STAFF PAPER

12 October 2011

Capital Markets Advisory Committee Meeting

Project	**Disclosures when a new IFRS is published**

Purpose

1. The purpose of this paper is to ask CMAC members for their views on the general disclosures when a new IFRS is published.
2. Our objective for this session is to find out (a) if the existing general disclosure requirements in IFRSs are sufficient to inform users when a new standard (or new standards) is (or are) applied, (b) does the IASB need to provide additional implementation guidance on disclosures or (c) if the IASB should prescribe additional disclosures.

Background

3. The IASB is currently developing four major standards—financial instruments, insurance, leases and revenue recognition. The Board has not yet decided on the effective dates for those projects or whether there would be a single-date (a 'big bang') approach or a sequential date approach[1]. However for the financial instruments and revenue recognition projects, the Board has committed itself that those standards would not be mandatory until at least 20X5. This is so that entities are provided with adequate time to transition to those IFRSs.
4. When a new IFRS is published but not yet mandatory (or effective), IFRSs require an entity to disclose:

[1] Based on a *Request for Views* and a user survey in which the Board asked respondents whether their major new standards should be mandatory on a sequential or a single-date approach, there were split views on this issue. Those who supported a single-date approach did so for comparability reasons and to ensure that groups of standards that are interlinked would be applied at the same time. Those who supported a sequential date approach stated that a sequential approach would make it easier to trace the impact of each new standard.

(a) The fact that a new IFRS has been published. Entities would typically disclose the title of the new IFRS, the date by which the application of the IFRS is required and the date at which the entity plans to apply the IFRS; and

(b) known or reasonably estimable information relevant to assessing the possible impact that application of the new IFRS will have on the entity's financial statements in the period of application.

5. IFRSs also require an entity to disclose the following information when there is a change in accounting policy (eg when an entity applies a new IFRS):

(a) The nature of the change in accounting policy.

(b) For the comparative amount (ie the year before implementation), an explanation of the nature, amount and reason for reclassification of the comparative amount.

(c) When applicable, a description of any transitional provisions and how they may have an effect on future periods.

(d) For the current period and each prior period presented, to the extent practicable, the amount of adjustment:

(i) for each financial statement line item affected; and

(ii) if IAS 33 *Earnings per Share* applies, for basic and diluted earnings per share

(e) the amount of the adjustment relating to periods before those presented, to the extent practicable.

6. For interim financial statements, if accounting policies or methods have been changed, an entity would also have to disclose a description of the nature and effect of the change. In addition, IAS 34 *Interim Financial Reporting* also has a disclosure principle requiring the entity to explain an event or transaction that is significant to an understanding of the changes in an entity's financial position or performance since the last annual reporting period.

7. The Board has also (as part of the annual improvements process—the ED was published in June 2011) recently clarified and proposed that when an entity

changes its accounting policy, the entity shall present three balance sheets, including one for the beginning of the required comparative period.

User survey

8. In March 2011, the staff posted on the IASB website a survey asking users whether the information that entities disclosed about new standards that are not yet effective is sufficient to notify them about forthcoming potential changes to the financial statements. If not, what information could be enhanced and how would that information make the transitional analysis more effective or efficient?

9. A small majority of respondents agreed that the information disclosed by companies was sufficient for their needs. Some respondents noted that the quality of the disclosures by entities varied. Furthermore, many users were of the view that the information provided by preparers during transition was not particularly helpful and stated their belief that many disclosures were boilerplate. As a result, those respondents suggested that the boards should consider the following:

    (a) An entity's timing when the new standard will be applied.

    (b) More quantitative estimates on the possible impact of the potential standards. However, those respondents did not specify what types of estimates would be useful.

    (c) Requiring companies to discuss the rule change in a way that relates to their business (eg discuss transactions, explain business mechanics), rather than explain the technicalities of the rule.

10. One respondent suggested that the boards could require more disclosure about a new standard's potential impact on an entity's financial statements, particularly by requiring more quantitative disclosures, but also recognised the concern that one could be essentially forcing them to early adopt the standard in the notes.

