

Beyond the GAAP

Mazars' newsletter on accounting standards

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Editors-in-Chief:

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

Columnists:

Isabelle Grauer-Gaynor, Mohamed Taghia and Arnaud Verchère

Contact us:

Mazars
Exaltis, 61, rue Henri Régnauld
92 075 – La Défense – France
Tel: 01 49 97 60 00
www.mazars.com

Editorial

Again this month IFRS 9 and IFRS 15 take centre stage in our highlights as they are the focus of attention for market regulators and the Monitoring Board of the IFRS Foundation.

As announced in our previous edition, our closer look study this month presents the key features of the new IFRS Conceptual Framework. In summary, the final text confirms and expands the main outlines proposed in the 2015 exposure draft.

Enjoy your reading!

Edouard Fossat

Isabelle Grauer-Gaynor

IFRS Highlights

The Monitoring Board work plan

On 30 April 2018 the Monitoring Board, a body composed of market regulators in jurisdictions requiring or authorising the use of IFRSs and charged with oversight of the IFRS Foundation, published its 2018-2019 work plan.

This plan encompasses two key areas:

- reviewing the oversight of the IASB's activities, conducted by the Trustees of the IFRS Foundation. This area includes continuing the Monitoring Board's dialogue with the Trustees on accounting matters of broad public interest, such as the impact and consistent implementation of the accounting standards that come into force this year and over the next few years (IFRS 9, IFRS 15, IFRS 16 and IFRS 17).
- monitoring and conferring with the Trustees of the IFRS Foundation. The subjects envisaged here include:
 - governance of the IFRS Foundation (strengthening the governance framework, in particular with respect to conflicts of interest; follow-up of the IFRS Reputation Research Report; the Trustees' review of the operational risks to which the IFRS Foundation is exposed, including the development of evaluation metrics and key performance indicators).
 - the funding of the organisation, and
 - the nomination of Trustees, including the Chair, whose mandate has expired.

The Monitoring Board work plan can be consulted at: <https://www.ifrs.org/-/media/feature/groups/monitoring-board/ifrs-foundation-monitoring-board-2018-2019-work-plan.pdf?la=en&hash=22745849044F688B4DAAB1D03AEB3C63D7B11085>

European highlights

ESMA: 22nd extract from the enforcement database

On 19 April 2018, the European Securities and Markets Authority, ESMA, published the 22nd extract from its enforcement database, containing 10 decisions taken by European regulators on the following topics:

1. Classification of an asset that is not expected to be sold within one year (IFRS 5)
2. Presentation and disclosure of restricted cash balances (IAS 7)
3. Perpetual notes classified as liabilities (IAS 32)
4. Disclosure of quantitative commodity price assumptions that have significant risk of resulting in material adjustments to carrying amounts (IAS 1 and IAS 36)

5. Purchase price allocation to a group of acquired assets (IFRS 3, IFRS 13 and IAS 38)
6. Demerger and distribution of a segment to the issuer's shareholders (IFRIC 17)
7. Presentation of revaluation losses of assets used in operating activities (IAS 1)
8. Obtaining power over an investee following a tender offer (IFRS 10)
9. Lack of foreign currency exchangeability and hyperinflation (IAS 8, IAS 21 and IAS 29)
10. Amortisation of content rights for films and television programmes (IAS 38).

This 22nd extract from the enforcement database and the list of all the decisions published by ESMA can be consulted at: <https://www.esma.europa.eu/press-news/esma-news/esma-publishes-22nd-extract-eecs-database>

ESMA's 2017 report on the activities of IFRS enforcers in Europe

On 3 April 2018 ESMA (the European Securities and Markets Authority) published its annual report on the activities of European regulators.

This report is an opportunity for ESMA to review the activities conducted in 2017 to promote good practices in the matter of financial reporting.

The interim and/or annual financial statements of 1,141 issuers were examined, representing an average examination rate of 19% of all IFRS issuers with securities listed on regulated markets. These examinations resulted in actions being taken towards 328 issuers (32% of the issuers examined), in order to address anomalies found mainly in the following areas:

- presentation of financial statements,
- impairment of non-financial assets,
- recognition of financial instruments.

The financial statements of 204 issuers were examined *a posteriori* in light of the 2016 ESMA enforcement priorities (for more details of these priorities, see the October 2016 edition of Beyond the GAAP no 104). These resulted in 76 enforcement actions being taken against 56 issuers, related to:

- the presentation of financial statements,
- the distinction between equity instruments and financial liabilities, and
- transitional disclosures of the expected impact of IFRS 9.

As always in this report, ESMA and the enforcers indicate the areas in which they plan to focus their efforts in 2018,

namely the new IFRS 9 and IFRS 15, in terms of both supervision and the promotion of good practices.

