

Beyond the GAAP

Mazars' newsletter on accounting standards

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Editorial

For the second time in its history, the IASB has launched a rapid-turnaround consultation with a comment period of just 30 days – the minimum permitted by its Due Process Handbook. What is more, it once again relates to financial instruments. The IASB is rushing it through in the hope that the document will be ready for first-time application alongside IFRS 9 in 2018. It is touch and go, as the basic principle needs to be approved by stakeholders and the amendments then need to go through the EU adoption process!

This hustle and bustle forms a sharp contrast with the time spent by the IASB on the quality and volume of the financial information disclosed in accordance with IFRS. This month's feature takes 'A Closer Look' at the development of financial information disclosure principles, announced by the IASB in May 2013. The document comprises almost a hundred pages, and stakeholders have a six-month comment period to formulate their thoughts.

Enjoy your reading!

Edouard Fossat

Isabelle Grauer-Gaynor

IFRS Highlights

IASB publishes exposure draft proposing amendments to IFRS 9 on prepayment features with negative compensation

On 21 April, the IASB published draft amendments to IFRS 9 – *Financial Instruments*. Readers will remember that under IFRS 9, financial assets must pass the SPPI test (solely payment of principal and interest) in order to be classified by business model. If they do not pass the test, they are measured at fair value through profit or loss. The aim of the new amendments is to clarify how the SPPI test is affected by prepayment features with negative compensation (so called ‘symmetric’ prepayment options).

The Board’s view, as set out in the draft, is that the prepayment penalty must be paid by the party that chooses to terminate the contract early. Thus, the Board believes that, if the formula used to calculate the prepayment amount could result in either party making a payment (and thus result in one entity being ‘forced’ to make a payment), the asset would not pass the SPPI test and should be measured at fair value through profit or loss.

The aim of the draft amendments is to introduce an exception to this principle, where the following conditions are met:

- the ‘symmetric’ aspect of the prepayment option is the only thing that would prevent the asset from passing the SPPI test;
- the fair value of the prepayment option is insignificant at initial recognition.

This second condition will automatically limit the scope of this exception.

The draft amendments are accompanied by a detailed Basis for Conclusions, addressing topics such as assets that are prepayable at their fair value (which would not pass the SPPI test) and assets for which the prepayment penalty incorporates the cost of terminating a hedging instrument (which must be assessed individually).

The mandatory effective date of the amendments is also open for comment. The Board suggests that the amendments should become mandatory for financial periods commencing on or after 1 January 2018, along with the rest of the standard. Once the amendments are finalised by the IASB, it will be a matter of keeping an eye on the EU adoption process. Hopefully this will proceed quickly enough to allow European companies to apply a consistent, future-proofed IFRS 9 framework without the need for complicated transition requirements that will confuse things for both preparers and users of financial statements.

The comment period closes on 24 May 2017.

The exposure draft is available via the following link: <http://www.ifrs.org/Current-Projects/IASB-Projects/Symmetric%20Prepayment%20Options/Pages/exposure-draft-and-comment-letters.aspx>.

European Highlights

ESMA publishes 2016 report on activities of European accounting enforcers

The European Securities and Markets Authority (ESMA) published its annual report on the activities of European accounting enforcers on 10 April 2017.

The report highlights the following key facts:

- European enforcers carried out unlimited-scope examinations of 812 sets of IFRS financial statements (including annual and interim financial statements, and ex-post and ex-ante examinations). This is around 14% of listed IFRS issuers in Europe;
- They also carried out focused examinations of 446 sets of IFRS financial statements, around 7% of listed IFRS issuers in Europe.

The report also mentions that enforcers carried out post-publication checks of the 2015 financial statements issued by 206 entities, to assess the extent to which they complied with ESMA’s enforcement priorities for 2015. (For more detail on these enforcement priorities, see *Beyond the GAAP* no. 93, October 2015). These checks resulted in enforcement actions being taken against 43 issuers by national enforcers:

- One issuer was required to re-issue its financial statements;
- Eight issuers were required to publish corrections;
- Thirty-four issuers are required to publish corrections in future financial statements.