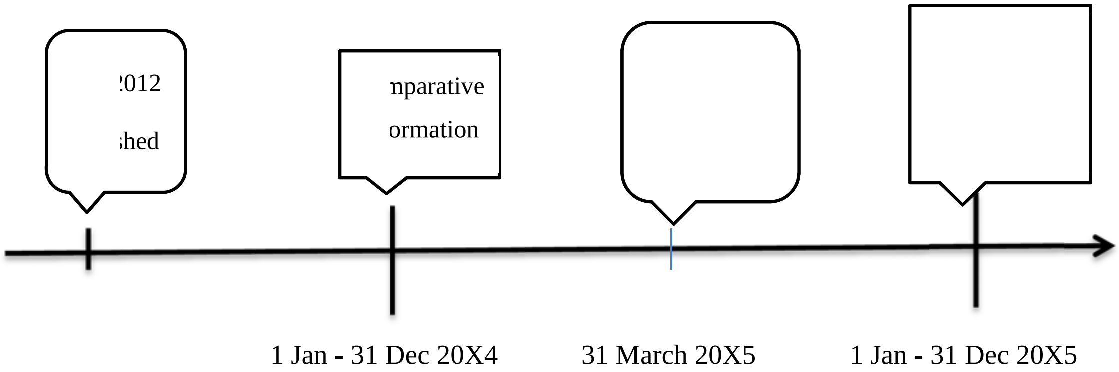
Discussion by CMAC

11. CMAC members are asked to discuss the types of disclosures that you expect an entity to disclose in particular times in the following *fictional example*[2].

12. We have provided some suggested answers – the first option (option (a)) for each question is based on the existing requirements, the second option (option (b) would amend the existing disclosures and the final option, (option (c)) asks CMAC members if they have other suggested disclosures for improvement. *Please choose one of them.*

> Fictional example
>
> The IASB published a standard, IFRS Z, in November 20X2. The mandatory effective date for that IFRS is 1 January 20X5. For IFRS Z, the Board decided that an entity would apply IFRS Z on a retrospective basis (ie as if the new standard, IFRS Z, had always been applied).
>
> The requirements in IFRS Z would have a material effect to Entity A's financial statements because Entity A has many operating leases that would have to capitalised (Entity A is predominantly a lessee). Entity A has decided to apply the requirements of IFRS Z from 1 January 20X5. It has an annual period that normally ends on 31 December. The comparative information (ie for annual period that ends on 20X4) would also have to be restated to comply with the new IFRS. Entity A also produces interim financial reports.

[2] We chose the leases project because most CMAC members would know some of the major changes expected to be proposed in the leases project. Moreover, the leases project is expected to impact many lessees' financial position and financial performance. The example given here is based on the boards' tentative decisions on recognition and measurement. The transitional provision in this example is only based on the most recent staff paper. The final requirements will not be determined until after the boards have completed all their deliberations, including those relating to any re-exposure, and balloted the final standard.



Some constraints to consider

13. Entities will need time to collect the information to comply with the new requirements.

14. Software companies could take about a year or more to develop the accounting programs to comply with new major accounting requirements. Most software companies do not start developing accounting software until the standard is published.

15. Any information about the possible effects when implementing a new IFRS in the future would need to be auditable.

16. A user may:

    (a) have higher expectations of the accuracy or precision of the information given if an entity provided more quantitative information (eg if they user could see pro-forma information as suggested in Question 1 option (b)) for the year before implementation (20X4); or

    (b) be more sensitive to any changes made between disclosures made in the year before implementation (in this example, 20X4) and the actual results given after the entity has implemented the standard (in the year 20X5).

Questions

Question 1

Disclosures for the year before implementation (31 December 20X4)

17. For the annual period that ends on 31 December 20X4 (year prior to implementation of IFRS Z), what should Entity A disclose? Please choose one option.

    (a) Rely on the general disclosure requirements in IFRSs (see paragraph 4).

