

Beyond the GAAP

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Two years and eight months elapsed between the publication of the first exposure draft on revenue recognition in June 2010 and the Boards' final redeliberations on the major themes of the project. At the end of their February meeting, the FASB and the IASB announced that they had finished their redeliberations on the substantive themes of the November 2011 exposure draft. Under the current plans, a further three and a half years will elapse between the publication of the final standard, which is still scheduled for the second quarter of 2013, and its mandatory effective date, which the two Boards have set at 1 January 2017. Nobody could have imagined at the outset that this would be such a long-term project... but surely the most important thing is that we can now see a light at the end of the tunnel?

Happy reading!

Michel Barbet-Massin

Edouard Fossat

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News

A new member for the IASB

On 22 February 2013, the Trustees of the IFRS Foundation (the oversight body of the IASB) announced that Gary Kabureck has been appointed as a member of the IASB. He will join the Board in April 2013 and his term will end on 30 June 2017.

Revised constitution for the IFRS Foundation

The Trustees of the IFRS Foundation published a revised version of the IFRS Foundation Constitution on 19 February 2013. The new constitution reflects the separation between the role of Chairman of the IASB and Chief Executive Officer of the IFRS Foundation. This new version can be found at the following link:

<http://www.ifrs.org/Alerts/Governance/Pages/Trustees-publish-revised-version-of-the-IFRS-Foundation-Constitution.aspx>

Translation of Philippe Danjou article published

Last month, we announced the IASB's publication of an article by Philippe Danjou, a member of the IASB, entitled "Une mise au point concernant les International Financial Reporting Standards (les normes IFRS)".

The English translation of the article, entitled "An update on International Financial Reporting Standards (IFRSs)", was put on line on the IASB's website on 21 February 2013. It is available at the following link:

<http://www.ifrs.org/Features/Pages/An-Update-on-IFRSs-by-Philippe-Danjou.aspx>

➤ IASB updates its work plan

The IASB has updated its work plan twice – on 4 February and 26 February 2013 – to reflect the Board's discussions in January and February 2013.

The new projects on the work plan are as follows:

- *IAS 19 – Defined Benefit Plans: Employee contributions*: the IASB has decided to publish a narrow-scope amendment to clarify the accounting treatment of employee contributions (cf. 'Highlights' below). An exposure draft is scheduled for the first quarter of 2013;
- *Novation of OTC derivatives and continued designation for hedge accounting*: the exposure draft of proposed amendments to IAS 39 and IFRS 9 was published on 28 February 2013 (cf. 'Highlights' below);

The main changes to the schedule are as follows:

- *Financial Instruments – Hedge Accounting*: the standard is now scheduled for publication in the second quarter of 2013, rather than the first;
- *Insurance Contracts*: the new exposure draft will be published in the second quarter of 2013;
- *Leases*: the new exposure draft is now scheduled for the second quarter of 2013, rather than the first quarter (for the Board's decisions, see 'A Closer Look' below);
- *Rate-regulated Activities*: the IASB has clarified that this project will take place in two phases:
 - Interim IFRS (permitting entities to continue applying local accounting standards): the exposure draft is scheduled for the second quarter of 2013;
 - Comprehensive project: the IASB has decided to publish a Request for Information in the second quarter of 2013, followed by a Discussion Paper;
- *Annual Improvements 2010-2012*: the final standard is now scheduled for the third quarter of 2013, rather than the second half;
- *IAS 41- Bearer Biological Assets*: a limited-scope exposure draft on bearer biological assets is scheduled for the 2nd or 3rd quarter of 2013, rather than the first half. For the Board's decisions, see 'Highlights' below;
- *IAS 36 - Recoverable Amount Disclosures for Non-Financial Assets*: the exposure draft was published on 18 January 2013 and the comment period was open

until 10 March. The IASB will publish the final standard in the second quarter of 2013;

- *Separate Financial Statements (Equity Method)*: the publication of the exposure draft may be postponed for a quarter, and is now scheduled for the second or third quarter of 2013;
- *Post-implementation review of IFRS 3*: the review of IFRS 3 has once again been postponed for a quarter, and is now expected to commence in the 2nd or 3rd quarter of 2013.

It should also be noted that the IASB plans to publish reports on the following topics in the second quarter:

- the Request for Information on the post-implementation review of *IFRS 8 – Operating Segments*; and
- the public forum on information overload in financial statements, which was held in London on 29 January 2013.

➤ Conceptual Framework

At its February 2013 meeting, the IASB began discussing the content of the planned Discussion Paper on the Conceptual Framework.

The following topics were discussed:

- The purpose of the Conceptual Framework;
- Definitions of the following elements of financial statements: assets, liabilities, equity, income and expense;
- Unit of account;
- Recognition and derecognition;
- The boundary between liabilities and equity;
- Measurement; and
- Reporting entity.

Discussions will continue at upcoming IASB meetings. In March 2013, the IASB will discuss presentation (including what should be included in other comprehensive income), disclosure, constructive obligations and other measurement approaches.

The IASB expects to be in a position to discuss a new draft of the Discussion Paper in April 2013.

Beyond the GAAP will take a look at the IASB's decisions during its February meeting in a future issue.

Employee contributions to defined benefit plans

During 2012, the IFRS Interpretations Committee received two questions (in May and September, respectively) relating to paragraph 93 of the revised IAS 19, which is mandatory for financial periods starting on or after 1 January 2013.

Paragraph 93 of the revised IAS 19 deals with the accounting treatment for contributions from employees and third parties set out in the formal terms of a defined benefit plan. It stipulates that these contributions:

- shall reduce either service cost (if they are linked to service) or remeasurements of the net defined benefit liability (asset) (if, for example, they are required to reduce a deficit arising from losses on plan assets or actuarial losses).
- are attributed to periods of service as a negative benefit using the projected unit credit method.

