Beyond the GAAP

Mazars' newsletter on accounting standards

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Editors-in-Chief:

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

Columnists:

Vincent Gilles, Isabelle Grauer-Gaynor, Eglé Mockaityte, Zornitsa Rushkova, Benjamin Scholl, Arnaud Verchère

Contact us:

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

Editorial

Following the summer break, IAS 12 – *Income Taxes* and IFRS 17 – *Insurance Contracts* are in the spotlight, with consultations on both from the IASB as well as a detailed Public Statement from ESMA, the European enforcer, on the former.

If the IASB's schedule is to be trusted, the final quarter will see the publication of a further three consultations, dealing with major issues: the presentation of financial statements, the accounting treatment of goodwill and impairment testing, and the proposed new macro hedge accounting approach. Remember to set aside time to consider the consultations that will most affect you, unless they are published as Christmas "presents", which means such time will have to be set aside in the (very busy) new year!

Enjoy your reading!

Edouard Fossat Isabelle Grauer-Gaynor

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

IFRS highlights

ED published on *Deferred Tax related to Assets and Liabilities arising from a Single Transaction* (proposed amendments to IAS 12)

In July 2019, the IASB published its exposure draft (ED/2019/5) of proposed amendments to IAS 12 – *Income Taxes*, which would clarify the accounting treatment of deferred tax related to assets and liabilities arising from a single transaction (as in the case of leases under IFRS 16 or decommissioning obligations).

The proposed amendments would primarily serve to limit the scope of the recognition exemption set out in paragraphs 15 and 24 of IAS 12, such that it would not apply to transactions for which an entity recognises both an asset and a liability. Readers will remember that, when this exemption applies to a temporary difference, an entity may not recognise a resulting deferred tax asset or liability, either on initial recognition or subsequently (cf. IAS 12.22.c). Thus, under the proposed amendments, an entity would be required to recognise deferred tax relating to temporary differences that arise on recognition of leases or decommissioning obligations: as a result, the tax expense would reflect tax deductions for these transactions as the asset is used and the liability is settled (whereas if no deferred tax were recognised, the tax expense would not reflect tax deductions until they were taken into account when calculating the tax payable).

The comment period is open until 14 November 2019. The exposure draft, together with explanatory supporting material *(In brief: Deferred Tax related to Assets and Liabilities arising from a Single Transaction),* are available on the IASB's website via the following links:
https://www.ifrs.org/projects/work-plan/deferred-tax-tax-base-of-assets-and-liabilities/comment-letters-projects/ed-deferred-tax-related-to-assets-and-liabilities-arising-from-a-single-transaction/
https://www.ifrs.org/projects/work-plan/deferred-tax-tax-base-of-assets-and-liabilities/#supporting-material

ED published on *Disclosure of Accounting Policies*

On 1 August 2019, the IASB published an exposure draft of proposed amendments to IAS 1 – *Presentation of Financial Statements* and Practice Statement 2 – *Making Materiality Judgements.* The amendments relate to the disclosures required on entities' accounting policies.

The ED proposes to amend IAS 1 to require entities to disclose only their 'material' accounting policies, as opposed to their 'significant' accounting policies, in line with the new definition of materiality, which focuses on whether information could reasonably be expected to influence decisions made by users of the entity's financial statements.

Explanatory paragraphs will also be added to IAS 1 and Practice Statement 2 to help entities determine whether accounting policies are material. Practice Statement 2 will also include worked examples.

The comment period is open until 29 November 2019. The exposure draft is available on the IASB's website via the following link:
https://www.ifrs.org/-/media/project/disclosure-initative/disclosure-initiative-accounting-policies/ed-di-accounting-policies-ias-1-ifrs-practice-statement-2.pdf?la=en

European highlights

Electronic reporting: ESMA updates ESEF manual

On 12 July 2019, the European Securities and Markets Authority (ESMA) published an update of its ESEF Reporting Manual. The manual is aimed at all market participants (issuers, software publishers, etc.) and is intended to assist with implementation of ESEF reporting.

In addition to updating the guidance included in the first edition, published in December 2017, the new edition has also been expanded to include additional guidance.

The manual will be updated regularly to take account of implementation problems frequently encountered by market participants and reported to national enforcers.

