

Beyond the GAAP

Mazars' newsletter on accounting standards

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Editorial

With annual report season in full swing, this issue of Beyond the GAAP is a slightly quicker read than last month's issue. However, it does contain some particularly significant news, notably a number of interesting agenda decisions published by the IFRS Interpretations Committee.

Following the IASB's decision to re-open IFRS 17 – *Insurance Contracts* (see last issue), the time has now come for the Board to identify which topics will form the subject of amendments. Beyond the GAAP presents the proposals to date in this month's 'A Closer Look' feature.

Enjoy your reading!

Edouard Fossat

Isabelle Grauer-Gaynor

IFRS highlights

Most recent IFRS IC agenda decisions

The IFRS Interpretations Committee (IFRS IC) has published four agenda decisions after its January 2019 meeting on the following topics:

- IFRS 15: identification of goods or services promised to a customer;
- IAS 37: deposits relating to taxes that are outside the scope of IAS 12
- IAS 27: investment in a subsidiary in the entity's separate financial statements (2 agenda decisions on this topic).

Details of the agenda decisions are presented in separate articles below.

The IFRS IC's most recent agenda decisions are available here:

<https://www.ifrs.org/news-and-events/updates/ifric-updates/january-2019/>

Agenda decision on IFRS 15: identification of goods or services promised to a customer

This IFRS IC agenda decision relates to the approach used in practice to identify the performance obligations (POs) in a contract, based on a fact pattern in which a stock exchange charges two types of fee to a customer:

- a non-refundable upfront fee on initial listing, relating to activities undertaken by the stock exchange at contract inception;
- an ongoing listing fee, paid regularly to the stock exchange for continuing to list the company.

The question put to the IFRS IC was whether or not the stock exchange promises to transfer an admission service that is distinct from the listing service. In other words, does the contract include two performance obligations or just one?

In the agenda decision, the IFRS IC noted that before identifying the POs in a contract in accordance with IFRS 15.22, an entity must identify all the goods or services promised to the customer (i.e. the contractual "promises"), taking account of the facts and circumstances of the contract.

The agenda decision also included a reminder that these contractual promises do not include activities that an entity must undertake to fulfil a contract unless those activities transfer a good or service to a customer (IFRS 15.25). This assessment is particularly important if the customer is charged a non-refundable upfront fee (IFRS 15.B49). It is common for such fees to be charged for activities that the entity is required to undertake at contract inception, but that

do not result in the immediate transfer of a promised good or service to the customer.

In the case of the fact pattern submitted to the IFRS IC, the Committee concluded that the activities undertaken by the stock exchange at contract inception to enable admission to the exchange (e.g. carrying out due diligence and reviewing the listing application) are required in order to provide the service for which the customer has contracted (i.e. the service of being listed on the exchange) but do not transfer a service to the customer.

In practice, this means that the non-refundable upfront fee on initial listing is an upfront payment for the ongoing listing service. It should therefore be recognised as revenue when the service is provided (i.e. over the estimated duration of the listing).

Agenda decision on IAS 37: deposits relating to taxes that are outside the scope of IAS 12

The IFRS IC agenda decision discusses a fact pattern in which an entity and a tax authority dispute whether the entity is required to pay a tax that is not within the scope of IAS 12 (liabilities, contingent liabilities and contingent assets relating to this tax thus fall within the scope of IAS 37). Although the entity is disputing the tax authority's decision, it has paid a deposit to the authority, either voluntarily in order to avoid penalties, or because it was required to do so under the tax dispute process. Upon resolution of the dispute, the tax authority will be required to either refund the deposit to the entity (if the dispute is resolved in the entity's favour) or use the deposit to settle the entity's liability (if the dispute is resolved in the tax authority's favour). The entity believes it is more likely than not that the dispute will be resolved in its favour.

The question related to whether or not the deposit paid to the tax authority should give rise to the recognition of an asset in the entity's financial statements.

The IFRS IC noted that if the tax deposit gives rise to an asset, that asset may not be clearly within the scope of any existing IFRS Standard, and moreover, no IFRS Standard deals with any similar issues. Thus, following the hierarchy of sources set out in IAS 8.10-11, the IFRS IC concluded that the right arising from the deposit meets the definitions of an asset set out in the Conceptual Framework published in March 2018 and in the previous Conceptual Framework. No matter what the outcome of the dispute, the entity has a right to obtain future economic benefits (either by receiving a refund of the deposit or by using the deposit to settle the tax liability). This right is an asset and not a contingent asset, so it does not fall within the scope of IAS 37 (as a reminder, IAS 37 sets a high threshold for distinguishing between contingent assets and

assets: the realisation of income must be “virtually certain” for the asset not to be classified as contingent). The IFRS IC also clarified that the right is not affected by whether the tax deposit is voluntary or required; the entity would draw the same conclusion whether or not it is required to make such a deposit under local legislation.

