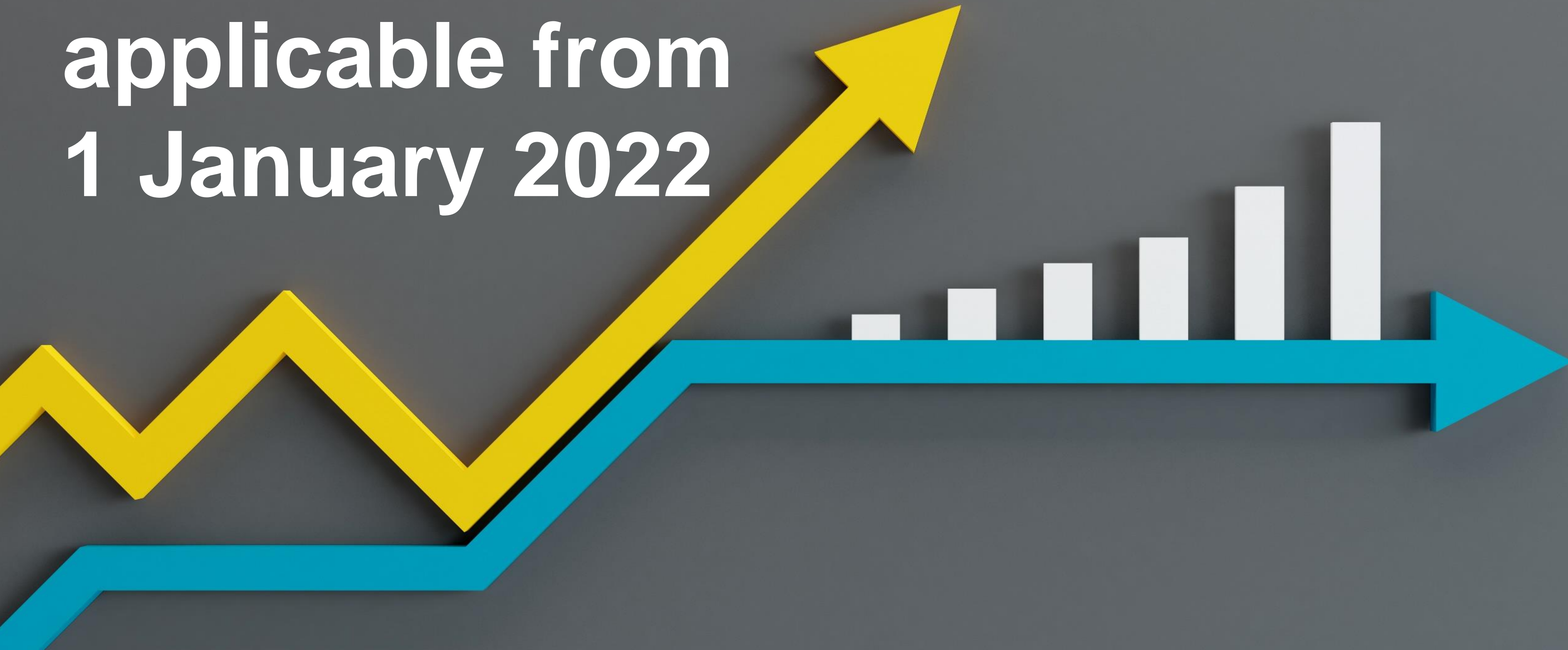
Sudit K. Parekh & Co. LLP
Chartered Accountants

