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Mazars' newsletter on accounting standards

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Editorial

The IASB published an update of its work plan on 25 February. According to this document, March 2014 should see the publication of the Discussion Paper on macro hedging and the draft amendment to IAS 1 resulting from the Disclosure Initiative. These two publications are eagerly awaited by stakeholders. Let us hope that they are not a disappointment!

In other news, nearly three years after publication of IFRS 13, and following its first mandatory application in 2013, the IFRS Foundation and the International Valuation Standards Council (IVSC) have announced the signature of a protocol for cooperation on standards and guidance for fair value measurement. This protocol, signed by Sir David Tweedie as president of the IVSC, may help to erase the differences between the two sets of standards which were highlighted when IFRS 13 was published.

Happy reading!

Michel Barbet-Massin Edouard Fossat

IFRS Standards

IFRS IC examines the liability/equity classification of instruments mandatorily convertible into shares

During its last meeting, the IFRS Interpretations Committee analysed the accounting classification under IAS 32 of a financial instrument with the following characteristics:

- The instrument has a stated maturity date and is redeemable by the delivery of a variable number of the entity's own equity instruments to equal a fixed cash amount. It is nevertheless subject to a cap and a floor.
- The instrument carries interest at a fixed rate and the payment of this interest is mandatory.
- The issuer has the contractual right to settle the instrument at any time before maturity. In this event, the issuer must pay all of the interest that would have been payable, and deliver the maximum number of equity instruments specified in the contract (i.e. the capped number of shares).

Therefore, under the contractual terms, the instrument does not carry an obligation for the issuer to deliver a variable number of shares insofar as the issuer may choose to redeem the instrument at any time before maturity by delivering the maximum (but fixed) number of shares.

The Interpretations Committee was consequently asked whether such instrument contains an equity component under IAS 32.

The Interpretations Committee noted that it was not sufficient to consider the contractual terms alone. Judgment is required to determine whether these contractual terms have substance, from the economic or the entity's business model point of view. If a contractual term lacks substance, that contractual term would be excluded from the analysis of the accounting treatment for the transaction. The IFRS IC recommended some approaches to the analysis of the instrument and emphasised the importance of conducting a case-by-case analysis in order to take account of the characteristics and circumstances of each transaction.

The Interpretations Committee also considered whether the cap and floor embedded in the instrument give rise to an equity component. The entity is certain to deliver a fixed minimum number of shares. The Committee therefore considered whether an equity component could be recognised in relation to this floor. It tentatively explained that IAS 32 does not permit to break down the conversion feature into multiple parts (a fixed element giving rise to an equity component and another element reflecting the variability of the number of shares to be delivered) but that the instrument should be analysed as a whole under IAS 32.

IAS 12: the IFRS IC tentatively concludes on recognition and measurement of deferred tax assets when an entity is loss-making

The IFRS Interpretations Committee (IFRS IC) received a request for guidance on the recognition and measurement of deferred tax assets when an entity is loss-making, in particular when tax laws limit the extent to which losses can be recovered against future profits (e.g. when tax law restricts the recovery of tax losses to 60 per cent of taxable profit in each year).

Following a first discussion in November 2013 (see Beyond the GAAP –November 2013), further analysis was produced by the staff. The IFRS IC, during its January 2014 meeting, tentatively concluded that neither an Interpretation nor an amendment to the Standard was needed because, according to paragraphs 28 and 35 of IAS 12:

- a deferred tax asset is recognised for the carry forward of unused tax losses to the extent of the taxable temporary differences, of an appropriate type, that reverse in an appropriate period (regardless of an entity's expectations of future tax losses),
- when tax laws limit the extent to which unused tax losses can be recovered against future taxable profits, the amount of deferred tax assets recognised from unused tax losses as a result of suitable taxable temporary differences is restricted as specified by the tax law,
- in both cases (i.e. whether tax laws limit or do not limit the extent to which they can be recovered against future profits), if the unused tax losses exceed the amount of suitable taxable temporary differences (after taking into account any restrictions), an additional deferred tax asset is recognised only if the requirements in paragraphs 29 and 36 of IAS 12 are met (i.e. an additional deferred tax asset is recognised only to the extent that it is probable that the entity will have appropriate future taxable profit, or to the extent that tax planning opportunities are available to the entity that will create appropriate taxable profit).

