IFRS/IFAS news

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Must know

IASB issues amendments to IAS 19 – plan amendment, curtailment or settlement

Issue

On 7 February 2018, the IASB issued amendments to the guidance in IAS 19, 'Employee Benefits', in connection with accounting for plan amendments, curtailments and settlements.

The amendments require an entity:

- to use updated assumptions to determine current service cost and net interest for the remainder of the period after a plan amendment, curtailment or settlement; and
- to recognise in profit or loss as part of past service cost, or a gain or loss on settlement, any reduction in a surplus, even if that surplus was not previously recognised because of the impact of the asset ceiling.

Impact

Changes in the terms or membership of a defined benefit plan might result in a plan amendment or a curtailment or settlement. IAS 19 requires an entity to determine the amount of any past service cost, or gain or loss on settlement, by remeasuring the net defined benefit liability before and after the amendment, using current assumptions and the fair value of plan assets at the time of the amendment. Current service cost and net interest are usually calculated using assumptions determined at the beginning of the period.

However, if the net defined benefit liability is remeasured to determine past service cost or the gain or loss on settlement, current service cost and net interest for the remainder of the period are remeasured using the same assumptions and the same fair value of plan assets. This will change the amounts that would otherwise have been charged to profit or loss in the period after the plan amendment, curtailment or settlement, and it might mean that the net defined benefit liability is remeasured more often.

A plan amendment, curtailment or settlement might reduce or eliminate a surplus, which could change the effect of the asset ceiling. Past service cost, or a gain or loss on settlement, is calculated in accordance with IAS 19, and it is recognised in profit or loss. This reflects the substance of the transaction, because a surplus that has been used to settle an obligation or provide additional benefits is recovered. The impact on the asset ceiling is recognised in other comprehensive income, and it is not reclassified to profit or loss. The impact of the amendments is to confirm that these effects are not offset.

Who is affected

The amendments will affect any entity that changes the terms or the membership of a defined benefit plan such that there is past service cost or a gain or loss on settlement.

The amendments are applied prospectively to plan amendments, settlements or curtailments that occur after the beginning of the first annual reporting period beginning on or after 1 January 2019.

IFRS 9 impairment: intercompany loans in separate financial statements

At a glance

IFRS 9 introduces an 'expected loss' model for recognising impairment of financial assets held at amortised cost, including most inter-company loans receivable. This is different from IAS 39, which had an 'incurred loss' model, where provisions were recognised only when there was objective evidence of impairment.

This change of approach will require lenders of inter-company loans to consider forward-looking information to calculate expected credit losses, regardless of whether there has been an impairment trigger. In some cases, impairment losses might be recognised where none were previously.

Issue

IFRS 9 requires entities to recognise expected credit losses for all financial assets held at amortised cost, including inter-company loans from the perspective of the lender. IAS 39, the previous standard for assessing impairment of inter-company loans, had an incurred loss model.

This change of approach might result in impairment losses being recognised where none were previously.

However, it is expected that a material impairment provision from inter-company loans within the scope of IFRS 9 might not require to be recognised, because:

- they are repayable on demand and the lender expects to be able to recover the outstanding balance of the loan if demanded;
- they are low credit risk, so 12- month expected credit losses can be calculated, which might not be material; or
- they have not had a significant increase in credit risk since the loan was first recognised, or have a remaining life of less than 12 months, so 12-month expected credit losses are calculated, which, as noted above, might not be material.

Where inter-company loans do not meet any of the three criteria above, lifetime expected credit losses will need to be calculated, which are more likely to give rise to a material impairment provision.

This In brief summarises our practical guidance in In depth 2018- 02, 'IFRS 9 impairment practical guide: inter-company loans in separate financial statements', on how to apply IFRS 9's impairment requirements to inter-company loans.

The appended decision tree and commentary will direct you to the relevant section of the In depth guidance, to assess whether a material impairment provision is required for your inter-company loans.

