



# Beyond the GAAP

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## CONTENTS

### Highlights

EUROPEAN highlights page 2

### A Closer Look

Recent IASB decisions on proposed amendments to IFRS 17 page 5

The IFRS IC stands by its assessment of the lease term page 7

Presentation of financial statements under IFRSs: publication of an exposure draft page 10

IFRS IC agenda decisions will soon be published only if the IASB does not object page 17

Events and FAQ page 19

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## EDITORIAL

As the 2019 financial statements are finalised, the first-time application of IFRS 16 will have kept stakeholders on their toes right up to the last minute. This is because the IFRS Interpretations Committee did not officially clarify until 16 December how the term of certain leases should be determined.

Apart from the substantive issues, the subject shed light on the due process underlying the Interpretations Committee's agenda decisions. The current simple majority rule allows the Committee to conclude that the contents of a standard form a sufficient basis for determining how to apply it to a given situation even when almost half of its members, despite their IFRS expertise, disagree. That may raise legitimate questions.

The current revision of the Due Process Handbook, which should result in the involvement of the IASB in deciding whether to publish an IFRS IC agenda decision, is rightly presented as a way of enhancing the Committee's due process.

The end of the year also saw the publication of a major new IASB exposure draft on the presentation of financial statements, which is sure to be a lively discussion topic in the months to come.

On behalf of the editorial team at Beyond the GAAP, we wish you an excellent 2020!

**Themis Polizos, Partner**





## EFrag conference on “IFRS and Regulation”: ESMA gives its opinion

On 28 November, the conference *IFRS and Regulation: searching for common ground* was held in Brussels by EFRAG to discuss the following questions:

- Should IFRS be more rules-based to support enforcement?
- should regulators issue implementation rules for principles-based IFRS?

Introducing this event, Steven Maijor, the Chair of the European Securities and Markets Authority (ESMA) noted the increasing scrutiny of IFRS by the European public institutions and emphasised that at heart the question was: “Are IFRS still well-suited to serve European capital markets?”

Mr Maijor answered this question by explaining why he believed that IFRSs could be a major contributor to strengthening European financial markets.

Mr Maijor stressed that principles-based IFRS offered a suitable basis for:

- adapting to the inevitable variety of facts that occur in the reality of business in a diverse jurisdiction such as the European Union,
- while enabling a sound and consistent approach to implementation and enforcement.

However, this combination of flexibility and rigour came with the inevitable cost of leaving some room for interpretation to both issuers and enforcers. To answer the questions posed by these areas of judgment, Mr Maijor said he supported submitting IFRSs to the IFRS Interpretations Committee when necessary, and that he did not support the issuance of national or regional implementation guidance because this would, in his view, be potentially detrimental for the EU-wide consistent application of IFRSs. M. Maijor also noted that diverse positions weaken the European Union’s influence internationally.

He went on to say that that IFRS IC agenda decisions – or other forms of educational material issued by the IASB – should not result in new requirements which would then be difficult to enforce, given that they are neither standards nor interpretations endorsed at European level.

## EU endorses IAS 1 and IAS 8 amendments on the term “material”

The amendments to IAS 1 and IAS 8 published on 31 October 2018 by the IASB were endorsed by the European Union on 29 November 2019.

These amendments result from the Better communication in Financial Reporting project, and

include an alignment of the definition of the term “material” used in the Conceptual Framework with that used in IFRSs, while making further minor improvements.

The new definition states that “Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity”.

Regulation (EU) 2019/2104, published in the OJEU on 9 December, sets the mandatory effective date of these amendments as no later than financial periods that are current at 1 January 2020.

The IASB had set the same date for the mandatory prospective application of these amendments, and had authorised early application.

The EU regulation is accessible at the following address: <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32019R2104&from=FR>.

## OJEU publishes amended Regulatory Technical Standards for the European Single Electronic Format

On 16 December 2019, the Commission Delegated Regulation (EU) 2019/2100 of 30 September 2019 amending Delegated Regulation (EU) 2019/815 was published by the OJEU. This regulation aims to update the taxonomy to be used when publishing annual financial reports using the single electronic reporting format (when these include consolidated financial statements under IFRSs).

Regulation 2019/815 had rested on a taxonomy drawn up by ESMA and based on the IASB’s IFRS taxonomy published in 2017. Given the changes in IFRSs and the IASB’s regular update of the IFRS taxonomy, ESMA submitted a new taxonomy to Europe, based on the IASB taxonomy published in 2019.

In practice, the Regulatory Technical Standards (RTS) will need to be updated every year in order to take account of the IASB’s regular amendments to the IFRS taxonomy.

Readers will recall that the European single electronic format (ESEF) is of mandatory application to financial periods current at 1 January 2020 for issuers whose securities are admitted to trading on a regulated market and who are required to publish an annual financial report under the terms of the Transparency Directive. The 2020 annual financial report (published in early 2021) must therefore be submitted to the local regulator in xHTML format. The IFRS consolidated accounts contained in this report must be tagged using iXBRL language and the RTS taxonomy (initially, only the primary financial statements must be tagged in this way).

 Regulation (EU) 2019/2100 may be downloaded at:  
[https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L\\_.2019.326.01.0001.01.ENG&toc=OJ:L:2019:326:TOC](https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2019.326.01.0001.01.ENG&toc=OJ:L:2019:326:TOC)

## Alternative Performance Measures: ESMA publishes a review of compliance with its guidelines

Four years after the publication of detailed guidelines<sup>†</sup> on the use of Alternative Performance Measures (APMs), ESMA has reviewed issuers' compliance through an analysis of (i) the 2018 regulated financial information published by a sample of 123 European issuers and (ii) evidence from National Competent Authorities' regarding the application of the APM Guidelines in prospectuses.

Despite their widespread use, ESMA observes that there are shortcomings in the identification and understanding of what is an APM which diminish the compliance and quality of the related information. ESMA highlights the fact that subtotals presented in the primary financial statements are an integral part of the scope of its guidelines (where these aggregates are used outside the financial statements). In the detailed information provided on the APMs identified as such by the issuer, the

regulator notices significant shortcomings in the compliance with the principles regarding explanations, reconciliations and definitions.