The 2017 activity report can be consulted at the following address:

https://www.esma.europa.eu/sites/default/files/library/esma32-63-424_report_on_enforcement_activities_2017.pdf

EFRAG research agenda consultation

On 6 April 2018 EFRAG published a consultation on its research agenda. This consultation has a number of objectives:

- to determine how the influence of its research activities on the IASB’s work could be substantiated;
- to assess and enhance the use of evidence in research, in particular for impact studies; and
- to obtain the views of constituents regarding a number of proposed research topics, and to gather further suggestions, in the light of the following criteria:
 - importance or urgency of the project topic to European constituents,
 - probability that the project will reach a useful conclusion in a reasonable time,
 - interaction with projects from other organisations, including the IASB.

EFRAG has put forward five research topics, in two categories:

- Addressing new developments:
 - Intangible assets: how can a full picture be provided of internally-generated intangibles without aligning the carrying amount of equity to market prices?
 - Cryptocurrencies: what accounting treatment should be used for the different constituents and transactions involving cryptocurrencies (currency miners, issuers, investors)?
- Enhancing current financial reporting:
 - Derecognition: analysis of the consistency of existing derecognition practices under different IFRSs, and a conceptual approach to the notions of performance or realisation.

- Transaction-related costs: analysis of the consistency of the accounting for and of the nature of costs regarded as transaction-related in different IFRSs, and search for a common principle.
- Variable and contingent payments: identification of the accounting issues involved and inventory of the frequency, magnitude and nature of these payments and their treatment in IFRSs in order to develop alternative accounting treatments, including improvements in presentation and disclosure.

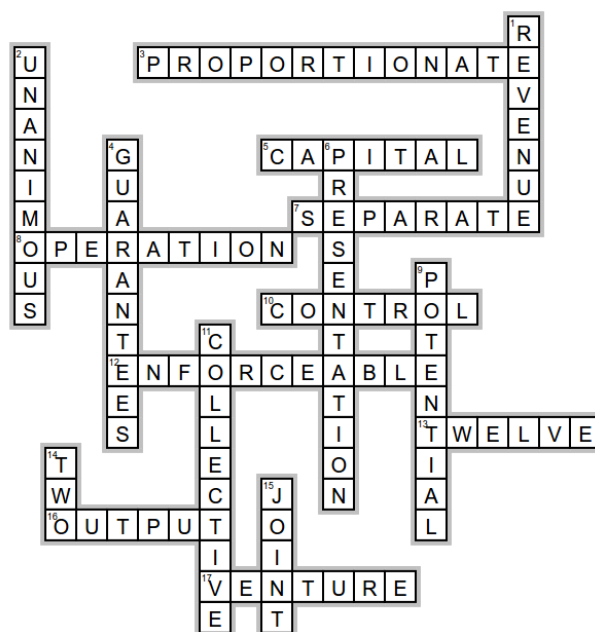
The consultation document is available on the EFRAG website:

<http://www.efrag.org/Activities/1710031306501984/2018-EFRAG-Research-agenda-consultation>.

Responses to this consultation can be submitted until 1 June 2018 using the online questionnaire on the EFRAG website at the following address:

<https://www.surveymzmo.eu/s3/90074633/EFrag-2018-Research-agenda-consultation>.

Crossword: last month’s solution



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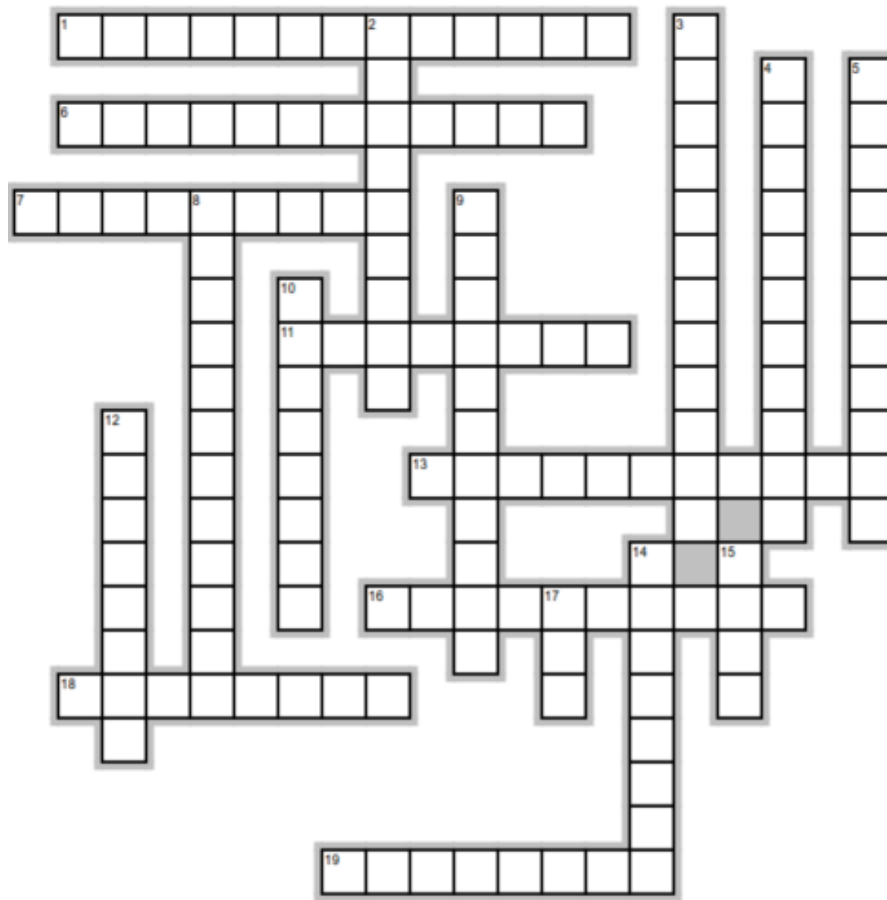
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Crossword: The fundamentals of IAS 16