The Committee was asked to clarify whether this paragraph means that contributions from employees set out in the formal terms of a plan should be taken into consideration when determining the present value of obligations in defined benefit plans.

At the end of its January meeting, the Interpretations Committee decided to submit to the IASB a proposed amendment to the revised IAS 19, stipulating that contributions from employees or third parties:

- should be treated as a reduction in short-term employee benefit cost, and accounted for as such over the period in which the contributions are made;
- if they are linked only to the services provided by the employee over that period.

Contributions from employees or third parties which are based on a fixed percentage of salary over the period will therefore reduce the cost for the period, but are not taken into account when determining the present value of the plan's obligations.

At the February meeting, the IASB studied the Committee's proposal and agreed to publish a limited-scope amendment to the revised IAS 19, but stipulated that contributions from employees linked only to the services rendered by the employee over the period should be treated as a reduction in the plan's service cost for the period rather than as a reduction in short-term employee benefit cost.

Discount rate for post-employment benefit obligations

At its January 2013 meeting, the IFRS Interpretations Committee continued to discuss the question it was asked about determining the rate used to discount post-employment benefits. At the end of the meeting the Committee asked its staff to consult the IASB on a number of points (cf. the January 2013 issue of Beyond the GAAP). That is what the IASB did during its February meeting.

Thus, the IASB has confirmed that:

- the discount rate reflects neither the entity-specific credit risk nor the risk that future experience may differ from actuarial assumptions;
- paragraph 84 of IAS 19 should be rephrased to make it clear that the discount rate is not a risk-free rate;
- the discount rate shall reflect the credit risk of high quality corporate bonds (HQCBs) and that a reasonable interpretation of HQCBs would be corporate bonds with a minimal or very low credit risk.

The IASB has also agreed to the Committee's proposal that IAS 19 should be amended to clarify that in the absence of HQCBs, government bonds may only be used if they are themselves of high quality.

Bearer biological assets

Readers will remember that IAS 41 makes a distinction between "consumable biological assets" and "bearer biological assets", without differentiating between the accounting treatments for each type.

Having realised this, in September 2012, the IASB added a limited-scope amendment to IAS 41 to its work plan, with a view to determining whether a specific accounting treatment was necessary for "bearer biological assets"

At its February 2013 meeting, the IASB continued its discussions on this topic and tentatively decided that:

- the recognition and disclosure requirements for property, plant and equipment under IAS 16 could be applied to the bare bearer biological assets;
- the revaluation model set out in IAS 16 should be permitted to the bare bearer biological assets;
- the bare bearer biological assets should be included in the scope of IAS 16, rather than adding requirements to IAS 41; and
- the produce growing on the bearer biological assets (such as fruit, wool, etc.) will remain within the scope of IAS 41.

As regards disclosures on bearer biological assets, the IASB is still considering what information is relevant. To address this issue, the IASB has decided to include a question in the forthcoming exposure draft to gather opinions from stakeholders (particularly investors) on whether the following information is important to them:

- the fair values of the bearer biological assets (including assumptions and inputs used);
- the significant inputs necessary for determining the fair value of the bearer biological assets;
- the productivity of bearer biological assets, e.g. age profile, productivity estimates, etc.

At the end of its February meeting, the IASB felt that it had completed its deliberations on the subject. The exposure draft of amendments to IAS 16 and IAS 41 is scheduled for the second or third quarter of 2013.

➤ IASB continues deliberating on phase 3 of IFRS 9 on hedge accounting

At its January 2013 meeting, the IASB continued its deliberations on phase 3 of IFRS 9 on hedge accounting. The following decisions were reached:

- to expand the notion of hedging costs to include foreign exchange basis spreads: this component, which is an integral part of all foreign exchange hedges and potentially a source of ineffectiveness, will be subject under IFRS 9 to the same accounting treatment as the forward element of foreign exchange forward contracts, or the time value of options. In practice, this means recognizing the changes in the value of the hedging derivative attributable to the basis spread in other comprehensive income rather than in profit or loss.

- to clarify the interaction between phase 3 of IFRS 9 and macro hedging: the Board has confirmed that the sections of the IAS 39 implementation guidance which did not appear in the phase 3 exposure draft of IFRS 9 will also not appear in the final standard. However, the Board has tentatively decided to add an explicit explanation that not carrying forward the implementation guidance of IAS 39 does not mean that the IASB rejected it.

Finally, the Board has asked its staff to look into the possibilities for entities to optionally apply the principles of IAS 39 to their macro hedging activities while awaiting the final standard, "Accounting for Macro Hedging".

➤ Exposure Draft of narrow-scope amendments to IAS 39 and IFRS 9 on "Novation of Derivatives and Continuation of Hedge Accounting"

On 28 February 2013, the IASB published an exposure draft of amendments to IAS 39 and IFRS 9, entitled "Novation of Derivatives and Continuation of Hedge Accounting".

This project is related to the changes to the regulation of financial markets, in particular within the European Union, through the European Market Infrastructure Regulation directive (EMIR).

The new directive:

- aims to reduce counterparty risk on the financial markets by requiring two parties to a contract to use central clearing, if specified thresholds are crossed;
- applies primarily (but not solely) to financial institutions;
- is likely to result in some entities changing their habits of dealing with derivatives.

The implementation of the new directive, which makes central clearing mandatory, means that all extant contracts must be "novated" to a central counterparty.

Under IAS 39 and IFRS 9 as they stand currently, this modification would require entities to discontinue all hedging relationships based on these derivatives, and then immediately re-document them.

The discontinuation of the hedging relationships would generate significant operating costs and potentially accounting ineffectiveness, which could have an impact on the profit or loss of the entities concerned.

The recently-published exposure draft aims to provide a practical and pragmatic solution to the unintended accounting consequences of the new regulation. It proposes a narrow-scope exception allowing hedging relationships to be continued when the novation of a derivative is required by a regulator.

