deferred tax liability shall be recognised for all deductible and taxable temporary differences associated with:
  - a right-of-use assets and lease liabilities
  - b decommissioning, restoration and similar liabilities recognised as part of the cost of the related asset.
- the cumulative effect of initially applying the amendments is recognised as an adjustment to the opening balance of retained earnings or components of equity, as appropriate.

The amendment to IAS 12 is effective for annual reporting periods beginning on or after 1 January 2023. Earlier application is permitted.

Amendment to IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors

Companies often struggle to distinguish between accounting policies and accounting estimates, and divergent practices have been observed. The Interpretations Committee received a request to clarify the distinction, and passed it to the International Accounting Standards Board (IASB) which has now published an amendment.

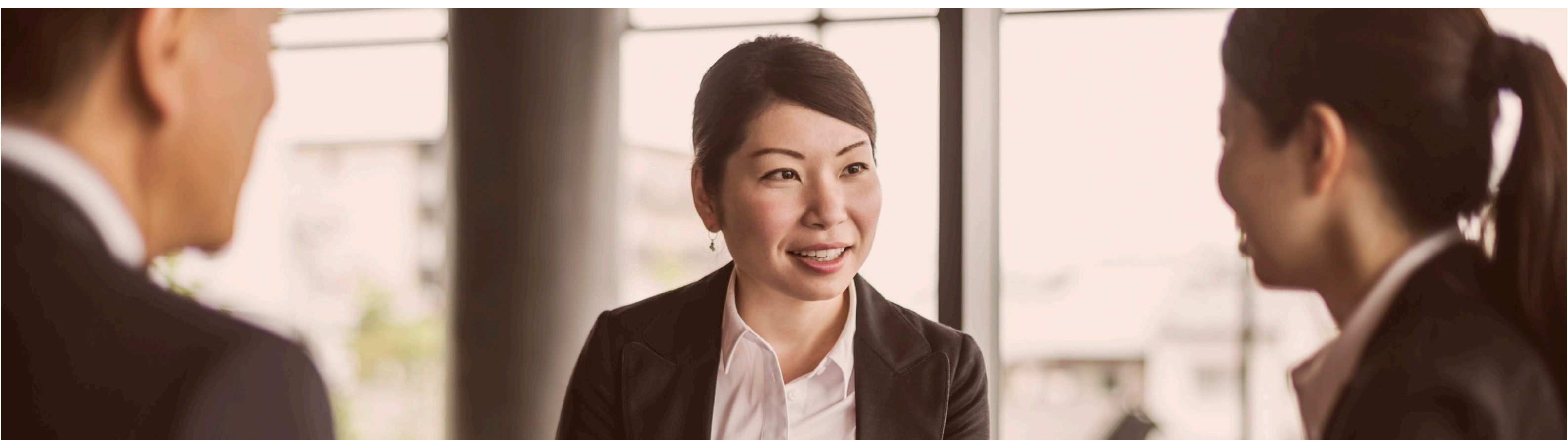
The amendment requires that companies should distinguish changes in accounting policies from changes in accounting estimates. Changes to estimates are applied prospectively compared to changes in accounting policies which are applied retrospectively, therefore requiring a restatement.

The changes to IAS 8 focusses on accounting estimates and clarifies that accounting estimates are “monetary amounts in financial statements that are subject to measurement uncertainty”.

The amendment replaces the ‘definition of a change in accounting estimates’ with a ‘definition of accounting estimates’.

IASB also clarified that a change in accounting estimate that results from new information or new developments is not the correction of an error. In addition, the effects of a change in an input or a measurement technique used to develop an accounting estimate are changes in accounting estimates if they do not result from the correction of prior period errors.

The amendment to IAS 8 is effective for annual reporting periods beginning on or after 1 January 2023. Earlier application is permitted.



IFRIC Update — Committee's agenda decisions

Attributing Benefit to Periods of Service (IAS 19 Employee Benefits)

The IFRS Interpretations Committee ("the Committee") received a submission about the periods of service to which an entity attributes benefit for a particular defined benefit plan, but decided not to add a standard-setting project to the work plan. Instead, the Committee decided to finalise an agenda decision that also explains how the applicable principles and requirements in IFRS Standards apply to the question.

Under the terms of the plan described in submission, employees are entitled to a lump sum benefit payment when they reach a specified retirement age provided they are employed by the entity when they reach that retirement age. The amount of the retirement benefit to which an employee is entitled depends on the length of employee service with the entity before the retirement age and is capped at a specified number of consecutive years of service.

