Beyond the GAAP

Mazars' newsletter on accounting standards

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Editors-in-Chief:

Michel Barbet-Massin, Edouard Fossat, Isabelle Grauer-Gaynor

Columnists:

Richard Chong Toua, Colette Fiard, Carole Masson, Egle Mockaityte, Camille Pellet, Arnaud Verchère, Mathieu Vincent

Contact us:

Mazars
Exaltis, 61, rue Henri Régnault
92 075 – La Défense – France
Tel.: +33 (0)1 49 97 60 00

Editorial

Following on from last issue's feature, which provided a general overview of standards applicable at 31 December 2018, Beyond the GAAP details, in special studies, two issues that may impact your financial statements either immediately with the first study on how to account for hyperinflation in Argentina, or more prospectively with the IASB's latest proposals on the costs to be taken into account to determine whether a contract is onerous.

Also, having reported that its standard on fair value, IFRS 13, is working well, the IASB is continuing its discussions on the improvements it could bring to its standard on insurance contracts.

Enjoy your reading!

Edouard Fossat Isabelle Grauer-Gaynor

Study | Survey | Expert opinion | Overview | **Newsletter**

IFRS Highlights

Report on the IFRS 13 post-implementation review

Readers will recall that all new standards undergo a Post-Implementation Review (PIR) to ensure that:

- the new standard has the expected impacts,
- the information required is useful to users of financial statements, and
- implementation has incurred no unexpected costs.

On 14 December 2018, the IASB published a feedback statement of its Post-implementation review of IFRS 13 – *Fair value measurement*, published in 2011 and effective since 2013.

The findings are positive for each of these aspects, and the report concludes that it is unnecessary to carry out any further work on this standard.

Nevertheless, the Board notes that IFRS 13 has some implementation challenges, largely in areas requiring judgement. For the most part, enterprises are resolving these challenges, but the Board concludes that it will continue to monitor these areas.

The IASB also plans to follow up on the comments submitted on the disclosures required by IFRS 13 in the course of its *Targeted Standards-level Review of Disclosures*. This project is part of the *Better Communication in Financial Reporting* initiative.

For more details, follow the link below:
https://www.ifrs.org/news-and-events/2018/12/iasb-completes-review-of-the-standard-on-fair-value-measurement/

Update on IFRS 17

During its December meeting, the IASB decided not to introduce amendments to IFRS 17 for 11 of the 12 topics reviewed (the full list can be consulted at: https://www.ifrs.org/news-and-events/updates/iasb-updates/december-2018/).

As a result, some of the issues raised by the insurance sector will continue to pose implementation difficulties. For example, insurers are still not allowed to present premiums invoiced but unpaid separately in the statement of financial position as receivables.

However, the IASB did decide to re-open IFRS 17 in relation to the level of aggregation of insurance contract assets and liabilities for presentation in the statement of financial position. Currently, IFRS 17 requires preparers to determine the presentation of insurance contract assets and liabilities in the statement of financial position using groups of insurance contracts (IFRS 17.78). This is a fairly detailed level of analysis, since each portfolio of contracts (such as credit insurance contracts, motor vehicle liability insurance, etc.[†]) may contain up to three separate groups depending on their expected profitability: onerous contracts, profitable contracts and potentially onerous contracts. The amendment approved by the IASB in December would consist of a net presentation as assets or liabilities in the statement of financial position at a more aggregate level, i.e. using portfolios rather than groups of insurance contracts. This will probably affect the amount of total assets/ total liabilities on the insurer's balance sheet, in particular in situations where some groups in a portfolio constitute assets and others liabilities.

The staff papers on the various topics addressed by the IASB in December can be consulted at: https://www.ifrs.org/-/media/feature/meetings/2018/october/iasb/ap02d-ifrs17.pdf.

The remaining topics identified by the staff in October 2018, and which the IASB has not yet resolved, will continue to be debated at future meetings. After the Board has considered all the topics individually, it plans to consider the package of amendments as a whole before concluding whether the benefits of making the amendments to IFRS 17 outweigh the costs.

Following the December decisions, the IASB has added a new project to its work plan, and has announced the publication of an exposure draft on IFRS 17 during Q2 2019.