The updated manual is available on ESMA's website via the following link:
https://www.esma.europa.eu/press-news/esma-news/esma-updates-esef-reporting-manual

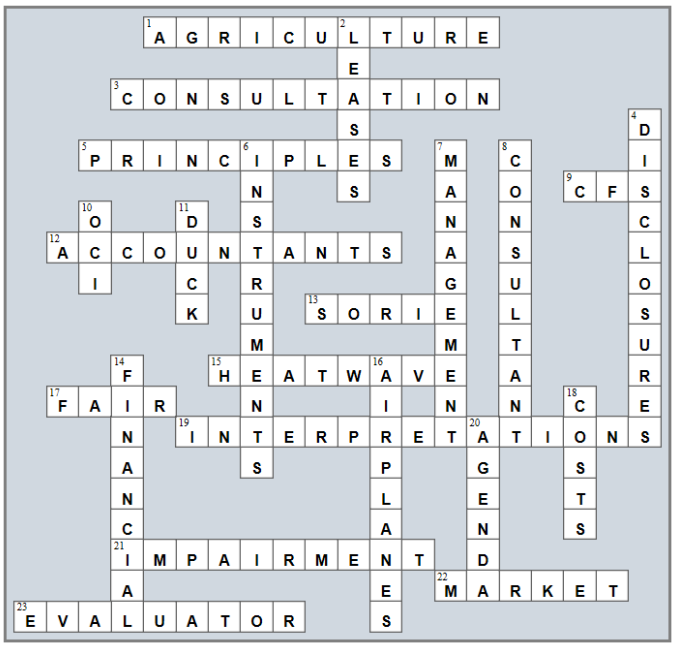
ESMA publishes 23rd extract from enforcement decisions database

On 16 July 2019, the European Securities and Markets Authority (ESMA) published the 23rd extract from its database of enforcement decisions. The extract comprises eight decisions made by European enforcers in their monitoring of issuers' financial statements. The decisions relate to the following topics:

1. Presentation of cash flows arising from changes in ownership interests in a subsidiary (IAS 7)
2. Presentation of cash flows arising from financing activities (IAS 7)
3. Definition of cash and cash equivalents (IAS 7)
4. Disclosure of fair value measurement of investments by an investment entity (IFRS 10, IFRS 12, IFRS 13, IAS 1)
5. Impact of forbearance on assessment of significant increase in credit risk (IFRS 9)
6. Accounting treatment of leased-out property acquired with a view to redevelopment (IAS 40)
7. Vesting and non-vesting features of performance conditions in share-based payment plans (IFRS 2)
8. Indications of impairment of assets (IAS 36, IAS 34)

The 23rd extract from the database and a list of all the decisions published by ESMA are available on its website via the following link:
https://www.esma.europa.eu/press-news/esma-news/esma-publishes-23rd-extract-eecs-database

Crossword: last month's solution



ESMA sets out expectations regarding deferred tax assets resulting from carry-forward of tax losses

On 15 July 2019, ESMA published a Public Statement setting out its expectations regarding the application of the requirements of IAS 12 on the recognition, measurement and disclosure of deferred tax assets (DTAs) resulting from the carry-forward of unused tax losses.

The Public Statement follows discussions between enforcers in the European Enforcers Coordination Sessions (EECS), which identified significant divergences in how these requirements are applied in practice. In recent years, enforcers have frequently identified situations[†] in which:

- material DTAs resulting from the carry-forward of tax losses have been recognised, despite a lack of evidence that they will be recoverable in future;
- insufficient disclosures on these DTAs have been provided in the notes.

The Public Statement, which includes illustrative examples, addresses two aspects in particular:

- how to assess the probability that future taxable profits will be available;
- where the issuer has a history of recent tax losses, how to assess whether "convincing other evidence" (IAS 12.35) shows that taxable profits will be available in the future.

It also includes recommendations for disclosures on DTAs that should be provided in the notes.

ESMA specifies that these considerations should be assessed in the light of the facts and circumstances specific to each issuer. It also notes that similar considerations may apply to other deductible temporary differences.

Following a brief reminder of the relevant requirements of IAS 12, we present the key points of the Public Statement, together with the examples provided by ESMA.

1. Reminder: what does IAS 12 say?

The recognition criteria for DTAs are the same, regardless of what kind of deductible temporary difference gave rise to them (IAS 12.24, 28-30):

What is the probability that the deductible temporary difference will be recoverable?

