# Report of the Emerging Economies Group Meeting

**October 2018**

## 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 16th EEG meeting held in Seoul, South Korea, on 29–31 October 2018, hosted by the Korea Accounting Standards Board (KASB).

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

### 16th EEG meeting agenda

Agenda topics included:

- the Discussion Paper–*Financial Instruments with Characteristics of Equity*;
- the next steps in the Goodwill and Impairment project;
- the accounting for micro-entities in Brazil;
- the forthcoming review of *IFRS for SMEs* Standard;
- implementation of *IFRS 9 Financial Instruments;*
- an introduction to the Extractive Activities project; and
- a project 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 on 25–27 March 2019 in Buenos Aires, Argentina.

## Introductory Comments

In his welcome address, Mr Su-Keun Kwak, IFRS Foundation Trustee, highlighted current challenges in the global economy, including the implications of Brexit. He noted that emerging economies will have a key role in global economic growth and hence the importance of members of emerging economies coming together to share their experience of IFRS Standards, which have become *the* global accounting standards.

Mr Gomes thanked Mr Kwak for his comments and thanked Mr Eui-Hyung Kim, Chair of the KASB, for hosting the 16th EEG meeting in South Korea.

## Discussion Paper–*Financial Instruments with Characteristics of Equity*

Mr Kumar Dasgupta, member of the IFRS Foundation's technical team, led the discussion on the Discussion Paper—*Financial Instruments with Characteristics of Equity* (FICE).

The Board issued the Discussion Paper in June 2018 with a six-month comment period.

### Introduction

Mr Dasgupta pointed out that the Board's objective in issuing the Discussion Paper is to receive feedback to enable it to decide whether to develop the proposals in the Discussion Paper and revise IAS 32 *Financial Instruments: Presentation.*

### Objective, scope and challenges

Mr Dasgupta explained that the Board and the IFRS Interpretations Committee (Committee) had been challenged in addressing questions on the application of IAS 32. Although IAS 32 had performed well during the financial crisis, he explained, since the financial crisis more complex financial instruments have been designed. However, IAS 32 lacks clear principles to apply when analysing these more complex financial instruments.

One of the key objectives of the Board in undertaking the project, Mr Dasgupta explained, is to articulate principles that would enable more consistent application of the accounting requirements in IAS 32, thereby providing useful information.

The EEG members welcomed the Board's decision to address the distinction between debt and equity, recognising that as an old Standard IAS 32 is challenging to apply. That said, some EEG members raised some concerns regarding the proposals set out in the Discussion Paper, including:

(a) the complexity of the proposals—those members considered that much of the complexity arises from the new terminology that is being proposed;

(b) the concern about complexity led some EEG members to question if the implementation costs of a future Standard would exceed the benefits because of the need to evaluate existing financial instruments to determine if a change in reclassification between debt and equity is required.

In view of the above, some members enquired as to whether the Board had considered improving the disclosure requirements for financial instruments with characteristics of equity rather than the more fundamental proposals in the Discussion Paper. Other EEG members supported the Board's approach in the Discussion Paper to develop the principles that underpin IAS 32.

### Overview of the Board's preferred approach

Mr Dasgupta provided an overview of the Board's rationale for the proposals in the Discussion Paper. In simplified terms, the Discussion Paper classifies a financial instrument as a financial liability if the answer is yes to one or both of the following questions:

Timing feature – can the issuer be required to pay cash or hand over another financial asset before liquidation?

Amount feature – has the issuer promised a return to the instrument's holder regardless of the issuer's own performance and share price?