IAS 19 requires an entity to attribute benefit to periods of service under the plan's benefit formula from the date when employee service first leads to benefits under the plan until the date when further employee service will lead to no material amount of further benefits under the plan. An entity's obligation increases until the date when further service by the employee will lead to no material amount of further benefits under the plan.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to determine the periods of service to which retirement benefit is attributed in the fact pattern described in the request. Consequently, the Committee decided not to add a standard-setting project to the work plan.

Hedging Variability in Cash Flows due to Real Interest Rates (IFRS 9 Financial Instruments)

The objective of hedge accounting is to represent, in the financial statements, the effect of an entity's risk management activities that use financial instruments to manage exposures arising from risks that could affect profit or loss.

More specifically, the request received described a fact pattern in which an entity with a floating rate instrument referenced to an interest rate benchmark, such as the London Interbank Offered Rate (LIBOR), enters an inflation swap which swaps the variable interest cash flows of the floating rate instrument for variable cash flows based on an inflation index. The request asked whether the entity can designate the swap in a cash flow hedging relationship to hedge changes in the variable interest payments for changes in the real interest rate.

As IFRS has a rebuttable presumption that unless inflation risk is contractually specified, it is not separately identifiable and reliably measurable and hence cannot be designated as a risk component of a financial instrument, the Committee focused on whether a non-contractually specified real interest rate risk component is separately identifiable and reliably measurable in the context of the proposed cash flow hedging relationship.

The Committee noted that for the market structure to support the eligibility of that risk component in the proposed cash flow hedging relationship, the real interest rate must represent an identifiable pricing element in setting the floating benchmark interest rate, thereby creating separately identifiable and reliably measurable cash flow variability in the floating rate instrument.

As the rebuttable presumption in IFRS 9 applies to both fair value hedges and cash flow hedges, the Committee therefore concluded that nominal rates generally do not change as a direct result of changes in real interest rates.

Consequently, the real interest rate risk component in the proposed cash flow hedging relationship does not meet the requirements in IFRS 9 to be designated as an eligible hedged item.

Costs Necessary to Sell Inventories (IAS 2 Inventories)

IAS 2 requires an entity to estimate the costs necessary to make the sale. This requirement does not allow an entity to limit such costs to only those that are incremental, thereby potentially excluding costs the entity must incur to sell its inventories but that are not incremental to a particular sale.

The Committee concluded that when determining the net realisable value of inventories, an entity is required to include costs necessary to make the sale in the ordinary course of business. An entity is required to use its judgement to determine which costs are necessary to make the sale considering its specific facts and circumstances, including the nature of the inventories.

Preparation of Financial Statements when an Entity is No Longer a Going Concern (IAS 10 Events after the Reporting Period)

The Committee received a request on the accounting which should be applied by an entity that is no longer a going concern. The request asked whether the entity:

- can prepare financial statements for prior period on a going concern basis if it was a going concern for those periods and has not previously prepared financial statements for those periods
- restates comparative information to reflect the basis of accounting used in preparing the current period's financial statements if it had previously issued financial statements for the comparative period on a going concern basis.

The Committee concluded an entity which is no longer a going concern cannot prepare financial statements (including those for prior periods that have not yet been authorised for issue) on a going concern basis.

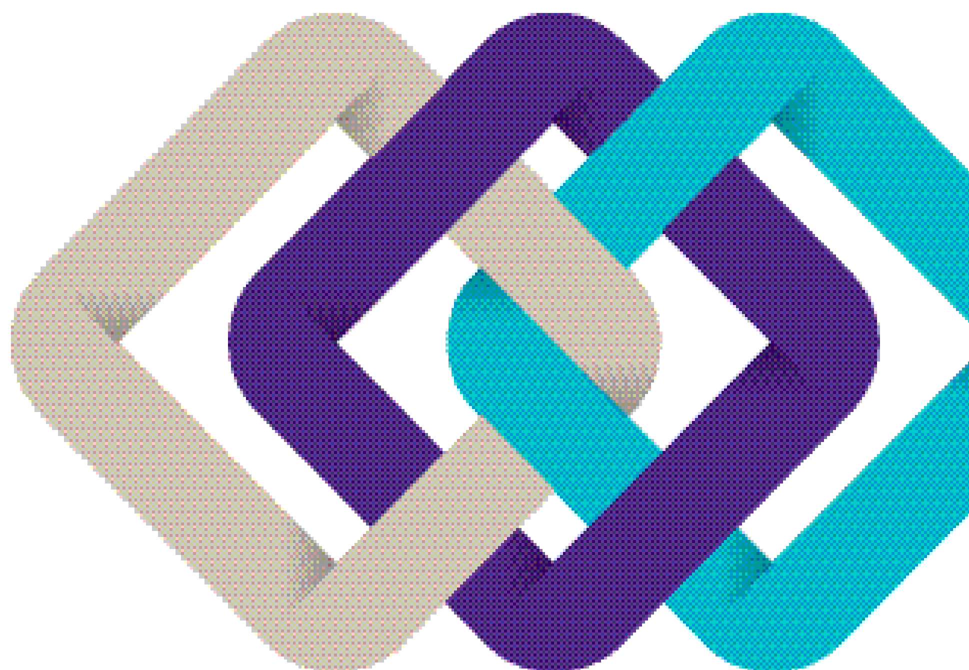
Non-refundable Value Added Tax on Lease Payments (IFRS 16 Leases)

