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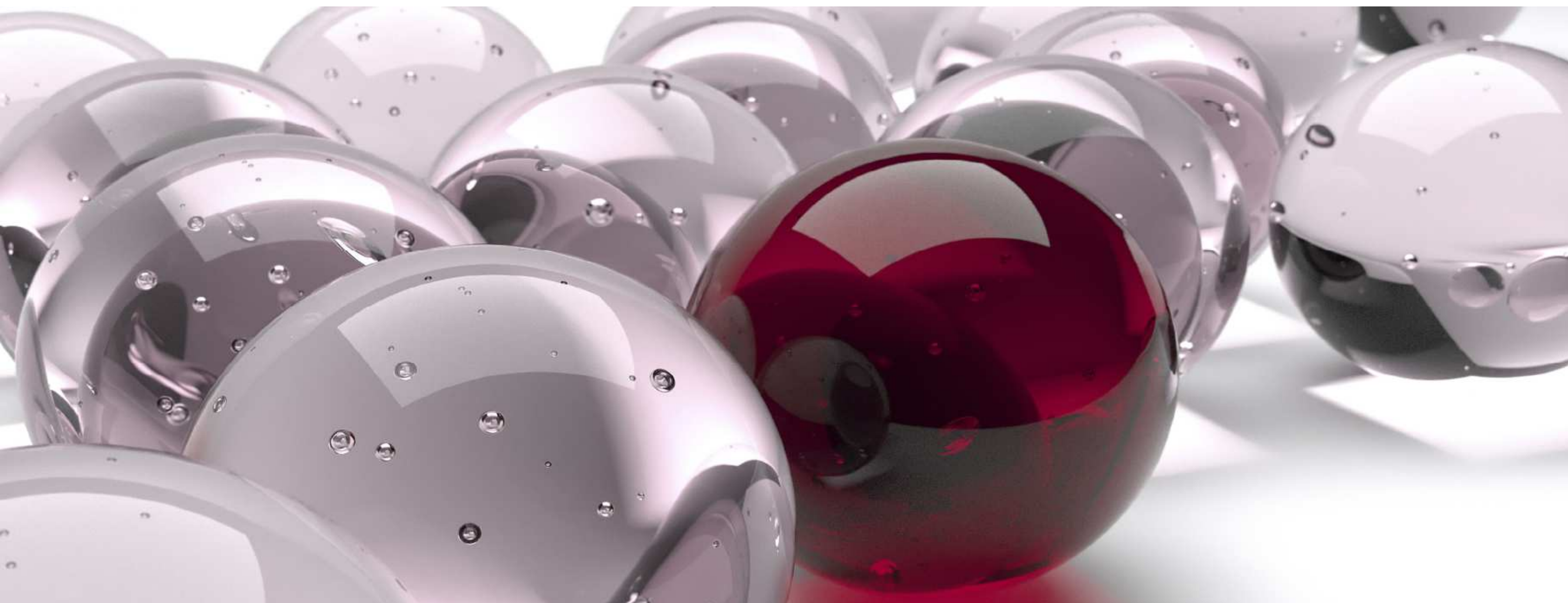
The Mazars' newsletter on accounting standards



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Editorial

After a short summer break, the IASB and the IFRS Interpretations Committee have returned to their work programme. September saw the publication of the Discussion Paper on rate-regulated activities and the continuation of discussions on the major insurance contracts and conceptual framework projects.

At the same time, the IFRS Interpretations Committee decided how best to document its observations on the application of IFRS 11. These will ultimately be formulated in a series of agenda decisions published in the *IFRIC Update*. The topics should be discussed at the November meeting with a view to finalisation in March. This should put an end to the discussions on the classification of project entities for IFRS 11.

Enjoy your reading!

