Mazars' newsletter on accounting standards

Beyond the GAAP

No 67 –May 2013

Editorial

When in August 2010, the IASB and the FASB published a joint exposure draft on leases, they could have had no idea that they would have to re-expose their proposals three years later. This, however, is what they were forced to do on 16 May 2013, so generally hostile were responses to the initial draft, so complicated the redeliberations and so changeable the positions.

The objective of improving the way in which leases are reported has not changed, but the solutions now proposed to achieve this end are significantly different from those put forward in the first exposure draft. This can partly be explained by the reintroduction of lease categories, justifying the coexistence of a dual approach to the accounting models. It remains to be seen if these new proposals will satisfy the critics!

Enjoy your reading!

Michel Barbet-Massin   Edouard Fossat

Contents

Editors in chief:
Michel Barbet-Massin, Edouard Fossat

Columnists:
Pauline Gouin, Vincent Guillard, Carole Masson, Egle Mockaityte, Didier Rimbaud and Arnaud Verchère.

Contact us:

Laurence Warpelin
Head accounting standards
laurence.warpelin@mazars.ch
Tel. +41 21 310 49 03

Denise Wipf
Director
denise.wipf@mazars.ch
Tel. +41 44 384 93 75

www.mazars.com

News

A new member on the IASB

On 23 May 2013, the Trustees of the IFRS Foundation, the IASB oversight body, announced the appointment of Sue Lloyd to the IASB with effect from 1 January 1014.

Ms Lloyd currently serves as a Senior Director of Technical Activities at the IASB. She is responsible for leading the technical staff in the development of new standards. The trustees have therefore recruited internally to replace Prabhakar Kalavacherla, one of two members of the Board to have voted against the new draft standard on leases.

New appointments to the IFRS Interpretations Committee

On 8 May 2013, the Trustees of the IFRS Foundation announced the appointment of Tony de Bell (PwC-UK), Reinhard Dotzlaw (KPMG-Canada), and Martin Schloemer (Bayer AG - Germany) as new members of the IFRS Interpretations Committee (IFRIC) with effect from 1 July 2013 for a renewable three-year initial term.

On the same day, the Trustees appointed Andrew Watchman (Grant Thornton-UK) to the committee, with effect from 1 July 2013, simultaneously announcing that he would be succeeded by Andrew Buchanan (BDO) on 1 July 2016.

As of 1 July 2013, five of the Committee's fourteen members will thus come from audit firms.

MAZARS

➲ IASB extends the scope of the relief proposed in draft amendments to IAS 39 and IFRS 9, *Novation of Derivatives and Continuation of Hedge Accounting.*

During its May meeting, the IASB continued its discussion of the limited amendments to IAS 39 and IFRS 9 entitled *Novation of Derivatives and Continuation of Hedge Accounting* which were published by the IASB in February (see the February edition of Beyond the GAAP) and reviewed the comments addressed to the IASB by stakeholders. This fairly pragmatic project aims to relax the existing hedge accounting rules in order to avoid discontinuation of hedging relationships in cases where the derivative is novated (there is a change of the counterparty to the derivative) to a central counterparty (CCP) as required by laws or regulations, such as under the European Union's EMIR directive.

In view of the comments received, the IASB decided to expand the scope of the relief introduced by this amendment to the following circumstances: (1) voluntary novation to a CCP associated with a legislative or regulatory change (i.e. the novation is not imposed by a regulatory authority), and (2) novation that provides the entity with indirect access to a CCP (through a clearing member for example).

This decision is likely to be welcomed by preparers.

The final amendment is expected by the end of June. The IASB also clarified in May that the date of first mandatory application of this amendment would be 1 January 2014; early application would be authorised.

It remains to be seen, however, whether the text will be finalised early enough to allow its transposition into European law before the closing of financial statements for the year 2013.

