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Editorial

Just over a month after the IASB published IFRS 16 – *Leases*, the FASB has published its own, broadly equivalent, standard. There is still one major difference between the two frameworks, namely the timing of recognition of the total lease expense (the FASB has opted for straight-line recognition for operating leases). However, the rules are the same as regards the principle of recognition in the balance sheet, the definition of a lease, determining the lease term, and the accounting treatment of variable lease payments.

Neither the IASB nor the FASB is planning any post-publication support activities like those carried out by the Transition Resource Group following the publication of IFRS 15. However, the IASB has created a dedicated email address that stakeholders can use to submit questions relating to practical difficulties with the implementation of IFRS 16.
It is not entirely clear how the IASB will respond to these questions, or what due process will be followed. However, it is worth keeping a close eye on discussions on both sides of the Atlantic, as they may address key accounting principles relating to the implementation of IFRS 16.

Enjoy your reading!

Michel Barbet-Massin Edouard Fossat

IFRS Highlights

Future IFRS 4 – *Insurance Contracts:* a light at the end of the tunnel?

At its February meeting, the IASB finalised its decisions on the future IFRS 4 standard on insurance contracts, and completed the review of its due process for the project.

It concluded that all the necessary steps have been completed, and the process of drafting the new standard can now commence. Once this has been done, a final meeting will be held to review the text and discuss any sweep issues arising, and to decide on the effective date for the new standard.

The IASB is expecting to publish the standard by the end of 2016.

All the decisions and documents relating to this project are available via the following link:
http://www.ifrs.org/Current-Projects/IASB-Projects/Insurance-Contracts/Pages/Insurance-Contracts.aspx

Implementation of IFRS 16

Last January, the IASB published IFRS 16, the new *Leases* standard. Shortly afterwards, following consultation with the Advisory Council, the IASB announced that it had decided it would not be necessary to set up a Transition Resource Group to support the implementation of IFRS 16, as it did for IFRS 15.

However, in February the IASB stated that it would like to hear about any issues encountered by stakeholders when implementing the new standard.

It has therefore created a dedicated email address (leases@ifrs.org) that stakeholders can use to submit questions relating to the implementation of IFRS 16. Questions should be submitted only if they are likely to affect a wide range of stakeholders and indicate that divergences in practice are likely.

The IASB has also created a webpage of resources to support the implementation of IFRS 16. The IASB will update the page throughout the implementation phase. Webcasts and podcasts by the IASB staff are already scheduled for March and April 2016, covering transition, scope, the definition of a lease, measurement and disclosures.

For more details on this initiative, visit the IASB's website:
http://www.ifrs.org/Current-Projects/IASB-Projects/leases-implementation/Pages/IFRS-16-Leases-Implementation.aspx

Change and continuity in IASB leadership

The IFRS Foundation announced on 12 February 2016 that Hans Hoogervorst has been reappointed as chair of the IASB for a second five-year term, until 30 June 2021.

In the context of the Foundation's ongoing review of the structure of the IASB, current vice-chair Ian Mackintosh decided that he would not stand for a second term. The review is looking at the number and country of origin of the Board's membership, following a consultation on the structure and effectiveness of the organisation in 2015 (see Beyond the GAAP no. 91, July-August 2015).

The IFRS Foundation will consider the various issues addressed in the consultation at its meeting in May 2016.

The consultation document and comment letters are available via the following link:
http://www.ifrs.org/About-us/IFRS-Foundation/Oversight/Trustees/Pages/Review-of-Structure-and-Effectiveness-Request-for-Views-and-Comment-Letters.aspx

FASB publishes new leases standard

On 25 February 2016, the Financial Accounting Standards Board (FASB) published its new leases standard, ASU 2016-02.

This standard is broadly equivalent to IFRS 16, which was published by the IASB on 13 January this year (see 'A Closer Look' in Beyond the GAAP no. 96, January 2016).

Like IFRS 16, the ASU will require lessees to recognise on the balance sheet the assets and liabilities for the rights and obligations created by those leases.

Although the two standards were the result of a joint project, they differ in some respects, particularly as regards lessee accounting:

- IFRS 16 introduces a single lessee accounting model;
- the US standard continues to differentiate between operating leases and finance leases. For operating leases, the total lease expense (including the interest expense) is recognised on a straight-line basis over the lease term. For finance leases, the total lease expense decreases over the lease term.

