IFRS LINK

Changes to IFRS

(for reporting periods beginning on or after 1 January 2009)

Introduction

In this edition of IFRS Link we consider a number of the new and revised accounting standards issued by the International Accounting Standards Board (IASB) which have mandatory application for accounting periods beginning on or after 1 January 2009. Specifically, it covers the following standards:

IFRS 7 – Financial Instruments: Disclosure

IFRS 8 – Operating Segments

IAS 1 – Presentation of Financial Statements

IAS 23 – Borrowing Costs

The revised version of IFRS 3 - Business Combinations, applies for reporting periods beginning on or after 1 July 2009 and is covered in edition 9 of IFRS Link.

July 2009 *Issue Number 10*

IFRS 7 – Financial Instruments: Disclosure

As a result of the global credit crisis, and in order to bring IFRS 7 more closely into line with US GAAP, a number of additional financial instruments disclosures have been introduced for reporting periods beginning on or after 1 January 2009. These disclosures relate to the use of fair value measurements, as well as liquidity risk. Comparative disclosure is not required on initial adoption of the amendments.

Fair Value Measurements

As well as clarifying that separate fair value disclosures are required for each class of financial instruments, the following additional disclosures are required:

- Disclosure of any changes to valuation techniques used, and the reason for such changes;
- The standard establishes a 3-level hierarchy of fair value measurement:
  - Level 1: Measurement based on unadjusted quoted prices in active markets for identical assets or liabilities;
  - Level 2: Measurement not based on quoted prices included in level 1, but which are observable for the asset or liability either directly or indirectly; and
  - Level 3: Measurement of assets or liabilities which is not based on observable market data.
- For each fair value measurement in the statement of financial position, disclosure is required as to which level of the hierarchy was used in determining fair value;
- Details of any transfers between hierarchy levels; and
- A reconciliation between the opening and closing balances for any fair value measurements in Level 3 of the hierarchy.

Liquidity Risk

The existing disclosure requirements for liquidity risk have been clarified and enhanced to enable financial report users to assess the nature and extent of liquidity risk for each financial instrument.

Specifically, entities should now provide two separate maturity analyses for both derivative financial instruments, and for non-derivative financial instruments (including issued financial guarantee contracts).

IFRS 8 – Operating Segments

Under the previous standard, IAS 14 – Segment Reporting, the identification of operating segments of a business utilised a risk-based approach, with business and geographical segments being identified on the basis of similar risk profiles.

The revised IFRS 8 uses a 'managerial approach' to identify operating segments. Under this approach, an operating segment is defined as a component of the business:

- Which engages in business activities which generate income and expenses;
- Which is regularly reviewed by the entity's *chief operating decision maker* to determine the allocation of resources to the segment, and assess its performance; and
- For which discrete financial information is available.

Chief Operating Decision Maker

IFRS 8 refers to a Chief Operating Decision Maker ("CODM"). The concept of a CODM relates to the function of making decisions, not necessarily a person with a specific title. The function of a CODM is to allocate resources and assess the performance of operating segments. Whilst CODM may refer to a person (such as a Chief Executive Officer or General Manager) it is also possible for it to relate to a group of persons (such as a group of executive directors who make such decisions collectively).

Given that the determination of segments is based on how management monitor and measure their business, it is possible that a segment could be identified using non-IFRS measures. It is also possible for an internal segment to be identified that does not derive income from external sources.

Despite the above revisions, a number of the elements from IAS 14 remain unchanged:

- The new standard still allows an entity to aggregate multiple operating segments into one segment where the segments have similar economic characteristics including:
  - The nature of products and services;
  - The nature of production processes;
  - The type or class of customer for the products and services;
  - The methods used to distribute products or provide services; and
  - The nature of the regulatory environment for each segment (i.e. banking, insurance or public utilities)
- The new standard still includes the same quantitative thresholds for the determination of which operating segments are to be reported. Any segment meeting one of the following criteria is required to be disclosed:
  - Its reported revenue (internal and external) is 10% or more of the reported revenue (internal and external) for all operating segments;
  - Its absolute reported profit or loss is 10% or more of the combined profit of all segments that did not report a loss and the combined loss of all segments that reported a loss; or
  - Its assets are 10% or more of the combined assets of all operating segments.

Where the total reportable segments do not represent at least 75% of the total external revenue of the entity, additional segments must be identified until this is achieved (even where those segments do not meet the 10% thresholds).

