Beyond the GAAP

Mazars' newsletter on accounting standards

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Editorial

The IASB's major projects are drawing towards their conclusion. Since 2014, the IASB has published standards on revenue, financial instruments and leases, and it is expected to complete the *Insurance Contracts* project and the *Conceptual Framework* by the end of 2017.

We now turn to the European endorsement process and the work of enforcers. IFRS 15 and IFRS 9 are scheduled for endorsement by the European Commission before the end of the year, and ESMA has published recommendations for disclosures on the IFRS 15 transition process. A similar publication relating to IFRS 9 is expected.

In addition to its major projects, the IASB is continuing with its maintenance of existing standards. In this issue, Beyond the GAAP focuses on the proposed amendments to IFRS 3 following the Post-implementation Review of the *Business Combinations* standard.

Welcome back and happy reading!

Michel Barbet-Massin Edouard Fossat

Study | Survey | Expert opinion | Overview | **Newsletter**

IFRS Highlights

China joins IFRS Foundation Monitoring Board

On 19 August 2016, the IFRS Foundation Monitoring Board (the body responsible for oversight of the IFRS Foundation) announced the appointment of a representative of the Ministry of Finance of the People's Republic of China as a member.

China joins the following countries on the IFRS Foundation Monitoring Board:

- Brazil (Comissão de Valores Mobiliários (CVM));
- the European Commission;
- Japan (Financial Services Agency (FSA));
- South Korea (Financial Services Commission (FSC));
- the United States (SEC);
- IOSCO (International Organization of Securities Commissions); and
- the Growth and Emerging Markets Committee of IOSCO.

Insurance project: IASB updates webpage

On 10 August 2016, the IASB updated the webpage for its *Insurance Contracts* project, to provide information on the current status of the project. The update includes information on:

- field work activities: the IASB has launched a fourth round of field work to help the staff to identify any major issues;
- how the IASB has responded to stakeholders' feedback on the 2013 Exposure Draft;
- the effect of redeliberations on the 2013 Exposure Draft. A paper explains where and how the 2013 Exposure Draft would change as a result of the Board's tentative decisions.

For more information, see the IASB's website: http://www.ifrs.org/Current-Projects/IASB-Projects/Insurance-Contracts/Project-News/Pages/project-news-August-2016.aspx

Crossword: last month's solution

European Highlights

ESMA: 19th extract from database of enforcement decisions

On 27 July 2016, ESMA (the European Securities and Markets Authority) published the 19th extract from its database of enforcement decisions on financial statements. The document contains 12 decisions that were taken by European enforcers, relating to the following subjects:

- Inflation-linked index derivatives in a host lease contract (IAS 39)
- Classification of a separate vehicle as a joint operation based on 'other facts and circumstances' (IFRS 11)
- The appropriate exchange rate when multiple exchange rates are available (IAS 21)
- Presentation of gains arising from the sale of an intangible asset (IAS 38)
- Identification of unobservable inputs (IFRS 13)
- Reverse acquisition of a listed shell company (IFRS 3, IAS 8 and IFRS 2)
- Disclosures on various categories of revenue (IAS 18 and IFRS 8)
- Determining whether a dealer network acquired in a business combination is an intangible asset with an indefinite useful life (IAS 38)
- Exchange of a business for an interest in a subsidiary and subsequent distribution of the acquired subsidiary to shareholders (IFRS 3 and IFRIC 17)
- Determining the maximum economic benefits available from a defined-benefit pension plan, and measurement of the plan's assets (IAS 19 and IFRIC 4)
- Measurement of a deferred tax liability relating to biological assets when the income tax rate changes over the assets' useful lives (IAS 12 and IAS 41)
- Accounting for contributions to a deposit guarantee fund in the interim financial statements (IFRIC 21).