Across

1. How the impacts of a change in depreciation plan are recognised
6. Must be recognised even if an item of property, plant & equipment is not in use
7. Their benefits can, under some conditions, be included in the costs of an item of property, plant & equipment
11. Unlike IFRS 15 and IFRS 16, IAS 16 contains no special measures for the payment of this kind of consideration to a supplier
13. Activity that does not negate the need for depreciation
16. Only some of these assets are covered by IAS 16
18. The alternative model to measurement at cost may lead to the recognition of taxes of this type
19. Important value for determining the depreciation plan of an item of property, plant & equipment

Down

2. These costs are included in the cost of an item of property, plant & equipment when they are necessary to bring it to its place of installation and use
3. One of the methods of depreciation
4. A part of an item of property, plant & equipment with such a cost must be depreciated separately
5. Under some conditions, the depreciation charges of property, plant & equipment can be this
8. It reduces the useful life of an item of property, plant & equipment (caused by rapid technological change)
9. Alternative model to measurement at cost
10. This type of cost cannot be included in the costs of an item of property, plant & equipment
12. Where the residual useful life of an asset changes, the duration of the depreciation plan must be this
14. Event generally triggering derecognition of an item of property, plant & equipment
15. Must be recognised separately from buildings, even when acquired together
17. Where the periodic revaluation of an asset is usually recognised

A Closer Look

Key features of the new IFRS Conceptual Framework

On 29 March 2018 the IASB published its new Conceptual Framework, nearly three years after the 2015 exposure draft.

This text is accompanied by amendments to certain IFRSs. These amendments are essentially designed to update references to the Conceptual Framework included in the standards. In certain cases, however, the IASB has updated the definition of the elements of the financial statements. This is the case for IFRS 2 on share-based payments, where this revision does not seem to entail any significant accounting changes. In other cases, however, the IASB has preserved the references to the definition of assets and liabilities in the 2001 Conceptual Framework. This applies to the “old” standards on assets (IAS 16 and IAS 38 for example) and on business combinations (IFRS 3). In these cases, the IASB decided that updating the definition could have entailed significant changes, which was not its intention.

This closer look study updates the study we published in Beyond the GAAP no 90 of June 2015 based on the IASB’s exposure draft.

Purpose and status of the Conceptual Framework

The Conceptual Framework consists of eight chapters and an extensive Basis for Conclusions. The introduction explains that its purpose is to:

- assist the IASB to develop and revise its standards;
- assist entities to develop consistent accounting policies when no standard applies to a particular transaction or other event, or when a standard allows a choice of accounting policy; and
- assist all stakeholders to understand and interpret the standards.

1. The objective of general purpose financial reporting

The primary purpose of financial information remains to be useful to existing and potential investors, lenders and other creditors (subsequently referred to as “users”) when making decisions about the financing of the entity (whether by holding equity or debt instruments) and exercising rights to vote on, or otherwise influence, management’s actions that affect the use of the entity’s economic resources.

The status of the Conceptual Framework in relation to the IFRSs remains unchanged. The standards continue to take precedence over the Conceptual Framework. However, should new provisions depart from the Conceptual Framework, the IASB has undertaken to explain the reasons in the Basis for Conclusions on that standard.

Eight chapters focused on financial statements

Although the document is entitled *Conceptual Framework for Financial Reporting*, most of the eight chapters (chapters 3 to 8) summarised below focus on the financial statements produced under IFRSs rather than on the much broader concept of financial reporting:

1. The objective of general purpose financial reporting;
2. Qualitative characteristics of useful financial information;
These two chapters had already been re-written in 2010. Nevertheless, some further changes have been made in response to the requests of constituents, to which we will return at point 2.
3. Financial statements and the reporting entity;
4. The elements of the financial statements;
5. Recognition and derecognition;
6. Measurement;
7. Presentation and disclosure;
8. Concepts of capital and capital maintenance.
This chapter has been re-issued unchanged and without discussion by the IASB, so we will not return to it in this study.

In what follows, we will try to highlight the major features of the text, particularly on the significant changes in each chapter.

Users base their expectations of returns on their assessment of:

- the amount, timing and uncertainty of future net cash inflows to the entity and
- management’s stewardship of the entity’s resources.