[†] A portfolio comprises contracts subject to similar risks and managed together. Insurers will have to exercise judgment in order to group their contracts into portfolios.

European highlights

EBA publishes a study on IFRS 9 impacts

On 20 December, the European Bank Authority (EBA) published a study reporting its first observations on the impact and implementation of IFRS 9 by EU banking institutions

This study builds on the studies conducted by EBA (in November 2016 and July 2017) ahead of the application of IFRS 9 and aims to report the first findings on the recent implementation of the standard (which became effective on 1 January 2018). A more detailed analysis is in progress.

The analysis is principally based on regulatory reports using COREP/FINREP templates notified to EBA for the second quarter of 2018 by a sample of 54 banks in 20 European countries (the same sample as that used in the previous studies).

The document presents the main, essentially quantitative observations of the study and sets out the next steps for EBA.

Main findings

EBA begins by highlighting the fact that this period represents the first application of IFRS 9 and that the impacts will have to be monitored over time on the basis of the indicators it has established (these indicators are presented in Annex III). Accordingly, it stresses that the study makes no recommendations at this stage.

The main finding is a negative CET1 impact of 47 bps on simple average, compared with 42 bps for the same sample of banks in the July impact study.

EBA also lists the main areas in which it intends to focus its work in the months and years to come:

- a better understanding of the causes of the impacts on CET1;
- analysis of the qualitative and quantitative criteria used for allocation to the three "buckets" for impairment purposes;
- monitoring prudential transitional arrangements.

EBA's next steps

EBA proposes to analyse some qualitative aspects as well as quantitative dimensions in future studies.

Following the identification of some limitations in the information available in FINREP/COREP templates, EBA will also consider whether any limited amendments could be necessary to the indicators that will be monitored over time.

As a medium/long term action, EBA will pay particular attention to banks using the standard method of calculating the ratio, and will also consider the possibility of conducting a benchmarking exercise for IFRS 9 modelling aspects.

Finally, EBA notes its intention to closely monitor the interaction of accounting/prudential provisions, in particular in terms of the volatility of own funds.

EBA's report can be consulted at:
https://eba.europa.eu/documents/10180/2087449/Report+on+IFRS+9+impact+and+implementation.pdf

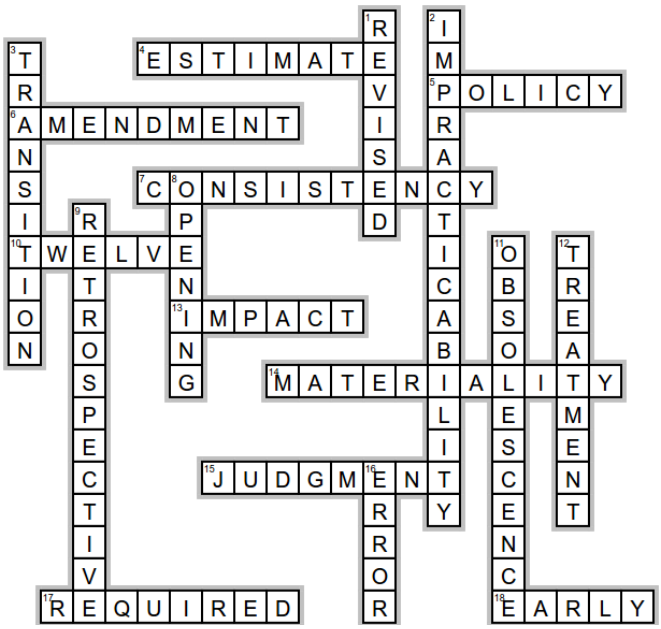
A new Mazars face on the EFRAG TEG

The new composition of the European Financial Reporting Advisory Group's Technical Expert Group has been approved by EFRAG's Board, and will be effective from 1 April 2019.