➲ The IASB continues its comprehensive review of *IFRS for SMEs*

During the meetings of April and May 2013, the Board had cause to examine some of the issues raised by the review of IFRS for SMEs, particularly:

- **Application scope of *IRFS for SMEs***

The IASB decided not to amend the scope of *IFRS for SMEs*. This standard cannot therefore be applied by publicly accountable entities, i.e. entities whose debt or equity instruments are traded in a public market (or are on the point of being so) and entities that hold assets in a fiduciary capacity for a broad group of third parties (banks, insurance companies, etc.).

- **Updating the standard**

The recent changes to IFRSs led the IASB to wonder whether *IFRS for SMEs* should be updated. After discussions, the IASB tentatively decided that for the present *IFRS for SMEs* would not be updated to incorporate IFRS 10, IFRS 11, IFRS 13, IFRS 3R and IAS 19R, on the grounds that many jurisdictions have only recently adopted *IFRS for SMEs* and so there is a special need to provide these entities with a stable platform at this time.

- **Application of more complex IFRS accounting policies**

The IASB considered whether an entity applying IFRS for SMEs should be able to apply a more complex accounting policy based on requirements currently required or permitted in full IFRS (including the revaluation of tangible fixed assets (IAS 16), the capitalisation of development costs (IAS 38) and the incorporation of borrowing costs in the cost of qualifying assets (IAS 23)), and ultimately decided not to include these options.

➲ Hedge accounting: choice of accounting principles in IFRS 9 and IAS 39

In recent months the IASB has been considering an option that would maintain the application of IAS 39 principles to "micro-hedging" activities while awaiting the finalisation of the future standard *Accounting for Macro Hedging*.

Last April, the Board decided to allow entities to choose either to apply hedge accounting in accordance with:

- IAS 39; or
- IFRS 9, while retaining the option to elect to apply IAS 39 in the particular case of a fair value hedge of the interest rate exposure of a portfolio of financial assets or financial liabilities.

This option will be an accounting policy choice applicable to all hedging relationships.

In practice, this may lead some entities to delay the first year of application of the "hedging" phase of IFRS 9.

The board emphasised that the new hedge accounting-related disclosure requirements will become part of IFRS 7 when IFRS 9 comes into effect. These new requirements will therefore be applicable to all entities, whether they have elected to apply IAS 39 or IFRS 9 for hedge accounting.

Finally, the IASB decided that the changes proposed to the final document as a result of redeliberations did not necessitate the publication of a new exposure draft.

The final publication of chapter 6 of IFRS 9 on hedge accounting is expected by the end of the third quarter of 2013.

➲ Publication of a limited amendment to IAS 36

On 29 May 2013, the IASB published the final amendments to IAS 36 following the entry into force of IFRS 13, *Fair value measurement* (see Beyond the GAAP, January 2013). These amendments:

- clarify that an entity must **disclose the recoverable amount of any asset or CGU for which a loss of value has been recognised or reversed during the period**, and no longer for all CGUs including significant non-amortisable intangible assets (including goodwill) even if there is no impairment;
- introduce a **new requirement for disclosures on fair value measurement when the recoverable value of any asset or CGU for which a loss of value has been recognised or reversed during the period is determined on the basis of fair value less costs of disposal.** These new disclosures are essentially similar to those already required by IAS 36.134(e) for CGUs including significant non-amortisable intangible assets (including goodwill) whose recoverable value is determined on the basis of fair value less costs of disposal.

These amendments will apply retrospectively to financial years beginning on or after 1 January 2014. Early application is possible (subject in Europe to endorsement by the European Union). However, an entity may not apply these amendments to periods (including comparative periods) in which it does not also apply IFRS 13.

➲ The future Revenue Recognition standard will soon be published!

In May 2013, the IASB concluded discussions on the future standard on Revenue Recognition.

The IASB therefore considered that the due process had been sufficient to allow the publication of this text, now anticipated in Q3 2013.

Some movement back and forth is still expected before then to finalise the standard, given the redeliberations which have taken place over several months. There will be no further call for comments on this subject. Note also that no member of the IASB has suggested that he or she would dissent from issuing the revenue standard when it is formally submitted to the vote for publication.