It should be noted that the exposure draft follows in the footsteps of another recent publication allowing the same measure of flexibility to entities preparing their financial statements under the US GAAP.

In view of the urgency of the situation, the comment period closes on 2 April 2013.

➤ IFRS 7: Continuing involvement and servicing arrangements

Following a recommendation from the IFRS Interpretations Committee, the Board has confirmed that when drafting the IFRS 7 amendment relating to disclosures on transfers of financial assets, its intention was that servicing arrangements provided by the transferor would meet the definition of continuing involvement under IFRS 7. The Board then referred the issue back to the IFRS IC to determine whether clarifications to the text are necessary.

European matters

➤ Investment entities: EFRAG endorsement advice

On 18 February 2013, EFRAG recommended the adoption of the *Investment Entities* amendments.

Readers will remember that these amendments:

- were published by the IASB on 31 October 2012;
- exempt investment entities from the requirement to consolidate certain investments in subsidiaries, instead requiring them to be measured at fair value through profit or loss;
- are mandatory for financial periods starting on or after 1 January 2014. Early application is permitted.

Adoption by the European Union is scheduled for the third quarter of 2013.

A Closer Look

Revenue recognition: major redeliberations complete!

In January and February 2013, the IASB and the FASB tackled the last remaining major subjects needing further discussion in order to finalise the future standard on revenue recognition. They were as follows:

- scope;
- repurchase agreements;
- effect of the revenue recognition model on asset managers;
- transfers of non-financial assets that are not an output of an entity's ordinary activities (for example, property, plant and equipment under IAS 16);
- disclosures;
- specific disclosures to be made in interim financial statements; and
- transition requirements.

The two Boards also decided to postpone the mandatory effective date of the future standard to 1 January 2017, whereas the exposure draft (admittedly published in November 2011) stated that the effective date would not be earlier than 1 January 2015. In view of the very significant changes necessitated by the implementation of the standard, this temporary reprieve will surely come as a relief to many preparers of financial statements.

The IASB and the FASB also agreed that early application of the future standard would not be permitted, although it should be published by 30 June 2013. The IASB has thus ceded some ground to the FASB here, as the exposure draft showed a difference of opinion on the subject. However, the IASB will not prohibit early application for first-time adopters of IFRSs.

We must emphasise that all the decisions here are, as always, tentative, until the future standard has been published by the IASB.

➤ Scope of the future standard

The two Boards confirmed the scope as set out in the November 2011 exposure draft, as well as the definition of a "customer" given in the November 2011 Exposure Draft (ED).

The two Boards also decided to make the following clarifications:

- contracts with a collaborator or partner acting as such are not limited to those contracts where the shared risks and benefits relate to the development and commercialisation of a product. Readers will remember that such contracts do not fall within the scope of the future standard;
- a contract with a collaborator or partner falls within the scope of the future standard on revenue recognition if the counterparty also meets the definition of a customer. Therefore, not all collaborative contracts are excluded from the scope of the future standard;
- application guidance will be provided for contracts with customers which fall partly within the scope of the future standard and partly within the scope of other IFRSs (for example, a "hybrid" financial services contract, part of which falls within the scope of the *Financial Instruments* standard and part within the scope of the revenue recognition standard).

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⇒ Repurchase agreements

The November 2011 ED stipulated that when an entity is evaluating whether a customer has obtained control of an asset, it must take account of any agreement to repurchase the promised asset or one of its components.

The application guidance in appendix B of the ED identified three broad types of repurchase agreements:

- the entity has an unconditional obligation to repurchase the asset (a forward);
- the entity has an unconditional right to repurchase the asset (a call option);
- the entity has an unconditional obligation to repurchase the asset at the customer's request (a put option).

This application guidance gave rise to the following accounting treatment (for put options):

- if the customer does not have a significant economic incentive to exercise its right, the entity shall account for the agreement in the same way as the sale of a product with a right of return;
- where this is not the case, if the repurchase price exceeds the original selling price of the asset and is more than the expected market value, the agreement is in effect a financing arrangement. As a result, the entity shall continue to recognise the asset and also recognise a liability that shall be measured at the original selling price of the asset.

In January 2013, the two Boards discussed sale and leaseback transactions that include a put option. The redeliberations took account of the discussions on sale and leaseback transactions which took place in September 2012 in the context of the *Leases* project (cf. *Beyond the GAAP* September 2012). At this time, the Boards had decided that:

- in order to determine whether or not a sale has taken place, entities should refer to the criteria for control set out in the future revenue recognition standard, and apply them to the transaction as a whole;
- the existence of a leaseback does not, in and of itself, prevent the transaction from being recognised as a sale and a leaseback.

The two Boards said at the time that if a sale and leaseback transaction includes a call option whose exercise price is lower than the original sale price, the transaction must be treated as a financing arrangement.

Following on from these decisions, in January 2013 the two Boards discussed the accounting consequences of including a put option in a sale and leaseback transaction.

In line with the accounting treatment for call options, the two Boards have tentatively decided that a sale and leaseback transaction which includes a put option that the customer (i.e. the buyer/lessor) has a net economic incentive to exercise, despite the fact that the repurchase price is less than the original selling price, shall be accounted for as a financing arrangement.

⇒ Effect of the revenue recognition model on asset managers

In January 2013, the two Boards paid particular attention to how the asset management industry is affected by the constraint on the cumulative amount of revenue recognised from ordinary activities. The principle set out in the November 2011 ED is that, if the amount of consideration to which the entity expects to be entitled is variable, the cumulative amount of revenue from ordinary activities that the entity recognises to date shall not exceed the amount to which it is reasonably assured to be entitled. Readers will remember that this constraint was clarified in the November 2012 redeliberations (cf. *Beyond the GAAP* November 2012).

