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Beyond the GAAP

MAZARS' NEWSLETTER ON ACCOUNTING STANDARDS

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EDITORIAL

Our last editorial touched, without wanting to believe it, on the wide repercussions we could expect from the coronavirus outbreak.

A few days later, with half the world's population now under lock-down (whether enforced or encouraged), this month's news has necessarily taken on a distinct flavour all its own. This is why we have produced a 'COVID-19 supplement' to examine the impacts of the crisis on 2019 reporting (for those entities still concerned!), and on the annual reporting that does not coincide with the calendar year and on the 2020 interim accounts.

While the crisis is absorbing a good deal of energy, the IASB has so far made only minor adjustments to its calendar and work plan. March, for example, saw the publication of a discussion paper on goodwill and impairment, to which we will return later in more detail. We also present the conclusions of the redeliberations on IFRS 17 amendments. The mandatory effective date of this standard has now been set at no later than 1 January 2023.

Enjoy your reading!

Edouard Fossat **Carole Masson**

IFRS highlights

IFRS IC clarifies the treatment of training costs incurred to fulfil a contract with a customer

In March 2020, the IFRS Interpretations Committee (IFRS IC) reached a final decision on the question of how to account for training costs incurred by an entity that are necessary to fulfil a performance obligation to a customer. These are costs incurred when the staff providing the service must first be trained, for example in specific technical aspects of customer equipment that will be used.

In the Committee's view, these costs are explicitly covered by IAS 38 on intangible assets, which states that they must be recognised as an expense when they are incurred. The IFRS IC also noted that IFRS 15 prohibits entities from capitalising the costs of fulfilling a contract where these are primarily within the scope of another standard that precludes their recognition as an asset.

Finally, the IFRS IC clarified that these costs are also immediately recognised as an expense when the contract explicitly permits the entity to charge them to the customer (as was the case in the fact pattern submitted to the Committee).

Discussion paper on goodwill and impairment

On 19 March, the IASB published a discussion paper on goodwill and impairment. Comments may be submitted no later than 15 September 2020 (unless the date is pushed back because of the COVID-19 outbreak).

This paper, which will be discussed in more detail in a future edition, presents the Board's current thinking on the issues raised during the post-implementation review of IFRS 3 on business combinations. The paper includes:

- a section on **improving disclosures about acquisitions:** management's objectives for the acquisition will in particular be disclosed in the year of acquisition. In subsequent financial periods, disclosures about how the acquisition has performed against those objectives will be provided;
- a section on **the accounting for goodwill:** as expected, at this stage the Board considers that goodwill should not be amortised (i.e. the impairment-only model should be retained). Nevertheless, proposals are being made for simplifying impairment tests and making them less costly, by providing relief from the requirement to perform a test annually if there is no indication that an impairment has occurred, and by simplifying the requirements for estimating value in use.

The IASB highlights the importance of this issue for stakeholders and encourages feedbacks concerning both disclosures and the accounting of goodwill.

The discussion paper can be found on the IASB site at: https://cdn.ifrs.org/-/media/project/goodwill-and-impairment/goodwill-and-impairment-dp-march-2020.pdf

IFRS taxonomy

On 17 March 2020, the IFRS Foundation published the IFRS Taxonomy 2020, which translates IFRSs into XBRL (eXtensible Business Reporting Language).

The IFRS taxonomy 2020 reflects the standards as published by the IASB at 1 January 2020, including those that are published but have not yet come into force.

Readers will note the importance of this taxonomy for European issuers, who have been required since 1 January 2020 to tag the consolidated IFRS accounts published in their annual financial reporting using iXBRL language. The taxonomy to be used (published by ESMA) is broadly inspired by the IASB taxonomy and is regularly updated to track the changes in the IFRS taxonomy.

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A Closer Look

The IASB's redeliberations on upcoming amendments to IFRS 17 are complete

The January, February and March meetings resulted in a wealth of decisions on the upcoming amendments to IFRS 17 – *Insurance Contracts*. The IASB has reached positions on the majority of topics identified by stakeholders, though not always in the direction they hoped for (in particular in terms of the aggregation of contracts by annual cohorts). A summary of all the IASB's tentative decisions since the start of these redeliberations can be found in paper 2C prepared by the staff ahead of the March meeting.

