

Beyond the GAAP

No 62 – December 2012

Over the course of the year, the IASB has redoubled its efforts on the financial instruments, revenue recognition, leases and insurance contracts projects – but has not yet published final standards for any of them. December 2012 saw nothing more significant than the publication of the proposed limited amendments to IFRS 10 and IAS 28, and to IFRS 11. The former aim to clarify the accounting treatment of sales between an investor and its associates or joint ventures, while the latter are intended to clarify the accounting treatment of interests in joint operations.

The last hurrah of 2012 in Europe has been the adoption of a slew of standards, amendments to standards and an interpretation, including the new consolidation package (IFRS 10, IFRS 11, IFRS 12, IAS 27, IAS 28).

Happy new year from the Beyond the GAAP editorial team, and happy reading!

Michel Barbet-Massin

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News

IASB launches survey on 'disclosure problem' in advance of public discussion forum

Last month, the IASB announced that it would be holding a public Discussion Forum on the perceived 'disclosure problem' in London on 28 January 2013.

In preparation for this event, the IASB launched a survey on financial disclosures on 20 December 2012. This will help the IASB to gain a better idea of the issues around financial disclosures. It is aimed at preparers and users of financial statements as well as other interested parties.

In its press release, the IASB says that the survey takes around 10 minutes and all responses will remain confidential.

The closing date for the survey is 15 January 2013.

For more information on the survey, see the IASB's press release at the following link:

<http://www.ifrs.org/Alerts/PressRelease/Pages/Disclosure-survey-launched.aspx>

➤ IASB work plan

On 20 December 2012, the IASB updated its work plan to take into account the results of its December discussions and the outcomes from the IASB's Agenda Consultation 2011.

The following new projects have been added to the work plan:

- *Rate-regulated activities*: the IASB has decided to carry out this project in two phases:
 - the publication of an interim standard that will allow grandfathering of local accounting requirements. An exposure draft is scheduled for the first or second quarter of 2013;
 - the comprehensive project on rate regulated activities, starting with the publication of a discussion paper in the second half of 2013.
- *IAS 12 - Deferred tax assets for unrealised losses*: the IASB finally decided against addressing this amendment in the 2010-2012 annual improvements and agreed instead that it should form a separate project, as the scope of the amendment is broader than the minor amendments or clarifications normally addressed in annual improvements. An exposure draft is scheduled for the last quarter of 2013.
- *IAS 36 - Recoverable amount disclosures for non-financial assets*: the IASB has decided to publish a limited amendment to clarify disclosure requirements, rather than including this project in the annual improvements process. An exposure draft is scheduled for the first quarter of 2013.

The main changes to the schedule are as follows:

- *IFRS 11: Acquisition of an interest in a joint operation*: the exposure draft was published on 13 December 2012, and the comment period is open until 23 April 2013. The project is scheduled for completion in the fourth quarter of 2013;
- *IFRS 10 and IAS 28: Sales or contributions of assets between an investor and its associate/ joint venture*: the exposure draft was published on 13 December 2012, and the comment period is open until 23 April 2013. The project is scheduled for completion in the third quarter of 2013;

- The interpretations on levies and puts are scheduled for the second and fourth quarters respectively (previously the first half and second half of 2013);
- *Conceptual Framework*: a discussion paper is scheduled for publication in the second quarter of 2013 (previously the first half).

➤ Acquisition of an interest in a joint operation: proposed amendments to IFRS 11

In December 2012, the IASB published an exposure draft on the proposed limited amendments to the accounting treatment of the acquisition of an interest in a joint operation under IFRS 11.

As a reminder, a joint operation is defined in IFRS 11 as a joint arrangement in which the parties with joint control over the arrangement have rights to the related assets and obligations for the related liabilities.

These proposals will only apply to situations in which the activity of the operation constitutes a business as defined in *IFRS 3 - Business Combinations*.

The goal is to standardise the range of accounting practices which currently exist due to the lack of guidance in the standards.

The IASB proposes that a joint operator shall apply IFRS 3 - *Business Combinations* to its share of the assets and liabilities of the joint operation.

