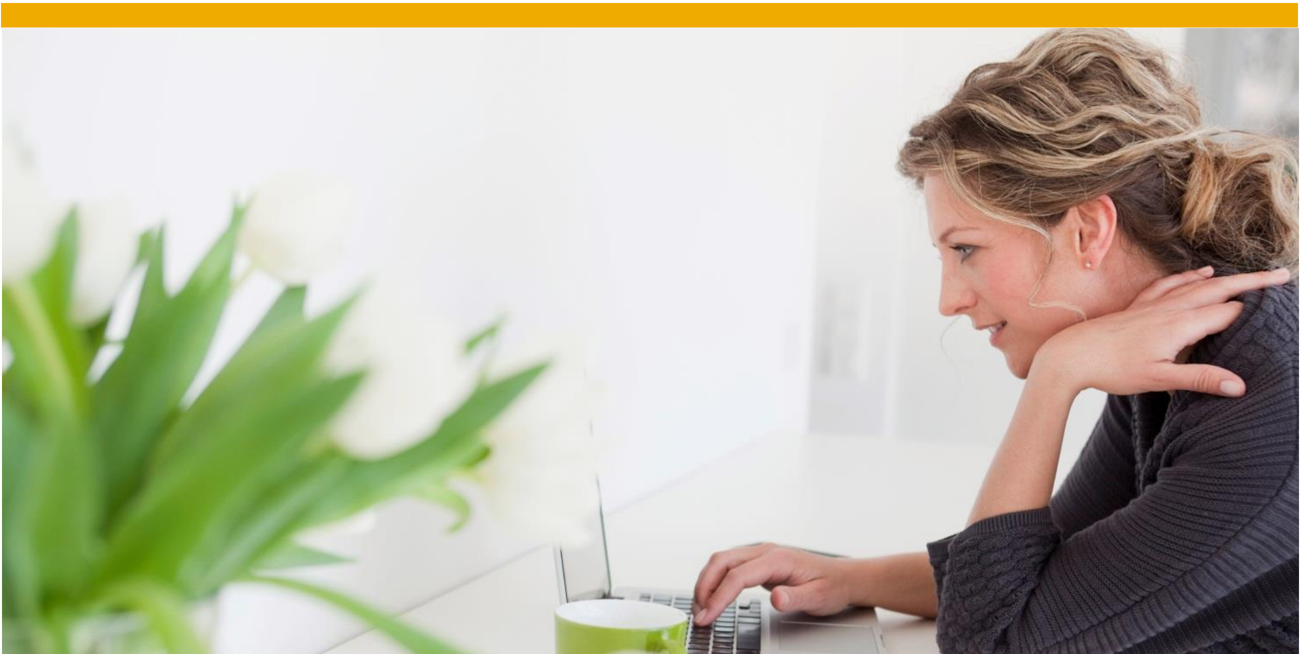

SAP® Financial Consolidation Starter Kit for IFRS, Regulation Update

Impacts of IFRS published in 2014

June 2015

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Introduction

The objective of this document is to describe the updates to be implemented within SAP® Financial Consolidation starter kit for IFRS (International Financial Reporting Standards) according to the new and revised standards issued in 2014 by the International Accounting Standards Board (IASB).

SAP® Financial Consolidation is part of SAP enterprise performance management (EPM) solutions. This product addresses financial consolidation requirements and can be integrated into both SAP and non-SAP software environments.

SAP starter kit for IFRS is a complete configuration on top of SAP Financial Consolidation – from data collection to publishing of financial statements – designed to perform, validate and publish a statutory consolidation in accordance with IFRS.

The new or revised standards published by the IASB in 2014 are the following:

Jan, 30	IFRS14 – Regulatory Deferral Accounts
May, 6	Amendments to IFRS11 – Accounting for Acquisition of Interests in Joint Operations
May, 12	Amendments to IAS16 and IAS28 – Clarification of Acceptable Methods of Depreciation and Amortisation
May, 28	IFRS15 – Revenue from Contracts with Customers
Jun, 30	Amendments to IAS 16 and IAS 41 – Bearer Plants
Jul, 24	IFRS9 – Financial Instruments
Aug, 12	Amendments to IAS27 – Equity Method in Separate Statements
Sept, 11	Amendments to IFRS10 and IAS28 – Sale or Contribution of Assets between an Investor and its Associate or Joint Venture
Sept, 25	Annual improvements, 2012-2014 cycle

All these standards or amendments are effective from 1 January 2016 except for IFRS 15 (1 January 2017) and IFRS 9 (1 January 2018).

This document firstly presents an overview of the 2014 publications thus identifying those that may have an impact on the starter kit. It then focuses on the amendments brought to the "consolidation" standards (IFRS10, IFRS11, IAS27 and IAS28) that call for a deeper analysis from a starter kit standpoint.