During the January and February meetings, the IASB defined the details of the upcoming amendments on the following topics:

- a scope exclusion from IFRS 17 for some credit card contracts;
- transition: a prohibition from applying the risk mitigation option retrospectively;
- risk mitigation option: extension of the scope of the option to non-derivative financial instruments measured at fair value through profit or loss;
- business combinations: contracts acquired at their settlement period after transition to IFRS 17;
- interim financial statements;
- insurance contract acquisition cash flows: aspects related to the transition and to business combinations;
- recognition of the contractual service margin (CSM) for contracts without direct participation features, providing an investment-return service in addition to insurance coverage;
- annual cohorts: contracts with intergenerational sharing of risks between policyholders;
- transition: additional modifications and reliefs.

These topics are discussed in the separate sections below. The IASB also considered some minor amendments and some fresh topics, such as the inclusion in the fulfilment cash flows of income tax payments and receipts that are specifically chargeable to the policyholder under the terms of an insurance contract. We invite our readers to read the IASB's February *Update* and papers 2D and 2F prepared by the staff in February for more information about these topics.

In March, the IASB confirmed that the mandatory effective date of IFRS 17 and IFRS 9 (for insurers having opted for the deferral of IFRS 9) would be postponed by an additional year (compared with the proposal in the June 2019 Exposure Draft). Therefore, the effective date is now annual periods starting 1 January 2023, whereas the standard (as initially published in 2017), before the amendments, had set the mandatory effective date at 1 January 2021.

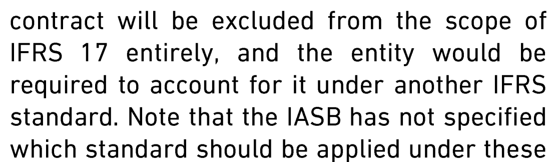
In March, the Board also authorised the staff to start drafting the final text of the amendments, for publication still expected in the second quarter of 2020.

The papers drawn up by the IASB staff ahead of the meetings are available on the IASB site (IASB Agenda meeting January / IASB Agenda meeting February / IASB Agenda meeting March).

1. A scope exclusion from IFRS 17 for some credit card contracts (January 2020 redeliberations)

The IASB has tentatively decided to make some changes to the IFRS 17 scope exclusion, proposed in last June's exposure draft, for credit cards with an insurance coverage. This scope exclusion targeted credit card contracts that meet the definition of an insurance contract and for which the entity does not reflect the insurance risk associated with individual customers when setting the price:

- the scope of the exclusion will be extended to include products similar to credit cards (e.g. debit cards);
- the contracts concerned will no longer be systematically excluded from the scope of IFRS 17 in their entirety; in some cases, the insurance component may fall back into the scope of IFRS 17. Two situations may occur:
  - **case 1**: if the insurance component is part of the terms of the contract, the contract must be separated into two components. IFRS 17 would apply to the insurance component and another applicable standard (for example, IFRS 9) would determine the accounting treatment of the other component;
  - **case 2:** in other cases (as we understand it, including where the inclusion of insurance cover is imposed by law or regulation) the



contract will be excluded from the scope of IFRS 17 entirely, and the entity would be required to account for it under another IFRS standard. Note that the IASB has not specified which standard should be applied under these circumstances, but if the indications in paragraph 7h of the exposure draft are confirmed when the amendments are finalised, the whole contract will presumably have to be accounted for under IFRS 9.

2. Transition: a prohibition from applying the risk mitigation option retrospectively (January 2020 redeliberations)

Some stakeholders had called for retrospective application of the risk mitigation option, in order to limit accounting mismatches in the income statement at the transition date, and during subsequent periods, between the contracts hedged and the risk mitigation instruments, but despite this the IASB confirmed that the retrospective application of this treatment would continue to be prohibited, including when an entity mitigates the financial risks arising from the insurance contracts using reinsurance contracts held. The IASB explains this decision by its wish to prevent the risk of the use of hindsight, which would be inevitable if retrospective application was authorised, in particular where the risk mitigation instruments are derivatives. The risk of hindsight can be defined as the risk that entities would arbitrarily designate some derivatives as risk mitigation instruments in full knowledge of the value of these contracts at the transition date, in order to optimise the performance of the related insurance contracts. For information, the IASB has in the past prohibited the retrospective designation of derivatives as designated hedging instruments for similar reasons (for example, during the transition to IFRS 9 phase 3).