The reintroduction of the concept of stewardship was requested by a large number of stakeholders. Although the IASB believed that it was always implicitly present in the 2010 Conceptual framework, this unambiguous reference marks it out as an objective of financial information in the same way as the assessment of future net cash flows.

Key points

Management's stewardship is reintroduced as a part of the objective of financial information.

2. The qualitative characteristics of useful financial information

When this chapter was drafted in 2010, it defined the qualitative characteristics of useful financial information in two categories:

- the fundamental qualitative characteristics of relevance and faithful representation and
- the characteristics that enhance the usefulness of financial information: comparability, verifiability, timeliness and understandability.

However, these characteristics are subject to cost constraints, and it is therefore important to determine whether the benefits to users of the information justify the cost incurred by the entity providing it.

Prudence and neutrality

In response to numerous stakeholders, prudence is reintroduced in support of the principle of neutrality for the purposes of faithful representation.

Prudence is understood here as the exercise of caution when making judgements under conditions of uncertainty. For example, the exercise of prudence means that assets and income are not overstated and liabilities and expenses are not understated.

The principle of prudence as defined by the IASB does not require asymmetry in the recognition of assets and liabilities, namely the recognition of assets with a very high degree of certainty by comparison with the recognition of liabilities as soon as they are probable. This reflects the recognition criteria set out (see point 5 below). Nonetheless, the text recognises that asymmetry can be necessary in order to select the most relevant and faithfully represented information.

Measurement uncertainty and faithful representation

The text provides clarification concerning measurement uncertainties. These are now conceived in terms of faithful representation, rather than in terms of the relevance of the information (as in the exposure draft). This is because the faithful representation of information does not mean that that information must be accurate in all respects. The Conceptual Framework observes that the use of estimates, which imply a certain degree of uncertainty, is an essential part of the preparation of financial information and this does not necessarily weaken the usefulness of the information, if the estimates are clearly and accurately described and explained.

Note that these clarifications come in response to stakeholders' requests for the reintroduction of the concept of measurement reliability, which was among the recognition criteria for assets and liabilities in the previous Conceptual Framework and in some existing IFRSs.

When this chapter in 2010 was drafted in 2010, the IASB considered that the concept of reliability was understood differently by stakeholders (in particular, as a synonym for verifiability or free of material error). These two aspects are considered as too simplistic by comparison with the IASB's interpretation. The concept of faithful representation adopted by the IASB is broader and, the Board says, covers the aspects of reliability.

We will see at point 5 below that the IASB no longer includes reliable measurement in its recognition criteria for assets and liabilities.

The IASB has reintroduced the need, in some cases, to strike a balance between relevance and faithful representation in order to provide useful information to the users of financial statements. For example, estimated information entailing a very high degree of uncertainty could be more usefully replaced by information whose estimation involves less uncertainty, or even by an absence of an estimate, as long as explanations are provided.

Substance over form and faithful representation

The IASB states that a faithful representation provides information about the substance of an economic phenomenon instead of merely providing information about its legal form.

When the IASB drafted this chapter in 2010, this clarification was regarded as redundant in the light of the concept of faithful representation. It has been included in the new version following stakeholders' requests for the reintroduction of this concept in an explicit fashion in the Conceptual Framework.

How substance is analysed is set out in the chapter on the elements of financial statements (Chapter 4). Obviously, the contract terms must be analysed in order to determine whether a term can be exercised in practice, or to identify terms that bind neither of the parties. But the analysis does not stop there. Contract terms should generally be read in the light of the law on which the contract is based, but should also be considered in the context of other contracts or events and circumstances which could impact the analysis of its terms.

Some IFRSs, including IFRS 15 on contracts with customers, provide criteria for bundling different contracts.

The IASB also draws on this analysis in its project on rate-regulated activities in order to take account of the relationship between the supplier and the regulatory authority, and to reflect in the accounts the deferral that can arise between the costs incurred by the supplier and the period over which it can cover them through the rates it charges its customers.

3. Financial statements and the reporting entity

This chapter explains that financial statements are a particular form of general purpose financial reports.

Another form of general purpose financial report is the management commentary, which is the subject of an IASB Practice Statement. Application of the Practice Statement is not mandatory, insofar as some jurisdictions already regulate in this area.

The financial statements include the following elements:

- the statement of financial position, which records assets, liabilities and equity;
- the statement(s) of financial performance, recognising income and expenses;
- other statements and notes. The latter must explain the elements recognised in the statements, the elements that have not been recognised, cash flows, contributions from holders of equity claims and distributions to them, and the methods, assumptions and judgements used in preparing the financial statements.

The cash flow statement and the statement of changes in equity are thus not explicitly mentioned in the Conceptual Framework, but they are required by IAS 1 on the presentation of financial statements.

The general purpose financial statements are prepared on the assumption that the reporting entity is a going concern. If this assumption is not appropriate, they are prepared in accordance with a basis other than IFRSs.

The Conceptual Framework explains that this assumption means that the entity has neither the intention nor the need to enter liquidation or cease trading in the foreseeable future.