The 19th extract from ESMA's database of enforcement decisions is available via the following link: https://www.esma.europa.eu/press-news/esma-news/esma-publishes-extract-enforcement-decisions-financial-statements

ESMA issues Public Statement on IFRS 15 implementation and disclosures

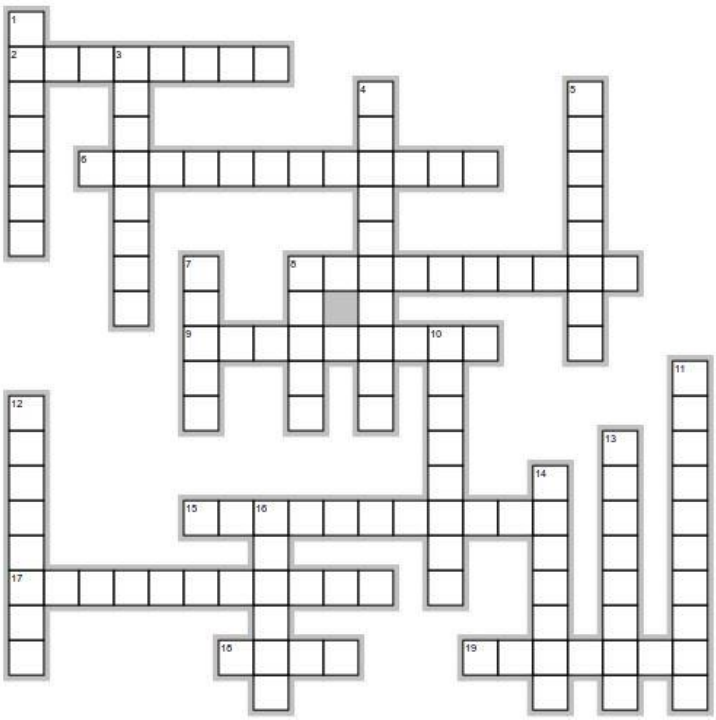
On 20 July, ESMA issued a Public Statement on the implementation of IFRS 15 – *Revenue from Contracts with Customers*, and on disclosures relating to the standard.

Readers will remember that IFRS 15 becomes mandatory for financial periods commencing on or after 1 January 2018. Early application is permitted subject to endorsement by the European Union, which is scheduled for the second half of 2016.

In a nutshell, ESMA indicates that disclosures on the impacts of the implementation of the new standard, both qualitative and quantitative, should become more and more precise in the interim and annual reporting periods leading up to the first application of the standard.

ESMA's Public Statement can be downloaded here: https://www.esma.europa.eu/press-news/esma-news/esma-issues-public-statement-ifrs-15

Crossword: Any gaps in your knowledge of IFRS 9?



Down:

1. The same accounting treatment can be used for the _ _ _ _ _ _ _ element of foreign exchange derivatives as for the time value of options.
3. The amendments made by IFRS 9 to IFRS 7 _ _ _ _ _ _ _ _ the disclosures required in the notes on financial instruments.
4. The less stringent requirements under IFRS 9 should mean that many industrial and services companies see lower profit or loss _ _ _ _ _ _ _ _ _ _ relating to hedging instruments.
5. The new model for classifying financial assets is based on two key criteria: the contractual characteristics (SPPI) and the _ _ _ _ _ _ _ _ model.
7. Practical expedients such as a provision matrix (estimated loss rates based on time past due) are permitted for _ _ _ _ _ receivables.
8. Entities may not opt for _ _ _ _ _ application of the hedge accounting portions alone.
10. Whereas the IAS 39 impairment model was based on recognition of incurred credit losses, the IFRS 9 impairment model is based on recognition of _ _ _ _ _ _ _ _ credit losses.
11. Under IFRS 9, entities may designate _ _ _ _ _ _ _ _ _ _ of non-financial risks as hedged items.
12. Following a significant deterioration in credit risk, an entity shall recognise an impairment loss equal to the expected credit losses at _ _ _ _ _ _ _ _.
13. Gains and losses on unconsolidated equity investments optionally measured at fair value through other comprehensive income may never be _ _ _ _ _ _ _ _ to profit or loss.
14. One of the factors to be taken into account under the ECL model is the probability of _ _ _ _ _ _ _.
16. As regards financial liabilities, IFRS 9 only changes the accounting treatment for those liabilities measured at FVTPL under the fair value _ _ _ _ _ _.

