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IFRS in Focus
Closing Out 2018

Contents

New accounting standards

The use of 'non-GAAP' or Alternative Performance Measures

Disclosure of judgements and estimates

Supplier financing arrangements

Statement of cash flows

Earnings per share

Operating segments

Reporting the effects of income tax

Uncertain tax positions

Impairment reviews

Brexit and 2018 annual reports

Currencies and hyperinflation

Changes to interbank offered rates (IBORs)

Other topics

New and revised IFRS Standards and Interpretations mandatorily effective for years ending on or after 31 December 2018

IFRS Interpretations Committee agenda decisions in 2018

New and revised IFRS Standards and Interpretations available for early application in years ending on or after 31 December 2018

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In this special edition of *IFRS in Focus*, we set out financial reporting issues that may be relevant for years ending on or after 31 December 2018 as a result of areas of regulatory focus, the current economic environment or changes in accounting standards.

New accounting standards

For many entities, the annual report for the year ending 31 December 2018 will be the first to reflect the application of IFRS 15 *Revenue from Contracts with Customers* and IFRS 9 *Financial Instruments*. It is critical that these major standards are properly applied and that their effect is clearly disclosed.

Most of the key considerations to achieve effective disclosure are common to the adoption of any significant new accounting standard:

- Clear and entity-specific explanation of the new accounting policies applied and, importantly, how they differ from previous policies.
- Disclosure of quantitative effects and line items affected.
- An explanation of the significant judgements and estimates made in applying the new requirements.
- Disclosure of how choices allowed by the standard, including the use of practical expedients, have been applied.
- A clear explanation of the transition approach adopted, again including the use of any options or transitional reliefs.

Disclosures on transition will be of particular importance for December 2018 reporting, with both IFRS 15 and IFRS 7 *Financial Instruments: Disclosures* (in respect of initial application of IFRS 9) including requirements for detailed, quantitative disclosure of the effects of transition. These disclosures will be subject to heightened regulatory and investor scrutiny and should be prepared carefully and thoroughly.

The specific issues that can arise in application of such wide-ranging standards are many and varied. Some of the more common issues arising from IFRS 15 and IFRS 9 are highlighted below.

Further resources on both IFRS 15 and IFRS 9 are available on IAS Plus.

IFRS 15 *Revenue from Contracts with Customers*
At the heart of the IFRS 15 model for revenue recognition is the concept of a 'performance obligation' (a promise to transfer a distinct good or service to the customer). Identification of performance obligations defines the unit of account for revenue recognition and drives the subsequent exercise to allocate the transaction price and, finally, to recognise revenue for each distinct performance obligation. This assessment requires a detailed understanding of an entity's revenue streams and may result in significant differences from previous approaches to 'unbundling'.

Judgement is also required in a number of other areas, including determining the relative stand-alone selling price for each distinct performance obligation and whether revenue should be recognised at a point in time or over time based on the transfer of control of the good or service to the customer. It should also be remembered that IFRS 15 has detailed requirements in respect of both the statement of financial position (for example, the recognition and measurement of contract assets and contract liabilities) and the treatment of costs (with stringent requirements on, for example, the capitalisation of costs to acquire a contract).

With all these requirements in mind, good practices to achieve clear entity-specific disclosures include the following:

- **Changes in accounting policies** – A clear explanation of not only new accounting policies, but also of changes compared to previous policies should be provided. Avoid the use of boilerplate language (such as 'when control is transferred') to describe triggers for revenue recognition. The disclosures should include policies for the statement of financial position items such as contract assets and liabilities. More specifically, there is a need for clarity in respect of variable consideration (including application of the constraint on recognition of such amounts) and the measurement of revenue over time (the actual method used and why it is appropriate, rather than simply whether an 'input' or 'output' approach is employed).

- **Transition adjustments** – Entities should provide clear disclosure of the transition method and of the adjustments arising from transition, including quantification and disaggregation of transition adjustments to provide an understanding of the nature and quantum of each significant adjustment. The link between the explanations for adjustments and the changes in accounting policies should be clear.

- **Performance obligations** – Noting the importance of performance obligations to the IFRS 15 model for revenue recognition, entities should provide clear, entity-specific explanation of how distinct promises to customers have been identified in each entity's unique contracts with customers. Again, the use of boilerplate language is discouraged in favour of entity-specific language.

- **Significant judgements** – IFRS 15 has specific requirements in respect of judgements over (for example) the determination and allocation of transaction price and the identification of costs that can be capitalised. These requirements are in addition to (not an example of) the more general requirements of IAS 1 *Presentation of Financial Statements*.

- **Statement of financial position** – Detailed information should be provided on accounts such as contract assets, accounts receivable and onerous contract provisions. For example, the disclosures should include an explanation of the distinction between accounts receivable and contract assets, the interaction between IFRS 15 and IFRS 9 (applying the expected credit loss approach to contract assets) and any change in the measurement of onerous contracts.

- **Comparability of amounts presented** – Entities applying the modified retrospective approach to transition will report revenue for 2017 under the old revenue standards and for 2018 under IFRS 15. In reporting alternative performance measures (APMs) affected by revenue, entities are expected to clarify that different measurement bases have been used in calculating current and prior year figures and to disclose current year measures on both an 'old' and 'new' standards basis.

- **Other issues** – Disclosure of the impact of transition on earnings per share and on the accounting for costs of obtaining and fulfilling contracts (both covered by prescriptive guidance in IFRS 15).