Michel Barbet-Massin Edouard Fossat

IFRS Highlights

Improvements to IFRSs – 2012-2014 Cycle

On 25 September the IASB published the final text of *Annual Improvements to IFRSs 2012–2014 Cycle.* The five definitive amendments, which concern four standards, are as follows:

- IFRS 5 – Non-current Assets Held for Sale and Discontinued Operations. The addition of guidance where an entity changes its method of disposal and reclassifies an asset held for sale as an asset held for distribution, or vice versa.
- IFRS 7 – Financial Instruments: Disclosures. Additional guidance to clarify whether a servicing contract is continuing involvement in a transferred asset for the purpose of applying the disclosures required.
- IFRS 7 – Financial instruments : Disclosures. Clarification on the applicability of the offsetting amendments to IFRS 7 offsetting amendment to condensed interim financial statements.IAS 19 - Employee benefits: establishes that the depth of the market for High Quality Corporate Bonds (HQCB) used to determine discount rates for post-employment benefits shall be assessed at the currency level (and therefore not necessarily at a country level, for example in the euro area).
- IAS 34 – Interim Financial Reporting. Clarifies the meaning of the phrase "elsewhere in the interim financial report".

These amendments are effective for annual periods beginning on or after 1 January 2016. Early application is authorised.

EFRAG does not expect the European Commission to endorse this text before the third quarter of 2015.

Discussion Paper on rate-regulated activities

On 17 September the IASB published for comments a Discussion Paper on rate-regulated activities. This working document aims to gather the views of stakeholders on what information about the effects of these activities is relevant to users of financial statements, and how it should be reflected in these statements. It contains no specific accounting proposals.

The comments period for this document expires on 15 January 2015. For more information, visit the IASB site at: http://www.ifrs.org/Alerts/Publication/Pages/IASB-publishes-a-Discussion-Paper-on-reporting-the-financial-effects-of-rate-regulation-September-2014.aspx

Unit of account and quoted investments

On 16 September the IASB published for comment the exposure draft *Measuring Quoted Investments in Subsidiaries, Joint Ventures and Associates at Fair Value* (ED/2014/4) with a view to amending IFRS 10, IFRS 12, IAS 27, IAS 28, IAS 36 and IFRS 13.

The draft amendments are intended to clarify that:

- the unit of account of an investment in a subsidiary, a joint venture or an associate is the investment as a whole, and
- for quoted investments, the recoverable amount of the investment is the quoted price multiplied by the quantity of instruments held.

It would no longer be possible to take account of a control premium, which is likely to provoke responses from many stakeholders.

Comments on this exposure draft may be submitted no later than 16 January 2015. The exposure draft can be accessed on the IASB web site at: http://www.ifrs.org/Alerts/Publication/Pages/IASB-publishes-Exposure-Draft-Measuring-Quoted-Investments-September-2014.aspx

IFRS IC rules on the classification of fair value measurements received from third parties

During its September meeting, the IFRS Interpretations Committee (IFRS IC) addressed the classification of fair value instruments in accordance with the 3-level hierarchy defined in IFRS 13. How should instruments be classified if their fair value has been calculated by third parties?

The debate focused on whether it is possible to classify as level 1 (corresponding to unadjusted quoted prices in active markets for identical instruments) the measurements provided by consensus pricing services such as MarkIT, R RICs by Thomson Reuters, Bloomberg Generic (BGN), Bloomberg CBBT etc.

The IFRS IC noted that classification at Level 1, 2 or 3 of the IFRS 13 hierarchy of fair value measurement depends mainly on the nature and observability of the inputs, and not on the type of valuation technique applied. Thus a fair value measurement provided by third parties may only be categorised within Level 1 of the fair value hierarchy if the valuation relies solely on Level 1 inputs (that is, unadjusted quoted prices).

Consequently, in order to classify an external valuation at Level 1, an entity would have to have a clear grasp of the inputs used by the external provider and be able to ensure that they were all at Level 1.

The Committee concluded that IFRS 13 was sufficiently clear and that neither an Interpretation nor an amendment was necessary. Stakeholders have three months to comment on this tentative decision.