Financial instruments: IASB is in the process of finalising phases 1 and 2 of IFRS 9 and sets 1 January 2018 as the mandatory effective date

During its February plenary session, the IASB announced that it had completed its deliberations of the limited amendments to IFRS 9 (phase 1 and on phase 2), standard that should replace the existing standard IAS 39. The Board decided that it was unnecessary to publish new exposure drafts on these projects and instructed the staff to proceed to finalising these two texts.

The complete version of IFRS 9 is expected in the second quarter of 2014.

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The IASB also decided that IFRS 9 should be applied to annual periods beginning on or after 1 January 2018 Readers will remember that the amendment to IFRS 9 published in November 2013 (mainly addressing hedge accounting) had temporarily removed the effective date of IFRS 9 (set to 2015 in the previous version of IFRS 9).

The IASB has decided that the mandatory effective date of IFRS 9 should not depend on the effective date of the future Insurance Contracts Standard. However, the IFRS 4 project may set out additional transition relief in order to avoid disadvantaging entities that issue insurance contracts if they apply IFRS 9 before the new IFRS 4 comes into force.

The application of these texts in Europe remains subject to their prior endorsement by the European Union.

Accounting for an interest in a joint operation structured through a separate vehicle in separate financial statements

IFRS 11- *Joint arrangements* sets out the accounting treatment for joint arrangements over which the parties exercise joint control. In particular, IFRS 11 requires a party to recognise its interest in a joint operation in the same manner in its separate and consolidated financial statements.

Therefore, in a joint operation, each party accounts for its share of the assets, liabilities, revenue and expenses in its IFRS separate financial statements. This accounting treatment applies even if the party holds an investment in a separate legal vehicle (such as an investment in a limited company).

At a meeting held in May 2012, the OIC (the Italian standard-setter) informed the IASB that this accounting treatment has created significant concerns for listed companies that present separate financial statements in accordance with IFRS. The OIC noted that under IAS 27R, investments in subsidiaries, associates or joint ventures are accounted for either at cost or at fair value in the investor's separate financial statements. The OIC suggested that this option should also be available to the accounting for an interest in a joint operation structured through a separate vehicle in the joint operator's separate financial statements.

More recently, EFRAG has written to the IASB in support of the OIC recommendation. The EFRAG letter may be consulted at: http://www.efrag.org/Front/n1-1280/Letter-to-the-IASB-on-accounting-for-Interests-in-Joint-Operations-structured-through-a-separate-vehicle-in-separate-financial-statements.aspx

This issue will be discussed again by the IASB in the coming months. The IASB will also discuss the proposal to amend IAS 27R to allow investments in subsidiaries, associates or joint ventures to be accounted for using the equity method in the separate financial statements (see Beyond the GAAP no 72 – November 2013).

IASB considers IFRS IC recommendations on IFRS 2

During 2013, the IFRS Interpretations Committee examined a number of aspects of IFRS 2 *Share-based payment*. At the end of its discussions, the IFRS IC recommended that the IASB should carry out narrow-scope amendments to IFRS 2 to address the following four issues:

- Accounting for cash-settled share-based payment transactions that include a performance condition;
- Share-based payments settled net of tax withholdings;
- Share-based payments in which the manner of settlement is contingent on future events controlled by neither the entity nor the counterparty;
- Modification of the terms and conditions of a share-based payment transaction from cash-settled to equity-settled.

At its February 2014 meeting, the IASB began to examine the Interpretations Committee's recommendations, and decided that IFRS 2 would be amended to specify the accounting treatment of the first two of these subjects.

The IASB has not yet taken any decisions on the other two recommendations, but has directed the staff to perform further analysis.

IFRS Foundation and IVSC launch cooperation

On 6 March the IFRS Foundation and the International Valuation Standards Council (IVSC) concluded protocols for cooperation on standards and guidance for fair value measurement.

This cooperation will primarily be conducted through the medium of working parties representing the two organisations, with a view to establishing consistency between the two sets of standards. Nonetheless, each organisation will remain responsible for the publication of its own standards.