✓ Probable ⇨ DTA (to the extent that it is probable that taxable profit will be available)

✗ Not probable ⇨ no DTA

Assessed on the basis of:

1. **taxable temporary differences**
2. **future taxable profits**
3. **tax planning opportunities**

However, when assessing the probability that future taxable profits will be available, the existence of tax losses is deemed to be strong negative evidence (IAS 12.34-36).

Thus, if an entity has a history of recent losses and insufficient taxable temporary differences against which the unused tax losses or unused tax credits can be utilised, the entity only recognises a DTA to the extent that there is "convincing other evidence" that sufficient taxable profit will be available (e.g. were these losses the result of identifiable causes that are unlikely to recur?)

2. Assessing the probability that future taxable profits will be available

ESMA's key messages can be summarised as follows:

- Take account of all available information, both negative and positive

  Is there sufficient positive evidence to outweigh existing negative evidence?

- Entities shall carry out an in-depth analysis of results, considering both the cause of the losses and the sustainability of taxable profits over time

  Losses arising from operations (i.e. an entity's recurrent activities) require stronger offsetting positive evidence than

[†]Readers may remember that ESMA carried out a study of 73 issuers in the European Economic Area with material DTAs in their IFRS financial statements for 2014 (cf. *ESMA Report on Enforcement and Regulatory Activities of Accounting Enforcers in 2015,* paras. 36-46). The study showed that 60% of the issuers did not provide sufficient evidence (and only half of them were unable to provide further details to justify their decision when requested).

losses resulting from non-recurring events. Pay attention to one-off events!

- Forecasts:
  They should always be reasonable, realistic and achievable. The longer they extend into the future, the less reliable they are.
- Expiry date of tax losses carried forward:
  If the tax losses have no expiry date, this is not in itself evidence that recovery is probable.
  Short expiration period: a more critical review is required.
- Ability to continue as a going concern:
  This is not in itself sufficient justification for recognising a DTA. Significant uncertainty regarding the entity's ability to continue as a going concern: heightened scepticism required.

To support its points, ESMA provides examples of positive and negative evidence:

Examples of positive evidence (indicative, non-exhaustive list)
- losses due to identifiable one-off or non-recurring events;
- a strong earnings history, except for the loss that created the unused tax loss carried forward (provided that the loss is not expected to recur);
- new business opportunities, e.g. new patents;
- restructuring or disposal[‡] which clearly eliminates the loss sources;
- convincing tax planning strategies;
- firm sales backlog or new contracts (considering also past realisation of sales backlog); and
- business acquisitions[§] generating sustainable profit margins which are sufficient to permit the issuer to utilise the existing tax losses carried forward and which can be utilised for that purpose (e.g. in the same tax jurisdiction).

Examples of negative evidence (indicative, non-exhaustive list)
- a recent history of tax losses arising from recurrent activities;
- the taxable entity is a start-up;
- a history of significant discrepancies between actual results and forecasts;
- losses of major customers and/or significant contracts;
- uncertainty regarding the issuer's going concern;
- a history of restructuring without returning to profitability or emerging from a bankruptcy;
- the taxable entity expects losses in upcoming years;
- the taxable entity has a history of unused tax losses and/or tax credits expiring; and
- the losses relate to the issuer's core activity and thus may reoccur in the future.

3. Assessing whether there is "convincing other evidence" that sufficient taxable profit will be available

ESMA's key messages can be summarised as follows:

- Evidence should be objectively verifiable.
  A history of recent losses is objectively verifiable negative evidence!
  The more negative evidence there is, the less confidence one should have in forecasts of future taxable profits.
- The reliability of profit forecasts also depends on the facts and circumstances of each case (e.g. the issuers' sector and/or experience).
  E.g.: it may be easier for issuers with long-term contracts to produce reliable profit forecasts, compared with start-ups that have a limited history of financial results.
- Issuers should not anticipate future events that they cannot control and that are still highly uncertain.
  E.g. future changes in tax laws or rates (other than those that are already substantively enacted – see IAS 12.46-47), possible business combinations, etc.
- Issuers should aim to ensure consistency with:
  The entity's history and industry trends;
  Projections used in other estimates in the financial statements (e.g. goodwill impairment testing**).
- The time period over which the forecast of taxable profits extends:
  IAS 12 does not specify a time limit!
  Exercise caution if the time period used for forecasts exceeds the entity's normal planning cycle.
- Tax planning opportunities:
  They must be realistic, profitable in tax terms and consistent with the issuer's business strategy. Where relevant, take account of the expected incremental deductible costs of implementing tax planning.

