

Beyond the GAAP

Mazars' newsletter on accounting standards

NEWSLETTER / No. 134 – June 2019



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Editorial

The half-yearly financial statements stand between you and your well-earned summer break, so it may be worth taking a look at the IFRS IC's agenda decisions on IFRS 15, IFRS 16 and cryptocurrencies. After that, you could take our crossword away with you - a light-hearted edition that brings the series to a close.

Last but certainly not least, don't forget to read our special study on the IASB's proposals to prepare for the interest rate benchmark reform. The consultation period may be over, but there will be lively discussions after the holidays!

We wish you a great summer!

Enjoy your reading!

Edouard Fossat

Isabelle Grauer-Gaynor

IFRS Highlights

Publication of exposure draft on IFRS 17 amendments

On 26 June 2019, the IASB published an exposure draft (ED/2019/4 *Amendments to IFRS 17*) proposing amendments to the insurance contracts standard.

Readers will recall that these proposals are intended to address the concerns and implementation difficulties identified shortly after the standard was published. These led to repeated discussions in the IASB (see issues 129 to 132 of *Beyond the GAAP* published from January to April 2019).

The comment period runs until 25 September 2019. The exposure draft can be accessed on the IASB web site at: <https://www.ifrs.org/-/media/project/amendments-to-ifs-17/ed-amendments-to-ifs-17.pdf?la=en>

Subsurface rights and IFRS 16

The IFRS Interpretations Committee (IFRS IC) received a request about a particular contract for subsurface rights granted to a pipeline operator (the customer) for the installation of a pipeline in exchange for consideration.

The request asked whether this contract met the IFRS 16 definition of a lease, given that:

- the contract specifies the exact location and dimensions (path, width and depth) of the underground space within which the pipeline is placed;
- the landowner retains the right to use the surface of the land above the pipeline, but it has no right to access or otherwise change the use of the specified underground space throughout the 20-year period of use;
- the customer has the right to perform inspection, repairs and maintenance work (including replacing damaged sections of the pipeline when necessary).

It's no real surprise that the Committee, whose agenda decision has just been published in the June 2019 IFRIC Update, concluded that this is indeed a lease to be recognised under IFRS 16, because:

- the underground space is physically distinct from the rest of the land, and the landowner has no real right of substitution;
- the customer has the right to obtain substantially all the economic benefits from use of the underground space, since it enjoys its exclusive use;
- the customer has the right to direct the use of the underground space throughout the use period, under the conditions predetermined in the contract.

Effect of a potential contribution discount on the classification of a post-employment benefit

The IFRS Interpretations Committee (IFRS IC) received a request about the classification of a post-employment benefit plan in which:

- the entity has an obligation to pay fixed annual contributions to the plan, relieving it of any legal or constructive obligation to pay further contributions if the plan does not hold sufficient assets;
- the entity is entitled to a potential discount on its annual contributions if the ratio of plan assets to plan liabilities exceeds a set level.

The request asked whether the existence of a right to a potential discount would result in classification as a defined contribution plan, or as a defined benefit plan.

In an agenda decision appearing in the June 2019 IFRIC Update, the Committee concluded that the existence of a right to a potential discount would not in itself result in classifying a post-employment benefit plan as a defined benefit plan.

Considering the classification of post-employment benefits more generally, the Committee reiterated:

- the importance of assessing all relevant terms and conditions of a plan, as well as any informal practices that might give rise to a constructive obligation; and
- that an entity should disclose the judgments that its management has made regarding the classification of post-employment benefit plans.

Accounting for costs to fulfil a contract using a method for measuring progress based on outputs

In June 2019 the IFRS IC published an agenda decision reiterating the principles of IFRS 15 on the distinction between the costs incurred by an entity which relate directly to the transfer of a good or service to the customer, and the costs which are necessary to fulfil the contract but which do not in themselves transfer a good or service to the customer. This distinction determines whether costs to fulfil must be expensed immediately, or whether they should be recognised as an asset (subject to all the criteria in paragraph 95).