3. Risk mitigation option: extension of the scope of the option to include non-derivative financial instruments measured at fair value through profit or loss (February 2020 redeliberations)

Readers will recall that the IASB's exposure draft of June proposed to extend the scope of the risk mitigation option to include reinsurance contracts held. In February, the IASB decided to extend this option further, including when the risk mitigation instrument is a non-derivative financial instrument measured at fair value through profit or loss. An entity may therefore extend the risk mitigation option to these instruments if and only if the conditions of IFRS 17 paragraph B116 are satisfied.

4. Business combinations: contracts acquired at their settlement period after transition to IFRS 17 (January 2020 redeliberations)

The IASB has decided to retain, unchanged, the requirements in IFRS 17 for insurance contracts acquired in their settlement period (i.e. that have already incurred claims) in a transfer of insurance contracts taking place after transition to IFRS 17. This refers to transfers of portfolios that do not form a business, and transfers in a business combination within the scope of IFRS 3. Note that in the upcoming amendments to IFRS 17 the IASB intends to introduce reliefs for such contracts, but only at the transition date.

Retention of the existing provisions for these contracts may have significant impacts, for example on how the contract liabilities are classified (they should probably be classified as "liabilities for remaining coverage" rather than "liabilities for incurred claims"). This classification will affect how the performance of these contracts is presented in profit or loss, and how the contractual service margin (CSM) is accounted for.

5. Interim financial statements (January 2020 redeliberations)

Departing from the principles of IAS 34, IFRS 17 contains a paragraph (B137) that requires that an entity should not change the treatment of accounting estimates made in previous interim financial statements when applying IFRS 17 in subsequent interim financial statements or in the annual financial statements. This provision means that the frequency of interim reporting can have an impact on the overall result of the insurance contracts in a given financial year.

Following stakeholder feedback, the IASB decided to amend paragraph B137 of IFRS 17 to introduce an accounting policy choice between applying this paragraph and not doing so. This means that entities would be required to make an accounting policy choice as to change or maintain the treatment of estimates made in previous interim financial statements when applying IFRS 17 in subsequent interim financial statements or in the annual reporting period. This accounting policy choice will apply to all insurance contracts issued and reinsurance contracts held (i.e. this will be an accounting policy choice at entity level).

6. Insurance contract acquisition cash flows: aspects related to the transition and to business combinations (January 2020 redeliberations)

In our December edition, we presented the IASB's recent decisions concerning the impairment testing of deferred acquisition costs, their subsequent allocation to groups of contracts, and the disclosures which will be required for these deferred acquisition cash flows.

During its January meeting, the IASB addressed some minor related topics concerning the measurement of an asset for insurance acquisition cash flows at the transition date, or at the date of business combinations taking place after the transition to IFRS 17.

The IASB confirmed that at the transition date entities will be required to identify, recognise and measure an asset for insurance acquisition cash flows for a group of insurance contracts retrospectively. If and only if it is impracticable for the entity to apply IFRS 17 retrospectively, the entity is required to measure an asset deferred for insurance acquisition cash flows applying either the modified retrospective approach or the fair value approach. January's IASB Update (accessible here) contains details for determining the amount of this asset at the transition date using the modified retrospective approach and the fair value approach, since these two approaches are not aligned.

Finally, the IASB also decided that after the transition to IFRS 17, an entity shall recognise an asset for deferred acquisition cash flows both for contracts acquired in a business combination and those acquired in a transfer of separate portfolios of insurance contracts that do not form a business. In this instance, the assets recognised will correspond to the fair value of the rights associated with these acquisition cash flows.

7. Recognition of contractual service margin attributable to an investment-return service for contracts without direct participation features (February 2020 redeliberations)

Last December the IASB confirmed the proposals of the exposure draft concerning the identification of an investment-related service, and the coverage units for insurance contracts with direct participation features following the VFA (variable fee approach). In February, it turned to a similar topic in respect of contracts without direct participation features following the general model. For these contracts, an entity must identify an 'investment-return service' in order to be able to recognise the CSM in profit or loss using a pattern that takes account of both the insurance coverage and the investment services relating to the underlying investments. In February, the IASB decided to amend the criteria for identifying an investment-return service, by replacing the references in paragraph B119B of the exposure-draft to a 'positive investment return' with the less restrictive notion of 'investment return'. The future definition should therefore include more insurance contracts than previously.