Across:

2. Hedge accounting remains _ _ _ _ _ _ _ _.
6. Shares in investment funds shall generally be recognised at fair value through _ _ _ _ _ _ _ _ _ _ _ _ _.
8. Under IFRS 9, the 80%-125% 'bright line' test for hedge effectiveness has been _ _ _ _ _ _ _ _ _ _.
9. The method for calculating _ _ _ _ _ _ _ _ _ _ cost has not changed.
15. Under IFRS 9, _ _ _ _ _ _ _ _ _ _ _ _ effectiveness tests are less stringent.
17. Some of the new requirements for quantitative disclosures will require substantial developments to _ _ _ _ _ _ _ _ _ _ _ systems.
18. The time value of options may now be treated as a _ _ _ _ of hedging, thus reducing volatility in profit or loss.
19. Unstructured debt instruments in the investment portfolio may only be measured at amortised cost if they are held to _ _ _ _ _ _ _ contractual cash flows.

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A Closer Look

Proposed amendments to IFRS 3 and IFRS 11 (published on 29 June 2016)

The IASB has published proposed amendments to IFRS 3 – *Business Combinations* and IFRS 11 – *Joint Arrangements.* The comment period is open until 31 October.

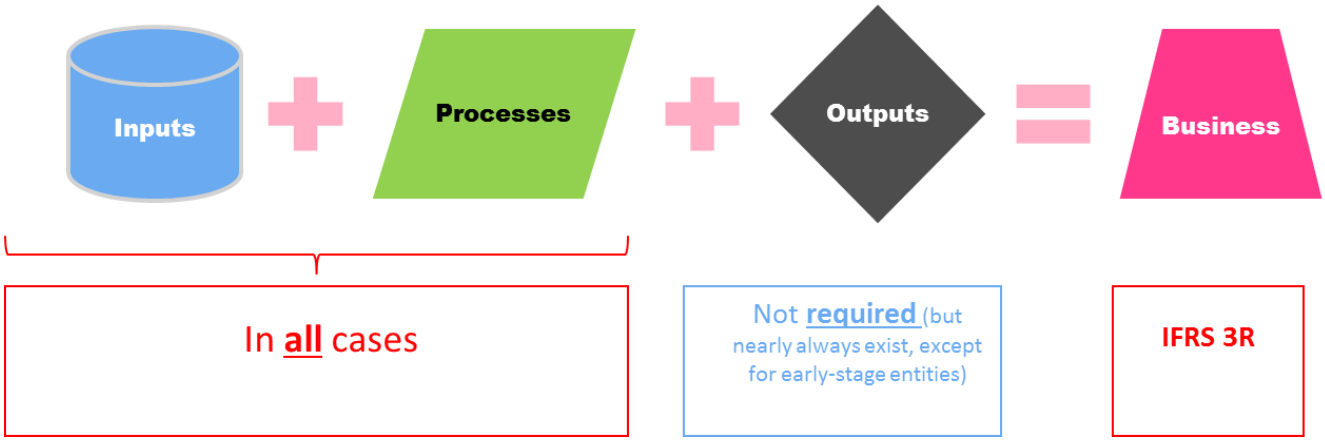
The Board is proposing that both amendments should be applied prospectively, with early application permitted. The effective date has yet to be decided.

IFRS 3 – Clarifying the definition of a business

Following the Post-implementation Review (PIR) of IFRS 3, and the discussions held by the IFRS Interpretations Committee in November 2015 and by the IASB in March 2016, the Board has decided to review the definition of a 'business'. (For more details on the findings of the PIR, see 'A Closer Look' in the July 2015 issue of Beyond the GAAP).