Having established this principle, the IFRS IC went on to observe that the issues relating to the recognition, measurement and presentation of this asset, and the disclosures required in the notes, may be similar or related to those that arise for a monetary asset (i.e. a right to receive a fixed or determinable number of units of currency – e.g. a receivable). Consequently, the entity’s management must make use of judgement to develop an accounting policy with reference to the requirements in IFRS standards that address these issues for monetary assets.

Readers will remember that an interpretation of IAS 12, published in June 2017 and effective for financial periods commencing on or after 1 January 2019, sets out the accounting treatment for taxes within the scope of IAS 12 when there is uncertainty over income tax treatments (IFRIC 23 – *Uncertainty over Income Tax Treatments*). If an entity were engaged in a similar dispute relating to a tax within the scope of IAS 12, the outcome would be the same (i.e. the entity would recognise an asset).

Agenda decisions on the investment in a subsidiary in the entity’s separate financial statements

In January 2019, the IFRS IC finalised 2 agenda decisions related to the accounting for an investment in a subsidiary in the entity’s separate financial statements. The first agenda decision looks at how to account for a partial disposal when the entity has elected to recognise its investment at cost in accordance with IAS 27, whilst the second agenda decision looks at the opposite fact pattern of a step acquisition.

Partial disposal of the investment in a subsidiary accounted for at cost in the separate financial statements

In the situation submitted to the IFRS IC, the entity loses control of its subsidiary and retains neither joint control nor significant influence on the investee. It therefore has to account for its equity investment in accordance with IFRS 9.

Similarly to IAS 28.22(b) on investments in associates and joint ventures and IAS 27.11B, it first needs to account, in profit or loss, for the difference between the cost of the retained interest and the fair value of the investment at the date control is lost.

The IFRS IC concluded that, subsequently, the investment retained, if not held for trading, is eligible to be accounted for at fair value with changes in fair value recorded in other comprehensive income (OCI) as defined by IFRS 9.4.1.4. That

election has to be made when the entity first applies IFRS 9 to that investment.

Step acquisition of an investment in a subsidiary accounted for at cost in the separate financial statements

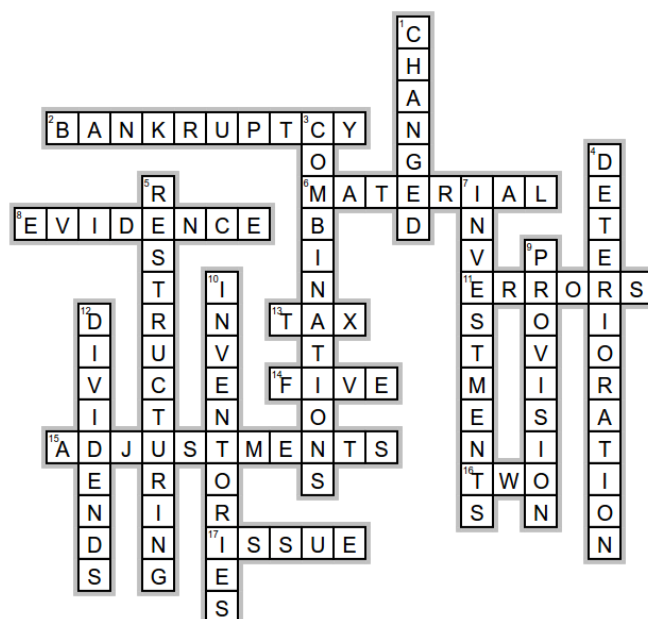
In the reverse situation of stepping up from an equity investment accounted for under IFRS 9 because it is neither an associate, a joint venture nor a subsidiary to a subsidiary, the IFRS IC concluded that, since IAS 27 does not define cost, two methods are possible to determine the cost of the investment in the subsidiary depending on whether the entity considers that the step acquisition involves the entity:

- exchanging its initial interest, plus consideration paid for the additional interest, for a controlling interest in the investee (fair value as deemed cost approach), or
- purchasing the additional interest while retaining the initial interest (accumulated cost approach).