In the case in question, the request was made to the IFRS IC in relation to a contract for the construction of a building sold to a customer. The Committee identified a single performance obligation and concluded that the entity transfers control of the building over time. Revenue is therefore recognised over time, using an output method. The worked example presented in the referral to the IFRS IC shows that the profit margin on the building's foundations is significantly lower than the margin on the building itself. In practice, the components of the construction (foundations, walls, windows and door, roof) have very different margins.

The request asked whether costs incurred in the construction of the foundations should be expensed immediately, or whether they could or should be capitalised.

The committee considered that these costs related to a partially satisfied performance obligation in the contract (that is, they are costs relating to a past performance) under paragraph 98(c) of the standard, since the costs incurred contribute to the construction of the building, control of which is transferred to the customer over time. In other words, these costs do not generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) its performance obligation in the future; It is therefore not possible to recognise an asset. Hence, the Committee decided that the difference in margin on the various construction components should not be taken into account when deciding how to account for the costs to fulfil that have been incurred.

Note also that, in this context, the Committee thought it necessary to examine the relevance of the method used to measure progress. IFRS 15 paragraph B15 requires an entity deciding whether to apply an output method to the measurement of progress to consider whether the output selected would faithfully depict the entity's performance towards complete satisfaction of the performance obligation. In this instance, the method seems debatable, as a cost-based method of measuring progress would probably better reflect the reality of performance to date.

How are IFRS standards applied to holdings of cryptocurrencies?

The IFRS IC has now clarified how IFRS standards are to be applied to holdings of cryptocurrencies meeting the following three characteristics:

- a digital or virtual currency recorded on a distributed ledger that uses cryptography for security,
- not issued by a jurisdictional authority or other party, and
- which does not give rise to a contract between the holder and another party.

What is the nature of these assets?

The IFRS IC concluded that these are intangible assets under IAS 38, since they can be individually sold or transferred (i.e. can be separated from the holder), but they do not give the holder a right to receive a fixed or determinable number of units of currency. The IFRS IC states that cryptocurrencies do not meet the definitions of:

- cash: cryptocurrencies certainly can be used as a means of exchange to obtain goods and services, but they are not used as a medium of exchange and as the monetary unit in pricing goods or services to such an extent that it would be the basis on which all transactions are measured and recognised;
- financial assets: cryptocurrencies are not equity instruments of another entity, do not give rise to a contractual right for the holder and are not contracts that may be settled in the holder's own equity instruments.

What IFRS standard applies to holdings of cryptocurrencies?

The IFRS IC concluded that cryptocurrencies held for sale in the ordinary course of business are covered by IAS 2 *Inventories*. An entity acting as a cryptocurrency broker-trader shall measure its cryptocurrencies at fair value less costs to sell.

If IAS 2 is not applicable, an entity applies IAS 38 *Intangible Assets* and recognises holdings of cryptocurrency either using the cost method or a revaluation model (i.e. fair value measurement by reference to an active market, with the recognition of any increase in value in OCI without subsequent recycling to profit or loss, and of any reduction in profit or loss).

What disclosures are required?

The Committee stressed that the disclosures required depend on which standard is applied (IAS 2 or IAS 38). For fair value measurement, IFRS 13 specifies the applicable disclosure requirements.

Finally, the Committee reiterates that an entity's management must disclose the significant judgments it has made when accounting for holdings of cryptocurrencies, including any significant events occurring after the reporting period (e.g. significant changes in value).