We must remember first of all that a business involves:

- inputs;
- processes; and
- usually, outputs.



a) A new approach to identifying a business

In practice, the amendments include some changes to the definitions of the various elements that constitute a business, as well as a new two-stage approach to identifying whether a transaction involves a business.

The first stage involves an assessment of whether substantially all of the fair value of the assets acquired is concentrated in a single asset (or a group of similar assets).

If the fair value of the assets is not concentrated in a single asset, the amendment proposes the use of a decision tree to assess whether one or more substantive processes have been acquired. Different situations are discussed, depending on whether or not the acquired set of activities and assets has the ability to generate outputs.

b) Changes to the definitions of the various elements

The new definition of outputs places more emphasis on goods and services provided to customers (to ensure consistency with the definition of 'output' in IFRS 15).

The new definition no longer specifies that the acquired elements should have the ability to reduce costs (or provide other economic benefits).

However, the proposed amendments stipulate that the acquired process(es) must be substantive and must have the ability to contribute to the creation of outputs.

The proposed definition removes the reference to 'market participants', which applied in situations when the acquired elements did not include all of the elements used by the seller. The Board felt that different acquirers might have different opinions on what a market participant's perspective might be.

Finally, the presence of a more-than-insignificant amount of goodwill no longer creates the presumption that a set of assets and activities is a business. The presence of goodwill is now simply an 'indicator' that the acquired assets and activities may constitute a business. It is, therefore, still necessary to carry out a full assessment.

c) First stage of the assessment: the concentration of fair value test

This new stage in the process is intended to make the assessment easier. If certain criteria are met, there is no need to carry on through the rest of the decision tree.

In practice, this new stage involves determining whether substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset (or a group of similar assets). If it is, the transaction does not involve a business.

A single identifiable asset is one that would be recognised as such in a business combination.

Thus, in practice, a building leased to a third party under an operating lease would not be broken down into a building and an intangible asset (i.e. the lease) but would be treated as a single identifiable asset.

Under the proposed amendments, entities would not be permitted to combine different classes of assets when assessing the concentration of fair value:

- Tangible and intangible assets;
- Different classes of intangible assets (trademarks, patents, customer relationships, etc.);
- Different classes of tangible assets (for example, inventory and manufacturing equipment, except in situations where assets cannot be physically separated without incurring significant cost or loss of value);
- Financial assets and non-financial assets;
- Different classes of financial assets (accounts receivable, marketable securities, cash, etc.).

The fair value of the gross assets is not the same as the transaction price, as it also includes the fair value of any liabilities, the fair value of any non-controlling interests and the fair value of any previously-held interest in the entity.

If the fair value of the gross assets is concentrated in a single asset, or a group of similar assets, the Board considers that the transaction does not involve a business. Thefore, in practice, there is no need to continue with the assessment.

d) Second stage: assessing whether one or more substantive processes have been acquired

If the concentration of fair value test does not conclude the assessment, the entity must proceed to the second stage. The assessment criteria for this stage differ, depending on whether or not the acquired assets and activities have outputs at the acquisition date.

If the acquired assets and activities do not have any outputs, the proposed amendments state that a substantive process can only exist if the inputs include an organised workforce that is capable of generating outputs. In other words, the presence of a workforce with responsibility for ancillary functions would not be enough to qualify the acquired assets and activities as a business.

If the acquired assets and activities do have outputs, a substantive process is deemed to exist in the following situations:

- If an organised workforce (i.e. one that is capable of generating outputs) has been acquired; OR
- If the acquired assets and activities include processes that contribute to the ability to generate outputs, and these processes are 'unique' or 'scarce', or cannot be replaced without significant cost or delay.

The proposed amendments to IFRS 3 include numerous illustrative examples, showing how the assessment process would work in specific situations.