The FASB has decided that the effective dates for the standard will be as follows:

- financial periods commencing on or after 15 December 2018 (i.e. 1 January 2019 where the financial period corresponds to the calendar year) for a public business entity, a not-for-profit entity that has issued securities that are traded, on an exchange or an over-the-counter market, and an employee benefit plan that files financial statements with the SEC (Securities and Exchange Commission);
- financial periods commencing on or after 15 December 2019 (i.e. 1 January 2020 where the financial period corresponds to the calendar year) for all other organisations.

Early application is permitted for all organisations.

The FASB says on its website that it will not undertake any post-issuance activities.

For more details, see the FASB's website: http://www.fasb.org/jsp/FASB/Page/BridgePage&cid=1351027207574

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A Closer Look

Limited amendments to IAS 12: Recognition of deferred tax assets for unrealised losses

As we mentioned in the previous issue, on 19 January 2016 the IASB published amendments to IAS 12 entitled *Recognition of Deferred Tax Assets for Unrealised Losses.* Readers will remember that these amendments mainly aim to clarify the recognition of deferred tax assets for unrealised losses on debt instruments measured at fair value. They also include some amendments of more general scope.
We take a detailed look at its provisions.

1. Why these amendments?

The IFRS Interpretations Committee had been asked for clarification of the recognition of deferred tax assets (DTAs) where:

- an entity holds a fixed-rate debt instrument measured at fair value through equity for accounting purposes and at amortised cost for tax purposes;
- changes in the market interest rate result in a decrease in the fair value of the debt instrument and an unrealised loss bringing its carrying value to below its tax value (deductible temporary difference);
- the entity has no taxable temporary differences or sufficient future taxable profit against which to utilise this deductible temporary difference, but expects to recover all the contractual cash flows by holding the instrument until maturity.

During discussions, it became apparent that some general clarifications to IAS 12 were needed, bringing amendments to the body of the standard. Therefore, three new paragraphs have been added – 27A, 29(a).(i), and 29A – along with a short example illustrating the application of paragraph 26(d) to debt instruments measured at fair value.

However, it was decided that it would be best to present a full account of the treatment of the case put before the IFRS IC, which relies on these amendments, in the *Illustrative Examples* annexed to the standard (*Example 7*).

2. What answers and clarifications do these amendments provide?

The case put before the IFRS IC raised a number of questions:

Is there a deductible temporary difference?

In the case in question, does the decrease in the fair value of the instrument recorded at the reporting date constitute a non-event in fiscal terms (i.e. considering the existence of a deductible temporary difference is here irrelevant)?

The IASB's answer to this question is **NO.**

This case does not stand outside the general concept of a deductible temporary difference.

This is now clarified in a short example that has been added after paragraph 26(d):

- At the start of Year 1, an entity purchases a debt instrument for CU1,000 (nominal value of CU1,000 payable on maturity in 5 years with interest payable annually);
- At the end of Year 2, the fair value of the debt instrument has decreased to CU918 as a result of an increase in market interest rates;
- The gains or losses are only taxable on the sale or maturity of the debt instrument and are determined as the difference between the amount recovered and the original cost of the instrument;
- The difference between the carrying amount (CU918) of the debt instrument and its tax base of CU1,000 at the end of Year 2 gives rise to a deductible temporary difference (CU 1.000 – CU 918 = CU 82), irrespective of how the entity expects to use the instrument.

This is because:

- if the entity sells the instrument at the end of Year 2, it will recognise a loss of CU82 (the difference between CU918, the amount recovered, and the original cost of the instrument, CU1,000), which will be deductible from its taxable profit;
- if the entity holds the instrument to maturity, by comparison with another investor that acquired the same instrument at the market price of CU918 at the end of Year 2 and decided to hold it until maturity (in order

to recover CU1,000), the entity will have an economic benefit in the form of an additional deduction of CU82 (it will deduct CU1,000 from the amount recovered at maturity, while the other investor will only be able to deduct CU918).

Is a deferred tax asset automatically recognised?

In the case in question, can the entity automatically recognise a DTA simply because it expects to recover the principal and not to be taxed on this flow?

The IASB's answer to this question is **NO**.

That would amount to analysing the deductible temporary difference in isolation (i.e. irrespective of the level of taxable profits expected, the reversal of other temporary differences, etc.).

The underlying principle of IAS 12 is that all deductible temporary differences should be assessed in combination – unless tax law requires entities to make a distinction, when determining the taxable result, between the different sources of tax deduction (for example, if tax law stipulates that some transactions are taxable at a normal rate and others at a reduced rate, and that tax losses can only be offset against gains of the same type, then deductible temporary differences will have to be assessed in combination with other transactions of the same type).