This will require the joint operator to:

- measure at fair value the identifiable assets and liabilities which it has acquired, with some exceptions;
- recognise acquisition-related costs as expenses in the period in which the costs are incurred and the services received (with the exception of the costs to issue debt or equity securities, which are recognised in line with IAS 32 and IFRS 9);
- recognise deferred tax assets and liabilities at the initial recognition of assets or liabilities, with the exception of deferred tax liabilities resulting from the initial recognition of goodwill; and

IFRS

- recognise as goodwill any excess of the consideration transferred over the identifiable assets acquired.

This accounting treatment applies to the acquisition of interests in both existing and new joint operations, unless there is no existing business (i.e. contributed by the joint operators) as defined under IFRS 3.

If this amendment to IFRS 11 is adopted by the IASB, it will be applicable prospectively.

The comment period is open until 23 April 2013.

- **EU Regulation no. 1254/2012** of 11 December 2012, adopting the consolidation package:

- **IFRS 10** – *Consolidated financial statements*
- **IFRS 11** – *Joint arrangements*
- **IFRS 12** – *Disclosure of interests in other entities*
- **IAS 27** – *Separate financial statements*
- **IAS 28** – *Investments in associates and joint ventures*

The consolidation package is mandatory for financial periods starting on or after 1 January 2014 (deferred by one year from the date set by the IASB). Early application is permitted.

- **EU Regulation no. 1256/2012** of 13 December 2012, adopting:

- **amendments to IFRS 7** – *Financial instruments: Disclosures - Offsetting financial assets and financial liabilities;*
- **amendments to IAS 32** – *Financial instruments: Presentation - Offsetting financial assets and financial liabilities.*

The amendments to IFRS 7 are mandatory for financial periods starting on or after 1 January 2013.

The amendments to IAS 32 are mandatory for financial periods starting on or after 1 January 2014, but early application is permitted. If these amendments are applied early, the amendments to IFRS 7 mentioned above must be applied from the same date.

The regulations can be viewed on the European Union website at the following link: <http://eur-lex.europa.eu/JOHtml.do?uri=OJ%3AL%3A2012%3A360%3ASOM%3AEN%3AHTML>

European matters

➤ EU adopts swathe of standards

In December 2012, the European Commission adopted several accounting standards, amendments to accounting standards and one interpretation.

The following regulations were published in the Official Journal of the European Union on 29 December 2012.

- **EU Regulation no. 1255/2012** of 11 December 2012, adopting:
 - **IAS 12** - *Income taxes - Deferred tax: recovery of underlying assets;*
 - **IFRS 1** - *First-time adoption of international financial reporting standards - Severe hyperinflation and removal of fixed dates for first-time adopters;*
 - **IFRS 13** – *Fair value measurement;*
 - **IFRIC 20** interpretation - *Stripping costs in the production phase of a surface mine.*

These standards and amendments are mandatory for financial periods starting on or after 1 January 2013, but early application is permitted.

As a reminder, the IASB has set the mandatory effective date for the amendments to IAS 12 and IFRS 1 at 1 January 2012 and 1 July 2011, respectively.

A Closer Look

Publication of proposed amendments to IFRS 10 and IAS 28

On 13 December 2012, the IASB published proposed amendments to IFRS 10 and IAS 28, with the objective of clarifying the accounting treatment of sales or contributions of assets (in a broad sense) between an investor (the parent company and its subsidiaries) and associates or joint ventures accounted for using the equity method.

In other words, if an entity contributes a subsidiary, or assets, to a company accounted for using the equity method (i.e. a joint venture as defined under IFRS 11 or an associate), should it recognise the gain or loss in full, or should it recognise a partial gain or loss to the extent of the third-party interests in the associate or joint venture?

Readers will remember that there is currently an inconsistency (as the IASB acknowledged in the December 2009 issue of IASB Update) between:

- interpretation SIC 13, which has now been incorporated into IAS 28, and which states that the gain or loss resulting from the contribution of a non-monetary asset to an associate or joint venture shall only be recognised in the consolidated accounts to the extent of the interests held by unrelated equity holders (i.e. partial gain or loss); and
- the revised IAS 27, which holds that loss of control of a subsidiary is a major event and that any retained portion should be remeasured at fair value through profit or loss (i.e. gain or loss recognised in full).