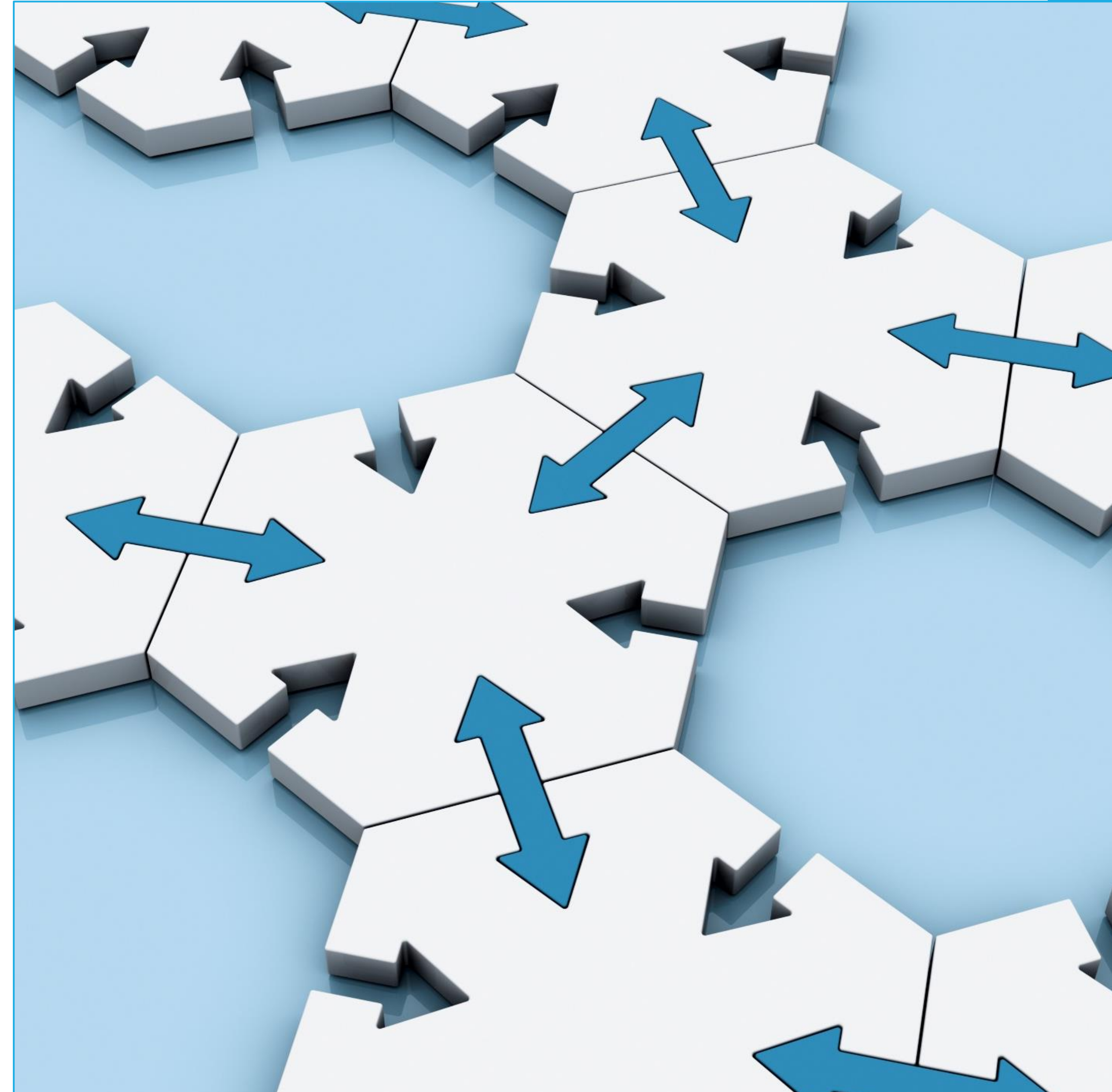
IFRS amendments applicable from 1 January 2022



Introduction

International Accounting Standards Board (IASB) has announced amendments to International Financial Reporting Standards (IFRS) which are applicable for reporting periods beginning on or after 1 January 2022. These amendments were issued by the IASB in May 2020 as narrow scope amendments. This article is a refresher on these IFRS amendments announced in 2020 which are now applicable. From an Indian perspective, these amendments if implemented in Indian Accounting Standards (IND-AS) will certainly be a qualitative addition. We discuss these amendments and their impact in the course of this article. Following standards have seen change:

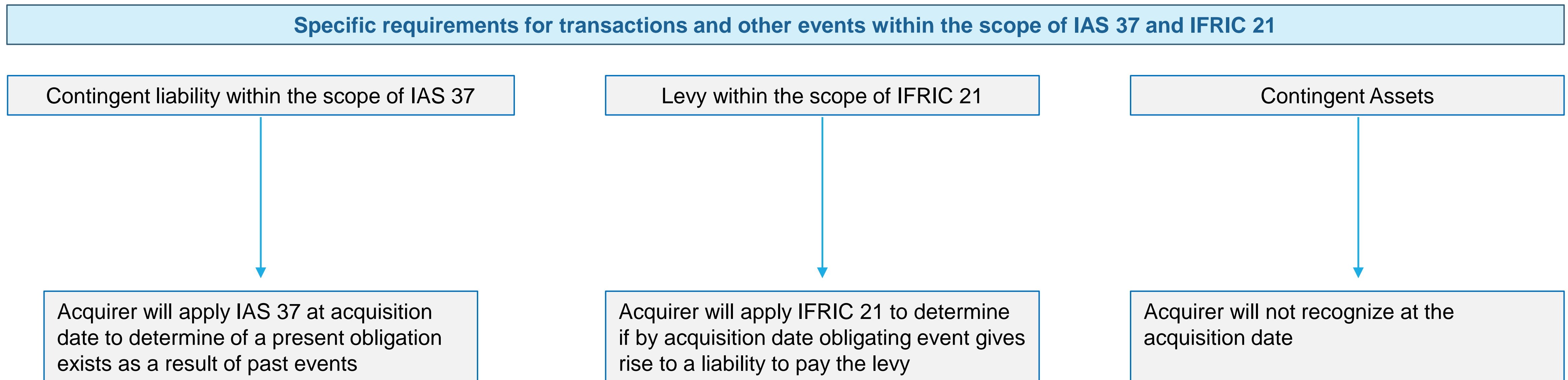
1. IFRS 3: Business Combinations
2. IAS 16: Property, Plant and Equipment
3. IAS 37: Provisions, Contingent Liabilities and Contingent Assets
4. Annual Improvements: 2018-2020



IFRS 3: Business Combinations – Reference to the Definition of Assets and Liabilities

IFRS 3 requires identifiable assets acquired and liabilities assumed in a business combination to meet the definition of assets and liabilities as laid out in IASB's Conceptual Framework on Financial Reporting. Prior to the amendment, the Conceptual Framework referred to here was the 1989 Conceptual Framework on Financial Reporting. However, as of March 2020, this 1989 framework was considered outdated. IASB, in its effort to update this outdated reference without significantly changing the requirements of the standard, now requires reporting entities to refer the 2018 version of the Conceptual Framework on Financial Reporting. The 2018 version contains revised definitions of an asset and liability that could impact which assets and liabilities of the acquiree qualify for recognition in the acquirer's books.

Also, in the course of post-acquisition accounting the prescriptions of other IFRS' could lead to the derecognition of assets and liabilities recognized in a business combination transaction thus resulting in day 2 gains or losses. Hence, exceptions to the recognition principle of IFRS 3 have been introduced to prevent the challenge of day 2 gains or losses arising for liabilities and contingent liabilities. These exceptions use the recognition principles of IAS 37 and IFRIC 21 and they do not rely upon the Conceptual Framework. Transactions and other events that fall within the scope of these exceptions have been illustrated as under:



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IFRS 3: Business Combinations – Reference to the Definition of Assets and Liabilities

Amendment Transition

- The above amendments shall be applicable to business combinations for which the acquisition date is the first annual reporting period beginning on or after 1 January 2022
- Prospective application is prescribed
- Early application is permitted in case the reporting entity has applied all the updated references and amendments contained in the 2018 version of the Conceptual Framework

Our Take

Institute of Chartered Accountants of India (ICAI) has ensured that IND-AS stays in line with IFRS by announcing amendments that complement IASB announcements. In the case of IFRS 3, the amendment to "definition of business" was announced by IASB on 22 October 2018. This IASB amendment was complemented in India by ICAI's exposure draft on Ind AS 103 in February 2019. This exposure draft was notified in the official gazette by Ministry of Corporate Affairs (MCA) on 24 July 2020 by G.S.R 463(E).