ESMA’s enforcement priorities for 2015 were published at a time of low interest rates, and low prices and high volatility on the commodities markets. Readers will remember that the priorities included impairment of non-financial assets; measurement of pension obligations; disclosures on non-financial liabilities; financial instruments with exposure to interest rate risk; exposure to foreign exchange rate risk and country risk; and presentation of the statement of cash flows.

The report also mentions ESMA’s enforcement priorities for 2016 (see *Beyond the GAAP* no. 104, October 2016) and highlights the following key points relating to European enforcers’ coordination activities:

- The most frequently discussed issues are the classification of financial instruments (debt vs. equity), deferred tax assets arising from unused tax losses, and the presentation of financial performance;
- ESMA has published 25 enforcement decisions in two batches (see Beyond the GAAP no. 102, July-August 2016, and no. 107, January 2017). Its database contains 965 decisions and 431 emerging issues.

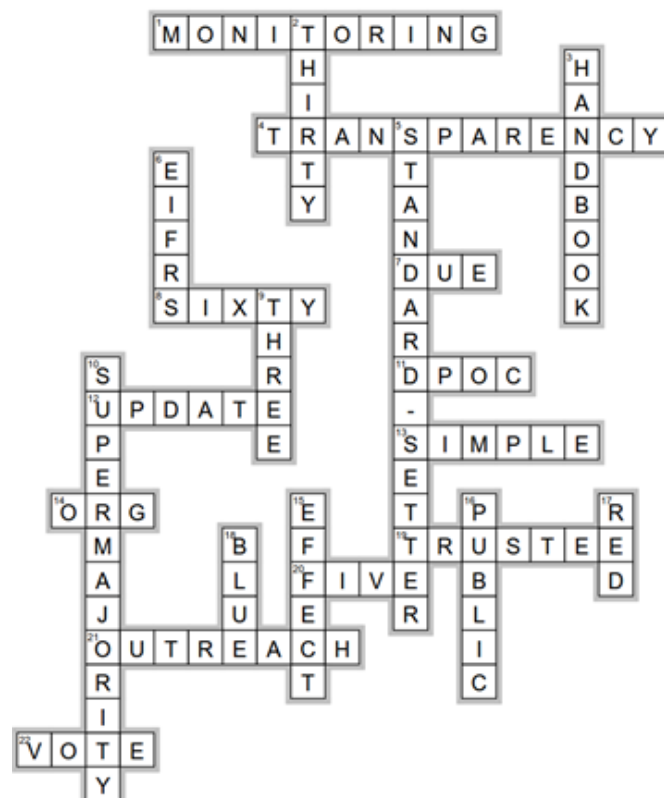
ESMA also states that in 2017 it will continue to monitor the application by issuers of its Guidelines on Alternative Performance Measures, which came into effect in July 2016 (see Beyond the GAAP no. 93, October 2015). It will also continue to monitor disclosures on the transition to IFRS 15 – *Revenue from Contracts with Customers* and IFRS 9 – *Financial Instruments* (see, respectively, Beyond the GAAP no. 102, July-August 2016, and no. 105, November 2016).

Finally, ESMA will complete its study on the implementation of IFRS 13 in 2017, and launch a similar study on the implementation of the consolidation standards (IFRS 10, 11 and 12). These two studies will enable ESMA to contribute to the IASB’s Post-implementation Reviews of these standards, which are expected to commence in the near future.

