International Financial Reporting Standards

GPF meeting, Nov 2014
Agenda Paper 2

IFRS Interpretations Committee Update

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.

© IFRS Foundation. 30 Cannon Street | London EC4M 6XH | UK. www.ifrs.org

IFRS®

IFRS Interpretations Committee Update

- Submissions to IFRS Interpretations Committee:
  - Foreign currency translation of revenue: for discussion
  - Foreign exchange restrictions in hyper-inflationary economies: for discussion

- Post-implementation review
  - IFRS 3 *Business Combinations* – Key findings: update

© IFRS Foundation. 30 Cannon Street | London EC4M 6XH | UK. www.ifrs.org

Foreign currency translation of revenue

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation

© IFRS Foundation. 30 Cannon Street | London EC4M 6XH | UK. www.ifrs.org

IFRS®

Foreign currency translation of revenue: the issue

- Entity enters into a foreign currency sales contract at T0.
- A non-refundable advance payment is received at T1.
- At a later date, T2, the entity delivers services/goods.
- Which exchange rate should be used to recognise the revenue?

IAS 21: A foreign currency transaction should be recorded on initial recognition using the spot rate at the date of the transaction

The date of transaction: date on which the transaction first qualifies for recognition in accordance with IFRSs.

Foreign currency translation of revenue: views

Revenue is recognised using the spot rate at the date:

- an enforceable contract is entered into (T0): View A
  - rights and obligations of transaction established at this date
- advance payment is received (ie on recognition of deferred revenue) (T1): View B
  - first recognition of transaction is when either of parties to contract first performs
- the revenue is recognised (T2): View C
  - if payment is in advance, the difference between the deferred revenue balance and amount of revenue due to fx movements is recognised as an exchange gain/loss as revenue is recognised
  - delivering services/goods is viewed as a transaction in its own right

© IFRS Foundation. 30 Cannon Street | London EC4M 6XH | UK. www.ifrs.org

Foreign currency translation of revenue: Questions for GPF

- In your experience:
  - how prevalent is the issue?
  - which exchange rate(s) are used in practice?
  - are you expecting practice to change under IFRS 15 *Revenue from Contracts with Customers*?

- New issue to be discussed by Interpretations Committee in November 2014

IFRS®

International Financial Reporting Standards

Foreign exchange restrictions in hyper-inflationary economies

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation

© IFRS Foundation. 30 Cannon Street | London EC4M 6XH | UK. www.ifrs.org

IFRS®

Foreign exchange restrictions in hyper-inflationary economies: background

- Severe foreign exchange restrictions with high/hyper inflation (eg Venezuela):
  - Multiple official exchange rates
  - Controlled/fixed exchange rates
  - Volume of exchanges restricted
  - Inability to repatriate local currency cash

IAS 29: hyperinflation adjustments to local financial statements

IAS 21: translate into group presentation currency at closing rate (ie spot rate at reporting date)

© IFRS Foundation. 30 Cannon Street | London EC4M 6XH | UK. www.ifrs.org

IFRS®

Foreign exchange restrictions in hyper-inflationary economies: the issue

- Prevalent practice: use official rate ‘available’ to group as closing rate for consolidation purposes
- But official rate:
  – may not reflect rate of high/hyper inflation
  – may not reflect limitations on quantity of local currency that can be exchanged
- So, economically, group financial statements appear to:
  – overstate subsidiary’s assets and liabilities
  – overstate subsidiary’s operating income
  – understate subsidiary’s fx gains/losses in profit/loss.

Foreign exchange restrictions in hyper-inflationary economies: accounting issues

- Which rate when multiple official exchange rates?
  - No guidance for translation of foreign operations
- Should IAS 21 allow/require a rate other than an official rate when there is a long-term lack of exchangeability?
  - Would require exception to use of closing rate in IAS 21

© IFRS Foundation. 30 Cannon Street | London EC4M 6XH | UK. www.ifrs.org

IFRS®

Foreign exchange restrictions in hyper-inflationary economies: IFRS IC discussion

- Tentative agenda decision: July 2014
- Multiple official exchange rates
  - Little diversity in practice regarding principle to use
  - No need for further guidance
- Long-term lack of exchangeability
  - Issue too broad for Interpretations Committee
  - Existing disclosure requirements in IFRS apply
- IASB informed of issue in September 2014
- IC to discuss responses to tentative agenda decision in November 2014

© IFRS Foundation. 30 Cannon Street | London EC4M 6XH | UK. www.ifrs.org

IFRS®

Foreign exchange restrictions in hyper-inflationary economies: Question for GPF

- We understand that a third official exchange mechanism has recently been introduced in Venezuela.
- How, based on your experience, has the situation evolved since the matter was raised at the GPF in March 2014?