This, of course, can only scratch the surface of the challenges arising from IFRS 15. The standard also has detailed and prescriptive guidance on, amongst other things:

- Timing of recognition of revenue related to variable consideration.

- Determining whether the entity is acting as an agent or as a principal in fulfilling a performance obligation and, therefore, whether revenue should be recognised on a gross or a net basis. Like the rest of IFRS 15, a control (rather than a risks and rewards) model is applied to this consideration.

- Customer options for additional goods or services, with the assessment hinging on whether the customer has paid up-front for a material right to access goods or services at a discount.

- Repurchase agreements, specifying that in many cases an arrangement in which an entity can (or can be required to) buy back an asset will not be accounted for as a sale.

IFRS 9 *Financial Instruments*

IFRS 9 is sometimes thought of as a standard aimed at financial institutions, and it is true that its effects will be most pervasive for entities engaged in lending and investing activities. However, the standard will also affect other entities in a number of significant ways:

- Application of the 'expected credit loss' approach to impairment applies not only to long-term lending by banks, but also to short-term financial assets such as trade receivables. A simplified model for the recognition of these losses is available, but it still requires the application of judgement and associated disclosure.

A Deloitte 'A Closer Look' publication addresses the application of the expected credit loss approach to trade receivables.

- Adoption of IFRS 9's revised approach to hedge accounting (which provides more flexibility in hedge designation and the assessment of hedge effectiveness) is voluntary, but additional disclosures in respect of hedging are required even if the hedging requirements of IAS 39 *Financial Instruments: Recognition and Measurement* continue to be applied.

- The strict requirements for measurement of a financial asset at amortised cost (based on the contractual cash flows of the asset and the business model under which it is held) apply to all entities and could result in assets being measured at fair value for the first time.

- A narrow-scope amendment to IFRS 9 in late 2017 included a clarification in the Basis for Conclusions that modifications to financial liabilities that do not result in derecognition will nevertheless result in a gain or loss in profit or loss at the point of modification.

A Deloitte 'A Closer Look' publication provides more detail on the effect of IFRS 9 on the accounting for modifications of financial liabilities.

For financial institutions, the impact will be more pervasive, with a high degree of scrutiny from regulators on their approach to, for example, impairment and on the quality of their disclosures. The following points should be taken into account by banks when preparing their financial statements applying IFRS 9:

- **Classification and measurement** – The accounting policy disclosures should address the key elements of the business model assessment and the cash flow characteristic test, (i.e. assessing if the contractual terms of the instrument give rise to cash flows that are solely payments of principal and interest on the principal outstanding ('SPPI' test)) for classification of financial assets, together with an explanation of how the criteria for any designation of assets or liabilities in a particular category have been met.

- **Impairment: Policies and methodologies** – As a key element of banks' accounting, the methodology for impairment measurement should be clear and comprehensive, covering the inputs, assumptions and estimation techniques used to determine expected credit losses. This discussion should be sufficiently granular to enable an understanding of how this approach differs by product or business line and how it differs from models used for regulatory purposes.

- **Impairment: Staging and credit risk profile** – Banks should clearly explain the quantitative and qualitative criteria used to assess whether its financial assets are in 'Stage 2' or 'Stage 3' of the expected credit loss model. If a 12-month probability of default (PD) is used as a proxy for lifetime PD in assessing whether a significant increase in credit risk has occurred this should be disclosed.

- **Impairment: Alternative economic scenarios** – An explanation should be provided of how alternative economic outcomes are selected from a range of possibilities, how those scenarios have been weighted in calculating expected credit losses and whether any material overlays to capture factors not reflected in the models used have been applied. Key economic variables used to determine the central scenario should also be disclosed, together with the difference between the base case scenario and the expected credit loss provision.

- **Judgements and estimation uncertainty** – As is the case with IFRS 15, specific disclosures (over and above the requirements of IAS 1) are required of the judgements and estimates made in applying IFRS 9. Judgements over significant increases in credit risk and the definition of default and estimates around economic scenarios and asset lifetimes are expected to be clear and comprehensive.

- **Regulatory definitions differ from IFRS 9 definitions** – Banking regulatory frameworks use similar terms as IFRS 9, however the definition of the terms may differ for accounting and regulatory purposes. Banks should make clear disclosures defining all significant terms used for accounting purposes (e.g. in the calculations of ECL), with a focus on explaining the differences between definitions as applied within their regulatory frameworks and those used for accounting purposes.

Non-banking entities are encouraged to:

- Explain the effect of IFRS 9 on their financial statements, including (if such is the case) why that effect is not material.

- Take care not to overlook categories of instruments that might be affected by IFRS 9. For example, the expected credit loss approach should be applied to IFRS 15 contract assets and to loans to associates and joint ventures and (in separate financial statements) loans to subsidiaries.

- Reconsider the treatment of embedded derivatives in financial assets, which will now usually result in an entire contract (i.e. embedded derivative(s) and 'host contract') being measured at fair value.

- Remember the disclosure requirements added to IFRS 7 for entities applying IFRS 9.

IFRS 16 *Leases*

As was the case for IFRS 15 and IFRS 9 a year ago, regulators expect that, in the year before the adoption of a major new standard, both qualitative and quantitative information on the application of that standard will be disclosed.

These disclosures should:

- Be entity-specific, identifying the lease portfolios most affected by IFRS 16.
- Explain the significant judgements and policy changes arising.
- Identify any exemptions or practical expedients the entity intends to apply, together with its intended approach to transition to IFRS 16.