ESMA’s report on the activities of European enforcers is available via the following link:

<https://www.esma.europa.eu/document/enforcement-and-regulatory-activities-accounting-enforcers-in-2016>

Crossword: last month’s solution



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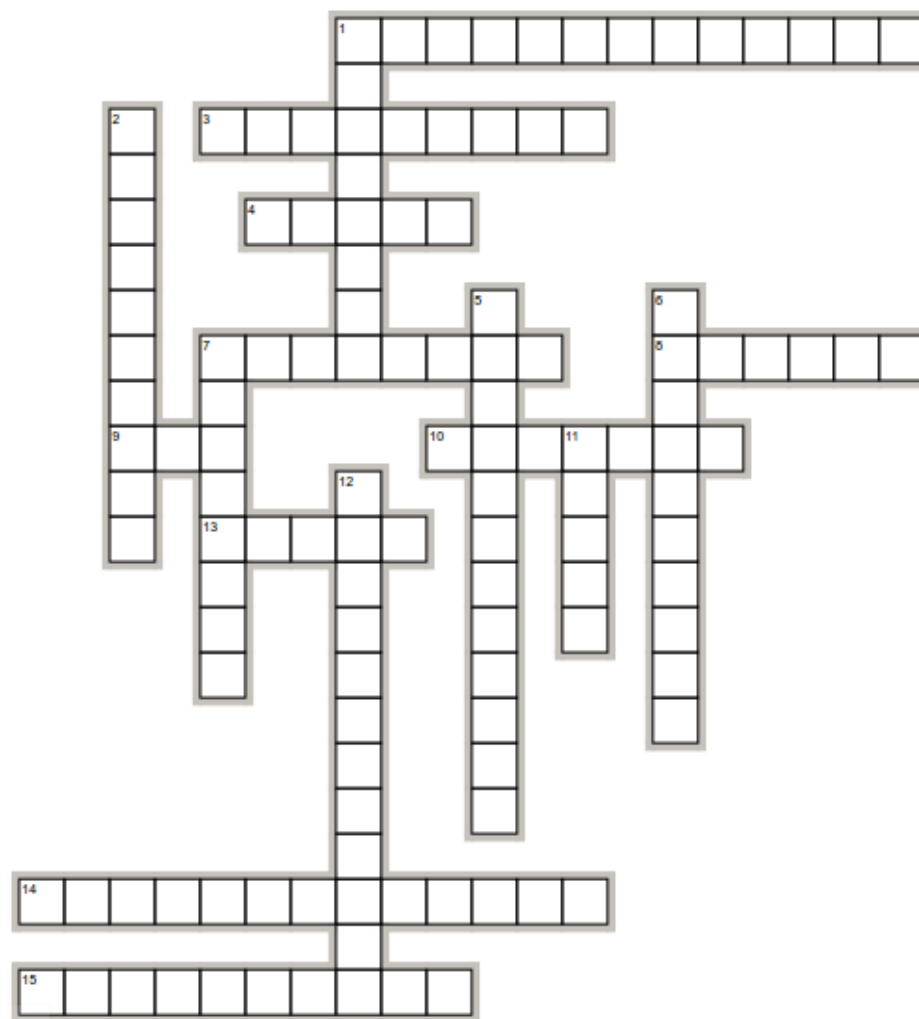
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Crossword: IFRS 8 in a nutshell



Across:

1. If the composition of reportable segments changes from one year to the next, this must be ensured
3. Only operating items that are regularly reviewed by the chief operating decision-maker need to be this
4. If not an individual, the chief operating decision-maker may be that
7. The number of the IAS standard replaced by IFRS 8
8. The IASB has carried out this type of exercise on the implementation of IFRS 8
9. Percentage threshold of any of three quantitative thresholds mentioned in the standard as of which an operating segment is to be reported under IFRS 8
10. The type of information covered by IFRS 8
13. The number of criteria which must be fulfilled to meet the definition of an operating segment
14. A board of directors, considered to be the chief operating decision-maker, may include this type of member according to the most recent exposure draft on IFRS 8
15. Amounts relating to reportable segments and IFRS amounts shall be this

Down:

1. Disclosures must be presented when transactions with a single of this type of the entity's stakeholders reach 10% or more of the entity's total transactions
2. Segments with similar economic characteristics may be this
5. The minimum percentage of an entity's revenue that must be accounted for as reportable segments
6. They must be disclosed if they differ from IFRS
7. The term 'chief operating decision-maker' refers to this within an organisation
11. The IASB published an exposure draft on IFRS 8 in this month of 2017
12. An entity must always provide such a breakdown of revenue

A Closer Look

IASB: What are the key principles for disclosure of financial information?

