Report of the Emerging Economies Group Meeting

March 2019

Emerging Economies Group

The Emerging Economies Group (EEG) was created in 2011 at the direction of the IFRS Foundation Trustees, with the aim of enhancing the participation of emerging economies in the development of IFRS Standards.

This Report of the Emerging Economics Group provides a summary of the 17th EEG meeting held in Buenos Aires, Argentina, on 25–27 March 2019, hosted by the Federación Argentina de Consejos Profesionales de Ciencias Económicas (FACPCE).

The EEG meeting was chaired by Amaro Gomes, a member of the International Accounting Standards Board (Board).

17th EEG meeting agenda

Agenda topics included:

- Rate-regulated Activities project;
- Application of IAS 29 *Financial Reporting in Hyperinflationary Economies* in Argentina;
- Business Combinations under Common Control;
- Goodwill and Impairment project;
- Extractive Activities;
- Comprehensive Review of the *IFRS for SMEs®* Standard;
- IFRS Interpretations Committee (Committee) on IAS 21 *The Effects of Changes in Foreign Exchange Rates—Lack of exchangeability*; and
- IASB Update.

The agenda papers for the meeting are available on the IFRS Foundation website:http://www.ifrs.org/groups/emerging-economies-group/#meetings

Contact
International Accounting Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London
E14 4HD
United Kingdom

Tel: +44 (0)20 7246 6410
Fax: +44 (0)20 7246 6411
Website: www.ifrs.org

For further information about the Emerging Economies Group click here.

The next Emerging Economies Group meeting will take place in December 2019 in Xiamen City, China.

Introductory Comments

Dr Jorge José Gil, Director of the Federación Argentina de Consejos Profesionales de Ciencias Económicas (FACPCE) welcomed the members of the EEG to Buenos Aires and wished them productive discussions.

Mr Gomes thanked Dr Gil for his comments and for hosting the 17th EEG meeting in Argentina.

Rate-regulated Activities project

Ms Mariela Isern, member of the IFRS Foundation's technical team, led the session. She said the objective was to provide EEG members with an update of the project on rate-regulated activities (project) covering:

(a) defined rate regulation;
(b) scope, unit of account, regulatory assets and regulatory liabilities;
(c) recognition;
(d) measurement;
(e) presentation; and
(f) disclosure.

Defined rate regulation

Ms Isern provided EEG members with:

(a) general background information on defined rate regulation;
(b) a description of the problem the project aims to solve; and
(c) a description of the accounting model being developed.

Ms Isern explained the common components of the rate used to charge customers for goods and services supplied subject to 'defined rate regulation'. A few EEG members mentioned components of the rate, such as performance incentives and penalties which are used to incentivise efficiencies in rate-regulated entities.

Another EEG member highlighted the requirement that regulatory agreements be binding, and noted that this may require judgment given that governments can change agreements during the regulatory period. Mr Darrel Scott, a Board member, agreed and noted that some activities that are similar except that do not have binding terms would therefore be outside the scope of defined rate regulation.

EEG members raised questions/points about the model:

(a) Whether the model will end up adjusting revenue or costs? Mr Scott explained that revenue would be recognised and measured applying IFRS 15 *Revenue from Contracts with Customers.* Ms Sue Lloyd, Vice-Chair of the International Accounting Standards Board, emphasised that the model is supplementary—IFRS Standards would be applied first and the model would not override existing requirements. Another EEG member said the supplementary nature of the model should be explained clearly so preparers understand how the rights and obligations arising from regulatory timing differences will be reflected in the financial statements.
(b) If the model would reflect adjustments for inflation? Mr Scott answered that this would depend on whether the inflation adjustment was prospective or retrospective. He added that if the inflation adjustment was a retrospective adjustment, it could give rise to a regulatory asset.
(c) The label 'regulatory expense' is confusing when used to reflect the consumption of a regulatory asset or the origination of a regulatory liability. The member thought a more suitable term for the concept would be 'negative regulatory income'.

Scope, unit of account, regulatory assets and regulatory liabilities

Scope

Ms Isern said that the Board's objective was to define what rate regulation would be within the scope of the model (defined rate regulation) and distinguish it from other types of rate regulation. In doing so the Board aimed to provide a scope that focuses on the features that are both *necessary* and *sufficient* for the recognition of regulatory assets and regulatory liabilities.