Entities should also be aware of the possibility of additional scrutiny of operating lease commitments in their 2018 financial statements, as if the 'cumulative catch up' approach to transition is applied this figure will need to be reconciled to the lease liability recognised upon application of IFRS 16.

The need for governance and control over preparation of these disclosures should not be overlooked. Although not yet reflected in the primary statements, this information is part of the financial statements and should be robust enough to be used for that purpose. In addition, it should be noted that disclosures under IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* are not optional, 'reasonably estimable' effects of applying new Standards are required to be disclosed.

The disclosures on the implementation of IFRS 16 in 2019 interim accounts are expected to cover:

- Quantitative disclosure accompanied by informative, entity-specific and detailed explanations.
- Clear explanation of the effect of transition, including comparison of new and previous accounting policies.
- Appropriate commentary on comparative amounts when transitional arrangements may have limited their comparability with current year figures.
- Clear explanation of key judgements made by management, including policy choices and any use of exemptions.
- An explanation of how the transition has been implemented, after careful consideration of the transitional disclosure requirements under IFRS 16 and the requirements of IAS 8.

A Deloitte 'IFRS in Focus' publication provides more detail on the disclosure of the effect of new accounting standards in interim financial statements.

Further resources on IFRS 16 are available on IAS Plus.

The use of 'non-GAAP' or Alternative Performance Measures

The use of 'non-GAAP' figures (sometimes referred to using other terms such as 'Alternative Performance Measures' ('APMs')) outside the financial statements themselves has been an area of regulatory concern in many jurisdictions around the world, with the International Organisation of Securities Commissions ('IOSCO') publishing a Final Statement on Non-GAAP Financial Measures in 2016 which is summarised below.

The adoption of new significant standards such as IFRS 9, IFRS 15 and IFRS 16 may lead entities to define new APMs and/or change the basis of calculation of existing APMs. If this is the case, disclosure should be provided on the extent of and rationale for any change in the APMs used.

The Deloitte publication 'Alternative performance measures: A practical guide' provides additional guidance on the use of APMs, setting out what is considered best practice and providing real-life examples of how entities present such measures.

IOSCO Statement on Non-GAAP Financial Measures

Scope – Applies to 'non-GAAP financial measures' being numerical measures of an issuer's current, historical or future financial performance, financial position or cash flow that is not a GAAP measure (defined as a measure determined pursuant to the issuer's financial reporting framework included in, for example, a press release or narrative section of an annual report).

Disclosures contained within the financial statements are not within the scope.

An operating or statistical measure that is not a financial measure is not within scope.

Defining the non-GAAP financial measure – The measure should be defined, explained (including a statement that it is not a standardised measure), clearly labelled and the reason for its use (including an explanation of why the information is useful to investors) explained.

Unbiased purpose – Non-GAAP measures should not be used to avoid the presentation of adverse information.

Prominence of presentation of GAAP measures – Non-GAAP measures should not be presented with more prominence than the most directly equivalent GAAP measure.

Reconciliation to comparable GAAP measures – A clear and quantitative reconciliation to the most directly equivalent GAAP measure should be provided.

Presentation consistently over time – Comparative values should be presented and non-GAAP measures generally presented consistently from year to year.

Any changes to a non-GAAP measure (or cessation of use of a non-GAAP measure) should be explained with comparative figure adjusted accordingly.

Recurring items – In IOSCO's experience, there are rarely circumstances in which restructuring costs or impairment losses can be justified as being 'non-recurring', 'infrequent' or 'unusual'.

Access to associated information – Information supporting the use and calculation of non-GAAP measures should be readily available to users either by directly accompanying the measure or by a cross-reference to where the information is available.

Disclosure of judgements and estimates

A Deloitte 'IFRS in Focus' publication provides more detail on the disclosure of significant judgements and sources of estimation uncertainty.

The disclosure of judgements and estimates remains, along with the use of Alternative Performance Measures, a common area of regulatory focus on reviews of financial statements. These disclosures are viewed as critical to an investor's ability to assess an entity's financial position and results and to gauge their sensitivity to changes in assumptions.

A key focus is on clarity of what each disclosure represents, that is distinguishing between :

- a *judgement* and a *source of estimation uncertainty*; and
- the items required by IAS 1 to be disclosed and any additional disclosures provided voluntarily.

Significant judgements (disclosure required by IAS 1:122)
This refers to judgements other than estimations made in applying an entity's accounting policies, often in how an item is characterised. For example, an assessment of whether an entity is acting as agent or principal in a revenue transaction may require significant judgement, but once that judgement is made the measurement of revenue may be straightforward.

IAS 1:122 requires disclosure, if the judgement has a **significant effect on the amounts recognised in the financial statements**, of information enabling a user to understand the judgement made, why it is significant and how the entity's conclusion was reached.

Sources of estimation uncertainty (disclosure required by IAS 1:125)
This refers to assumptions or other sources of estimation uncertainty (including judgement involving estimation), primarily over the measurement of an item. For example, it may be clear that an uncertain tax position exists, but assigning a value to that exposure may involve a significant degree of estimation (particularly if there is a wide range of potential outcomes).

IAS 1:125 requires disclosure, if the source of estimation uncertainty results in a **significant risk of material adjustment to assets or liabilities within the next financial year**, of the nature of the uncertainty and carrying amount of affected assets and liabilities and of sufficient information for users to understand the judgements made about sources of estimation uncertainty.

