IFRS LINK

IFRS 15 Revenue from Contracts with Customers

After a discussion and development phase spanning several years, the IASB and FASB have concluded the joint project on revising the rules for revenue recognition. On 28 May 2014, the IASB issued IFRS 15 Revenue from Contracts with Customers. The objective of the revised standard is to increase convergence between IFRS and US GAAP through uniform accounting policies in particular and thus to promote comparability across industries and capital markets. It also aims to eliminate inconsistencies between IAS 18 Revenue and IAS 11 Construction Contracts, integrate missing application guidance – for example for multiple element arrangements – and reduce the complexity of the provisions. The revised rules in IFRS 15 replace the existing standards IAS 11 Construction Contracts, IAS 18 Revenue as well as the corresponding interpretations (IFRIC 13 Customer Loyalty Programmes, IFRIC 15 Agreements for the Construction of Real Estate, IFRIC 18 Transfers of Assets from Customers as well as SIC-31 Revenue – Barter Transactions Involving Advertising Services).

The scope of IFRS 15 extends to all contracts with customers except for lease agreements, insurance contracts, financial instruments and certain non-monetary exchanges which are expressly excluded from the scope of the new standard. The nature of the transaction or the company's industry do not have any impact on the application of IFRS 15. The new rules also apply to the measurement and recognition of profits and losses from the sale of certain non-financial assets that are not an output of the entity's ordinary activities (eg sale of property, plant and equipment or of intangible assets).

Contrary to the rules in IAS 11 and IAS 18 applicable to date, the new standard no longer makes a distinction between different types of orders and services. Instead, it presents uniform criteria for revenue recognition. The core principle of IFRS 15 is that an entity should recognise revenue if the goods have been delivered or service has been provided and that the amount of revenue recognised should correspond to the counterperformance expected. In the standard, this core principle is implemented using a five-step model (Fig.1).

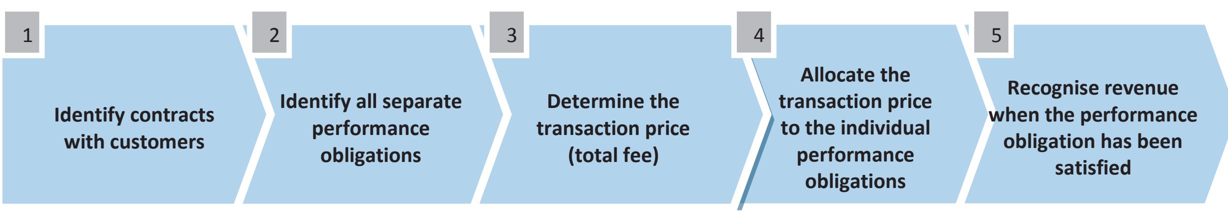


Fig.1

Step 1: Identify contracts with customers

A contract is an agreement between two or more parties that creates enforceable rights and obligations. Contracts can be written, oral or agreements implied by customary business practice that have commercial substance and meet certain criteria. One important criterion is that it is probable that the consideration will be collected. An entity must take into account both the ability and the intention of the customer to pay the consideration. If this criterion is not met, no contract exists for revenue recognition purposes.

Under certain circumstances, an entity has to recognise as one contract two or several contracts concluded simultaneously or within a short period of each other.

The standard provides detailed guidance on how to account for contract modifications. If certain conditions are met, contract modifications will be accounted for as a separate contract or as a modification to the original contract.

Step 2: Identify all separate performance obligations

As soon as a contract as defined in Step 1 has been identified, an entity must assess the contractual terms in order to identify as individual performance obligations those goods and services promised to the customer that are distinct. This is the case if the customer can benefit from the good or service on its own (eg by utilisation or sale) or in conjunction with other readily available resources, and the promise to transfer the good or service is separately identifiable from other promises in the contract. The revenue is then recognised when the respective performance obligation is met. The criterion of being distinct is fleshed out in the standard using detailed rules and examples. For example, a software manufacturer concludes a contract with a customer that covers both the software license and services such as installation, updates and technical support. It is possible to distinguish between four different performance obligations here (see IFRS 15 IE 52).

Note: The main change is that it is no longer the contract concluded with the customer that constitutes the accounting unit but the distinct performance obligations included in that contract. In practice this means that all contracts in an entity have to be subjected to a detailed review for independent performance obligations.

Step 3: Determine the transaction price

The transaction price is the amount to which an entity expects to be entitled from the customer in exchange for the transfer of goods and services. The entity must also take into account the following matters when determining the transaction price:

- consideration components withheld in favour of third parties are not taken into account (eg VAT)
- variable consideration that stems from contractual side agreements such as bonus and rebate agreements must be estimated and recognised at either the expected value or the most probable value
- the time value of money must be taken into account if significant financing components (e.g. long payment terms) or deviating market interest rates are used. If the period between provision of the service and payment by the customer is no more than one year, significant financing components can be disregarded for simplification purposes
- in an exchange transaction, non-cash considerations must be recognised at fair value if the fair value can be reliably determined
- consideration payable to the customer reduces the transaction price (eg percentage rebates depending on the volumes purchased in the year) unless payment to the customer is made for a distinct service provided for the contractor

Note: Although these rules are not all new, the specific details provided for the individual rules may result in deviations from the procedures adopted thus far.