Such choice is however considered by the IFRS IC as being an accounting policy choice, which needs to be consistently applied to such operations and disclosed in the notes to the financial statements. However, Committee members consider that the first of these two methods would provide more useful information to users of financial statements than the second.

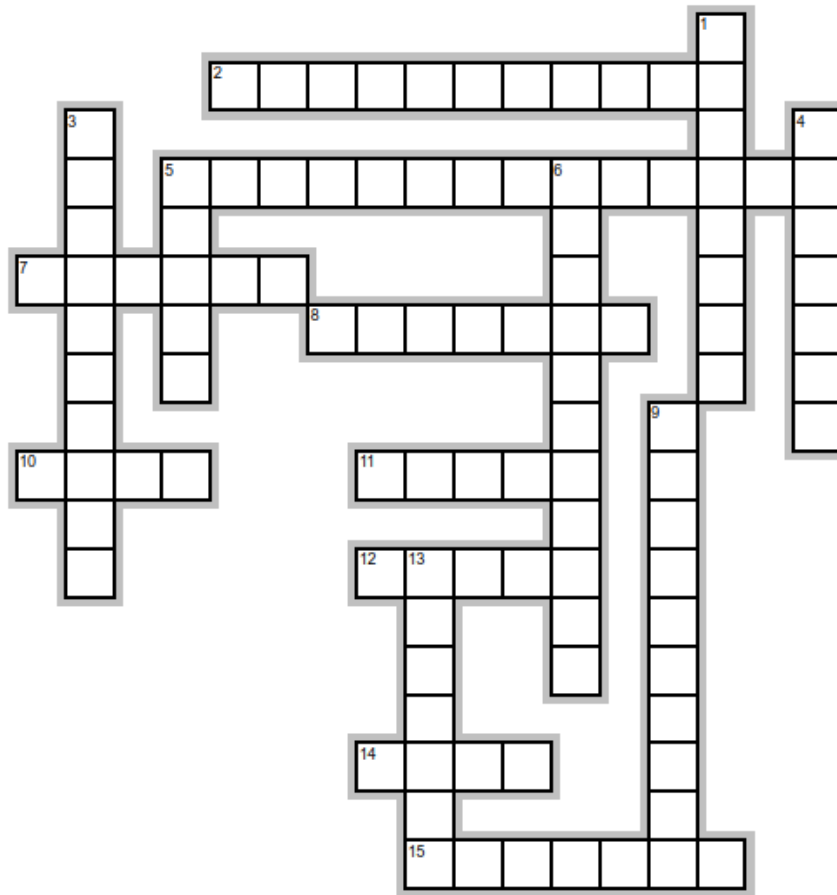
When using the second method, regardless of where, in profit or loss or OCI, the entity had presented changes in fair value of the initial interest under IFRS 9, the difference between the fair value of the initial interest at the date of obtaining control and its original cost is to be recognised in profit or loss.

Crossword: last month’s solution



Crossword:

How well do you know IAS 41?



Across:

2. The title of IAS 41
5. Growth forms part of this biological process
7. These plants do not fall within the scope of IAS 41
8. The point after which biological assets are no longer covered by IAS 41
10. These costs are deducted from fair value when measuring biological assets
11. An example of agricultural produce
12. The impact of such changes related to biological assets is presented in profit or loss
14. This is recognised when a calf is born
15. The number of the IAS that covers plants outside the scope of IAS 41

Down:

1. Cost may be used when fair value cannot be measured in such way
3. IAS 41 also covers these types of grants
4. The exception to the general measurement principle only applies if the entity determines at this time of recognition that fair value cannot be measured reliably
5. The number of features common to agricultural activity as defined in IAS 41, according to paragraph 6
6. At the end of the reporting period it shall not take account of any contract to sell at a future date
9. An example of a plant that does not fall within the scope of IAS 41 (2 separate words)
13. Biological assets that always fall within the scope of IAS 41

A Closer Look

IASB planning amendments to IFRS 17 – *Insurance Contracts*

At its January meeting, the IASB decided to make amendments to IFRS 17 – *Insurance Contracts*, relating to the following topics:

- recognition of cash flows relating to the acquisition of insurance contracts;
- reinsurance contracts purchased by a primary insurer (reinsurance contracts held);
- amortisation of the contractual service margin (CSM) in profit or loss for contracts that include an investment return service.