On 30 March 2017, the IASB published a Discussion Paper on the principles of disclosure for financial information (see Beyond the GAAP no. 109, March 2017).

The document is part of the IASB's Disclosure Initiative, which in turn forms part of its work on Better Communication in Financial Reporting, one of its central themes for the next five years (see Beyond the GAAP no. 105, November 2016).

In this document, the Board proposes that its future work should focus on the development of principles in the following four areas:

- principles of effective communication;
- principles on where to disclose financial information;
- principles to address specific concerns expressed by users of financial statements;
- principles to improve disclosure objectives and IFRS disclosure requirements.

The IASB is considering the form in which these various principles should be published.

Some Board members believe that principles of this kind are by their very nature "educational" rather than mandatory – like the guidance on applying the concept of materiality (see Beyond the GAAP no. 95, December 2015). The principles could be published in the form of illustrative examples, a Practice Statement or separate educational material.

Other members, in contrast, believe that the principles should be mandatory and should form part of a general disclosure standard. This could be IAS 1 – *Presentation of Financial Statements*, or another standard.

It is also possible that some principles are better suited to being presented in educational material, while others should be mandatory. In this situation, a mixed approach could be most appropriate.

1. The seven principles of effective communication

The IASB begins by identifying its concerns about financial information as disclosed currently. There are three of these:

- Not enough relevant information is disclosed, meaning that users of financial information could make inappropriate investing or lending decisions;

- Too much irrelevant information is disclosed, obscuring the information which is actually relevant. The IASB suggests that this can also add unnecessary ongoing costs to the preparation of financial statements;
- The information provided is communicated ineffectively: financial statements are difficult to understand, meaning that users may overlook relevant information or fail to identify relationships between information in different parts of the financial statements.

These problems primarily result from stakeholders' behaviour, although the IASB also accepts responsibility for issues with disclosure requirements under IFRS. Behavioural issues include the use of checklist approaches rather than judgement; the perceived need to 'be on the safe side' on the part of various stakeholders, rather than implementing the concept of materiality; and rigid processes for gathering and presenting information.

To address these issues, the IASB has proposed seven key principles of effective communication:

1. The information provided should be entity-specific, rather than copying generic phrasing from the standards;
2. The information should be described as simply and directly as possible;
3. The information should be organised in such a way as to highlight key points;
4. Where relevant, the information should be linked to other information within the financial statements or in other parts of the annual report;
5. The information should not be duplicated unnecessarily;
6. The information should be presented in such a way as to optimise comparability between entities;
7. The information should be communicated in an appropriate format.

These principles echo those drawn up by many other organisations and bodies in recent years. At the European level these include EFRAG[†], as well as ESMA[‡].

As regards the final principle, the IASB is planning to provide guidance on the circumstances in which an issuer could use the various different possible formats: lists, tables, narrative text, graphs and diagrams.

[†] *Towards a Disclosure Framework for the Notes – Discussion Paper*, July 2012, ANC, EFRAG and FRC

[‡] *PUBLIC STATEMENT - Improving the quality of disclosures in the financial statements*, 27 October 2015, ESMA

2. Principles on where to disclose financial information

Roles of the various financial statements

The IASB begins by defining the roles of the various documents that constitute the financial statements. It proposes a distinction between the notes and the primary financial statements, which include the statement of financial position, the statement(s) of profit or loss and other comprehensive income, the statement of changes in equity and the statement of cash flows.

The primary financial statements present summary information in a structured and comparable form. Readers of the financial statements can use them to:

- gain an overview of the entity's assets, liabilities, equity, income and expenses;
- make comparisons between entities and across reporting periods; and
- identify areas that they may wish to investigate further by reading the notes.