An EEG member noted the Board's tentative decision to remove from the definition the feature relating to 'imposing limitations on entry into an industry (and on exit from it)' could broaden the definition and thereby the scope. Ms Isern explained that the Board considered this feature redundant, because it does not give rise to assets or liabilities. Mr Scott said it would be helpful to hear examples that illustrate how the criteria might be unhelpful.

Unit of account

EEG members agreed individual regulatory timing differences (RTDs) should be the unit of account for the model.

Regulatory assets and regulatory liabilities

Ms Isern noted that the project's tentative proposals were that a 'regulatory asset is a present regulatory right to increase the rate to be charged in future periods as a result of past events'.

An EEG member noted that entities, other than rate-regulated entities, have a right to charge higher rates in the future and questioned the distinction for rate-regulated entities. Mr Scott agreed. He explained that an entity subject to 'defined rate regulation' is bound by the regulatory agreement to sell a defined product for a predetermined price. However, the same agreement gives the entity an absolute right to increase predetermined prices in future period(s) as a specific consequence of the occurrence of a past event. That is different to the right enjoyed by unregulated entities.

On the topic of regulatory liabilities, an EEG member gave an example in which the entity billed customers in advance for future capital costs. The EEG member agreed that this gave rise to a regulatory liability applying the model.

Mr Gomes noted that the Board carefully considered the *Conceptual Framework* definitions of 'asset' and 'liability' when discussing regulatory assets and regulatory liabilities.

Recognition

Ms Isern explained the Board's tentative decisions to recognise regulatory assets and regulatory liabilities if it is more likely than not that they exist.

An EEG member was concerned the scope and recognition requirements could lead to the recognition of regulatory assets that would not satisfy the *Conceptual Framework* definition of an asset.

EEG members discussed whether recognition of regulatory assets and regulatory liabilities should be asymmetrical. An EEG member said the threshold did not need to be symmetrical.

Measurement

Ms Isern explained the Board's tentative decisions on the measurement of regulatory assets and regulatory liabilities.

Main features of the measurement technique

An EEG member said it is important the Board identifies the measurement basis as either 'historical cost' or 'current value'. The member noted this impacted business combinations where acquired assets and liabilities are measured at fair value.

Discount rate

Ms Isern outlined the Board discussions regarding the discount rate, she noted the Board is still discussing the discount rate to use when measuring regulatory assets or regulatory liabilities.

An EEG member said that if the main purpose of the model is to mitigate the risk of timing mismatches, using the regulatory rate would be simple and cost beneficial. If the regulatory rate was not going to be applied, entities would find it difficult to determine an appropriate rate.

Some members identified complexities in the discount rate for the model that staff had proposed including:

(a) how often the excess of the regulatory interest or return over the rate that would compensate the entity for time value of money and risk inherent in the cash flows would be related to an identifiable transaction or event so it could be recognised in the identified period.

(b) whether complexity was added to the model by having different measurement requirements for:

   (i) RTDs relating to items forming part of regulatory operating expenditures (reg opex); and

   (ii) RTDs relating to items forming part of regulatory capital expenditures (reg capex).

   An EEG member supported a simple method of measuring RTDs relating to items of reg capex, which only considers estimates of future cash flows excluding cash flows reflecting regulatory interest or return discounted at 0%.

In relation to measuring RTDs relating to items of expense or income that will form part of reg opex or reg capex when cash is paid or received, a few EEG members said it made sense to align the measurement of the regulatory asset or regulatory liability with the measurement of its related liability or asset.

Presentation

Ms Isern explained the Board's considerations and key tentative decisions on the presentation aspects of the model, that is, on:

(a) the statement of financial position; and
(b) the statement(s) of financial performance.

Statement of financial position

An EEG member asked why the Board tentatively decided to permit, rather than require, entities to offset regulatory assets and regulatory liabilities under specific circumstances. Mr Scott said this was because the probability of reversal of the regulatory asset and regulatory liability may be different. In such a case, an entity would need to assess whether offsetting would provide useful information.

Statement(s) of financial performance

An EEG member asked if the Board's tentative decision to include regulatory interest income and regulatory interest expense within regulatory income and regulatory expense was that the regulatory interest or return has an operational rather than a financial nature. Ms Isern agreed, and explained the Board has tentatively decided that the regulatory return on assets is related to the principal revenue-producing activities (operating activities) rather than financing activities.