EUROPEAN highlights

EFRAG calls on the IASB to introduce a public fatal flaw review

On 30 September EFRAG published a letter addressed to the IASB, reiterating its desire to enhance quality control procedures prior to finalisation of a standard.

EFRAG called for the inclusion of a public fatal flaw review as a formal step in the IASB due process including discussion of the fatal flaw results in a public meeting of the IASB based on a public summary report of these results before the final text of the standard is approved by the IASB.

The letter to the IASB can be consulted on the EFRAG site at: http://www.efrag.org/Front/n1-1386/EFRAG-calls-again-for-public-fatal-flaw-reviews.aspx

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A closer look

Publication of an amendment to IFRS 10 and IAS 28

On 11 September 2014 the IASB published an amendment to IFRS 10 and IAS 28, aimed at clarifying the accounting treatment of the sale or contribution of assets (in the broad sense) between a group (i.e. a parent company and its subsidiaries) and entities accounted for on an equity basis.

When an entity contributes a subsidiary, or assets, to an equity-accounted entity (i.e. a jointly controlled entity classified as a joint venture under IFRS 12 or an associate), the revised standard clarifies the level of profit or loss amount that must be accounted for in the consolidated accounts.

In other words, the amendment indicates in which cases the full result must be recorded, and when a partial gain or loss is recognised.

Readers will remember that there is inconsistency (recognised by the IASB, see *IASB Update* of December 2009) between:

- the interpretation SIC 13, now incorporated into IAS 28, which stated that, in the consolidated accounts of a group, the result due to the contribution of a non-monetary asset to an associate or a joint venture should only be recognised to the extent of the proportion now held by interests outside the group (i.e. partial gain), and
- IAS 27R / IFRS 10, which held that the loss of control of a subsidiary constituted a major event and it was therefore necessary to remeasure any retained portion at fair value through profit or loss (i.e. total gain).

  For more details on this issue, see our study published in the July-August 2012 edition of Beyond the GAAP.

In the absence of clarifications in the texts, both options (partial gain or loss vs. full gain or loss) were possible in practice, provided, naturally, that the option was applied consistently over time.

Apart from the inconsistencies between the texts, the former situation privileged form (the existence of a subsidiary) over the substance of the operation, which entailed the risk of structuring transactions.

In the case of group which had opted to follow the option in IAS 27R (full gain or loss), the contribution of an individual asset (i.e. not constituting a business) could:

- Either give rise to a partial gain or loss in the case of the contribution of the individual asset as such,
- Or give rise to a full gain or loss, by initially contributing the individual asset to a legal structure set up for the purpose - a "shell" company - before selling or contributing shares in this newco to the equity-accounted entity.

Ultimately, the amendment proposes to differentiate the accounting treatment to reflect the nature of the assets:

- Contributions that constitute a business under IFRS 3 shall be treated in accordance with IAS 27R / IFRS 10 (therefore, a full gain or loss should be recognised).

  The board believes that the logic introduced by IFRS 3R / IAS 27R, leading to the recognition of a full gain or loss on loss of control, is only applicable to the transfer of a business (and not to the simple transfer of individual assets).
- Contributions that do not constitute a business under IFRS 3 will be treated in accordance with the principles of the interpretation SIC 13 (i.e. a partial gain or loss is recognised).

  In this instance, the Board considers that the exemption introduced by IAS 27R (and taken over unchanged in IFRS 10), consisting of the recognition of a full gain or loss on disposal, cannot be applied (insofar as there is no transfer of a business).

