Report of the Emerging Economies Group Meeting

May 2018 [updated 22 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 15th EEG meeting held in Kuala Lumpur, Malaysia on 14th-16th May 2018, hosted by Mohamed Raslan Abdul Rahman, chair of the Malaysian Accounting Standards Board (MASB)

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

15th EEG meeting agenda

Agenda topics included:

- IFRS 16 *Leases*
- Member topics
  - Involuntary common infrastructure costs
  - Consolidation of not-for profit-entities
  - Presentation of current/non-current assets
- Digital currencies
- Accounting for micro-entities and private-entities
- Accounting for subsidiary entities
- IASB Update
- Initial feedback on the implementation of IFRS 9 *Financial Instruments* in Emerging Economies

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
30 Cannon Street
London EC4M 6XH
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 29 – 31 October 2018 in South Korea.

Introductory Comments

Mohamed Raslan Abdul Rahman, chair of the MASB, welcomed the members of the EEG to the meeting. He welcomed representatives of the Accounting Standards Board of Japan and Lao Chamber of Professional Accountants and Auditors, as observers to the meeting.

Amaro Gomes, chair of the EEG and member of the Board, thanked Mohamed Raslan Abdul Rahman for his welcome and the MASB for its kind hospitality.

IFRS 16 *Leases*

Darrel Scott, member of the Board, presented on IFRS 16 *Leases.*

Overview

Darrel Scott provided an overview of IFRS 16, outlining the need for change and why the Board issued the Standard.

EEG members enquired why IFRS 16 does not update lessor accounting requirements, similar to the lessee requirements. Amaro Gomes explained that, in contrast to lessee accounting, there were no strong arguments to change lessor accounting. The financial statements of lessees lacked information about the indebtedness and the extent of residual value guarantees of a lessee, inhibiting the ability of users of financial statements to assess the credit risk of an entity.

One EEG member explained that a consequence of not changing lessor accounting is the effect on Government statistical reports, because property, plant and equipment are included in both the lessor and lessee statements of financial position.

EEG members discussed the difference between the US Financial Accounting Standards (FASB) Board's and the Board's presentation models. Darrel Scott noted that the IFRS 16 *Basis for Conclusions* (paragraphs BC303–BC310[1]) compares the FASB decisions with those of the Board.

Several EEG members noted the importance of working closely with taxation authorities when implementing IFRS 16 because the changes to the recognition of assets and the corresponding depreciation charges could accelerate when taxation cash flows occur.

In relation to implementation, an EEG member noted the importance of assessing the overall lease arrangement; this might include arrangements with third parties such as banking entities, when considering the requirements of IFRS 16.

Recognition exemptions

An EEG member asked how an entity assesses if it is *reasonably certain* it will extend a lease (when considering if the short-term leases exemption applies), where the entity has an option to extend the lease. Darrel Scott responded that, in assessing *reasonably certain* evidence can be obtained from the documentation supporting the decision to acquire the right-of-use asset, including reviewing the business case presented with the capital request and/or management plans and budgets. This consideration of the relevant facts and circumstances is in line with the requirements of IFRS 16 (paragraphs 19 and B37-B40).

An EEG member noted the assessment of the lease term is difficult when the lessee has an option to extend but does not have the practical ability to extend at the time it enters into the lease.

EEG members discussed the recognition exemption for *underlying assets* of low value. EEG members noted the exemption is not subject to materiality thresholds and is applied to the underlying asset.

[1] References to specific paragraph numbers in the IFRS 16 *Leases* were not necessarily discussed at the meeting. They have been added in this Update to supplement the discussion.

Definition of a lease

Darrel Scott provided an overview of the definition of a lease.

EEG members discussed examples from their jurisdictions, including:

(i) Whether a contract could contain a lease if an asset is provided free-of-charge and payment is made only for the materials used to operate the asset? Darrel Scott noted that in determining if a contract contains a lease it is necessary for management to apply judgement; in this example, he would suggest management would compare the cost of acquiring the materials from a third party with the cost of the materials from the supplier that is providing the asset free-of-charge.

