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Mazars' newsletter on accounting standards

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Editorial

The IASB is making progress with its proposed amendments to IFRS 15, following on from the work of the Transition Resource Group. Meanwhile, stock market regulators are committed to improving the quality and readability of financial reporting, with ESMA recently publishing its *Guidelines on Alternative Performance Measures* and the French market regulator (AMF) releasing a guide to improving the relevance, consistency and readability of listed companies' financial statements. Companies that want to overhaul their financial reporting will have plenty to think about at the end of this financial period!

Enjoy your reading!

Michel Barbet-Massin Edouard Fossat

IFRS Highlights

IASB reports on IFRS 3 PiR

On 17 June 2015, the IASB announced that it had completed the Post-implementation Review (PiR) of IFRS 3, and published a report on the findings of the review.

Readers will remember that this review began in February 2014 (see the February 2014 issue of Beyond the GAAP). It is a key part of due process as set out in the IFRS Foundation Due Process Handbook.

Having completed the review, the IASB has reached the conclusion that many stakeholders are broadly satisfied with IFRS 3. However, there are some areas of the standard which require further research, such as:

- the effectiveness and complexity of impairment tests;
- subsequent accounting for goodwill;
- the definition of a business combination;
- identification and fair value measurement of intangible assets, particularly customer relationships and brand names.

Further detail on this report will be provided in a future issue of Beyond the GAAP. In the meantime, the report is available on the IASB website via the following link: http://www.ifrs.org/Current-Projects/IASB-Projects/PIR/PIR-IFRS-3/Documents/PIR_IFRS%203-Business-Combinations_FBS_WEBSITE.pdf

New composition of ASAF

On 24 June 2015, the Trustees of the IFRS Foundation announced the new composition of the Accounting Standards Advisory Forum (ASAF) for the next three years.

As a reminder, the ASAF is a technical advisory body that provides a platform for discussion between the IASB and the major national and regional standard-setters.

The ASAF is composed of 12 members representing different geographical zones, as follows:

- Africa: 1 representative (South Africa);
- Asia-Oceania: 4 representatives (Asian-Oceanian Standard-Setters Group – AOSSG, China, Japan, New Zealand);
- Europe: 4 representatives (EFRAG, France, Germany, Italy);
- The Americas: 3 representatives (Canada, Group of Latin American Accounting Standard Setters – GLASS, USA).

For more details, see the press release on the IASB's website: http://www.ifrs.org/Alerts/PressRelease/Pages/IFRS-Foundation-Trustees-announces-new-composition-of-ASAF.aspx

IASB proposes amendments to IAS 19 and interpretation IFRIC 14

On 18 June 2015, the IASB published for comment exposure draft ED/2015/5 *Remeasurement on Plan Amendment, Curtailment or Settlement/ Availability of refund from a Defined benefit Plan* of proposed amendments to IAS 19 – *Employee Benefits* and IFRIC 14 – *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction.*

The proposals are the fruit of discussions within the IFRS IC, and aim to clarify:

- The requirements of IAS 19 regarding the impact of a plan amendment, curtailment or settlement on the determination of service cost and net interest. The current standard requires an entity to determine the impact of a plan amendment, curtailment or settlement by using the actuarial assumptions and fair value of plan assets at the time of such an event (ie a plan amendment, curtailment or settlement). However, it does not explain how such a remeasurement would affect the determination of service cost and net interest in the period following the event. The amendment proposes to clarify that an entity should determine service cost and net interest for the remaining period (ie the period following the event) by using the updated assumptions used in the more recent measurement.
- The requirements of IFRIC 14 for situations where an entity's unconditional right to a refund of a surplus is limited by other parties' (e.g. pension trustees') power to increase benefits or wind up a plan, and the impact on recognition of assets.

The comment period is open until 19 October 2015. The exposure draft can be accessed on the IASB's website via the following link: http://www.ifrs.org/Current-Projects/IASB-Projects/IAS-19-Remeasurement-amendment-curtailment/Documents/ED_Proposed%20amendments%20to-IAS-19-and-IFRIC-14_JUNE%202015.pdf

FASB confirms one-year deferral of Topic 606 mandatory effective date

On 9 July, the FASB confirmed that it would be going ahead with its proposal to defer the mandatory effective date of Topic 606 (the US equivalent of IFRS 15) by one year. Thus, public entities will be required to apply the standard for financial periods commencing on or after 15 December 2017.

This deferral is likely to bolster the IASB's tentative decision to similarly defer the mandatory effective date of IFRS 15 by one year.

European highlights

EFRAG requests public review of *Leases* standard prior to publication

On 15 June 2015, EFRAG sent a letter to the IASB requesting that the fatal flaw review process for the forthcoming *Leases* standard be opened up to the general public.

EFRAG states that a public review would ensure that the wording of the standard and the definition of a lease can be understood by stakeholders. Readers will remember that the definition of a lease – notably the aspects that distinguish it from a service contract – was a major sticking point when drafting the standard. The definition had still not been finalised with only a few months to go before publication of the final standard (scheduled for the fourth quarter of 2015).

EFRAG suggests that a public review is key to ensuring consistent application of the standard in the future, and is all the more important as the proposed standard requires significant use of judgement.

However, EFRAG is very clear in its letter that the goal of this review is not to re-open the debate on the fundamental principles of the proposed standard.