Apart from these observations, ESMA expects issuers to consider the findings of this report to continue their work to ensure compliance and to enrich communication on APMs (with special attention to the expected impact of IFRS 16 in 2019) and includes a set of recommendations to this end. These refer in part to the Q&A<sup>‡</sup> published in October 2017 and also provide additional insights concerning the practices observed by the regulator in the use of APMs including adjustments for "non-recurring" or "special items".

ESMA will also use the results of this report to prepare its responses to the IASB consultation in view of the presentation of financial statements project (see the special study in this edition).

ESMA's report on APMs is available at the following address:

<https://www.esma.europa.eu/press-news/esma-news/esma-eu-issuers-need-improve-their-disclosure-alternative-performance-measures>

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<sup>†</sup> [ESMA Guidelines](#)

<sup>‡</sup> [ESMA Questions and Answers](#)



### Recent IASB decisions on proposed amendments to IFRS 17

During its December meeting, the IASB continued its discussions of future amendments to IFRS 17 – *Insurance Contracts*, expected in June 2020. The documents drawn up by the IASB staff ahead of the meeting are available on the IASB site at: <https://www.ifrs.org/news-and-events/calendar/2019/december/international-accounting-standards-board/>.

In accordance with the decisions taken in November and reported in the previous issue of *Beyond the GAAP*, the IASB confirmed its intention to retain a number of provisions of the exposure draft as previously proposed. The IASB also clarified the content of the future amendments on the two following topics:

- the methods of accounting for insurance contracts acquisition cash flows;
- the recognition of the loss-recovery gain on reinsurance treaties held when the underlying insurance contracts become onerous.

These topics are discussed in the sections below.

#### 1. Provisions of the exposure draft that have been confirmed by the IASB

The IASB has tentatively decided to finalise the following IFRS 17 amendments, as proposed in the exposure draft:

- scope: option to exclude from IFRS 17 (and to account for them under IFRS 9) those loans which transfer a significant insurance risk;
- Contractual service margin (CSM) attributable to investment services: inclusion of investment services in the pattern of CSM recognition in profit or loss (i.e. within coverage units) for insurance contracts with direct participation features;

- presentation of insurance contracts on the statement of financial position: aggregation at portfolio rather than group level;
- applicability of the risk mitigation option for reinsurance contracts held;
- transition reliefs for business combinations; and
- transition reliefs for the risk mitigation option: application from the transition date and the option to apply the fair value approach.

#### 2. Accounting for acquisition cash flows

The IASB confirmed the proposals of paragraphs 28A and B35A of the exposure draft, which require a systematic and rational allocation of insurance acquisition cash flows that are directly attributable to a group of insurance contracts to (a) that existing group and (b) to all the future groups that will include contracts expected to arise from renewals of the contracts in that group.

The Board also finalised the details of the recovery test:

- clarifying that impairment testing is only required if the facts and circumstances indicate that the asset may be impaired (i.e. IFRS 17 will not require systematic impairment testing at every reporting date); and
- confirming that the unit of account for an asset representing acquisition cash flows is the group of contracts to which these cash flows have been allocated, which suggests that recovery testing should be carried out at the level of each group.

The final text of the amendments should also contain clarifications as to the possibility of subsequent reallocation of the deferred acquisition costs allocated to the different groups.

In December, the IASB tentatively decided to introduce the following principle:

- the maximum amount of costs allocated to existing or future groups that should be tested for impairment will be “fixed” at the date of initial recognition of these groups (i.e. the costs allocated to them cannot subsequently be revised / reallocated to other groups of insurance contracts);
- however, the amounts allocated for future renewals (i.e. to groups of insurance contracts yet to be recognised at the reporting date) should be revised at each reporting date, to reflect any change in the assumptions that determine the inputs to the method of allocation. Our understanding is that this measure is intended to rebalance the amount of deferred costs allocated to future groups in cases where impairment is identified after recoverability testing.

Readers should also note that Agenda Paper 2B prepared by the IASB staff ahead of the meeting (available on [IASB site](#)) includes a detailed worked example in the Appendix. This example illustrates step-by-step the various stages of IFRS 17 impairment testing as currently envisaged by the IASB.

 The IASB has also confirmed the new disclosures which will be required for acquisition cash flows, as follows:

- a reconciliation from the opening to the closing balance (showing separately any recognition of impairment losses and reversals of impairment losses);
- quantitative information, in appropriate time bands, about when an entity expects to derecognise these costs (i.e. the anticipated date of their inclusion in the measurement of the carrying value of the group of insurance contracts to which they have been allocated).

### 3. Recognition of income on reinsurance contracts held when the underlying insurance contracts become onerous

To respond to the many comments of stakeholders, the IASB decided to extend the scope of reinsurance treaties held (i.e. “ceded” reinsurance) which might benefit from an alignment with the accounting treatment of the underlying onerous contracts issued. The exposure draft had proposed to recognise income (against the adjustment of the CSM) for contracts providing “proportionate” coverage (restrictively defined) when a loss is recognised on onerous direct business at the date of initial recognition.

In fact, the IASB Update of December 2019 does not indicate exactly how the scope of contracts affected by this new provision will be extended. However, it appears from Agenda Paper 2C prepared by the IASB staff ahead of the meeting (available on [IASB site](#)) that the IASB is prepared to remove the reference to “proportionate” contracts and therefore to make the new treatment mandatory for all reinsurance contracts held. Therefore, the final version of the amendments should be followed closely on this point.

The IASB has also decided to add clarifications on the following aspects:

- The method of calculating income at inception will be different from that proposed in the exposure draft, *a priori* to accommodate all types of reinsurance contracts held, including non-proportional treaties, as a result of the decision to extend the scope of contracts concerned:
  - the entity should first calculate the percentage of claims on underlying insurance contracts issued the entity expects to recover from the reinsurance treaty held;

Finally, it should be noted that the IASB has taken no account of stakeholders’ criticisms concerning how acquisition costs are presented on the statement of financial position, and will continue to require that they be presented in the carrying amount of the related insurance contracts (i.e. separate presentation as an asset will not be authorised).

- it should then multiply the loss recognised on underlying insurance contracts by this percentage to determine the amount of the gain to be recognised on the reinsurance contract held.

Our understanding is that the main difference as compared with the initial proposal in paragraph B119D of the exposure draft lies in the calculation of the percentage of losses described in the first step above, which is potentially different from the percentage indicated in the contract. This calculation will probably require the exercise of judgment, in particular for treaties with no fixed recovery rate, or for proportional treaties with the right to recover from the reinsurer a fixed percentage of claims, but with either a minimum retention or a maximum limit provision.