European highlights

Single electronic reporting format (ESEF): ESMA publishes draft taxonomy updates

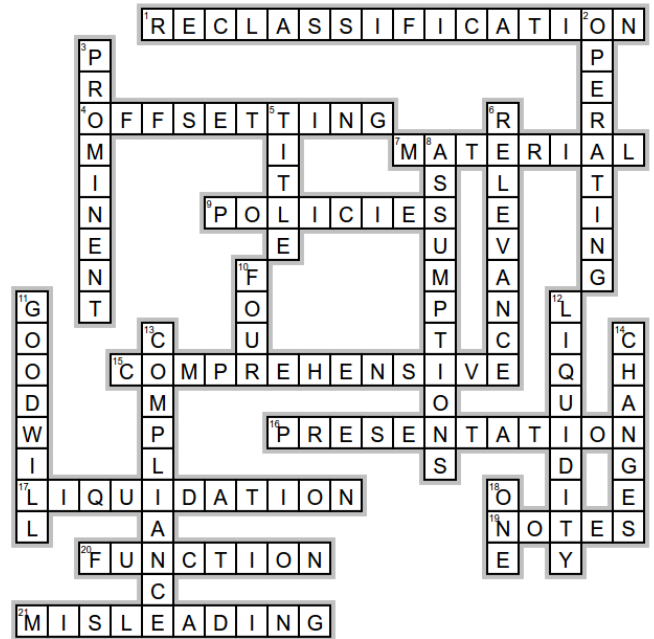
Following the publication of the RTS Regulation on electronic reporting (ESEF) on 29 May 2019 in the OJEU (see Beyond the GAAP no 133 of May 2019), ESMA issued draft updates of the taxonomy on 7 June.

This is because the regulation published in May relied on the 2017 taxonomy. The draft that ESMA has now published updates to this taxonomy to reflect the changes in IFRS taxonomy published annually by the IASB, specifically those issued in 2018. Accordingly, ESMA will issue similar updates every year, and these will have to be published in the OJEU to amend the RTS.

ESMA's draft updates can be consulted at:

<https://www.esma.europa.eu/press-news/esma-news/esma-integrates-latest-ifrs-updates-in-its-esef-taxonomy>

Crossword: last month's solution



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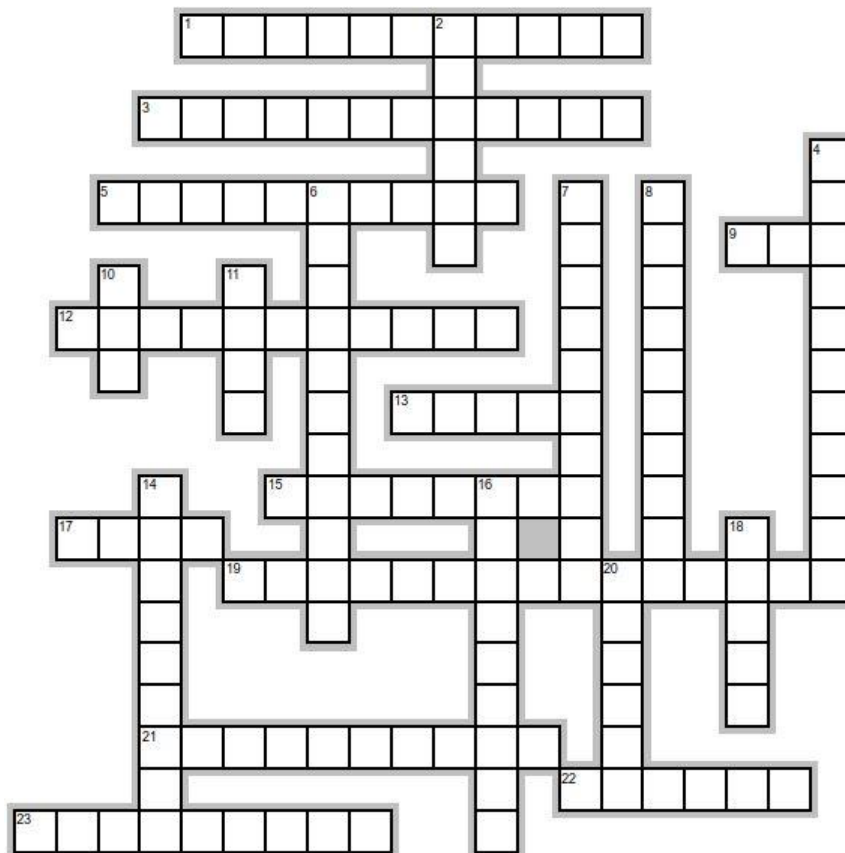
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Crossword: The wonderful world of IFRS