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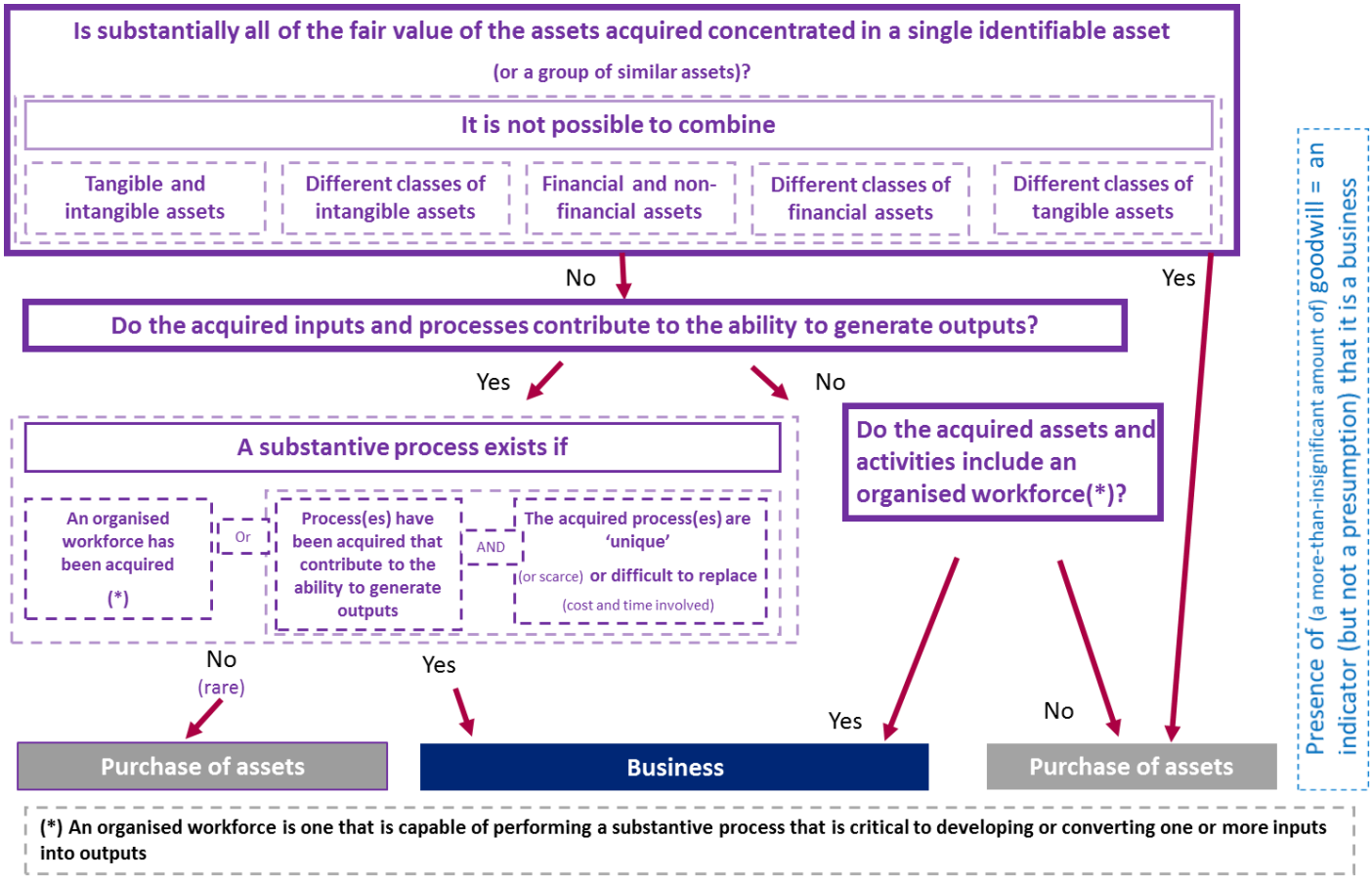
e) Purchase of assets vs. business combination - in summary

The proposed amendments include a partial decision tree. We here provide a more complete version, drawing on the further details and examples provided:



Key points to remember

- The definition of a business has changed only slightly.
- The amendments clarify the process for assessing whether the transaction is a business combination or a purchase of assets, through additional guidance and several illustrative examples.
- A 'concentration of fair value' test has been introduced, allowing entities to quickly identify certain situations in which the transaction is a purchase of assets rather than a business combination.
- The acquisition of an organised workforce with the skills to generate outputs is a key indicator that the acquired assets and activities may constitute a business.