- The gain on reinsurance contracts held described above would only be accounted for when the reinsurance contract held is recognised before or at the same time as the loss is recognised on the underlying insurance contracts.
- It will also be clarified, in the final amendments to IFRS 17, that paragraph 66(c)(ii) of IFRS 17 (which refers to the subsequent measurement of a group of reinsurance treaties held when a group of underlying insurance contracts becomes onerous after initial recognition) also applies when underlying insurance contracts are measured applying the simplified approach called the premium allocation approach.

In the coming months, the IASB will continue to discuss the various outstanding topics (such as annual cohorts, the identification of an investment component in contracts subject to the general model of IFRS 17, the effective date of the standard, etc.). We will be sure to keep you up to date concerning the main changes to IFRS 17.



### The IFRS IC stands by its assessment of the term of a lease

At the end of its November meeting, the IFRS Interpretations Committee confirmed its reading of IFRS 16 on the determination of the lease term and the useful life of non-removable leasehold improvements. The IFRS IC rejected the idea of amending the new leases standard immediately after its entry into force.

A final decision has therefore been published in the November edition of the *IFRIC Update*, which appeared on 16 December (<https://www.ifrs.org/news-and-events/updates/ifric-updates/november-2019/>).

Almost three weeks elapsed between the date of the Committee's meeting and the release of the *IFRIC Update*. This abnormally long delay can be explained by the intervention of the Due Process Oversight Committee (DPOC), as a result of two letters sent to its president by Acteo, Afep and Medef (three representative bodies of French preparers) and by the 100 Group (a representative body of finance directors of large UK preparers).

Setting aside its technical content, this agenda decision highlights two aspects:

- the reluctance of the IASB to amend its standards shortly after their publication, even in areas where they are clearly subject to debate, and
- the simple majority rules that apply within the Interpretations Committee, which enable it to assert that a standard is sufficient clear when almost half the Committee members, despite being specialists in IFRS, think the opposite.

#### 1. A referral by ESMA resulting a controversial tentative decision from the IFRS IC

In March 2019, ESMA asked the IFRS IC to advise on how to determine the lease term for certain types of leases, and on useful life of non-removable leasehold improvements. The question concerned the following two types of leases:

- contracts with an unlimited term, cancellable at any time if either the lessee or the lessor gives notice, without incurring penalties;
- short-term leases (generally one year), subject to unlimited renewable by tacit agreement for an equivalent period, unless otherwise decided by either party and notified in advance.

In its referral, ESMA asked the IFRS IC the two questions summarised below.

##### **How should the term of a cancellable or renewable lease be determined?**

The issue raised was as follows: in application of paragraph B34 of IFRS 16, and to assess whether there is more than an insignificant penalty, should account only be taken of contractual clauses that allow either party to terminate the contract without penalties, subject to a notice period? Or should entities also consider the existence of "economic" penalties that would result from the termination of the lease and which would limit the lessee's capacity to end the lease (for example, the cost of abandoning or dismantling leasehold improvements)?

##### **What is the useful life of non-removable leasehold improvements?**

The issue raised was the following: is there an interaction between the depreciation period for non-removable leasehold improvements (under IAS 16) and the lease term (as determined under IFRS 16)? In other words, is the useful life of non-removable leasehold improvements limited by the lease term determined in application of IFRS 16?

At the end of its June meeting, the IFRS IC published a tentative decision to the effect that:

- where a lease is enforceable, an entity should assess whether a lessee is reasonably certain to extend (or not to terminate) the lease, and
- that a lease is enforceable if the lessee and the lessor do not both have the right to terminate it with no more than an insignificant penalty. To determine the significance of the penalty, an entity must consider the broader economics of the contract, and not only the contractual termination payments.

Thus, if the costs represented, for example, by the lessee's abandonment of leasehold improvements is more than insignificant, the lessee should consider that it has a right to use the asset (and the obligation to make lease payments). The IFRS IC's approach takes no account of the lessor's right to oppose the continuation of the lease.

This tentative decision received much comment: the IFRS IC received 31 comment letters. 17 of them called on the IASB to amend IFRS 16, saying that the standard's provisions on the lease term were unclear and

 inadequate to support the Interpretation Committee's decision.

## 2. A meeting to confirm the analysis and reject an amendment of the standard

The topic therefore returned to the agenda at the November meeting of the IFRS IC. If the comment letters had influenced the debates, it was not enough to persuade the Committee to amend its decision. The IFRS IC decided, by the very narrow majority of 7 to 6, to publish a definitive agenda decision in line with the tentative decision taken in June.

whether the lessee is reasonably certain not to exercise the option to terminate the lease.

### IFRS IC position on the lease term

Readers will recall that, according to paragraph 18 of IFRS 16, the lease term corresponds to the non-cancellable period of a lease, together with both a) periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and b) periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.

To determine the lease term and assess the length of the non-cancellable period, paragraph B34 of IFRS 16 requires an entity to determine the "enforceable" period and states that "a lease is no longer enforceable when the lessee and the lessor each has the right to terminate the lease without permission from the other party with no more than an insignificant penalty."

In its final decision, the IFRS IC reiterated the Board's view (BC156) that the lease term should reflect an entity's reasonable expectation of the period during which the underlying asset will be used, because that approach provides the most useful information.

To determine the enforceable term of the leases that were the subject of the referral, in application of paragraph B34, the Committee observed that an entity should consider

- a) the broader economics of the contract, and not only contractual termination payments. For example, if either party has an economic incentive not to terminate the lease such that it would incur a penalty on termination that is more than insignificant, the contract is enforceable beyond the date on which the contract can be terminated;
- b) applying paragraph B34, a lease is no longer enforceable only when both parties have the right to terminate the lease without permission from the other party with no more than an insignificant penalty. Consequently, if only one party has the right to terminate the lease without the consent of the other with a no more than insignificant penalty, the contract is enforceable beyond the date on which the contract can be terminated by that party.