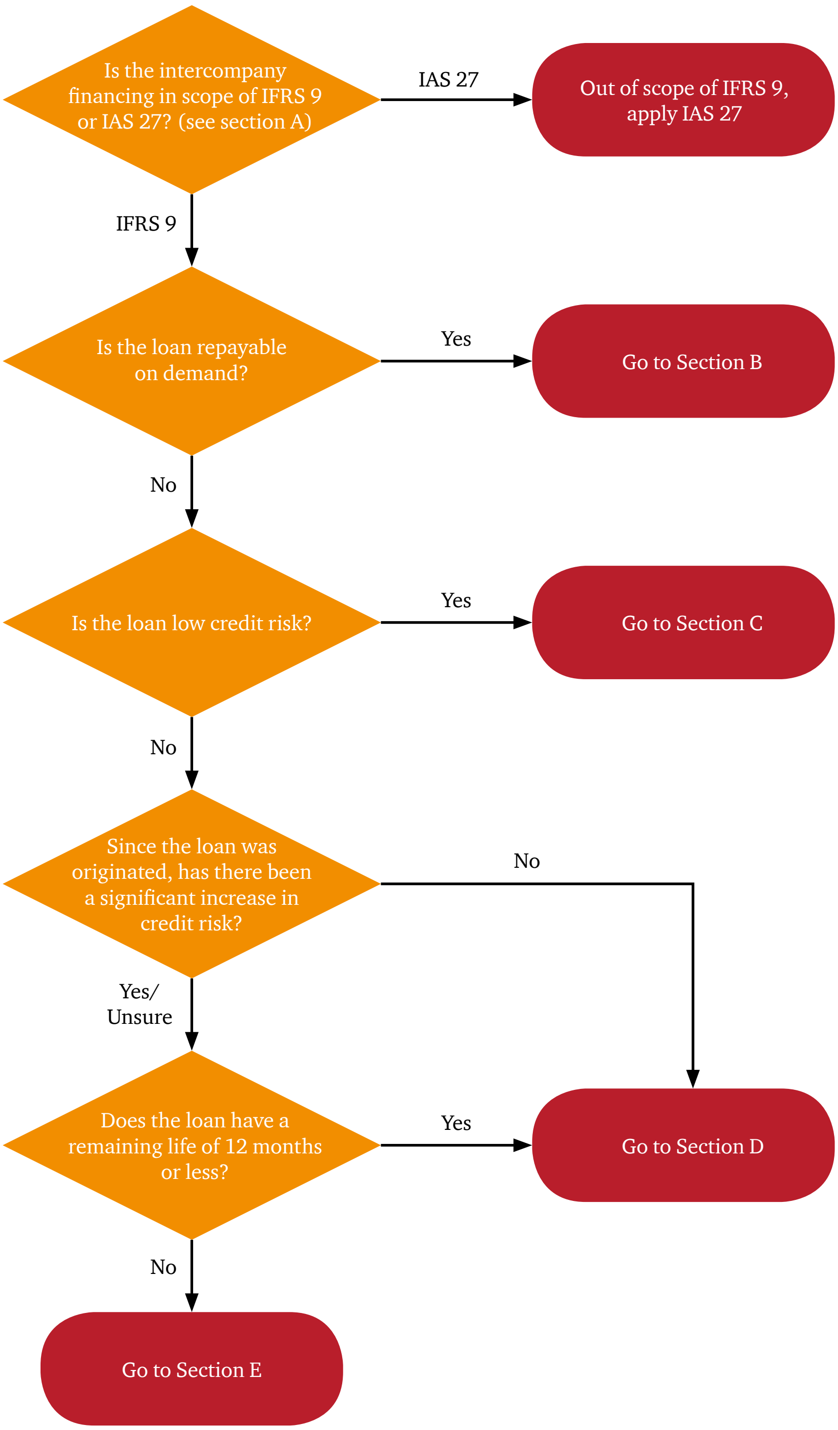
Irrespective of whether calculating expected credit losses for inter-company loans gives rise to a material impairment provision, entities will need to ensure that their approach and the relevant assumptions made are documented.

Where can further information be found?

PwC's In depth 'IFRS 9 impairment practical guide: inter-company loans in separate financial statements' provides guidance on IFRS 9's impairment requirements for inter-company loans.