At the same meeting, the IASB decided not to grant first-time adopters of IFRSs the same reliefs as will be offered to preparers already applying IFRSs when they apply the new Revenue Recognition standard for the first time.

In practice, IFRS 1 will not authorise first-time adopters to restate only current contracts on the date of first application (i.e. in application of the former standard).

However, a simplification will be offered for full retrospective restatement, as first-time adopters will have the option not to restate contracts which are completed before the start of the earliest comparative period presented.

➲ Conceptual framework

The IASB continued to discuss the future Discussion Paper on the Conceptual Framework, addressing the following areas:

- Purpose and status of the conceptual framework;
- Elements of financial statements, i.e. Definitions of assets and liabilities;
- Recognition and derecognition;
- Measurement;
- Presentation in the statement of comprehensive income – profit or loss and other comprehensive income (OCI).

Board members seem to have completed their preliminary discussions. The Discussion Paper is expected to be published during July 2013, and will have a 180-day comment period.

Beyond the GAAP will return to the content of the future conceptual framework once the Discussion paper has been published.

IFRS

IASB publishes a summary of feedback from Disclosure Forum

On 28 November 2013 the IASB published a summary of the feedback from the public Forum held in January 2013 to consider the disclosure overload in financial statements.

This forum was organised by the IASB to enable stakeholders (investors, preparers, auditors, regulators, and standard setters) to discuss how to improve the usefulness and clarity of disclosures in financial statements.

As well as summarising the feedback, this document also sets out the measures which the IASB proposes to take to address on-going concerns about the quality and quantity of financial reporting disclosure. The board proposes to:

- make narrow scope amendments to IAS 1 to address perceived impediments to preparers exercising their judgement in presenting their financial reports;
- develop educational material on materiality with input from an advisory group;
- conduct broader research into the challenges associated with disclosure effectiveness.

This IASB report can be consulted on the IASB site at: http://www.ifrs.org/Alerts/PressRelease/Pages/IASB-publishes-Feedback-Statement-on-Disclosure-Forum.aspx

IFRIC issues definitive interpretation on levies (IFRIC 21)

On 20 May 2013, the IFRS Interpretations Committee (formerly IFRIC) published the final version of its interpretation on accounting for levies.

This interpretation, which clarifies the obligating event for the recognition of a liability, will be of mandatory application to financial periods beginning on or after 1 January 2014. Early application is pemitted.

According to the EFRAG timetable updated at 21 May 2013, the European Union is expected to endorse this text during Q1 2014.

Beyond the GAAP will return in more in detail to the provisions of this Interpretation in the June edition.

EUROPE

EFRAG launches field test on the new draft standard on Leases.

On 22 May 2013, EFRAG and the main national accounting standard-setters (ANC, ASCG, FRC and OCI) called for European companies applying IFRS to take part in field testing the new IASB and FASB proposals on accounting for leases, published by the IASB on 16 May 2013. EFRAG and its partners are seeking to:

- understand the operational difficulties of the proposals, and
- quantify the efforts involved to implement the requirements.

The study consists of a questionnaire to be returned no later than 31 July 2013 (http://www.efrag.org/Front/n1-1153/EFRAG-and-the-National-Standard-Setters-ANC--ASCG--FRC-and-OIC-invite-companies-to-participate-in-field-testing-of-the-proposed-accounting-guidance-for-leases.aspx).

Proposed interim standard on rate-regulated activities not supported by EFRAG

On 25 April 2013, the IASB published for comments its draft provisional standard on rate-regulated activities, entitled ED/2013/5 *Regulatory Deferral Accounts*. Less than a month later, EFRAG put its draft comment letter on line, and explains that it cannot support the draft since the provisional standard would:

- introduce unequal treatment between (a) first-time adopters that could take advantage of the ED and (b) entities that already apply IFRS who could not apply it; and
- damage the comparability of financial statements, since the draft is not limited to facilitating first-time adoption of IFRSs but also aims to maintain previous accounting policies for an indefinite period.

