Q3
2020

ZAMPA DEBATTISTA

AUDIT & IFRS NEWSLETTER

EXCELLENCE IS OUR AIM.
PRO-ACTIVENESS IS KEY TO OUR SUCCESS.

INTRODUCTION

Issue 2 of the audit and IFRS newsletter is split into three parts:

- An amendment issued by the IASB during Q3 2020, relating specifically to the IASB's response to the IBOR reform. This change is effective from 1 January 2021.
- An update, and overview, of the ongoing projects being undertaken by the IASB's. These may or may not eventually result in an amendment.
- A special feature relating to the European Single Electronic Format (ESEF).

PART 1: Change Effective 1 January 2021

THE IBOR REFORM AND IFRS – PHASE 2 AMENDMENTS

IBOR stands for 'Interbank Offered Rates'. These are the benchmark interest rates that underpin the measurement of numerous financial instruments. Examples include LIBOR (London Interbank Offered Rates), EURIBOR (Euro Interbank Offered Rate) and others.

Many companies have contracts with floating interest rates based on LIBOR or EURIBOR. For instance, a company might have a loan receivable whereby interest is charged at 1% + LIBOR. Other companies might use an IBOR as a basis to determine a discount rate. Reliable discount rates are useful in various circumstances, such as when initially measuring a financial liability, or when determining the value-in-use of a cash generating unit under IAS 36.

Beyond the financial reporting world, the process by which such benchmark rates are being calculated, is being reformed. Amongst a number of future uncertainties in this respect is the impact on financial reporting.

As a result, the IASB undertook a two-phase project, the second and final phase of which has resulted in a package of new amendments, issued during Q3 2020. The amendments that were issued relate to the following aspects:

- Changes to contractual cash flows – to reflect the changes to the alternative benchmark rate, entities will need to update the effective interest rate to reflect the change. It will not be necessary to derecognise or adjust the carrying amount of financial instruments for changes required by the reform.

- Hedge accounting – if a hedge meets other hedge accounting criteria, there will not be the need to discontinue hedge accounting just because of the changes required by the reform.

- Disclosure requirements – companies need to disclose information about new risks arising from the reform and how it manages transition to the new rates.

PART 2: Ongoing IASB Developments And Projects

RESEARCH PROJECTS

Business Combinations Under Common Control

The next milestone is the publication of a discussion paper in November 2020.

The following are in the scope of this project:

- Business combinations under common control that are currently excluded from the scope of IFRS 3 'Business Combinations'.

- Group restructurings.

- The need to clarify the description of business combinations under common control, including the meaning of 'common control'.

The objective of the project is reaching a decision in relation to whether and when a current value approach based on acquisition method set out in IFRS 3 'Business Combinations' is applicable to transactions within the scope of the project.

Currently, a common control transaction is a transfer of assets or an exchange of equity interests among entities under the same parent's control. It's necessary that all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the combination.

Examples of common control combinations include:

- Combinations between subsidiaries of the same parent.

- The acquisition of a business from an entity in the same group.

There are two possible methods for a business combination involving entities under common control:

- A predecessor value method – assets and liabilities of the acquired business are reported at carrying amounts, rather than fair values. No goodwill is recorded and comparatives are sometimes restated as if the combination had taken place at the beginning of the earliest comparative period presented.

- An acquisition method – accounting similar to IFRS 3.

Dynamic Risk Management

The IASB is exploring whether it can develop an accounting model that will enable investors to understand a company's dynamic risk management activities, and evaluate the effectiveness of those activities.

The next milestone is a core model outreach scheduled for Q4 2020. This will enable the gathering of stakeholders' views before further developing the model.

Extractive Activities

There might be a replacement of IFRS 6 'Exploration For And Evaluation Of Mineral Resources', which was originally issued in 2004. In June 2020, the IASB discussed feedback on its request for information from jurisdictions, stakeholder groups and national standard-setters, but no decisions were made so far.

The IASB expects to decide on the project direction during the first half of 2021.

Financial Instruments with Characteristics Of Equity

The next milestone is a decision on the project direction scheduled for Q4 2020.