This principle is now established in a new paragraph to the standard:

> *§27A : "When an entity assesses whether taxable profits will be available against which it can utilise a deductible temporary difference, it considers whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of that deductible temporary difference. If tax law imposes no such restrictions, an entity assesses a deductible temporary difference in combination with all of its other deductible temporary differences. However, if tax law restricts the utilisation of losses to deduction against income of a specific type, a deductible temporary difference is assessed in combination only with other deductible temporary differences of the appropriate type."*

The measurement of deferred taxes must reflect the manner in which the entity expects to recover or settle its assets and liabilities (see IAS 12.51). It may therefore be necessary to take account of the entity's intentions when combining deductible temporary differences in order to analyse their recoverability.

By way of illustration, let us consider some aspects taken from the detailed illustrative example (Example 7).

- *An entity holds three debt instruments, A, B and C, measured at fair value through equity. It expects to sell Debt Instrument C before maturity and to hold A and B until maturity.*
- *Tax law distinguishes gains resulting from collecting contractual cash flows on a debt instrument until maturity, which are classified as 'ordinary gains and losses', from those resulting from the sale of the instrument, which are 'capital gains and losses':*
  - *different tax rates apply to these two categories;*
  - *capital losses can only be offset against capital gains.*
- *At the end of Year 1, the entity identifies the following temporary differences and the categories in which they fall in order to establish its taxable result (taking account, where appropriate, of how it intends to use the underlying assets and liabilities):*

	Carrying amount (kCU)	*Tax base (kCU)*	*Taxable temporary difference (kCU)*	*Deductible temporary difference (kCU)*	
Instrument A	*1 943*	*2 000*		*57*	*Ord.*
Instrument B	*778*	*750*	*28*		*Ord.*
Instrument C	*1962*	*2000*		*38*	*Cap.*
Other sources	*Not specified*		*50*	*430*	*Ord.*

- *In this example, the entity must analyse separately:*
  - *the recoverability of deductible temporary differences in the capital gains and losses category ⇨ this concerns only one deductible temporary difference, in respect of Instrument C (kCU 38);*
  - *the recoverability of deductible temporary differences in the ordinary gains and losses category ⇨ deductible temporary differences arising from Instrument A (kCU 57) and other sources (kCU 430) must be assessed in combination, taking into account the existence of taxable temporary differences in the same category arising from Instrument B (kCU 28) and other sources (kCU 50).*

How is the recoverability of deductible temporary differences to be analysed?

More generally, where the insufficiency of taxable profits limits the recognition of DTAs, how should the recoverability of the deductible temporary differences be assessed?

In Illustrative Example 7 the IASB explains that **this analysis is carried out in successive stages**:

- **Step 1**: a DTA is recognised where, **at the reporting date, there exist taxable temporary differences of the appropriate type and reversing over the appropriate period** (in practice, this means examining the bases of deferred tax liabilities at the reporting date);
- **Step 2**: a further DTA may be recognised to the extent that **it is probable that the entity will have sufficient taxable profit of the appropriate type** (in practice, this step will require an examination of the forecasts of the entity's future taxable profits, or 'tax planning');
- **Step 3**: where necessary, an additional DTA is recognised insofar as **tax planning opportunities are available to the entity that will create appropriate taxable profit.**

In particular, the amendments **clarify step 2**:

1) Initial clarification, fairly 'mechanical' in its principle, is provided by the addition of a new paragraph that explains that when assessing the probability that there will be sufficient taxable profit in the future in order to utilise a deductible temporary difference, an entity must consider the taxable result before reversal of this difference (in order to avoid a comparison that takes account of the deduction twice).

§29.(a).(i): "In evaluating whether it will have sufficient taxable profit in future periods, an entity compares the deductible temporary differences with future taxable profit that excludes tax deductions resulting from the reversal of those deductible temporary differences. This comparison shows the extent to which the future taxable profit is sufficient for the entity to deduct the amounts resulting from the reversal of those deductible temporary differences."

2) A second clarification is provided for users who had considered that future taxable profits taken into account in the tax planning were necessarily limited to the balance sheet amounts (in the case before the IFRS IC, the entity expects to recover the nominal value of the instrument at maturity, and hence to receive a flow of economic benefits greater than the carrying amount):

- first, the IASB notes that determining temporary differences and measuring the deferred taxes that result from these temporary differences are two separate steps (see BC 49, added by these amendments);
- it then confirmed that it may in some cases be necessary to look beyond the carrying amount to assess the probable flow of economic benefits expected from an asset – which naturally raises the question (without doubt the aspect that was discussed most keenly when these amendments were drafted) of under what conditions, and to what extent, this is possible. A new paragraph in the body of the standard goes some way to providing an answer, indicating that it would be necessary to have "sufficient evidence" that an asset will be recovered for more than its carrying amount:

§29A : "The estimate of probable future taxable profit may include the recovery of some of an entity's assets for more than their carrying amount if there is sufficient evidence that it is probable that the entity will achieve this. For example, when an asset is measured at fair value, the entity shall consider whether there is sufficient evidence to conclude that it is probable that the entity will recover the asset for more than its carrying amount. This may be the case, for example, when an entity expects to hold a fixed-rate debt instrument and collect the contractual cash flows."