(ii) In the circumstances that a contract contains the right to purchase the asset, whether the contract is accounted for applying IFRS 16 or IFRS 15 *Revenue from Contracts with Customers?* An EEG member noted that IFRS 16 (paragraph 63(a)) includes, as an example of situations which would normally lead to a lease being classified as a finance lease, the situation in which the lease transfers ownership of the underlying asset to the lessee by the end of the lease term.

(iii) Whether a contract could contain a lease if the underlying asset is not specified in the contract; for example, if the contract includes the provision of IT equipment but the IT equipment is not specified in the contract. Darrel Scott explained that an entity would need to consider if the supplier has substantive right to substitute the assets (paragraphs B14-B19 of IFRS 16 address substantive substitution rights).

Right-of-use model

Darrel Scott explained the right-of-use model set out in IFRS 16, including what is included and what is not included in the Statement of Financial Position.

Lessee Accounting

Darrel Scott presented an overview of lessee accounting requirements. EEG members discussed:

(i) If the initial measurement of the right-of-use asset could include design costs that are specific to the underlying asset.

(ii) How to address situations in which the lease term is not the same as the expected life of the right-of-use asset. Darrel Scott noted that IFRS 16 sets out the requirements for the period over which a lessee depreciates a right-of-use asset if the lease term and the expected life of the right-of-use asset are not the same (paragraph 32). EEG members discussed instances in which the assessment of *reasonably certain* to define a lease term could differ from the assessment of expected useful life of an asset.

(iii) EEG members discussed variable lease payments including:

(a) How to measure the right of use asset and lease liability in a contract to lease land in which there are no fixed payments – Darrel Scott noted that IFRS 16 addresses "in-substance" fixed lease payments and includes examples of payments that are structured as variable lease payments but there is no genuine variability in those payments (paragraph B42).

(b) The circumstances in which lease payments are contingent on output (for example power generation) and the industrial facility is built for the customer. It was explained that the entity would need to consider whether these are in-substance fixed payments (paragraph B42 of IFRS 16) or variable lease payments.

(c) How to ensure fair presentation if variable payments are not included in the lease liability – Darrel Scott noted that IFRS 16 (paragraph 53(e)) requires disclosure of the expense relating to variable lease payments not included in the measurement of the lease liability. He also noted IFRS 16 requires the disclosure of additional information about variable lease payments (paragraphs B48-B49) that a lessee needs to consider to meet the disclosure objective in IFRS 16 (paragraph 51).

(d) The requirement for a lessee to measure payments that depend on an index or a rate at the commencement date of the lease. Darrel Scott noted the Board's rationale is set out in the IFRS 16 *Basis for Conclusions* (paragraph BC165-BC166) and focuses on providing comparable information.

An EEG member raised a question regarding residual value guarantees – Darrel Scott noted that IFRS 16 (Paragraph 27(c)) requires amounts expected to be payable to the lessee under residual value guarantees to be included in the lease liability.

In concluding the discussion, Amaro Gomes agreed with an EEG member that when applying the right-of-use model management are required to exercise judgement, taking into consideration the facts and circumstances.

Modifications

EEG members discussed the accounting for modification of lease contracts. EEG members asked:

(i) For the conceptual justification of the remeasurement of the right-of-use asset. Darrel Scott said that the IFRS 16 *Basis for Conclusions* (paragraphs BC203 and BC204) explains the Board's rationale for lease modifications and notes the approach results in accounting outcomes that faithfully represent the substance of a lease modifications and closely align the gain or loss recognition with a corresponding change in the lessee's rights and obligations under the lease.

(ii) Why a modified discount rate is applied where there is an additional liability (paragraphs 41, 43 and 45(c)), in contrast to the amortised cost methodology in IFRS 9 *Financial Instruments,* which does not modify the interest rate? Darrel Scott noted that when a contract is modified, the parties would consider the rates prevailing at that time, and the modified rate properly represents the modified liability.