Step 4: Allocate the transaction price

Where a contract with a customer has several performance obligations, the transaction price must be allocated to the performance obligations identified by reference to their relative standalone selling prices (with some exceptions). The standalone selling prices must be determined, or estimated if necessary, at the time of concluding the contract using observable standalone selling prices in comparable transactions. IFRS 15 describes the following possible estimation methods:

- adjusted market assessment approach
- expected cost plus a margin approach
- residual approach; use is only permissible if standalone selling prices for a good vary substantially or are uncertain.

Discounts granted must also be allocated on the basis of the relative standalone selling prices. If certain criteria are met, for example documentation that shows that the discount refers only to one or individual performance obligations, the discount must be allocated directly to this performance obligation/s.

Note: If no standalone selling prices are available, significant scope for judgements arises, but these must be disclosed in the notes to the financial statements.

Step 5: Recognise revenue when the performance obligations have been satisfied

According to IFRS 15, revenue must be recognised when the performance obligation is satisfied, i.e. control of the agreed-upon good or service is transferred to the customer. Control is deemed to have been transferred if the customer has obtained control of the asset, ie the customer can obtain the benefits from the asset and direct its further use. This also includes the ability to prevent others from directing the use of and obtaining the benefits from the asset. The amount of revenue corresponds to the amount allocated to the respective performance obligation by the entity in the previous step.

For each performance obligation identified, an entity must first assess upon concluding the contract whether the performance obligation will be satisfied over time or at a point in time. An entity recognises revenue over time if one of the following criteria is met:

- the customer simultaneously receives and consumes all of the benefits provided by the entity as the entity performs (eg service contract).
- the entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced (eg creation of an asset at the customer's premises).
- the entity's performance does not create an asset with an alternative use to the entity. Furthermore the entity has an enforceable right to payment for performance completed to date and can also expect the contract to be completed (eg creation of an asset pursuant to a customer order).

If none of these criteria are met, the performance obligation is satisfied at a point in time.

For performance obligations satisfied over time, an entity recognises revenue according to the percentage of completion. If it is not possible to determine the percentage of completion with reasonable assurance, revenue is recognised only to the extent of the costs incurred provided that it can be assumed that these are covered as part of satisfying the performance obligation. For performance obligations satisfied at a point in time, revenue is recognised when control is passed. For entities with customer contracts relating to the supply of consumer goods, merchandise or other products, no material changes are expected compared to the current rules.

According to the rules for licenses, which are defined for the first time, a distinction must be made regarding whether an entity grants the customer the license at a point in time as it exists (revenue recognition for a performance obligation satisfied at a point in time) or whether the license is granted for a period of time and the customer can adapt the license during this period (revenue recognition for a performance obligation satisfied over time). A large number of other matters are also addressed for the first time which may affect existing accounting practice, for example rules on contract modifications or repurchase agreements.

In addition to the five-step model, the standard includes details on the recognition of additional costs for obtaining a contract and that are directly related to its performance. These costs must be recognised and subsequently amortised if it is expected that they will not be recovered and would not have been incurred without the contract. If the contract has an expected term of no more than one year, these costs can also be expensed immediately as a practical expedient.

In the financial statements, contracts with customers will be presented in an entity's statement of financial position as a contract liability, a contract asset or a receivable. A contract liability is presented where a customer has paid an amount of consideration prior to the entity performing by transferring the related good or service (in the past: prepayment received). By contrast, where the entity has satisfied a performance obligation and the customer has not yet paid the related consideration, a contract asset is presented – provided that the entity's right to consideration is still subject to conditions. If there are no conditions, a receivable is recognised pursuant to IAS 39 / IFRS 9.

IFRS 15 also introduces presentation rules and calls for extensive disclosures in the notes. These disclosures relate among others to the nature, amount, timing and uncertainty of revenue, including the resulting cash flows. Additionally, the major features of customer contracts as well as the performance obligations must be described and information must be provided on the significant judgements and estimates, on changes over time and on the capitalised costs to obtain or fulfil a contract.

Pending EU endorsement, the standard will be subject to mandatory application from 1 January 2017 onward. The standard will apply retrospectively, with certain limited transitional expedients available. The complexity and scope require early preparation for first-time application of IFRS 15. The standard can be purchased from the IASB at (www.ifrs.org).

The IASB and FASB have set up a joint advisory group, Transition Resource Group (TRG) to identify problems that may arise during the transition to IFRS 15 Revenue from Contracts with Customers (or the corresponding ASC 606). The TRG is to support the two boards with additional measures such as the publication of clarification or other guidelines.

Note: IFRS 15 contains extensive application guidance, some of which reflects existing accounting practice and thus is merely of a clarifying nature, but which could also lead to changes in the presentation of issues. In addition, entities will have to rely more on judgements. The changes will particularly affect entities that combine different services in one customer contract. The new rules on revenue recognition will be especially relevant for entities in the telecommunications, software development, construction and plant engineering sectors.