    An example could be as shown below:

> The Entity is required to adopt IFRS Z *Leases* for the financial year commencing 1 January 20X5 and the effect of the standard will be first reflected in the Entity's financial statements in the quarter ending 31 March 20X5.
>
> <u>Transitional disclosures as at 31 December 20X4</u>
>
> IFRS Z will require all leases to be capitalised, including leases currently classified as operating leases. This would result in an increase in the assets and liabilities recognised related to operating leases. Applying IFRS Z would also result in the Entity not recognising operating lease expenses. Instead, the Entity would recognise an interest expense arising from the unwinding of the discount on the liability to pay lease payments as well as an amortisation expense from the amortisation of the right-of-use lease asset. So far, the Entity believes that applying IFRS Z would not have a significant effect on the profit or loss of the Entity during the year if IFRS Z was applied.
>
> The Entity also has some property, plant and equipment that are recognised under finance leases. On transition to IFRS Z, those types of property, plant and equipment will be reclassified as 'leased assets' as opposed to 'property, plant and equipment'.

    (b) Pro-forma information for each line item that would be affected.

> The Entity is required to adopt IFRS Z *Leases* for the financial year commencing 1 January 20X5 and it will be first reflected in the Entity's financial statements in the quarter ending 31 March 20X5. Applying IFRS Z means capitalising most of the Entity's existing operating lease arrangements as assets and liability to pay for leases.

Transitional disclosures as at 31 December 20X4

When implementing IFRS Z, the Entity estimates that the opening adjustments as at 1 January 20X4 are as follows:

	Actual*	Adjustment	Pro forma	Notes
	CU	CU	CU	
Statement of financial position				
Property, plant and equipment				
Owned asset	100	0	100	
Leased asset	0	850	850	(1)
Liabilities to pay for leases	(60)	(900)	(960)	(1)

* reported in this financial statement

Statement of financial performance				
Operating lease expense	350	(350)	0	(2)
Depreciation/amortisation	20	200	220	(2)
Lease interest expense	10	300	310	(2)

Notes:

(1) If the Entity applied IFRS Z *Leases*, the Entity anticipates that it might have to recognise CU850 of leased assets and a corresponding liability of CU900 because the Entity would no longer be recognising operating lease expenses when they are due to the lessor.

(2) Applying IFRS Z meant that the Entity would no longer be recognising operating lease expenses when they are due to the lessor. Rather, the Entity would be recognising interest expense to reflect the liability to pay for those leases and an amortisation expense for the lease assets instead of recognising a single operating lease amount.

(c) Other types of disclosure (please explain what they should be and why). Other examples of other disclosures could be:

(i) Pro-forma information on how the opening equity (or retained earnings) could be affected.

(ii) How the entity uses leases in its business and how applying IFRS Z could affect the entity's business model.

Question 2

Disclosures consequence of new IFRSs in the year of implementation (20X5)—the first annual financial reports

Question 2A: Single-date approach in the year of implementation

18. If the boards decided on a single-date approach for the four major standards (ie insurance, leases, financial instruments and revenue recognition) for the annual period that ends on 31 December 20X5, what should Entity A disclose? Please choose one of the following options.

(a) Rely on the general disclosure requirements in IFRSs (see paragraph 5 in this staff paper for the types of information that would be required).

(b) Reconciliation of:

(i) equity reported under IAS 17 to equity in accordance with the new IFRS Z; and

(ii) total comprehensive income in accordance with the IFRS Z for the latest period in the entity's most recent annual financial statements. The starting point for that reconciliation shall be the total comprehensive income in accordance with IAS 17 for the same period.

This reconciliation is adapted from the requirements in IFRS 1 *First-time Adoption of IFRSs*. Please refer to the Appendix for an example of the reconciliation in relation to equity and total comprehensive income.

(c) Other types of disclosure—please explain. (This could be a modification of the suggested options above.)

Question 2B: Sequential-date approach

19. Would your response to Question 2A differ if the Board decided on a sequential approach (eg (a) each standard has a different effective date or (b) interlinked standards have the same effective date)?