Therefore, if an entity concludes that the contract is enforceable beyond the notice period of a cancellable lease (or the initial period of a renewable lease), it then applies paragraphs 19 and B37–B40 of IFRS 16 to assess

## IFRS IC position on the useful life of non-removable leasehold improvements

Paragraph 50 of IAS 16 requires an item of property, plant and equipment (asset) to be depreciated over its useful life, defined as “the period over which an asset is expected to be available for use by an entity”. Paragraphs 56 and 57 of this standard provide further requirements on the useful life of an asset. In particular, paragraph 56(d) specifies that in determining the useful life of an asset, an entity considers any ‘legal or similar limits on the use of the asset, such as the expiry dates of related leases’, while paragraph 57 specifies that the useful life of an asset ‘is defined in terms of the asset’s expected utility to the entity’, and ‘may be shorter than its economic life’.

The Committee concluded that an entity shall apply paragraphs 56–57 of IAS 16 in determining the useful life of non-removable leasehold improvements. If the lease term is shorter than the economic life of those leasehold improvements, the entity shall consider whether it expects to use the leasehold improvements beyond that lease term. If the entity does not expect to use the leasehold improvements beyond the lease term, it then concludes that the useful life of the non-removable leasehold improvements is the same as the IFRS 16 lease term. According to the Committee, an entity might often reach this conclusion for leasehold improvements, since the entity will use and benefit from them only for as long as it uses the underlying asset in the lease.

## IFRS IC position on the interaction between lease term and useful life

The Committee notes that, in assessing whether a lessee is reasonably certain to extend (or not to terminate) a lease, paragraph B37 of IFRS 16 requires an entity to consider all relevant facts and circumstances that create an economic incentive for the lessee. This includes significant leasehold improvements undertaken (or expected to be undertaken) over the term of the contract that are expected to have significant economic benefit for the lessee when an option to extend or terminate the lease becomes exercisable (paragraph B37(b)).

Recalling its position on determining the enforceable period of the lease, for which an entity must take account of the broader economics of the contract (for example, the costs of abandoning or dismantling non-removable leasehold improvements), the committee stresses that, if an entity expects to use non-removable leasehold improvements beyond the date on which the contract can be terminated, the existence of those leasehold improvements could indicate that the entity might incur a more than insignificant penalty if it terminates the lease. Consequently, applying paragraph B34 of IFRS 16, an entity must consider whether the contract is enforceable for at least the period of expected utility of the leasehold improvements.

In this way, the Committee has established an interaction between the enforceable lease term and the useful life non-removable improvements.

### 3. A decision imposed on entities, but which will probably require a delay before application

Those entities which have taken a legal approach to the lease term will have no choice but to change their estimates.

They will in future have to take account of the broader economics of the contract when determining the enforceable lease term, for example by considering the “economic penalty” represented by abandoning leasehold improvements undertaken (or planned) to the underlying leased asset.

This change is not necessarily expected to take effect in the 2019 financial statements, given the publication date of the IFRS IC decision and the time that will be required to amend the estimates, as was emphasised in a recent IFRS IC

podcast:

<https://www.ifrs.org/news-and-events/2019/12/q4-2019-interpretations-committee-podcast-published/>.

However, as indicated by ESMA in its *European common enforcement priorities for 2019 annual financial reports*, and consistently with IAS 8, detailed disclosures must be included in the notes.

### Key points to remember

- Applying paragraph B34 of IFRS 16, to determine the enforceable term of an lease with an unlimited term, but cancellable at any time if either party gives notice, without incurring penalties, or of a lease concluded for a short term (generally, one year) but subject to unlimited renewal by tacit agreement, the IFRS IC has clarified that:
  - an entity shall consider the broader economics of the contract, and not only contractual termination payments. For example, if either party has an economic incentive not to terminate the lease such that it would incur a penalty on termination that is more than insignificant, the contract is enforceable beyond the date on which the contract can be terminated;



- a lease ceases to be enforceable only when both parties have the right to terminate the lease without permission from the other party with no more than an insignificant penalty. Consequently, if only one party has the right to terminate the lease without permission of the other party with no more than insignificant penalty, the contract is enforceable beyond the date on which the contract can be terminated by that party.
- To determine the useful life of non-removable leasehold improvements, an entity shall apply paragraphs 56–57 of IAS 16:
  - if the lease term under IFRS 16 is shorter than the economic life of those leasehold improvements, the entity shall consider whether it expects to use the leasehold improvements beyond that lease term;
  - if the entity does not expect to use the leasehold improvements beyond the lease term under IFRS 16, it then concludes that the useful life of the non-removable leasehold improvements is the same as the IFRS 16 lease term.
- According to the IFRS IC, there is an interaction between the lease term and the useful life non-removable improvements:
  - if an entity expects to use non-removable leasehold improvements beyond the date on which the contract can be terminated, this could indicate that the entity might incur a more than insignificant penalty if it terminates the lease;
  - applying paragraph B34 of IFRS 16, an entity must consider whether the contract is enforceable for at least the period of expected utility of the leasehold improvements.
- The IFRS IC decision will necessitate a potentially long implementation period, and *a priori* may not always be applied as from the 2019 financial statements. In the meantime, detailed disclosures should be provided in the notes.



# Presentation of financial statements under IFRSs: publication of an exposure draft

On 17 December 2019, as part of its work plan on *Better Communication in Financial Reporting*, the IASB published an exposure draft entitled *General Presentation and Disclosures* (including illustrative examples) in conjunction with the Primary Financial Statements project (PFS)\*. The comments period runs until 30 June 2020. IAS 1 should eventually be replaced by a new IFRS, although many of the provisions of IAS 1 would be retained in the new standard or transferred to IAS 8 (which would be renamed *Basis of Preparation, Accounting Policies, Changes in Accounting Estimates and Errors*). This new text is likely to be of mandatory (retrospective) application no earlier than the 2024 financial year (given the IASB's normal due process and the period of time that will have to be allowed to entities to make the changes that this new standard may entail). Amendments will also be needed to several standards affecting the presentation of financial statements, including IAS 7 *Statement of Cash Flows*.