IFRS 9 Financial Instruments – full version

The IASB issued the final version of IFRS 9 (2014) at the end of July. Triggered by the crisis on the financial markets, the project to replace IAS 39 Financial Instruments has now reached completion after a period of more than six years. IFRS 9 (2014) was developed in three phases:

Phase 1: Classification and measurement
This phase focused on the rules for classification and measurement of financial instruments that go back to the rules already published in 2009 and 2010 but which were subsequently changed significantly once again. The classification of financial instruments is based both on the business model within which the instrument is held and on the contractual cash flows of the instrument. For financial liabilities, the existing rules in IAS 39 were more or less adopted without change.

Phase 2: Impairment
In future, credit risks will be presented in the form of an expected loss model, which will replace the incurred loss model used at present. The new impairment model focuses on risk provisioning at an earlier stage in general.

Phase 3: General hedge accounting
The rules on general hedge accounting were already published in November 2013. The rules on macro hedge accounting were removed from the overall project for IFRS 9 and are currently being developed by the IASB as part of a separate project.

The objective of IFRS 9 (2014) is to avoid a high level of complexity and a lack of transparency, in general by allowing for fewer exceptions and changes between the measurement categories and by focusing on fair value measurement. The rules in IFRS 9 (2014) aim to provide useful information on the amount, timing and uncertainties arising from financial instruments. The requirements for the scope of application as well as recognition and derecognition are more or less unchanged compared with IAS 39.

IFRS 9 (2014) as a whole is to be subject to mandatory application from 1 January 2018 onward. Thus all rules contained in the new standard, from the classification and measurement to impairment and general hedge accounting, are subject to mandatory application at the same time. IAS 39 will be then removed as of that date – with the exception of a small number of rules such as portfolio fair value hedge accounting. However, application by EU issuers of financial statements depends additionally on EU endorsement, which is still pending. The standard can be purchased from the IASB at (www.ifrs.org).

Note: Additionally, the IASB has granted all entities an option, until completion of the project on macro hedge accounting, to continue to apply the rules on hedge accounting in IAS 39 instead of the rules on general hedge accounting pursuant to IFRS 9 (2014). The reason for this is that IFRS 9 (2014) does not yet contain any complete rules for portfolio hedges. This would have resulted in a gap in the rules for as long as the project on macro hedge accounting is still ongoing. It remains to be seen whether this option will also be adopted in the EU and how the disclosures in the notes based on the hedge accounting model pursuant to IFRS 9 (2014) will be handled.

Classification and measurement of financial instruments

Initial measurement of financial instruments will still be at fair value. The rules on classification and measurement of financial instruments govern their subsequent measurement. Instead of the existing four categories for classifying a financial asset, IFRS 9 (2014) now provides for three measurement categories:

- AC = amortised cost
- FVTOCI = fair value through other comprehensive income
- FVTPL = fair value through profit or loss

Although the permissible measurement categories are similar to those in IAS 39, the criteria for allocation to the individual measurement categories differ considerably. The categories are based on the entity's business model for managing its financial assets and the contractual cash flow characteristics of the respective financial asset. A financial asset is measured at amortised cost if the entity's business model provides for holding the financial asset in order to collect the contractual cash flows and the financial asset generates contractually agreed cash flows on specified dates that constitute interest and principal payments on the principal amount outstanding. All instruments that do not meet this condition are allocated to the fair value category. Reclassification between the fair value category and the amortised cost category is mandatory if the entity's business model for managing financial assets changes.

The distinction between equity instruments and debt instruments is made in accordance with the criteria in IAS 32. Due to a lack of contractual payment rights, equity instruments cannot meet the cash flow criterion (collection of the agreed interest and principal payments on the principal amount outstanding) and therefore have to be measured at fair value through profit or loss. The existing cost exemption (measurement at cost) for unlisted equity instruments with no quoted prices on an active market and whose fair value cannot be reliably measured (eg unlisted shares in a German limited liability company) no longer applies. For the initial recognition of equity instruments not intended for trading, the standard contains an irrevocable option to recognise the fair value changes of those instruments at fair value through other comprehensive income (FVTOCI). However, it is then not permissible to recognise impairment or later gains or losses on sale in profit or loss, ie the amounts recognised in equity are not reclassified to the income statement even if the equity instrument is disposed of. Only dividends are recognised in the income statement.

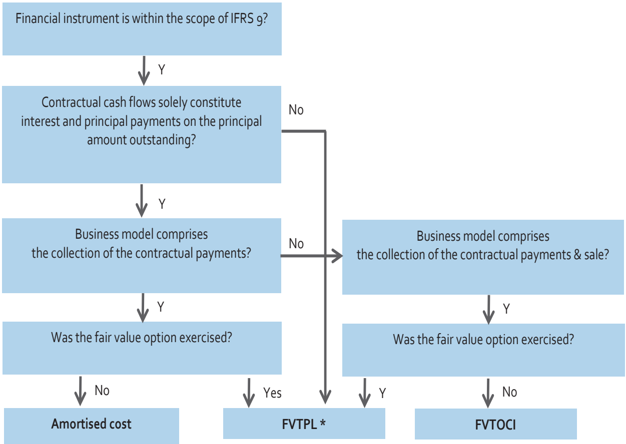
Furthermore, measurement at fair value through other comprehensive income (FVTOCI) is provided for in the case of certain debt instruments. However, this requires that the business model criterion is met in addition to the cash flow criterion (identical to AC) for the debt instruments in question, ie that it is possible both to hold and to sell the financial instrument. For those instruments, income and expenses from the internal rate of return, from impairments and from currency translation are recognised in profit or loss. The remaining changes in fair value are recognised in equity and reclassified to profit or loss when the financial instrument is derecognised.