EEG members discussed some examples that explained the application of proposals in the Discussion Paper. In discussing the examples, the EEG members suggested areas that the Board could consider when addressing feedback on the proposals, including:

(a) further explanation of the amount feature. In particular, clarifying the term 'available economic resources'. EEG members queried whether 'available economic resources' should be based on net assets at a point in time, future forecasts (including growth). Members also enquired if 'available economic resources' is based on the financial statements or other financial information.
(b) application of the amount feature to financial instruments with cumulative features that would be classified as financial liabilities. Members noted that, depending on circumstances, this proposal, if implemented, could significantly change current practice. EEG members recommended that the Board consider examples where the proposals in the Discussion Paper could lead to reclassification, for example, application of the amount feature to a cumulative preference share where there is no obligation on liquidation to settle outstanding accumulated dividends, or a perpetual bond where accumulation is at the option of the issuer.
(c) the measurement requirements on reclassification when there is a change in the terms and conditions of a financial instrument.

EEG members raised some questions that the Chairman noted were outside the scope of the project. The Chairman further clarified that the Board's aim in developing the Discussion Paper was to provide principles that support the classification of debt and equity. Consequently, the Discussion Paper does not address the accounting for deferred income, the interaction between the proposals in the Discussion Paper and prudential capital requirements, or the requirement in many Latin American jurisdictions for the compulsory payment of dividends.

**Application of the Board's preferred approach to non-derivative financial instruments**

Mr Dasgupta outlined how the Board's preferred approach would apply to non-derivative financial instruments. Specifically, he explained how an entity would assess if an amount is independent of the entity's available economic resources.

An EEG member suggested the description in paragraph 3.17 of the Discussion Paper implies that the amount of a financial liability cannot exceed the entity's available economic resources. The member suggested that some of the drafting of the Discussion Paper should be clarified.

EEG members discussed whether it was possible to have an entity without equity—members agreed that an entity, such as a cooperative credit union, could have no equity. Similarly, members also questioned whether an entity could exist without economic resources.

**Classification of derivative financial instruments**

EEG members discussed the Board's proposals on classification of derivatives on own equity and the rationale that supports the proposals.

Mr Dasgupta explained that the Board aims to address application challenges that arise in applying the fixed-for-fixed condition in IAS 32[1]. Mr Gomes added that application difficulties arise with the fixed-for-fixed condition because 'fixed-for-fixed' describes a circumstance as opposed to establishing a principle.

The Board's preferred approach would classify a derivative on own equity instruments as a financial asset or a financial liability if:

(a) it is net-cash settled (the timing feature); or
(b) the net amount of the derivative is affected by a variable that is independent of the entity's available economic resources (the amount feature).

Mr Gomes noted that the amount feature encompasses the fixed-for-fixed condition.

EEG members asked about the classification of mandatory convertible notes issued in a foreign currency and a financial instrument with an anti-dilution feature that includes a ceiling and a floor.

**Compound instruments and redemption obligation arrangements**

EEG members discussed the types of financial instruments issued in their jurisdictions, including compound instruments, convertible bonds, written puts on non-controlling interests and contingent

[1] Paragraph 16(b)(ii) of IAS 32 states that a 'financial instrument is an equity instrument if, and only if, the instrument will or maybe settled in the issuer's own equity instruments, it is a derivative that will be settled only by the issuer exchanging a fixed amount of cash, or another financial asset for a fixed number of its own equity instruments…'.

convertible bonds.

EEG members noted that proposals in the Discussion Paper for the accounting for compound financial instruments are more complex than current requirements. The members also noted the consequences arising from the classification of financial instruments regarding interest payments and dividends and consequently profits that are available for distribution.

In relation to written puts on non-controlling interest, members noted the inter-relationship with the option not to recognise the fair value of non-controlling interests in IFRS 3 *Business Combinations*.

Some members noted that convertible foreign currency bonds are regularly issued in their jurisdictions. These members noted that as the net amount of the financial instrument is affected by a variable other than the entity's own share price, these financial instruments would be classified as financial liabilities which would be a major change from current practice.

Financial instruments issued vary by jurisdiction; consequently, EEG members focused on different aspects of the proposals in the Discussion Paper.

### Presentation of equity instruments

In providing an overview of the proposals in the Discussion Paper on the presentation of equity instruments Mr Dasgupta explained that the proposals regarding presentation of equity instruments aim to address concerns that equity investors require more information about their investments, including information about potential future profit distributions.