For more details on this issue, see our study in the July-August 2012 issue of Beyond the GAAP.

As things stand at present, either option is permissible (partial or full gain or loss), as long as the entity is consistent over time.

In addition to the inconsistency described above, the current situation privileges form (the existence of a subsidiary) over the substance of the operation, which increases the risk of transaction structuring.

If an entity has opted to apply the revised IAS 27 (i.e. gain or loss recognised in full), the contribution of an asset which does not constitute a business may result in either:

- Recognition of partial gain or loss if the transaction is simply treated as the contribution of an asset which does not constitute a business; or
- Recognition of gain or loss in full, if the asset is first transferred to a legal entity created specifically for this purpose, after which shares in this entity are sold/contributed to the associate or joint venture.

The new amendment proposes different accounting approaches for different types of asset:

- Assets which constitute a business (as defined under IFRS 3) are treated in line with the revised IAS 27 / IFRS 10 (i.e. gain or loss recognised in full).

The Board considers that the approach introduced by IFRS 3R / IAS 27R, which results in recognition of gain or loss in full at loss of control, only applies to transfers of assets which constitute a business.

- Contributions of assets which do not constitute a business, as defined under IFRS 3, should be treated in line with interpretation SIC 13 (i.e. partial gain or loss).

The Board considers that the exception introduced by IAS 27R (and reproduced identically in IFRS 10), which results in full recognition of profit or loss, is not applicable in this situation (as there has been no loss of control of a business).

We should also remember that elimination of intra-group transactions is part of the equity method and is therefore the standard accounting treatment.

A Closer Look

In order to limit transaction structuring, the amendment refers back to the indicators in IFRS 10 which allow an entity to determine when multiple arrangements should be accounted for as a single transaction.

It should also be noted that the approach applies both to 'downstream' transfers of assets or businesses (i.e. from the entity to an associate or joint venture) and to 'upstream' transfers (from an associate or joint venture to the entity).

The comment period is open until 23 April 2013. The exposure draft proposes prospective application, but does not give any indication of the planned effective date.

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A Closer Look

Revenue recognition project: IASB and FASB still discussing but close to agreement

At their joint meeting in December 2012, the two Boards continued their redeliberations on the *Revenue Recognition* project, addressing the following points:

- allocating the transaction price to separate performance obligations;
- recognition of the costs of obtaining the contract;
- the consequences of the revenue recognition proposals for some bundled arrangements (particularly in the telecommunications industry);
- constraints on the cumulative amount of revenue recognised in the case of licences.

➤ Allocating the transaction price to separate performance obligations

The proposals for allocating the transaction price are found in Step 4 of the revenue model proposed by the IASB and the FASB. The second exposure draft, published in November 2011, stated that entities should estimate the stand-alone selling prices of goods or services corresponding to separate performance obligations where these were not directly observable.

The exposure draft listed various methods of doing this, notably the 'residual method', which could only be used if the stand-alone selling price of a good or service was highly variable or uncertain. In this case, the exposure draft stated that the entity could estimate the selling price by reference to the total transaction price, minus the sum of the observable stand-alone selling prices of the other goods or services promised in the contract.

In December 2012, the two Boards clarified that the residual method may be used for contracts which include **two or more goods or services** that have highly variable or uncertain stand-alone selling prices. In practice, a combination of techniques may be used for estimating these prices, as follows:

- First apply the residual approach in order to estimate the aggregate stand-alone selling price of all the goods and services with highly variable or uncertain selling prices;
- Then use another technique to estimate the individual stand-alone selling prices which make up the aggregate sum calculated using the residual method.

The two Boards also clarified that:

- If an entity is allocating a discount to one or more performance obligations, this should be done **before** applying the residual method;
- If the transaction price includes an amount of consideration that is contingent on a future event or circumstance, the entity may allocate the contingent consideration **to more than one** distinct good or service (whereas the second exposure draft said it could only be allocated to one).