[‡] In our opinion, provided that these events are reasonably certain or under the control of the entity (cf. ESMA's point regarding future events)
[§] In our opinion, provided that these events are reasonably certain or under the control of the entity (cf. ESMA's point regarding future events)

** ESMA recognises that the objective of each analysis is different and thus there may be key differences - notably: discounting (possible under IAS 36 – *Impairment of Assets*, but not under IAS 12); differences between the taxable reporting entity (IAS 12) and the Cash Generating Unit (IAS 36); differences between taxable profit and cash flows.

4. Disclosures in the notes on DTAs resulting from carry-forward of tax losses

In line with its previous points, ESMA reminds issuers of the need to provide disclosures that are:

- specific to the entity's facts and circumstances, and not boilerplate;
- proportionate in light of the materiality of the assets in question and the level of uncertainty/judgement used.

ESMA then provides examples of disclosures to be presented in the notes, applying relevant paragraphs of IAS 12 – *Income Taxes* and IAS 1 – *Presentation of Financial Statements.*

Examples of the type of content that issuers should consider in the context of IAS 12.82 (recognition of DTAs on the basis of probable future taxable profits when the entity has a history of recent tax losses), IAS 1.122 (judgements) and IAS 1.125 & 129 (sources of estimation uncertainty):
- the taxable entity, its location and the applicable tax rules;
- positive and negative evidence considered;
- period(s) over which the DTAs are expected to be used;
- critical judgements used in the recognition of DTAs and related uncertainties (e.g. tax planning opportunities);
- explanation and assessment of the impact on the recovery of DTAs of any significant changes in key assumptions;
- significant unrecognised DTAs; and
- sensitivity analysis of assumptions used, if relevant.

5. In conclusion

ESMA finishes by stating that all stakeholders should take this Public Statement into account when preparing financial statements, and that enforcers will pay close attention to these points when carrying out examinations.

ESMA's Public Statement is available on its website: https://www.esma.europa.eu/press-news/esma-news/esma-sets-out-expectations-regarding-application-ias-12

A Closer Look

Key points of the ED on amendments to IFRS 17

As announced in the 'IFRS highlights' section in our June issue, the IASB published an exposure draft (ED/2019/4 *Amendments to IFRS 17*) on 26 June 2019, proposing amendments to the insurance contracts standard.

In this issue of Beyond the GAAP, we present a concise tabular summary of the key points of this exposure draft. In the table below, the following acronyms are used, defined as follows:

- **CSM** (contractual service margin): a component of the book value of the asset or liability for a group of insurance contracts, representing the unearned profit the entity will recognise as it provides the services specified in these insurance contracts.
- **VFA** (variable fee approach): a specific recognition approach (as a modification to the general model) under IFRS 17 that is used only for insurance contracts with direct participation features.
- **FRA** (full retrospective approach): a transition approach to IFRS 17 which, except where an exemption is specifically permitted, requires fully retrospective application for insurance contracts at the date of transition to IFRS 17 (i.e. pre-existing contracts shall generally be recognised as if IFRS 17 had been applied since inception).
- **MRA** (modified retrospective approach): another transition approach (a more flexible variant of the FRA) that permits a limited number of specified exemptions to fully retrospective application for pre-existing contracts. It may only be used in situations where the FRA is not practicable.
- **FVA** (fair value approach): a third transition approach, which is significantly different from both the FRA and the MRA, in that the CSM is determined almost exclusively based on information and estimates available at the transition date. It may only be used in situations where the FRA is not practicable.