The agreement may be consulted at:
http://www.ifrs.org/Use-around-the-world/Documents/IFRS-Foundation-IVSC-Protocol-February-2014.pdf

Europe

Entities invited to share their practical experience of IFRS 3

In January 2014, the IASB launched the post-implementation review (PiR) of IFRS 3 *Business combinations* and published a request for information open for comments until 30 May 2014 (see our special study in this issue).

In conjunction with this post implementation review, EFRAG and accounting standard setters in France (ANC), Germany (ASCG), Italy (OIC) and the United Kingdom (FRC), in coordination with the staff of the IASB, launched an outreach exercise in the shape of a questionnaire inviting entities to share their practical experiences of IFRS 3 *Business combinations.*

The results of this outreach exercise, expected by 15 April 2014, will be used by EFRAG and the national standard setters to prepare a response to the IASB's request for information.

For more information, visit the EFRAF site at:
http://www.efrag.org/Front/n1-1278/Call-for-Evidence--EFRAG-and-the-National-Standard-Setters-ANC--ASCG--FRC-and-OIC-invite-companies-to-share-their-experiences-with-IFRS-3---Business-Combinations-.aspx

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A Closer Look

The IFRS Interpretations Committee clarifies IFRS 11 provisions on the classification of joint arrangements

During its January 2014 meeting the IFRS Interpretations Committee (the IFRS IC) discussed the issues arising from the application of IFRS 11 *Joint arrangements,* mainly with respect to the classification of a joint arrangement as a joint operation or a joint venture.

IFRS 11, which will be of mandatory application in Europe in 2014, sets out the accounting treatment for joint arrangements, that is to say entities over which the parties have joint control. The standard identifies two types of joint arrangements: joint operations and joint ventures. This classification is crucial because it determines the accounting treatment of the joint arrangement:

- in a joint operation, each party accounts for its share of the assets, liabilities, revenue and expenses. This is therefore close to the proportionate consolidation method set out in IAS 31 (although there are some differences, *inter alia* regarding the share to be recognised).
- in a joint venture, a party accounts for the joint arrangement using the equity method. This method results in the loss of the revenue generated by the joint arrangement in the parties' consolidated financial statements. Only the share of the result generated by the joint arrangement is accounted for in the parties' consolidated financial statements.

Whether an arrangement is classified as a joint operation or as a joint venture will depend on the rights and obligations of the parties in the arrangement:

- in a joint venture, the parties have rights to the net assets of the arrangement (generally, the right to a dividend).
- in a joint operation, the parties have rights to the assets, and obligations for the liabilities, relating to the arrangement.

One of the significant impacts of IFRS 11 is that the legal form of a joint arrangement is not the main factor in deciding whether it is classified as a joint operation or a joint venture. IFRS 11 requires the parties to a joint arrangement to consider all the "other facts and circumstances" to assess whether the arrangement is a joint operation or a joint venture. For example, a separate vehicle, such as a limited company, may be classified as a joint operation in some cases, due to the "other facts and circumstances", even if the legal form does not confer to the parties rights to the assets, and obligations for the liabilities, relating to the arrangement.

It is these provisions in IFRS 11 relative to the "other facts and circumstances" which are most subject to interpretation. The question is whether:

- the classification of a joint arrangement depends solely on the rights and obligations of the parties over the assets and liabilities of the arrangement; or
- whether it is possible, in the light of the "other facts and circumstances", to classify a joint arrangement as a joint operation based on the economic substance of the arrangement (rather than its legal substance).

The IASB is aware of these debates: a feedback request was sent to the stakeholders in July 2013 to identify the difficulties of first application of IFRS 11. IASB staff submitted the 26(!) questions raised by the application of IFRS 11 to the IFRS IC in November 2013. These questions relate not only to the classification of the joint arrangement, but also to the accounting for a joint operation.

The IFRS IC clarified the classification of a joint arrangement in the January 2014 IFRIC Update in the shape of a tentative agenda decision. This is a provisional conclusion, which should be confirmed in May 2014 after any comment letters have been sent to the Interpretations Committee. The Interpretations Committee noted that:

- the classification of a joint arrangement depends on rights to the assets and obligations for the liabilities of the parties to the arrangement;
- rights and obligations, by nature, are enforceable;
- the assessment of "other facts and circumstances" should be focused on whether those facts and circumstances create enforceable rights to the assets and obligations for the liabilities.