➤ Recognition of the costs of obtaining the contract

The two Boards confirmed the proposals set out in the second exposure draft (published in November 2011), according to which an entity shall recognise as an asset the incremental costs of obtaining a contract with a customer if it expects to recover them.

A Closer Look

The Boards have also decided to retain the practical expedient proposed in the exposure draft, namely the option of recognising the incremental costs of obtaining a contract as expenses when incurred, if the amortisation period of the asset that the entity would otherwise have recognised is less than one year.

➔ Consequences of the revenue recognition proposals for bundled arrangements

In December, the two Boards reconsidered the consequences of the revenue recognition model (as proposed in the November 2011 exposure draft) for specific types of contract, namely those which comprise provision of services together with initial provision of a distinct good that allows these services to be provided.

The discussions related specifically to contracts offered to customers by companies operating in the telecommunications sector. If the Boards' proposals are retained in the final standard, they will bring about major changes in the accounting treatment of transactions with customers.

This is illustrated in the following example (taken from agenda paper 7C, which was discussed at the joint meeting in December 2012):

An entity enters into a contract with a customer, under which it agrees to:

- provide a handset at a price of 100, whereas the handset has an observable selling price of 250 (when it is sold without network services);
- provide network services over 12 months for 20 per month (which corresponds to the selling price of a monthly prepaid card providing the same call credit).

The accounting treatment currently used by telecoms operators is as follows:

	T ₀	T ₁₋₁₂	Total
Handset	100	0	100
Network services	0	240	240
Total revenue	100	240	340

This accounting treatment limits the amount of revenue recognised for the handset to the actual income received at the time of the sale.

Applying the proposals in the November 2011 exposure draft would require an entity to use the following accounting treatment:

	T ₀	T ₁₋₁₂	Total
Handset	173 ¹	0	173
Network services	0	167	167
Total revenue	173	167²	340

¹ 173 = 250 for the selling price of the handset on its own / (250 + 240 for the selling price of network services on their own) * 340 for the transaction price

² 167 = 240 / (240 + 250) * 340

The new proposals would therefore result in accelerated revenue recognition for telecom operators.

Despite strong opposition from stakeholders, the two Boards decided in December 2012 to retain this type of contract within the scope of the general accounting provisions in the future standard on revenue recognition. This applies to both allocation of the transaction price to separate performance obligations, and recognition of the costs of obtaining the contract.

A Closer Look

However, the final standard will clarify that the 'portfolio' approach described in the second exposure draft may be applied to contracts of the type used in the telecommunications industry. In practice, this means that an entity may apply the future standard to a portfolio of contracts with similar characteristics if it reasonably expects that the result thus obtained will not differ significantly from the result of applying the standard to the individual contracts.

This solution is not likely to meet with the full approval of the companies concerned, as they already indicated that the portfolio approach would not solve all the practical problems raised by the future standard, given that it will probably be necessary to identify a very large number of portfolios due to the great diversity of contracts.

➤ Constraints on the cumulative amount of revenue recognised in the case of licences

The second exposure draft (published in November 2011) stipulated general rules governing the constraints on the cumulative amount of revenue recognised to date. These rules, which have since been broadly confirmed (cf. Beyond the GAAP November 2012), stipulated that an entity should only recognise the amount of revenue to which it is reasonably assured to be entitled. To assess this, the entity shall take into account its experience with similar types of performance obligations where this experience is predictive of the amount of consideration to which the entity will be entitled. This constraint is intended to avoid subsequent downward adjustments to revenue already recognised.

Notwithstanding these general principles, the second exposure draft included a specific rule for situations in which an entity licences intellectual property to a customer and the customer promises to pay an additional consideration that varies in line with the customer's subsequent sales of a good or service (e.g. a sales-based royalty). In this situation, the second exposure draft ruled that the entity was not reasonably assured to be entitled to the additional consideration until the uncertainty was resolved. Therefore, it should not recognise this revenue unless or until the customer's subsequent sales took place.

In December 2012, the Boards decided to delete this specific rule for licences. Therefore, in future, entities shall use the general principles set out in the future standard when recognising revenue related to intellectual property licences. However, the final standard will include further clarifications, with a view to achieving the same accounting outcome as originally planned.

