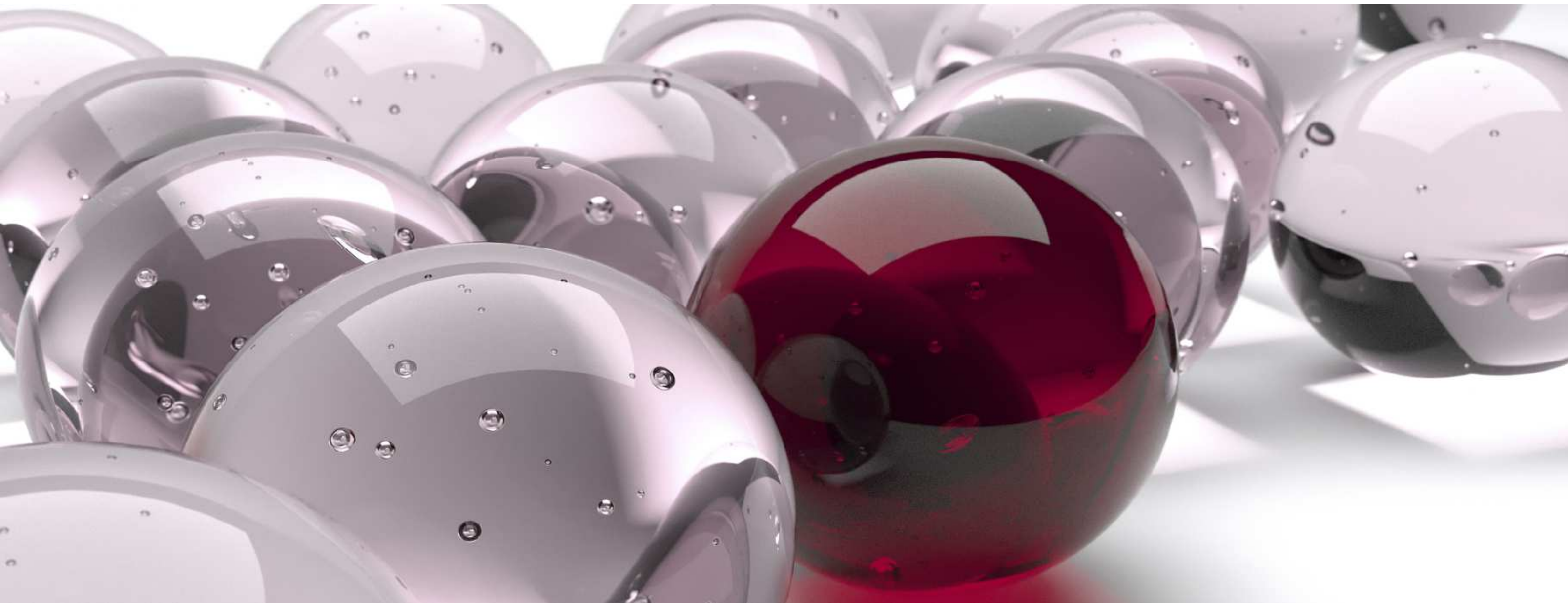
No 80 – July-August 2014

Beyond the GAAP

Mazars' newsletter on accounting standards



Contents

Highlights

IFRS standards page 2

Europe page 3

A Closer Look

The IASB clarifies the accounting treatment of joint arrangements page 4

Events and FAQ page 5

Editors in chief:

Michel Barbet-Massin, Edouard Fossat

Columnists:

Vincent Gilles, Egle Mockaityte, Didier Rimbaud and Arnaud Verchère

Contact us:

Mazars
Exaltis, 61, rue Henri Régnault
92 075 – La Défense – France
TEL: +33 49 97 60 00
www.mazars.com

Editorial

The IASB has taken advantage of the summer break to finalise a number of publications. These include the complete version of IFRS 9 on financial instruments, published in July.

While this publication, along with the issue of IFRS 15 in May, brings two major projects to a conclusion, other long-term projects are still awaiting completion.

The continued redeliberations on the Leases project will receive particular attention, not least in the light of the consultation initiatives launched by EFRAG and the main European accounting standard-setters.

Redeliberations on accounting for insurance contracts will also take time and energy, while work on the conceptual framework should result in the publication of an exposure draft in the first quarter of 2015.

Hence the coming months will be busy and perhaps turbulent in the world of IFRSs. Beyond the GAAP will continue to steer you through these developments.

Enjoy your reading!

Michel Barbet-Massin Edouard Fossat

IFRS Highlights

The IASB publishes the full and final version of IFRS 9 on financial instruments!

On 24 July the IASB finalised its project for the replacement of IAS 39 on financial instruments by issuing the full version of IFRS 9. In addition to the provisions drawn from IAS 39 (scope, derecognition) and the section on hedge accounting that was finalised in November 2013, the new IFRS 9 now also contains the final provisions on:

- the classification and measurement of financial instruments;
- and the impairment of financial instruments exposed to third party credit risk.