Disclosure

An entity must disclose the following information for each reportable segment:

- The factors used to determine each reportable segment;
- The types of products/services from which the reportable segment earns its revenue;
- The profit/loss and total assets of each reportable segment; and
- A reconciliation of the above segment information to the entity's reported figures.

Additional disclosure of liabilities and some elements of profit and loss are required in instances where this information is provided to the chief operating decision maker of the entity.

An entity must also disclose specific information at an entity-wide level of:

- External revenue by each product and service;
- External revenue and non-current assets by:
  - The entity's country of domicile;
  - All foreign countries; and
  - Information about reliance on major customers (although there is no requirement to provide the names of each customer).

IAS 1 – Presentation of Financial Statements

One of the major changes arising as a consequence of the revised IAS 1, is a change to the terminology used in describing the elements of the financial statements. For reporting periods beginning on or after 1 January 2009, financial statements will comprise the following:

- Statement of Financial Position (previously 'Balance Sheet').
- Statement of Comprehensive Income (previously 'Income Statement' and 'Statement of Recognised Income and Expense' (if presented)).
- Statement of Cash Flows (previously 'Cash Flow Statement').
- Statement of Change in Equity (no change).

Although the terminology has changed within the standards, there is no obligation for companies to adopt the new terminology in their financial statements (they may continue to refer to income statement, balance sheet, and cash flow statement). However, in the future all accounting standards will use the new terminology.

In addition to the changes in terminology, the format of some of the reports has been changed as follows:

- The new Statement of Comprehensive Income includes *all* 'comprehensive income'. This includes the period profit or loss, as well as other comprehensive income amounts such as gains on revaluation or foreign exchange gains and losses. Under the previous IAS 1, these amounts were presented in the Statement of Changes in Equity (except where a Statement of Recognised Income and Expense was prepared).

- The content in the Statement of Changes in Equity has been reduced to include only prior period adjustments and owner changes in equity (transactions with owners in their capacity as owners). All other information that previously appeared in the Statement of Changes in Equity is now captured in the Statement of Comprehensive Income.
- The formats of the Statement of Financial Position and Statement of Cash Flows remain fundamentally unchanged.
- There is an option for two different formats for the Statement of Comprehensive Income:
  - Option 1: A single statement reporting total comprehensive income; or
  - Option 2: Two statements, the first of which shows the components of profit and loss (income statement), and the second of which begins with the profit and loss figure, and then displays all other components of comprehensive income. Where an entity elects this option, the income statement must be displayed immediately before the statement of comprehensive income.

The other major change to IAS 1 relates to prior period adjustments, retrospective application of accounting policies, and reclassification of items.

In each of the above instances, the Statement of Financial Position must show:

- The financial position at the end of the current reporting period (per previous IAS 1);
- The financial position at the end of the previous reporting period (per previous IAS 1); and
- The financial position at the commencement of the previous reporting period (new requirement under revised IAS 1).

IAS 23 – Borrowing Costs

The revised IAS 23 has removed the choice of accounting policy for borrowing costs available under the previous version of the standard. The purpose of this change has been to improve comparability between financial reports by having all entities adopt the same treatment of borrowing costs. It also ensures that the requirements of IAS 23 are more closely aligned with the requirements of US GAAP.

Under the previous version of the standard, where borrowing costs related to qualifying assets (assets which take a long time to be ready for their intended use or sale), the entity had the option to either capitalise those costs as part of the asset, or expense those costs.

The revised IAS 23 removes this option, and entities are now required to capitalise all borrowing costs relating to the acquisition, construction or production of a qualifying asset.

Whilst the revised standard is only mandatory for reporting periods beginning on or after 1 January 2009, it should be noted that early adoption is allowable.

For further details about the articles contained in this publication, please contact Yvonne Lang at:

Nexia Smith & Williamson
25 Moorgate, London, EC2R 6AY, UK

tel: + 44 (0) 20 7131 4000
fax: + 44 (0) 20 7131 4001
email: yvonne.lang@smith.williamson.co.uk

Nexia International does not accept any responsibility for the commission of any act, or omission to act by, or the liabilities of, any of its members. Nexia International does not accept liability for any loss arising from any action taken, or omission, on the basis of these publications. Professional advice should be obtained before acting or refraining from acting on the contents of these publications.

Membership of Nexia International, or associated umbrella organizations, does not constitute any partnership between members, and members do not accept any responsibility for the commission of any act, or omission to act by, or the liabilities of, other members.