© IFRS Foundation. 30 Cannon Street | London EC4M 6XH | UK. www.ifrs.org

International Financial Reporting Standards

Post-implementation review on IFRS 3 *Business Combinations*

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation

© IFRS Foundation. 30 Cannon Street | London EC4M 6XH | UK. www.ifrs.org

IFRS®

Post-implementation review on IFRS 3 *Business Combinations* – Key findings

- Request for Information published on 30 January 2014
  - (comment period ended on 30 May 2014)
- Feedback received on the following issues (among others):
  - Challenges and complexity of testing goodwill for impairment
  - Subsequent accounting for goodwill (impairment only approach vs. amortisation and impairment approach)
  - Challenges in applying the definition of a business
  - Identification and fair value measurement of intangible assets such as customer relationships and brand names
  - Fair value measurement of contingent consideration and usefulness of subsequent accounting
  - Usefulness of accounting for step acquisitions and loss of control

Post-implementation review on IFRS 3 *Business Combinations* – Findings

Separate recognition of intangible assets from goodwill:

- Usefulness - Users have mixed views.
- It is useful because:
  - it provides an insight on why a company purchased another company;
  - it provides information on the future cash flows arising from the acquiree;
  - it helps in understanding the components of the acquired business, including its primary assets (i.e. the value-drivers).
- It is not useful because:
  - The valuation of intangible assets such as brands and customer relations, is highly subjective. These intangible assets should be recognised only if there is a market for them.
  - The amortisation of these intangible assets appears to be double counting. The post-combination results include maintenance expenses and amortisation.
  - Management value the business as a whole, rather than individually value the assets acquired and the liabilities assumed.

© 2014 IFRS Foundation. 30 Cannon Street | London EC4M 6XH | UK. www.ifrs.org

Post-implementation review on IFRS 3 *Business Combinations* – Findings

Non-amortisation of goodwill and indefinite-lived intangible assets:

- Usefulness - Users have mixed views.
    - Non-amortisation of goodwill:
        - is useful to calculate performance measures (such as Return of Invested Capital), which can be used to assess stewardship;
        - permits understanding of whether the management has overpaid or whether the acquisition was successful.
    - Impairment test is not effective. Impairment losses are not recognised early enough. The market ignores the impairment test results.
- Challenges:
    - Impairment test is costly and complex.
    - The assumptions used in the impairment test are subjective/too optimistic.
    - Purchased goodwill may be supported by internally generated goodwill (ie it is difficult to separate the cash flows between these two).

© 2014 IFRS Foundation. 30 Cannon Street | London EC4M 6XH | UK. www.ifrs.org

Post-implementation review on IFRS 3 *Business Combinations* – Findings

Academic literature review

- We reviewed 28 published academic studies on business combination accounting.
- This review provides evidence generally in support of the current requirements relating to goodwill and other intangible assets.
- In particular, several studies show that:
  - the amount of goodwill and other intangible assets recognised in accordance with IFRS 3 is positively associated with share prices (ie the information is useful for investors)
  - there is a significant negative association between goodwill impairment expense and share price (ie impairment expense provides relevant information)
  - managers are exercising their discretion in the recognition of goodwill and impairment expense. Some studies point to earnings management and income smoothing and a lack of timeliness in recognising impairment.
  - impairment-related disclosures are important to users but there are some areas of improvement.

© 2014 IFRS Foundation. 30 Cannon Street | London EC4M 6XH | UK. www.ifrs.org

IFRS®

Post-implementation review on IFRS 3 *Business Combinations* – Findings

- Results already presented to IASB
  - Sufficient information to prepare Feedback Statement
- Publish Feedback Statement
  - Summary of feedback and results of academic literature review
  - Identification of areas for possible further work
- Discuss our findings with FASB
  - Maintaining convergence important

© 2014 IFRS Foundation. 30 Cannon Street | London EC4M 6XH | UK. www.ifrs.org

Thank you

IFRS®