EFRAG's letter is available from its website via the following link:
http://www.efrag.org/files/ED%20Leases%202013/Leases_-_150615_Letter_to_IASB_for_public_fatal_flaw_review.pdf

ESMA publishes recommendations on Alternative Performance Measures

On 30 June 2015, ESMA published its final recommendations on Alternative Performance Measures (APM) – i.e. performance measures that are not defined under IFRS. These guidelines aim to encourage companies to publish transparent, neutral, comparable and high-quality information on financial performance indicators, so that users are better able to understand the performance data that is provided to them using these indicators.

It should be noted that, in contrast to the draft guidelines published in February 2014, the final guidelines do not apply to financial statements drawn up under IFRS. Due to criticisms from stakeholders, ESMA ultimately decided to limit the scope of its recommendations, and thus excluded performance measures disclosed in IFRS financial statements.

The key recommendations from ESMA include the following:

- Provide a clear and readable definition of APMs used, and label them according to their content and basis of calculation;
- Disclose a reconciliation of each APM to the most directly reconcilable line item, sub-total or total in the financial statements, separately identifying and explaining the material reconciling items;
- Explain the reasons for using each APM, and why it is a relevant and reliable measure;
- Disclose comparative data, and reconciliations for all comparatives presented;
- Be consistent over time. If a change is required due to exceptional circumstances, follow the steps below:
  - Explain the change;
  - Explain why it results in more reliable and relevant information;
  - Provide restated comparative figures.
- If an APM is no longer used, explain the reasons why;
- etc.

These guidelines will replace the recommendations published in 2005 by the CESR (the precursor to ESMA). The mandatory effective date for the guidelines is 3 July 2016, as ESMA wanted to allow issuers time to work towards compliance, and to adapt their internal procedures and reporting systems.

The ESMA guidelines are available here:

http://www.esma.europa.eu/system/files/2015-esma-1057_final_report_on_guidelines_on_alternative_performance_measures.pdf

European adoption of IFRS 15 rescheduled

It is looking likely that the IASB will go ahead with its plans to make some limited amendments to IFRS 15 and to defer the effective date of the standard (probably to 1 January 2018). As a result, the EU has modified its schedule for adoption of the standard. The ARC vote is now scheduled for the fourth quarter of 2015, and final adoption of IFRS 15 by the European Union is expected in the first quarter of 2016.

A closer look

IFRS 15: IASB and FASB decide to clarify agent versus principal considerations

In June, the IASB and FASB discussed the current provisions of IFRS 15 (and Topic 606) regarding agent versus principal considerations. Readers will remember that in May, the IASB tentatively decided to amend the guidance to clarify the role of the entity in service contracts (see the May 2015 issue of Beyond the GAAP). The IASB stated at the time that it would wait until it had discussed the issue with the FASB in June before finalising its proposed amendments.

In contrast to their unsuccessful attempts to reach consensus on other topics, the two Boards managed to agree on the amendments to be made to IFRS 15 and Topic 606 regarding agent versus principal considerations.

Proposed amendment to paragraph B35

Paragraph B35 of IFRS 15 is to be amended as follows:

"An entity that is a principal controls:

(a) A good or another asset (for example, a right) that it obtains from another party that it then transfers to the customer;

(b) A right to a service to be performed by the other party, which gives the entity the ability to direct the other party to provide that service to the customer on the entity's behalf in satisfying its performance obligation; or

(c) A good or service that it then integrates with other goods or services into a bundle of goods or services that represents the performance obligation to the customer."

These proposed changes are intended to clarify the provisions of the standard in situations where the entity must apply the control principle to services.

Examples 45-48 shall be amended in line with the clarifications, and additional examples will be added.

Unit of account for the agent versus principal evaluation

To help entities determine the unit of account for the agent versus principal evaluation, the IASB is planning to make clearer links with the standard's provisions for identifying performance obligations.

More specifically, this means that the proposed amendment will clarify that the analysis should be carried out separately for each distinct good or service as defined in the standard, or each distinct bundle of goods or services constituting a single performance obligation.

In practice, the specified good or service for which the analysis is being carried out may, in certain circumstances, be a right to an underlying good or service provided by a third party.

Agent/principal indicators in paragraph B37 to be rewritten

Contrary to what the IASB originally decided in May, the indicators listed in paragraph B37 of the standard (which were carried over from IAS 18) are to be amended in order to link more clearly with the general principle of control set out in paragraph B35.

The relationship between this general principle and the indicators was one of the major concerns expressed by stakeholders (cf. the TRG's discussions in July 2014). In practice, the indicators will be rewritten with the emphasis on identifying whether an entity is a principal (as in IAS 18), rather than on identifying whether it is an agent. Additional details will be provided for each indicator, explaining how it demonstrates that the entity controls the good or service before it is transferred to the customer.

The paragraph introducing these indicators is to be rewritten as follows:

"Indicators that an entity controls the specified good or service before it is transferred to the customer include, but are not limited to, the following, each of which may be more or less persuasive to the control evaluation depending on the nature of the specified good or service and the terms of the contract: (…)".

Exposure draft scheduled for July

As regards IFRS, these amendments will be included in the limited exposure draft that is scheduled for publication by the end of July. In addition to agent versus principal considerations, the exposure draft is expected to include proposed amendments relating to the accounting treatment of licenses, identifying performance obligations, and transition requirements (when contracts are modified before the transition date). The IASB decided in June that this new exposure draft would have a 90-day comment period. Stakeholders would thus have until the end of October to respond. The IASB is still hoping to finalise these amendments by the end of 2015.