The key points of the exposure draft published in June are presented below:

#	Topic	Concerns about the current requirements of the standard	IASB response and proposed amendments	ED reference
1	**Scope** of IFRS 17: Loans and other forms of credit that transfer significant insurance risk	Some stakeholders (particularly banks) have raised concerns about loan contracts and other forms of credit that must be accounted for under IFRS 17 because they transfer significant insurance risk, but that actually have a relatively small insurance component. Some groups that do not issue insurance contracts in the strict sense have had to apply IFRS 17 just for these contracts.	The IASB has decided to amend IFRS 17 to exclude certain contracts from its scope, if their main objective is the granting of loans or other forms of credit, and to permit entities to elect to apply IFRS 9 instead of IFRS 17 for other types of contract: - loans with an insurance component: entities may elect to apply IFRS 9 instead of IFRS 17 - credit card contracts that provide insurance coverage where the price of the contract does not reflect the individual insurance risk of each customer: excluded from the scope of IFRS 17 and must be accounted for under IFRS 9 instead.	Paras. 7(h), 8A, Appendix D and BC9–BC30
2	**Measurement**: Insurance acquisition cash flows relating to contracts with an automatic renewal clause (where future renewals do not fall within the contract boundary)	In some cases, an entity may pay non-refundable acquisition costs at an amount that takes account of expected future contract renewals, which do not fall within the boundary of the original contract. These cash flows may even exceed the amount of the premium. Allocating the entirety of these cash flows to the original contract, rather than allocating part to the expected renewals, may require entities to treat the original contract as onerous and to recognise a loss on initial recognition.	The IASB has decided to amend the standard to permit entities to allocate a portion of the acquisition costs to future renewals. This portion would continue to be recognised as an asset until recognition of the renewals, and would be subject to a recoverability assessment at each year-end. In addition, specific disclosures would be required in the notes on insurance acquisition cash flows recognised as assets: - a reconciliation from the opening to the closing balance (separately identifying any impairment losses or reversals of impairment losses); - when the entity expects to derecognise these assets, in appropriate time bands.	Paras. 28A–28D, 105A–105C, B35A–B35C and BC31–BC49

#	Topic	Concerns about the current requirements of the standard	IASB response and proposed amendments	ED reference
3	**Measurement**: CSM – coverage units for insurance contracts that include investment services	The standard does not faithfully reflect the fact that some contracts include both insurance coverage and investment services. The current version of the standard requires entities to recognise the investment services portion of the product only during the insurance coverage period; it may not be recognised during periods when insurance coverage is not provided. However, in practice, it is possible that investment services and insurance coverage are provided over different periods.	The IASB has decided to amend the standard to require entities to: - recognise expected profit in line with the provision of both insurance coverage and investment services. It should however be noted that slightly different terms are used for the VFA and the general model (investment-related service/investment-return service). Where the general model is applied, some contracts may not be able to recognise the investment services component in line with amortisation of the CSM, due to limitations on the definition of an investment-return service; - disclose in the notes: ▪ quantitative information on when they expect to recognise the CSM in profit or loss, in appropriate time bands; and ▪ the approach used to determine the relative weighting of each type of service.	Paras. 44–45, 109 and 117(c)(v), Appendix A, B119–B119B and BC50–BC66
4	**Measurement**: CSM – Reinsurance contracts held – limited scope of risk mitigation option under the VFA	Stakeholders feel that the scope of the risk mitigation option is very limited. More specifically, they believe that reinsurance contracts held are also, from an economic point of view, risk mitigation instruments.	The IASB has decided to amend the standard to permit entities to apply the risk mitigation option when they use reinsurance contracts held to mitigate financial risks associated with contracts with direct participation features.	Paras. B116 and BC101–BC109
5	**Measurement**: Reinsurance contracts held – initial recognition when underlying contracts are onerous	Where onerous contracts issued are covered by reinsurance contracts, the positive impact of the reinsurance is not recognised at an amount equal to the loss on the underlying contracts at initial recognition.	The exposure draft proposes amendments to the standard where reinsurance contracts provide "proportionate" coverage (with a new definition of contracts that provide "proportionate" coverage that could limit applicability). Insurers will henceforth be required to immediately recognise income from reinsurance contracts held when they recognise losses on onerous underlying insurance contracts issued (including on initial recognition of the underlying contracts).	Paras. 62, 66A–66B, B119C–B119F and BC67–BC90
6	**Presentation in the statement of financial position**: Separate presentation of groups of insurance contracts that are assets and those that are liabilities	IFRS 17 does not permit groups of insurance contracts that are assets to be offset against those that are liabilities. Some stakeholders believe that the prohibition against offsetting assets and liabilities will exacerbate the operational challenges involved in developing new information systems.	The IASB is proposing to amend the standard by requiring entities to present IFRS 17 assets and liabilities in the statement of financial position by portfolio of contracts, rather than by group of contracts (i.e. a less fine division).	Paras. 78–79, 99, 132 and BC91–BC100