The official announcement of these decisions is available on the IASB's website via the following link: <https://www.ifrs.org/news-and-events/updates/iasb-updates/january-2019/>.

The agenda papers for the topics addressed by the IASB in January are also available on the IASB's website, via the following link: <https://www.ifrs.org/news-and-events/calendar/2019/january/international-accounting-standards-board/>.

These changes are intended to address criticisms raised by stakeholders, and thus to more faithfully represent the performance of insurance contracts in financial statements. Beyond the GAAP will address each of these topics below, point by point.

1. Cash flows relating to the acquisition of insurance contracts

The IASB has tentatively decided to clarify the accounting treatment of insurance acquisition cash flows attributable to expected future renewals of newly issued contracts. Thus:

- On initial recognition of insurance contracts, insurers shall allocate the insurance acquisition cash flows between (a) the contracts newly entered on the balance sheet and (b) the future contracts that are expected to result from the renewal of these contracts.
- The insurance acquisition cash flows allocated to future contracts shall be recognised as assets, in accordance with IFRS 17.27, until the date of initial recognition of the contracts resulting from the expected renewals. If the insurer expects that the original contract (with, say, an initial term of one year) will be renewed several times consecutively, this portion of the cash flows could continue to be recognised as an asset for several years, depending on how many times the insurer expects to renew the original contract that gave rise to the costs.
- At the end of each reporting period, the insurer shall assess the recoverability of these costs. This assessment shall be based on the fulfilment cash flows of the related group of contracts (i.e. the assessment is performed on a group of insurance contracts basis, rather than for each contract individually).
- If the recoverability assessment shows that any portion of the asset recognised is unrecoverable, it shall be derecognised and an expense shall be recorded in profit or loss.
- Subsequently, some or all of this expense may be reversed (and a gain recorded in profit or loss) if a subsequent recoverability assessment shows that some or all of the costs previously recognised, and then recorded as an expense because they were assessed as non-recoverable, are now recoverable again.

2. Reinsurance contracts held

At its January meeting, the IASB tentatively decided to make amendments to some specific points of IFRS 17 relating to reinsurance contracts held (i.e. the accounting treatment in the financial statements of a primary insurer that is using reinsurance to reduce its risk exposure to the underlying insurance contracts it has underwritten).

The proposed amendments relate to the following two topics:

- onerous underlying contracts; and
- ineligibility for the variable fee approach (VFA) when the underlying contracts are eligible for the VFA.

Topic 1: onerous underlying contracts

In accordance with IFRS 17.66(c) (ii) (the scope of which will be expanded), insurers will henceforth be required to immediately recognise a gain for reinsurance contracts held when they recognise losses on onerous underlying insurance contracts (including at initial recognition).

This gain shall only be recognised to the extent that these reinsurance contracts cover the losses of each contract on a proportionate basis (our understanding is that this amendment relates only to proportional reinsurance treaties).

This amendment is intended to address stakeholders' criticisms of the accounting treatment at initial recognition of reinsurance contracts held, and should reduce accounting mismatches in profit or loss that could have resulted from the existence of onerous underlying insurance contracts.

It should be noted that the explanation of the proposed amendment in *IASB Update* (i.e. that the gain shall be recognised in profit or loss at the same time as the entity recognises a loss on the onerous contract), as well as some paragraphs in the agenda paper, would seem to suggest that mismatches are nonetheless unavoidable if the reinsurance treaty was signed after the onerous underlying contracts were issued.

The IASB has also decided to extend the principle described above to contracts recognised in accordance with the (simpler) premium allocation approach (PPA).

3. Amortisation of the CSM

The IASB has tentatively decided to amend IFRS 17 to modify the pattern of amortisation in profit or loss of the contractual service margin (CSM) for contracts that are accounted for under the general model and that include both insurance coverage and an investment return service:

- in the general model, the CSM shall henceforth be recognised in profit or loss on the basis of coverage units that are determined by considering both insurance coverage and any investment return service;

Readers may remember that the IASB already decided, last June, to make similar changes to the amortisation pattern of the CSM for contracts accounted for using the VFA. However, the terminology used is not quite consistent, with "investment-related services" used for the VFA in June 2018, and "investment return service" used for the general model in January 2019.

- the standard will also be amended to clarify that an investment return service exists only when an insurance

Topic 2: ineligibility for the variable fee approach (VFA) when the underlying contracts are eligible for the VFA

Reinsurance contracts held will still not be eligible for the VFA[†].