Meanwhile, the role of the notes is to:

- provide further information necessary to disaggregate, reconcile and explain the items presented in the primary financial statements; and
- supplement the primary financial statements with other information that is required to meet the objective of financial statements.

When discussing the location of information within the financial statements, the IASB generally uses 'present' for the inclusion of information in the primary financial statements, and 'disclose' for inclusion of information in the notes. However, these terms are not always used consistently.

Rather than making a hard and fast rule about the distinction between the two terms, the IASB's preliminary view is that it will henceforth always provide context by specifying where the information should be provided.

General principle on the provision of information necessary to comply with IFRS outside the financial statements

As specified in various standards (notably IFRS 7 – *Financial Instruments: Disclosures*), some information may be provided outside the financial statements (e.g. in the annual report) as long as a cross-reference is included. This approach can be used to avoid duplication or to emphasise relationships between different pieces of information. The IASB is proposing to permit an extension of this practice, provided that the following three conditions are met:

- The information is provided within the entity's annual report, which in turn presupposes that this report is published at approximately the same time as the financial statements;

- Locating the information outside the financial statements makes the annual report as a whole more understandable, and the information is faithfully represented;
- The information concerned is clearly identified and incorporated into the financial statements by means of a cross-reference. The IASB suggests that this should involve: a list of any such information in the financial statements, with the references and clear descriptions of the items to which the information relates, identification of this information as information that is necessary to comply with IFRS and that forms part of the financial statements, and the same availability over time as the financial statements.

The risk of having a principle rather than specific requirements is that entities could make excessive use of this practice, to the point where the financial statements would no longer stand alone. The IASB has therefore asked stakeholders to identify situations in which this principle should not apply.

Provision of non-IFRS information within the financial statements

To clarify exactly what it is referring to, the IASB has identified three different categories of information:

- **Category A:** information specifically required by IFRS;
- **Category B:** additional information necessary to comply with IFRS;
- **Category C:** additional information that does not fall within the first two categories, including information that is inconsistent with IFRS and some non-financial information.

While there is no question about the information in categories A and B being required under IFRS, the IASB suggests that non-IFRS information should only be included in the financial statements if certain conditions are met:

- The information must be clearly identified as not being prepared in accordance with IFRS and, if applicable, as unaudited;
- A list of this information should be provided together with the statement of compliance with IFRS;
- An explanation should be provided of why the information is deemed to be useful (in terms of both relevance and faithful representation).

As for the previous topic, the IASB has asked stakeholders if there should be any restrictions or prohibitions on the inclusion of this type of information in the financial statements.

3. Principles to address specific concerns expressed by users of financial statements

Two issues in particular seem to have raised concerns among users of financial statements. These are: the inclusion of performance measures in the statement(s) of profit or loss and other comprehensive income; and disclosure of accounting policies.

Performance measures in the statement(s) of financial performance

This issue, which relates to the previous topic of providing non-IFRS information in the financial statements, fits more naturally within the IASB's project on primary financial statements (see Beyond the GAAP no. 105, November 2016). It will in fact also be discussed in that project. However, the IASB wanted to gather opinions from stakeholders to inform subsequent project discussions.

In this section, for a change, the IASB begins with specifics to develop general principles. With that in mind, it is worth noting that the standards do not always specify what details should be presented in the financial statements, particularly as regards sub-totals.

Thus, the IASB begins by proposing that:

- EBIT (earnings before interest and tax) may be presented in the statement(s) of financial performance irrespective of whether expenses are presented using the 'nature of expense' method or the 'function of expense' method;
- In contrast, EBITDA (earnings before interest, taxation, depreciation and amortisation) may only be presented in the statement(s) of financial performance if the 'nature of expense' method is used (as depreciation is itself a grouping by nature of expense) and if the sub-totals presented are in accordance with IAS 1.

From these two cases, the IASB has developed the following general principles for inclusion of performance measures in the financial statements:

- These measures shall be displayed with equal or less prominence than IFRS measures;
- Issuers must clearly indicate whether or not these measures form part of the financial statements, and whether they have been audited;
- They must be neutral and free from error or bias;
- Comparative information must be presented;
- Presentation and measurement techniques must remain consistent over time;
- They must be reconciled with the most directly comparable IFRS measure;
- The issuer must provide explanations of why the measures are relevant, any adjustments that have been made, and any other necessary information.