Across

1. Sector that will always be associated with the very last IAS
3. A period recently shortened for major draft texts, but maintained at maximum length for essentially minor amendments
5. We sometimes wonder whether the IFRS standards are really based on these
9. Meaningful for banks and insurance companies? (initials)
12. With the application of IFRS, the newspapers have finally started writing about them
13. Initials of the statement of performance required under IFRS which sounds somewhat apologetic
15. Meteorological term for the overheating that may describe the recent implementation of major accounting standards
17. Value deserved by the brave
19. It's more than two years since the committee of this name published any
21. No, it's not just an accounting entry!
22. Inappropriate description of fair value. especially when we know that that is the least common level...
23. With the growing complexity of IFRS calculations, is the IASB encouraging the growth of this profession?

Down

2. This standard challenges the notion of ownership
4. If you provided everything the standards seem to require, you'd drown in them
6. Wonder why tangible and intangible assets are not named like financial assets?
7. Most dangerous stakeholder in IFRS
8. Profession largely sustained by incessant changes to IFRS standards
10. A category no one really comprehends (initials)
11. Animal metaphor adopted by two IASB chairmen
14. According to former IASB chairman Sir David Tweedie, anyone who has read the standard covering this type of instruments and understood it hasn't read it properly
16. IFRS 16 will reassure their passengers, especially the former IASB chairman, as to their existence for the companies which operate them!
18. Expenses or assets? When incurred during acquisition, recognition sometimes differs completely from one standard to another. Can the Conceptual Framework provide any help on this?
20. If IFRS standards were clear, the IFRS IC wouldn't need to publish these decisions!

A Closer Look

Reform of interbank interest rate benchmarks: proposed amendments to IAS 39 and IFRS 9 on affected hedging relationships

The ongoing reform of short-term interest rate benchmarks, and the growing uncertainties affecting future cash flows, have persuaded the IASB to put forward amendments to hedge accounting requirements in IAS 39 and IFRS 9.

This study will set out the background to the review, the IASB's exposure draft and the foreseeable impacts of the IASB's proposals regarding hedge accounting.

1. Background to the review and IASB exposure draft

Following the 2008 liquidity crisis and the market manipulation of short-term InterBank Offered Rates ("IBOR") such as LIBOR or EURIBOR, the Financial Stability Board (FSB) issued a report in 2014 questioning the reliability of these rates. Drawing the lessons of these events, the report recommended improving the governance of existing reference rates (including IBOR, but also very short-term rates like EONIA) and introducing alternative risk-free interest rates (RFR).

In response to these recommendations, a large-scale reform was launched, but there has been no consistent implementation in the various national and transnational jurisdictions affected. While some jurisdictions have moved towards the effective replacement of the existing interest rate benchmarks, others have left the door open to the coexistence of old and new reference rates, or have even simply maintained the old rates. These disparities are also reflected in the divergence between timetables for introducing the reforms from one jurisdiction to another and one rate to the next.

The reform thus introduces uncertainties regarding the timing and the amount of future contractual cash flows based on these reference rates. In some cases, the replacement of existing rates by alternative rates would require the amendment of all the affected contracts. This could be very onerous if the amendments require the signature of contractual amendments with the counterparties. This will be time-consuming, and the effective dates of these changes could in practice be spread over many months or even years.

2. IASB's proposed response to the problems identified for accounting hedges

The main aim of the proposed amendments is to relax the IAS 39 and IFRS 9 eligibility conditions for an interest rate hedging relationship, in order to avoid a situation in which a hedging relationship is discontinued or becomes ineligible solely due to the uncertainties caused by the reform of benchmark rates for future contractual cash flows.