If this tentative decision is confirmed, we believe that the consequences will be as follows:

- the joint operation / joint venture distinction should be based on an analysis of the legal and contractual substance of the joint arrangement;
- activities that are operationally very similar but that are conducted through different joint arrangements might be accounted for differently under IFRS 11 if the contractual terms agreed by the parties confer different rights to the assets, and obligations for the liabilities, relating to such activities;
- the classification of a joint arrangement as a joint operation based on "other facts and circumstances" should in practice mainly concern upstream production entities providing output to the parties, where the parties have an obligation to purchase the outputs produced by these upstream entities.

During its forthcoming meetings, the Interpretations Committee should provide guidance in order to clarify in what situation the "other facts and circumstances" create enforceable rights to the assets and obligations for the liabilities. For example, the following issues may be discussed:

- Should the parties' commitments to purchase the outputs produced by the joint arrangement be firm and contractually agreed for the arrangement be classified as a joint operation? How should we analyse contracts containing "take-or-pay" mechanisms or "cash calls" where the joint arrangement is loss-making?
- Does the fact that the outputs are purchased at a market price (and not at cost plus) mean that the arrangement cannot be classified as a joint operation?
- How should we analyse a limited-life entity set up to conduct a specific project, for example in the construction business?

The Interpretations Committee should also provide guidance on the accounting for a joint operation. For example, the following issues may be discussed:

- How to account for a joint operation when the ownership interests of the parties are different from the percentage of the outputs taken by the parties?
- How to account for the rights and obligations when the percentage of outputs taken by the parties varies over time?

We shall return in future issues to the clarifications brought by the Interpretations Committee to these topics.

Finally, it should also be remembered that the IASB is in the process of finalising the IFRS 11 amendments on the acquisition of an interest in a joint operation (which constitutes a "business" as defined in IFRS 3.) The final amendments should be published by the end of March 2014.

A Closer Look

IASB launches Post-implementation Review of IFRS 3 *Business combinations*

The IFRS Foundation's Due Process Handbook states that every new standard should be subject to a Post-implementation Review (PiR) within a minimum period of two years after its first application.

After IFRS 8 in 2012/2013, it's now the turn of IFRS 3 *Business Combinations* to be subject to a post-implementation review, three years after the mandatory effective date of the revised standard.

The aim of this review is to assess whether:

- IFRS 3 provides information that is useful to the users of financial statements;
- there are areas of IFRS 3 that represent implementation challenges and, as a result, impair the consistent implementation of the requirements;
- unexpected costs have arisen when preparing, auditing, or enforcing the requirements of the standard or when using the information provided by the standard.

To do so, the IASB will draw on the comments of stakeholders – preparers of financial statements, investors, market regulators, the audit profession, accounting standard-setters, valuation specialists and academics – obtained in the course of outreach activities and via the Request for Information (RfI) published on 30 January 2014.

The IASB will present the conclusions of its work in a report. Depending on the nature of any findings, the IASB will decide to:

- retain IFRS 3 as issued, if no major problems emerge;
- continue to monitor the implementation of IFRS 3, if the results of the PiR are inconclusive; or
- revise IFRS 3 to remedy problems identified by the PiR, following the existing procedures for amending standards.

Beyond the GAAP presents the main issues identified by the IASB on which the Board would like to receive comments from stakeholders in response to the Request for Information. Comments will be taken until 30 May 2014.

1. Definition of a business

The definition of a business is key, since IFRS 3 only applies to the acquisition of a business. In the event that the elements acquired do not constitute a business, the transaction should be treated as the simple acquisition of a group of assets (and liabilities, as appropriate).