The Conceptual Framework also states that the financial statements are prepared from the perspective of the reporting entity as a whole, not from the perspective of some or all of the entity's users.

This is a useful clarification, because in practice the perspective taken in drafting the various standards is not always clear. It is nevertheless not explained further by the Conceptual Framework.

Having established the perspective from which the financial statements should be prepared, chapter 3 then turns to the concept of the reporting entity.

Key points

The concepts of prudence, measurement uncertainty and the primacy of substance over form are reintroduced, alongside explanations of the qualitative characteristics of useful financial information.

A reporting entity is an entity that chooses, or is required, to prepare general purpose financial statements.

To clarify what “reporting entity” means in the context of consolidated and unconsolidated accounts, the Conceptual Framework uses the concept of control, though this is not defined in this chapter. Hence:

- in consolidated financial statements, the reporting entity consists of an entity and the entities it controls,
- in unconsolidated financial statements, the reporting entity consists of the parent company only.

Unconsolidated financial statements can be useful to users if only because, in some jurisdictions, dividends are based on the distributable reserves of the parent and not that of the group. However, for the Conceptual Framework, unconsolidated financial statements are generally inadequate to meet users' needs. They cannot replace consolidated financial statements.

This chapter focuses on the concept of control, making no reference to joint control or significant influence. The boundaries of the reporting entity are therefore those of the parent company and its subsidiaries.

In passing, this chapter also notes that:

- the reporting entity can consist of only a portion of a legal entity;
- a reporting entity can comprise two or more entities, in which case combined financial statements can be prepared where these entities do not have a parent-subsidiary relationship with each other.

Key points

A reporting entity is an entity that chooses, or is required, to prepare general purpose financial statements, which are drawn up:

- on a going-concern assumption, and
- from the perspective of the entity.

4. Elements of the financial statements

The new Conceptual Framework disassociates the definition of assets and liabilities from the recognition criteria (see point 5 below).

The concept of economic resource

The founding concept underlying all the others, an economic resource is a right that has the potential to produce economic benefits. This definition is now separate from the definition of the elements of the financial statements, in order to avoid a certain confusion encountered by the IASB between assets and liabilities and flows of economic benefits. It also makes it easier to establish parallels between assets and liabilities.

In this definition, for the economic resource to have the “potential to produce” economic benefits, it does not need to be certain, or even likely, that the right will produce economic benefits. It is only necessary that the economic resource already exists and that there is at least one circumstance in which it would produce economic benefits.

It also clarifies that it is the economic resource that constitutes the right, not the future economic benefits.

Further, a right that does not create rights for the entity beyond those that exist for other parties will generate no economic benefits.

For example, this applies to the right of use of roads.

Elements of the financial statements

The elements of the financial statements relate to resources, claims and changes in resources and claims.

The elements of the financial statements are therefore:

	Elements of financial statements
Resources of the entity	Asset
Claims against the entity	Liability
	Equity
Financial performance (changes in resources and claims)	Income
	Expenses

Assets (liabilities) are defined as present economic resources controlled by the entity (present obligations of the entity to transfer economic resources) as a result of past events.

Equity continues to be defined as the residual interest in the assets of the entity after deducting all its liabilities

Similarly, income and expenses are defined as changes in assets and liabilities other than those relating to contributions from holders of equity claims. This definition is unchanged.

The concept of control

Control is defined as the ability of the entity to direct the use of an economic resource and obtain the (positive or negative) economic benefits that flow from it

This definition includes the recent changes in IFRS 10 on consolidated financial statements and IFRS 15 on revenue recognition.

The concept of risks and rewards will in future be no more than an indicator of control.

So if one entity (an agent) acts on behalf of and for the benefit of another entity (the principal), the economic benefits generated flow not to the agent but to the principal.

Link between obligation to transfer and right to receive

Although asymmetry in the recognition of assets and liabilities is not required by the concept of prudence (see above, point 2), the Conceptual Framework states that, if one entity has an obligation to transfer an economic resource, it follows that another entity has a right to receive that economic resource. Nevertheless, the objective of financial information may sometimes be met by requiring different recognition criteria and measurement concepts for these assets and liabilities in the entities concerned.

This is not new: under IAS 37, it applies to a litigation provision that will be accounted for when the obligation to pay is more probable than improbable, whereas the potential beneficiary cannot recognise the future payment until it is certain.

The concept of present obligation

Apart from locating its origin in past events – meaning that the entity has already obtained economic benefits or taken an action and, as a consequence, will or may have to transfer an economic resource that it would not otherwise have had to transfer – in order for an obligation to be present, the entity must have no practical ability to avoid a transfer. Thus an obligation cannot simply result from a management intention.

As at present, an obligation can be constructive.

In consequence, an entity establishing its financial statements on a going-concern basis has no practical ability to avoid an obligation if this can only be achieved by liquidation or by ceasing to trade. Conversely, the entity would have the practical ability to avoid the transfer of resources if this transfer is only required in the event that the entity goes into liquidation or ceases to trade.