IAS 1 includes sensitivity analyses and ranges of possible outcomes as examples of disclosures that explain the estimates made and there is a clear regulatory expectation that such disclosures will be provided for all items identified as sources of estimation uncertainty disclosed under IAS 1:125.

Voluntary disclosures on items not strictly falling into either category (for example, longer term sources of estimation uncertainty not expected to be resolved within the next financial year) can also be of value to investors. It is recommended that such additional disclosures are clearly identified as such and the rationale for their inclusion is explained.

It is also important that the key judgements and sources of estimation uncertainty identified are reviewed and, if necessary, refreshed each year (the application of new revenue accounting policies under IFRS 15 could, for example, eliminate the need for some previous judgements but also introduce new ones) and that they are consistent with other aspects of the annual report. If, for example, an issue has been focused on by the audit committee, it might (depending on its nature) be a candidate for identification as a key judgement or a source of estimation uncertainty.

Supplier financing arrangements

Supplier financing arrangements are often designed to benefit both the buyer and the supplier in liquidity terms. In some jurisdictions, they have become common in response to public policy initiatives that encourage prompt payment to suppliers. A high-profile corporate failure in the UK in January 2018 has brought with it both media and parliamentary interest in such arrangements.

The terms of 'supplier financing', including 'reverse factoring', arrangements vary, but typically involve suppliers being paid in line with, or in advance of, invoice terms by a third-party financial institution who are then reimbursed by the purchaser at a later date.

Arrangements of this type raise important financial reporting questions around:

- The classification of liabilities as either trade payables (as the original obligation arose from the purchase of goods or services) or as borrowings (as the eventual payment will be made to a financial institution, possibly on a significantly deferred basis compared to the original payment terms of the supplier).

- The presentation of payments and receipts in the statement of cash flows. If the entity's liability is classified as a trade payable, only an operating cash outflow arises. If a borrowing is recognised, it becomes necessary to consider whether, following the form of the transaction, only a financing cash outflow arises on final payment to the financial institution, or whether the transaction should be 'grossed up' to present an operating cash outflow to the supplier and simultaneous financing inflow as a liability to the financial institution is drawn down.

These issues should be considered carefully based on the facts and circumstances of the arrangement (which can vary significantly). Critically, full and clear disclosure should be provided of:

- The approach to the presentation of significant supplier financing arrangements and (in accordance with IAS 1:122) the judgements made in applying that policy.

- The carrying amount of the liabilities in question and the line item(s) in which they are presented.

- How supplier financing transactions have been reflected in the entity's statement of cash flows, including the amount of any 'gross up' applied. The revised requirements of IAS 7 *Statement of Cash Flows* on the disclosure of movements in financing liabilities should also not be overlooked should any cash flows be presented as financing.

- Disclosures required by paragraph 39(c) of IFRS 7 when supplier financing arrangements have been used as a tool to manage liquidity risk.

Suppliers should also be aware of the need to properly account for and disclose the effects of their participation in such arrangements. This is equally true for 'traditional' factoring arrangement for financial assets where IFRS 7 includes specific disclosures where the entity has exposure to a transferred asset, whether it is derecognised or not.

Statement of cash flows

The proper presentation of cash flows and related disclosures remain an area of regulatory focus, in particular the classification of cash flows (for example, restructuring or acquisition-related cash flows should be included in operating cash flows rather than investing activities) and whether items should be included in the statement of cash flows at all (for example, non-cash movements such as the unwind of discounts should be excluded).

> The IFRS Interpretations Committee published an agenda decision in June 2018, confirming that a loan facility with a 14-day contractual notice period should not be considered part of cash and cash equivalents because it is not due on demand and does not often fluctuate between a positive and negative balance. The significance of this conclusion should not be overlooked as it illustrates how narrow the definition of 'cash and cash equivalents' is.

Disclosures supporting the statement of cash flows are also an important area of focus. The amendments to IAS 7, requiring disclosure of changes in liabilities from financing activities (sometimes termed a 'gross debt reconciliation'), were effective for December 2017 year-ends but some entities have overlooked this new requirement. For 2018 financial statements, it is thus important to revisit those disclosures to ensure that the requirements of IAS 7:44A-E are met in full.

Other disclosures supporting the statement of cash flows should also not be overlooked. For example, any 'restricted cash' balances should be clearly explained. These disclosures might be particularly relevant for groups operating in jurisdictions with controls over currency exchanges or restrictions with respect to repatriation, (i.e. controls exercised over 'dividend distributions' to owners).

> **Investments in Money Market Funds**
> Investing in Money Market Funds (MMFs) instead of holding cash at a bank is a common low risk investment strategy. Care should be given in assessing whether investments in MMFs meet the definition of cash and cash equivalents given the terms of MMFs can vary considerably. In the EU, new reforms have been introduced in 2018 that standardise the terms of MMF investments and introduce a distinction between short-term MMFs and standard MMFs, the former being less risky and investing in shorter dated securities than the latter. Given these reforms, existing MMFs may have been restructured to comply with these new regulations and the classification of investments should be reconsidered.

Earnings per share

Similar to the preparation of a statement of cash flows, the calculation of basic and diluted earnings per share ('EPS') might sometimes be considered a purely mechanical exercise. It is, however, an important and complicated one in which errors can easily occur.