In its main outlines, and pending a more detailed study in a future edition, this exposure draft aims to **improve the comparability of the statement of profit or loss** (and, to a lesser extent, the statement of cash flows) by setting out new rules on their structure and content that will be more detailed and prescriptive than those currently set out in IAS 1. The IASB is also keen to improve the **transparency of disclosures**, particularly in relation to Alternative Performance Measures or APMs which correspond to subtotals of income or expenses other than those subtotals defined and required as part of the PFS project (these being known as Management Performance Measures, MPM). This approach is not dissimilar to that already initiated by ESMA in 2015, and which led to the publication of detailed guidelines† for the use of APMs towards European issuers. Those APMs which do not correspond to the IASB's definition of an MPM would continue to be covered solely by the regulator's guidelines and may therefore continue to be used without any new "constraint".

This study includes the key provisions of this draft text and highlights the significant changes it is likely to introduce for entities.

*These new provisions are contextualised in a Mazars study‡ on APM disclosures in the 2017 and 2018 financial reporting of a sample of large companies listed on the CAC 40 and the Euro Stoxx 50.*

## 1. Towards a more structured statement of profit or loss

The IASB's decision to focus on the **standardisation of the presentation of the statement of profit or loss** results from extensive consultations and the identification of requirements of all the stakeholders involved (analysts, investors, issuers, regulators, etc.) over the past several years. It was indeed in 2016, following the IASB's 2015 consultation on its 2017-2021 work plan, that the international standard-setter decided to launch the active research phase of its PFS project.

Thus, the IASB found that subtotals of income and expenses were among the most important indicators for users, and are the preferred measures for comparing and shedding light on the performance of entities.

In the absence of binding rules in the existing IFRSs, the IASB observed a **very wide diversity of practices** in the presentation of these subtotals in the statement of profit or loss, sometimes within the same business sectors. Given the confusion that these diverse practices are likely to cause, the IASB decided that a common set of principles was required, as set out below.

### Fewer presentation options for entities

The IASB's main proposals for improving the comparability of the income statement are as follows:

- the **definition of categories** consistent with the analyses customarily carried out (in the IASB's view) by users:
  - an *Operating* category defined as a residual, i.e. what is left once income and expenses have been allocated to the *Investing* and *Financing* categories (see definitions below), and excluding the share of the net gain of equity-accounted entities classified as "integral" (see below);
  - an *Investing* category, presenting returns from investments that generate a return individually and largely independently of other resources held by the entity (for example, income and expenses generated by financial assets other than cash and cash equivalents; the share of profit or loss from equity-accounted entities classified as "non-integral" - see details below etc.);
- a *Financing* category, presenting income and expenses on assets and liabilities arising from financing activities, such as income and expenses from cash and cash equivalents in accordance with

\* The exposure draft can be consulted on the IASB website in the [area dedicated](#) to the PFS project.

† [ESMA Guidelines & Questions and Answers](#)

‡ The study can be downloaded by clicking on this [link](#).

IAS 7 and liabilities arising from financing activities (including lease liabilities arising from the application of IFRS 16);

- **an obligation to present new subtotals** (see the model of the statement of profit or loss presented below), including a subtotal for the operating result (*Operating profit or loss*) that does not include the share of profit or loss from equity-accounted entities (see below).

This operating result also excludes the impact of discounting long-term provisions, whether or not operational (such as dismantling provision) and the net interest (income) on the liabilities (assets) on defined benefit plans, all of which the exposure draft classifies under *Financing*.

**Model statement of profit or loss proposed for corporates<sup>††</sup> with “traditional” business activities:**

|                                                                                                     |          |                                        |
|-----------------------------------------------------------------------------------------------------|----------|----------------------------------------|
| Revenue                                                                                             | X        | Operating                              |
| Operating expenses                                                                                  | (X)      |                                        |
| <b>Operating profit or loss</b>                                                                     | <b>X</b> |                                        |
| Share of profit or loss of integral associates and joint ventures                                   | X        | Integral associates and joint ventures |
| <b>Operating profit or loss and income and expenses from integral associates and joint ventures</b> | <b>X</b> |                                        |
| Share of profit or loss of non-integral associates and joint ventures                               | X        | Investing                              |
| Income from investments                                                                             | X        |                                        |
| <b>Profit or loss before financing and income tax</b>                                               | <b>X</b> | Financing                              |
| Interest revenue from cash and cash equivalents                                                     | X        |                                        |
| Expenses from financing activities                                                                  | (X)      |                                        |
| Unwinding of discount on pension liabilities and provisions                                         | (X)      |                                        |
| <b>Profit or loss before tax</b>                                                                    | <b>X</b> |                                        |

Extract from the exposure draft entitled *General Presentation and Disclosures* published by the IASB on 17 December 2019 (Figure 1 – page 7)

## Specific provisions for presenting the share of the profit or loss from equity-accounted entities

The share of profit or loss from equity-accounted entities that are part of the main business (*Share of profit or loss of **integral** associates and joint ventures*) would be presented below the operating result as defined by the IASB (see above), in a separate category on the statement of profit or loss. The *Share of profit or loss of **non-integral** associates and joint ventures* would be

presented in profit or loss before financing and tax, in the *Investing* category.

<sup>††</sup> The IASB takes account of specified entities conducting particular business activities, such as real estate companies or financial institutions (banks and insurance companies), by including all the income and expenses made in the course of the entity's main business activities in the *Operating profit*. For example, a bank whose main business consists of providing financing to customers should present its interest income and expenses in the *Operating* category.

## A retained latitude in the presentation of additional subtotals

Entities would still be permitted to present **additional subtotals**, other than the three required subtotals proposed in the project documentation (i.e. *Operating profit or loss*, *Operating profit or loss and income and expenses from integral associates and joint ventures*, *Profit or loss before financing and income tax*), provided that these subtotals fit with the structure of the statement of profit or loss proposed by the IASB and that they meet the requirements of IAS 1 regarding the presentation of additional subtotals (i.e. that such presentation is relevant to an understanding of the entity's financial performance). These provisions are retained in the draft standard.

In practice, it would therefore no longer be possible to present a **cost of net financial debt** in profit or loss, insofar as this subtotal could contain items belonging (i) in the Financing category (since it includes income and expense from cash and cash equivalents under IAS 7) and (ii) in the Investing category (for the income and expense generated by other financial assets, i.e. other than cash and cash equivalents), as defined by the IASB. Such a change would for example have a considerable impact on French companies, which make extensive use of this aggregate in accordance with a recommendation from the French standard-setter on the format of consolidated accounts of established under IFRSs.