Another EEG member asked why the consumption of a regulatory asset is not just reversed against accounts receivable. Mr Scott said this would override the information from IFRS 15 presented in the revenue line.

A few EEG members supported having no mismatch between the presentation of an asset or a liability remeasured through other comprehensive income (OCI) and the presentation of the related movement (or partial movement) of the regulatory asset or regulatory liability.

Disclosure

Ms Isern explained the Board's considerations and key tentative decisions on the disclosure aspects of the model.

An EEG member concerned about disclosure overload asked whether the model would result in additional disclosure requirements. Ms Isern said the model would result in the recognition of rights and obligations that are currently not recognised, consequently disclosure would be needed to explain the amounts recognised.

Other matters

An EEG member asked about the expected timeline for the next consultation document. Ms Isern responded that the next consultation document is expected to be published in the second half of 2019. Mr Gomes clarified that the Board first had to decide whether the next consultation document would be a Discussion Paper or an Exposure Draft.

Financial Reporting in Hyperinflationary Economies

Dr Domingo Marchese, representing the FACPCE, discussed challenges in applying IAS 29 *Financial Reporting in Hyperinflationary Economies* following the economy in Argentina being characterised as hyperinflationary in 2018. Dr Marchese commented that the FACPCE and regulators developed joint non-authoritative guidance that aimed to improve consistent application among entities applying IAS 29.

Dr Marchese noted the following points:

(a) IFRIC 7 *Applying the Restatement Approach* under IAS 29 *Financial Reporting in Hyperinflationary Economies* addresses how an entity should account for opening deferred tax items in its restated financial statements. It does not, however, develop general reasoning about the application of the restatement approach to other gains or losses.

(b) IAS 21 *The Effects of Changes in Foreign Exchange Rates* includes requirements for translating the results and the financial position of an entity whose functional currency is the currency of a hyperinflationary economy, but is silent when the functional currency is from a non-hyperinflationary economy and the presentation currency is from a hyperinflationary economy. Dr Marchese explained that in his view, when applying IAS 29, the restatement of the comparative financial statements requires the recognition of a 'translation adjustment' in OCI. However, he was aware this matter was not being treated consistently in practice.

(c) Other challenges in applying IAS 29 include:
  (i) equity shares issued with a deferred payment;
  (ii) legal and regulatory reserves; and
  (iii) items accounted for in OCI.

Mr Felipe Pérez Cervantes, Chairman of the Consejo Mexicano de Normas de Información Financiera (CINIF), presented the research undertaken by the Argentine and Mexican standard-setters analysing whether the scope of IAS 29 should be broader. Mr Pérez Cervantes noted that the research would be submitted to the IASB in the hope it would assist the Board's research pipeline project on IAS 29.

Business Combinations under Common Control (BCUCC)

Mr Scott presented a synopsis of the December 2017 EEG discussion on the BCUCC project. He then detailed the discussions the Board has had since that meeting. He began by explaining the measurement approaches that are being explored:

(a) a current value approach based on the acquisition method set out in IFRS 3 *Business Combinations*—the receiving entity will reflect acquired assets and liabilities at their acquisition date fair values; and
(b) a predecessor approach—the receiving entity will reflect acquired assets and liabilities at their predecessor carrying amounts.

Mr Scott stated in response to a question that the Board understands there are multiple predecessor approaches currently in use. Consequently, assuming the Board does propose this becomes a measurement approach within the model, it will need to consider developing a single predecessor approach that can be applied consistently.

Mr Scott noted that the Board is considering where the line should be drawn between a current value approach and a predecessor approach. In considering this the staff are analysing:

(a) BCUCCs that affect non-controlling interests (NCIs) in the receiving entity; and
(b) lenders and other creditors.

BCUCCs that affect NCIs in the receiving entity

Mr Scott said the Board's initial discussions on BCUCC that affect NCIs in the receiving entity focused on an approach based on the acquisition method set out in IFRS 3, with modifications.

In relation to where the line should be drawn between a current value approach and a predecessor approach, an EEG member spoke about making the distinction between whether the receiving entity's equity instruments are publicly traded or not.

Another EEG member said the predecessor method has worked well for many years in her jurisdiction, and she was concerned that an approach based on the acquisition method could result in restructuring opportunities and that the usefulness of information might be affected. She also expressed a view that in addition to the financial statements, NCI usually could have access to business combination related information in practice.