The two Boards have tentatively confirmed that, where an asset manager's performance-based incentive fees are variable (e.g. dependent on how the fund has performed against a benchmark), these fees shall be subject to the

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proposed constraint on revenue recognised, as explained above.

In practice, this means that a variable consideration may only be recognised as revenue if the entity is not expecting these amounts to be significantly revised downwards before they are confirmed. This will only be the case if the benchmark used to determine the consideration has low volatility, which is rare in practice.

➤ Transfers of non-financial assets which are not an output of an entity's ordinary activities

The two Boards have confirmed the proposal made in the November 2011 ED that IAS 16, IAS 38 and IAS 40 should be amended to require entities to apply:

- the requirements on control proposed in the future revenue recognition standard, in order to determine when the asset shall be derecognised; and
- the requirements on measurement proposed in the future standard, to determine the amount of gain or loss that shall be recognised when the asset is derecognised;

in the event of the transfer of a non-financial asset that is not an output of the entity's ordinary activities.

➤ Disclosures

In February 2013, the two Boards discussed the following disclosure-related topics:

- disaggregation of revenue;
- reconciliation of contract balances;
- analysis of remaining performance obligations;
- assets recognised from the costs of obtaining or fulfilling contracts with customers;
- onerous performance obligations;
- qualitative information about performance obligations and significant judgements.

a) Disaggregation of revenue

The two Boards have confirmed the proposal set out in the November 2011 ED that requires entities to disaggregate revenue from contracts with customers. The objective of disaggregation has been confirmed as follows:

"An entity shall disaggregate revenue from contracts with customers into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors."

Implementation guidance shall be included in the final standard, to explain that when determining the various categories, an entity should consider how revenue is disaggregated in:

- disclosures presented outside the financial statements, e.g. in presentations to investors or earnings releases;
- information reviewed by the management to evaluate the financial performance of operating segments; and
- any other relevant analysis in which the entity or users of financial statements evaluate performance or allocation of resources.

The Boards also clarified that an entity will not be required to use a minimum number of categories.

Finally, they decided that an entity should explain how the disclosures on disaggregated revenue from ordinary activities correlates with its reportable segments as required to be disclosed under IFRS 8.

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b) Reconciliation of contract balances

The November 2011 ED required entities to present in tabular format a reconciliation from the opening to the closing aggregate balance of contract assets and contract liabilities.

As a reminder:

When either party to a contract has performed, an entity shall present the contract in the statement of financial position as a contract liability, a contract asset, or a receivable depending on the relationship between the entity's performance and the customer's payment.

A contract asset is an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer, when that right is conditioned on something other than the passage of time (for example, the entity's future performance).

In February 2013, the IASB and the FASB decided to eliminate the requirement above as regards reconciliation of contract balances, in response to strong representations from both users and preparers of financial statements.

In the future standard on revenue recognition, this reconciliation will be replaced by a combination of quantitative and qualitative disclosures, including:

- the opening aggregate balance and closing aggregate balance of contract assets, contract liabilities and receivables from contracts with customers, if these amounts are not presented separately in the balance sheet;
- the amount of revenue recognised in the current period that was included in the contract liability balance;
- an explanation of how the entity's contracts and typical payment terms will affect the entity's contract asset balance and contract liability balance; and
- an explanation of significant changes in contract asset balances and contract liability balances, which should include both qualitative and quantitative data. Examples of significant changes include:
 - changes to contract balances resulting from business combinations;
 - impairment of a contract asset; etc.

The two Boards also decided that an entity should disclose the amount of revenue recognised in the period that arises from amounts allocated to performance obligations satisfied (or partially satisfied) in previous periods (e.g. due to a change in transaction price or to changes in estimates relating to the constraint on revenue recognised).

c) Analysis of remaining performance obligations

The two Boards have confirmed that, for contracts with an initial expected duration of more than one year, the entity shall present the following disclosures as of the end of the current reporting period:

- the aggregate amount of the transaction price allocated to remaining performance obligations;
- an explanation of when the entity expects to recognise that amount as revenue.

The two Boards also clarified that:

- contract renewals (which do not represent a significant economic benefit to the customer, i.e. the customer has no particular economic incentive to renew the contract, so there is no need to recognise the renewal as a separate performance obligation from the original contract) are not included in the disclosures on remaining performance obligations;
- the aggregate amount of the transaction price allocated to remaining performance obligations corresponds to the amount that will not be subject to significant downward revisions (i.e. the amount taking account of the constraint on revenue recognised, which will be presented in the notes); and
- an entity will not be prohibited from including information on contracts with an initial duration of less than one year in the disclosures on remaining performance obligations.

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d) Assets recognised from the costs of obtaining or fulfilling contracts with customers

According to the November 2011 ED, an entity should disclose a reconciliation of the opening and closing balances of assets recognised from the costs incurred to obtain or fulfil a contract with a customer, by main category of asset (for example, costs of obtaining contracts with customers, pre-contract costs, setup costs, etc.).

In February 2013, the two Boards decided to replace this requirement with a combination of quantitative and qualitative data, including:

- the closing balances of assets recognised from the costs of incurring or fulfilling contracts with customers, by main category of asset;
- the amount of amortisation recognised in the period; and
- the method used by the entity to determine the amortisation for each reporting period.

e) Onerous performance obligations

In February 2013, the two Boards decided to remove the paragraphs relating to disclosure requirements on that subject, as they were felt to be irrelevant now. This is in line with last July's decision not to include the proposals on onerous performance obligations from the second ED in the final standard (cf. Beyond the GAAP July 2012).

f) Qualitative information about performance obligations and significant judgements

The two Boards have decided that the final standard will retain the paragraphs from the November 2011 ED relating to qualitative disclosures on performance obligations and disclosures on significant judgements made in applying the standard on revenue recognition.