However, stakeholders raised concerns about the potential accounting mismatches that could result from this ineligibility (as insurance contracts issued would be accounted for using the VFA, while reinsurance contracts held to reduce exposure to the underlying contracts would be accounted for using the general model set out in IFRS 17). To address these concerns, the IASB decided to expand the scope of the risk mitigation exception set out in IFRS 17.B115, which is intended to reduce accounting mismatches in profit or loss resulting from the use of different measurement approaches for the underlying insurance contracts issued and the instruments used to mitigate financial risks.

An entity will henceforth have the option of applying this exception when the instrument used to mitigate risk is a reinsurance contract held – provided that this reinsurance contract meets the eligibility criteria set out in IFRS 17.B116. IFRS 17 originally stipulated that the risk mitigation exception only applied when an entity used derivatives to manage exposure to insurance contracts issued that were accounted for using the VFA.

Finally, we noted that reinsurance contracts issued were not mentioned in *IASB Update*; however, agenda paper 2D, which deals primarily with reinsurance contracts held, also includes a proposal that reinsurance contracts issued should continue to be ineligible for the VFA.

contract includes an investment component. The standard will not include a definition or criteria to help entities identify when an investment return service exists. Insurers must use their judgement, and must do so consistently. However, the IASB has not ruled out the possibility of including an explanation of what such judgements might involve in the IFRS 17 Basis for Conclusions;

- the standard will also stipulate that the period of investment return services should be regarded as ending when the entity has made all investment component payments to the policyholder and should not include any period of payments to future policyholders;
- the amended IFRS 17 will also require assessments of (a) the relative weighting of the benefits provided by insurance coverage and investment return services and (b) their pattern of delivery to be made on a systematic and rational basis;

[†] The variable fee approach is one of the models that can be used to recognise insurance contracts under IFRS 17. Only insurance

contracts with direct participation features are eligible for the variable fee approach.

- the amendments will confirm that cash flows relating to fulfilling the investment return service (e.g. the costs of managing underlying assets) shall be included in the measurement of the insurance contract;
- no changes will be made to IFRS 17 relating to fulfilment cash flows that adjust the CSM (i.e. the impacts of changes in financial assumptions will continue to be

treated differently under the general model and the VFA);

- finally, the amendments will establish that eligibility for the premium allocation approach (PAA) should be assessed by considering both the insurance coverage period and the period over which any investment return service is provided.

4. What are the next steps?

The other topics identified by the staff in October, on which the IASB has not yet reached a decision, will continue to be discussed at future Board meetings. Further amendments to IFRS 17 could thus be proposed. Readers will remember that the IASB identified 25 topics for discussion in October.

Once all the topics have been discussed, the package of amendments as a whole will be reviewed by the IASB, to ensure that:

- the benefits of amending IFRS 17 outweigh the costs; and

- the proposed amendments would not unduly disrupt implementation processes already under way.

At this point, the IASB will also consider whether the various amendments will require any changes to the disclosure requirements of IFRS 17.

The IASB thus still has some work left to do before it can draw up the final list of proposed amendments. It will, however, need to work fast, as it has already announced the publication of an exposure draft of the amendments in the second quarter of 2019.

Key points to remember

The January meeting resulted in substantial progress on the accounting treatment of:

- cash flows relating to the acquisition of insurance contracts;
- the contractual service margin (CSM) for contracts that include an investment return service; and
- reinsurance contracts purchased by a primary insurer (reinsurance contracts held).

It will be necessary to keep a close eye on the exact wording of the forthcoming amendments, to ensure that they will achieve the desired aims.

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Events and FAQ

Frequently asked questions

IFRSs

- IFRS 16: identifying leases and determining the lease term
- IFRS 16: the commencement date of a lease and its impact on determining the discount rate
- IFRS 16: relocation and overlapping leases
- The tax rate used at the end of the reporting period to recognise deferred tax
- The accounting treatment of tax relating to changes in the fair value of a debt linked to an NCI put
- Liquidity agreements relating to French employee investment funds (FCPEs)

Upcoming meetings of the IASB, IFRS Interpretations Committee and EFRAG

IFRS		EFRAG	
IASB	Committee	Board	TEG
11-15 March	5-6 March	27 February	20-21 March
8-12 April	30 April	4 April	16-17 April
13-17 May	11-12 June	7 May	22-23 March

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