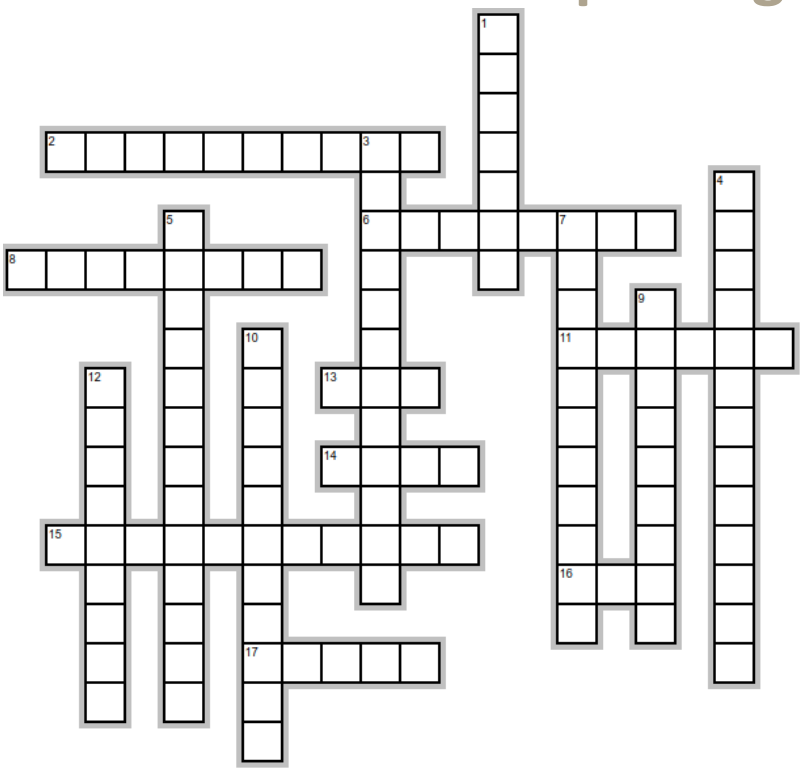
The TEG issues technical recommendations on IFRSs as part of the European adoption process, and gives technical positions during the preparation of the standards.

As well as renewed mandates for Geert Ewalts (Netherlands), Günther Gebhardt (Germany), Heinz Hense (Germany), Andrew Spooner (United Kingdom), and Ambrogio Virgilio (Italy), the new TEG will see the appointment of Mazars France partner Isabelle Grauer-Gaynor following the retirement of Silvia Dinova.

Crossword: last month's solution



Crossword: Events after the reporting period



Across:

2. An event which, when it occurs after the reporting period, usually leads to adjustments, as it confirms that the customer was credit-impaired at the end of the reporting period
6. Events of such magnitude after the reporting period that do not lead to adjustments require an entity to provide disclosures as to their nature, and an estimate of its financial effect, or a statement that such an estimate cannot be made
8. When this becomes available after the reporting date concerning a contingent liability that existed at the reporting date, an entity must consider recognising or modifying a provision under IAS 37, and must also update its disclosures about the contingent liability
11. Their discovery between the end of the reporting period and the date when the financial statements are authorised for issue shows that the financial statements are incorrect, and that the amounts recognised must be adjusted
13. Changes to laws in this area, enacted or announced after the reporting period and classified as non-adjusting events, may nevertheless have a significant effect on certain assets and liabilities that must be disclosed
14. Assets cannot be classified in accordance with this IFRS if the decision to sell comes after the reporting date
15. They must be recognised when subsequent events provide evidence of conditions that existed at the end of the reporting period
16. Number of types of post-balance sheet events
17. The date when it is authorised concludes the period during which post-reporting date events are reported

Down:

1. If subsequent events suggest that the going concern assumption is no longer appropriate, the basis of accounting must be this
3. An IFRS standard is dedicated to these, which are an example of non-adjusting events that require significant disclosures in the notes
4. This type of change in operating results and financial position after the reporting period may indicate a need to consider whether the going concern assumption is still appropriate
5. If significant, such a situation announced after the reporting date should generally be accompanied by disclosures in the notes
7. A decline in their fair value between the end of the reporting period and the date when the financial statements are authorised for issue does not lead to adjustments
9. It must be adjusted if a court case confirms that the entity had a present obligation at the end of the reporting period
10. Their sale after the reporting period may give evidence about their net realisable value at the reporting date
12. If an entity declares them after the reporting period, it shall not recognise them as a liability at the end of the reporting period

A Closer Look

Hyperinflation in Argentina: IAS 29 is back on the menu

The 2018 reporting date sees the application of IAS 29 for preparers with significant exposure in Argentina, after the country was classified as a hyperinflationary economy for IFRS purposes as of 1 July 2018.
The present study describes and illustrates the main principles of this complex and little-used standard.

