STAFF PAPER

May 2016

Board Meeting

Project	**Agenda Consultation 2015**
Paper topic	New Project Suggestions

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Introduction

1. The feedback received on the Agenda Consultation included suggestions for additional projects to be added to the Board's agenda. The Board discussed these suggestions at the April Board meeting[1].

2. The Board asked for 10 of these possible new projects to be brought back for further consideration. This paper provides a description of those 10 issues together with staff comments on what next steps the Board could take, if it wanted to pursue further any of these suggested new projects. The Board will not be asked to make any decisions in this particular Board session; instead the Board will be asked to make decisions in a later session in the context of the Board's agenda as a whole (see Agenda Paper 24A).

3. This paper includes the following sections:

   (a) a description of each suggested new project; and

   (b) a question for the Board.

Suggested new projects

4. The 10 suggested new projects are:

[1] See Staff Paper 24F for the April 2016 Board meeting (http://www.ifrs.org/Meetings/MeetingDocs/IASB/2016/April/AP24F-Agenda-Consultation.pdf)

(a) IFRS reporting by subsidiaries

(b) Variable and contingent consideration for asset purchases

(c) Risk sharing / collaborative arrangements

(d) Assessment of the need to withdraw IAS 26 *Accounting and Reporting by Retirement Benefit Plans*

(e) Digital currencies, including cryptocurrencies

(f) General principles for separate financial statements.

(g) General principles for combined financial statements

(h) Non-reciprocal transactions, including with governments

(i) Review of IAS 20 *Accounting for government Grants and Disclosure of Government Assistance*

(j) Relevance of referring to pronouncements of other standard-setting bodies in the hierarchy in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

IFRS reporting by subsidiaries (reference A1[2])

5. The national accounting standard-setter in some countries have developed an accounting regime for the financial statements of non-publically accountable subsidiaries of listed entities that is based on 'full IFRS' recognition and measurement principles, but with reduced disclosure requirements. Some stakeholders have suggested that the Board should introduce a similar approach in IFRS Standards. They argue that introducing such an approach would have the potential to reduce costs in financial reporting for subsidiaries of listed groups, without removing information needed by the users of these financial statements.

6. Typically these subsidiaries would meet the IFRS definition of a small and medium-sized entity (SME). However, using the *IFRS for SMEs* is not attractive to some of these subsidiaries because they need to report to their parent, for consolidation purposes, numbers that comply with the recognition and

[2] The reference number refers to the paragraph number in the Appendix of the April 2016 staff paper (paper A24F) in which extracts from the comments received were provided

measurement requirements of the full IFRS Standards. For their own financial statements, they would prefer to use those recognition and measurement requirements, but with less onerous disclosure requirements.

7. We think that the Board could explore an approach that allows subsidiaries that meet the definition of an SME to use:

   (a) the recognition and measurement of full IFRS Standards; combined with

   (b) the disclosure requirements from the *IFRS for SMEs*. Because these subsidiaries meet the definition of an SME, we think that the Board should be satisfied that those disclosure requirements are sufficient in the financial statements of those subsidiaries.[3]

8. The disclosure requirements from the *IFRS for SMEs* might need some tailoring to make them compatible with the recognition and measurement requirements of full IFRS Standards. However, in our view, any such tailoring should be restricted to the absolute minimum, for the following reasons:

   (a) to avoid the risk of appearing to create a third dialect of IFRS Standards (alongside IFRS Standards and the *IFRS for SMEs*); and

   (b) to minimise the work needed, both for stakeholders and for the Board and staff.

9. If the Board wishes to pursue this approach, we recommend beginning with some initial research to assess its feasibility. That research would involve:

   (a) initial discussion with national standard setters to obtain their views on its feasibility; and

   (b) an initial review of the disclosure requirements in the *IFRS for SMEs* to assess whether any tailoring is likely to be needed.

[3] If the parent produces consolidated financial statements in accordance with full IFRS Standards, the full IFRS Standards would apply to those consolidated financial statements.

10. Some respondents also suggested exploring the development of pushdown accounting[4], which would result in a change in measurement basis for the subsidiaries. We do not recommend exploring pushdown accounting.

Variable and contingent consideration for asset purchases (reference A14)

11. The question of how to account for variable and contingent payments for asset purchases outside of a business combination has occupied the Interpretations Committee for some time. The Interpretations Committee has been unable to reach conclusions on all of the issues because the existing requirements in IFRS Standards are insufficient in this respect.

12. The discussions at the Interpretations Committee have focused on property, plant and equipment and intangible assets, however other assets can also be affected, including inventory, investment properties and assets in the scope of IFRS 6 *Exploration for and Evaluation of Mineral Resources*.

