US ACCOUNTING UPDATE

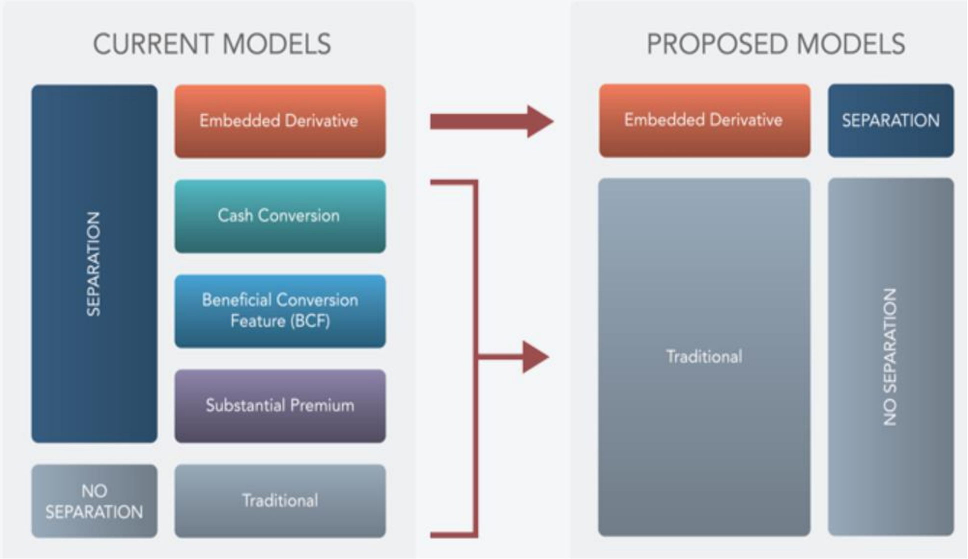
JULY 2019

US GAAP (US Generally Accepted Accounting Principles)

FASB issued ASU on distinguishing liabilities from equity

Impact: Entities that issue convertible instruments and/or contracts in an entity's own equity

FASB issued proposed Accounting Standards Update to simplify an issuer's accounting for financial instruments with characteristics of liabilities and equity. The amendments in the proposed ASU aim to improve the guidance related to both convertible instruments and the derivatives scope exception for contracts in an entity's own equity. The update would eliminate the models for separating embedded conversion features from convertible instruments as required by ASC 470-20 (Debt — Debt with Conversion and Other Options) summarized in the chart below[1].



Bifurcation of embedded conversion feature required under ASC 815-15 (Derivatives and Hedging — Embedded Derivatives) would still need to be complied with.

Further, the ASU would simplify the accounting for contracts in an entity's own equity by requiring the issuer to disregard events that could trigger an adjustment to the contract's settlement amount or trigger net cash settlement, if the likelihood of such event occurring is remote.

Derivatives Scope Exception

As per the current guidance on derivatives scope exception, if the following two criteria are not met, the contract must be recognized as an asset or liability:

(1) the contract is indexed to an entity's own stock (referred to as the indexation guidance) and

(2) the contract is equity classified (referred to as the settlement guidance).

[1]https://www.fasb.org/cs/Satellite?c=FASBContent_C&cid=1176173044121&pagename=FASB%2FFASBContent_C%2FGeneralContentDisplay

Such strict application of the derivatives scope exception guidance results in accounting for some contracts as derivatives while economically similar contracts are accounted for as equity. With the proposed ASU[2]:

- An entity would be allowed to qualitatively screen out any contingent events that are considered to have a remote likelihood of occurring and disregard these events in the assessment of the derivatives scope exception, and
- Remove three conditions required to qualify for the settlement guidance related to settlement in unregistered shares, collateral requirements, and shareholder rights.

This is aimed at providing relief for private companies and small public companies that continue to have errors in their financial statements because of the form-based (or rules-based) accounting requirements. The proposed ASU would also improve and amend the related disclosure and EPS guidance.