The application of IAS 29 requires the restatement of financial statements by entities whose functional currency is the currency of a hyperinflationary economy. These arrangements take effect from the start of the reporting period during which the existence of hyperinflation has been identified[‡].

In the case of Argentina, IAS 29 applies from 1 January 2018 for entities whose functional currency is the Argentinian peso and which report at 31 December.

How to restate financial statements in the entity's functional currency under IAS 29

These restatements are intended to reflect the impacts of inflation by applying a general price index (GPI) to the items not already expressed in terms of the measuring unit current at the end of the reporting period (effectively excluding monetary items which do not need to be revalued[§]). The standard does not oblige preparers to select any specific GPI, except to the extent that all entities that report in the currency of the same economy should use the same index.

In the case of Argentina, a composite index has been elected by an international consensus, consisting of the wholesale price index at 31 December 2016[**] and the consumer price index at 1 January 2017.

Hence, non-monetary assets and liabilities (for example, inventories, tangible and intangible assets) must be restated in two stages:

- at the opening date, by applying the GPI between the recognition date and the opening balance sheet at 1 January 2018 (including equity but excluding reserves, which are derived by calculating the difference);
- at the closing date, by applying the GPI between the opening or recognition date (if later) and the year-end closing at 31 December 2018 (including all components of equity, except for income).

Items recorded in profit or loss for the period[††] must also be restated by applying the change in the GPI between the recognition date and the end of reporting period. Depreciation and changes in inventories must be calculated taking account of the effects of the IAS 29 restatements of assets and inventories carried out in the previous steps.

The gain or loss on the net monetary position resulting from these restatements is accounted for in profit or loss and must be presented separately.

Impacts on consolidated IFRS accounts

The financial statements restated under IAS 29 must be converted into the group presentation currency, if it is different from the entity's functional currency, by applying the closing rate to all items of the statement of financial position and the income statement.

In September 2018, an IFRS IC decision clarified the method of determining a closing rate when a currency is subject to a long-term lack of exchangeability.

Following IAS 21, the consolidated figures for comparative periods presented in a stable currency (for example, the euro) are not restated (i.e. 2017 and, where applicable, 2016).

The gain or loss on the net monetary position (as calculated for the entity) is retained in the consolidated accounts.

Finally, there is a choice of accounting policy for revaluation of non-monetary items' impact in the opening group's equity, which may be presented in the reserves or in other comprehensive income (foreign exchange differences in OCI). This choice must be applied consistently over time and in the same way for all the entities whose functional currency is that of a hyperinflationary economy, and must be disclosed in the notes.

[‡]IAS 29 provides examples of the characteristics of the economic environment. For practical purposes, it is usual to refer to the work of the International Practices Task Force, most recently published in November 2018.

[§]Monetary items are money held and items to be received or paid in money.

[**]With exception of November and December 2015, to which the customer price index is applied (wholesale price index unavailable).

[††]i.e. income statement and statement of comprehensive income.

Other repercussions

As well as these consequences, the first application of IAS 29 at the 2018 reporting date may have further impacts, as follows:

- a remeasurement of deferred taxes, in application of IAS 12 and IFRIC 7, as a result of the accounting revaluation of non-monetary assets, where it contributes to widening the gap with their fiscal value (in accordance with the local legislation applicable);
- a review of impairment tests for revalued non-current assets, even where there is no indication that these assets may be impaired.

In practice, the application of IAS 29 thus calls for the exercise of significant judgment (many estimates, reliability of available information, etc.). However, the Standard observes that the consistent application of these procedures and judgements from period to period is more important than the precise accuracy of the resulting amounts included in the restated financial statements.

In their recommendations for 2018 financial reporting, the regulators have not failed to alert issuers with significant interests in Argentina to the need to report on the accounting and financial impacts of the classification of this country as a hyperinflationary economy.

Illustration

The financial statements used in this example have been simplified for educational purposes.

A subsidiary issues its financial statements at 31 December 2018 in the Argentinian peso (its functional currency). It applies the provisions of IAS 29 for the first time as of 1 January 2018. It only has one non-monetary asset (a plot of land).