EEG members were concerned that the proposals on the attribution of earnings in the Discussion Paper would be costly to implement. One EEG member suggested that the information may not benefit prospective investors. Mr Gomes asked EEG members to seek explicit feedback from investors in their jurisdictions and include this feedback in comment letters responding to the Discussion Paper.

EEG members suggested the proposals in the Discussion Paper could be simplified by grouping financial instruments with similar risks for presentation.

EEG members asked that the Board considers clarifying the relationship between the presentation proposals in the Discussion Paper and any proposal that arises from the Primary Financial Statements project.

### Disclosures

EEG members questioned how to determine the priority of claims on liquidation as part of the proposed disclosures. EEG members were concerned about the level of judgement required to determine the priority of claims and consequences if that priority was challenged.

EEG members asked whether the disclosure proposals had been evaluated in relation to the Basel capital requirements. An EEG member said that prudential regulators are interested in the project and potential implications of Tier 2 and 3 capital. The Board has regular meetings with the Basel Committee, which provide an opportunity for the Board to discuss technical projects, such as the Discussion Paper.

### Concluding remarks

In concluding the discussion, Mr Gomes observed that comments by EEG members were broadly consistent with other feedback being received and there did not appear to be matters specific to emerging economies. He asked that members include comments made at this EEG meeting in responding to the Discussion Paper. He requested that EEG members, when responding to the Discussion Paper, provide a clear rationale for their views and set out alternatives for the Board to consider.

## Next steps in the Goodwill and Impairment project

Mr Chungwoo Suh, a Board member, presented an overview of the findings from the Board's research on goodwill and impairment. He also set out the Board's objectives for the next stage of the project.

### Project objective

EEG members discussed the objective of the project and commented on the subsequent measurement of goodwill.

Some EEG members pointed to concerns that the impairment approach to the subsequent accounting for goodwill results in 'too-little-too-late' and that this could potentially give rise to significant impairment charges in an economic downturn. These members asked if the Board could amend the impairment test so it is forward looking. Other EEG members suggested that the Board accept amortisation is easier for preparers and reduces the risk of 'too-little-too-late'.

Another EEG member noted that goodwill amortisation is a methodology for allocating the costs of an asset to a time period. In contrast impairment is the remeasurement of an asset to determine its recoverable amount. In considering the subsequent accounting for goodwill, this EEG member said, the Board needed to decide whether it is trying to allocate the costs of goodwill or remeasuring an asset.

One EEG member estimated that in their jurisdiction goodwill could represent up to 40% to 50% of the capital of an entity. Deciding the period over which goodwill should be amortised is difficult, this member said, the difficulty is compounded when an acquired entity is merged with an existing business. Another EEG member said that an entity should identify the component parts of goodwill, including the control premium paid. Identifying the component parts of goodwill should help determine the amortisation period for goodwill.

Another EEG member noted that analysts in their jurisdiction recognise that the effectiveness of the impairment test is limited and suggest that amortisation addresses the 'too-little-too-late' concern. This member recommended the Board introduce an amortisation and impairment model for the subsequent accounting of goodwill.

**Identifiable intangibles**

An EEG member noted that identifying intangible assets in a business combination is not easy and there is often a fine line between recognising intangible assets and recognising goodwill. However, the difference in the subsequent accounting for the two assets is significant. Mr Darrel Scott noted that identifiable intangible assets have a definite life; therefore, amortisation allocates the cost of the asset over the period the asset is consumed. In contrast, goodwill arguably does not have a definite life.

**Current work the Board is undertaking**

Mr Suh explained that the Board is discussing how to improve disclosure that provides users with improved information about business combinations, goodwill and impairment.

*Improving disclosures*

The EEG members supported the Board's decision to try to improve disclosures about the success of an acquisition, but noted that entities may be concerned about disclosing sensitive data. Other suggestions for the Board to consider when developing the disclosures included how to provide disclosures if the acquisition is merged within an existing business (cash generating unit) and the period of time for which the disclosures should be required.