The two Boards also decided to require the following additional qualitative disclosures:

- the judgements made in determining the amount of the costs of obtaining and fulfilling contracts with customers capitalised in accordance with the future standard;
- the methods and assumptions used by the entity when determining the amount of the transaction price that will not be revised downwards (i.e. the constrained amount under the future standard);
- a description of the practical expedients that will be proposed in the final standard and used by the entity as accounting policies.

➤ Specific disclosures in interim financial statements

Convergence efforts failed at this point, as the IASB and the FASB were not able to reach an agreement.

The IASB, alone, decided not to proceed with the amendments to IAS 34 on interim financial statements, which were proposed in the November 2011 ED. The proposals caused concern among many commentators, as they seemed to call into question the basic principle of IAS 34, which is that when an entity chooses to publish condensed financial statements, the disclosures in the notes should be limited to the major events and transactions of the period and minimal mandatory other disclosures well-listed in IAS 34.

In contrast, the above-mentioned ED proposed that interim financial statements (whether condensed or not) should include the same quantitative disclosures as annual financial statements. This was harshly criticised by preparers of financial statements.

Therefore, the IASB ultimately decided not to proceed with these proposals. Instead, the minimum requirement will be disclosures on disaggregated revenue, as discussed in February 2013 (see above). IAS 34 will be amended to reflect this.

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Any additional qualitative or quantitative disclosures will have to comply with the general requirements of IAS 34.

Meanwhile, the FASB has confirmed the proposals set out in the ED (subject to the amendments to disclosures discussed previously). Companies which publish their accounts under US GAAP will thus be subject to tighter constraints on presentation of revenue disclosures in interim financial statements.

➤ Transition requirements

The two Boards have confirmed that the future standard on revenue recognition will generally be applicable retrospectively. The optional practical expedients for transition, which were set out in the second ED published in November 2011, have also been confirmed.

However, the two Boards have decided to propose an alternative transition method, which would require an entity to:

- apply the requirements of the new standard only to contracts that are not completed under IAS 11/IAS 18 at the date of initial application of the new standard (for example, at 1 January 2017 for an entity whose reporting period corresponds to the calendar year, taking into account the two Boards' decision on the mandatory effective date);
- recognise the cumulative effect of initial application of the future standard as an adjustment to the opening balance of retained earnings in the year of initial application (comparative periods presented would therefore not be restated); and
- provide the following disclosures, for the year of initial application:
 - the impact of initial application of the new revenue recognition standard on each line of the financial statements;
 - an explanation of the significant changes between the amounts recognised under the new standard and the amounts that would have resulted from the application of IAS 11/IAS 18.

This alternative approach should please many of the preparers of financial statements, who felt that the transition requirements set out in the ED would be too onerous to implement. However, prospective application of the future standard has been definitively ruled out.

By the end of the February meeting, the two Boards had completed their redeliberations on the major themes of the November 2011 ED. Any remaining minor issues may be discussed over the coming weeks, if the staff discovers issues that need resolving as they draft the final standard, which is scheduled for publication in the second quarter of 2013.

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Leases: IASB staff prepare the 2nd exposure draft

For around four months now, the IASB staff has been working on the second exposure draft of the future leases standard. This process has raised new questions which have had to be put to the two boards.

In January 2013, the IASB and the FASB reached tentative decisions on the following two points:

- How to identify separate lease components within a contract, and
- The classification of leases

In February 2013, the two Boards again discussed a number of points and reached tentative decisions on:

- Accounting for the right of use of an investment property in accordance with IAS 40, and
- The first application of the future standard to leases that are currently classified as finance leases.

Finally, the publication of the exposure draft has been put back to the second quarter of 2013.

➤ Identifying a lease component

The new exposure draft will include guidance on how to identify whether a lease contains one or more lease components.

Let us take the example of a farm lease (an example presented by the IASB staff). A farm lease includes the lease of farmland, agricultural equipment, barns, farmhouse, etc.

Should this be regarded as a single lease (i.e. the lease of the farm as a whole) or does a lease exist for each asset class (i.e. a distinct lease on the farmland, the agricultural equipment, stables, barns etc.)?

The Boards recommend using the principles for the identification of separate performance obligations set out in the revenue recognition project (see paragraphs 28 and 29 of the Revenue Recognition ED issued in November 2011). Similar guidance would thus be included in the coming ED on leases (extract from agenda paper 3A – January 2013):

"An entity would consider the right to use an identified (underlying) asset to be a separate lease component if the lessee can benefit from the use of the identified asset either on its own or together with other resources that are readily available to the lessee.

Readily available resources are goods or services that are sold or leased separately (by the lessor or other suppliers) or resources that the lessee has already obtained (from the lessor or from other transactions or events)."

Each separate lease component identified in the same lease contract should be accounted for as a separate lease.

➤ The classification of leases

Reminder of the classification principle

Last June, the Boards reintroduced the idea that there are two lease categories. The accounting treatment of leases by both lessor and lessee differs on the basis of whether the lessee consumes more than an insignificant portion of the underlying asset over the lease term.

The Boards have also simplified the application of this principle to property leases.

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Thus, **depending on the nature of the leased asset** (property or otherwise), **the analysis conducted to classify a lease will differ:**

- **Property:** the lessee consumes an insignificant portion of the asset, unless it can be shown that:
 - the lease term is for the major part of the economic life of the underlying asset; or
 - the present value of fixed lease payments represents substantially all of the fair value of the underlying asset.
- **Assets other than property:** the lessee consumes more than an insignificant portion of the asset, unless it can be shown that:
 - the lease term is an insignificant portion of the economic life of the underlying asset; or
 - the present value of the fixed lease payments is "insignificant" relative to the fair value of the underlying asset.

At their January meeting, the boards proposed to issue guidance in the new ED on how the analysis should be conducted in order to classify a lease:

- How should we determine the nature of the underlying asset (property or otherwise) for classification purposes when a lease (identified as a single lease component) contains the right to use several assets of a different nature?