The IASB is considering making clarifying amendments to IAS 32 'Financial Instruments: Presentation' to address common accounting challenges that arise in practice with complex financial instruments, and to further develop some presentation and disclosure requirements.

Goodwill and Impairment

The next milestone is the feedback on the discussion paper to be received by 31 December 2020. A decision is expected to be made during H1 2021.

The IASB is suggesting changes to IFRS standards that would require a company to disclose information about its objectives for an acquisition, and in subsequent periods, information about how that acquisition is performing against those objectives.

There are mixed views about the effectiveness of the annual impairment test required for goodwill.

The IASB is considering new disclosure requirements that provide investors with the information needed on the performance of an acquisition. The IASB, so far, doesn't seem inclined to reintroduce amortisation of goodwill.

Pension Benefits That Depend on Asset Returns

The next milestone is review research scheduled for November 2020.

A narrow scope amendment to IAS 19 'Employee Benefits' is to be considered after evidence is gathered. The IASB intends to use illustrative examples to explore how a 'capped' ultimate cost adjustment model would apply. The IASB also plans to assess the use of pension benefits that depend at least partly on the return on a specified pool of assets.

Post-Implementation Review of IFRS 10 'Consolidated Financial Statements', IFRS 11 'Joint Arrangements' and IFRS 12 'Disclosure Of Interests In Other Entities'

The IASB is currently in the first phase of the post-implementation review of IFRS 10, IFRS 11 and IFRS 12. This first phase involves an initial identification and assessment of matters to be examined.

The publication of the request for information for the post-implementation review has been postponed to Q4 2020.

STANDARD-SETTING PROJECTS

Management Commentary

An exposure draft in this respect is expected for the first quarter of 2021.

This project is a result of the Board wanting to explore how broader financial reporting could complement financial statements prepared applying IFRS. This would revise the IFRS Practice Statement 1 'Management Commentary'.

The IASB discussed the objective of management commentary, as well as the disclosure objectives of certain types of such management commentary.

In the case of the objective of management commentary, the revised practice statement should:

- Retain the statement that management commentary is prepared for existing and potential investors, lenders and other creditors, and refer to them as 'primary users'.

- Explain that primary users are expected to have reasonable general knowledge of business and economics, and to be able to review and analyse the information diligently, but the users aren't expected to have knowledge of the entity to which the management commentary relates.

The IASB decided to specify, in the disclosure objectives, ways with which management commentary should enhance the understanding of investors and creditors.

Primary Financial Statements

A replacement to IAS 1 is currently being discussed. The deadline for exposure draft feedback in this respect was 30 September 2020.

The proposals put forward would result in a new IFRS standard that sets out general presentation and disclosure requirements relevant for all companies.

The focus of these improvements is on the way financial performance is reported, including:

- New subtotals in the profit and loss – there would be three new profit subtotals. These will enable comparability, since as things stand, all companies report operating profit but the term is not defined by IFRS standards.

- Non-GAAP transparency – there would be a new requirement for companies to disclose management performance measures in a single note to the financial statements. These would add much needed transparency and discipline in relation to non-GAAP
- measures.

- Improved disaggregation of information – it is being proposed that guidance is provided to companies in order for them to label sufficiently, resulting in more useful information to users.

- Limited changes to the statement of cash flows to improve consistency in classification by removing options.

Rate-regulated Activities

The next milestone is an exposure draft expected for Q1 2021.

Rate regulation is the setting by regulatory bodies or governments of prices that can be charged to customers for services or products through regulations, often where an entity has significant market power, or dominance (e.g. local electricity service).

The IASB intends to come up with proposals to give financial statement users better information about a company's incremental rights and obligations arising from its rate-regulated activities.

MAINTENANCE AND OTHER PROJECTS

The following are the IASB's maintenance and other projects, currently in the pipeline, and a brief description of what they're about. Any confirmed amendments will be included in our next issue:

- Amendments to IAS 8 'Accounting Policies, Changes In Accounting Estimates And Errors' to help entities distinguish accounting policies from accounting estimates.