Enforceable rights

Darrel Scott presented a number of examples to the EEG members demonstrating enforceable rights. EEG members asked:

(i) What happens in the situation that an entity exits a property and the lessor is obliged to compensate the lessee if the property is re-let within a 12-month period? It was agreed that the lessee would need to apply judgement as to whether it is reasonably certain the property would be re-let in the 12-month period.

(ii) What happens if the lease is open-ended but subject to a 3-month termination clause? Darrel Scott noted that in this situation, assuming the termination clause is such that the lessee does not have enforceable rights beyond 3 months, the lease term would be 3 months, and consequentially the recognition exemption would be available.

Concluding remarks

In concluding the discussion, Darrel Scott explained the resources available on the IFRS Foundation website to support implementation of IFRS 16. He encouraged EEG members to access the materials available on the website.

EEG member topics

Topic 1 - Involuntary common infrastructure costs

The EEG members discussed a paper presented by Bee-Leng Tan, Executive Director of the MASB on the accounting for costs incurred to construct common infrastructure as part of a property development.

EEG members discussed the generally accepted accounting practice in their jurisdictions, applied by property developers, for common infrastructure costs. Most members stated that an accrual basis is applied – that is, the costs of constructing the common infrastructure are accrued to the costs of property development, as incurred.

In addition, a member jurisdiction stated that both an accrual and prepayment basis are applied. The prepayment basis is applied when the property developer pays the government authority to construct the common infrastructure. The amount prepaid to the government authority is recognised as an asset, which is subsequently amortised over the period the property is developed.

EEG members did not identify instances in which a property developer recognises a liability for the total expected cost of constructing the common infrastructure on, or at the time, the property developer obtains planning permission from the local government authority or on the commencement of phases with the overall property development.

Some EEG members observed that the unit of account should be considered in determining the appropriate accounting treatment. EEG members noted that in their jurisdictions the common infrastructure is not a separated component of the property development, that is, there is no separate unit of account.

The EEG members were not supportive of the alternative view in the agenda paper, recognising an intangible asset (development right obtained from the authority) with a corresponding liability for the expected cost of constructing the common infrastructure costs.

EEG members noted the principle that the unit of account is the overall development project could be applied to social housing costs.

Topic 2 - Consolidation of not-for-profit entities

Mr Zaware, Chair of the Accounting Standards Board of the Institute of Chartered Accountants of India, presented a paper on the Consolidation of not-for-profit entities. He explained that entities in India are required to spend a percentage of profit before tax on corporate social responsibility activities and that many entities do so by establishing a not-for-profit entity.

An EEG member noted that a not-for-profit entity is not a business, and therefore it would be inappropriate to consolidate it. Many EEG members noted similar obligations in their jurisdictions and noted the expense is recognised as incurred and that generally the not-for-profit entity is not consolidated.

In concluding the discussion Darrel Scott noted that IFRS 10 *Consolidated Financial Statements*, does not require that a controlled entity is a business. The core principle in IFRS 10 relates to whether an entity has control of the activities. He further noted that in many circumstances, the not-for-profit entity is controlled for the benefit of its donor. However, he noted that in similar situations he had observed in practice, the effect of consolidation was not material. He therefore noted the importance of assessing the materiality of the not-for-profit entity in deciding whether consolidation is necessary.

Topic 3 - Presentation of current/non-current assets

Mr Zaware asked EEG members for their comments on the classification of security deposits in accordance with IFRS Standards when a utility company collects a refundable security deposit at the time of a new connection and expects that it will hold the security deposit for longer than 12 months.

EEG members did not support the proposal that classification of the deposits was a matter of substance over form. However, some EEG members suggested considering if the customer has an alternative supplier could affect classification.

Amaro Gomes and Darrel Scott noted that the requirements of IAS 1 are explicit and consequently there is a high hurdle for overcoming those requirements.