Like IAS 39, IFRS 9 (2014) also contains an irrevocable option to measure financial assets at fair value through profit or loss upon initial recognition if this eliminates or significantly reduces an accounting mismatch. An accounting mismatch arises if financial instruments that are linked in economic terms are not measured in the same way and thus lead to a mismatch in the statement of financial position or the income statement.

Derivatives used outside of hedge accounting will continue to be measured at fair value through profit or loss.

As in IAS 39, embedded derivatives are not recognised separately if the host contract is a financial asset. In such cases, the category decision must be applied to the entire structured instrument. If the host contract is a non-financial instrument, the separation rules used to date continue to apply.

The following diagram illustrates the classification and measurement of financial assets (Fig.2).



* For equity instruments, there is an option to recognise changes in fair value in other comprehensive income
Source: Based on the project summary by the IASB

Fig.2

Reclassification is only possible and permissible if the underlying business model changes.

IFRS 9 (2014) does not result in any major changes for the classification of financial liabilities compared with IAS 39. Initial recognition of financial liabilities is at fair value. Subsequent measurement must be at fair value through profit or loss if the liabilities are held for trading. This applies accordingly to derivatives that are not included in hedge accounting. If financial liabilities are not measured at fair value through profit or loss, they must be measured at amortised cost using the effective interest method. Any accounting mismatch can be avoided by exercising the fair value option. However, when using the fair value option, any fair value changes that are attributable to a change in the liability's credit risk must be recognised in other comprehensive income. It is not permissible to reclassify these amounts to the income statement at a later stage. There is one exception, however, namely cases in which the procedure outlined would create or enlarge an accounting mismatch. In such a case, the whole fair value change must be recognised in profit or loss.

Unlike financial assets, in the case of financial liabilities the contractual provisions must be examined in order to determine whether embedded derivatives are present that have to be recognised separately from the host contract.

Note: The new criteria for the classification of financial assets require new processes to be created to allow for appropriate classification. These criteria are based on the entity's business model as well as the collected cash flow criterion of the financial asset and require a large degree of judgement on the part of the entity. This is because the classification determines subsequent measurement and thus has a direct influence on the volatility of the income statement and of equity, which in turn can impact significantly on the key performance indicators (KPIs) of the entity or, if applicable, on existing covenants.

Impairment

The second phase of the IFRS 9 (2014) project relates to impairment rules. The rules have been adjusted to move away from the previously used basis of incurred losses in favour of expected losses. The main reasons for this change involved the delayed and in some cases understated recognition of credit default events as well as overstated non-recurring effects in the recognition of impairment when a credit default event occurred. The expected loss model adopted in IFRS 9 (2014) means it should be possible to recognise expected credit default events much sooner than in the past, thus remedying the much-bemoaned 'too little, too late' problem in relation to impairment. The impairment model in IFRS 9 (2014) corresponds more or less to the draft published in March 2013. It is applicable to financial assets measured at amortised cost or at fair value through other comprehensive income with changes recognised in equity and to leases pursuant to IAS 17 and contract assets pursuant to IFRS 15. Loan commitments and financial guarantee contracts also fall under the scope of the impairment model, which thus constitutes a fundamental extension of the scope compared with IAS 39.

IFRS 9 (2014) continues to aim to take expected losses into account when the instruments are measured. In order to determine the specific risk provision needed, the instruments are broken down into three stages.

- all instruments are generally allocated to Stage 1 upon initial recognition. Risk assessment for this stage is based on a period of twelve months after the reporting date. The expected loss is calculated as the present value of the expected default within the 1-year period under review. The impairment loss required must be recognised through profit or loss. The gross carrying amount, ie the carrying amount before recognising expected losses, must still be used as a basis for the interest revenue to be recognised using the effective interest method

- stage 2 is for instruments that have a significantly higher default risk since initial recognition. The period for calculating the risk for this stage is extended to the entire remaining term of the instruments. The impairment loss necessary is determined from the present value of all expected losses over the entire remaining term of the instrument. The comments in Stage 1 apply by analogy to interest calculations
- stage 3 is for cases that have a significantly higher default risk as well as objective evidence of impairment. The risk of at least partial default is so high in this stage that there is a change in perspective. What were previously hypothetical expected losses become losses that are more or less certain. The procedure in Stage 3 corresponds more or less to the incurred loss model that already exists in IAS 39. There is no change in the way in which risk provision is calculated compared with Stage 2. The present value of the expected losses, in terms of the entire remaining term, is likewise used for risk provision. In this stage, the input value for the interest revenue calculated using the effective interest method is the net carrying amount of the instrument, ie after taking the impairment loss into account.

The following diagram summarises the determination of impairment, the presentation of interest revenue and impairment as well as the effective interest rates to be used for the individual stages (Fig.3).