## 2. Improving the aggregation and disaggregation of information presented

The exposure draft puts forward **new principles for the aggregation and disaggregation of the information presented in all the primary financial statements**, with a view to:

- setting out an approach to the application of these principles by entities that would ensure that:
  - items on the same line of a given primary financial statement will share at least one characteristic;
  - these aggregated items, where material, will subsequently be described in the notes on the basis of other characteristics.
- clarifying the respective roles of the primary financial statements and the notes so that entities will be able to decide where to report the information in question;
- establishing practices for the aggregation of dissimilar and immaterial items in the primary financial statements, in particular in the statement of profit or loss, that limit the use of non-descriptive labels as far as possible (which translates in practice to avoiding the presentation of items under "other").

The IASB's proposals for aggregation and disaggregation in the statement of profit or loss also aim to:

- **prohibit a "mixed" presentation of operating expenses in the statement of profit or loss** (i.e.

When calculating these subtotals, entities would no longer be permitted to exclude certain *unusual items* as defined below, particularly when presenting current operating profit or loss in the income statement, a practice that is particularly widespread in Europe, and notably in France.

**The IASB would finally not impose specific labels** (even for the subtotals that would henceforth be required, although in practice the possible options would necessarily be limited), but would require entities to choose labels that are not misleading.

broken down by both nature and function). This option presentation is not a free choice for issuers but shall be made in the light of a set of factors to be proposed by the IASB. This initial analysis of expenses would have to be mandatorily presented in the statement profit or loss (whereas IAS 1 only encourages such a practice, thus authorising presentation in the notes). An entity opting for a presentation by function would also (in a "second" analysis) need to disclose a disaggregation of its operating expenses by nature in the notes to the financial statements. The level of detail of this information would therefore no longer be left to the entity's discretion, as currently authorised by IAS 1, since the draft standard calls for a complete (and not selective) analysis by nature of all operational expenses (but without mandatory cross-referencing with the breakdown by function i.e. without requiring a "matrix" approach to operating expenses);

- **define the concept of *unusual items*** (i.e. non-current items), **requiring disclosures about these items in the notes**. In practice it will be impossible to present these items separately in the statement of profit or loss (see prohibition of the "mixed" approach).

The IASB defines the *unusual items* as income and expenses with limited predictive value, since it would be reasonable to assume that similar items, in terms



of their amount or their nature, would be unlikely to arise for several future periods.

For example, the IASB does not expect changes in value following recurring remeasurements of items in the financial statements to be classified by their very nature as non-recurring items. An entity would therefore not be authorised to classify them as such unless these changes were material, and similar changes in amount were not expected to recur for future periods, in order to ensure relevant information with predictive value for the assessment of future performance.

The *unusual items* would be presented in each relevant category of the statement of profit or loss (as proposed by the IASB and described above),

depending on their nature or function. The Board believes that a description of the *unusual items* in the notes would provide the most complete information for users and meet the concerns of some stakeholders as to the significance that might otherwise be ascribed to these items (i.e. if presented directly in the statement of profit or loss).

The IASB also clarified that disclosures on *unusual items* should be both qualitative and quantitative, describing the impacts on each line of the statement of profit or loss concerned.

### 3. Increasing the transparency of APMs reflecting financial performance

While recognising the need for management to retain some latitude in its use of performance measures, and the usefulness of information specifically provided to this effect for investors, the IASB would like to **mitigate the absence of transparency and discipline sometimes surrounding the publication of “non-GAAP” indicators**. The IASB has therefore considered ways of increasing their understanding and reliability, and proposes to make it mandatory to publish information about these indicators in a single note. Beyond the GAAP presents the scope and content of these proposals below.

#### The IASB's aim: a focus on *Management Performance Measures*

The exposure draft defines *Management Performance Measures* (or MPMs) as subtotals of income and expenses that:

- are used in public communications outside financial statements;
- complement the totals or subtotals specified by IFRS Standards;
- communicate management's view of a given aspect of the entity's financial performance;
- correspond neither to the subtotals required in the statement of profit or loss, nor to other subtotals listed in the exposure draft, namely:
  - gross profit or loss (revenue less cost of sales) and any similar subtotal,
  - the *Operating profit or loss* (as the required subtotal on the IFRS statement of profit or loss, as defined in the draft text) before depreciation and amortisation,
  - profit or loss from continuing operations, and
  - profit or loss before income tax.

The indicators relating to financial position and cash flows would therefore not be affected and may continue to be covered solely by ESMA guidelines where they are within the scope of APMs.

#### Presentation of a single note on *Management Performance Measures* in the notes to the audited financial statements

To encourage transparent communication on MPMs, the IASB proposes to introduce a **minimum list of mandatory disclosures** that must appear in the notes to the financial statements (and hence be audited) **for all the MPMs used by the entity** (though some arrangements apply if one or more MPMs are also segment indicators disclosed by the entity in applying IFRS 8).

For each MPM, these disclosures would provide:

- the definition of the MPM and its calculation method, including the explanation of any changes in its definition, where applicable;
- an explanation of how the MPM provides useful information about the entity's performance;
- a cautionary statement to readers that the MPM communicates management's view and is not necessarily comparable with measures sharing similar descriptions provided by other entities;
- the reconciliation of the indicators defined in IFRSs (i.e. the subtotals or totals that are most directly comparable). This reconciliation should present the income tax effect and of the effect on non-controlling interests for each reconciling item, including for those indicators not affected by these effects (such as indicators of operating performance).

An illustration of such a reconciliation is presented below.

The Board believes that including this information directly in the notes to the financial statements would make it possible to submit MPMs to the appropriate level of analysis and to meet therefore the expectations of investors, given that it will be subject to audit.