There are significant divergences in the accounting treatment for these two situations. The main differences noted by the IASB in the RfI are the following:

- Payment of a premium: in a business combination, such a premium is recognised as a separate asset (goodwill). In an asset acquisition, it is allocated to the identifiable assets based on their relative fair values.
- Deferred taxes: in the case of business combination, the deferred taxes arising from the initial recognition of assets and liabilities are recognised on the acquisition date. In the case of an asset acquisition, no deferred taxes are recognised when the carrying value of the assets differs from their tax base.
- Acquisition costs: they are capitalised as part of the cost of the asset in the case of asset acquisitions. In a business combination, they are accounted for as an expense when incurred.

The IASB asks stakeholders if there are benefits from having separate accounting treatments for business combinations and asset acquisitions.

It also asks them to identify the main practical challenges they face when assessing a transaction to determine whether it is a business, and what main considerations they take into account to reach an opinion.

2. Fair value

Fair value measurement of the cost of the assets acquired and the liabilities assumed is a key feature of the accounting treatment of a business combination (this has been the case since the first version of the standard published in 1983).

The IASB is interested in finding out whether a number of factors have had an impact on the extent of the use, implementation challenges, audit or enforcement of fair value measurements in business combinations. These factors include:

- the amendments to the criteria for recognition of intangible assets, which have resulted in more intangible assets being recognised separately from goodwill;
- the financial crisis that started in 2007, which may have made it more difficult to measure some categories of assets and liabilities at fair value.

The IASB asks to what extent the information derived from the fair value measurements is relevant, and the information disclosed about fair value measurements sufficient.

It is also interested to know the main difficulties encountered in determining fair value, and whether these problems are more challenging for particular categories of assets and liabilities.

The IASB asks how useful stakeholders find the information obtained from annually assessing goodwill and intangible assets with indefinite useful lives for impairment, and whether improvements are needed regarding the information provided.

Finally, the IASB would like to know about the main implementation or auditing challenges of these impairment tests.

3. Separate recognition of intangible assets from goodwill and the accounting for negative goodwill (badwill)

The IASB explains its reasons for strengthening the requirement to recognise intangible assets that can be identified separately from goodwill in IFRS 3: some of these intangible assets have a finite useful life and should be amortised, while others have an indefinite useful life and are subject to impairment testing. The 2008 amendments (the revised IFRS 3) also increased the number of intangible assets recognised separately from goodwill.

In 2004, IFRS 3 also introduced changes in the accounting for negative goodwill by requiring its immediate recognition in profit or loss. The standard also required entities to disclose a description of the reasons why the transaction resulted in a gain.

The IASB asks stakeholders whether they find the separate recognition of intangible assets useful, and what main challenges this separate accounting treatment brings.

It also asks how useful they find the recognition of negative goodwill in profit or loss, and the disclosures about why the transaction resulted in a gain.

4. Non-amortisation of goodwill and indefinite-life intangible assets

One of the main changes introduced by IFRS 3 in 2004 was to preclude amortisation of goodwill and instead to require annual impairment testing. In parallel, IAS 38 was amended to require an intangible asset to be regarded as having an indefinite useful life and no longer amortised when there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.

This was because the IASB concluded that testing the value of goodwill annually provides better information than trying to amortise it by recognising a charge that depends on factors that cannot be determined.

A crucial element of impairment testing is the allocation of goodwill to cash-generating units, clarified in IAS 36 which addresses the partial disposal of a CGU or internal reorganisation that changes the composition of CGUs.

5. Non-controlling interests

Since 2003, IAS 27 has required minority (non-controlling) interests to be presented within equity, separately from the equity of the shareholders of the parent entity, insofar as they do not meet the definition of a liability.

In 2008, the IASB changed the term 'minority interest' to 'non-controlling interest' and introduced the following changes:

- For each business combination, an entity may opt to measure NCIs either at fair value or at their proportionate share in the recognised amounts of the acquiree's identifiable assets and liabilities;
- When an entity obtains control of another entity, any subsequent changes in a parent's ownership interest that do not result in a loss of control are treated as transactions between shareholders and do not impact profit or loss. Those changes are accounted for in equity;
- Entities are required to attribute total comprehensive income to the owners of the parent entity and the NCIs to reflect their respective interests, even if this results in the NCIs having a deficit balance.

The IASB is interested to know whether the stakeholders consider the information resulting from the presentation and measurement of NCIs is useful and complete.