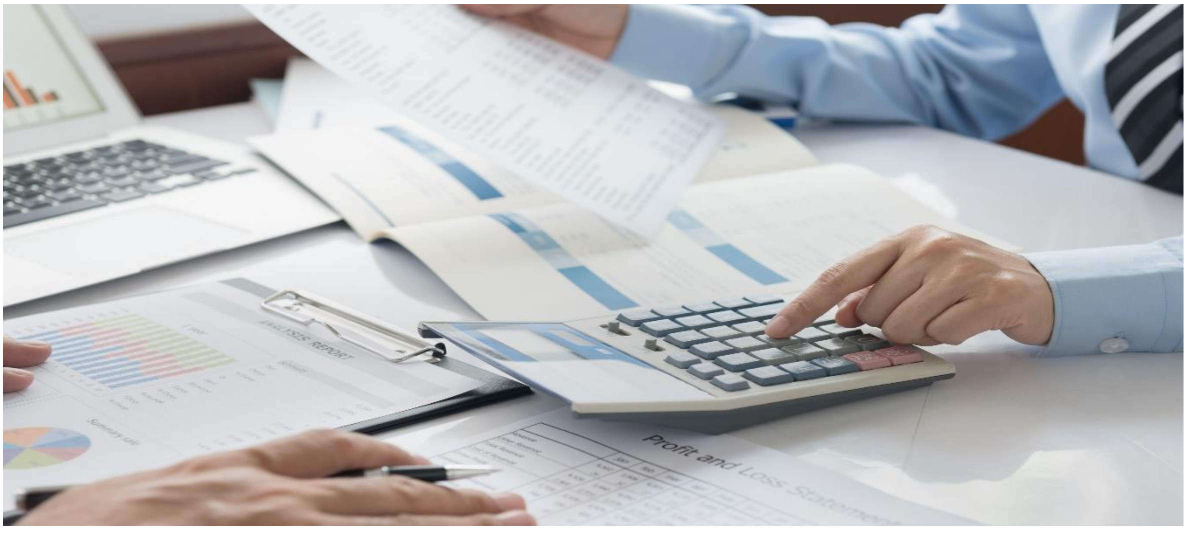
Proposed clarification on recognition and measurement of financial instruments and the accounting for equity method investments issued

Topic 321(Investments—Equity Securities), provides companies with the option to measure certain equity securities without a readily determinable fair value at cost, minus impairment, if any, unless an observable transaction for an identical or similar security occurs (the measurement alternative).

FASB vide the proposed amendment aims to clarify certain interactions between Topic 321, Topic 323 and Topic 815. The interaction of guidance to account for certain equity securities under Topic 321, the guidance to account for investments under the equity method of accounting in Topic 323 (Investments—Equity Method and Joint Ventures), and the guidance in Topic 815 (Derivatives and Hedging), could change how an entity accounts for an equity security under the measurement alternative or a forward contract or purchased option to purchase securities that, upon settlement of the forward contract or exercise of the purchased option, would be accounted for under the equity method of accounting.

To reduce diversity in practice and increase comparability of the accounting for these interactions, FASB has issued the proposed update that would[3]:

- Clarify that an entity should consider observable transactions that require it to either apply or discontinue the equity method of accounting for the purposes of applying the measurement alternative in accordance with Topic 321 immediately before applying or upon discontinuing the equity method.
- Clarify that for the purpose of applying paragraph 815-10-15- 141(a) an entity should not consider whether, upon the settlement of the forward contract or exercise of the purchased option, individually or with existing investments, the underlying securities would be accounted for under the equity method in Topic 323. An entity would also evaluate the remaining characteristics in paragraph 815-10-15-141 to determine the accounting for those forward contracts and purchased options.