13. The variable payments could depend on variables such as:

    (a) An index or rate such as LIBOR, or an inflation index;

    (b) The purchaser's future activity derived from the underlying asset, for example reaching a milestone or obtaining regulatory approval; and

    (c) The acquired asset complying with an agreed-upon specification at specified dates in the future, for example asset quality or performance.

14. The industries that we understand to be most affected by this issue are the extractive industries, pharmaceutical and biotech industries, real estate and telecommunications.

15. The reasons why entities contract for variable or contingent amounts are varied and include:

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[4] Pushdown accounting is defined in US GAAP as 'Use of the acquirer's basis in the acquiree's separate financial statements'. In other words, the measurement basis of a subsidiary's assets and liabilities is changed in its separate financial statements to align it with the measurement basis of those assets and liabilities used by its parent in the parent's consolidated financial statements. This change in measurement basis is made when there is a change in control of the subsidiary. US GAAP provides an option for the use of pushdown accounting when certain thresholds are met.

(a) Disagreement between the purchaser and the seller about the value of the asset, for example due to significant uncertainty about the asset's future earning potential;

(b) To help the purchaser finance the purchase; and

(c) To allow the seller to reduce its risk exposure to the asset by effectively selling part of the asset.

16. The key financial reporting issues that the Interpretations Committee has debated are:

(a) When should a liability be recognised for a future variable or contingent payment, at what value, and should part or the whole of that amount be reflected in the measurement of the asset acquired?

(b) After the liability is recognised, do remeasurements of the liability represent revisions to the measurement of the asset purchased, or are the remeasurements part of the entity's performance?

17. The financial reporting for this issue sits at the intersection of guidance in a number of IFRS Standards; diversity in practice has arisen due to the difficulties in determining the appropriate interaction of these Standards. In addition, this issue includes measurement challenges because of the uncertainty about the future events on which the transaction amount is based. Consequently, identifying appropriate disclosures about that uncertainty is likely to form part of any solution that is developed.

18. We think that the discussions at the Interpretations Committee, and the results of outreach that it has undertaken as well as the feedback in the agenda consultation, demonstrate that this is an important issue that is widespread. Consequently we think the Board should consider taking on a project to address this area of financial reporting.

19. We think that this issue shares some characteristics with risk sharing / collaborative arrangements (see next section). This is because the reason for the variable or contingent payment is sometimes to reflect the transacting parties' desire to share the risks and benefits associated with the asset being transacted. However, we think that the topic of risk sharing / collaborative arrangements is

broader and that it would be better for the Board to address the narrower issue of variable and contingent pricing for asset purchases first; resolving this accounting issue may relieve those concerns that are common to both topics.

Risk sharing / collaborative arrangements (reference A15)

20. The topic of risk sharing / collaborative arrangements is broad, and shares many of the characteristics described above for variable and contingent consideration for asset purchases. For the purposes of this paper we consider the topic of risk sharing and collaborative arrangements as one that is focused on *activities*, in order to distinguish it from the previous topic which is about the purchase of assets, however the line can be a fine one.

21. Risk sharing / collaborative arrangements arise in a range of industries, including extractive industries, pharmaceutical and biotech industries, aerospace and defence industries and construction. They are attractive when an investment is unique, high risk and large. The parties participating might contribute similar skills and resources, but in other circumstances could bring very different contributions, for example different technical or commercial expertise, or some might bring only finance but are prepared to take on operational risk with their investment.

22. One of the comment letters received (EY, CL41) identified that a reason why these arrangements are difficult to account for under current IFRS Standards is because the arrangements are based on risk sharing, whereas the Board's recent standards have tended to focus on the notion of control, including the concept of sharing control. That comment letter and the comment letter from the Belgian Accounting Standards Board (CBN/CNC, CL96) identified that a project on this topic would need to consider revenue and expense recognition as well as asset and liability recognition and measurement. Guidance on revenue and expense recognition could be needed for the accounting for the shared outputs from an arrangement.

23. A more complex question might arise over the accounting for the contributions to the arrangement by those parties that are contributing assets or services to the arrangement; should this be reflected as revenue from the 'sale' of goods or

services to the arrangement, or does it reflect an investment in the arrangement? If the contribution reflects an investment, how should that investment be measured? For example, if the contribution is of internally-generated technology that has little or no carrying amount on the contributing party's statement of financial position, should the investment be measured by reference to the carrying amount of the technology, or its fair value?

24. We noted in the previous section that we think that the Board should first address the issue of variable and contingent consideration for asset purchases. We think that the need for a project on risk sharing / collaborative arrangements could be reconsidered after completion of a variable and contingent consideration project.