Executory contracts

The Conceptual Framework defines an executory contract as a contract that is equally unperformed by the parties: neither party has fulfilled any of its obligations, or both parties have partially fulfilled their obligations to an equal extent. Hence an executory contract contains a combined right and obligation constituting a single asset or liability. The entity has an asset if the terms of the exchange are favourable; otherwise, it has a liability.

Unit of account

The unit of account is defined as a group of rights and obligations to which recognition criteria and measurement concepts are applied.

Possible units of account include:

- an individual right or individual obligation;
- all rights, all obligations, or all rights and all obligations, arising from a single source, for example, a contract;
- a subgroup of those rights and/or obligations, such as a subgroup of rights over an item of property, plant and equipment for which the useful life and pattern of consumption differ from those of the other rights over that item;
- a group of rights and/or obligations arising from a portfolio of similar items;
- a group of rights and/or obligations arising from a portfolio of dissimilar items, such as a portfolio of assets and liabilities to be disposed of in a single transaction; or
- a risk exposure within a portfolio of items, for example where a portfolio of items is subject to a common risk.

Determining which unit of account to use involves considering the relevance of the resulting information, ensuring that it faithfully represents the substance of the transaction, and ensuring that the costs of providing the information do not exceed the benefits of providing it.

Readers will recall that these three criteria correspond to the two fundamental characteristics of financial information and to the cost constraint, addressed in chapter 2 (see point 2 above). The arguments in the following chapters of the Conceptual Framework (recognition, measurement, and

presentation and disclosure) and developed below also rely on these criteria.

The Conceptual Framework states that different units of account can be used for recognition and for measurement.

Thus if sales are recognised per transaction, the concept of probability of occurrence means that it is more relevant to calculate the guarantee provision for these sales on the basis of the total sales.

Hence when determining the unit of account, it may be useful to consider whether the rights and obligations may be the subject of separate transactions, expire in different ways, be used in combination, or present similar economic characteristics and risks.

Key points

Only the definitions of assets and liabilities have been amended; equity, income and expenses continue to be defined in relation to assets and liabilities.

The definition of control is aligned with the recent definition in IFRS 10 and IFRS 15

The definition of the elements of the financial statements has been separated from the recognition criteria.

The Conceptual framework clarifies the concepts of the executory contract and unit of account.

5. Recognition and derecognition

Recognition

The recognition of assets and liabilities is subject to the criteria of relevance and faithful representation, and to the condition that the costs must be proportional to the benefits.

The recognition of assets and liabilities therefore no longer relies on the concept of probability, nor on the criterion of reliable measurement.

Hence the recognition of an element may not produce relevant information in the following cases:

- where it is uncertain whether an asset (e.g. rights which are not legal, such as know-how) or a liability (e.g. because of uncertainties concerning the obligating event) exists;
- existence of an asset or liability where the probability of an inflow or outflow of economic benefits is very low.

Faithful representation may be affected by the level of measurement uncertainty. This may be the case under highly uncertain circumstances, where:

- the range of possible outcomes is exceptionally wide and the probability of each outcome is exceptionally difficult to estimate;
- the measure is exceptionally sensitive to small changes in estimates of the probability of different outcomes (for example, if the probability of certain scenarios occurring is exceptionally low, but the magnitude of the amounts will be exceptionally high if they occur); or

- the measure requires exceptionally difficult or exceptionally subjective allocations of cash flows that are difficult to distinguish from other elements.

Faithful representation of assets and liabilities involves not only their description and measurement in the statement of financial position (including interactions with other assets and liabilities) but also their representation in income and expenses and in equity, as well as the appropriate disclosures, in order to determine whether this objective has been reached.

Derecognition and contract modifications

Derecognition, defined as the removal of all or part of a recognised asset or liability from an entity's statement of financial position, must faithfully represent both:

- any assets and liabilities retained after the transaction or other event that led to the derecognition; and
- the change in the entity's assets and liabilities as a result of that transaction or other event.

Of course, derecognition can result in a change in the unit of account, in particular where it is partial.

In general a result (gain or loss) can only be recognised on the component actually transferred.

However, before derecognising an element, the entity must determine whether it should retain it on the balance sheet.

This would be the case of a transfer without loss of control, in which case an asset should be maintained on the statement of financial position against a financing liability.

Contract modifications are mentioned in the context of derecognition in so far as they increase or reduce existing rights or obligations. In deciding how to account for contract modifications, it is necessary, where rights and obligations are increased, to consider whether these rights and obligations are distinct from those in the initial contract (and are therefore new rights and obligations) or not (in which case they are part of the existing rights and obligations, which must be remeasured). If a contract modification both reduces existing rights or obligations and adds new rights or obligations, it is necessary to consider both the separate and the combined effect of those modifications.

6. Measurement

The chapter on measurement describes the two main measurement bases (historical cost and current value, which includes fair value), the information they contain and the aspects to be considered when selecting a measurement basis.