**Model reconciliation table for an MPM (presented in the notes to the financial statements):**

(in currency units)

| Management performance measure                                                                                                                                               | Adjustments for unusual items |              |                            | Other adjustments  | Measure specified by IFRS Standards |        |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------|--------------|----------------------------|--------------------|-------------------------------------|--------|
|                                                                                                                                                                              | Offshore income tax           | Property tax | Restructuring in Country B | Revenue adjustment |                                     |        |
| Revenue                                                                                                                                                                      | –                             | –            | –                          | (6,200)            |                                     |        |
| Cost of goods sold                                                                                                                                                           | –                             | –            | (4,990)                    | –                  |                                     |        |
| General and administrative expenses                                                                                                                                          | –                             | (2,500)      | (410)                      | –                  |                                     |        |
| Adjusted operating profit / Operating profit                                                                                                                                 | 55,370                        | –            | (2,500)                    | (5,400)            | (6,200)                             | 41,270 |
| Expenses from financing activities                                                                                                                                           | –                             | –            | (600)                      | –                  |                                     |        |
| Income tax                                                                                                                                                                   | 4,000                         | 625          | 900                        | 1,550              |                                     |        |
| Adjusted profit / Profit                                                                                                                                                     | 41,225                        | 4,000        | (1,875)                    | (5,100)            | (4,650)                             | 33,600 |
| Profit attributable to non-controlling interests <sup>(a)</sup>                                                                                                              | –                             | –            | (1,020)                    | –                  |                                     |        |
| Adjusted profit attributable to holders of claims against the parent classified as equity / Profit attributable to holders of claims against the parent classified as equity | 33,485                        | 4,000        | (1,875)                    | (4,080)            | (4,650)                             | 26,880 |

- (a) In this example, there are no amounts attributable to non-controlling interests for the tax reform (which affected offshore income tax and property tax) because it arose at the parent entity level. Also, there are no amounts attributable to non-controlling interests for the revenue adjustment because the revenue would have arisen from wholly owned subsidiaries.

Extract from the exposure draft entitled *General Presentation and Disclosures* published by the IASB on 17 December 2019  
(Illustrative examples - note 2)

## 4. Targeted improvements for the statement of cash flows

In the case of the statement of cash flows, the IASB chose to focus on targeted improvements.

The most significant proposals concern:

- the definition of a **single starting point** for entities using the indirect method of reporting cash flows from operating activities. The Board **proposes to use the *Operating profit or loss subtotal*** as required in the statement of profit or loss (see above);
- the **separate presentation of cash flows from equity-accounted entities** within cash flows from investment activities, in accordance with the distinction between *integral* and *non-integral*

entities applied in the statement of profit or loss (see above);

- the **removal of the choices** previously available to issuers for the **classification of cash flows in respect of interest and dividends**. The table below summarises these proposals, which would make it mandatory for entities that are not financial institutions to present interest and dividends (both paid and received) in a given category of cash flows.

Finally, it should be noted that the definitions of operating, investing and financing activities used in the statement of cash flows have not been aligned with those proposed by the IASB for the *Operating*, *Investing* and *Financing* categories in statement of profit or loss.

### IASB proposals for the classification of cash flows in respect of interest and dividends:

| Cash flow item                                                                                                                                                                                                                                   | Most entities | Specified entities <sup>(a)</sup>                                                                                                               |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------|-------------------------------------------------------------------------------------------------------------------------------------------------|
| Interest paid                                                                                                                                                                                                                                    | Financing     | Accounting policy choice, possible location depends on the classification of the related income and expenses in the statement of profit or loss |
| Interest received                                                                                                                                                                                                                                | Investing     |                                                                                                                                                 |
| Dividends received                                                                                                                                                                                                                               | Investing     |                                                                                                                                                 |
| Dividends paid                                                                                                                                                                                                                                   | Financing     |                                                                                                                                                 |
| (a) An entity that provides financing to customers as a main business activity or in the course of its main business activities invests in assets that generate a return individually and largely independently of the entity's other resources. |               |                                                                                                                                                 |

Extract from the exposure draft entitled *General Presentation and Disclosures* published by the IASB on 17 December 2019 (Figure 2 – page 14)



## Key points to remember

The exposure draft published by the IASB on 17 December 2019 as part of its Primary Financial Statements project should eventually lead to a new IFRS to replace IAS 1 (although some of its provisions will be retained in practice), no earlier than for reporting periods beginning on or after 1 January 2024.

This draft standard proposes:

- More prescriptive principles for structuring the statement of profit or loss, leading to:
  - the definition of categories (i.e. *Operating*, *Integral associates and joint ventures*, *Investing* and *Financing*) constraining the presentation of income and expenses;
  - the requirement for new mandatory subtotals (i.e. *Operating profit or loss*, *Operating profit or loss and income and expenses from integral associates and joint ventures*, *Profit or loss before financing and income tax*), without preventing the presentation of other additional subtotals, under conditions (hence, the separate presentation of a current operating result or a cost of net financial debt would generally no longer be possible);
  - the requirement to break down the share of net profit or loss of associates and joint ventures depending on whether these equity-accounted entities are *integral* to the group's main course of business activities (the share from *integral* entities being presented immediately after the *Operating profit or loss*, and the share from *non-integral* entities falling into the *Investing* category).
- Provisions to improve the aggregation and disaggregation of information presented, including:
  - prohibiting the “mixed” presentation of operating expenses in the statement profit or loss (i.e. at once by nature and by function) and requiring disclosures by nature in the notes where the function method has been chosen in the statement of profit or loss;
  - making it impossible to present *unusual items* (as defined in the PFS project) separately in the statement profit or loss, and requiring disclosures on these items in a separate note.
- Additional disclosures to be provided in a specific and audited note, where the entity has used financial performance indicators within the scope of *Management Performance Measures*, providing:
  - the definition of these indicators, and of their calculation method;
  - an explanation of their use and their relevance for understanding the entity's performance;
  - a reconciliation with the closest IFRS indicator, including the tax and non-controlling interests effects for each reconciling item;
  - a cautionary statement to readers that the company uses entity-specific MPMs which are not necessarily comparable with similar indicators used by other companies.
- Targeted proposals for the presentation of the statement of cash flows, once again aimed at improving comparability across companies such as:
  - the introduction of a single starting point for entities using the indirect method (i.e. the *Operating profit or loss*);
  - the elimination of options for the classification of cash flows in respect of interest and dividends paid and received (except for financial institutions).



## A CLOSER LOOK

### IFRS IC agenda decisions will soon be published only if the IASB does not object

The Due Process Oversight Committee (DPOC)\* is currently finalising a new version of the IFRS Foundation's Due Process Handbook†, launched in April 2019 with the publication of an exposure draft entitled "Proposed amendments to the IFRS Foundation Due Process Handbook", the main proposals of which were laid out in the April edition of Beyond the GAAP no 132.