A closer look

Evaluation of 10 years of IFRS in Europe: European Commission report published

On 18 June 2015, the European Commission published its report to the European Parliament and the Council, entitled "Evaluation of Regulation (EC) no. 1606/2002 of 19 July 2002 on the application of International Accounting Standards".

This evaluation exercise found that the so-called "IAS Regulation" has had a generally positive effect, in that:

- Financial statements drawn up under IFRS are of higher quality and more relevant, thus achieving the objective of improving the transparency and comparability of the financial reporting of listed companies. Moreover, the objectives of the IAS Regulation remain relevant;
- The mechanisms put in place within the European Union (EU) ensure proper application of the standards;
- The functioning of capital markets has improved: higher liquidity, lower costs of capital, increased cross-border transactions, easier access to capital at EU and global level, and improved investor protection and confidence;
- The EU's decision to adopt IFRS gave the standards a boost at the global level, and they are now accepted in more than 100 countries;
- The cost/benefit ratio of IFRS implementation seems to be positive;
- The scope of the IAS Regulation, and the options given to Member States, are appropriate;
- The process for EU endorsement is adequate and the recent reform of EFRAG (see Beyond the GAAP, January 2015) should enhance the EU's influence over the development of standards earlier in the process;
- The governance of the IFRS Foundation has improved, notably thanks to the creation of the Accounting Standards Advisory Forum (which provides a platform for consultation with standard-setters) and the introduction of post-implementation reviews.

On the down side, the European Commission identified the following negative points:

- the complexity of the standards, although this is partly due to the complexity of business;
- the increasing volume of financial statements;
- the standards' unsuitability for the needs of long-term investors;
- some lack of consistency and coherence in the implementation of standards;
- a need to improve translations of standards;
- a need for guidance to improve understanding of the adoption criteria for IFRS;
- a need for the IFRS Foundation to improve its financing structure in order to guarantee long-term sustainability and ensure that all countries that use IFRS contribute;
- a need to link representation on the governing and monitoring bodies of the IFRS Foundation to the use of IFRS and financing of the organisation;
- the fact that the United States still has not decided to apply IFRS to its domestic companies.

The European Commission recognises that accounting standards can have broad economic effects. However, it has not been possible to gain a clear picture of the role of accounting standards (specifically fair value and recognition of loan impairment) in the most recent financial crisis. Moreover, the new IFRS 9 standard on financial instruments, which was intended to address criticisms voiced during the financial crisis, is currently being assessed for European adoption. Finally, the European Commission welcomes the reintroduction of the concept of prudence to the *Conceptual Framework* project (see next item on page 7).

The evaluation was carried out in 2014 and the European Commission used a number of different methods to arrive at these findings:

- a public consultation in the form of a questionnaire, carried out between August and November 2014, to which 200 responses were received (see the July 2014 issue of Beyond the GAAP);
- meetings with the ARC and with an informal group of 18 experts from public and private sector organisations from the various Member States;
- a review of the academic literature on the impact of mandatory adoption of IFRS in the EU and on the performance of IFRS during the crisis, taking account of the fact that the effects of IFRS are difficult to isolate from broader economic effects and the impact of other regulatory changes.

The report is available in all EU languages via the following link, together with the Staff Working Paper, available in English only:
http://ec.europa.eu/finance/accounting/ias-evaluation/index_en.htm.

A closer look

IFRS *Conceptual Framework* revision: key points in 9 pages (instead of 200!)

Following its first consultation in 2013, the IASB has continued to work on its *Conceptual Framework* and published an exposure draft on 28 May 2015.

This exposure draft is accompanied by a separate exposure draft of amendments to other standards. These primarily relate to changing the terms used in references to the Conceptual Framework, as its name has been changed.

Purpose and status of the Conceptual Framework

The exposure draft, which has eight chapters plus a Basis for Conclusions, explains in the introduction that its purpose is:

- To assist the IASB with developing and revising its standards;
- To assist companies with developing consistent accounting policies when no standard applies to a particular transaction or event, or when a standard allows a choice of accounting options; and
- To assist all stakeholders with understanding and interpreting the standards.

The status of the Conceptual Framework with relation to IFRS remains unchanged. In practice, the standards take precedence over the Conceptual Framework. However, the IASB states that, if in future it specifies requirements that are not in line with the Conceptual Framework, it will explain the reasons for this in the Basis for Conclusions.

Eight substantial chapters, focusing on financial statements

Although the official title of the document is "Conceptual Framework for Financial Reporting", the majority of the eight chapters that we summarise here (chapters 3 to 8) focus on financial statements presented under IFRS, rather than financial reporting, which is a much broader concept:

1. The objective of general purpose financial reporting;
2. Qualitative characteristics of useful financial information;

   Remember that these first two chapters have already been revised, in 2010. However, a few amendments have been made in this exposure draft in response to comments from stakeholders. We will come back to this in section 2.

3. Financial statements and the reporting entity;
4. The elements of financial statements;
5. Recognition and derecognition;
6. Measurement;
7. Presentation and disclosure;
8. Concepts of capital and capital maintenance.

   This chapter is largely unchanged from the existing Conceptual Framework, so we do not discuss it in this article.

In the following discussion, we identify the key elements of the draft Conceptual Framework, particularly the major changes in each chapter. In section 8, we discuss the effects analysis carried out by the IASB, which is included in the Basis for Conclusions.