- Amendments to IAS 12 'Income Taxes' to require an entity to recognise deferred tax on initial recognition of particular transactions to the extent that the transaction gives rise to equal amounts of deferred tax assets and liabilities, both of which would be recognised.

- Disclosure initiative – accounting policies, to guide entities in determining which accounting policies to disclose.

- Disclosure initiative – targeted standards-level, to help stakeholders improve the usefulness of disclosures for the primary users of financial statements.

- Amendments to IAS 21 'The Effect Of Changes In Foreign Exchange Rates' to tackle situations when the spot exchange rate is not observable.

- Amendments to IFRS 16 'Leases', to improve an illustrative example on lease incentives, and to improve the guidance on how a seller-lessee in a sale and leaseback transaction would apply the subsequent measurement requirements in IFRS 16.

- Amendments to IAS 37 'Provisions, Contingent Liabilities And Contingent Assets' include clarifications to the following matters:
  - Identifying certain present obligations: is an obligation conditional on an entity's own future actions a present obligation and hence a liability, or not?
  - Obligations to deliver goods and services: Should such obligations comprise only the incremental costs of fulfilling the obligation, or also include an allocation of other directly related costs?
  - Discounting of provisions: Should the rate at which an entity discounts a provision for the time value of money reflect the entity's own credit risk, that is, the possibility that it may fail to fulfil its obligations?

- The proposed IFRS For SMEs Standard – a request for information has been published by IASB, as part of its comprehensive review of the IFRS For SMEs Standard. Comments are to be submitted by 27 October 2020.

- Amendments to IFRIC 14 'IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction' – The clarification of how a company determines the economic benefits available in the form of a refund from a plan when other parties have rights to make particular decisions about the plan.

PART 3: The European Single Electronic Format (ESEF)

INTRODUCTION

What is the ESEF?

It is the electronic reporting format in which issuers on EU-regulated markets shall prepare their annual financial report for financial years beginning on or after 1 January 2020. This includes issuers of both shares and bonds operating in regulated markets.

What is its objective?

One objective is to make things easier. For issuers, submission will be easier. For investors and regulators, there will be a facilitation of access, analysis and comparability.

It is also intended to provide more transparent information to investors, in line with the Transparency Directive. For securities traded on EU-regulated markets, information will flow more regularly to investors.

The Taxonomy

A taxonomy has been created, which is basically a dictionary of accounting terms – this is expected to be always updated as time goes by.

The electronic report will be created by means of tagging – any financial data will be tagged to a term included in the taxonomy.

If a company has unique information, the issuers can create 'extensions' or 'entity-specific taxonomy elements'. This would be useful if the company's unique information, or circumstance, cannot be found in the core taxonomy. However, regulations issued in this respect require that extensions be anchored to the closest existing taxonomy element.

It deserves mention that the ESEF Taxonomy is very similar to the IFRS Taxonomy. Preparers can use the IFRS Taxonomy to tag the information disclosed within the IFRS financial statements. Preparers can access the taxonomy, and can also download it freely. XBRL taxonomy files are available through ESMA's official website.

Tutorials have been released purposely to assist preparers with, amongst others, the process of mapping the IFRS financial statements to the ESEF taxonomy. Issuers should use these XBRL taxonomy files as a starting point to create their own taxonomies.

Detailed Tags and Block Tags

Detailed tagging will only be required for the primary financial statements. This is mandatory for reporting periods starting on or after 1 January 2020.

On the other hand, block tags will be mandatory for the notes as from 2022. Detailed tagging of the notes is voluntary. It will still be allowed to provide more detailed information than the minimum required.

Validation and Submission of Reports

The submitted file needs to be correct in all respects. Therefore, various checks and rules need to be run prior to submission – some of these are included directly in the taxonomy itself. Also, some may be implemented by software developers.

Further Information

Further information can be obtained from the following sources:

- www.mfsa.mt
- www.esma.europa.eu

GET IN TOUCH:

- John Debattista - jd@zampadebattista.com
- Paul Zammit - pz@zampadebattista.com