These principles are very close to the requirements set out by ESMA in its Guidelines on Alternative Performance Measures (see Beyond the GAAP no. 93, October 2015). However, ESMA's guidelines⁵ focused on the use of such measures outside the financial statements (notably in management reports, presentations to analysts and press releases). The IASB is therefore building on this to develop a similar set of principles for measures included in the financial statements.

While on this topic, the IASB also intends to develop guidance on how and when items can be presented in the statement(s) of financial performance as unusual or infrequently occurring. This guidance could address the following issues:

- Can the term 'infrequently occurring' be used if the item has occurred more than once over a given period to be determined (e.g. five years) or it is likely to occur in the foreseeable future?
- The use of such terminology will depend on the entity's particular circumstances, as some items might be frequent for some entities but not for others;
- In addition to the nature and frequency of the item, its size should also be taken into consideration;
- Other characteristics of an item could make separate disclosure relevant for users of financial statements. These could include the variability of the item and whether current-period amounts represent a remeasurement of prior-period estimates;
- Separate presentation could be appropriate to isolate the impact of an event that affects several line items (such as the consequences of a hurricane).

The IASB also seeks stakeholders' views on whether it should prohibit certain terms, such as 'non-recurring' or 'special'.

Accounting policies

The IASB's stance on disclosure of accounting policies is based on the first of the seven principles mentioned above: the policies disclosed must be entity-specific.

It goes on to identify three categories of accounting policies:

- **Category 1:** accounting policies that are always necessary for understanding information in the financial statements, and that relate to material items, transactions or events. Disclosures are always necessary in the following four situations:
 - When policies have changed over the period;
 - If the entity had a choice of accounting options;
 - When accounting policies were developed in accordance with IAS 8, i.e. in the absence of an IFRS that applies specifically to the items, transactions or events;

⁵ <https://www.esma.europa.eu/press-news/esma-news/esma-publishes-final-guidelines-alternative-performance-measures>

- When the items, transactions or events required the entity to make significant judgements or assumptions.
- **Category 2:** accounting policies that are not included in category 1, but that relate to items, transactions or events that are material due to their amount or nature;
- **Category 3:** any other accounting policies that are not included in categories 1 or 2.

The IASB believes that accounting policies in categories 1 and 2 should always be disclosed. However, those in category 3 do not need to be disclosed (although this does not prevent entities from disclosing them, if this is consistent with the seven principles set out above).

The IASB also draws on these principles when discussing the location of accounting policy disclosures. The amendments to IAS 1 – *Presentation of Financial Statements*, which came into effect in 2016 (see Beyond the GAAP no. 84, December 2014), clarified that the standard does not require the notes to be presented in a specific order. Thus, accounting policy disclosures may be located either in a single note, or in individual notes with the relevant information, or through a combination of these two approaches. However, the IASB stipulates the following:

- The location of category 1 accounting policies should always be clearly indicated;
- Significant judgements and assumptions should be presented alongside the relevant accounting policy, and clearly highlighted;
- If an entity does wish to disclose category 3 accounting policies, it should consider presenting them separately from the other two categories, either at the end of the relevant note or in a separate note, or even outside the financial statements with a cross-reference.

4. Principles to improve disclosure objectives and IFRS requirements

The IASB is considering developing a centralised set of disclosure objectives that would form a basis for developing disclosure objectives and requirements in standards. However, it has not yet decided on the best approach. It suggests two possible methods – or a hybrid of both – and also invites stakeholders to suggest alternative methods:

- **Method A:** this method would focus on the different types of information disclosed about an entity’s assets, liabilities, equity, income and expenses. It is the closest to the IASB’s current approach to developing standards. It would permit the development of disclosure objectives and requirements for each standard;
- **Method B:** this method would focus more on information about an entity’s activities (e.g. its operating activities, which could be broken down into operating assets, liabilities, income and expenses). Thus it would diverge from current practice, and it would be unlikely that disclosure objectives could be developed at the level of individual standards, as activities would incorporate topics covered by various standards.