During the March 2021 meeting, it was concluded that the non-refundable value-added tax (VAT) should be excluded from the measurement of the lease liability and suggested not explaining the accounting treatment lessees apply to it because its impact is not material nor widespread.

Most of the Committee members agreed with the accounting conclusion but some of them were not convinced that the matter is not material nor widespread based on the limited outreach performed by the staff.

Outreach conducted by the Committee and comment letters on the Committee's tentative agenda decision provided limited evidence:

- that non-refundable VAT on lease payments is material to affected lessees
- of diversity in the way lessees in similar circumstances account for non-refundable VAT on lease payments.



Proposed amendment to IFRS 17 Insurance Contracts

Initial Application of IFRS 17 and IFRS 9 — Comparative Information

This amendment relates to financial assets relating to insurance contract liabilities for which comparative information presented on initial application of IFRS 17 and IFRS 9 has not been restated for IFRS 9. An entity can apply a classification overlay approach which is intended to achieve classification outcomes more consistent with what they would have been under IFRS 9.

In the comparative periods presented on initial application of IFRS 17 and IFRS 9, application of the amendment would be optional.

The proposed scope of the classification overlay should be expanded such that:

- If an entity applies the classification overlay, it must disclose this application.
- An entity has an option of applying the classification overlay on an instrument-by-instrument basis so as to avoid accounting mismatches and achieve better consistency in financial statements when applying IFRS 17 and IFRS 9 for the first time. There is no requirement to separately identify the financial assets to which the optional classification overlay has been applied to.
- When an entity applies IFRS 17, only then can it avail this amendment. When applying the classification overlay, the entity does not need to apply the impairment requirement of IFRS 9.

Narrow scope amendment is expected by the end of 2021.

Proposed amendments to IAS 21 The Effects of Changes in Foreign Exchange Rates

The proposed amendments add requirements to IAS 21 which specifies the exchange rate to use in reporting foreign currency transactions when exchangeability between two currencies is temporarily lacking. Amendment will help the companies determine whether a currency can be exchanged into another currency, and what accounting to apply if the currency cannot be exchanged.

The following key changes have been made to the standard:

- Definition: A currency is exchangeable into another currency when an entity is able to exchange that currency for the other currency.
- When exchangeability between two currencies is lacking, the entity shall estimate the spot exchange rate at that date. The estimated spot exchange rate shall meet the following conditions assessed at the measurement date:
  - a A rate at which an entity would have been able to enter into an exchange transaction had the currency been exchangeable into the other currency
  - b A rate that would have applied to an orderly transaction between market participants
  - c A rate that faithfully reflects the prevailing economic conditions

When an entity estimates a spot exchange rate because exchangeability between two currencies is lacking, it is required to disclose information that would enable users of its financial statements to evaluate how lack of exchangeability between two currencies affects, or is expected to affect, its financial performance, financial position and cash flows.

An entity will have to disclose information about:

- the nature and financial effects of a lack of exchangeability
- the spot exchange rate(s) used
- the estimation process
- the risk to which the entity is exposed.

The Board tentatively decided to permit an entity to apply the proposed amendments earlier than the effective date.

To get a staff summary of the tentative decisions reached by the IASB in its public meetings, visit IASB Updates.

To get a summary of the decisions reached by the IFRS Interpretations Committee in its public meetings, please visit IFRS Interpretations Committee Updates.

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