*Simplifying the accounting for goodwill*

EEG members supported permitting an indicator-only approach to determine whether an impairment test is required, although some members supported a requirement to undertake a full impairment test every three years.

*Exploring whether to reintroduce amortisation of goodwill*

EEG members noted that in determining the useful life of goodwill, synergies that can be part of the reason for acquisition and/or economic growth can be difficult to measure because they do not typically have definite lives.

An EEG member noted that businesses know why they are prepared to pay a particular price for the acquisition; it is accountants that struggle to account for the price paid. He suggested that a better understanding of the reasons for the acquisition and expected cash flow changes would help improve application of the impairment test.

## Accounting for micro-entities in Brazil

The EEG members discussed how the member jurisdictions have addressed the accounting for micro-entities and compared the different features of micro-entity financial statements in jurisdictions.

Mr Rogerio Mota, Chair of International Affairs CPC, Brazil, presented an overview of the Brazilian accounting framework and key aspects of the financial reporting standards.

EEG members agreed to continue to discuss the topic at the next EEG meeting.

## *Forthcoming review of the IFRS for SMEs* Standard

Mr Scott presented an overview of the plan for the next comprehensive review of the *IFRS for SMEs* Standard. EEG members suggested the Board consider the following topics:

(a) the intended scope of the Standard; in particular, members stressed that the scope influences how the Board determines the requirements in the Standard;
(b) application questions regarding ‘over-the-counter’ markets and the meaning of ‘traded in a public market’ within the definition of public accountability;
(c) whether the Standard is positioned as a simplified accounting standard for small and medium-sized entities or as a simplification of IFRS Standards; and
(d) the application of the Standard to small banks and financial institutions.

EEG members made a number of suggestions for topics to be included in the forthcoming review, including:

(a) the undue cost or effort exemption, in particular members noted application of the exemption can create tension with auditors;
(b) inclusion of recently issued Standards (including the revised *Conceptual Framework*) in the *IFRS for SMEs*; it was noted that in looking at the recently issued Standards and their application to small and medium-sized entities the Board should consider the users needs;
(c) issues considered but not incorporated in the last review, such as borrowing costs. Members also noted that in some circumstances, such as biological assets, it is simpler to estimate fair value than calculate costs; and
(d) the requirement to prepare consolidated financial statements—members noted that in some jurisdictions entities were not required to prepare consolidated financial statements.

An EEG member noted that in some instances the *IFRS for SMEs* Standard includes a fall back to IFRS Standards (for example, IAS 39 *Financial Instruments: Recognition and Measurement*) whereas in other instances it provides an accounting policy option (for example, the subsequent measurement of property, plant and equipment). EEG members discussed the advantages and disadvantages of the two approaches and noted the need to balance providing simplified accounting principles with users’ information needs.

## Implementation of IFRS 9 *Financial Instruments*

Mr Gomes provided an overview of the implementation support that is available on the IFRS Foundation’s website to help implement IFRS 9.

Mr Rogerio Mota provided an overview of the requirements for banks in Brazil. He noted that in Brazil banks prepare consolidated financial statements applying IFRS Standards and are also required to prepare regulatory financial statements.

Members discussed the application of the expected credit loss model in IFRS 9; and noted the complexity of some models being developed. EEG members noted the importance of working with central banks and regulators on implementing the expected credit loss model. Mr Scott noted that IFRS 9 focuses on mispriced risks whereas a Regulators focus will be on high risk loans.

## Introduction to the Extractives Activities project

Mr Scott provided an overview of the initial work being performed on this project.

EEG members noted that any change to current accounting practice will require support from the industry, noting the extent of influence that this industry has. The members suggested that the Board clearly defines the project’s objective and scope before proceeding with the project.

EEG members suggested some topics for the Board to consider in this project, including:

(a) accounting for intangible assets;
(b) application of the *Conceptual Framework*, including identifying the unit of account; and
(c) accounting for mineral rights before legal rights are obtained.

## 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 Buenos Aires, Argentina 25–27 March 2019.