1. The objective of general purpose financial reporting

The main objective of financial reporting is still to be useful to existing and potential investors, lenders and other creditors of the entity (hereafter referred to as "users") when making decisions about financing the entity.

In this context, users base their expectations of returns on their assessment of the following:

– the amount, timing and uncertainty of future cash inflows to the entity; and

– management's stewardship of the entity's resources.

The reintroduction of the term 'stewardship' was suggested by a large number of stakeholders. Although the IASB felt that it was implicitly addressed in the 2010 version of the Conceptual Framework, mentioning it explicitly allows the IASB to make the link with the overall objective of financial reporting and to identify it alongside assessment of future cash inflows as a contributing factor in users' decision-making.

Key points to remember

The exposure draft reintroduces the idea that one of the purposes of financial reporting is to hold management to account for their stewardship of resources.

2. Qualitative characteristics of useful financial information

It should first be noted that this chapter, which was initially drafted in 2010, divides the qualitative characteristics of useful financial information into two categories:

– Fundamental qualitative characteristics: relevance and faithful representation;

– Enhancing qualitative characteristics, which increase the usefulness of information: comparability, verifiability, timeliness and understandability.

Applying these characteristics is subject to a cost constraint, in the sense that it should be considered whether the benefits of reporting the information justify the cost of doing so.

Prudence and neutrality

The concept of prudence is reintroduced to support the principle of neutrality, as requested by many stakeholders. These concepts are discussed in the context of providing a faithful representation.

The link between prudence and neutrality is important to note, as some stakeholders argued that prudence is inconsistent with neutrality and should therefore not be reintroduced.

The exposure draft defines prudence as the exercise of caution when making judgements under conditions of uncertainty. Thus, exercising prudence simply means not overstating assets and income or understating liabilities and expenses.

Thus, the notion of prudence as defined by the IASB is different from 'asymmetric prudence' – i.e. recognising assets only with a very high degree of certainty, but recognising liabilities if they are probable. This is consistent with the recognition criteria defined in the exposure draft (cf. section 5, below).

Measurement uncertainty and relevance

The exposure draft provides additional detail on measurement uncertainty. This is discussed within the section on relevance.

As it is not always possible to observe the value of an asset or liability directly, an estimate must be used. This therefore raises the question of the relevance of the resulting information. The higher the level of measurement uncertainty, the less relevant the information, even if it is only a disclosure in the notes. However, the exposure draft also states that an estimate may still be relevant even if it bears a high level of measurement uncertainty.

In practice, these clarifications do not provide definitive guidance on whether estimates with a high level of uncertainty should be recognised or, if not recognised, whether they should be disclosed in the notes.

It should be noted that these clarifications were added in response to requests from stakeholders to reinstate the notion of reliability of measurement. This is one of the criteria for recognising assets and liabilities in the current Conceptual Framework and existing IFRS.

When drafting this chapter in 2010, the IASB noted that there was no common understanding of reliability among stakeholders (with some interpreting it as a synonym for verifiability or freedom from material error). The IASB felt that these interpretations were reductive and simplistic. It therefore replaced the term 'reliability' with 'faithful representation', a broader term which was felt to cover the key aspects of reliability.

We will see in section 5, below, that the IASB no longer includes reliability of measurement as a criterion for recognising assets and liabilities.

Substance over form and faithful representation

The IASB stipulates that a faithful representation of economic phenomena must include information about the substance of the phenomenon, not merely its legal form.

When drafting the chapter in 2010, the IASB felt that it would be redundant to stipulate that faithful representation required substance over form. However, the concept is explicitly mentioned in the Conceptual Framework exposure draft following requests from stakeholders.

Key points to remember

The notions of prudence, measurement uncertainty and substance over form have been reintroduced, adding to the explanations of the qualitative characteristics of useful financial information.

3. Financial statements and the reporting entity

This chapter starts out with a general explanation of the role of financial statements in providing information on economic resources, claims against the entity and changes in those economic resources and claims over the period. The explanations of all these terms are left until the following chapters.

General purpose financial statements are drawn up on the basis that the entity is a going concern and will continue to operate for the foreseeable future. If this is not the case, the financial statements may have to be prepared on a basis other than IFRS, and have a specific purpose.

The draft Conceptual Framework also specifies that the financial statements are prepared from the perspective of the entity as a whole, not from the perspective of its investors.

This clarification is useful, as in practice it is not always clear as to which perspective was in mind when drawing up the individual standards.

Having clarified this issue of perspective, chapter 3 of the exposure draft then goes on to define the concept of the reporting entity. The concept of control appears here, although it is not defined in this chapter. The reporting entity is defined as the entity which:

– has direct control only over other entities;

  In this case, the entity prepares its financial reporting on the basis of direct future cash flows. As a result, its financial statements are unconsolidated financial statements.
  We believe that "direct control" must imply "integrated into the legal structure", in line with this concept of unconsolidated financial statements.

– or has both direct and indirect control over other entities.

  In this case, the financial statements prepared by the entity are consolidated financial statements (as they include the assets and liabilities held directly by the entity as a legal structure, as well as those held by other legal structures that are controlled by the reporting entity). Consolidated financial statements are more likely to provide useful information to users than unconsolidated financial statements. However, an entity may choose, or be obliged, to present its unconsolidated financial statements as well as its consolidated financial statements.

This chapter focuses on control, and does not include any mention of joint control or significant influence. The boundaries of an entity are thus deemed to be the boundaries of the parent company and its subsidiaries.