IAS 33 *Earnings per Share* is prescriptive in how EPS is calculated, with requirements that in some cases diverge from those of other Standards. The standard also uses terminology that does not appear elsewhere in IFRS Standards. As such, it is important to consider these calculations clearly and on their own terms. The use of 'common sense' or an assumption of consistency with other accounting requirements (for example, IFRS 2 *Share-based Payments*) may lead to mistakes.

Common pitfalls in EPS calculations include failure to adjust both basic and diluted EPS retrospectively for changes in the number of shares in issue without a corresponding change in resources (arising from, for example, a scrip dividend, share split or share consolidation) and errors in the treatment of treasury shares, or shares held in an employee benefit trust ('EBT') or similar vehicle. These shares are not considered 'outstanding' and so are excluded from the 'number of shares' in basic and diluted EPS and have no further effect on the calculations. There are many other potential complications and each instrument which could potentially result in the delivery of ordinary shares (or the repurchase of existing ordinary shares) should be considered carefully to determine its potential effect on basic and/or diluted EPS.

Operating segments

IFRS 8 *Operating Segments* requires certain entities (essentially those with publicly traded securities) to disclose information about their operating segments, products and services, the geographical areas in which they operate, and their major customers. Information is based on internal management reports, both in the identification of operating segments and measurement of the disclosed segment information.

Common pitfalls in operating segments disclosures include:

- The incorrect identification of operating segments and/or their inappropriate aggregation into reporting segments.

- Disclosures that do not provide enough detail to enable the users of the financial statements to understand how management has chosen to organise the entity.

- Lack of reconciliation of the total reportable segment measure of profit or loss to the entity's profit or loss before tax, particularly where APMs are used.

- The "All other segments" category and reconciling items presented as a single "other" column.

- Absence of information about geographical areas, presented separately for the country of domicile and foreign countries, and about reliance on major customers.

- Inconsistencies between the operating segments in the IFRS 5 *Non-current Assets Held for Sale and Discontinued Operation* disclosures and the equivalent information presented elsewhere in the annual report.

Reporting the effects of income tax

The reporting of income tax remains an area of high focus, both from the point of view of quality reporting and more generally as a result of regulatory and media scrutiny of entities' tax affairs.

In respect of financial statements, the effective tax rate reconciliation required by IAS 12 *Income Taxes* is an important source of information on the sustainability of an entity's effective tax rate and the factors affecting it. The nature of reconciling items and why they have arisen should be clearly explained and a clear distinction drawn between significant one-off or unusual items and those that are expected to recur.

Care should also be applied in the recognition of deferred tax assets arising from unused tax losses, particularly if the entity continues to incur losses. Entities are required to disclose the judgements made and evidence that supports the recognition of such assets. For example, where an entity is loss making, disclosure of the evidence over the availability of future profits to support a deferred tax asset is required.

Income tax is also relevant to other issues discussed in this publication:

- Income tax is a common source of **estimation uncertainty**, particularly in respect of uncertain tax positions, to be disclosed in accordance with IAS 1. Significant risks of material adjustment in the next financial year should be disclosed, including quantitative information such as sensitivities or ranges of possible outcomes. The possibility of material adjustments in later periods is also valuable information which could be included in, for example, the tax note.

- The effects of income tax should be appropriately reflected in any **Alternative Performance Measures**. For example, a policy on presentation of 'adjusted' or 'underlying' profit should cover the reporting of items such as one-off tax credits.

Tax issues for 2018 annual reports

The reporting of tax for accounting purposes is, of course, driven by developments in an entity's tax positions and in the tax law to which they are subject. Some topical issues relevant for December 2018 reporting are highlighted below.

'Brexit' and corporation tax

As with 'Brexit' more generally, the effects on the United Kingdom's departure from the EU on corporation tax are as yet unclear. It appears that following exit from the EU, although any withdrawal agreement may include some high-level considerations of tax legislation, there will be no detailed legislative changes. Therefore, 'Brexit' is not, in itself, anticipated to result in new tax legislation, rather it will impact which existing tax legislation applies (i.e. UK entities will no longer be subject to tax legislation applicable to EU-entities, but to tax legislation applicable to non-EU entities).

Applying SIC Interpretation 25 *Income Taxes—Changes in the Tax Status of an Entity or its Shareholders*, the effects of a change in tax status should be recognised when that change occurs. As such, the future change in tax status of UK entities will not result in changes to recognised tax balances as at December 2018. Entities should, however, provide disclosures on the significant risks and uncertainties around future tax rates and payments.

U.S. tax reform

Significant and wide ranging changes to the U.S. tax code (commonly known as the Tax Cuts and Jobs Act) were signed into law on 22 December 2017, necessitating an accelerated exercise by entities with significant U.S. operations to account for their effects on 31 December 2017 reporting. For 31 December 2018 reports, entities should consider whether any refinements to that exercise are needed and ensure that the U.S. tax in 2018 has been properly accounted for and disclosed.

A Deloitte 'IFRS in Focus' publication provides more detail these changes and their accounting effects.

Base Erosion and Profit Shifting

The OECD and the G20 project on 'Base Erosion and Profit Shifting' ('BEPS') was initiated in 2015 to address perceived inequalities and inconsistencies in the global tax landscape. This had resulted in a 15-point action plan to modernise the principles underlying today's international tax landscape and to develop a consistent framework for countries to base their tax legislation upon.

During 2018, governments have continued to develop and implement their responses to the BEPS initiative. Tax authorities will also now have greater visibility over international businesses' transfer pricing profiles through the filing of Country-by-Country reports and Master transfer pricing files. An increased focus on this area by tax authorities is therefore expected going forward.