During its meeting of 16 December 2019, the DPOC considered the following three aspects of agenda decisions (AD)‡:

- enhancement of the due process procedures for IFRS IC agenda decisions;
- improvement of the description of the nature of IFRS IC agenda decisions in the Handbook; and
- rejection of the exposure draft's proposal to authorise IASB agenda decisions.

The decisions taken at the December meeting of the DPOC generally reflect the proposals of the technical staff presented in Agenda Paper 2 prepared for this meeting.

The IFRS Foundation has not yet announced the estimated publication date of the definitive updated version of the Due Process Handbook. The DPOC nevertheless clarified, at the end of its December meeting, that the essential aspects of the review of the Handbook were now complete, and that the future amendments would not be re-exposed. These amendments will be finalised as soon as possible.

#### 1. Improvement of the due process procedures for IFRS IC agenda decisions

The DPOC's main decision relates to the fact that the due process applicable to the publication of an agenda decision by the IFRS IC should be amended in order to give the IASB formal involvement in the publication decision.

In practice, and assuming that the amendments discussed in December are indeed final, IASB members should hold a formal (public) vote on agenda decisions at the first Board meeting following the final vote of the Interpretations Committee.

If no more than three of the 14 members of the Board object to publication, the agenda decision will be published. In other words, an agenda decision will not be published if four or more Board members oppose it. The IASB would then have to decide the best way forward for the subject of the AD. It should be noted that this due process already applies, since the IASB is asked whether it objects to the publication of a draft IFRS IC interpretation.

The DPOC sees the Board's involvement in the publication of agenda decisions as a way to emphasise the fact that agenda decisions (while not being part of IFRS Standards) are important and must be taken in account where they are applicable (i.e. in light of the transaction or fact pattern in question). In effect, the IASB's vote would confirm that a standard does not need amendment, that the agenda decision does not change the existing standard to which it refers (by adding new or amending existing principles) and that compliance with IFRSs also entails compliance with agenda decisions.

The DPOC rejected the proposal, championed by some stakeholders, to amend the majority rules within the IFRS IC to introduce super-majority voting rather than the simple majority required today. The DPOC noted the difficulty of finding the right level for a qualified majority (one vote more than a simple majority, two-thirds majority, something else?) and concluded that the involvement of the IASB would meet the demands of those who wished to see the due process for agenda decisions strengthened and enhanced.

#### 2. Amending the description of the nature of agenda decisions in the Handbook

The DPOC proposes to change the description of the nature of agenda decisions in the Handbook as follows:

- removal of the paragraph from the April 2019 exposure draft that stated that the explanatory material in an agenda decision (which explains

how the applicable principles and requirements in the Standards apply to the transaction or fact pattern described) "should be seen as helpful, informative and persuasive". This change is accompanied by a new paragraph to clarify that compliance with an agenda decision is mandatory

\*The IFRS Foundation's DPOC is responsible for the oversight and control of all the organisation's procedures.

†The Due Process Handbook sets out the procedures governing the work of the IASB, its Interpretations Committee IFRS IC and their services.

‡ Agenda decisions are the formal explanations of the IFRS Interpretations Committee (IFRS IC) on the points referred to it for analysis, but for which the Committee has concluded that the IFRS is sufficiently clear and requires no more standardisation work by the IASB.



for entities if the transaction or fact pattern applies to them (for example, if the facts and circumstances are similar);

- removal of the description of the explanatory material in an agenda decision as providing “new information that was not otherwise available and could not otherwise reasonably have been expected to be obtained”. The final version of the Handbook will therefore state that the explanatory material in an agenda decision “often provides additional insights that might change an entity’s understanding of the principles and requirements in IFRS Standards”. The Handbook, in conjunction with IAS 8 – *Accounting Policies, Changes in Accounting Estimates and Errors*, should thus make it easier to qualify an accounting change resulting, where applicable, from the application of agenda decisions (i.e. if they change past practices);

- the addition of clarifications on the timing of the implementation of agenda decisions. The exposure draft endorsed the idea (previous set out by IFRS IC chair Sue Lloyd last March; see Beyond the GAAP no 131 of March 2019) that companies should be entitled to sufficient time to assess whether an agenda decision should lead to changes in accounting policy, and to implement these changes if so. The clarifications endorsed by the DPOC would therefore indicate that: (a) determining how long is sufficient to implement an agenda decision is a matter of judgment that depends on an entity’s particular facts and circumstances; b) nonetheless entities would be expected to implement an agenda decision on a timely basis. In other words, agenda decisions should be taken into account as promptly as possible; the time allowed is not a “grace period”.

### 3. Rejection of the exposure draft proposal relating to the IASB’s agenda decisions

Finally, the DPOC also decided to reject the exposure draft proposal relating to the IASB’s agenda decisions. This proposal would have given the Board the ability to publish its own agenda decisions to address aspects of the implementation of new standards in “rare circumstances”, under the same consultation conditions as those applying to the IFRS IC, but without replacing the work of the Interpretations Committee (for example, to

reflect the work of a transition resource group, such as the TRG that followed the publication of IFRS 15 – *Revenue*).

Consequently, this power will continue to be limited to the IFRS IC. Stakeholders’ comments had been generally opposed to this proposal.

For more information, readers are invited to consult:

- agenda paper 2 prepared by the technical staff ahead of the DPOC meeting with the detail of these proposals (<https://cdn.ifrs.org/-/media/feature/meetings/2019/december/dpoc/ap2-agenda-decisions.pdf>);
- the recording of the DPOC’s discussions (<https://www.ifrs.org/news-and-events/calendar/2019/december/due-process-oversight-committee/>, under “Due process handbook review” / Audio)



## Frequently asked questions

### IFRSs

- Factoring contract
- Revenue recognition: agent/principal analysis
- Acquisition date and recognition of a business combination
- Accounting for a put on non-controlling interests
- Programme to assign receivables
- Sale and leaseback transaction
- Recognition of a liquidity guarantee granted to employees or financial intermediaries

## UPCOMING MEETINGS OF THE IASB, IFRS INTERPRETATIONS COMMITTEE AND EFRAG

| IFRS           |            | EFRAG       |               |
|----------------|------------|-------------|---------------|
| IASB           | Committee  | Board       | TEG           |
| 27-31 January  | 21 January | 14 January  | 29-30 January |
| 24-28 February | 3-4 March  | 18 February | 5 March       |
| 16-20 March    | 29 April   | 17 March    | 26 March      |

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