Because of the uncertainties for contracts based on reference rates, in 2018 the IASB launched a review to consider the potential accounting impacts of this reform. Because of its scale, the project will have two phases:

- a phase addressing accounting issues identified in the period before the effective replacement of an existing interest rate benchmark (pre-replacement issues or phase I); and
- a phase addressing accounting issues raised by the effective replacement of the interest rate benchmark (replacement issues or phase II).

The exposure draft entitled *Interest Rate Benchmark Reform* published in May 2019 belongs to the first of these phases and proposes amendments to the hedge accounting requirements of IAS 39 and IFRS 9[†].

This is because, to the extent that these two standards require forward-looking analysis to establish the effectiveness of hedging relationships, these uncertainties are likely to cause some of these hedges to be discontinued, due to:

- the disappearance (or the no longer "highly probable" nature) of a benchmark interest rate risk component or of the hedged cash flows;
- the amendment of hedged contracts that might lead to their derecognition;
- an ineffective relationship, generated by the reform, between the hedging instrument and the hedged item.

The proposed reliefs relate firstly to the criteria for the prospective assessments.

For cash flow hedges, IAS 39 and IFRS 9 both require that if a hedged item is a future transaction, it must be "highly probable" if the hedging relationship is to be eligible. If this future transaction corresponds to cash flows based on the

[†] www.ifrs.org/-/media/project/ibor-reform/ed-ibor-reform-may-19.pdf?la=en

existing interest rate benchmarks, its “highly probable” nature may be called into question by the potential replacement of the existing reference rate by an alternative.

The IASB proposes to deal with this risk by taking no account of the effects of the ongoing interest rate reform when assessing whether such a future transaction is “highly probable”.

The Board also proposes to overlook the impact of the reform on the prospective effectiveness assessments carried out for fair value and cash flow hedges, namely:

- the prospective effectiveness assessment under IAS 39 (i.e. the changes in future values of the hedging instrument and the hedged item should offset each other such that the hedge is expected to be “highly effective” throughout its life);
- the demonstration of an economic relationship between the hedged item and the hedging instrument under IFRS 9 (i.e. the value of the hedging instrument and the value of the hedged item will generally move in opposite directions because of the same risk, which is the hedged risk).

Another expedient is proposed by the Board for the special case of a hedge of an interest rate risk component affected by the reform that is not contractually specified. This arrangement relates, for example, to situations where an entity establishes a fair value hedging relationship in which the hedged risk corresponds to the changes in value of a fixed-rate instrument (e.g. a fixed rate liability at 4%) in light of a benchmark interest rate (e.g. EURIBOR 3M).

IAS 39 and IFRS 9 allow the hedging of a designated risk component of an item rather than the item in its entirety, provided that this risk component is separately identifiable and reliably measurable from inception and throughout the life of the hedging relationship. The Exposure Draft proposes that an entity should apply the requirement—that the benchmark interest rate risk component hedged is separately identifiable—only at the inception of the hedging relationship, rather than continuously.

Note, however, that the reliefs advanced by the IASB are only intended to prevent the discontinuation of hedging relationships affected by the benchmark rate reform due to a failure to meet the prospective eligibility criteria, and not to eliminate the recognition of any ineffectiveness caused by the reform: the exposure draft is clear that any ineffectiveness caused by the rate reform would continue to be recognised in profit or loss.