These initiatives highlight the importance that entities should give to consideration of risks relating to tax as these can have significant effects on the recognition and measurement of tax balances.

Uncertain tax positions

Whilst IFRIC Interpretation 23 *Uncertainty over Income Tax Treatments* is not effective until 2019, the conclusions it reaches are consistent with already effective accounting standards and provide an appropriate approach to dealing with uncertain tax positions.

In brief, its conclusions are as follows:

- Uncertainties in income tax liabilities or assets should be reflected in recognising a tax liability or asset only when payment or recovery becomes probable.

- Judgement is required in identifying the unit of account to be applied in assessing the probability of payment or recovery (i.e. whether there is a single tax uncertainty or group of related uncertainties).

- Full 'detection risk' (i.e. all relevant information being available to the tax authorities) is assumed in making these judgements.

Impairment reviews

The performance and disclosure of impairment reviews remains an area of regulatory challenge. In conducting an impairment review under IAS 36 *Impairment of Assets*, it is important to consider carefully all inputs into a calculation of the recoverable amount (both cash flow forecasts and the discount rate(s) applied to them). It is also important to exercise care in the identification of cash-generating units and in aggregating those cash-generating units for the purposes of testing goodwill for impairment. An appropriate discount rate should also be applied to each cash-generating unit (or group of cash-generating units) rather than the same rate being applied across an entity.

In terms of disclosure, there is an expectation that entities will:

- Disclose not only growth and discount rates, but also other key assumptions such as revenue growth, margins and operating costs used in estimating recoverable amounts.

- Identify, when material, assumptions that are specific for an individual cash-generating unit rather than disclosing only an average value or range for an assumption covering multiple cash-generating units.

- Clearly explain whether reasonably possible changes in key assumptions, whether individually or in combination, could result in an impairment.

- Explain the period over which growth rates are applied, why certain growth rates were used and any significant changes in growth or discount rates.

- Indicate how impairment of subsidiaries, associates and joint ventures has been considered by a parent company whose net assets exceed its market capitalisation.

Brexit and 2018 annual reports

Regulators highlight the importance of disclosure on the possible effects of the United Kingdom's decision to leave the European Union.

Entities are encouraged to provide disclosure which distinguishes between the specific and direct challenges to their business model and operations from the broader economic uncertainties which may still attach to the UK's position at the reporting date. Where there are particular threats, for example the possible effect of changes in import/export taxes or delays to their supply chain, these should be clearly identified and the annual report should explain any actions planned or taken to manage the potential impact.

The broad uncertainties that may be still attached to Brexit when entities report will require disclosure of sufficient information to help users understand the degree of sensitivity of assets and liabilities to changes in management's assumptions. It is expected that many entities will want to consider a wider range of reasonably possible outcomes when performing sensitivity analysis on their cash flow projections and which should be disclosed and explained. Not all entities will require extensive disclosure, but where sensitivity or scenario testing indicates significant issues, relevant information and explanation should be reflected in the appropriate parts of the annual report and accounts, for example in impairment disclosures, for disclosure of sources of estimation uncertainty under IAS 1. The economic scenario(s) incorporated into an assessment of expected credit losses under IFRS 9 should also be considered carefully and disclosed as appropriate.

Some entities may also need to consider whether uncertainties arising from Brexit affect their ability to continue as a going concern.

The significant uncertainties and unknowns in respect of the final terms of the United Kingdom's departure pose challenges in preparing a report for publication possible shortly before the March 2019 deadline set by the triggering of 'Article 50' in 2017 and create a need for a comprehensive post balance sheet events review in the year-end reporting plan, in order to identify both adjusting and non-adjusting events and to make the necessary disclosures required by IAS 10 *Events after the Reporting Period*. The distinction between adjusting and non-adjusting events should be considered carefully to ensure that only adjusting events are reflected in the recognition and measurement of assets and liabilities at the reporting date. For example, it is clear that changes in fair values after the reporting date are non-adjusting events.

The details of the exit scenario might become clearer by the date the 2018 annual financial reports are authorised for issue. In that case sufficient transparency on the impact on an entity's exposures and activities as well as risks and sources of estimation uncertainty should be provided, together with information on how these risks are managed.

Inflation in Argentina

For 2018 year-ends, the Argentine economy is considered hyperinflationary (as that term is defined in IAS 29 *Financial Reporting in Hyperinflationary Economies*). This will impact the consolidated financial statements of entities with Argentine foreign operations (subsidiaries, associates or joint arrangements) as:

- Inflation accounting will need to be applied in preparing the foreign operations' financial statements; and
- Those financial statements will then be translated into the investor's presentation currency at the closing rate (differing from the usual process for translation of foreign operations).

The application of inflation accounting is complex and should be incorporated into the planning for preparation of 2018 annual reports that are affected.

A Deloitte IFRS in focus publication provides more details on the measurement of inflation in Argentina.

Currencies and hyperinflation

Currency in Zimbabwe

Zimbabwe witnessed significant monetary and exchange control policy changes between 2016 through to 2018. The challenges were as a result of the shortage of the foreign multi-currencies in Zimbabwe, especially the US$ which had been in wide use. US$ cash and local bank foreign nostro reserves were in very limited supply. The Reserve Bank of Zimbabwe (RBZ) legally introduced local bond notes in October 2016 at fixed rate of 1:1 with the US$ and encouraged the increased use of the other multi-currencies. Electronic money was also encouraged through the Real Time Gross Settlement (RTGS) system and mobile platforms.