The EFRAG draft comment letter can be consulted at the following address: http://www.efrag.org/Front/n1-1159/EFRAG-s-Draft-Comment-Letter-on-the-IASB-s-draft-ED-2013-5-Regulatory-Deferral-Accounts.aspx

Standards and interpretations applicable at 30 June 2013

To coincide with the preparation of interim financial reports, Beyond the GAAP presents an overview of the IASB's most recent publications. For each text, we clarify whether it is mandatory for this closing of accounts, or whether early application is permitted, based on the EU endorsement status report (Position as at 30 May 2013): http://www.efrag.org/WebSites/UploadFolder/1/CMS/Files/Endorsement%20status%20report/EFRAG_Endorsement_Status_Report_30_May_2013.pdf

As a reminder, the following principles govern the first application of the IASB's standards and interpretations:

- The IASB's draft standards cannot be applied as they are published standards.
- IFRIC's draft interpretations may be applied if the two following conditions are met:
    - The draft does not conflict with currently applicable IFRSs;
    - The draft does not modify an existing interpretation which is currently mandatory.
- Standards published by the IASB but not yet adopted by the European Union may be applied if the European adoption process is completed before the interim financial reports have been approved by the relevant authority (i.e. usually the board of directors).
- Interpretations published by the IASB but not yet adopted by the European Union at the end of the interim financial reporting period may be applied unless they conflict with standards or interpretations currently applicable in Europe.

It should also be noted that under IAS 34 "Interim Financial Reporting", the changes in accounting policies required for 2013 by new standards must also be disclosed in the interim financial reporting published during the course of the year.

Situation of European Union adoption process for standards and amendments published by the IASB

Standard	Subject	Effective date according to the IAS	Date of publication in the OJEU	Application status on 30 June 2013
Amendments to IAS 1	Presentation of Items of Other Comprehensive Income	**1/07/2012** Early application permitted	**6 June 2012**	**Mandatory**
Amendments to IAS 19	Employee Benefits	**1/01/2013** Early application permitted	**6 June 2012**	**Mandatory**

A Closer Look

Standard	Subject	Effective date according to the IAS	Date of publication in the OJEU	Application status on 30 June 2013
Amendments to IFRS 7	Disclosures – Offsetting Financial Assets and Financial Liabilities	**1/01/2013** Early application permitted	**29 December 2012**	**Mandatory**
Amendments to IAS 32	Offsetting Financial Assets and Financial Liabilities	**1/01/2014** Early application permitted		**Permitted**
IFRS 13	Fair Value Measurement	**1/01/2013** Early application permitted	**29 December 2012**	**Mandatory**
Amendments to IAS 12	Recovery of Underlying Assets	**1/01/2012** Early application permitted		**Mandatory**
Amendments to IFRS 1	Severe Hyperinflation and Removal of Fixed Dates for First-Time Adopters	**1/07/2011** Early application permitted		**Mandatory**
IFRS 10	Consolidated Financial Statements	**1/01/2013** Early application permitted if all these Standards are applied at the same time	**29 December 2012** Mandatory to financial year starting on 01/01/2014	**Permitted** Early application permitted if all these standards are applied at the same time
IFRS 11	Joint Arrangements			
IFRS 12	Disclosures of interests in Other Entities			
IAS 27R	Separate Financial Statements			
IAS 28R	Investments in Associates and Joint Ventures			
Amendments to IFRS 10, IFRS 11 and IFRS 12	Transition Guidance	**1/01/2013** Early application permitted	**5 April 2013** Mandatory to financial year starting on 01/01/2014	**Permitted**