The two Boards have now completed their redeliberations on the main points of the future standard on revenue recognition. The only thing remaining to be done at the start of 2013 is to discuss the scope of the future standard, the disclosure requirements and the interim requirements. For preparers of financial statements, these are far from minor matters.

A Closer Look

IASB publishes the outcomes from the IASB's Agenda Consultation 2011

On 18 December 2012, the IASB published the outcomes from the IASB's Agenda Consultation 2011 (as published in July 2011). The consultation garnered more than 240 comment letters. Beyond the GAAP presents the main points of the report published by the IASB.

The full document can be found on the IASB's website at the following link: <http://www.ifrs.org/Current-Projects/IASB-Projects/IASB-agenda-consultation/Documents/Feedback-Statement-Agenda-Consultation-Dec-2012.pdf>

➤ The key messages from respondents

The IASB says in its report that the five key messages from the 246 comment letters can be summarised as follows:

- Respondents hoped for a period of relative calm, following a decade of almost continuous change in financial reporting;
- An almost unanimous support for the IASB to prioritise work on the *Conceptual Framework* to provide a consistent and practical basis for standards;
- Respondents wanted targeted improvements to meet the needs of new adopters;
- Respondents wanted the IASB to pay greater attention to the implementation and maintenance of existing standards;
- Finally, respondents hoped for improvements in the way in which the IASB develops the standards themselves, by conducting more rigorous cost-benefit and problem definition.

➤ The IASB's three priorities for its future work programme

In response to the opinions expressed in the comment letters, the IASB is focusing its future work programme on three major priority areas:

- implementation and maintenance of existing standards (including Post-implementation Reviews);
- reworking the *Conceptual Framework*; and
- a small number of major projects.

The major projects include:

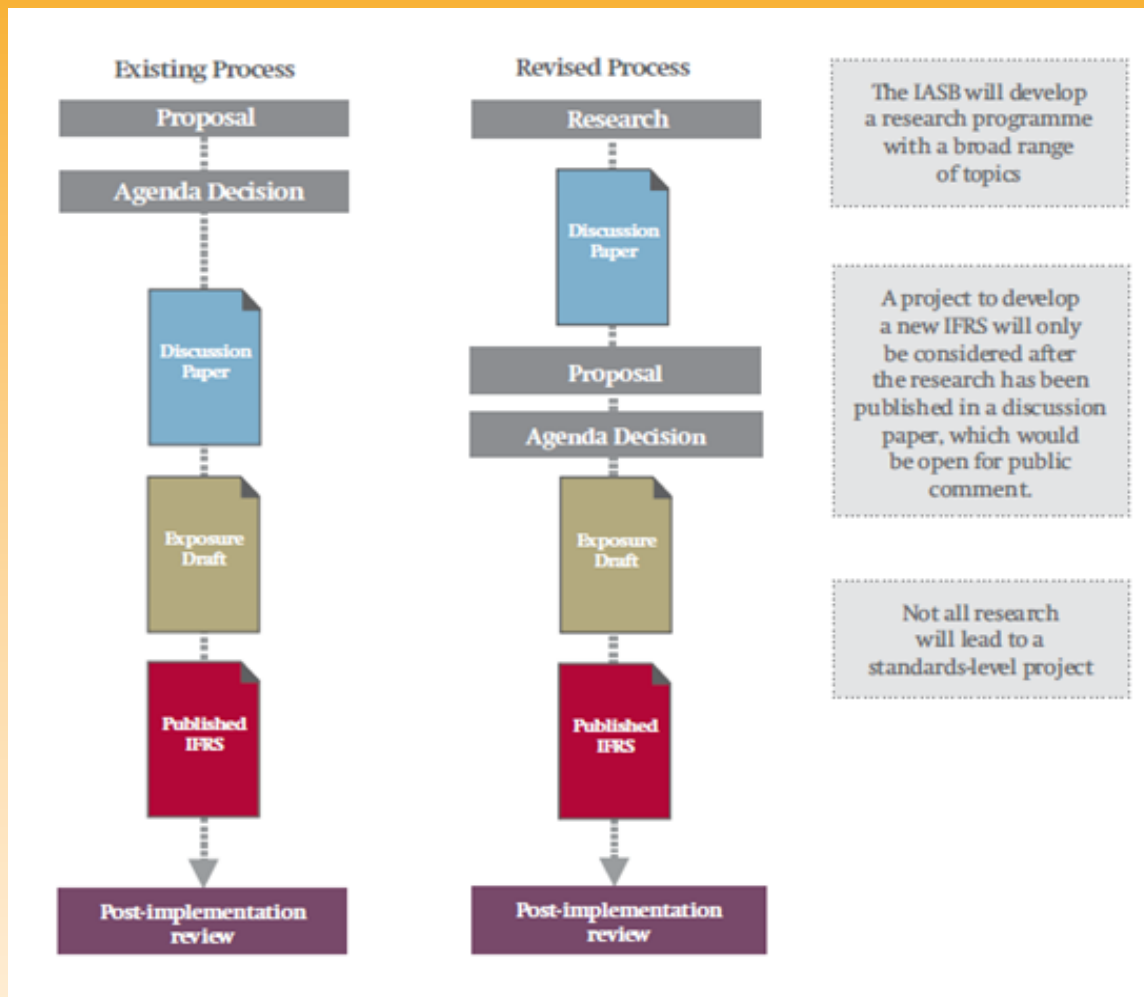
- the four existing major projects, namely *Financial Instruments (IFRS 9)*, *Leases*, *Revenue Recognition* and *Insurance Contracts*. The IASB emphasises in its report that completion of these projects is a high priority;
- three additional projects on agriculture, specifically biological assets; rate-regulated activities; and use of the equity method in separate financial statements.