The boards decided that an entity should determine the nature of the underlying asset on the basis of the nature of the primary asset within the lease component.

Examples presented by the IASB staff (extract from agenda paper 3A – January 2013)

Lessee leases a specified floor of a building. The lease provides access to the floor via a lift and heating/air-conditioning from the centralised heating/air-conditioning system: the primary asset is the floor of the building. The lease is a property lease.

Lessee leases a large turbine housed in a building plus the land on which the turbine is situated. The building exists only to house the turbine, and the life of the building is directly tied to the life of the turbine (ie when the turbine can no longer be used and is dismantled, the building will be demolished): the primary asset is the turbine. The leased asset is the equipment (and not the property).

- How should a property lease (identified as one lease component) be classified when it relates to both land and building elements?
 - The measurement of the present value of lease payments in relation to the fair value of the asset should reflect the property as a whole (land + building).
It will not therefore be necessary to allocate lease payments between the building and the land, or to compare these two lease payments with the fair value of the land and the building respectively.
 - The assessment of the lease term as regards the economic life of the asset will be made by comparing it with the economic life of the building, which is considered to represent the economic life of the property as a whole (land + building).

➤ Accounting for the right of use of an investment property

The IASB tentatively decided to require an entity to account for right-of-use assets in accordance with IAS 40 *Investment Property* if the leased property meets the definition of an investment property in accordance with that standard.

As a reminder, IAS 40 authorises two models for the measurement of investment property: at cost and at fair value.

A Closer Look

➤ Transition proposals for leases that are currently classified as finance leases under IAS 17

The IASB and the FASB tentatively decided to provide specific transition relief for existing leases that are classified as finance leases (as defined in IAS 17 or Topic 840).

Lessees and lessors would not be required to make any adjustments to the carrying amount of any assets and liabilities associated with those leases at transition to the new standard. The Boards propose to provide guidance on the subsequent measurement of those assets and liabilities in the future standard.

DOCTR'in English ●●●●●●●●●●

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A Closer Look

Reopening IFRS 9 phase 1, Classification and Measurement: the main proposals in the November 2012 exposure draft

After discussing aspects of the classification and measurement model for financial instruments in the existing IFRS 9 throughout 2012, the IASB published draft amendments to this standard on 28 November 2012, before it had even reached its mandatory effective date, that is 1 January 2015.

Below we remind readers of how this project fits into the broader proposals to revise the standard on financial instruments, and we set out the main measures proposed in the new exposure draft.

➤ Update on the revision of IAS 39

The project to reform the standard on financial instruments was divided into three sub-projects:

- phase 1: Classification and measurement;
- phase 2: Impairment;
- phase 3: General hedge accounting model (micro-hedging).

These three phases will be integrated into the future IFRS 9 standard which will eventually replace IAS 39.

The complex subject of macro-hedging, which is of crucial importance to financial institutions, was removed from the scope of the IFRS 9 project in order to avoid delays in the finalisation of the standard. It will be the subject of a separate standard for which the IASB is currently drafting a Discussion Paper.

As far as the IASB was concerned, phase 1 of IFRS 9 on the classification and measurement of financial assets was complete.

The text published in 2010 (and supplemented in 2011) proposed that the new provisions for the classification and measurement of financial assets should apply to reporting periods beginning on or after 1 January 2015, and authorised early application except in Europe².

The draft amendments to Phase 1 of IFRS 9 which have just been published suggest that the IASB was too hasty in finalizing this first stage in 2010.

The proposed amendments aim to:

- clarify the accounting treatment of some instruments which have caused problems for early adopters of IFRS 9 outside the European Union;
- improve convergence with the future FASB model of classification and measurement;
- take into account potential interaction with the IASB's Insurance Contracts project (IFRS 4 phase II).

In parallel, the IASB is continuing to finalise the other phases of the IFRS 9 project:

- a new Phase 2 exposure draft is expected during the first quarter of 2013;
- a finalised version of Phase 3 should be published during the second quarter of 2013.

¹ Subject to endorsement by the European Union for entities within its jurisdiction

² In Europe, Phase 1 cannot be applied early because it has not yet been adopted. The EU has opted to make its decision as to the endorsement of the future IFRS 9 as a whole, rather than on a phase by phase basis.

A Closer Look

➔ The current provisions of IFRS 9 Phase 1

A new model for financial liabilities

IFRS 9 maintains most of the provisions of IAS 39 on the classification and measurement of financial liabilities.

However, IFRS 9 amends the accounting treatment of financial liabilities which are optionally designated at fair value through profit or loss:

- changes in the value of these liabilities over the period are recognised in the profit or loss for the period;
- with the exception of the portion of the change in value attributable to the issuer's own credit risk, which is immediately recognised in other comprehensive income, unless recognition in OCI creates or enlarges an accounting mismatch in profit or loss;
- the amounts recognised in OCI cannot subsequently be recycled to profit or loss (even upon prepayment or settlement of the debt).