Standard	Subject	Effective date according to the IAS	Date of publication in the OJEU	Application status on 30 June 2013
Amendments to IFRS 1	Government Loans	**1/01/2013** Early application permitted	**5 March 2013**	**Mandatory**
Improvements to IFRS (2009-2011)	Annual improvements to various standards (issued on 17 May 2012).	**01/01/2013** Early application permitted	**28 March 2013**	**Mandatory**
IFRS 9	Financial Instruments (standard intended to gradually replace the provisions of IAS 39)	**1/01/2015** Early application permitted	Endorsement postponed	**Not permitted**
Amendments to IFRS 10, IFRS 11 and IFRS 12	Investment Entities	**01/01/2014** Early application permitted	Awaiting endorsement by the EU (expected in Q3 2013)	**Not permitted**

➲ Situation of the European Union adoption process for interpretations published by the IFRS Interpretations Committee

Interpretation	Subject	Effective date according to the IAS	Date of publication in the OJEU	Application status on 30 June 2013
IFRIC 20	Stripping Costs in the Production Phase of a Surface Mine	**1/01/2013** Early application permitted	**29 December 2012**	**Mandatory**
IFRIC 21	Levies (issued on 20 May 2013)	**1/01/2014** Early application permitted	Awaiting endorsement by the EU (expected in Q1 2014)	**Permitted**

IASB and FASB publish the 2nd ED on Leases

When in August 2010, the IASB and the FASB published a joint exposure draft entitled *Leases*, they could have had no idea that they would have to re-expose their proposals almost three years later.

This, however, is what they were forced to do on 16 May 2013, so generally hostile were responses to the initial draft (nearly 800 comments letters were addressed to the two boards), so complicated the redeliberations which followed from January 2012 onwards, and so changeable the positions adopted by the two boards.

The objective of improving the way in which leases are reported, based on the principle that an entity should account for the assets and liabilities arising under a lease, has not changed since this joint project was first launched, but the solutions now proposed to achieve this end are significantly different from those put forward in the first exposure draft. This can partly be explained by the reintroduction of lease categories, justifying the coexistence of a dual approach to the accounting models. It remains to be seen if the new proposals will satisfy the critics!

The call for comments on the re-exposure of the joint leases project has been launched, and will end on 13 September 2013.

For now, the two boards have made no announcement of the publication date of the final standard, nor on when it will be of mandatory application.

At this stage, they have said that they:

- intend to conduct outreach activities during the comments period, and will take the results of these activites into account when they finalise the standard;
- will await the redeliberations before setting the mandatory application date.

Because of the disruption which this new standard could cause for very many entities, we here present the general principles developed in this new exposure draft.

Scope

The definition of a lease in this second exposure draft is as follows:

> **A contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration.**

The standard would apply to all contracts satisfying this definition, with the exception of:

- leases of intangible assets for lessors only, (ED paragraph 4 a)),
- leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources, within the scope of IFRS 6,
- leases of biological assets within the scope of IAS 41,
- service concession arrangements within the scope of IFRIC 12.

However, a lessee would have the option of applying the future standard to leases of intangible assets (choice of accounting principles).

➲ Identifying a lease

In order to assist in the definition of a lease, the 2nd exposure draft introduces a series of criteria for determining:

- whether a contract is a lease;
- whether a contract contains a lease.

These proposals aim to make a distinction between leases and service contracts and to exclude these last from the scope of the standard.

According to the 2nd Exposure draft, a contract is (or contains) a lease if the following two conditions are satisfied:

- fulfilment of the contract depends on the use of an identified asset; **and**
- the contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration

Fulfilment of the contract depends on the use of an identified asset

An asset would be identified if were explicitly or implicitly identifiable, and the supplier does not have a substantive right to substitute the asset.

A supplier would be regarded as having a substantive right to substitute the asset if he could:

- replace the asset without requiring the consent of the customer; **and**
- there are no barriers (economic or otherwise) that would prevent the supplier from replacing the asset.

The contract conveys the right to control the use of the identified asset

To satisfy this criterion, it must be demonstrated that the contract gives the lessee the right:

- **to direct the use of the identified asset; and**

  This condition is fulfilled when the contract conveys rights that give the customer the ability to make decisions about the use of the asset that most significantly affect the economic benefits to be derived from use of the asset throughout the term of the contract.