The ICAI is expected to announce referential amendments similar to those announced by the IASB to ensure that the challenge of day 2 gains or losses is dealt with.

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IAS 16: Property, Plant and Equipment (PPE) - Net Proceeds from Test Runs

IAS 16 Scenario prior to amendment and the need for change

Costs directly attributable to bringing an asset to the location and condition necessary for it to operate in the manner intended by management (directly attributable costs) comprises the cost of an item of PPE. Costs of testing whether an asset is functioning properly are a part of directly attributable cost and are eventually capitalized as a part of the cost of the item of PPE. The net sale proceeds from selling any items during the test phase are deducted from the cost of testing. After deduction of such sale proceeds from the cost of testing, the balance testing costs are capitalized as a part of PPE.

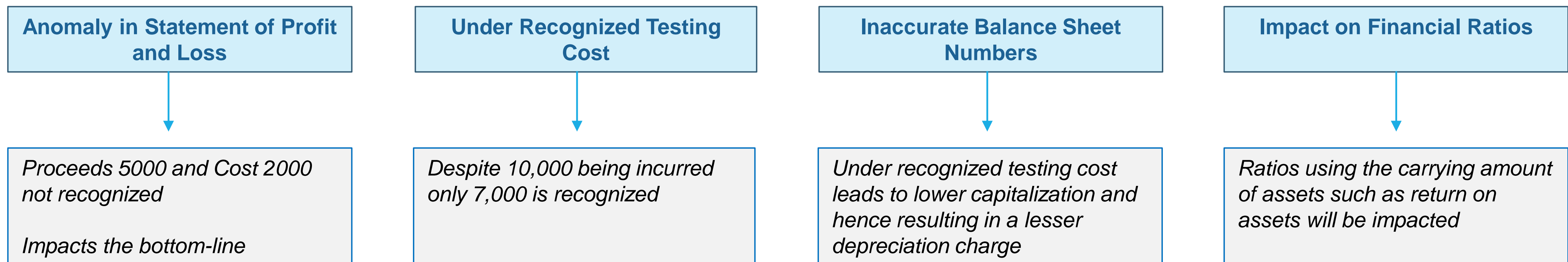
In practice, this requirement led to diverse interpretations and applications such as:

- Reporting entities deducted only the proceeds of selling test items while the testing process of testing lasted
- The proceeds of all sales from the item of PPE were deducted from total testing costs until the asset was in the location and condition necessary for it to operate in the manner intended by the management.

This in turn impacted the overall usefulness and quality of financial reporting. Let us consider the following example to understand this impact better:

An entity is in the process of installing a new assembly line. As on 31 December 2021, the assembly line is under construction but has developed the capacity to engage in test runs. CU 5,000 of proceeds have been obtained from selling sample test units. The cost of producing these test samples is CU 2,000. The total cost of testing is CU 10,000 which does not include test proceeds and test sample cost.

- Prior to the amendment, sale proceeds of test units CU 5000 and corresponding cost CU 2,000 did not find any representation in the financial statements and were automatically knocked off against the total cost of testing.
- This happened despite the sales proceeds and its corresponding expenses meeting the definition of income and expenses as laid out in the Conceptual Framework on Financial Reporting. IASB acknowledged that this practice resulted in the overall usefulness and quality of financial statements reducing owing to the following factors:



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IAS 16: Property, Plant and Equipment (PPE) - Net Proceeds from Test Runs

Amendment to IAS 16

IASB acknowledged the above shortcomings and in May 2020 PPE – proceeds before intended use, which made amendments to IAS 16 was issued.

The amendments will:

a. Prohibit a company from deducting from the cost of PPE the amount received from selling items produced while the company Is preparing the asset for its intended use

b. Such sales proceeds and related costs will be recognized in profit and loss

Clarifications issued by IASB

Meaning of "Testing"

Assessing whether the technical and physical performance of the asset is such that it is capable of being used in:

- The production or supply of goods , or
- Rental to others, or
- Administrative purposes

Cost of item produced

Cost of Items Produced; while bringing an item of property, plant and equipment to the location and condition necessary for it to be capable of operating in the manner intended by management **shall be measured in accordance with IAS 2**.