Movements in the GPI are as follows:

	GPI
At the date of share capital contribution	1.00
At the date of land acquisition	1.15
At closing date 31/12/2017	1.30
Average 2017	1.25
At closing date 31/12/2018	3.20
Average 2018	2.80

Step 1: The subsidiary establishes its financial statements in the Argentinian peso before restating under IAS 29.

	Step 1		
	31 Dec. 2017 (published)	1 Jan. 2018 (before rest.)	31 Dec. 2018 (before rest.)
Land	65 000	65 000	65 000
Cash	35 000	35 000	54 000
Total Assets	**100 000**	**100 000**	**119 000**
Share capital	50 000	50 000	50 000
Reserves	-	50 000	50 000
Net income	50 000	-	19 000
Total Equity	**100 000**	**100 000**	**119 000**
Provisions and non-financial debts	-	-	-
Financial debts	-	-	-
Total Equity and Liabilities	**100 000**	**100 000**	**119 000**

	31 Dec. 2017 (published)	1 Jan. 2018 (before rest.)	31 Dec. 2018 (before rest.)
Revenue	82 000	-	42 000
Operating expenses	(32 000)	-	(23 000)
Net income	**50 000**	**-**	**19 000**

Step 2:

The subsidiary restates the non-monetary items in the opening balance sheet (land and share capital) to reflect the GPI changes between their contribution date and 1 January 2018. The reserves are derived by calculating the difference in order to balance the statement of financial position.

	Step 2.1	
	1 Jan. 2018 (after rest.)	
Land	73 478	*= 65 000 * (1.30 / 1.15)*
Cash	35 000	
Total Assets	**108 478**	
Share capital	65 000	*= 50 000 * (1.30 / 1.15)*
Reserves	43 478	
Net income	-	
Total Equity	**108 478**	
Provisions and non-financial debts	-	
Financial debts	-	
Total Equity and Liabilities	**108 478**	

At the reporting date, the subsidiary restates the non-monetary items remeasured in the previous step (land, share capital and reserves) to reflect the GPI changes between 1 January and 31 December 2018. The net income for the period is not restated at this stage.

	Step 2.2	
	31 Dec. 2018 (after rest. on closing B/S)	
Land	180 870	*= 73 478 * (3.20 / 1.30)*
Cash	54 000	
Total Assets	**234 870**	
Share capital	160 000	*= 65 000 * (3.20 / 1.30)*
Reserves	107 023	*= 43 478 * (3.20 / 1.30)*
Net income	19 000	
Total Equity	**286 023**	
Provisions and non-financial debts	-	
Financial debts	-	
Total Equity and Liabilities	**286 023**	

The subsidiary then restates the items recorded in profit or loss for the period by applying the change between the average index for 2018 and 31 December 2018. An average index for the year can only be used where the activity is not seasonal, and where the change to the index is regular over the period concerned.

	31 Dec. 2018 (after rest. on P&L)	
Revenue	48 000	*= 42 000 * (3.20 / 2.80)*
Operating expenses	(26 286)	*= (23 000) * (3.20 / 2.80)*
Net income	**21 714**	

Finally, the subsidiary recognises the loss on the net monetary position in order to balance the statement of financial position following all the previous steps, and presents it separately in profit or loss.

	Step 2.4 31 Dec. 2018 (after gain/loss on net position accounting)	
Land	180 870	
Cash	54 000	
Total Assets	**234 870**	
Share capital	160 000	
Reserves	107 023	
Net income	(32 154)	*= 234 870 - 160 000 - 107 023*
Total Equity	**234 870**	
Provisions and non-financial debts	-	
Financial debts	-	
Total Equity and Liabilities	**234 870**	

	31 Dec. 2018 (after gain/loss on net position accounting)	
Revenue	48 000	
Operating expenses	(26 286)	
Gain / loss on net monetary position	(53 868)	*= (32 154) - 48 000 - (26 286)*
Net income	**(32 154)**	

For the requirements of group consolidated accounts in euro, the assets, liabilities, equity, income and expense items deriving from the subsidiary's consolidation package are then converted at the closing exchange rate of the reporting period concerned (i.e. 31 December 2017 and 31 December 2018).
The loss on the net monetary position is maintained in profit or loss in the consolidated accounts.