In passing, the chapter also notes that:

– a reporting entity may only be a portion of the legal entity;
– a reporting entity may be composed of two or more entities, in which case it would prepare combined financial statements if the entities do not have a parent-subsidiary relationship.

Key points to remember

A reporting entity is an entity that chooses, or is required, to prepare general purpose financial statements, which are drawn up:

– on the basis that the entity is a going concern; and
– from the perspective of the entity as a whole.

4. The elements of financial statements

As hinted in the July 2013 Discussion Paper, the IASB wanted to uncouple the definitions of assets and liabilities from the recognition criteria (see section 5, below).

The concept of an 'economic resource'

The concept of an 'economic resource' is key to defining all the other concepts discussed in this chapter. It is defined as a right that has the potential to produce economic benefits. This definition is now presented separately from the definitions of the elements of financial statements, as the IASB had found that confusion arose between assets/liabilities, and the flows of economic benefits that might potentially result from them. The definition of an 'economic resource' also allows for clearer parallels between assets and liabilities.

The phrase 'potential to produce' should be understood to imply that it need not be certain, or even probable, that the resource will produce economic benefits. The exposure draft stipulates that it is only necessary that the economic resource exists, and that it would produce economic benefits in at least one circumstance.

It is also clarified that the economic resource is the right, not the future economic benefits.

Moreover, if the entity's rights are identical to those held by all other parties, they do not generate economic benefits.

  For example, this would include the right to access public roads.

The elements of financial statements

The elements of financial statements are linked to resources, claims, and changes in resources and claims.

Thus, the elements of financial statements are as follows:

	Elements of financial statements
Resources of the entity	Asset
Claims against the entity	Liability
	Equity
Financial performance (changes in resources and claims)	Income
	Expenses

Assets (liabilities) are defined as present economic resources controlled by the entity (present obligations of the entity to transfer economic resources) as a result of past events.

Equity is still defined as the residual interest in the assets of the entity after deducting its liabilities.

Similarly, expenses and income are defined as changes in assets or liabilities other than those resulting from transactions with holders of equity claims. This is the same as the current definition.

The concept of control

Control is defined as the entity's ability to direct the use of the economic resource and obtain the (positive or negative) economic flows resulting from it.

  This definition reflects the recent amendments to IFRS 10 - *Consolidated Financial Statements* and IFRS 15 – *Revenue from Contracts with Customers*.

  Thus, the concept of 'risks and rewards' is now only an indicator of control.

Thus, if a reporting entity is acting on behalf of, and for the benefit of, another entity, the economic benefits will not flow to the reporting entity but to the other entity (the principal). Thus, the reporting entity is acting as an agent.

Relationship between the obligation to transfer and the right to receive

Although 'asymmetric prudence' does not form part of the IASB's concept of prudence (see above, section 2), the exposure draft states that, if an entity has an obligation to transfer economic resources, it logically follows that another entity has the right to receive these resources.

However, the requirements of financial reporting do not necessarily imply that the same criteria must be used by both entities for recognition and measurement of their respective assets and liabilities.

This is not an entirely new development: this was already the case for provisions for lawsuits under IAS 37. A provision is recognised if it is more likely than not that a present obligation exists, whereas the potential recipient only recognises the payment once it is certain to be received.

The concept of a present obligation

For a present obligation to exist, it must have arisen from past events, and the entity must have no practical ability to avoid the transfer. The management's intention to make a transfer is not sufficient to constitute a present obligation.

> An obligation may be implicit, as is the case currently.

As a result, an entity that draws up its financial statements on a going concern basis has no practical ability to avoid a transfer that could be avoided only by liquidating the entity or ceasing to trade. On the other hand, it does have the ability to avoid a transfer of resources that would only be required on liquidation of the entity or cessation of trading.

> The IASB notes in its effects analysis that this definition of an obligation is inconsistent with the provisions of IFRIC 21 – *Levies* (see section 8). This interpretation states that an obligation only exists once all the relevant events have occurred.
>
> It should also be noted that the IASB's research programme includes a project on liabilities. The Board is currently awaiting completion of the Conceptual Framework revision before mapping out the scope of the liabilities project.

Executory contracts

The exposure draft defines an executory contract as one that is equally unperformed by both parties to the contract: neither of the parties has fulfilled any of its obligations, or both parties have fulfilled their obligations partially and to an equal extent. Thus, an executory contract establishes a combined right and obligation that constitute a single asset or liability. If the terms of the transaction are favourable to the entity, it has an asset. If they are not, it has a liability.

Unit of account

The unit of account is defined as the group of rights and obligations to which the recognition and measurement criteria are applied.

Thus, the unit of account may be:

- an asset or liability in its entirety (e.g. a machine);
- particular rights or obligations relating to an asset or liability (e.g. a right of use);
- a portfolio of
  - similar assets or liabilities (e.g. insurance contracts);
  - dissimilar assets or liabilities (e.g. they are to be disposed of in a single transaction); or
  - a risk exposure within a portfolio of items, if the portfolio is subject to a common risk.

When determining the unit of account, the entity must aim to provide the most relevant and useful information, faithfully represent the substance of the transaction, and ensure that the cost of providing the information does not exceed the benefits.

> Readers should note that these three criteria correspond to the two fundamental characteristics of financial information and the cost constraint, discussed in chapter 2 (see section 2, above). These criteria are also central to the subsequent chapters of the Conceptual Framework on recognition, measurement, presentation and disclosure, which we summarise below.