IFRS 9 introduces significant changes in comparison with IAS 39.

- The provisions for the classification and measurement of financial assets will in future depend on a combined analysis of the business model for each asset portfolio and the contractual characteristics of the financial assets. Reclassifications between amortised cost and fair value categories are probable.
- The impairment model moves away from the current approach based on incurred losses in favour of an expected loss approach. This change will have profound impacts, both in terms of the impairments to be recognised in the financial statements (a significant increase is anticipated) and in terms of changes in information systems.
- Finally, it should be remembered that the hedge accounting chapter which we presented in our January 2014 edition contains many significant improvements to align the accounting treatment more closely with an entity's risk management.

For entities whose reporting period coincides with the calendar year, the IASB expects an effective date of 1 January 2018. Early application will be permitted. Europe must now decide whether to endorse this text in its accounting standards and announce its effective date for European entities. While industrial and commercial entities will be interested in the possibility of applying the new hedge accounting provisions as early as possible, the financial sector (banks, insurance entities etc.) will probably be in less of a hurry, given the scale of the work that this new standard represents for the sector which must gear up without delay.

In parallel the IASB is continuing its work on IFRS 4 *Insurance contracts*, and on the future standard on dynamic risk management (macro-hedging) which will be two natural companions to IFRS 9 for financial institutions.

Finally, readers will recall that IFRS 9 will not lead to convergence between IFRS and American standards in the matter of financial instruments. At the beginning of 2014, the US standard setter withdrew definitively from this project - which was initially a joint undertaking - in order to develop its own model for the classification and impairment of financial assets.

We will present these new provisions of IFRS 9 in more detail in a future edition of Beyond the GAAP.

Recognition of deferred tax assets for unrealised losses

The IASB has published on 20 August 2014, an exposure draft (*ED/2014/3 Recognition of Deferred Tax Assets for Unrealised Losses*) to clarify the accounting for deferred tax assets for unrealized losses on debt instruments measured at fair value, in accordance with IAS 39 and IFRS 9, particularly in situations where the entity reports tax losses.

The exposure draft aims to clarify that:

- An unrealized loss on a debt instrument measured at fair value gives rise to a deductible temporary difference even if the holder expects to recover its carrying amount by holding it to maturity and collecting all of the contractual cash flows and if the loss is not tax-deductible until realised.
- When assessing the probability that future taxable profit will be available for the purpose of recognising deferred tax assets, an entity's estimate of future taxable profit assumes that it will recover an asset for more than its carrying amount, provided such a recovery is probable.
- Probable future taxable income excludes tax deductions represented by those deductible temporary differences (i.e. tax deductions resulting from the reversal of the temporary differences).
- An entity assesses the utilisation of deductible temporary differences related to unrealised losses on debt instruments measured at fair value in combination with other deductible temporary differences.

The ED complements IAS 12 in its mandatory part and the accompanying guidance (adding a detailed illustrative example). These amendments would apply retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* but an entity would not be required to restate the opening retained earnings or other components of equity of the earliest comparative period presented.

Comments should be sent to the IASB by 18 December 2014.

Narrow-scope amendment to IAS 27 – Equity method in Separate Financial Statements

On 12 August 2014, the IASB published a narrow-scope amendment to IAS 27 entitled *Equity Method in Separate Financial Statements.* The changes to IAS 27 will allow entities to use the equity method to account for their investments in subsidiaries, joint ventures and associates in their separate financial statements, which will reduce the cost of preparing separate financial statements while providing information helpful to an assessment of the investor's net assets and profit or loss. In future, IAS 27 will therefore propose three approaches to account for investments in subsidiaries, joint ventures and associates in the separate financial statements: in accordance with IAS 39/IFRS 9, at cost or by the equity method.

An entity shall apply that amendment for annual periods beginning on or after 1 January 2016 retrospectively in accordance with IAS 8. Earlier application is permitted

EUROPEAN Highlights

European Commission launches consultation on the impact of IFRSs

On 7 August 2014, the European Commission launched a public consultation to seek views from all interested parties on their experience of Regulation 1606/2002 ('the IAS Regulation'). The consultation takes the form of a questionnaire for return no later than 31 October 2014.

For more details of this consultation, visit the European Commission's site at: http://ec.europa.eu/internal_market/consultations/2014/ifrs/index_en.htm

EFRAG to hold outreach event on the Leases project

On 30 June, EFRAG, together with the French, German, Italian and British standard-setters, launched a public consultation on the definition of a lease and on the latest proposals for lessee accounting models put forward by the IASB and the FASB (see Beyond the GAAP, June 2014).