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IAS 16: Property, Plant and Equipment (PPE) - Net Proceeds from Test Runs

Impact of Amendment on Disclosures

There is no addition in disclosures under IAS 16 with respect to sales of items that are produced as output by the reporting entity in the course of its ordinary activities. In such cases IFRS 15 and IAS 2 will apply.

Impact on disclosures

Items sold that are not a part of the reporting entity's ordinary activities:

- Sale proceeds and corresponding cost of production recognized in statement of profit and loss will be disclosed separately
- Specify the line items where such proceeds and their corresponding items costs are included in the statement of comprehensive income

Sale proceeds and corresponding costs if presented separately in the statement of comprehensive income will not require any disclosure

Accounting Illustration

An entity is in the process of installing a new assembly line. As of 31 December 2021, the assembly line is under construction but has developed the capacity to engage in test runs. CU 5,000 of proceeds have been obtained from selling sample test units. Cost of producing these test samples is CU 2,000. The total cost of testing is CU 10,000, which does not include test proceeds and test sample cost.

For Reporting Period 2021

Total cost of testing incurred		10,000 (A)
Sale proceeds of test items Less: Cost of producing test samples Net Proceeds of selling test items	5000 Less: 2000 3000 (B)	
Costs of testing form a part of directly attributable costs i.e., capitalized	(A) – (B)	7,000

In Financial Statements for 2022

Accounting Items Impacted	Impact	CU
PPE Under Construction	Debit	3,000
Retained Earnings	Credit	3,000

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IAS 16: Property, Plant and Equipment (PPE) - Net Proceeds from Test Runs

Amendment Transition

- Early application i.e., before 1 January 2022 is permitted
- Retrospective application only. Applicable only to items of PPE that are brought to the location and condition necessary for them to function in the manner intended by management on or after the beginning of the earliest period presented in the financial statements in which the entity first applies the amendments
- Cumulative effect of applying the amendments as an adjustment to opening retained earnings will have to be traced back to the start of the earliest presented period

Our Take

- Management estimation and judgment will play a key role in implementing this amendment. Since IAS 2 will have to be applied to measure the cost of items produced, a demarcation will have to be defined between the following costs:

Costs associated with producing and selling items before the item of PPE is available for use	Cost associated with making the item of PPE available for its intended use

- Auditors may require reliable and holistic data to assess the demarcation of the above costs (which needless to say, will be driven by management's judgment). The unavailability/shortage of such data may create hurdles in audit closure.
- Industries where PPE is subjected to longer periods of testing such as pharma, mining, etc. may find this amendment challenging to implement.
- Expect the same amendments to be made applicable to IND AS 16.

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IAS 37: Provisions, Contingent Liabilities and Contingent Assets

IFRS Interpretation committee received requests to clarify what costs an entity should consider in assessing whether a contract is onerous. IAS 37 defines an onerous contract as “A contract under which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The term unavoidable costs under a contract are defined as ‘the least net cost of exiting the contract.’ This will be lower of:

- Cost to exit or breach the contract and
- The cost of fulfilling the contract

The Interpretation Committee’s research revealed contrasting views on unavoidable costs . Practitioners are tied between unavoidable costs being either:

- Only the incremental costs of fulfilling the contract; or
- All costs that relate directly to the contract

The introduction of IFRS 15: Revenue from contracts with customers saw the withdrawal of IAS 11 and IAS 18 (erstwhile standards on revenue recognition).

While IFRS 15 does not prescribe guidance on unavoidable costs for onerous contracts, reporting entities were required to refer IAS 37 which too does not expressly provide guidance on what encompasses unavoidable costs. Under the erstwhile revenue recognition standards, guidance on onerous contracts was provided under IAS 11 by specifying which costs to include under the meaning of “unavoidable costs.” However, with the withdrawal of IAS 11, IASB identified a lack of prescribed guidance on this matter.