Question 2C: For all IFRSs or only major standards/amendments?

20. If you chose option (b) to Question 2A, would you only recommend it for major projects (ie not amendments to IFRSs arising from annual improvements or Interpretations of IFRSs, unless those amendments result in a significant restatement of the entity's financial statements)?

Question 3

Disclosure about new IFRSs for the first interim financial reports

Question 3A: Single-date approach

21. If the boards decided on a single-date approach for the four major standards (ie insurance, leases, financial instruments and revenue recognition) for the first interim period that ends on 31 March 20X5, what should Entity A disclose? Please choose one the following options.

    (a) Rely on the general disclosures for when an entity publishes interim financial reports and has made a change in accounting policy—a description of the nature and effect of the change (see paragraph 6).

    (b) Require the entity to provide the reconciliations as suggested in Question 2 option (b) as part of the interim financial statements.

    (c) Other types of disclosure—please explain.

Question 3B: Sequential-date approach

22. Would your response to Question 3A differ if the Board decided on a sequential approach (eg (a) each standard has a different effective date or (b) interlinked standards have the same effective date)?

Question 4 Other types of disclosures

23. Are there are other types of information that the entity should disclose before the standard becomes mandatory? For example:

    (a) For annual periods that end in 20X2 and 20X3 (years before the comparative year and the year of implementation), do you have any proposals on the types of disclosures that you would find useful?

    (b) Whether the entity has developed and disclosed any changeover plans from the previous IFRSs to the new IFRSs. This may include a discussion of how applying the new IFRS could have an effect on an entity's contractual relationships (eg complying with debt covenants and executive remuneration arrangements) and the steps that management expect to take as a consequence of those IFRSs.

Appendix

A1. The appendix illustrates how an entity could disclose reconciliation to show the effects in equity and the statement of comprehensive income between the requirements of previous IFRSs and the new IFRSs. We need to emphasise that this is only one way to show the reconciliation.

A2. Reconciliation to show the effects in equity arising from the new IFRS Z as of 1 January 20X4 is below.

Note		Previous IFRS	Effect of transition to new IFRS	New IFRS
		CU	CU	CU
1	Property, plant and equipment (net)	1,350	600	1,950
2	Liability to pay for lease payments	(60)	(850)	(910)
	Total asset less total liabilities	1,290	(250)	1,040
3	Retained earnings	1,290	(250)	1,040
	Total equity	1,290	(250)	1,040

Notes:

1 The adjustments to property, plant and equipment are as follows:

	CU
Property, plant and equipment 31 December 20X4 under previous IFRS	1,350
Add: right-of-use assets (capitalising former operating leases)	700
	2,050
Less: depreciation/amortisation	(100)
	1,950

2 Applying IAS 17 *Leases*, the Entity would only recognise a liability of CU60 for finance leases. Applying IFRS Z results in the Entity recognising an additional liability of CU850.

3 The adjustments to retained earnings are as follows:

	CU
Depreciation (note 1)	100
Lease interest expense	150
Total adjustment to retained earnings	250

A3. Reconciliation of total comprehensive income for 20X4 is below.

Note		Previous IFRS	Effect of transition to new IFRS	New IFRS
		CU	CU	CU
1	Operating lease expense	350	(350)	0
2	Depreciation of finance lease PPE	20	(20)	0
2	Amortisation of right-of-use assets	0	300	300
3	Lease interest expense	10	340	350
	Profit (loss) for the year	380	270	650

Notes:

1 All depreciation of finance leases will reclassified as amortisation of right-of-use assets. Amortisation of the right-of-use assets increased by CU280 because the Entity was required to capitalise all operating leases as right-of-use assets. This resulted in additional amortisation expenses.

2 Applying IFRS Z resulted in the Entity capitalising operating leases and recognising a liability to pay for lease payments. The increase in lease interest expense arises from the unwinding of the discount on the liability to pay for lease payments.