	Recognition	Presentation	Interest rate
Stage 1: Standard case	Impairment equal to 12-month expected credit losses	Separate presentation of impairment and interest revenue	Original effective interest rate
Stage 2: Significant deterioration in credit quality	Impairment equal to lifetime expected credit losses	Separate presentation of impairment and interest revenue	Original effective interest rate
Stage 3: Default	Impairment equal to lifetime expected credit losses	Netted presentation of impairment and interest revenue	Adjustment of the original effective interest rate

Change in default risk since acquisition

Fig.3

Stage 1 instruments must be evaluated at each reporting date to determine whether there has been a significant rise in the default risk. If this is the case, the instrument must be moved to Stage 2. Whether a significant change in the probability of default has occurred is assessed by comparing the probability of default upon initial recognition of the instrument with the probability of default calculated as of the reporting date. This comparison must be made on the basis of the probability of default for the entire remaining term (lifetime PD – probability of default). IFRS 9 (2014) also provides for the following simplifications when applying the transfer criterion from Stage 1 to Stage 2:

- if a financial instrument has a low default risk – corresponding to an external rating as 'investment grade' (AAA to BBB rating) – it is possible to allocate the financial instrument to Stage 1 in full without checking for a significant deterioration in credit quality
- there is a rebuttable presumption that items more than 30 days past due must be transferred from Stage 1 to Stage 2
- the assessment of a significant increase in default risk based on the 12-month PD of the financial instrument can be carried out as an estimate for the probability of default for the entire remaining term (lifetime PD) provided that there are no special grounds to indicate that an assessment of the lifetime PD is necessary, as is the case for example for instruments held to maturity.

However, indications of actual default or an impairment loss are not a necessary transfer criterion. Reclassification can be necessary even without the existence of such matters. How ever, if there is objective evidence of impairment as of the reporting date, the instrument has to be classified as Stage 3. Direct allocation to Stage 3 takes place regardless of whether the instrument was previously allocated to Stage 1 or Stage 2. The indications of objective impairment presented in the standard correspond to the criteria already contained in IAS 39.

The 3-stage model is designed to be used dynamically. If the reasons for a downgrade no longer apply in a later assement period, the previous downgrading must be reversed. The instrument must then once again be subject to the assement criteria for the stage in which it is classified after the transfer.

For selected instruments, IFRS 9 (2014) provides for simplifictions to the general impairment model. These instruments include trade receivables, receivables from leases and contract assets pursuant to IFRS 15. If the simplification rule is used, the instruments are allocated in full to Stage 2 upon initial recognition. In this case, risk provision is based on the expected losses over the remaining term. As a practical exception for the estimation of the expected losses for trade receivables, the standard also proposes a provision matrix that incorporates historical observed default rates. Receivbles are broken down into groups based on whether they are for example not past due, less than 30 days past due etc. Uniform write-downs are then applied.

Another exception relates to financial assets for which objective evidence of impairment already exists upon acqusition. These must be considered separately both in terms of interest and loss recognition. When the asset is initially recognised, the effective interest is based on the expected cash flows instead of the contractual cash flows. This results in an effective interest rate that was adjusted for the default risk and that must be used in the subsequent periods to determine interest revenue. Because the expected loss is taken into account as described above, no further risk provision is necessary on the date of initial recognition. However, if there are changes regarding the estimate of the expected loss, these must be recognised immediately and in full through profit or loss.

The IASB has announced that it will also set up a Transition Resource Group (TRG) for the topic of impairment of financial instruments (as part of IFRS 9 (2014)). The TRG is to be made up of issuers of financial statements, regulators and auditors and is to devote itself to identifying problems that may arise during transition to the new impairment model.

Note: Compared with the impairment model used in IAS 39, the impairment model pursuant to IFRS 9 (2014) will lead to earlier recognition of credit losses, as not only the incurred losses but also the expected losses will be taken into account. The simplifications for trade receivables regarding the use of a lifetime PD or a provision matrix constitute major relief for industrial firms. Nevertheless entities must analyse the rules quickly in order to adjust the processes and systems in good time and if necessary to determine the effects on key performance indicators.

General hedge accounting

The rules on general hedge accounting were already issued in November 2013 and have been adopted unchanged in IFRS 9 (2014). In future, hedge accounting is to present actual risk management in a more realistic manner, thus no longer primarily avoiding or eliminating accounting mismatches. The most important changes in hedge accounting and their impact are summarised in brief below:

- **Permissible hedged items**
  The group of permissible hedged items has been extended considerably. They include individual items, closed portfolios and certain components. To be eligible for designation as a hedged item, it must always be possible to measure the item reliably. Recognised assets and liabilities, firm commitments, highly probable forecast transactions and net investments in a foreign operation still qualify as hedged items. Closed portfolio hedges were very restrictive under IAS 39 (homogeneity test required!). For the designation of a closed portfolio, IFRS 9 (2014) merely requires each item in itself (including the components of items) to be a permissible hedged item and the items to be managed on a portfolio basis for risk management purposes. The designation of individual components of groups of items (layer designations) as well as net items (eg a group of expected sales and expected expenses that will affect income within the same reporting period) are also permissible.

  In addition, IFRS 9 (2014) allows for aggregated exposures that are a combination of a derivative and an exposure to be designated as a hedged item. For example, this means that an entity purchasing commodities in foreign currency can first hedge against the commodity price risk using a commodity derivative and also eliminate the currency risk using a currency derivative at a later date. At that point in time, the expected commodities purchase together with the commodities futures then become the 'new' hedged item, which is hedged using a currency derivative.