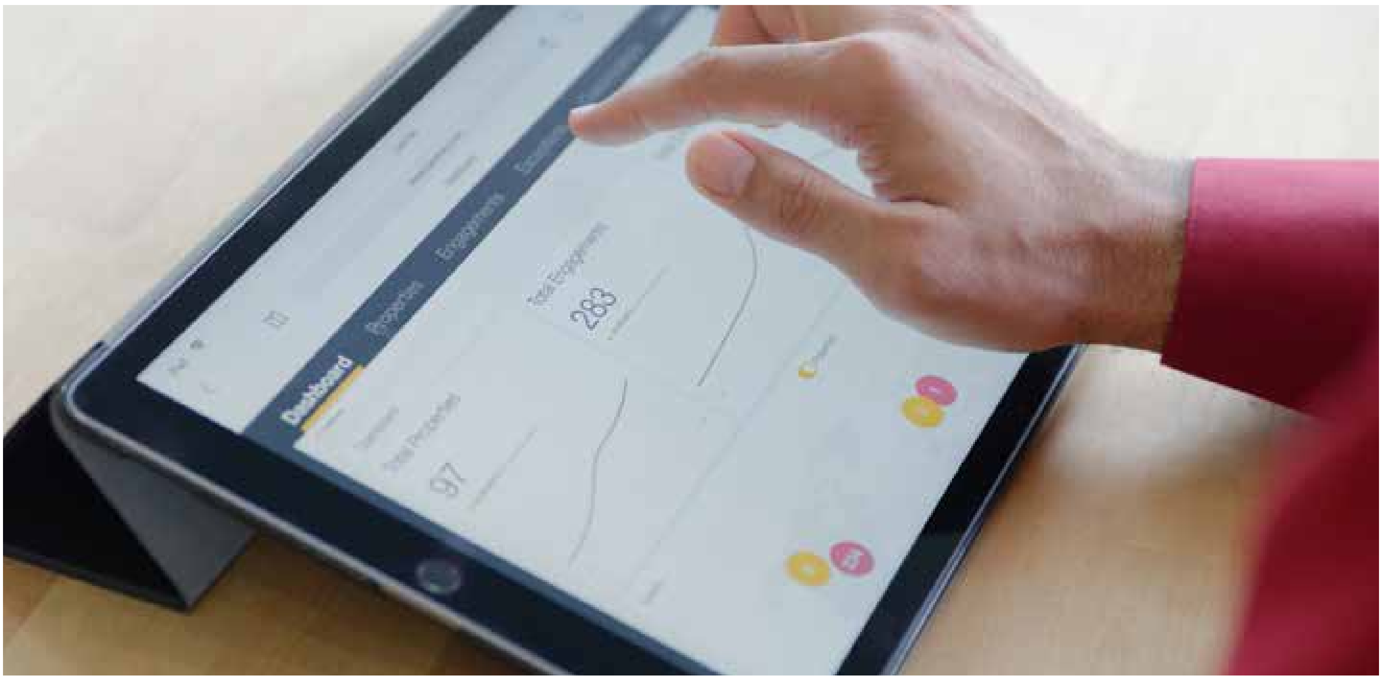
Appendix – Decision tree and commentary

Use the following decision tree to direct you to the relevant section of the In depth, and commentary below, to determine if a material impairment provision is required:



In depth Section	Common Example	Commentary
Section A *Is the loan in the scope of IFRS 9?*	Lender accounts for the intercompany financing as an 'investment in subsidiary' under IAS 27. Borrower accounts for the financing received as a capital contribution.	• Inter-company financings that, in substance, form part of an entity's 'investment in a subsidiary' are not in IFRS 9's scope. Rather, IAS 27 applies to such investments. • An inter-company loan is outside IFRS 9's scope (and within IAS 27's scope) only if it meets the definition of an equity instrument for the subsidiary (for example, it is a capital contribution). • All loans to subsidiaries that are accounted for by the subsidiary as a liability are within IFRS 9's scope. • If the terms of an intra-group financing are clarified or changed on adoption of IFRS 9, careful analysis might be required.
Section B *Loan is repayable on demand*	Inter-company loan is repayable on demand. The borrower does not have sufficient available liquid assets to repay the inter-company loan if it was demanded at the reporting date. However, if the lender demanded repayment of the inter-company loan, it would allow the borrower to continue trading/sell its assets to fund repayment of the loan over a period of time, to maximize recovery of the loan.	• For loans that are repayable on demand, expected credit losses are based on the assumption that repayment of the loan is demanded at the reporting date. • If the borrower has sufficient accessible highly liquid assets in order to repay the loan if demanded at the reporting date, the expected credit loss is likely to be immaterial. • If the borrower could not repay the loan if demanded at the reporting date, the lender should consider the expected manner of recovery to measure expected credit losses. This might be a 'repay over time' strategy (that allows the borrower time to pay), or a fire sale of less liquid assets. • If the recovery strategies indicate that the lender would fully recover the outstanding balance of the loan, the expected credit loss will be limited to the effect of discounting the amount due on the loan (at the loan's effective interest rate, which might be 0% if the loan is interest free) over the period until cash is realised. If the time period to realise cash is short or the effective interest rate is low, the effect of discounting might be immaterial. If the effective interest rate is 0%, and all strategies indicate that the lender would fully recover the outstanding balance of the loan, there is no impairment loss to recognise.
Section C *Loan has low credit risk*	The borrower of the inter-company loan has a strong capacity to meet its contractual cash flow obligations in the near term. Any adverse changes in economic and business conditions in the longer term will not necessarily reduce the borrower's ability to repay the loan.	• A loan has low credit risk if the borrower has a strong capacity to meet its contractual cash flow obligations in the near term, and adverse changes in economic and business conditions in the longer term might, but will not necessarily, reduce the ability of the borrower to fulfil its obligations. • For loans that are low credit risk at the reporting date, IFRS 9 allows a 12-month expected credit loss to be recognised. • An external rating of 'investment grade' is an example of low credit risk. However, an intra-group loan should not be assumed to have the same rating as other instruments issued by the borrower (such as loans to third parties) without further analysis. • Low credit risk loans might have very low risk of default (or 'probability of default' (PD)). • A 'short-cut' can be used to determine if the expected credit loss on a low credit risk loan needs to be recognised. This short-cut assumes that the PD for the inter-company loan is that of the lowest investment grade (either BBB- or Baa3, depending on the credit ratings agency used) and the maximum possible loss in the event of a default (that is, the loan is fully drawn and no amount is recovered). If this results in an immaterial expected credit loss, no further work is required. If, however, this short-cut results in a material expected credit loss, further work will be required to estimate both the actual PD and the actual loss in the event of a default.

In depth Section	Common Example	Commentary
Section D *No significant increase in credit risk since the loan was originated, or remaining life is less than 12 months*	Inter-company loan is a 'quasi equity' loan and the lender is unable to determine that the loan is low credit risk. However, since the loan was first granted, there have not been any actual or expected significant adverse changes in the operating results of the borrower, nor any actual or expected significant adverse changes in the regulatory, economic or technological environments of the borrower. The inter-company loan is not 30 days past due.	• For loans where there has not been a significant increase in credit risk (that is, where they are in stage 1), a 12-month expected credit loss is recognised. • A similar short-cut could be used as for low credit risk loans to determine if the expected credit loss on a stage 1 loan is material. This short-cut assumes the maximum possible loss in the event of a default (that is, the loan is fully drawn and no amount is recovered). If, when the PD is applied to the outstanding balance of the inter-company loan, this results in an immaterial expected credit loss, no further work is required. If, however, this short-cut results in a material expected credit loss, further work will be required to estimate the actual loss in the event of a default.
Section E *Other intercompany loans*	Inter-company loan does not fall into any of the categories above (that is, it has had a significant increase in credit risk since it was first recognised).	• For loans that are in stage 2 or 3, a lifetime expected credit loss is recognised. • In measuring the expected credit loss, all reasonable and supportable information that is available without undue cost or effort should be considered. This includes both internal and external information, and information about past events, current conditions and forecasts of future economic conditions. • The effect of credit enhancements such as collateral, guarantees and letters of support should also be considered. Guarantees that are contractually enforceable have a greater effect than letters of support that are not. • Calculating lifetime expected losses can be complex. If support is required, consult with an IFRS 9 specialist.



ISAK 34: Uncertainty over income tax treatments

Issue

On 28 February 2018, the Indonesia Accounting Standard Board (DSAK-IAI) issued ISAK 34, which clarifies how the recognition and measurement requirements of PSAK 46 'Income taxes', are applied where there is uncertainty over income tax treatments.

Impact

When does the Interpretation apply?