- **to derive the benefits from use of the identified asset.**

  A customer does not have the ability to derive the benefits from use of an asset if:

  - the customer can obtain the benefits from use of the asset only in conjunction with additional goods or services that are provided by the supplier and not sold separately by the supplier or other suppliers; and
  - the asset is incidental to the delivery of services because the asset has been designed to function only with the additional goods or services provided by the supplier.

The draft standard provides illustrations of these complex principles in a series of examples.

➲ Separating components of a contract and allocating the consideration

Once it has been determined that a contract is (or contains) a lease, the components of the lease must be identified in order to account for each of them separately.

The right to use an asset will be considered as a separate lease component if both of the following criteria are met:

- the lessee can benefit from use of the asset either on its own or together with other resources that are readily available to the lessee, and
- the underlying asset is neither dependent on, nor highly interrelated with, the other underlying assets in the contract.

Identifying each separate lease component must therefore be carried out from the lessee's point view, even when recognising a lease in the lessor's accounting.

The consideration (i.e. lease payments) is allocated:

- by the lessor, using the requirements of the future standard on Revenue Recognition;
- by the lessee, on the basis of the relative observable stand-alone prices for the lease components, if they are observable. Failing this, allocation methods will vary depending on whether there are no observable stand-alone prices, or whether the components for which no price is observable contain a lease component.

Lease term

The 2nd exposure draft defines the lease term as the non-cancellable period for which the lessee has the right to use an underlying asset.

This non-cancellable lease period includes:

a. periods covered by an option to extend the lease if the lessee has a significant economic incentive to exercise that option; and
b. periods covered by an option to terminate the lease if the lessee has a significant economic incentive not to exercise that option.

A decision as to whether a lessee has a significant economic incentive to exercise an option to extend a lease, or not to exercise an option to terminate a lease, is taken at the start of the lease.

Two types of leases

The single lease accounting model was strongly criticised on the grounds that it failed to recognise the economic reality of all leases, in particular in profit or loss.

Remember that under this model, a lessee would have recognised a right-of-use and a lease liability corresponding to the discounted value of the lease payments. The right-of-use would have been amortised on a straight-line basis over the lease term, and the lease liability would have generated interest expense calculated by the effective interest rate method, so that the total expense recognised would have diminished over the lease term.

To answer these criticisms, the boards propose to distinguish two lease categories:

- **Type A** leases: the lessee consumes more than an insignificant part of the economic benefits of the asset;
- **Type B** leases: the lessee consumes an insignificant part of the economic benefits of the asset.

For reasons of simplicity, the boards propose to assume that a lease belongs to one or other of these categories, depending on the nature of the leased asset.

Assets other than property:

Leases of assets other than property (for example, equipment, vehicles, etc.), would be assumed to be Type A leases, because the lessee generally consumes more than an insignificant portion of the asset. This assumption may be refuted if it can be shown that:

- the lease term is for an insignificant portion of the **economic life** of the underlying asset; **or**
- the present value of the lease payments is insignificant relative to the fair value of the underlying asset at the commencement date of the lease.

Property:

Property leases would be assumed to be Type B leases, because the lessee generally consumes only an insignificant portion of the asset. This assumption may be refuted if it can be shown that:

- the lease term is for **the major part of the remaining economic life** of the underlying asset, **or**
- the present value of the lease payments accounts for substantially **all of the fair value of** the underlying asset at the commencement date of the lease.

It should be emphasised that for both lessors and lessee, the accounting model would be determined by allocating the lease to either Type A or Type B.

➲ Lessee accounting

The exposure draft proposes an accounting model for lessees depending on whether the lease is Type A or Type B. In other words, the two models coexist, depending on whether the lessee consumes more than an insignificant portion of the asset.

"Amortisation and interest" model

The "amortisation and interest" model would apply to all Type A contracts.