Assessment of the need to withdraw IAS 26 (reference A35)

25. IAS 26 was issued in 1987, and has not been revised since. Concerns about its relevance have been raised for some time.

26. We think a first step could be to ask the International Forum of Accounting Standard Setters (IFASS) whether IFASS members believe there is a need to keep IAS 26. If IFASS members believe there is no need to keep IAS 26, we will consider recommending to the Board that it issue a proposal to withdraw IAS 26.

Digital currencies, including cryptocurrencies (reference A18)

27. A digital currency can be thought of as an online currency that can be used to settle transactions. The use of digital currencies is an emerging business practice.

28. We have not conducted even preliminary research on this topic, and so we do not know what issues may arise. As a first step we think the Board could ask the national accounting standard-setters (NSS) that raised this issue to let us know what issues they believe may arise. These NSS were the Canadian Accounting Standards Board (CL37), the New Zealand Accounting Standards Board (CL26) and the Asia-Oceania Standard-Setters Group (CL102).

29. When we have their response, we would then consider whether we should recommend carrying out any research on this topic.

General principles for preparing separate financial statements (reference A3)

30. Separate financial statements are important in many jurisdictions, and will often provide the basis for dividend distribution and the starting point for income tax assessment. Separate financial statements may also be the basis on which laws or regulations determine whether an entity is insolvent or bankrupt.

31. IFRS Standards make little reference to separate financial statements, whether in terms of specific requirements or specific exceptions from the general IFRS requirements. In 2014 a group of European standard-setters[5] published a discussion paper[6] on the subject of separate financial statements. That work identified three main financial reporting areas for further consideration; measurement of investments, common control transactions including accounting for business combinations under common control in separate financial statements and disclosures in separate financial statements.

32. We think the Board could undertake a preliminary assessment of this subject, including consideration of the needs of users of separate financial statements. This could draw on the guidance about user needs in the revised Conceptual Framework after that has been finalised.

General principles for preparing combined financial statements (reference A4)

33. The Conceptual Framework ED describes combined financial statements as 'financial statements that are prepared for two or more entities that do not have a parent-subsidiary relationship with each other'. The demand for such combined financial statements can arise for a number of reasons. These include:

    (a) Two or more entities that are controlled by the same shareholder (ie a natural person) and those two entities conduct their operations together. Some argue that preparing combined financial statements of such entities permits the overall operations of those entities to be understood

[5] European Financial Reporting Advisory Group, the Spanish Instituto de Contabilidad y Auditoría de Cuentas, the Italian Organismo Italiano di Contabilità and the Dutch Raad voor de Jaarverslaggeving

[6] http://www.efrag.org/Activities/228/Proactive---Separate-Financial-Statements-prepared-under-IFRS

better. A common variant of this is the circumstance in which the entities are controlled by members of the same family.

(b) Two divisions of a group that are proposed to be 'spun off' together in a public offering; preparation of combined financial statements that contain those two divisions could allow the selling entity to present an overall picture of the two divisions to prospective investors.

(c) Two mutual insurance entities; a mutual life insurer managed by the same management team as a mutual non-life insurer, but with each mutual insurer having different owners.

34. We think the description proposed in the Conceptual Framework ED would, if finalised, make it clear that combined financial statements can be prepared in accordance with IFRS Standards. We think this may remove some of the uncertainty that has until now existed about whether it is possible to prepare combined financial statements in accordance with IFRS Standards.

35. The *IFRS for SMEs* includes some limited guidance on the preparation of combined financial statements; it does not require combined financial statements to be prepared, nor does it set out when combined financial statements could be prepared. It requires that when combined financial statements assert compliance with the *IFRS for SMEs*, those financial statements should comply with all requirements of the *IFRS for SMEs*. It explains that this includes elimination of all intercompany transactions, balances and profits. It also specifies disclosures that must be given in respect of combined financial statements.

36. If the Board decided to explore developing guidance for combined financial statements, we propose that it first researches the circumstances in which there is greatest demand for combined financial statements, and obtain a broad understanding of both the practical and conceptual issues that preparers, auditors, regulators, users and others face with the preparation and interpretation of combined financial statements.

37. We think the issues that would require consideration could include:

(a) How to determine which businesses, or parts of businesses, should be included and what should be excluded from the combined financial statements (ie how to determine the boundary of combined financial statements)?

(b) In what circumstances could or should there be changes to which businesses, or parts of businesses, are included in a set of combined financial statements (ie when should there be changes to the boundary of combined financial statements)?

38. However, the subject of combined financial statements was raised in only two comment letters[7] in the Agenda Consultation. There has only been one question on the subject of combined financial statements to the IFRS Interpretations Committee and we are not aware of widespread demand to develop standards-level requirements of when and how combined financial statements should or may be prepared.