#	Topic	Concerns about the current requirements of the standard	IASB response and proposed amendments	ED reference
7	**Effective date** of IFRS 17 and temporary exemption from IFRS 9	Implementation of IFRS 17 requires a lot of complex work within a very short time-frame, with the standard currently due to come into effect for annual reporting periods commencing on or after 1 January 2021. Insurance companies that meet the criteria set out in IFRS 4 can defer application of IFRS 9 – *Financial Instruments* (which will also have a significant impact on insurers) to the same date.	The IASB has decided to defer the effective date of IFRS 17 to annual reporting periods commencing on or after 1 January 2022. Insurance companies would also be permitted to defer application of IFRS 9 to the same date.	Paras. C1, proposed amdmt. to IFRS 4 and BC110–BC118
8	**Transition requirements**	If application of the full retrospective approach (FRA) is impracticable, an entity may use the modified retrospective approach (MRA) or the fair value approach (FVA) as alternative methods of determining the CSM for groups of insurance contracts at the date of transition to IFRS 17. For the MRA, IFRS 17 defines a limited set of permitted modifications that entities can make to the FRA. Some stakeholders believe that the MRA does not permit sufficient modifications to be applicable in practice, and that a more principles-based approach would be better, or that additional modifications could be permitted.	The IASB has not taken this approach (i.e. the MRA remains broadly unchanged and the permitted modifications are still limited to those explicitly set out in the standard), but instead has proposed three targeted amendments to the transition requirements of IFRS 17: - MRA and FVA: Business combinations – for contracts acquired in a business combination that have already incurred claims prior to the date that they were acquired by the entity, the entity may classify liabilities arising from such contracts as "liabilities for incurred claims" (instead of "liabilities for remaining coverage") at the date of transition. - FRA, MRA and FVA: Risk mitigation – an entity may apply the risk mitigation option prospectively on or after the transition date if and only if the entity designates risk mitigation relationships at or before the date it applies the option. - FVA: Risk mitigation – an entity may choose to use the fair value approach to measure groups of insurance contracts that would otherwise be measured using the FRA, if it chooses to apply the risk mitigation option prospectively after the date of transition to IFRS 17, and if it has used derivatives or reinsurance contracts to mitigate financial risks before the transition date.	Paras. C3(b), C5A, C9A, C22A and BC119–BC146

The exposure draft also proposes a number of minor amendments (see paras. BC148−BC163) intended to clarify the terminology of IFRS 17 or to correct unintended consequences, omissions and conflicts between the requirements of IFRS 17 and those of other standards, such as IFRS 9.

It should be noted that the IASB has decided against amending IFRS 17 at this stage on a number of topics identified by stakeholders, which may continue to pose implementation challenges or risk failing to faithfully represent the performance of contracts within the scope of IFRS 17 over the coming years. These include:

- the requirement to group contracts into annual cohorts;
- the lack of separate presentation of premiums receivable in the statement of financial position;
- the prohibition on applying the VFA (variable fee approach) to reinsurance contracts issued and held;

- the retention of paragraph B137 of IFRS 17, which relates to interim financial statements and stipulates that insurers shall not change the treatment of accounting estimates made in previous interim financial statements. This paragraph sets out an exception to the general principle of IAS 34, which states that the frequency of an entity's reporting shall not affect the measurement of its annual results.

As a reminder, the comment period is open until 25 September 2019. The exposure draft is available on the IASB's website via the following link:
https://www.ifrs.org/-/media/project/amendments-to-ifrs-17/ed-amendments-to-ifrs-17.pdf?la=en

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Events and FAQ

Frequently asked questions

IFRSs

- Classification of liabilities arising from uncertain tax positions in the statement of financial position
- The correct accounting treatment of an NCI put
- Accounting for a sale-and-leaseback transaction
- IFRS 15 and costs to fulfil a contract
- Transfers of investment property to inventories
- Control of infrastructure financing entities
- Classification of cash flows arising from a sale-and-leaseback transaction in the statement of cash flows

Upcoming meetings of the IASB, IFRS Interpretations Committee and EFRAG

IFRS		EFRAG	
IASB	**Committee**	**Board**	**TEG**
23-27 September	16-17 September	24 September	16-17 September
21-25 October	25-26 November	8 October	26-27 September
18-22 November	21 January	13 November	5-6 November