IFRS 11 – Acquisition of an interest in a joint-operation

The IASB wished to clarify the accounting treatment of the acquisition of interests in joint operations, depending on whether or not the entity obtains control (i.e. exclusive control) of the joint arrangement. This clarification was necessary as it became apparent that there was diversity in practice.

Readers will remember that IFRS 11 distinguishes between different types of joint arrangement:

- **Joint ventures**
  In the (most common) situation where the parties only have rights to the net assets of the joint arrangement, they account for their interest using the equity method.
- **Joint operations**
  In the (rare in practice) situation where the parties have rights to the assets and obligations for the liabilities of the joint arrangement, they recognise their share of the assets and liabilities (and revenue and expenses). In other words, the accounting method is similar to proportionate consolidation.

  In practice, if the rights to the assets and obligations for the liabilities of the arrangement are equal, the same accounting method is used by joint operators as by parties to an arrangement who do not share joint control.

In practice, given that joint operations are relatively rare, the clarifications will not change the accounting treatment in many situations.

For a reminder of the IFRS IC's discussions on the 'other facts and circumstances' that should be taken into account when determining whether an arrangement is a joint operation, see our 'A Closer Look' feature in the November 2014 issue of Beyond the GAAP.

a) Situations in which an entity obtains control (i.e. exclusive control) of a joint arrangement

The amendment stipulates that in a situation in which an entity obtains control (i.e. exclusive control) of a joint arrangement, it shall remeasure its previously held interests in the assets and liabilities of the joint arrangement at fair value through profit or loss.

This accounting treatment is based on the same logic as step acquisitions. The same accounting treatment is used, irrespective of whether the entity was a joint operator or simply a party to the arrangement (i.e. without joint control).

b) Situations in which an entity does not obtain exclusive control of a joint arrangement

In a situation in which an entity does not obtain exclusive control of a joint arrangement, the acquisition of a further interest in a joint arrangement shall not give rise to remeasurement of its previously held interests.

The logic behind this is that the scope of consolidation is not affected by the transaction. Furthermore, this accounting treatment is consistent with that for transactions in which an entity moves from having significant influence to joint control (or vice versa). The Board felt that such transactions were comparable.

The same accounting treatment is used for situations in which the acquisition of an additional interest gives the entity joint control (when previously it participated in the joint arrangement but did not have joint control).

Key points to remember

- This amendment to IFRS 11 will only apply in a small number of situations.
- If an entity gains exclusive control over a joint operation, assets and liabilities previously accounted for under IFRS 11 shall be remeasured at fair value.
- If the acquisition of additional interests does not give the entity exclusive control, no remeasurement shall take place. The entity shall simply recognise an additional share of the assets and liabilities.

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Events and FAQ

Frequently asked questions

IFRS

- Accounting for a reverse acquisition of a shell company.
- The correct accounting treatment for a contract for the sale of trade receivables.
- Accounting for fees due under a contract to open a line of credit.
- Leveraged employee stock ownership plans and non-transferability discounts.
- Accounting for the replacement of an IAS 19 defined-benefit plan by free share allocations (IFRS 2).
- Applying IFRS 15 to regulated water supply activities.
- The correct accounting treatment for an issue of shares with equity warrants attached.

Upcoming meetings of the IASB, the IFRS Interpretations Committee and EFRAG

IFRS		EFRAG	
IASB	**Committee**	**Board**	**TEG**
17-21 October	8-9 November	6 October	26-28 October
14-18 November		10 November	23-25 November
12-16 December		13 December	19-20 December

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