The IASB also decided to clarify the recognition of costs related to investment activities. Entities will be required to include these costs within the boundary of an insurance contract to the extent that the entity performs such activities to enhance benefits from insurance coverage for the policyholder, even if the entity has concluded that the contract does not provide an investment-return service.

Finally, the IASB confirmed the disclosure requirements for this service and its impact on coverage units as proposed in the June exposure draft. Entities must publish information that includes:

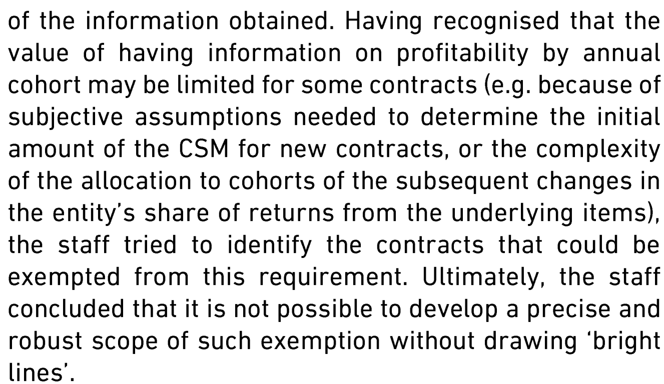
- quantitative information about when the entity expects to recognise in profit or loss the residual contractual service margin;
- for contracts containing both types of services, a description of the approach used to determine the relative weighting of the benefits provided by insurance coverage and the investment-return service.

8. Annual cohorts: contracts with intergenerational sharing of risks between policyholders (February 2020 redeliberations)

The IASB decided to retain, unchanged, the annual cohort requirement, including for contracts subject to the variable fee approach that share the returns on underlying items across generations of policyholders.

In the paper AP2B, the IASB staff recall the importance of having information on the returns on contracts by annual cohort, in particular when the contractual cash flows that do not vary in response to the returns of the underlying items are not insignificant (e.g. because of minimum rate guarantees embedded in the contracts) and differ depending the year of issue. This is particularly important in the current low interest rate environment.

At the request of stakeholders, the IASB staff carried out additional work to identify some examples of contracts with contractual features (see paper 2B, paragraph 27) such that the costs of applying the annual cohort requirement (as opposed providing this information at a more aggregated level) are likely to exceed the benefits



of the information obtained. Having recognised that the value of having information on profitability by annual cohort may be limited for some contracts (e.g. because of subjective assumptions needed to determine the initial amount of the CSM for new contracts, or the complexity of the allocation to cohorts of the subsequent changes in the entity's share of returns from the underlying items), the staff tried to identify the contracts that could be exempted from this requirement. Ultimately, the staff concluded that it is not possible to develop a precise and robust scope of such exemption without drawing 'bright lines'.

The IASB confirmed the staff's proposal on 25 February. The topic of annual cohorts, which is very strategic for some insurers, now seems closed as far as the international standard-setter is concerned, regardless of stakeholders' efforts to shift the IASB from its historic position.

It remains to be seen whether EFRAG's recent letter to the IASB sent on 24 March 2020 (which you can download here) will change the IASB's opinion. In this letter, the President of the EFRAG Board urges the IASB to find an appropriate solution for a particular contract population (previously identified in EFRAG's Comment Letter on the exposure draft published by the IASB in June 2019), and suggests that if such a solution is not found:

- the relevance of the information resulting from the application of IFRS 17 may raise serious concerns, as it might not be aligned with the underlying economic realities; and
- the required cost-benefit trade-off would not be met.

We will have to keep an eye on the European Union's endorsement process to see if an exemption similar to the one requested from the IASB will be granted to European entities, given the importance of intergenerational sharing of returns between policyholders for some insurers.