The preliminary results of this public consultation will be discussed at an outreach event organised by EFRAG in Brussels on 15 September next. These initial findings will be followed by two debates, one on the definition and identification of leases and the other on the two accounting models supported by the IASB and the FASB respectively. For more details of this event, visit the EFRAG site at: http://www.efrag.org/Front/n1-1370/NewsDetail.aspx

Become a Subscriber

Keep up to date with international accounting with the English edition
of Mazars' Newsletter on accounting standards entitled

Beyond the GAAP

Beyond the GAAP is a totally free newsletter. To subscribe, send an e-mail to doctrine@mazars.fr mentioning:
The name and first name of the people to whom you would like to send Beyond the GAAP,
Their position and company,
Their e-mail address

From the following month, they will receive an e-mail including a link to the last issue of Beyond the GAAP

A Closer Look

The IASB clarifies the accounting treatment of joint arrangements

The IFRS IC's 2014 clarifications may lead listed entities to review their joint arrangements and amend their accounting treatment

Since the beginning of the year, the IFRS Interpretations Committee (the committee responsible for interpreting the IFRSs published by the IASB) has been discussing issues arising from the application of IFRS 11 *Joint arrangements.* These issues mainly concern the classification of a joint arrangement as a joint operation or a joint venture. This classification is crucial since it determines the accounting treatment of the arrangement in the IFRS accounts of the parties. Since 1 January 2014, joint ventures must be accounted for by the equity method, while joint operations continue to be accounted for by a method close to the proportional consolidation method (although there are some differences, inter alia regarding the consolidation percentage).

To grasp what is at stake in these discussions, remember that joint arrangements have long been used some groups in their international development (in particular in Asia). IAS 31 (which has been replaced by IFRS 11) allowed the recognition of joint ventures using the proportional consolidation method, and hence allowed the inclusion in the consolidated revenue of their share in the revenue generated by the joint arrangement. The application of IFRS 11 eliminates the proportional consolidation method for joint ventures and therefore results in a significant loss of revenue for those groups that structure their joint arrangements through joint ventures. Under the equity method, only the share of the net result generated by the joint venture is accounted for in the IFRS accounts of the parties.

The IFRS IC was asked under what circumstances a joint arrangement structured via a separate legal vehicle could be classified as a joint operation. IFRS 11 does specifically state that a separate legal vehicle may be classified as a joint operation (rather than a joint venture) when the contractual agreements or other facts and circumstances confer in substance on the parties both (direct) rights to the assets and (direct) obligations for the liabilities relating to the arrangement. More exactly, the question is whether it is possible, in the light of the "other facts and circumstances", to describe a joint arrangement as a joint operation based on the economic substance of the arrangement (rather than its legal substance). Classification as a joint operation would allow the parties to recognise their share of the revenue generated by the joint arrangement.

During its discussions in January and May 2014, the IFRS IC confirmed that the distinction between a joint operation and a joint venture depended on an analysis of the legal and contractual nature of the arrangement, including when assessing the "other facts and circumstances". This would therefore be an analysis of the substance based on the legal and regulatory environment in which the arrangement operates and on the contractual agreements concluded for the arrangement (including the commercial contracts concluded between the parties and the joint arrangement).

This approach to the analysis led the IFRS IC to conclude in July 2014 that joint arrangements structured via a separate legal vehicle established for a particular project leading to the provision of a good or service to an end customer (for example, in real estate development) did not meet the definition of a joint operation. It is not generally possible to demonstrate in such cases that the parties have (direct) rights to the assets of the joint arrangement.

In consequence the "other facts and circumstances" referred to by IFRS 11 leading to classification as a joint operation will in practice only concern upstream production entities (structured via a separate legal vehicle) providing output to the parties, in which the parties have an obligation (and not merely the intention) to purchase the outputs produced by these upstream entities at their production cost (or a "cost plus" price). In this instance, through the acquisition of the outputs, the parties have rights over the underlying assets used in the production of the outputs and obligations for the liabilities of the arrangement (the cash flows from the parties being used to settle the liabilities of the arrangement on a continuing basis over the lifetime of the arrangement).

Listed entities must therefore consider all the consequences of these IFRS IC clarifications and review the classification of their joint arrangements. Regulators are to pay particular attention to the disclosures provided on this topic.

Events & FAQ

Frequently asked questions

IFRSs

- Diluted earnings per share: Impact of the issue of convertible bonds
- Costs of listing and issuing new equity instruments: allocation of costs that related to both the capital increase and the listing?
- Distinction between a business combination and an asset acquisition.
- First consolidation and transition to IFRSs
- Accounting treatment of a promise to purchase at a fixed sum

Forthcoming meetings of the IASB, IFRS Interpretations Committee and EFRAG

IASB	Committee	EFRAG
18 - 24 September 2014	16 – 17 September 2014	3 - 5 September 2014
16 - 24 October 2014	11 - 12 November 2014	8 - 10 October 2014
13 - 21 November 2014	27 - 28 January 2015	5 - 7 November 2014

Beyond the GAAP is published by Mazars. The purpose of this newsletter is to keep readers informed of accounting developments. Beyond the GAAP may under no circumstances be associated, in whole or in part, with an opinion issued by Mazars. Despite the meticulous care taken in preparing this publication, Mazars may not be held liable for any errors or omissions it might contain.

The drafting of the present edition was completed on 18 September 2014
© Mazars – September 2014 – all rights reserved