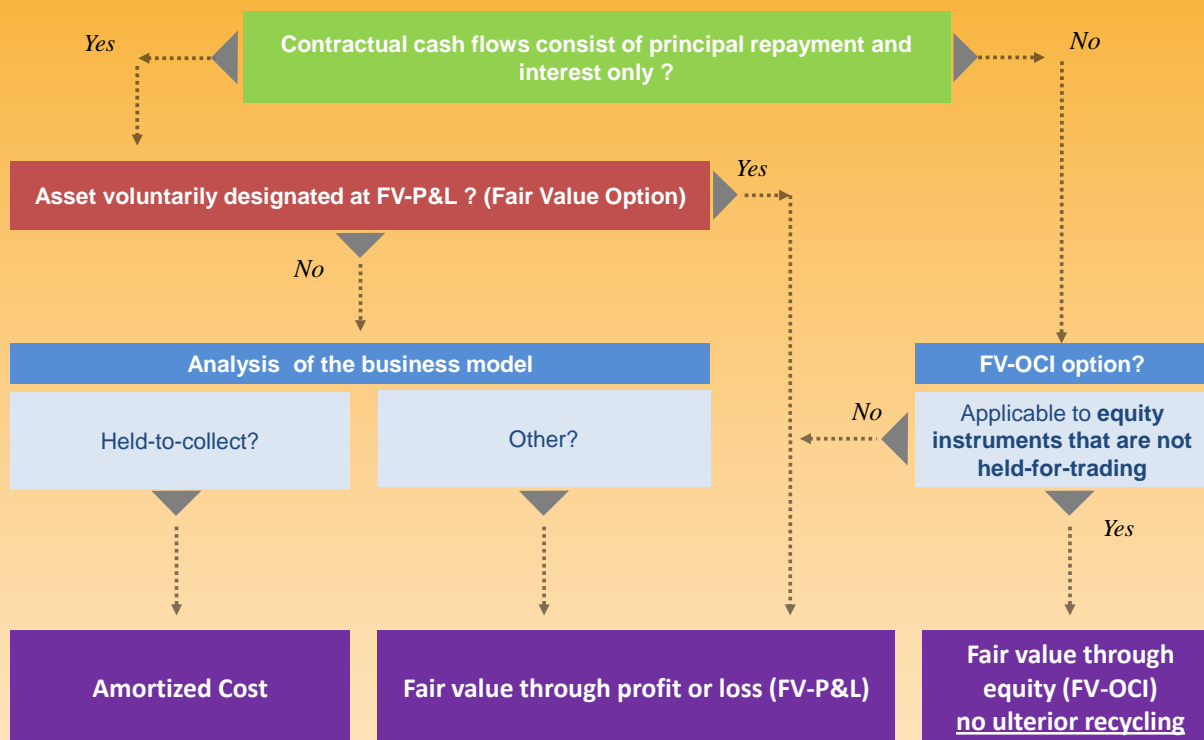
A new model for financial assets

IFRS 9 introduces a new classification model for financial assets.

- Two new criteria must be met if a financial asset is to be measured at amortised cost:
 1. A contractual cash flow characteristics criterion which states that cash flows from the instrument should represent "solely payments of principal and interest" (SPPI), where interest is consideration for the time value of money and for the credit risk;
 2. A business model criterion: assets are held in order to "collect contractual cash flows".
- The fair value through profit or loss category becomes the residual category. An entity may opt irrevocably to classify any financial asset in this category if this reduces an accounting mismatch.
- Subsequent reclassification between the amortised cost and fair value through profit or loss categories for debt instruments which meet the SPPI criterion are mandatory where the entity changes its business model (which the IASB expects to happen very seldom).
- The concept of embedded derivative is removed, and each instrument must be classified in one of the categories (either amortised cost or fair value through profit or loss) in its entirety.
- Equity instruments which are not held for trading may optionally be designated at fair value through Other Comprehensive Income.
However, contrary to the rules which apply to the existing "Available for Sale" category, recycling of the amounts accumulated in OCI to profit or loss is forbidden, even on disposal.
In return, equity instruments are no longer impaired.

A Closer Look

The new classification model for financial assets in IFRS 9 (2010) can be summarised as follows:



➤ Main proposals in the November 2012 Phase 1 exposure draft

The main amendments proposed by the exposure draft relate to:

- The principal and interest criterion (SPPI): the ED relaxes the application of this criterion and provides more application guidance;
- The introduction of a second business model in which assets are managed *both* in order to collect contractual cash flows *and* for sale, along with a new associated category of financial assets which will lead to measurement at Fair Value through Other Comprehensive Income (FV-OCI);
- Clarifications are brought to the "Held to collect contractual flows" business model.

"Solely payments of principal & interest" (SPPI) criterion

The exposure draft clarifies the application of the SPPI criterion to assets which have a "modified economic relationship" between the components of the contractual cash flows (principal, consideration for the time value of money, and credit risk).

In particular, where a modified economic relationship is identified, a case by case analysis is required in order to determine whether the instrument fulfils the SPPI criterion.

This analysis consists of comparing the cash flows of the actual instrument with those of a similar (actual or hypothetical) benchmark instrument meeting the SPPI criterion.

A Closer Look

For example, for a variable-rate loan for which the contractual reference rate is EURIBOR 3M that is reset monthly (instead of every three months, which indicates a modified economic relationship), the benchmark may be a similar loan indexed to EURIBOR 1M and reset every month.

Note that:

- when comparing cash flows, an entity must consider all the “reasonably possible” scenarios. It is not enough to compare the cash flows on the basis of interest rate conditions at the analysis date;
- this detailed assessment is not required if the respect or the failure to respect the principle and interest criterion is obvious with little or no analysis;
- in other respects, the role of the SPPI criterion remains unchanged. Instruments which do not meet this criterion must be measured at fair value through profit or loss (with the exception of equity instruments measured at fair value through OCI).

A second business model: Held to collect and sell (HTC&S)

This second model covers financial assets which are **managed in accordance with a mixed business model whose objective is both to collect contractual cash flows and to sell the assets.**

The application guidance in the exposure draft includes some examples of activities carried out by financial and non-financial entities which correspond to this mixed business model.

Instruments that meet the SPPI criterion and that are managed in accordance with this business model are accounted for as follows:

- presentation in the statement of financial position at fair value ;
- recognition in profit or loss of the same impacts as for an instrument measured at amortised cost (including the amount of impairment; this constitutes a significant difference if compared to the existing category “Available for sale”);
- recognition in OCI of the residual fair value changes (i.e. which not recognised in profit or loss). The cumulative amount in OCI should be recycled to profit or loss when the asset is derecognised;
- reclassification to other categories if the business model changes (this is expected to be infrequent);
- option to designate the instrument at fair value through profit or loss (FV-P&L) if an accounting mismatch is identified (fair value option identical to that available to instruments measured at amortised cost).