Overview of IFRS new or revised standards

- **Two major projects achieved in 2014**
  - ✓ **IFRS9 (Financial Instruments): extensive analysis still to be carried out**
  - ✓ **IFRS15 (Revenues): key accounting standard but no change required in the starter kit**
- **Three amendments to the “consolidation” standards (IFRS10, IFRS11, IAS27, IAS28): limited amendments but requiring deeper analysis from a starter kit standpoint**
- **Other 2014 publications: no impact on the starter kit for IFRS**

As listed in the introduction, the IASB published 9 new or revised standards in 2014. Two of them are the conclusion of major projects: IFRS15 (Revenue) and IFRS9 (Financial Instruments).

IFRS9 – Financial Instruments

The publication of the fourth version of IFRS9 in July 2014 is the final step of a major project started in 2002 to reform financial instruments accounting. We have already published a document that summarizes the main requirements introduced by IFRS9. It is available on SAP Community Network: https://scn.sap.com/docs/DOC-60428.

The adoption of IFRS 9 will necessarily require configuration changes in the starter kit for IFRS that may include the chart of accounts, the accounting schemes and the financial statements. Beyond these changes, the most important issue remains the transition period, up to the mandatory effective date (annual periods beginning on or after 1 January 2018). Until this date, some starter kit users will still refer to IAS 39 (current standard for financial instruments accounting). Therefore, the question arises whether a configuration compliant with both IAS39 and IFRS9 is worth considering. If not, the question of when the starter kit should be updated will have to be answered.

Given that IFRS 9 addresses a complex and large topic and its mandatory effective date is still distant, we will carry out a dedicated analysis to its consequences on the starter kit probably in late 2015 / early 2016.

IFRS15 - Revenue from Contracts with Customers

Started in 2002, this convergence project led with the US Financial Accounting Standards Board (FASB) finally came to an end in May 2014 with the publication of IFRS15 and its US equivalent Topic 606 (introduced into the FASB Accounting Standards Codification® by Accounting Standards Update 2014-09). Both texts are very similar even though some minor differences remain.

IFRS15 replaces the previous revenue standards IAS18 Revenue and IAS11 Construction Contracts and the related interpretations (IFRIC13, IFRIC15, IFRIC18, SIC31). Effective from 1 January 2017, earlier application is permitted.

IFRS15 sets out the requirements for recognizing revenue that apply to all contracts with customers, except for contracts that are within the scope of the standards on leases, insurance contracts and financial instruments.

IFRS15 establishes a comprehensive framework, based on a five-step approach, to determine when and how revenue should be recognized:

Unlike IAS18, the new standard does not include separate guidance for 'sales of goods' and 'provision of services'. Rather, it requires to assess (using the same criteria) whether revenue should be recognized **over time** or at **a particular point in time**.

In addition, IFRS15 provided extended guidance (the new standard together with the application guidance, illustrative examples and basis for conclusions have more than 300 pages) to assist companies in applying the revenue framework to certain areas (e.g. warranties, licensing, repurchase agreements …). Lastly, IFRS15 significantly expands the disclosure requirements about revenue recognition.

What will change from existing practice?

According to the IASB, for many contracts such as straightforward retail transactions, IFRS15 will have little, if any, effect on the amount and the timing of revenue recognition. On the other hand, IFRS15 may result in substantial changes to the timing of revenue recognition for some contracts such as long-term service contracts or multiple-element arrangements (e.g. telecom operators).

Which impact on systems?

In some cases, changes may be required to processes and IT systems to comply with new model and / or new disclosure requirements. However, these changes only affect transactional levels where revenues are recognized. We do not expect any change in the consolidation software as IFRS15 may modify the amount and/or the timing but does not affect the accounting schemes used for revenue recognition. As a consequence, the starter kit needs not be updated to comply with IFRS15.

Other 2014 publications

Amendments to IFRS10, IFRS11, IAS27 and IAS28 – referred to as "consolidation" standards – require a deeper analysis from a starter kit standpoint; they are examined in the second part of this document. The other 2014 publications are listed below.

IFRS14 – Regulatory Deferral Accounts

This new standard deals with rate-regulated activities where an authorized body (usually depending from a government) regulate the supply and pricing of particular types of activity by private entities, including utilities, telecommunications or transport. These regulations are often designed to allow the suppliers to recover specified costs and other amounts through the prices they charge to customers. However, rate regulation is also designed to protect the interests of customers. Consequently, the rate regulation may defer the recovery of these amounts in order to reduce price volatility. The suppliers usually keep track of these deferred amounts in separate regulatory deferral accounts until they are recovered through future sales of the regulated goods or services.