Digital Currencies

Michelle Sansom, Associate Director of the IASB, provided an overview of the work that the IFRS Interpretations Committee and the Board are undertaking in relation to commodity loans and related transactions, including digital currencies.

Kris Peach, chair of the Australian Accounting Standards Board (AASB), presented by video conference an overview of the AASB research into digital currencies: *Digital Currencies – A case for standard-setting*. The research outlined the problems associated with the accounting for digital currencies and possible solutions.

Yasunobu Kawanishi, Board member of the Accounting Standards Board of Japan (ASBJ), provided an overview of the work of the ASBJ, including its recently issued standard *Practical Solution on the Accounting for Virtual Currencies under the Payment Services Act.*

EEG members provided an overview of legal requirements in their jurisdictions. This identified a wide variety of approaches to the regulation of digital currencies; some jurisdictions have prohibited the use of digital currencies whilst acknowledging entities may use digital currencies outside their jurisdictions and therefore there are financial reporting implications. Other jurisdictions had not yet addressed regulation of digital currencies.

A number of jurisdictions noted that commodity type transactions (including gold) discussed in agenda paper 2 were common in their jurisdictions.

The EEG members discussed three possible standard-setting activities the Board or the IFRS Interpretations Committee could undertake. EEG members supported the Board considering the development of a new Standard that addressed items held for investment purposes. The EEG members acknowledged that defining the scope of such a proposal would need careful consideration.

Accounting for micro-entities and private-entities

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

Michelle Sansom provided an overview of the approach adopted by the United Kingdom in FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*. Bee-Leng Tan provided an overview of Malaysian Private Entities Reporting Standard (MPERS).

Bee-Leng Tan also presented the results of the MASB survey undertaken on behalf of the AOSSG on the application of the *IFRS for SMEs* among the Asia-Oceanian Standard-Setters Group.

In concluding the discussion, Darrel Scott noted that the discussions helped EEG members identify common themes on reporting for micro-entities.

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

Accounting for subsidiary entities

Igor Sukharev, Head of Division, Department of Regulation on Accounting, Financial Reporting and Auditing, Ministry of Finance Russia, and Ms. Anna Uzoznikova presented a comprehensive paper on *Accounting for Subsidiary Entities*. The paper presented set out a number of possible topics where simplification might be possible for subsidiaries.

In considering the paper EEG members suggested considering first whether the simplifications could be permitted in the individual, separate or consolidated financial statements. Once this was complete EEG members suggested prioritising the topics, such as borrowing costs.

Some EEG members suggested that it might be useful to categorise the topics depending on the subject, for example disclosure exemptions, inter-company transactions.

In concluding the discussion, Darrel Scott noted that the paper would provide useful input to the Board's research pipeline project on Reduced Disclosure for Subsidiaries.

IASB Update

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

Initial feedback on the implementation of IFRS 9 *Financial Instruments* in Emerging Economies

EEG members received a presentation from Chan Hooi Lam, MASB member, on the implementation of IFRS 9 in Malaysia and a presentation from Mr Yong Woo Kwon, Korea Accounting Standards Board staff member on the implementation of IFRS 9 in Korea.

An EEG member asked about the collation of the data required to build the expected credit loss impairment models. The KASB and MASB EEG members acknowledged the importance and challenge of collating the data required for the models but noted that banks had reported improvements in internal communication between risk and general ledger departments enhancing governance, following implementation of IFRS 9.

An EEG member stressed:

(i) the importance of established governance procedures to test and validate the models being applied; and

(ii) the importance of working with the Regulators and/or the Central Bank.

Some EEG members noted the challenge in implementing IFRS 9, especially where convergence/adoption of IFRS Standards was more recent and the jurisdiction had not previously applied IAS 39 *Financial Instruments: Recognition and Measurement*.

In concluding the session, Amaro Gomes noted the importance of working with investors and users of financial statements in order that they understood the forthcoming changes.

Next meeting

The next meeting of the EEG will be held in South Korea 29 – 31 October 2018.