Accordingly, on 14 May 2020, IASB has announced that for reporting periods beginning on or after 1 January 2022, a reporting entity would include all costs that relate directly to a contract under the meaning of unavoidable costs. The directly related cost approach adopted by the IASB shall result in the following costs being covered:

- Incremental costs (direct expenses)
- Allocated costs only if they directly relate to the contract (contract management costs, depreciation on assets used specifically for the project)
- Administrative and general overheads that are explicitly chargeable to the counterparty

The reporting and presentation benefits of adopting the directly related cost approach have been summarized as under:

Benefits of adopting the directly related cost approach

- It would be more consistent to include all costs that relate directly to contract
- This is consistent with IAS 37 and other standards as well

- Inclusion of all costs will prove to be more useful information for users of financial statements

- Benefit of providing such detailed disclosures is likely to outweigh the cost

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IAS 37: Provisions, Contingent Liabilities and Contingent Assets

Accounting Illustration

As of 31 December 2021, a contract where all obligations have not been fulfilled is identified as onerous. The provisions made for this contract by the management only consider incremental costs. If all costs that directly relate to the contract are taken into consideration, overheads that are allocated to this contract would additionally amount to CU15,000.

As per the amendment, the undermentioned adjustment would be required to be made as of 1 January 2022 for financial statements of 2022:

Accounting Items Impacted	Impact	CU
Retained Earnings	Debit	15,000
Provision for Onerous Contract	Credit	15,000

Corresponding adjustments to the comparatives of 2021: **None**

Amendment Transition

- Amendments are applicable to contracts where all obligations are not yet fulfilled.
- Amendments are effective for annual periods beginning on or after 1 January 2022.
- Early application is permitted.
- Comparatives are not restated.

Our Take

- The amendment brings about clarity and consistency in the application of IAS 37.
- Reporting entities that previously interpreted unavoidable costs to cover only incremental costs will have to account for an increase in cost to the extent of cost allocations that relate directly to the contract.
- Reporting entities that previously followed the guidance under IAS 11 and booked contract losses will now exclude indirect costs from their accounting provisions.
- Significant management judgment will be required to arrive at costs that are directly related to the contract.
- Expect similar changes to be introduced to Ind AS 37.
- Auditor’s professional judgment will be key in these aspects.
- From an Indian Accounting perspective, a similar amendment for Ind AS reporting may be expected. Ind AS 115: Revenue from contracts with customers will provide sufficient guidance in India.

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Annual Improvements to IFRS 2018-2020

IASB has issued the Annual Improvements 2018-2020 for IFRS standards. These improvements albeit essential do not carry a pressing urgency to be implemented with immediate effect. The Annual Improvements 2018-2020 introduce amendments for annual reporting periods on or after 1 January 2020 with an option for early adoption. The following IFRS standards will undergo amendments under the Annual Improvements 2018-2020:

- IFRS 1: First time adoption of IFRS – The amendment covers voluntary exemption for measuring cumulative translation differences of subsidiaries becoming first-time adopters at a date later than their parent
- IFRS 9: Financial instruments – The amendment clarifies fees paid or received between the borrower and the lender in the 10% test for derecognition of financial liabilities
- IFRS 16: Leases – The amendment removes illustration 13 of IFRS 16. Illustration 13 catered to lease incentives and was unclear on whether the reimbursement covered therein the definition of a lease incentive. Since the amendment caters to the removal of an illustration which is merely a non-obligatory part of the core standard, there is no effective date of implementation, nor will there be any cardinal impact in reporting
- IAS 41: Agriculture – The amendment does away with excluding cash flows for tax when measuring the fair value

Amendment to IFRS 1: First time adoption of IFRS

The amendment applies to subsidiaries that become first time adopters of IFRS later than its parents. Para D16(a) of IFRS 1 permits subsidiaries implementing IFRS for the first time to measure their assets and liabilities at the carrying amount included in the parent’s consolidated financial statements

However, Para D16(a) contains no guidance on cumulative translation differences. Subsidiary companies with foreign operations or branches which are foreign operations face a hiccup in the first-time implementation of IFRS due to this lack of guidance