It would also like to know the main challenges in the accounting treatment of NCIs, and what the measurement options were under which those challenges arise.

6. Step acquisitions and loss of control

The revision of IFRS 3 in 2008 brought about significant changes in the recognition of step acquisitions and partial disposals leading to loss of control. The IASB considered that gain of control or loss of control constitute a major change in the nature and economic circumstances of an investment, so that:

- an acquirer should remeasure its previously-held equity interest at its acquisition-date fair value and recognise the related gain or loss in profit or loss. The fair value of these interests is then regarded as a part of the acquisition price for the purposes of accounting for the business combination;

- Any investment retained in a former subsidiary is measured at fair value at the date that control is lost and any resulting gain or loss should be recognised in profit or loss. This fair value is then regarded as the cost of the residual asset for the purposes of its accounting treatment under the appropriate standard (IAS 28, IAS 39, etc.).

The IASB concluded that this revised treatment would improve the understandability and relevance of the information provided and would also reduce the cost of accounting for such transactions.

The IASB asks stakeholders how useful they find information resulting from this accounting treatment of step acquisitions or partial disposal leading to loss of control.

7. Disclosures

IFRS 3 requires information to be disclosed about business combinations that occur during or after the end of the reporting period concerned but before the financial statements are published. The purpose of these disclosures is to enable users to understand the impact of the transaction on the accounts of the acquirer.

IFRS 3 requires information about:

- the assets and liabilities of the acquiree;
- the consideration transferred, including equity interests of the acquirer and contingent consideration;
- transactions that are recognised separately from the acquisition of assets and assumption of liabilities in the business combination; and
- the contribution of the acquiree to the performance of the group.

The IASB asks stakeholders to identify:

- *the information needed to understand the effect of the acquisition on a group which is not required by IFRS 3, and*
- *the information required to be disclosed by IFRS 3 that is not useful.*

Finally, the IASB asks what the main challenges are to preparing, auditing or enforcing the disclosures required by IFRS 3.

8. Other matters

The accounting for business combinations encompasses a wide range of areas. The IASB has focused on those areas that it has identified as posing the most significant challenges. However, it is keen to ensure that respondents have an opportunity to raise any additional matters that they think are relevant and that have not been addressed by any individual question in this RfI.

The IASB asks if there are other matters that the IASB should be aware of as it considers the PiR of IFRS 3.

More generally, the IASB is interested in understanding how useful stakeholders find the information that is provided by the existing standard and whether improvements are needed.

Finally, the IASB is interested in all the issues arising in the practical implementation of the standard and in any learning points for its standard-setting process.

9. Impacts of IFRS 3

When it issued the revised IFRS 3 in 2008, the IASB thought that the standard would benefit both preparers and users of financial statements by achieving convergence to common high quality, understandable and easily applied accounting standards in both IFRS and US GAAP. The unification of accounting principles would improve the comparability of financial information and reduce accounting costs for entities that issue financial statements in accordance with both IFRS and US GAAP.

The IASB also believed that the guidance in IFRS 3 was not unduly complex, and that the amendments had addressed the deficiencies of the preceding versions of IFRS 3 and IAS 27 without changing the basic principles of accounting for business combinations.

The IASB is seeking stakeholders' views on:

- *the parts of the standard that have particularly benefited preparers and users;*
- *those which have resulted in considerable unexpected costs to users, preparers, auditors or enforcers;*
- *those which have had an effect on how entities conduct their acquisitions (for example, an effect on contractual terms).*

Events & FAQ

Frequently asked questions

IFRS

- Documentation of a hedging relationship between a foreign currency loan and an operating lease.
- Disclosures required in a business combination.
- Provision for restructuring costs and business combinations.
- Consolidation of a foreign subsidiary under a safeguard proceeding.
- Debt restructuring by issuing equity instruments (IFRIC 19).
- Classification of a hybrid instrument.

Upcoming meetings of the IASB, IFRS Interpretations Committee and EFRAG

IASB	Committee	EFRAG
13 – 21 March 2014	25 March 2014	2 – 4 April 2014
22 – 25 April 2014	13 – 14 May 2014	7 – 9 May 2014
19 – 23 May 2014	15 – 16 July 2014	11 – 13 June 2014

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