IFRS14 is an interim standard that allows first-time adopters to maintain these deferral accounts until the comprehensive rate-regulated activities project (started in 2012) is completed.

The impact of IFRS14 will be limited, firstly because it only covers those specific activities. Furthermore, this standard only applies to first-time adopters (i.e. entities that will publish their first IFRS financial statements from now). Consequently, no change is needed in the starter kit.

Amendments to IAS16 and IAS38 – Clarification of Acceptable Methods of Depreciation and Amortization

Following these amendments, revenue-based methods are clearly no more acceptable for property, plant and equipment (IAS16). For intangible assets (IAS38), there is a rebuttable presumption that a revenue-based method is not appropriate. But this presumption can be overcome in the following circumstances:

- The intangible asset is expressed as a measure of revenue

  Example given (IAS38.98C): an entity acquires a concession to explore and extract gold from a gold mine. The expiry of the contract may be based on a fixed amount of total revenue to be generated from the extraction (and not be based on time or on the amount of gold extracted).

- It can be demonstrated that revenue and the consumption of the economic benefits of the intangible asset are highly correlated.

These amendments may have an impact on the amount recognized as a depreciation or amortization. However, they do not change the accounting schemes. As a consequence, the starter kit needs not be updated to comply.

Amendments to IAS16 and IAS41 – Bearer Plants

These amendments change the financial reporting for bearer plants such as grape vines, oil palms and rubber trees. Until then, bearer plants were regarded as biological assets and thus measured at fair value less costs to sell according to IAS41 principles.

The IASB decided that bearer plants should now be accounted for in the same way as property, plant and equipment (IAS16) because their operation is similar to that of manufacturing. Bearer plants will then be measurement using either cost model or revaluation model as permitted by IAS16, whereas the produce growing on bearer plants remain measured at fair value according to IAS41 requirements.

The starter kit for IFRS does not address industry-specific issues. Therefore, the changes brought to the accounting for bearer plants do not have any impact on the starter kit.

Annual improvements, 2012-2014 cycle

The annual improvement process provides a vehicle for making minor, non-urgent amendments to standards. The 2012-2014 cycle brings amendments to the following standards:

- IFRS5 (Non-current Assets Held for Sale and Discontinued Operations): the amendments clarify that discontinuation of held-for-distribution accounting should be the same as the discontinuation of held-for-sale accounting

- IAS19 (Employee Benefits): the amendments relate to the discount rate to be used in a regional market sharing the same currency (e.g. the Eurozone). The standard now clearly requires that the depth of the market for high quality corporate bonds should be assessed at a currency level in this case (and not at a country level).

- IFRS7 (Financial Instruments: Disclosures) and IAS34 (Interim Financial Reporting) have also be modified; the amendments are really minor and do not call for any particular comment.

None of these amendments require changes in the starter kit for IFRS.

Amendments to the ‘consolidation’ standards

- **Amendments to IFRS 11: no change planned in the starter kit**
- **Amendments to IAS 27**
  - ✓ **Option for measuring investments at equity in local statements**
  - ✓ **Update needed in the starter kit to make this new option available**
- **Amendments to IFRS 10 & IAS28 : no change required in the starter kit**

IFRS11 – Accounting for Acquisition of Interests in Joint Operations

New requirements

The acquisition of interests in a joint operation (see the definition below) was not explicitly addressed by IFRS resulting in different approaches in practice. These amendments clarify that all the principles required in IFRS3 as regards business combinations should apply, including goodwill recognition. IFRS11 now also specifies that this applies to the acquisition of both the initial interest and additional interests in a joint operation. However, when an additional interest is acquired, previously held interests in the joint operation are not remeasured if the joint operator retains control.

A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets and obligations to the liabilities relating to the arrangement.

The accounting principles are the following. A joint operator shall recognize in relation to its interest in a joint operation:

- its assets including its share of any assets held jointly,
- its liabilities including its share of any liabilities incurred jointly,
- its revenue from the sale of its share of the output arising from the joint operation,
- its share of the revenue from the sale of the output by the joint operation,
- its expenses, including its share of any expenses incurred jointly.

These principles apply to consolidated statements <u>as well as to separate statements</u>. It means that these accounting entries should be recognized in the joint operator’s individual statements provided that IFRS are applied in local statements.

The amendments published in May 2014 clarify that all the principles required in IFRS3 as regards business combinations should apply, including goodwill recognition, when a joint operator acquires an interest in a joint operation.

In the starter kit

In the starter kit, local data as entered in packages should be IFRS compliant. It implies that joint operators should account for their interests in joint operations in their packages (meaning at local

level). In the current version of the starter kit, goodwill is not included in the chart of accounts available in the packages as it is only populated at consolidated level.