The exposure draft stipulates that different units of account may be used for recognition and measurement.

> Thus, sales may be recognised by transaction, but it would be more relevant to calculate the warranty provision on the basis of all the sales, taking probability into account.

Thus, when determining the unit of account, an entity may wish to consider whether rights and obligations cannot (or are unlikely to) be the subject of separate transactions, expire in different patterns, are used together, or have similar economic characteristics and risks.

Key points to remember

Only the definitions of assets and liabilities have changed; equity, expenses and income are still defined in relation to assets and liabilities.

The definition of control is in line with the recently-issued IFRS 10 and IFRS 15 standards.

The definitions of assets and liabilities are no longer linked to recognition.

The exposure draft provides additional clarifications on executory contracts and the unit of account.

5. Recognition and derecognition

Recognition

Recognition of assets and liabilities is subject to the following criteria: relevance, faithful representation, and the cost/benefit constraint.

Thus, recognition of assets and liabilities is no longer based on either probability or reliability of measurement (see sections 2 and 8).

Disclosures in the notes cannot compensate for the omission of relevant information, but they may provide useful additional information. Moreover, in certain circumstances it may not be relevant to recognise an asset or a liability, but a disclosure in the notes would be a useful method of informing users about the transaction.

Thus, recognition of an element may not produce relevant information in the following situations:

- uncertainty regarding the existence of an asset (particularly regarding rights that are not legal rights, such as know-how) or a liability (e.g. if it is unclear whether a past event causing an obligation has occurred), or uncertainty as to whether an asset is separable from goodwill;
- a very low probability that an existing asset or liability will give rise to an inflow or outflow of economic benefits;
- a very high level of measurement uncertainty on all possible measures, due for example to an extremely wide range of possible outcomes, or particular difficulty in estimating future cash flows.

Faithful representation of assets and liabilities requires an entity to consider not only the description and measurement of the item in the statement of financial position, including its relationship to other assets and liabilities, but also, the entity must consider the depiction of resulting income, expenses and equity, and make any necessary related disclosures in order to ensure a faithful representation of the overall effect of the transaction or event.

Derecognition and modification of contracts

Derecognition, defined as the removal of all or part of a previously recognised asset or liability from the statement of financial position, must provide a faithful representation of both:

- the assets and liabilities retained after the transaction or other event that led to the derecognition; and
- changes in assets and liabilities resulting from that transaction or event.

Clearly, derecognition (particularly partial recognition) may result in a change to the unit of account used.

The exposure draft stipulates that under normal circumstances, income or expenses may only be recognised on the component that is actually transferred.

However, before derecognising an element, the entity should analyse the substance of the transaction to determine whether it should continue to recognise the element in the statement of financial position.

> This would be the case for a disposal where the entity retains control. In this situation, the entity should continue to recognise the asset in the statement of financial position, with a financing liability on the liability side of the balance sheet.

Contract modifications are discussed in the context of derecognition, as they may involve adding and/or reducing rights and obligations relating to the contract.

If the modification adds rights and obligations, then in order to identify the correct accounting treatment, the entity must consider whether they are distinct from the rights and obligations created by the original terms of the contract (i.e. they are new) or whether they are part of the same unit of account as the existing rights and obligations (in which case they must be remeasured).

If the modification both reduces existing rights and obligations and adds new ones, the entity must consider the combined effect, rather than looking at each aspect separately.

Key points to remember

Recognition of assets and liabilities must be approached in such a way that the financial statements as a whole possess the two fundamental characteristics of useful financial information (relevance and faithful representation), subject to the cost constraint.

As a result, recognition is no longer dependent on:

- meeting a probability threshold; or
- fulfilling the 'reliability of measurement' criterion.

Derecognition of assets and liabilities may be full or partial. The substance of the transaction is key to the analysis.

6. Measurement

The chapter on measurement describes the two main categories of measurement basis (historical cost and current value, which includes fair value). It discusses their advantages and disadvantages, as well as factors to consider when choosing a measurement basis.

Historical cost

Measurement at historical cost is summarised in the table below:

Historical cost	Non-financial asset	Non-financial liability	Financial asset	Financial liability
Initial measurement	Cost incurred, including initial transaction costs	Consideration received, net of initial transaction costs	Cost incurred, including initial transaction costs	Consideration received, net of initial transaction costs
Subsequent measurement	Initial measurement, adjusted to reflect, where needed: - Consumption (depreciation/ amortisation) - Impairment	Initial measurement adjusted to reflect, where needed: - Interest accumulated - Fulfilment of liability - Onerous activities	Initial measurement adjusted to reflect, where needed: - Interest accumulated - Changes in estimates of cash flows (including impairment on assets) - Receipts/payments	

Current value

This section of the Conceptual Framework describes two types of current value measurement basis: fair value and value in use/fulfilment value.

Fair value

The definition of fair value is that given in IFRS 13. In other words, it is the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date.
This price includes:

– estimates of future cash flows;
– possible variations in the amount and timing of these cash flows;
– the time value of money;
– the risk premium or risk discount corresponding to the price for bearing the uncertainty inherent in these cash flows;
– other factors, such as liquidity risk, that market participants would take into account in the circumstances pertaining to the element/transaction to be measured;
– for a liability, the possibility that the entity may not be able to fulfil the obligation (own credit risk).

Transaction costs are not included in fair value, either on acquisition/recognition, or on disposal/derecognition.