The DSAK IAI had clarified previously that PSAK 46, not PSAK 57 'Provisions, contingent liabilities and contingent assets', applies to accounting for uncertain income tax treatments. ISAK 34 explains how to recognise and measure deferred and current income tax assets and liabilities where there is uncertainty over a tax treatment.

An uncertain tax treatment is any tax treatment applied by an entity where there is uncertainty over whether that treatment will be accepted by the tax authority. For example, a decision to claim a deduction for a specific expense or not to include a specific item of income in a tax return is an uncertain tax treatment if its acceptability is uncertain under tax law. ISAK 34 applies to all aspects of income tax accounting where there is an uncertainty regarding the treatment of an item, including taxable profit or loss, the tax bases of assets and liabilities, tax losses and credits and tax rates.

What is the unit of account?

Each uncertain tax treatment is considered separately or together as a group, depending on which approach better predicts the resolution of the uncertainty. The factors that an entity might consider to make this determination include:

1. how it prepares and supports the tax treatment; and
2. the approach that it expects the tax authority to take during an examination.

What should an entity assume about the examination of tax treatments by taxation authorities?

An entity is required to assume that a tax authority with the right to examine and challenge tax treatments will examine those treatments and have full knowledge of all related information. Detection risk is not considered in the recognition and measurement of uncertain tax treatments.

When should an entity account for any uncertain tax treatments?

If an entity concludes that it is probable that the tax authority will accept an uncertain tax treatment that has been taken or is expected to be taken on a tax return, it should determine its accounting for income taxes consistently with that tax treatment. If an entity concludes that it is not probable that the treatment will be accepted, it should reflect the effect of the uncertainty in its income tax accounting in the period in which that determination is made (for example, by recognising an additional tax liability or applying a higher tax rate).

How is the effect of uncertainty recognised?

The entity should measure the impact of the uncertainty using the method that best predicts the resolution of the uncertainty (that is, the entity should use either the most likely amount method or the expected value method when measuring an uncertainty).

The most likely amount method might be appropriate if the possible outcomes are binary or are concentrated on one value. The expected value method might be appropriate if there is a range of possible outcomes that are neither binary nor concentrated on one value. Some uncertainties affect both current and deferred taxes (for example, an uncertainty over the year in which an expense is deductible). ISAK 34 requires consistent judgements and estimates to be applied to current and deferred taxes.

What about changes in circumstances?

The judgements and estimates made to recognise and measure the effect of uncertain tax treatments are reassessed whenever circumstances change or when there is new information that affects those judgements. New information might include actions by the tax authority, evidence that the tax authority has taken a particular position in connection with a similar item, or the expiry of the tax authority's right to examine a particular tax treatment. ISAK 34 states specifically that the absence of any comment from the tax authority is unlikely to be, in isolation, a change in circumstances or new information that would lead to a change in estimate.

What about the disclosures?

There are no new disclosure requirements in ISAK 34. However, entities are reminded of the need to disclose, in accordance with PSAK 1, the judgements and estimates made in determining the uncertain tax treatment.

Effective date and transition

The Interpretation is effective for annual periods beginning on or after 1 January 2019. Earlier application is permitted. An entity can, on initial application, elect to apply this Interpretation either:

1. retrospectively applying PSAK 25, if possible without the use of hindsight; or
2. retrospectively, with the cumulative effect of initially applying the Interpretation recognised at the date of initial application as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate).

Insight

ISAK 34 provides a framework to consider, recognise and measure the accounting impact of tax uncertainties. The Interpretation provides specific guidance in several areas where previously PSAK 46 was silent. For example, the Interpretation specifies how to determine the unit of account and the recognition and measurement guidance to be applied to that unit.

There is no specific guidance in PSAK 46, and entities today might be using different models to determine the unit of account and measure the consequences of tax uncertainties. The Interpretation also explains when to reconsider the accounting for a tax uncertainty, and it states specifically that the absence of comment from the tax authority is unlikely, in isolation, to trigger a reassessment.

Most entities will have developed a model to account for tax uncertainties in the absence of specific guidance in PSAK 34. These models might, in some circumstances, be inconsistent with ISAK 34 and the impact on tax accounting could be material. Management should assess the existing models against the specific guidance in the Interpretation and consider the impact on income tax accounting.

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