In October 2018, the RBZ instructed the separation and official opening of the Foreign Currency Account RTGS account (FCA RTGS for local electronic money transfers) and the FCA Nostro for actual foreign currency deposits or export proceeds. The money circulating in Zimbabwe is estimated at US $9 billion of which the estimated actual foreign currency is less than US$500 million, with RTGS making the balance, The acute shortage of the foreign currency in cash and in local bank foreign nostro accounts led to the use of unofficial exchange rates.

IAS 21 *The Effects of Changes in Foreign Exchange Rates* requires that entities reconsider their functional currency when events occur that may result in a change. The above would be considered to be such an event. Entities in Zimbabwe should after 1 October therefore consider whether the use of the US$ as a functional currency is still appropriate or whether the functional currency is now the RTGS (which is considered to be a legal currency for use in Zimbabwe entities). Although the official exchange rate between the RTGS and the US$ is 1:1, consideration also should be given to the use of unofficial exchange rates. Indeed, where unofficial exchange rates exist, it may be appropriate to use the unofficial rate for translation and remeasurement purposes, provided the unofficial exchange rate is legal and capable of providing the quantity of foreign currency translated.

When the identification of an appropriate exchange rate is a significant judgement or gives rise to a source of estimation uncertainty, disclosure should be provided as required by paragraphs 122 and 125 of IAS 1.

Changes to interbank offered rates (IBORs)

Work is underway in many jurisdictions, to transition from the current interbank offered rate (IBOR) system to alternative risk-free rates (RFRs) as soon as 2020. The accounting impact of IBOR replacement is on the IASB's research agenda and is expected to move to its active standard setting agenda in due course.

A Deloitte 'Thinking Allowed' publication provides a brief status update on IBOR replacement in several jurisdictions and focuses on some of the potential accounting consequences under IFRS Standards

Other topics

Regulators also noted concerns over:

- **Business combinations** – Specifically the measurement and disclosure of deferred and contingent consideration and whether payments to former owners of an acquiree should be treated as consideration or a remuneration for post-combination services.

- **Defined benefit pension plans** – Disclosure remains important of items such as future funding requirements and significant changes to, for example, actuarial assumptions or expected contributions.

- **Provisions and contingent liabilities** – The appropriate discount rate should be applied to provisions (not the rate used for impairment reviews, as the requirements of IAS 36 and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* are quite different in this respect). Also, reimbursement rights such as insurance assets should not be netted against provisions in the statement of financial position.

- **Deferred tax on share-based payments** – Challenging the allocation between profit or loss and equity.

New and revised IFRS Standards and Interpretations mandatorily effective for years ending on or after 31 December 2018

IFRS
New Standards
IFRS 9 *Financial Instruments*
IFRS 15 *Revenue from Contracts with Customers*

Amended Standards
Clarifications to IFRS 15 Revenue from Contracts with Customers
Amendments to IFRS 4 Applying IFRS 9 *Financial Instruments* with IFRS 4 *Insurance Contracts*
Amendments to IFRS 2 Classification and Measurement of Share-based Payment Transactions
Amendments to IFRS 1 and IAS 28 issued in the Annual Improvement Cycle 2014-2016
Amendments to IAS 40 Transfers of Investment Property

IFRIC Interpretations
IFRIC 22 *Foreign Currency Transactions and Advance Consideration*

The Clarifications to IFRS 15 issued in April 2016 addressed a number of issues highlighted by discussions of the IASB and FASB's joint Transition Resource Group for Revenue Recognition. Details of the group's discussions can be found here.

A similar group, the IFRS Transition Resource Group for Impairment of Financial Instruments has been instigated by the IASB to discuss issues arising from the expected loss-based impairment model of IFRS 9. Details of this group's discussions can be found here.

IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers* (including clarifications published in 2016)
IFRS 9 and IFRS 15 fundamentally change the accounting for financial instruments and revenue contracts respectively. Issues arising in their application are discussed in the main body of this publication.

Amendments to IFRS 4 *Insurance Contracts* – Applying IFRS 9 *Financial Instruments* with IFRS 4 *Insurance Contracts*
The amendments allow entities meeting strict criteria to be considered to be 'engaged in predominantly insurance activities' to defer application of IFRS 9 until the earlier of their adoption of IFRS 17 *Insurance Contracts* and a period beginning on or after 1 January 2021*.

Separately, all entities with contracts in the scope of IFRS 4 are provided with an option to make adjustments to the profit or loss effects of designated qualifying financial assets to remove the impact of IFRS 9 (compared to the previous profit or loss effect of IAS 39). This is termed 'the overlay approach'.

Amendments to IFRS 2 *Share-based Payments* – Classification and measurement of share-based payment transactions

The amendments to IFRS 2 clarify that:

- Vesting and non-vesting conditions in respect of cash-settled share-based payment transactions should be treated in a similar way to conditions over equity-settled transactions (i.e. market and non-vesting conditions factored into the estimate of fair value, whilst service and non-market conditions are taken into account by adjusting the number of awards included in the measurement of the liability). Unlike equity-settled transactions, both estimates are revised at each reporting date;

- Specifically in circumstances where tax law or regulation requires an entity to withhold on behalf of their employees a number of equity instruments necessary to meet the employee's tax liability (typically remitted to the tax authority in cash), the arrangement should be classified as equity-settled in its entirety (rather than recognising a cash-settled element in respect of the net settlement feature); and

- A modification to a share-based payment arrangement that results in the classification changing from cash – to equity-settled should be accounted for by the:

  – derecognition of the cash-settled liability;

  – recognition of the equity-settled share-based payment at its fair value (to the extent that services have been received); and

  – immediate recognition in profit or loss of any difference between the two values.