By way of illustration, let us return to the fact pattern in Illustrative Example 7.

- *In the case of the deductible temporary difference arising on Instrument C (kCU 38), which is categorised by tax law under capital gains and losses:*
  - *in step 1, no taxable temporary difference of the relevant type (i.e. capital gains and losses) has been identified;*
  - *in steps 2 and 3, the example indicates that the entity does not expect any future taxable profit of the relevant type (the only anticipated transaction is the sale of Instrument C at the beginning of Year 2 for its fair value at the end of Year 1, representing a loss in tax terms) and that there is no tax planning opportunity (whether in terms of capital or ordinary gains and losses).*

***Conclusion*: no DTA can be recognised for this deductible temporary difference**

- *For the other deductible temporary differences (kCU 57 + kCU 430 = kCU 487), which are categorised as ordinary gains and losses:*
  - *at step 1, taxable temporary differences of the relevant type (ordinary gains and losses) reversing over the appropriate period (the example assumes that these temporary differences will reverse over the same period) have been identified at kCU 28 + kCU 50 = kCU 78;*
  - *at step 2, the example states that the entity expects to recognise a tax loss of kCU (200) during the reversal period, falling into the 'ordinary gains and losses' category. This loss will include the reversal of all the temporary differences mentioned ⇨ the expected taxable profit, before reversal of these deductions, therefore stands at kCU (200) + kCU 487 = kCU 287.*

Conclusion:

- ***Step 1:** recognition of a DTA of kCU 78 x 30% = **kCU 23**;*
- ***Step 2:** recognition of an additional DTA reflecting the relevant future taxable profit expected (kCU 287) less the amounts taken into consideration in step 1 (kCU 78), i.e. kCU 209 x 30%[(1)] = **kCU 63**;*
- ***Step 3**: no additional DTA is recognised for this step as no tax planning opportunities have been identified.*
- ***In total : a DTA of kCU 86 (kCU 23 + kCU 63) is therefore recognised[(2)].***

(1) *The assumed tax rate applied in the illustrative example for transactions categorised as ordinary gains and losses.*

(2) *More accurately: taking account of the taxable temporary differences at the reporting date and the presentation requirements in IAS 12 requiring the offsetting of deferred tax assets and deferred tax liabilities under certain conditions that are satisfied here, in reality a net DTA of kCU 63 (= kCU 86 - kCU 23) should be recognised.*

3. What the amendments do not clarify...

Because the original question concerned financial assets measured at fair value through equity, many people were expecting an illustration of the allocation of deferred tax assets between the proportion to be recognised in the profit or loss and the proportion to be accounted for in other comprehensive income. The illustrative example gives no illustration of this calculation and confines itself to repeating the general principles set out in IAS 12 paragraph 63 (the allocation should be "based on a reasonable pro rata allocation" or "other method that achieves a more appropriate allocation in the circumstances").

The amendments acknowledge the fact that during tax planning operations entities may in some cases assume that an asset will be recovered for more that its carrying amount.

However, they say nothing about the measurement of future outflows for the settlement of liabilities applied in the tax planning and their link with the carrying amounts.

4. Effective date and method of first application

These amendments are applicable to annual periods beginning on or after 1 January 2017. Early application is authorised (subject to their endorsement by the EU).

Entities shall apply these amendments retrospectively. However, when accounting for the impact of their first application on the opening equity in the first comparative period, it will not be necessary to allocate the change between the different components of equity.

Events and FAQ

Frequently asked questions

IFRS

- Depreciation and amortisation of assets undergoing valuation as part of a PPA analysis.
- Assessing control for an entity where the acquirer is also a service provider with management responsibility.
- Disposal of assets and decommissioning: distinguishing between the site and the structure under IFRS 5 and decommissioning obligations relating to a unilateral promise to sell.
- Business combinations with call or put options – Calculating the percentage of interest.

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

IFRS		EFRAG	
IASB	**Committee**	**Board**	**TEG**
15-16March	22 March	13 April	22-23 March
18-22 April	10-11 May	13 May	27-29 April
16-20 May	12-13 july	16 June	25-27 May

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