This does not preclude the IASB from requiring an entity to measure an item at fair value less costs to sell, as it does in IFRS 5 – *Non-current Assets Held for Sale and Discontinued Operations*; in IAS 36 – *Impairment of Assets*; and for biological assets and agricultural produce in IAS 41 – *Agriculture*.

Value in use (assets) and fulfilment value (liabilities)

The value in use of an asset is the present value of the cash flows that an entity expects to derive from the continuing use of an asset and from its ultimate disposal, including transaction costs in this case.

The fulfilment value of a liability is the present value of the cash flows that an entity expects to incur to fulfil an obligation.

These current values are specific to the entity (unlike fair value which is a market price). As a result, they are not directly observable, so cash-flow-based measurement techniques must be used to determine them.

Choosing a measurement basis

When choosing a measurement basis, the entity must consider the financial statements as a whole, i.e. both the statement of financial position and the statements of financial performance.

Generally speaking, the same measurement basis should be used for both initial and subsequent recognition.

Relevance

To ensure that the measurement basis produces relevant information, the following aspects should be taken into account:

– how the item contributes to future cash flows, particularly with regard to the nature of business activities;

  This criterion was added by the IASB to satisfy those commenters who thought that IFRS should place more emphasis on an entity's business model.

– the characteristics of the element: for example, the nature and extent of the variability in future cash flows, or the sensitivity of the value of the item to changes in market factors or to other risks inherent in the item.

  These criteria are in line with those set out in the recently-issued IFRS 9 – *Financial Instruments*.

As stated in section 2, the relevance of financial information may be affected by the level of measurement uncertainty.

Faithful representation

Faithful representation does not require the amounts to be perfectly free from error: if limitations and explanations are given alongside the figure, this can suffice to meet the criterion.

Moreover, if assets and liabilities are related, a similar measurement basis may be needed for both in order to faithfully represent the entity's activities.

The exposure draft explains how the enhancing characteristics listed in section 2 (comparability, verifiability, timeliness and understandability) can help to provide a more faithful representation.

It may be necessary to use more than one measurement basis for a single element in order to provide relevant information. This may be done by:

– using one measurement basis in the statement of financial position (generally historical cost) and another in the notes (generally fair value):

  For example, this applies to:
  - investment property recognised at cost, for which the fair value must be disclosed in the notes;
  - biological assets which are recognised at cost as their fair value cannot be reliably determined, and for which the entity is required to disclose (if possible) the range of estimates within which fair value is highly likely to lie;
  - financial instruments recognised at amortised cost, for which the fair value must be disclosed in the notes.

  However, if tangible or intangible assets are recognised using the revaluation model, the disclosures in the notes must include the carrying amount, for each class of assets that would have been recognised in the statement of financial position if the entity had used the cost model.

– using one measurement basis in the statement of financial position (generally fair value or another current value) and another in the statement of profit or loss (generally historical/amortised cost). The difference between the two measurement bases is recognised in other comprehensive income.

  For example, this applies to available-for-sale financial instruments under the current IAS 39, as well as those held to collect and sell under IFRS 9, which is currently going through the EU adoption process.

Key points to remember

The exposure draft confirms the use of a mixed measurement basis approach (historical cost and current value).

When choosing a measurement basis, an entity must take into account:

– the fundamental characteristics of useful financial information (relevance and faithful representation) and, more specifically, the entity's business activities, the characteristics of the element, and the level of measurement uncertainty; and

– the cost constraint.

It may be necessary to use more than one measurement basis for a single element in order to provide relevant information.

Both the statement of financial position and the statement of profit and loss must be considered for the purposes of determining the measurement basis to apply.

7. Presentation and disclosure

Financial statements and communication

This chapter states that financial statements (including the notes) are a communication tool. Thus, in order to communicate effectively, the following principles should be taken into account:

– the information should be entity-specific rather than generic;

  For example, it is pointless to state that revenue is recognised when the risks and rewards are transferred, in line with IAS 18. It would be more useful to explain when this transfer occurs, with reference to the company's business activities and usual contractual terms.

– if presentation and disclosure requirements are formulated in terms of principles rather than rules, this gives companies the freedom to include useful information and exclude information that would not be useful;

– duplication of information in different parts of the financial statements is usually unnecessary and makes the financial statements more difficult to understand;

– a balance must be achieved between requiring information that is comparable between entities and over time, and giving companies the flexibility to provide relevant information that faithfully represents their assets and liabilities, as well as the transactions and other events of the period.

  Readers should note that these principles, which are already inherent in IFRS, will be discussed in more depth in the Disclosure Initiative research project (see the December 2014 issue of Beyond the GAAP), which will focus on how to put these principles into practice.

Financial performance

The rest of the chapter focuses on how to present information on financial performance, although this concept is not defined.

  The IASB recently added a project on financial performance to its research programme.

The statement of profit or loss is identified as the main source for communicating information on financial performance.

As a result, there is a rebuttable presumption that all income and all expenses for the period will be recognised in the statement of profit or loss.

This presumption may be rebutted, in which case the income or expense will be recognised in other comprehensive income. The presumption may not be rebutted for the following items, which must be recognised in profit or loss:

– income or expenses recognised at historical cost;

– all components of income and expenses measured at historical cost if they are separately identified within a current value measurement.

  For example, this would apply to financial instruments held to collect and sell under IFRS 9, for which the component corresponding to interest income must be recognised in profit or loss.

The exposure draft identifies a second rebuttable presumption relating to other comprehensive income, namely that these items will be reclassified into the statement of profit or loss at some future point.