Amendments to IFRS 1 *First-time Adoption of international Financial Reporting Standards* and IAS 28 *Investments in Associates and Joint Ventures* issued in the Annual Improvements Cycle 2014-2016

The amendments:

- Delete redundant short-term exemptions in IFRS 1 relating to the adoption of new standards whose effective date has now passed; and

- Clarify that the option in IAS 28 for a venture capital organisation (or similar entity) to measure investments in associates and joint ventures at fair value through profit or loss is available separately for each associate or joint venture via an election to be made at initial recognition of the investment.

Amendments to IAS 40 *Investment Property* – Transfers of investment property

The amendments to IAS 40 clarify that a property can be transferred to or from investment property when there is evidence that a change in use of that property has occurred and that a change in management's intentions alone would not be enough to support such a change.

IFRIC Interpretation 22 – *Foreign Currency Transactions* and advance consideration

The interpretation addresses the question of the measurement of transactions for which an entity pays or receives consideration in advance in a foreign currency, concluding that the 'date of the transaction' for the purposes of determining the appropriate exchange rate to be applied is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration.

IFRS Interpretations Committee agenda decisions in 2018

Along with its activity developing formal interpretations of IFRS Standards and proposing that the IASB make amendments to Standards, the IFRS Interpretations Committee regularly publishes summaries of issues that it has decided not to add to its agenda, often accompanied by a discussion of the accounting issue submitted.

Whilst the commentary included in an agenda decision is not formally part of IFRS Standards, it is an important source of guidance that should be carefully considered when selecting a suitable accounting policy for a transaction. In many jurisdictions, there is an expectation from regulators that entities will take into consideration agenda decisions when applying IFRS Standards.

In 2018, the following agenda decisions have been published by the Committee.

January IFRIC Update	IAS 28 – Contributing property, plant and equipment to an associate
March IFRIC Update	IFRS 9/IAS 1 – Presentation of interest revenue for particular financial instruments
	IFRS 15 – Revenue recognition in a real estate contract
	IFRS 15 – Revenue recognition in a real estate contract that includes the transfer of land
	IFRS 15 – Right to payment for performance completed to date
June IFRIC Update	IAS 7 – Classification of short-term loans and credit facilities
September IFRIC Update	IFRS 9 – Classification of a particular type of dual currency bond
	IAS 21 – Determination of the exchange rate when there is a long-term lack of exchangeability
	IAS 23 – Expenditures on a qualifying asset
	IAS 23 – Borrowing costs on land

New and revised IFRS Standards and Interpretations available for early application in years ending on or after 31 December 2018

Paragraph 30 of IAS 8 requires entities to consider and disclose the potential impact of new and revised IFRS Standards that have been issued but are not yet effective. As discussed above, the sufficiency of these disclosures (particularly as they relate to IFRS 16 on leasing) is a current area of regulatory focus.

The list below reflects a cut-off date of 30 November 2018. The potential impact of the application of any new and revised IFRS Standards issued by the IASB after that date but before the financial statements are issued should also be considered and disclosed.

IFRS	Effective date – periods commencing on or after:
New Standards	
IFRS 14 *Regulatory Deferral Accounts*	First time adopters whose first annual IFRS financial statements are for a period beginning on or after 1 January 2016.
IFRS 16 *Leases*	1 January 2019
IFRS 17 *Insurance Contracts*	1 January 2021*

Amended Standards	
Amendments to IFRS 10 and IAS 28 – Sale or Contribution of Assets between an Investor and its Associate or Joint Venture	The IASB decided in December 2015 to defer indefinitely the effective date of these amendments.
Amendments to IFRS 9 – Prepayment Features with Negative Compensation	1 January 2019
Amendments to IAS 28 – Long-term interests in Associates and Joint Ventures	1 January 2019
Amendments to IFRS 3, IFRS 11, IAS 12 and IAS 23 issued in the Annual Improvement Cycle 2015-2017	1 January 2019
Amendments to IAS 19 – Plan Amendment, Curtailment or Settlement	1 January 2019
Amendments to the *Conceptual Framework for Financial Reporting*, including amendments to references to the Conceptual Framework in IFRS Standards	1 January 2020
Amendments to IFRS 3 – Definition of a Business	1 January 2020
Amendments to IAS 1 and IAS 8 – Definition of Material	1 January 2020

IFRIC Interpretations	
IFRIC 23 *Uncertainty over Income Tax Treatments*	1 January 2019

*In November 2018, the IASB tentatively decided that the mandatory effective date of IFRS 17 should be deferred by one year, so that entities would be required to apply IFRS 17 for annual periods beginning on or after 1 January 2022 and that the fixed expiry date for the temporary exemption in IFRS 4 from applying IFRS 9 should be amended so that all entities would be required to apply IFRS 9 for annual periods beginning on or after 1 January 2022. An exposure draft proposing these changes is expected in 2019.

A Transition Resource Group for Insurance Contracts has been set up following publication of IFRS 17. Details of this group's discussions can be found here.

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