  In future it will also be possible to designate risk components from financial and non-financial hedged items separately if they can be identified separately and measured reliably. IAS 39 only provided this option for financial hedged items (ie financial instruments) but not for hedged items of a non-financial nature, such as expected future commodities purchases. For non-financial hedged items, IAS 39 only allowed for components in the form of currency risks to be designated individually. By contrast, individual commodities risks could not be designated as hedged items, and this often led to inefficiencies, as the commodities derivative concluded did not cover all risks resulting from the non-financial hedged item.

- **Permissible hedging instruments**
  Under IAS 39, only derivatives and – for the hedging of foreign currency risks – regular way contracts could be designated as permissible hedging instruments. IFRS 9 (2014) allows for derivatives but also non-derivative financial assets or liabilities measured at fair value through profit or loss to be designated as hedging instruments for hedges for all risks (and not only to hedge against currency risks). By contrast with currency risk hedges, non-derivative financial instruments can only be designated as hedging instruments in full for all other risk components.

- **Time value of options**
  When an entity only designates the changes in the intrinsic value of a purchased option as a hedging instrument, IAS 39 requires that the fair value changes in time value components be recognised in profit or loss. In future, these fair value changes in the time value will be recognised in other comprehensive income to the extent that the option relates to the hedged item perfectly in terms of its contractual term. The fair value changes in the time value must then be reclassified to profit and loss depending on the underlying hedged item. In the case of a transaction-related hedged item, reclassification to profit and loss takes place when the hedged item eventuates and affects profit or loss. In the case of a time-period related hedged item (option is used to hedge an item over a period of time), the original time value of the option is recognised in profit and loss for the duration of the hedging relationship.

- **Assessing hedge effectiveness**
  According to IFRS 9 (2014), in future it is only possible to assess hedge effectiveness on a forward-looking basis (no longer retrospectively). A qualifying hedge must be considered effective if it meets the hedge effectiveness requirements on a forward-looking basis, ie it provides evidence of minimisation of the expected hedge ineffectiveness and, as expected, does not reach a coincidental offset. The effectiveness range from 80 to 125% no longer applies. It should be noted, however, that like under IAS 39 any ineffectiveness must still be determined and recognised in profit and loss. This is done by means of a regular quantitative assessment based on the dollar-offset test. Then the absolute changes in the

value of the hedged item and the hedging instrument for the period are compared and the ineffectiveness determined in this manner is recognised in profit and loss.

- **Terminating hedge relationships**
  Unlike in the past, it is no longer possible to derecognise accounting hedges in an arbitrary manner. Instead, hedges must be adjusted; derecognition is only possible – and is then mandatory – if the economic hedging relationship ends.

- **Extended disclosure requirements**
  The disclosure requirements have been extended considerably in order to obtain better information about the entity's risk management strategy and its application to risk management, on the influence of the entity's hedging activities on the amount, timing and uncertainty of future cash flows as well as on the effects of hedge accounting on the entity's statement of financial position, statement of comprehensive income and statement of changes in equity.

Note: The considerable increase in hedged items and hedging instruments permissible means that economic hedging strategies can be accounted for better in future. However, this requires a detailed analysis of existing hedging strategies and their future accounting. Depending on the hedging relationships to be presented, considerable adjustments may also be necessary to processes and systems.

The removal of an effectiveness interval with quantitative threshold values is a fundamental difference from IAS 39.

The new rule to take into account fair value changes in the time value of options will in future lead to less volatility in the income statement. By contrast, however, volatility in equity will increase. This is expected to lead to companies once again becoming more interested in using options as hedging instruments.

Amendment to IAS 27 - Equity Method in Separate Financial Statements

In August 2014, the IASB issued the amendment to IAS 27 on the equity method in separate financial statements. The amendment reintroduces the option to use the equity method in separate financial statements of an investor for investments in subsidiaries, joint ventures and associates.

The background to the project is the fact that in some countries there are local laws which require investments in subsidiaries, joint ventures and associates to be recognised in the investor's separate financial statements using the equity method, but this is not permitted under IAS 27. In order to comply both with the rules in IAS 27 and with local law, it would be necessary to prepare two sets of financial statements. In order to stop this from dissuading companies from adopting IFRS, in December 2013 the IASB issued exposure draft ED/2013/10, which set out the basis for the change that has now been pronounced (see IFRS Link for the first quarter of 2014).

The amendment means that companies now have three possibilities for measuring investments in subsidiaries, joint ventures and associates in separate financial statements: at amortised cost, at fair value in accordance with IAS 39 / IFRS 9 or using the equity method.

The amendments take effect for reporting periods beginning on or after 1 January 2016. Earlier application is permitted. The amendment can be purchased from the IASB at (www.ifrs.org).

Changes to accounting for bearer plants

The IASB issued amendments to IAS 16 Property, Plant and Equipment and IAS 41 Agriculture in June 2014. The amendments relate to bearer plants such as grape vines, rubber plants and oil palms, which provide a harvest of biological assets over several periods without being sold themselves as agricultural produce. According to the amendments, bearer plants now fall under the scope of IAS 16 instead of IAS 41. This results in changed measurement in particular. In the past, these items were measured at fair value less costs to sell during and after the growth phase. Under IAS 16, these plants now have to be measured at accumulated cost during the growth phase, and later at amortised cost (cost model) or using the revaluation model pursuant to the option in IAS 16. The background to this amendment is that the IASB considers that such plants are similar to internally generated property, plant and equipment. It is no longer in favour of classifying bearer plants as equivalent to other plants and animals as was done in the past. In the past, fair value measurement pursuant to IAS 41 was considered appropriate because the transformation process for agricultural assets can only be measured appropriately using a fair value. Because transformation ends for bearer plants when the plant has ripened, it no longer seemed appropriate to account for them under IAS 41.