Non-reciprocal transactions, including with governments (reference A7)

39. Four comment letters[8] identified non-reciprocal transactions as an area requiring attention by the Board. These respondents identified several different transactions, including income taxes, levies, pollutant pricing mechanisms and government grants as examples of transactions in which the non-reciprocal nature of the transactions contributed to the difficulties in accounting for them.

40. Some argue that the non-reciprocal aspect of these transactions distinguishes them from other types of transaction, and might reflect an absence of a commercial rationale for the transaction on the part of the 'contributing' party, and instead reflect some other motivation, such as social or political. Some also observe a non-voluntary aspect of some of these transactions, principally taxes. The form of the transactions might also differ from other types of transaction, in so far as they might be statutory, rather than contractual.

41. We do not think that a right or obligation is different because the source of that right or obligation (ie statutory vs contractual) is different, nor do we think the

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[7] Fédération des Experts Comptables Européens (FEE, CL29), KMPG (CL51)

[8] UK Financial Reporting Council (UK FRC, CL7), European Securities and Markets authority (ESMA, CL11), Deloitte Touche Tohmatsu Limited (DTTL, CL89), Institute of Chartered Accountants in England and Wales (ICAEW, CL107)

right or obligation differs because the motivation that led to its creation is different (ie social vs commercial). However, we acknowledge the questions raised about the relevance of historical cost measurements for such transactions when there is not an exchange of consideration at fair value because of the non-reciprocal nature of the transaction.

42. We also note the concerns raised by some about the timing of income statement recognition for some of these transactions. For example does an annual levy relate to a point in time or a period of time? If the levy relates to a period of time, how best should that levy be reflected in the measurement of the performance of the entity when that period of time does not coincide with the entity's reporting period?

43. We are not persuaded that the non-reciprocal aspect of these transactions makes them sufficiently different from exchange transactions to justify a separate basis of accounting. Indeed some of these transactions come with obligations or require the satisfaction of certain pre-conditions, and so may not be wholly non-reciprocal. We think that work on broader projects, such as completion of the Board's Conceptual Framework, followed by a possible review of IAS 37 *Provisions, contingent Assets and Contingent Liabilities*, could help inform any future consideration of the financial reporting issues associated with non-reciprocal transactions.

44. Although projects on income taxes, levies, pollutant pricing mechanisms have proved challenging, we do not think their most challenging aspects arise from the fact that they are non-reciprocal. So we think that addressing those topics together in a single project would be unlikely to increase the chances of reaching a timely and successful conclusion.

Review of IAS 20 (reference A8)

45. Concerns about the consistency of IAS 20 with the Conceptual Framework have been raised over several years, however specific concerns about the application of IAS 20 or the information it produces have been fewer.

46. Several respondents suggested for a broader review of existing standards against the revised Conceptual Framework. If the Board decides to take on such a

project, it could include IAS 20, however we do not see a pressing need to carry out a separate review of IAS 20.

47. One of the comments received (Austrian Financial Reporting and Auditing Committee (AFRAC), CL62) referred to an increasing complexity of grants. The IFRS Interpretations Committee has recently been discussing a forgivable government loan which is forgiven if the project which it is financing is unsuccessful, but repayable at twice the amount received if successful. We think that complexities such as this would be better considered as part of a project on risk sharing arrangements – this is considered in paragraphs 20-24 above.

Relevance of referring to pronouncements of other standard-setting bodies in the hierarchy in IAS 8 (reference A34)

48. One respondent to the Agenda Consultation (European Financial Reporting Advisory Group (EFRAG), CL113) suggested that following the widespread adoption of IFRS Standards in most jurisdictions, the Board should reconsider the relevance of the current hierarchy in IAS 8. This stakeholder thought that the 'suggestion to consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards needs to be removed so that constituents would not automatically assume that any US GAAP guidance is relevant for IFRS compliant standards'. Another respondent (Association for Financial Markets in Europe (AFME), CL50) requested 'more clarity on whether the Board considers that particular pronouncements by other standard-setting bodies (such as FASB) do not conflict with the requirements of [IFRS Standards and the Conceptual Framework]'.

49. We note that the hierarchy in IAS 8 assists in the development of an accounting policy when IFRS Standards do not provide guidance that specifically applies to a transaction, other event or condition. We think that it would be neither helpful nor appropriate nor feasible to analyse particular requirements of particular national standard setters to assess whether those requirements conflict with the hierarchy in IAS 8.

50. We recommend no work on this topic.

Question for the Board

Question for the Board
Does the Board have any questions or comments about the projects that we have described above and our assessment of these?