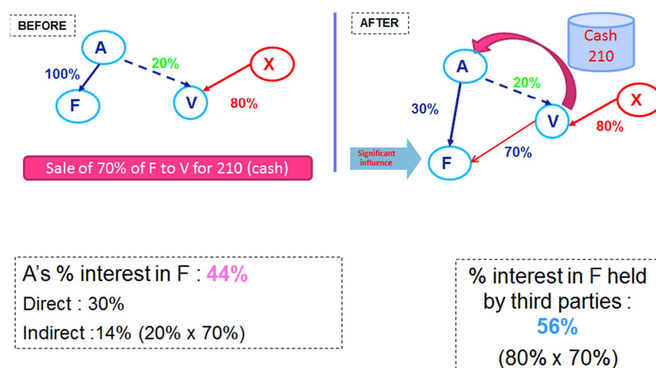
  It will also be remembered that the elimination of internal gains and losses is inherent in the equity method, and that this accounting treatment therefore corresponds to normal accounting treatment .

In order to restrict structuring opportunities, the amendment refers to the indicators in IFRS 10 for determining the cases in which different transactions must be considered as a whole.

Illustration

A sells 70% of its subsidiary F (in which is has a 100% interest) to the entity V, in which it has a 20% interest and significant influence, for the sum of 210.

The carrying amount of A's interest in F is 100 (before disposal). The fair value of the 30% interest retained in F is 90. A is able to exercise significant influence over F through its 30% interest.



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Since the entity F does not constitute a business in accordance with IFRS 3, A must recognise a partial gain on account of this operation.
The gain associated with the loss of control of F by A comprises two parts:

- the gain resulting from the sale of the 70% interest,

  The gain from the sale, equal to 140 (210 received less 70% x 100 of the net consolidated value of F), is recognised at 80% (i.e. the percentage of V held by third parties), resulting in a gain of 112 (or 140 x 80%).

  The remainder (28, i.e. 140 x 20%) is eliminated against the carrying amount of the investment in V accounted for using the equity method.

- and the gain resulting from the fair value remeasurement of the 30% retained in F.

  Only 56% of the gain resulting from the remeasurement at fair value of the 30% retained in F, equal to 60 (i.e. fair value of 90, less 30% of the net carrying amount, or 100 x 30%), is recognised in profit or loss.

  This is because in total A has a 44% interest in F, 30% directly and 14% indirectly (or 20% of V x 70% held by V in F). The remeasurement of the interest in F therefore results in a gain of 34 (or 60 x 56%). The unrecognised portion of the gain on remeasurement is also eliminated against the carrying amount of the equity-accounted investment in F.

Note that the principle of eliminating part of the remeasurement gain is due to the fact that A has significant influence over F. If A's interest in F were accounted for in accordance with IAS 39, the gain would be recognised in full.

	BEFORE	Sale of 70%	Remeasur. 30%	AFTER
Investment in V	X	- 28 (**)		X - 28
« Investment in F »	100	- 70	+ 60 - 26 (*) } + 34	64
Cash		+210		210
	100 + X	112	34	246 + X

P&L – Sale of 70% titres F	140 x 80% = 112
P&L – Remeasur. Invest. F	60 x 56% = 34
	+146

(*) 60 x 44% = 26

(**) 140 x 20% = 28

The amendment is applicable prospectively to financial years current at 1 January 2016. Early application is possible.

Naturally, for European companies, the application of this amendment assumes that it will first be endorsed by the European Union.

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Events and FAQ

Frequently asked questions

IFRSs

- Analysis of contracts to determine whether the seller acts as principal or agent under IAS 18 and IFRS 15.
- Amortisation of development costs: impact of amendments to IAS 16 and IAS 38 on acceptable methods of depreciation or amortisation.
- Measurement and recognition of post-employment benefits with a promised return: can the draft recommendation IFRIC D9 be applied?
- Identification of the scope of entities and interests concerned by the disclosures on structured entities required by IFRS 12.
- Treatment of deferred taxes arising from financial leases.

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

IASB	Committee	EFRAG
16 to 24 October 2014	11 and 12 November 2014	8 to 10 October 2014
13 to 21 November 2014	27 and 28 January 2015	5 to 7 November 2014
14 to 18 December 2014	24 and 25 March 2015	1 to 4 December 2014

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