Proposed amendments to IAS 37 on onerous contracts

In December, the IASB published an exposure draft intended to clarify the concept of "cost of fulfilling a contract", used in defining an onerous contract under IAS 37.

An onerous contract is a contract in which the unavoidable costs of meeting the contractual obligations under the contract exceed the economic benefits expected to be received under it. The standard states that the unavoidable costs of a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it.

Comments on this exposure draft are open until 15 April 2019. The exposure draft can be consulted at:
http://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FSiteAssets%2FEFRAG%2520Endorsement%2520Status%2520report%25202%2520November%25202018.pdf

1. Origins of the project

Following a referral to the IFRS Interpretations Committee some months ago, divergent practices have been found in the determination of which costs to include when identifying an onerous contract.

Since the replacement of IAS 11 and IAS 18 by IFRS 15 at 1 January 2018, and because IFRS 15 refers back to IAS 37 in order to determine whether a contract is onerous, this is an issue which now affects a growing number of contracts. Previously, IAS 11 had stated "directly" – without reference to IAS 37 - that an expected loss on a contract should be accounted for immediately, and that this loss was identified inter alia in terms of the total contract costs, meaning costs that relate directly to the specific contract, costs that are attributable to contract activity in general and can be allocated to the contract, and such other costs as are specifically chargeable to the customer under the terms of the contract.

Against this background, the IFRS IC was asked to clarify whether the costs to fulfill a contract should include:

- only the incremental costs (i.e. the costs that would not have been incurred if the contract had not been obtained), thus excluding the proportional depreciation of assets used in order to fulfil the contract;
- or all the costs to fulfil the contract, as previously required by IAS 11 on construction contracts.

2. What clarifications will be made?

The amendments proposed by the IASB, following the work of the Interpretations Committee, state that the cost of fulfilling a contract comprises the costs that relate directly to the contract. This would apply to all the contracts within the scope of IAS 37 (not only contracts with a customer under IFRS 15).

IAS 37 would also be supplemented with examples of costs that relate directly to a contract to provide goods or services:

- direct labour (for example, salaries and wages of employees who manufacture and deliver the goods or provide the services directly to the counterparty);
- direct materials (for example, supplies used in fulfilling the contract);
- allocations of costs that relate directly to contract activities (for example, costs of contract management and supervision; insurance; and depreciation of tools, equipment and right-of-use assets used in fulfilling the contract);
- costs explicitly chargeable to the counterparty under the contract; and
- other costs incurred only because an entity entered into the contract (for example, payments to subcontractors).

The amendments would also stipulate that general and administrative costs do not relate directly to a contract unless they are explicitly chargeable to the counterparty under the contract.

This would bring the costs to fulfill under IAS 37 into line with the similar concept developed in IFRS 15.

It is also consistent with the concepts in IAS 2 on the cost of inventories and IAS 16 / IAS 38 / IAS 40 on the cost of long-term assets.

This exposure draft only addresses one of the many questions posed by the identification of onerous contracts in practice. In particular, the Board has decided not to consider, for now, the tricky issue of the economic benefits expected under a contract, where divergent practices also exist.

3. Arrangements for first application

The proposed amendments would be applicable prospectively to contracts existing at the beginning of the annual reporting period in which they are first applied. Comparative periods would not be restated.

The impacts of the change of accounting policy would be recognised in the opening equity at the date of initial application.

The IASB has not yet set an effective date for these amendments. Early application should be possible.

Events and FAQ

Frequently asked questions

IFRS

- Reclassification of French Contribution on Companies' Added Value (CVAE) and deferred tax impacts
- IFRS 15: How should sales representatives' bonuses be treated?
- Obligation to pay dividends when share subscription warrants are exercised
- Argentinian subsidiaries: how to apply IAS 29?
- Customer's right to access the supplier's software hosted in a cloud
- Reverse factoring contract

Upcoming meetings of the IASB, IFRS Interpretations Committee and EFRAG

IFRS		EFRAG	
IASB	**Committee**	**Board**	**TEG**
6-8 February	5-6 March	29 January	13-14 February
11-15 March	30 April	27 February	20-21 March
8-12 April	11-12 June	4 April	16-17 April