The amendment now allows subsidiaries that use Para D 16(a) to measure their assets and liabilities as per parent’s consolidated statement also to measure cumulative translation differences as per parents consolidated statements

Under the announced amendment, a similar leeway is granted to Associate and Joint Ventures

Our Take

- The amendment will bring about resultant ease in transition to IFRS for non-IFRS companies.
- The need to maintain a separate set of books of accounts will no longer be an additional cost and compliance burden for subsidiary entities.
- A similar announcement should be forthcoming in India as Para D 16(a) of IND-AS 101 replicates IFRS 1. In geographies like India, maintenance of a separate set of books of account is often a pain point for Indian arms of foreign companies. This requires a substantial GAAP conversion effort and audit support exercise during the closure process. The introduction of this amendment will make life much easier for Indian subsidiaries of foreign companies that use IFRS as their GAAP.

Annual Improvements to IFRS 2018-2020

Amendment to IFRS 9: Financial Instruments

In the event of an exchange between an existing borrower and lender of debt instrument which involves substantially different terms from those existing, Para 3.3.2 of IFRS 9 requires the extinguishment (derecognition) of the existing financial liability and the recognition of a new financial liability. A similar requirement of derecognition of the existing liability and recognition of new financial liability is prescribed in the case of a substantial modification of the terms of an existing liability or a part thereof.

Para 3.3.6 of IFRS prescribes that the terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid (net of any fees received and discounted using the original effective interest rate), is at least 10% different from the discounted present value of the remaining cash flows of the original financial liability.

The amendment clarifies that only the fees paid or received between the borrower and the lender, including fees paid or received by either the borrower or the lender on the other's behalf, will be included in applying the 10% test.

The amendment is applied prospectively to modifications and exchanges that occur after the date the entity first applies the amendment.

Our Take

- This is more of a welcome clarification than an amendment.
- The past 2 reporting periods have seen a heavy impact of the pandemic on businesses. There have been numerous instances across sectors and industries of debt restructuring and reconstruction. This clarification shall enable better representation of financial liabilities in the books and add value for users of financial information, especially lenders.
- A similar clarification is expected to be made in India for IND-AS 109: Financial Instruments.

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Annual Improvements to IFRS 2018-2020

Amendment to IFRS 41: Agriculture

Amendments to IAS 41 in 2008 prescribed removing a pre-tax discount rate when measuring fair value. However, the need to use pre-tax cash flows while calculating the fair value was not removed.

The need to discount pre-tax cash flows with a post-tax discount rate was a conceptual disconnect in the prescriptions of IAS 41 and it led to a further gap in aligning with IFRS 13.

With the intent of aligning fair value measurement in IAS 41 with IFRS 13, the requirement of excluding cash flows for tax when measuring the fair value has now been removed. Like IFRS 13, now the preparers of financial statements can use internally consistent cashflows and discount rates based on which an informed decision on whether to use pre-tax or post-tax cashflows and discount rates for fair value measurement.

The amendment is applicable prospectively. It shall be applied for fair value measurements on or after the date of application by the reporting entity.

Our Take

- For present value techniques to be applied effectively it is essential that cash flows and discount rate are consistent i.e., pre-tax cash flows to be discounted at a pre-tax rate and post-tax cash flows at a post-tax rate.
- When determining and reporting future expected cashflows, the management assumptions, factors influencing calculations, open market factors, market participants view, etc. play a crucial role. Currently, all the said factors lean towards using a post-tax basis for calculation and estimation.
- It is expected that amendment will be correspondingly introduced by ICAI and MCA in India for Ind AS 41. With Ind AS 41 aligning with Ind AS 113, Indian Accounting Standards will be better aligned with IFRS.
- It is essential to mention that currently, in India, the agro-industry and its various branches are facing inflationary trends. The final output of the agro-industry is the primary input for FMCG and food processing. With rising material costs, cost control and pricing is a major mandate for leaders in FMCG and food processing industries. Such an amendment will enable users of IND AS 41 to better present their financial information enabling informed decision making for various crucial sectors dependent on agriculture for their inputs. As an agricultural economy India should prioritize amendments and improvements to Ind AS 41.

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