This presumption could be rebutted if, for example, there is no clear basis for identifying the period in which reclassification to profit or loss would enhance the relevance of the information in the statement of profit or loss. However, the exposure draft goes on to explain that this would raise a question as to whether it was appropriate to rebut the first presumption.

  As a reminder, the elements of OCI that may not be reclassified to profit and loss currently include the following: changes in a revaluation surplus on property, plant and equipment, and remeasurements or actuarial gains and losses on defined benefit plans.

Key points to remember

Financial statements should be viewed as a communication tool.

The statement of profit or loss is identified as the main source for communicating information on financial performance.

It is presumed that all income and all expenses for the period will be recognised in profit or loss, unless this would not result in relevant information.

Upcoming research projects will allow the IASB to:

– clarify how the principles of effective communication, as set out in the Conceptual Framework chapter on presentation and disclosure, should be put into practice; and

– define the concept of financial performance.

8. Effects analysis

The Basis for Conclusions includes an analysis of the effects of the changes to the Conceptual Framework on the existing standards and current projects.

The analysis is approached in terms of potential inconsistencies between these standards and projects and the proposed Conceptual Framework. The Basis for Conclusions identifies two categories of inconsistency: 'main inconsistencies' and 'minor inconsistencies'.

Only two main inconsistencies have been identified. These relate to some of the classification requirements of IAS 32 – *Financial Instruments* (notably the clauses on share settlement and the exceptions for puttable instruments) and to interpretation IFRIC 21 – *Levies.* The IASB is not currently planning to make changes to these documents as a result of the Conceptual Framework.

It should however be noted that the IASB has two research projects under way which could resolve these issues in the long term. The first focuses on the distinction between debt and equity, and the second on liabilities.

The minor inconsistencies are primarily terminological issues. For example, existing standards refer to the 'reliability of measurement' criterion for recognition of assets and liabilities (see section 2, above). The IASB is not planning to change these references, as they do not contradict the proposed Conceptual Framework.

Moreover, as noted in section 2, the IASB feels that the concept of faithful representation includes the key aspects of reliability.

In contrast, the IASB states that it has not attempted to identify how a set of hypothetical standards drawn up now, in the light of the proposed Conceptual Framework, would differ from the existing IFRS. This is because the revision of the Conceptual Framework was never intended to involve radical changes to the standards.

Key points to remember

The IASB has only identified two main inconsistencies between existing standards and the proposed Conceptual Framework. These inconsistencies may be resolved eventually by ongoing research projects on the issues concerned.

Conclusion

The proposed Conceptual Framework will not cause any significant upheaval in the world of IFRS, given the few inconsistencies with existing standards. Rather, it simply clarifies, reworks and adds to the existing Conceptual Framework, restructuring its logic to focus on the fundamental characteristics of financial statements and the cost/benefit constraint.

In the process, the IASB has:

- listened to the concerns of stakeholders by reintroducing the concepts of prudence, stewardship and substance over form (admittedly in a different form to how they appeared originally) and by introducing the concept of business activities as an aspect to be taken into account when choosing a measurement basis;
- uncoupled the definitions of the elements of financial statements from the recognition criteria;
- confirmed the shift in its thinking by defining control in line with relevant recently-published standards, and by removing probability from the recognition criteria and relegating it to measurement issues alone;
- clarified that information should be presented from the perspective of the entity as a whole;
- put an end to two rumours: firstly, it has quashed the rumour of "full fair value" by developing a mixed measurement basis approach. Secondly, the rumour that profit or loss was to be abandoned is proven completely unfounded, as it is identified as the main source of information on financial performance.

However, some key issues, such as the definition of financial performance and the distinction between debt and equity, have not been addressed in the Conceptual Framework but have instead been shelved, to be dealt with in the course of future research projects. To be fair to the IASB, it had set itself an extremely tight deadline (initially the end of 2015) which would have been difficult to reconcile with devoting adequate time to these hotly-debated issues.

The IASB is proposing that the Conceptual Framework will come into effect:

- immediately after publication of the final document, for use by the IASB and the IFRS IC;
- 18 months after publication of the final document, for entities that may need to refer to it.

Comments on the proposals can be sent to the IASB until 26 October 2015, via the following link: http://www.ifrs.org/Current-Projects/IASB-Projects/Conceptual-Framework/Pages/Conceptual-Framework-Exposure-Draft-and-Comment-letters.aspx

Key points to remember

The new Conceptual Framework is not expected to affect existing standards in the short term.

There are only a few instances of inconsistencies between existing standards and the Conceptual Framework, as the exposure draft allows for leeway in how the principles are applied.

Events and FAQ

Frequently asked questions

IFRS

- Accounting for an advance that is repayable in kind;
- Recognition of death-in-service benefits;
- Accounting of a stock split in the financial statements of the shareholder;
- Consolidation of a 49%-owned foreign subsidiary, following the passing of a law regulating foreign investments;
- Loss of control and recognition date of gains or losses on disposals in situations where the documents have been lost;
- Accounting of options that permit payment of dividends in shares;
- Low float of listed securities: the impact on impairment tests and the unit of account.

Upcoming meetings of the IASB, the IFRS Interpretations Committee and EFRAG

IFRS		EFRAG	
IASB	**Committee**	**Board**	**TEG**
21-25 September	8-9 September	1er September	9-11 September
19-23 October	10-11 November	21 September	7-9 October
16-20 November	12-13 January	28 October	4-6 November