Disclosures would be required to identify the hedging relationships that are affected by this amendment. The IASB proposes that the quantitative disclosures for hedge accounting required by IFRS 7 should be presented, separating the relationships affected by the amendments from other hedging relationships. The disclosures which would be required are as follows:

Hedging instrument
<ul style="list-style-type: none"> ▪ Carrying amount of the instrument ▪ Fair value change of the instrument used as a basis for recognition of hedge relationship ineffectiveness ▪ Nominal value of instrument
Hedged item
<ul style="list-style-type: none"> ▪ Fair value hedges: <ul style="list-style-type: none"> ○ Carrying amount of the hedged item ○ Balance of the reserve for fair value hedge adjustments on the hedged item recognised in the statement of financial position ▪ Cash flow hedge or hedge of a net investment in a foreign operation: <ul style="list-style-type: none"> ○ Balances in the cash flow hedge reserve / foreign currency translation reserve for continuing hedges ○ Balances in the cash flow hedge reserve and the foreign currency translation reserve from any hedging relationships for which hedge accounting is no longer applied. ▪ All hedges: <ul style="list-style-type: none"> ○ Change in the fair value of the hedged item used as the basis for recognising hedge ineffectiveness

The IASB suggests that this amendment should be of mandatory retrospective application as of 1 January 2020. Early application will be possible (depending on the endorsement timetable in the different jurisdictions).

The amendment would apply for a limited period, ending either:

- when there is no longer any uncertainty with respect to the timing and the amount of the interest rate benchmark-based cash flows; or
- when the hedging relationship is discontinued, or when the entire amount accumulated in the cash flow hedge reserve accounted for in OCI with respect to that hedging relationship is reclassified to profit or loss.

The exposure draft was open for comments until 17 June 2019. The letters received have been published on the IASB’s website and can be consulted at: <https://www.ifrs.org/projects/work-plan/ibor-reform-and-the-effects-on-financial-reporting/comment-letters-projects/exposure-draft/#comment-letters>

Key points

- An ongoing general reform of interbank interest rate benchmarks, introducing uncertainties regarding the timing and the amount of future contractual cash flows using these reference rates.
- An IASB project that has been in progress since 2018 to address potential accounting impacts of this reform, both ahead of the replacement of these benchmark rates (phase I) and at the time of their effective replacement (phase II).
- For phase I, the IASB published an exposure draft in May 2019 proposing amendments to the hedge accounting requirements of IAS 39 and IFRS 9 in order to avoid the discontinuation or ineligibility of hedging relationships due solely to this reform. These amendments consist of:
 - disregarding the effects and uncertainties caused by the reform:
 - when assessing the “highly probable” nature of a future hedged transaction in a cash flow hedge;
 - in the prospective effectiveness assessments conducted for fair value and cash flow hedges (i.e. the prospective effectiveness test under IAS 39 or the demonstration of an economic relationship between the hedged item and the hedging instrument under IFRS 9); and
 - in the case of a non-contractually specified hedge of an interest rate risk component, the “separately identifiable” nature of this component need only be considered at the inception of the hedging relationship, rather than continuously.

Nevertheless, any ineffectiveness caused by this reform will continue to be recognised in profit or loss.

- Separate presentation, for the affected hedging relationships, of the quantitative disclosures already required by IFRS 7 for hedge accounting.
- Mandatory retrospective application from 1 January 2020, until such time as the uncertainties caused by the reform no longer affect the contractual cash flows, or the affected hedging relationship is discontinued.

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Events and FAQ

Frequently asked questions

IFRS

- Internal cross-border restructuring
- Balance sheet classification of liabilities for uncertain tax positions
- Accounting treatment of a put on non-controlling interests
- Accounting for a leaseback transaction
- IFRS 15 and costs to fulfil a contract
- Transfer of investment property to inventories
- Control exercised over an infrastructure financing entity
- Cash flow statement classification of cash flows from a sale and leaseback transaction

Upcoming meetings of the IASB, IFRS Interpretations Committee and EFRAG

IFRS		EFRAG	
IASB	Committee	Board	TEG
22 - 26 July	16-17 September	10 September	3-4 September
23 - 27 September	25-26 November	8 October	26 September
21 - 25 October	21 January	13 November	5-6 November

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The drafting of the present issue was completed on 17 July 2019.
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