Lenders and other creditors

Mr Scott provided a summary of the staff's work on understanding the information needs of lenders and other creditors of the receiving entity in a BCUCC.

Prospective equity investors

Mr Scott presented a fact pattern in which parent entity P controls and wholly owns businesses A and B. The fact pattern included four variations of the group structure before restructuring and the subsequent sale of businesses A and B together in an initial public offering. The EEG members agreed that from an accounting perspective, the accounting for these four scenarios should be the same.

Goodwill and Impairment project

Ms Lloyd said the purpose of the session was to provide an update on the goodwill and impairment project. The Board is pursuing three objectives:

(a) identifying better disclosures for business combinations;
(b) simplifying the accounting for goodwill; and
(c) improving the calculation of value in use (VIU).

Identifying better disclosures for business combinations

Ms Lloyd explained that through discussions with preparers, auditors and users of financial statements the Board is hoping to identify better disclosures about a business combination and its subsequent performance.

An EEG member queried whether the financial statements are the right place to disclose information about the expected synergy and the strategy of the business combination and whether that information could be better placed in the management commentary. Ms Lloyd explained that if the disclosure is placed in management commentary, it would not be mandatory.

An EEG member expressed general support for improving disclosure requirements; however, noted that quantifying the synergies of an acquisition can be difficult—and it would be helpful if more guidance was provided. This member also said that, on certain occasions, the acquired business is reorganised, making it difficult to determine the performance of the business acquired.

Simplifying the accounting for goodwill

Ms Lloyd said that the Board has not yet decided whether to reintroduce goodwill amortisation, but has acknowledged there is a need to consider it. Ms Lloyd also said the staff will present a paper on the advantages and disadvantages of reintroducing goodwill amortisation in a future meeting of the Board.

A few EEG members agreed with reintroducing goodwill amortisation. Their main reasons were:

(a) some regulators are concerned that goodwill impairment is used to manipulate profit or loss; and
(b) amortisation is a practical solution, which is preferred to the potentially conceptually sounder impairment calculation.

A few EEG members disagreed with reintroducing goodwill amortisation. Their main reasons were:

(a) using amortisation would simplify concerns from preparers and auditors but would not result in useful information; and
(b) in some jurisdictions, when the Board decided no longer to amortise goodwill, it was very difficult to persuade entities why amortisation was no longer required. Consequently, reviving a requirement to amortise only a couple of years after the change would be difficult to explain; Ms Lloyd agreed.

An EEG member queried whether a third approach had been considered: to remove goodwill from the financial statements. Ms Lloyd said that the Board considered this approach but decided not to pursue it, because many have the view that management must be held accountable for the acquisition amount paid.

Extractive Activities

Mr Scott introduced the research project on Extractive Activities and commented that the Board has begun gathering information to help it decide whether to develop proposals to replace or amend IFRS 6 *Exploration for and Evaluation of Mineral Resources*.

Mr Scott explained that the Board had asked the national standard-setters involved in the development of the 2010 Discussion Paper *Extractive Activities* (discussion paper) to identify significant developments in extractive activities and if further research would be required. He said the overall feedback is that the discussion paper remains a valid starting point for the Board.

Mr Scott identified the main themes from the feedback and asked whether the feedback is consistent with EEG members' jurisdictions and whether there is anything they would add to what the Board has heard so far. EEG members agreed that the feedback was consistent with findings in their jurisdictions.

One EEG member asked whether in cases where entities recognised a separate right, that right needed to satisfy the definition of an asset in the *Conceptual Framework*. Mr Scott said this question relates to the next step of the project, which is for the staff to analyse whether the changes to the *Conceptual Framework* or IFRS Standards issued since 2010 have any implications for extractive activities. He added that the Board wants to examine the reserves and resources classifications in more detail, to determine whether to introduce additional reporting requirements related to transparency and sustainability.

Mr Gomes noted that when the discussion paper was open for comment, countries in Latin America had yet to adopt IFRS Standards. He said this meant that at that time the Board did not receive many comments on the discussion paper from that region. He stated that it would be important for the Board to receive more comments from this region in the future.

Comprehensive Review of the *IFRS for SMEs* Standard

Ms Michelle Sansom noted that as part of the review of the *IFRS for SMEs* Standard (2019 Review), the staff is considering whether to recommend that the Board consults on extending the scope of the Standard to include some publicly accountable entities.