In introducing this second business model and the new measurement approach, the IASB is trying to address the concerns of insurance companies which, as the IFRS 4 project currently stands, could see the financial parameters of their liabilities impact OCI. The board believes that this category will enable them to reduce accounting mismatches.

It is probable that this objective will only be reached partially, insofar as equity instruments cannot benefit from recycling from OCI to P&L.

“Held to Collect” business model

The exposure draft clarifies this business model that allows for measurement at amortised cost, in particular by providing guidance as to the frequency and nature of sales permissible under the model.

The clarifications also aim to specify the scope of this category following the introduction of the HTC&S business model.

If the business model is based on the collection of contractual cash flows:

- **sales due to deteriorating credit quality** such that the assets no longer meet the criteria of the entity's documented investment policy **are compatible with a HTC model**, whatever
 - their frequency or
 - their volume.
- Sales for other reasons are tolerated if they satisfy one of the following conditions:
 - they are infrequent (even if the volume is significant); or
 - they are insignificant, both individually and in aggregate (even if they are frequent);
 - they take place close to the maturity date of the instrument and the proceeds from sales approximate the collection of the remaining contractual cash flows.

The fact that a sale is imposed by a third party (such as a regulator), or is not at the initiative of the entity, has no impact on the analysis of the business model.

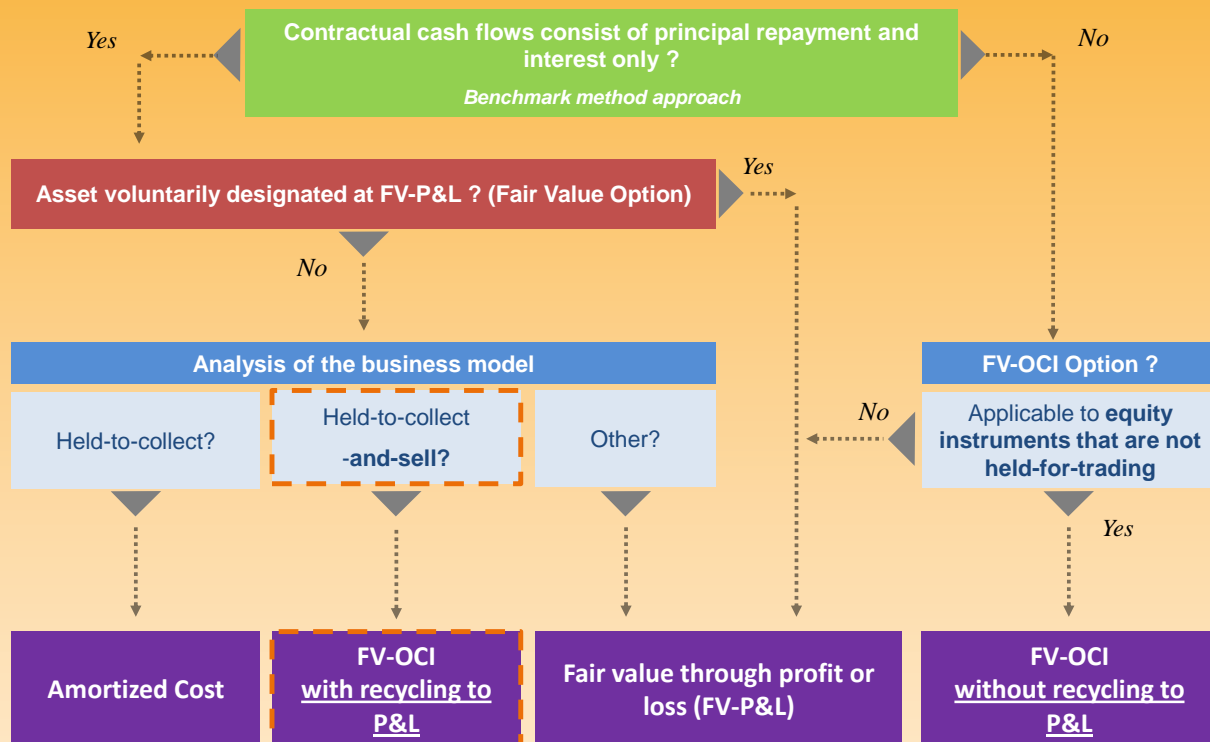
What does not change...

The exposure draft is entitled "Limited amendments to IFRS 9". Many aspects of IFRS 9 are unaffected by the proposed amendments. Without mentioning them all, it is worth noting that:

- there are no changes to the treatment of financial liabilities;
- the bifurcation of embedded derivatives is still prohibited for financial assets (but is still applicable to financial liabilities);
- the prohibition on recycling to profit or loss the fair value changes accumulated in OCI for instruments optionally measured at FV-OCI is maintained.

A Closer Look

The new classification model (2012 exposure draft)



➤ Next steps

Comments on this exposure draft should be addressed to the IASB by 28 March 2013.

The IASB will consider the reactions of stakeholders during the second quarter of 2013. It has not so far announced any date for the publication of the final amendments.

➤ Frequently asked questions

- Accounting treatment of a technology licence agreement;
- Presentation of the effects of a business combination in profit or loss;
- Restructuring of an ORA (bond redeemable with shares);
- Deconsolidating impact of the assignment of a public service concession (IFRIC 12);
- Accounting treatment of withholding taxes linked with the provision of services.

Upcoming meetings of the IASB, IFRS Interpretations Committee and EFRAG

IASB

14 - 22 March 2013

17 - 26 April 2013

16 - 24 May 2013

Committee

12 - 13 March 2013

14 - 15 May 2013

16 - 17 July 2013

EFRAG

3 - 5 April 2013

6 - 8 May 2013

12 - 14 June 2013

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