➤ A new procedure for developing standards

In the report, the IASB announces a new procedure for developing standards, with an initial research phase before standard development begins. The conclusions of the research will be published and open to public comment.

A Closer Look

No decisions will take place on whether or not to develop a new standard until this phase has been completed.



➤ Research projects identified by the IASB

The report summarises the subjects on which the IASB will carry out preliminary research projects over the next three years. They are as follows:

- Emissions Trading Schemes;
- Business Combinations under Common Control;
- Discount Rates;
- Equity Method of Accounting;
- Intangible Assets, Extractive Activities; Research & Development Activities;
- Financial Instruments with the Characteristics of Equity;
- Foreign Currency Translation;
- Non-financial Liabilities (amendments to IAS 37); and
- Financial Reporting in High Inflationary Economies.

The IASB notes that not all of these research projects will necessarily lead to a standards-level project. If the research phase shows that changes to existing standards are not required, the project will be removed from the technical programme.

➤ Longer-term topics

In addition to the above-mentioned topics to be researched by the IASB, the report encourages national standard-setters to investigate the following three topics, which it classifies as 'longer-term' due to their nature and complexity:

- Income taxes;
- Post-employment benefits (the second phase); and
- Share-based payments.

The IASB indicates that it will allocate staff to these projects to ensure that information gathered is likely to benefit the IASB when it does take a more active role in the project.

Finally, the IASB mentions other issues which it plans to investigate over the next three years, notably:

- Islamic transactions and instruments (Shariah compliance);
- improving and simplifying disclosure requirements.

Frequently asked questions

- Accounting treatment of a buy/sellback transaction in equities;
- Accounting treatment of a government guarantee;
- Accounting treatment of payments made by the concession holder to the licensor in the context of a PPP or concession;
- Acquisition of individual assets versus business combination;
- Consequences on consolidated accounts under IFRS of the ANC's new ruling on emissions trading;
- Loss of control on expiry of a shareholders' agreement;
- Accounting treatment of a liability guarantee clause relating to a business combination accounted for under the previous version of IFRS 3.

Upcoming meetings of the IASB, IFRS Interpretations Committee and EFRAG

IASB

25 - 31 January 2013
13 - 22 February 2013
14 - 22 March 2013

Committee

22 - 23 January 2013
12 - 13 March 2013
15 - 16 May 2013

EFRAG

16 - 18 January 2013
27 February – 1 March 2013
3 - 5 April 2013

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