9. Transition: additional modifications and reliefs

The IASB decided to take account of some stakeholders' proposals, and suggested amending the existing transition requirements as follows:

- **Date of analysis for investment contracts under the modified retrospective and fair value approaches**: the IASB decided to add a new modification/exemption, similar to that in IFRS 17 paragraphs C9 and C21, permitting an entity to determine - for example - whether a contract is eligible for the variable fee approach at the transition date. This new measure allows entities to determine whether an investment contract meets the definition of **an investment contract with discretionary participation features** using information available at the transition date (rather than at inception or initial recognition). Consistent with other modifications in the modified retrospective approach, an entity would apply the extended modification only to the extent that it does not have reasonable and supportable information to apply a retrospective approach.
- **Insurance contracts held using the modified retrospective approach:** readers will recall that IFRS 17 will be amended (as explained in previous editions) in order to allow entities, under certain conditions, to recognise a gain at inception and a loss-recovery component on the reinsurance contracts held This accounting treatment will apply to reinsurance contract held that are acquired before or at the same time as the underlying onerous contracts are issued. In line with this change, the IASB decided to amend the proposed change in the modified retrospective approach for reinsurance contracts held when underlying insurance contracts are onerous. The amendment will specify that if an entity does not have reasonable and supportable information to identify whether the reinsurance contract held was acquired before or at the same as the directly underlying insurance contracts, the entity should assume that the reinsurance contract held was acquired after the date on which the insurance contracts were issued. Consequently, the reinsurance contract held would not include any loss-recovery component at the transition date.
- **Estimates in the interim accounts before transition in the modified retrospective approach:** in line with the January decision on whether to change the estimates used in previous interim financial statements when preparing the annual financial statements (presented above in our article), the IASB decided to add a new modification to the modified retrospective approach for entities that make an accounting policy choice not to change the treatment of accounting estimates made in previous interim financial statements:
  - under this modification, an entity would determine the contractual service margin, risk component, and amounts related to insurance finance income or expenses at the transition date as if the entity had not prepared any interim financial statements before the transition date;
  - an entity would apply the modification only to the extent that it does not have reasonable and supportable information to apply retrospectively its accounting policy choice.

Key points to remember

- The IASB's redeliberations on upcoming amendments to IFRS 17 are now complete. These amendments should be published by the IASB during the second quarter of 2020.
- The mandatory effective date of IFRS 17 has finally been deferred to 1 January 2023, two years after the date initially announced. Further, standard IFRS 9 on financial instruments will also be applied no later than 2023 by those insurers that opted to defer its application.
- The main tentative decisions (tentative, in the sense that the amendments have not yet been published) taken as a result of the IASB's redeliberations have been presented in the editions 139, 138 and 135 of Beyond the GAAP.
- During this phase of redeliberations, and in light of stakeholder feedback, the IASB has changed its position on several crucial topics by comparison with the proposals in the June 2019 exposure draft. For example, it has decided to relax the conditions for the recognition of a gain at inception on reinsurance treaties held hegding underlying onerous contracts issued. The IASB has also given entities more time to prepare the first application of IFRS 17.
- The IASB has also clarified some new features in the exposure draft, such as the recognition of assets for deferred acquisition flows and their impairment, IFRS 17 scope exclusions, or the recognition of the investment service income for contracts that contain an investment service component on top of insurance coverage.
- Nonetheless, some thorny issues remain unresolved by the IASB, in particular:
    - the requirement to monitor the profitability of all insurance contracts (including those benefitting from intergenerational risk sharing) by annual cohorts; and
    - the prohibition from applying the risk mitigation option to VFA contracts retrospectively at the transition date.

Events and FAQ

Frequently asked questions

IFRSs

- COVID-19 crisis and impacts on annual statements at 31 December 2019 (disclosures on events after the reporting period)
- Accounting for short-time working arrangements
- Presentation of health crisis impacts in the income statement
- Recognition of a marketing contract
- Bonds redeemable for shares: analysis of the distinction between debt and equity
- Derecognition effect of a programme to assign receivables
- Renegotiation of an operating lease by a lessor
- Recognition of a sale and leaseback transaction
- IFRS 16 and acquisitions: recognition of leases acquired as part of a business combination

UPCOMING MEETINGS OF THE IASB, IFRS INTERPRETATIONS COMMITTEE AND EFRAG

IFRS		EFRAG	
IASB	Committee	Board	TEG
20 - 24 April	29 April	21 April	16 April
18 - 22 May	16-17 June	26 May	6-7 May
22 - 26 June	15-16 September	16 June	3-4 June

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