In light of the amendments published in 2014, the question arises whether goodwill account should be made available at local level. We have decided not to make this enhancement for the following reasons.

Firstly, it seems that very few joint arrangements that are structured through a separate legal entity have been classified as joint operations when IFRS11 was adopted (1st January 2013 except for European Union members – 1st January 2014). Secondly it is rather infrequent for a joint operator to acquire an interest in a joint operation; most joint operations are "custom made" to meet specific objectives. Lastly, the implications of making goodwill accounts available at local level would be important, in particular as regards consolidation rules.

As a consequence, it seems preferable not to modify the starter kit to meet infrequent requirements while jeopardizing the core consolidation rules.

IAS27 – Equity Method in Separate Statements

New option for measuring investments in local statements

These amendments introduce a new option: in separate (local) financial statements, the investments in subsidiaries, joint ventures and associates can now be accounted for using the equity method. It comes in addition to the existing methods, being at cost or in accordance with IFRS9 (fair value).

Even if these amendments do not affect the consolidated statements, they will have an impact on consolidation software. Indeed, local data as entered in the consolidation database will be affected if the new accounting method is elected. Not only will the carrying amount of the investments change but the underlying accounting schemes will also differ from those currently used.

When using cost method, the carrying amount of the investment in the parent's balance sheet does not change from a period to another, except when a transaction occurs: purchase of an additional interest, subscription to a capital issuance or disposal.

When measured using the equity method, the carrying amount of the investment should reflect every change in the held entity's equity:

- dividends paid (see below)
- net profit for the period
- other comprehensive income
- capital issuance or reduction
- other movements resulting from changes in scope when the entity itself holds investments in subsidiaries, joint-ventures or associates.

As regards dividends, IAS 27 now specifies (§12) that they are recognized in profit or loss except when the equity method is elected, in which case they are recognized as a reduction from the carrying amount.

In the starter kit

In the current starter kit, investments can be measured in local statements at cost or in accordance with IFRS 9.

Because the equity method is commonly used in some jurisdictions, it seems necessary to update the starter kit in order to make this option available. It means that the accounting schemes available at local level (in packages) should allow entering specific movements relating to equity method (as listed above). Besides, consolidation rules should be adapted so that consolidation figures remain correct whatever the method used for measuring investments in local statements.

A dedicated document will be published once the starter kit has been updated to explain more precisely the changes needed in the configuration.

IFRS10 and IAS28 – Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

New requirements

These amendments address a conflict between IAS 28 and IFRS 10 regarding transactions between an associate or a joint venture and an investor.

IFRS10 required full profit or loss recognition when an investor sold or contributed a subsidiary to a joint venture or an associate. In contrast, IAS28 required that gains or losses resulting from transactions between an entity and its associate or joint venture were recognized only to the extent of unrelated investors' interests in the associate or joint venture.

The amendments issued in 2014 now precise that the extent of gain or loss recognition should depend on the nature of the asset sold or contributed. If it constitutes a business as defined by IFRS3 (Business Combinations), the gain or loss is recognized in full. In the other cases, the gain or loss is recognized only to the extent of unrelated investors' in the associate or joint venture.

Even if clearer than the previous versions of IFRS10 and IAS28, these new requirements introduce new complexity as the definition of a business is not straightforward. When a subsidiary is sold to an associate or a joint venture, it will be essential to consider whether this subsidiary contains a business (full gain recognition) or is rather a collection of assets (partial gain recognition).

In the starter kit

In the current starter kit, internal profit or loss resulting from a transaction between an associate or a joint venture and a subsidiary is not automatically eliminated. It should be done manually when needed.

Because their nature cannot be automatically identified (business or not), transactions between an associate or a joint venture and a subsidiary should remain processed manually.

As a consequence, no change is required in the starter kit following these amendments.

Conclusion

The IASB published two major standards in 2014: IFRS 15 regarding revenue recognition and the final version of IFRS 9, which makes the reform of financial instruments accounting now complete.

IFRS 15 does not call for changes in the Financial Consolidation starter kit for IFRS as the new requirements may modify the amount of revenue or the timing for its recognition but do not affect the accounting schemes used.

IFRS 9 requires configuration changes in the starter kit for IFRS. A comprehensive analysis will be carried out later (probably in late 2015 / early 2016) to consider these changes and the way the transition period (up to 1 January 2018) can be dealt with.

The amendments to IAS 27 published in 2014 introduce a new option for measuring investments in subsidiaries, joint-ventures and associates in the holding's separate (local) statements using the equity method. The starter kit for IFRS will be updated to make this new option available in local packages.

The other standards or amendments published in 2014 do not require any update of the starter kit for IFRS.