The amendments apply retrospectively as of 1 January 2016. Earlier application is permitted. The text of the amendment can be purchased only from the IASB at (www.ifrs.org).

ED/2014/2 Investment Entities – Applying the Consolidation Exception

The IASB issued amendments to IFRS 10, IFRS 12 and IAS 27 as far back as October 2012, granting an exception in relation to the consolidation of subsidiaries if the parent company meets the definition of an investment entity. In such a case, the subsidiary is not consolidated but is instead presented at fair value in the financial statements. The IFRS Interpretations Committee subsequently received different queries in connection with the implementation of the exception. This prompted the IASB in June 2014 to issue ED/2014/2 Investment Entities – Applying the Consolidation Exception (proposed amendments to IFRS 10 and IAS 28) for comments.

The draft serves to clarify three issues in relation to applying he exception from the consolidation duty for investment ›ntities that account for their subsidiaries at fair value. The ›roposed amendments confirm that the exception from he consolidation duty also applies to subsidiaries of an nvestment entity which are themselves parent companies. 'hey also clarify to what extent an investment entity must :onsolidate a subsidiary that provides investment-related ervices. Additionally, use of the equity method is simplified or entities that are not investment entities themselves but hat hold investments in an associate which is an investment ›ntity.

;tatements could be submitted to the IASB up until 15 ;eptember 2014. The draft can be found on the website of he IASB.

Other Standard Setters

Note on accounting for deferred tax assets

'he IFRS Committee at the ASCG (Accounting Standards Committee of Germany) has developed a note on lealing with unused tax losses in response to a decision by he IFRS Interpretations Committee (IFRS IC). In May 2014, he IFRS IC decided on how to account for unused tax losses ›ursuant to IAS 12 Income Taxes – regardless of whether or ıot tax losses are expected – and whether (and if necessary ıow) a minimum taxation rule impacts on the accounting.

'he decision by the IFRS IC comprises the following points:

- deferred tax assets on unused tax losses can only be recognised to the extent that taxable temporary differences exist that will reverse in future and against which the unused tax losses could be offset in the period concerned. It is irrelevant whether or not tax profits or losses are expected for the corresponding period
- if a minimum taxation rule exists, the amount of the deferred tax assets for/on unused tax losses is limited in the respective periods despite taxable temporary differences that will reverse in future. If a sufficient amount of taxable temporary differences exist for the entire planning period, deferred tax assets from unused tax losses may nevertheless be recognised in full. Once again, it is irrelevant whether or not tax profits or losses are expected.
- for the amount in excess of the taxable temporary differences, deferred tax assets can only be recognised to the extent that future tax profits are expected or profits are available for the offsetting of unused tax losses according to the tax planning.

'he note can be downloaded directly from the ASCG vebsite.

Note: The decision by the IFRS IC constitutes a specific nterpretation of the IFRS. In its note, the ASCG confirms he relevance for Germany. To the extent that other methods ıave been used in the past, this results in a change in the ıccounting method which must be carried out retrospec-ively according to IAS 8.

ESMA report on disclosures in the notes related to business combinations (IFRS 3)

The European Securities Markets Authority (ESMA) published a report on 16 June 2014 (Review on the application of accounting requirements for business combinations in IFRS financial statements) concerning a review performed by it of disclosures on business combinations. ESMA is an independent EU authority and one of its goals is to ensure uniform enforcement of securities law within the European Union – which also extends to the IFRSs. In addition, ESMA's pronouncements must be observed by the FREP (Financial Reporting Enforcement Panel) as part of the enforcement proceedings in order to ensure that the IFRSs are applied uniformly across Europe.

The subject of the review was compliance with and implementation of the main requirements pursuant to IFRS 3. It involved an analysis of 56 sets of financial statements of European companies from the year 2012. ESMA finds that some good business combination disclosures are provided in the annual financial statements but that there are also certain areas where improvements are needed. These include among others the topics presented below:

Recognition and measurement of goodwill

Descriptions of the factors making up goodwill in the opinion of the company representatives are often missing, or a general reference is made to the realisation of synergy effects. There is no detailed statement regarding how the expected synergies are to be achieved.

Furthermore, in 24% of the business combinations analysed, no further intangible assets were recognised separately from goodwill. Issuers with high goodwill in relation to the purchase price should consider whether further intangible assets exist that should be recognised separately.

Reasons for negative goodwill

One third of issuers reporting negative goodwill and thus a bargain purchase gain did not disclose an explanation of why the transaction resulted in a gain.

More differentiation in the formation of groups

The quality of the disclosures on the main groups of assets and liabilities acquired can be improved by a lower level of aggregation of the fair values of the main assets and liabilities acquired. This would also lead to better-quality information. According to ESMA, assets and liabilities of a different nature in particular should not be aggregated.