An EEG member said that extending the scope of the *IFRS for SMEs* Standard would allow more companies to access the capital market and this could be positive.

This member noted the Board should consider simplifying the *IFRS for SMEs* Standard, which he finds too complex for small entities. He noted that his jurisdiction has simplified the national Standard based on the principles of the *IFRS for SMEs* Standard. Mr Scott responded that the Board considered the issue of simplification as part of the 2015 Review. He noted that the *IFRS for SMEs* Standard is intended for entities that prepare general purpose financial statements. He added that in discussions with some jurisdictions he suggested that if entities do not require general purpose financial statements, they should rather use another framework, such as a tax accounting framework.

Another EEG member noted that under the staff proposals, entities that hold assets in a fiduciary capacity could only apply the *IFRS for SMEs* Standard if their members unanimously agree to do so. He expressed concern about what would happen if users disagreed with the entity using the *IFRS for SMEs* Standard.

Another EEG member recommended against changing the scope of the *IFRS for SMEs* Standard. She noted her jurisdiction was concerned that if the scope were extended, the *IFRS for SMEs* Standard would become more complex.

Ms Sansom told EEG members that the Board discussed the relationship between the *IFRS for SMEs* Standard and full IFRS Standards during its March 2019 meeting. She reported that in those discussions, two views emerged:

(a) first, that the *IFRS for SMEs* Standard is an independent set of reporting standards written for the requirements of small and medium entities; and
(b) second, that the *IFRS for SMEs* Standard is a simplified version of full IFRS Standards that deviates from full IFRS Standards only for good reasons.

An EEG member said there should only be one accounting model. He acknowledged there may be two different users needing different information, but that this could be dealt with by specifying different disclosure or presentation requirements.

Another EEG member expressed concern that adapting concepts for small entities was quite complex. He said a balance should be found because sometimes even the *IFRS for SMEs* Standard is too complex for small and medium entities.

Another EEG member shared that his jurisdiction's approach is to require full IFRS Standards for listed entities and general accepted accounting principles developed by the national standard-setter for non-listed entities. He said they try to minimise the differences, with the ultimate goal of the two sets of standards converging in the long-term.

IAS 21 *The Effects of Changes in Foreign Exchange Rates—Lack of exchangeability*

Ms Lloyd provided EEG members with an update on the Committee's work on the Lack of exchangeability (IAS 21) project. She explained that the work comprised two steps:

(a) a September 2018 Agenda Decision on how to determine the exchange rate when a currency has a long-term lack of exchangeability; and
(b) research into possible narrow-scope standard-setting to provide guidance on which exchange rate to use when the spot exchange rate cannot be observed.

September 2018 Agenda Decision

Ms Lloyd explained that the Agenda Decision addresses the limited circumstances when a long-term lack of exchangeability results in foreign operations being unable to access foreign currencies using an official exchange rate(s). Ms Lloyd noted that those circumstances existed in Venezuela at the time the Agenda Decision was published. She stated that the Agenda Decision aimed to clarify that the official exchange rate need not be used if it did not meet the definition of a closing rate in IAS 21.

Research into possible narrow-scope standard-setting

Ms Lloyd explained that, as part of this work, the staff proposed a definition each for:

(a) exchangeability;
(b) a temporary lack of exchangeability; and
(c) a long-term lack of exchangeability.

An EEG member commented that in his experience, lack of exchangeability relates more to the time it may take an entity to access the amount of foreign currency it needs, rather than to a limitation on the amount of foreign currency it can obtain. He gave an example in which an entity needs 100 foreign currency units (FCU) and is able to obtain FCU50 today and FCU50 in three months. He said the rate for the FCU50 in three months will be at a different exchange rate and that exchange rate may not be available today.

An EEG member agreed that estimating the exchange rate to use when there is a long-term lack of exchangeability is complex. The EEG member had two concerns:

(a) one of the estimation methodologies used is based on the inflation rates of the currencies. However, it may not be possible to use this method when inflation rates are not available.
(b) at times, entities argue that the 'best information that can be used' arises from the black market. The EEG member was concerned entities used this argument.

IASB project update

EEG members received an update on the Board's and the Committee's activities.

Next meeting

The next meeting of the EEG will be held in Xiamen City, China in December 2019.