Under this model, the lessee:

- would amortise the right-of-use asset on a straight-line basis (unless another systematic basis is more representative of the pattern in which the lessee expects to consume the right- of-use asset's future economic benefits); and
- would recognise the lease payments at amortised cost.

The total lease expenses (amortisation and interest) would thus diminish over the lease term. This model is similar to the finance lease model in IAS 17.

A "single expense" model

The "single expense" model would apply to all Type B contracts.

In this approach, the lessee would recognise a single expense over the lease term on a straight-line basis.

This approach entails adjusting the amortisation expense on the right-of-use so that the single lease expense, aggregating the interest charge on the lease liability (reducing over the lease term, under an "amortised cost at the effective interest rate" approach) and the amortisation expense on the right-of-use (increasing over the lease term), is accounted for on a straight-line basis over the lease term.

Comparative analysis of the two lessee models

Type A	Type B
Recognition of a lease liability (Discounted value of lease payments)	**Recognition of a lease liability** (Discounted value of lease payments)
Recognition of the "right-of-use" asset (Value of the lease liability plus any direct costs)	**Recognition of the "right-of-use" asset** (Value of the lease liability plus any direct costs)
Amortisation of the right of use (straight-line or other method)	**Single linear expense over the length of the lease term** (sum of the interest expense on the lease liability and the reconstituted amortisation over the lease term, such as to reduce the right-of-use value to zero over the lease term)
Recognition of interest on lease liability in profit or loss	

➲ Lessor accounting

For lessors, the exposure draft also proposes an accounting model for each of the two lease types.

Receivable and residual asset approach

The receivable and residual asset approach would apply to all Type A leases.

Under this model, the lessor:

- derecognises the leased asset,
- would recognise a lease receivable (discounted value of lease payments);
- would recognise a net residual asset,

> *The residual asset corresponds to the gross residual asset (the present value of the amount the lessor expects to derive from the underlying asset following the end of the lease term, discounted using the rate the lessor charges the lessee), less any unearned profit (difference between the fair value and the carrying amount of the underlying asset immediately before the commencement date, less the profit recognised at the commencement date).*

- and recognise any profit relating to the lease.

During the lease, the lessor recognises interest income on the lease receivable and the unwinding of the discount on the residual asset (calculated on the gross residual value).

An approach "similar to IAS 17 operating lease accounting"

An approach "similar to IAS 17 operating lease accounting" would apply to all Type B leases.

Under this model, the lessor:

- would retain the asset on the statement of financial position, and
- would recognise a lease income in profit or loss on a straight-line basis over the lease term (unless another systematic basis were more representative of the pattern in which income is earned from the underlying asset).

Comparative analysis of the two lessor models

Type A	Type B
Derecognition of the leased asset	**No impact on statement of financial position** (The leased asset remains on the statement of financial position)
Recognition of the lease receivable (Present value of the lease payments plus any direct costs)	-
Recognition of the net residual asset (Present value of the residual asset less any unearned profit)	-
Gain or loss resulting on the de-recognition of the asset at the commencement date (Difference between the lease receivable and the carrying amount of the leased asset, less the net residual asset).	-
Recognition of the interest income on the lease receivable and the unwinding of discount on the residual asset over the lease term	**Straight-line recognition of lease income** over the lease term

➲ A simplified accounting treatment for short-term leases

The second exposure draft offers the option to adopt a simplified accounting treatment for short-term leases, i.e. leases not exceeding a period of 12 months, renewal options included.

This choice of accounting principle for short-term leases would be made by class of underlying asset. If an entity opted for the simplified approach, it would not therefore have to classify short-term leases as Type A or Type B.

In this simplified model, only the lease payments will be recognised in profit or loss on a straight line basis, by both lessors and lessees.

➲ Disclosures

The 2nd Exposure draft proposes a very significant increase in the volume of disclosures, to meet the objective of enabling users of financial statements to understand the amount, timing and uncertainty of cash flows arising from leases.