Disclosures on contingent liabilities

Only 11% of the issuers reviewed recognised contingent liabilities arising from business combinations. Of these, very few gave the required IFRS 3 disclosures.

Disclosures on fair value measurement techniques

ESMA is calling for more detailed information on fair value neasurement (measurement techniques) used in the /aluation of assets, liabilities and non-controlling interests ıs well as on the assumptions made. Some issuers referred o external valuations without providing details of the echniques and assumptions used to determine the fair /alue. A mere reference to the fact that an external ıppraiser was used to provide valuations without giving any ıdditional details on how the values were determined is ıot considered sufficient. Only 35% of the issuers reviewed lisclosed how fair values were determined. However, the ‹ey assumptions used were not explained.

Ɔeneral observations

Vhile IFRS 3 disclosures have generally been provided by ssuers, in some cases their understandability was impaired, ‚uch as when disclosures were not tailored to the specific :ircumstances of a transaction or were insubstantial. In ɔther cases, some disclosures were presented outside the inancial statements. ESMA suggests that all information ɔe presented in one separate section in order to improve ransparency.

:SMA is calling on the national authorities responsible to ake enforcement actions in cases where the report points o a breach of IFRS requirements and where this breach is :onsidered material. ESMA also hopes that the IASB will :ake the findings of the report into account in its ɔost-implementation review of IFRS 3, as it believes that the ·eport will assist the IASB in identifying areas that lead to livergence in practice or lack of comparability and where ıdditional clarification or guidance would be helpful.

Note: While the pronouncements by ESMA do not have direct legal effect, they are extremely relevant for issuers of IFRS financial statements, as the FREP can only deviate from the recommendations if it provides grounds for this decision. The complete report and a related press release are available on ESMA's website. A letter to the IASB concerning the findings of the review is also available there.

EFRAG and ASCG issue a statement on the proposed amendments to IAS 1

The European Financial Reporting Advisory Group (EFRAG) has submitted a statement to the IASB regarding the latter's draft ED/2014/1 Disclosure Initiative (Proposed amendments to IAS 1). The Accounting Standards Committee of Germany (ASCG) has issued a statement to the IASB through its IFRS Committee.

The exposure draft is part of the IASB's Disclosure Initiative, which comprises a series of sub-projects. The initiative aims to result in improvements to IAS 1 and IAS 7 in the short term. Another objective in the medium term is to fundamentally re-examine the development of presentation and disclosure requirements in the IFRS financial statements (including disclosures in the notes) and to develop improvements in the corresponding principles (principles of disclosure). Based on that, all of the standards are to be fundamentally re-examined (see IFRS Link for the second quarter of 2014).

Both committees welcome the proposed amendments in principle. While EFRAG has suggested some changes in wording, ASCG is proposing further amendments:

- adding an example for aggregation regarding the presentation of line items in the statements of financial position
- clarifying the additional reference to consistency regarding the presentation of additional line items, headers and subtotals, and
- rewording "disclosure of accounting policies" into "disclosure of selection and application of accounting policy".

ASCG emphasises that the narrow-focus IASB proposals for clarification in IAS 1 are seen as a step in the right direction. At the same time it is concerned that proposed improvements will be introduced using a piecemeal approach over a longer period and without any clear overall vision. The statements are available for download on the EFRAG and ASCG websites.

Adoption of IFRS by the EU

EU Endorsement

The following table contains standards and interpretations that have not yet been adopted by the EU and those that have been adopted since our last edition (endorsement). This information is based on the EU Endorsement Status Report dated 12 August 2014 as issued by EFRAG (European Financial Reporting Advisory Group). Where EU endorsement has taken place, the table contains a link to the corresponding directive published in the Official Journal of the European Union.

New standards

Standards	IASB entry into force	EU endorsement
IFRS 9 Financial Instruments (24 July 2014)	1 January 2018	postponed
IFRS 14 Regulatory Deferral Accounts (30 January 2014)	1 January 2016	to be decided
IFRS 15 Revenue from Contracts with Customers (28 May 2014)	1 January 2017	Q2/2015

Amendments to standards

IAS 27 - Equity Method in Separate Financial Statements (12 August 2014)	1 January 2016	Q3/2015
IAS 16 and 41- Accounting for Bearer Plants (30 June 2014)	1 January 2016	Q1/2015
IAS 16 and 38 - Clarification of Acceptable Methods of Depreciation and Amortisation (12 May 2014)	1 January 2016	Q1/2015
IFRS 11 - Amendments concerning Acquisitions of Interests in Joint Operations (6 May 2014)	1 January 2016	Q1/2015
IAS 19 Defined Benefit Plans: Employee Contributions (21 November 2013)	1 July 2014	Q4/2014
Annual Improvements to IFRSs (2010-2012 Cycle) (12 December 2013) (standards affected: IFRS 1, IFRS 2, IFRS 3, IFRS 8, IFRS 13, IAS 16, IAS 24, IAS 38)	1 July 2014	Q4/2014
Annual Improvements to IFRSs (2011-2013 Cycle) (12 December 2013) (standards affected: IFRS 1, IFRS 3, IFRS 13, IAS 40)	1 July 2014	Q4/2014

Interpretations

IFRIC 21 Levies (20 May 2013)	1 January 2014	Published 14 June 2014

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