Historical cost

The historical cost of an asset is the value of the costs incurred in acquiring or creating the asset, i.e. the consideration paid to acquire or create the asset plus transaction costs. Conversely, the historical cost of a liability is the value of the consideration received minus transaction costs.

This historical cost is then updated to depict, where applicable:

- for an asset: the consumption of part or all of the economic resource that constitutes the asset (depreciation or amortisation); payments received that extinguish part or all of the asset; the effect of events that cause part or all of the historical cost of the asset to be no longer recoverable (impairment); and the accrual of interest to reflect any financing component of the asset.
- for a liability: fulfilment of part or all of the liability (e.g. by making payments or by delivering goods); the effect of events that increase the value of the obligation to such an extent that the liability becomes onerous; and the accrual of interest to reflect any financing component of the liability.

Current value

The Conceptual Framework details three types of current value: fair value, value in use or fulfilment value, and current cost (a little used concept corresponding to the replacement value at the measurement date; unlike fair value and value in use or fulfilment value, this is an entry value).

Fair value

The definition of fair value is that given in IFRS 13. Fair value is the price that would be received to sell an asset, or paid to

Key points

The recognition of assets and liabilities must satisfy the fundamental characteristics of useful financial information (relevance and faithful representation) in all the financial statements, subject to the cost constraint.

Accordingly, it no longer depends:

- on a probability threshold; or
- on the reliable measurement criterion.

The derecognition of assets and liabilities can be total or partial. The substance of the transaction is the key to the analysis.

transfer a liability, in an orderly transaction between market participants at the measurement date.

This price includes:

- estimates of future cash flows,
- possible variations in the estimated amount or timing of future cash flows,
- the time value of money,
- the price for bearing the uncertainty inherent in the cash flows (a risk premium or risk discount),
- other factors, for example, liquidity risk, if market participants would take those factors into account in the circumstances,
- for a liability, the possibility that the entity may fail to fulfil its liability (own credit risk).

Transaction costs are not included in fair value, either or acquisition or disposal.

This does not prevent the IASB from requiring measurement at fair value less costs to sell: for example in IFRS 5 on assets held for sale, IAS 36 on the impairment of assets, or IAS 41 on biological assets and agricultural products.

Value in use (assets) and fulfilment value (liabilities)

For an asset, value in use is the present value of the cash flows that an entity expects to derive from the use of an asset and from its ultimate disposal, including transaction costs on disposal.

For a liability, fulfilment value is the present value of the cash flows that an entity expects to be obliged to transfer as it fulfils an obligation.

These current values are entity-specific (unlike fair value, which is a market value). As they cannot be observed directly, they are determined using cash-flow-based measurement techniques.

Because value in use and fulfilment value are based on future cash flows, they do not include transaction costs incurred on acquiring an asset or taking on a liability. However, any transaction costs an entity expects to incur on the ultimate disposal of the asset or on fulfilling the liability are taken into account.

Selecting a measurement basis

A measurement basis must be selected for both the statement of financial position and the statement(s) of financial performance.

In general, it must be applied consistently to initial and subsequent measurements.

Relevance

A measurement basis produces relevant information when the following aspects are taken into account:

- the characteristics of the element: for example, the nature or the variability of cash flows and whether the value of the asset or liability is sensitive to market factors or other risks;

Note that this and the following criterion are taken from IFRS 9 on financial instruments.

- how that asset or liability contributes to future cash flows, in particular due to the nature of the entity's business activities.

This criterion is the IASB's response to proponents of taking the business model into account in IFRSs.

Faithful representation

Faithful representation does not mean that measures must be perfectly accurate in all respects: the limitations and/or descriptions of an estimated value may supplement it in a way that meets this target.

Additionally, in order to faithfully represent the activities of an entity, the same measurement basis can be required for associated assets and liabilities.

The Conceptual Framework details ways of enhancing faithful representation that can be brought by the other characteristics mentioned at point 2 – comparability, verifiability, timeliness and understandability.

Several measurement bases applied to the same element may be relevant either with:

- one recognition method for the statement of financial position (generally historical cost) and another in the notes (generally fair value):

7. Presentation and disclosure

Presentation and disclosure as communication tools

This chapter states that presentation and disclosure are communication tools. Effective communication of information in financial statements requires:

- focusing on presentation and disclosure objectives and principles rather than focusing on rules;
- classifying information in a manner that groups similar items and separates dissimilar items; and
- aggregating information in such a way that it is not obscured either by unnecessary detail or by excessive aggregation.

For example, this applies to:

- investment property accounted for at cost, whose fair value must be shown in the notes,
- biological assets accounted for at cost because their fair value cannot be reliably determined, and for which, where possible, entities are asked to provide a range of values within which fair value is likely to sit,
- financial instruments accounted for at amortised cost, whose fair value must be shown in the notes.

However, when tangible and intangible assets are recognised using the revaluation method, the notes must indicate, for each asset class concerned, the amount that would have appeared in the statement of financial position under the cost model.