The Discussion Paper concludes with a proposed approach developed by the New Zealand Accounting Standards Board (NZASB), with the spirit of Method A. It begins by identifying seven types of information:

1. Information about the reporting entity (e.g. segment information, scope of consolidation, related parties);
2. Information about the measurement bases and uncertainties;
3. Information about the risks arising from the entity’s assets and liabilities;
4. Information about the financial position, financial performance and cash flows;
5. Forward-looking information, if it is relevant and relates to the existing assets and liabilities;
6. Information about management’s stewardship of the entity’s resources (such as executive compensation and transactions with management as related parties);
7. Any other relevant information.

An overall disclosure objective would be developed for each standard, linked to the objective of financial statements as stated in the *Conceptual Framework*, and to the objective of that standard.

Disclosures would then be classified into two tiers:

- **Tier 1:** summary information. This would be selected based on the types of information (as listed above) that are necessary, in the context of the item or transaction, to give an overall picture. This information would always be required, subject to a materiality judgement;
- **Tier 2:** additional information which would be provided if necessary to meet the overall disclosure objective of the standard. This would depend on the relative importance of the item or transaction at the level of the reporting entity, and on the amount of judgement involved in accounting for it. The IASB suggests that it would include both further details of Tier 1 information, and additional types of information.

The NZASB is planning to develop guidance on elements to consider when using judgement (to be included either within each standard or in a general standard like IAS 1). These elements include: how much emphasis to place on specific disclosures; the level of detail required (for users assumed to have a reasonable knowledge of business and economic activities); how much aggregation or disaggregation to undertake; and the circumstances in which additional information is required to meet the disclosure objective.

Finally, the NZASB’s approach includes less prescriptive language on disclosure requirements. Thus, for Tier 1 information, it uses the wording, “an entity discloses,” and for Tier 2 information it uses, “an entity considers disclosing,” or “examples of information that the entity considers disclosing include...”.

The document includes two examples of how the approach might be applied, to IAS 16 – *Property Plant and Equipment* and IFRS 3 – *Business Combinations*.

Key points to remember

- The IASB has not yet decided whether its proposed principles should be included in various standards or brought together in a single standard. It is also not yet clear whether they will be mandatory or simply play an educational role;
- The IASB has proposed seven principles of effective financial communication, which are in line with guidelines and recommendations published by other standard-setters and enforcers;
- The IASB plans to define the roles of the primary financial statements and the notes, and to specify when and how:
 - IFRS information may be provided outside the financial statements; and
 - non-IFRS information may be provided within the financial statements;
- The IASB intends to develop principles for the inclusion of performance measures within the financial statements, and improve accounting policy disclosures in the notes;
- The IASB is considering developing centralised disclosure objectives as a basis for developing better disclosure requirements for the various standards. These objectives could be included in individual standards, or brought together in a single standard;
- The New Zealand Accounting Standards Board has proposed an approach to developing disclosure objectives and requirements. Illustrative examples are provided to show how this would apply to two different standards.

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Events and FAQ

Frequently asked questions

IFRS

- Renegotiation by an acquirer of an IFRS 2 share-based payment plan that was agreed by the acquiree;
- Impact of dilutive instruments in the calculation of diluted earnings per share;
- Accounting treatment of a minority re-investment in a divested holding;
- Amortisation method for an intangible asset;
- Accounting treatment of a public service delegation contract for the collection and recovery of waste.

Upcoming meetings of the IASB, IFRS Interpretations Committee and EFRAG

IFRS		EFRAG	
IASB	Committee	Board	TEG
15-19 May	13-14 June	31 May	28-30 June
19-23 June	12-13 September	20 July	26-28 July
17-21 July	21 November	14 September	20-22 September

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