[2] https://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176173060361&acceptedDisclaimer=true

[3] https://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176173051604&acceptedDisclaimer=true

FASB issues clarifications on codification improvements to ASU on Stock Compensation (Topic 718) and Revenue from Contracts with Customers (Topic 606)

Impact: All entities

In its meeting on July 31, 2019 the Board discussed comments received on its March 2019 proposed Accounting Standards Update to Compensation—Stock Compensation (Topic 718) and Revenue from Contracts with Customers (Topic 606): Codification Improvements—Share-Based Consideration Payable to a Customer.

The Board affirmed its decisions to require[4]:

(1) that an entity measure and classify the share-based awards in accordance with Topic 718; and

(2) that post-grant-date changes in measurement of the share-based awards due to the form of consideration should not be recognized in revenue and should be recognized elsewhere in the income statement.

The Board also clarified the following amendments in the proposed Update:

1. An entity should follow Topic 718 to evaluate conditions that affect the vesting and fair value of the share-based awards.
2. An entity should estimate the fair value of the share-based awards when a grant date has not been achieved but goods and services have been delivered to a customer.
3. A nonpublic entity making the election to measure its liability-classified share-based awards not issued to customers at intrinsic value should initially and subsequently measure share-based awards issued to customers at fair value.
4. An entity should assess the fair value of distinct goods and services received from a customer when determining whether the share-based awards reduce the transaction price.

The amendments are be effective for fiscal years beginning after December 15, 2019, for all entities.

IFRS (International Financial Reporting Standards)

Exposure draft on changes to IAS 12 – Income Tax published

Impact: All entities

IAS 12 specifies how a company accounts for income tax, including deferred tax, which represents amounts of tax payable or recoverable in the future.

The existing guidance under IAS 12 prohibits an entity from recognizing deferred tax arising from the initial recognition of an asset or a liability in particular situations (recognition exemption).The update has been released to respond to requests on clarification whether the recognition exemption in IAS 12 applies to a transaction that results in the recognition of both an asset and a liability seeking specific clarification on recognition of deferred tax for items such as leases and decommissioning obligations.

Responding to the requests, IASB issued proposed amendments to the standard that would require an entity to recognize 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. The proposed amendments would apply to particular transactions for which an entity recognizes both an asset and a liability, such as leases and decommissioning obligations[5].

According to the proposed amendments, the recognition exemption in the Standard would not apply to leases and decommissioning obligations—transactions for which companies recognize both an asset and a liability.

[4]https://www.fasb.org/cs/ContentServer?c=FASBContent_C&cid=1176173026560&d=&pagename=FASB%2FFASBContent_C%2FActionAlertPage

[5]https://www.ifrs.org/-/media/project/deferred-tax-related-to-assets-and-liabilities-arising-from-a-single-transaction/ed-deferred-tax-related-to-assets-and-liabilities-ias-12.pdf

Proposal to require disclosure of material accounting policies issued

Impact: All entities

All entities complying with IFRS disclose their 'significant' accounting policies as required by IAS 1. The Board proposes to replace the requirement to disclose 'significant' accounting policies with a requirement to disclose 'material' accounting policies.

Consequently, amendments to IAS 1 and IFRS Practice Statement 2 are also being proposed to help entities apply the concept of materiality in making decisions about accounting policy disclosures.

The proposed amendments are intended to help entities:

- identify and disclose all accounting policies that provide material information to primary users of financial statements; and
- identify immaterial accounting policies and eliminate them from their financial statements.

The proposed amendments build on Definition of Material, issued in October 2018, which made amendments to IAS 1 and IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

For help on technical accounting and other queries, please contact:

Name	Area	Email
Atul Deshmukh	International	atul.deshmukh@knavcpa.com
Amber Mehta	Canada	amber.mehta@knavcpa.com
Haresh Thakkar	India	haresh.thakkar@knavcpa.com
Navneet Sharma	USA	navneet.sharma@knavcpa.com
Bhavita Shah	UK	bhavita.shah@knavcpa.com
Boon Kiat Wong	Singapore	boon.kiat@knavcpa.com