- one measurement basis on the statement of financial position (generally fair value or a current value) and another in profit or loss (generally historical cost), the difference between the two measurement methods being recognised in Other Comprehensive Income.

This applies to financial instruments (held to collect and sell under IFRS 9).

Key points

The mixed model (historical cost and current value) is confirmed.

The selection of a measurement basis must take into account:

- the key characteristics of useful financial information (relevance and faithful representation) and more particularly the characteristics of the element, the contribution to cash flows due to economic activities, and measurement uncertainty;
- the cost constraint.

Several measurement bases applied to the same element may be relevant. The assessment must be made considering the needs of the representation both on the statement of financial position and on the statement of profit or loss.

Presentation and disclosure objectives and principles

A balance is needed between:

- giving entities the flexibility to provide relevant information that faithfully represents the entity's assets, liabilities, equity, income and expenses; and
- requiring information that is comparable, both from period to period and across entities.

Effective communication in financial statements is also supported by considering the following two principles:

- entity-specific information is more useful than standardised descriptions; and

For example, it is of no value to say that revenue in accordance with IFRS 15 is recognised when control is transferred. However, providing the time of this transfer in light of the

activity and habitual contractual arrangements of the entity would be more useful.

- duplication of information in different parts of the financial statements is usually unnecessary and can make financial statements less understandable.

Classification

The bulk of the chapter is devoted to the classification of assets and liabilities, equity and finally income and expenses. The concept of financial performance, which is not defined, is addressed through the classification of income and expenses in either:

- the statement of profit or loss, or
- other comprehensive income (OCI).

The statement of profit or loss is the primary source of information about financial performance.

It therefore follows that, in principle, all income and expenses for the period are recognised in the statement of profit or loss.

However, in exceptional circumstances the IASB may decide that items arising from a change in the current value of an asset or liability are to be included in other comprehensive income, if excluding them from the statement of profit or loss enhances relevance and provides a more faithful representation. However, items measured on a historical cost basis may not be recorded in other comprehensive income.

Conclusion

Far from revolutionising the IFRS landscape, the new Conceptual Framework clarifies, redefines and supplements the existing version, re-examining the argument in the light of the fundamental characteristics of the financial statements and cost-benefit constraints.

In passing, the IASB has:

- listened to the stakeholders and restored, albeit in different form, the concepts of prudence, stewardship, and substance over form, while introducing the concept of business activities to be taken into account when selecting a measurement basis;
- separated the definition of the elements of the financial statements from the recognition criteria;
- confirmed the development of its thinking by bringing the concept of control into line with the definition in recent standards, and by removing probability from the recognition criteria, so that this concept now only comes into play in measurement aspects;
- clarified that the financial statements must be established from the perspective of the entity;
- debunked two myths: that of ‘full fair value’, by developing measurement principles based on a mixed

This applies to financial instruments that are held to collect and sell under IFRS 9, where the part corresponding to interest income is included in the statement of profit or loss.

For other comprehensive income, a second principle states that these elements must be reclassified into the statement of profit or loss.

However an exemption may be provided from this principle if, for example, there is no clear basis for identifying the period in which recycling to profit or loss would enhance the relevance and faithful representation of the information in that statement.

Note that currently, the elements of OCI that cannot be recycled in P&L are: remeasurement adjustments on fixed assets, remeasurements or actuarial gains and losses on defined benefit plans and fair value changes to the own credit risk for liabilities recognised at fair value in profit or loss.

Key points

Presentation and disclosure must be seen as communication tools.

The statement of profit or loss is the primary source of information about financial performance.

All the income and expenses for the period are accounted for in this statement, unless doing so does not provide relevant information or a faithful representation of performance.

measurement model, and that of disappearance of the statement of profit or loss, by confirming that it is the main source source of information for assessing the entity’s financial performance.

The Conceptual Framework will come into force:

- immediately, for its own work and that of the IFRS IC;
- in 2020 for entities referring to it, where necessary.

The text of the Conceptual Framework is available on the site [ifrs.org](https://www.ifrs.org) in the part reserved to subscribers. Explanatory documents, however, are freely available at: <https://www.ifrs.org/projects/2018/conceptual-framework/#educational-material>

Key points

The new Conceptual Framework is unlikely to have any short-term impacts on the existing standards.

Cases in which future standards do not comply with the Conceptual Framework will be limited, given the degree of latitude allowed by the text.

Events and FAQ

Frequently asked questions

IFRS

- Calculation of basic and of diluted earnings per share (IAS 33).
- Impact of the repayment of subordinated perpetual notes on consolidation requirements.
- Acquisition with crossed put and call – determining the percentage of interest
- Contingent consideration conditional on presence
- Tax rate to apply in accounting for a business combination

Upcoming meetings of the IASB, IFRS Interpretations Committee and EFRAG

IFRS		EFRAG	
IASB	Committee	Board	TEG
21-25 May	12-13 June	30 May	13-14 June
18-22 June	11-12 September	27 June	5 July
16-20 July	27-28 November	3 July	5-6 September

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