To achieve this objective, both lessors and lessees would in future be required to provide quantitative and qualitative information on:

- its leases (general description, variable lease payments, lease payments with a termination option, purchase options, residual value guarantees, restrictions, information about leases that have not yet commenced but that create significant rights and obligations, etc.);
- significant assumptions and judgements made in applying the standard (the determination of whether a contract contains a lease, the allocation of the consideration in a contract between lease and non-lease components, and the determination of the discount rate);
- the amounts recognised in the financial statements relating to those leases (reconciliation between the opening and closing balances, variable lease payments recognised, year by year timing of undiscounted lease payments, etc.)
- etc.

What are we to make of the leases project?

The recently-published draft standard would, if adopted, constitute a major change in the way in which leases are accounted for, and would have a significant impact on the financial statements.

For lessees, all leases would in future be recognised in the statement of financial position, whereas this only applies to finance leases today.

For lessors too, the future standard would have significant repercussions although the accounting models for Type A and Type B leases look fairly similar to those for finance leases and operating leases in the existing IAS 17. Many leases presently classified as operating leases will become Type A leases, meaning that more assets would be derecognised.

The main ratios used by entities would therefore necessarily be affected (indebtedness, return on assets, EBITDA, operating margins, etc.), significantly increasing the risk of breach of covenant.

In operational terms, the new proposals are likely to be a rise in the costs of accounting for leases, due to the increasing complexity of accounting principles (analysis of leases, residual value, remeasurement, etc.), and to the enhanced disclosures required.

Impact of IFRS 7 amendment on the transfer of financial assets on the financial statements at 31 December 2012

The IFRS 7 amendment on disclosures regarding transfers of financial assets was of mandatory application for reporting periods commencing on or after1 July 2011. For many issuers, 30 June 2012 was therefore the first date on which they applied this amendment, so we originally thought it would be worthwhile to analyse the impact of this amendment on the disclosures in financial statements published at 30 June 2012.

The result of this survey (see Beyond the GAAP September 2012) unfortunately failed to meet expectations, mainly because most entities produced condensed interim financial statements at 30 June 2012, and because de facto the amendment gave rise to a limited number of additional disclosures, some entities opting to postpone this task until 31 December 2012, especially since the concept of continuing involvement in IFRS 7 has since been subject to clarifications.

Hence it was important to return to the impact of the IFRS 7 amendment, *Transfers of Financial Assets,* in the light of the financial statements published at 31 December 2012 by issuers in our sample (the 71 CAC 40 and Euro Stoxx 50 entities at 30 June 2012).

Below, we provide a summary of this survey. The full text can be consulted at http://www.mazars.com/Home/Our-expertise/Business-oriented-publications/Beyond-the-GAAP-Newsletter

➲ Background: What is in the IFRS 7 amendment?

Readers will remember that this amendment aimed to enable users of financial accounts to:

- understand the relationship between transferred financial assets that are not derecognised in their entirety and their associated liabilities; and
- assess the nature of an entity's continued involvement in derecognised financial assets, and the associated risks..

What the standard says

Entities must provide disclosures on (IFRS 7 paragraphs 42A to 42H):

- Transferred financial assets that are not derecognised in their entirety ;
- Transferred financial assets that are derecognised in their entirety, but in which the entity has continuing involvement; and
- The timing of transfers of financial assets, to highlight "window dressing" transactions (for derecognized assets).

The entity shall provide the required disclosures in a single note to the financial statements. For more details on the IFRS 7 amendment, see Beyond the GAAP, May 2012.

➲ How has the notion of continuing involvement been clarified?

Following a request from the IFRS IC, the IASB board confirmed that its intention, in publishing the IFRS 7 amendment on transfers of financial assets, was that servicing agreements would meet the definition of continuing involvement for the purposes of the IFRS 7 disclosures

However the board's position relies on the assumption that servicing agreements generally give rise to variable compensation reflecting the performance of the transferred assets.

In its recommendations for the 2012 reporting period, the AMF stressed that the concept of continuous involvement in IFRS 7 is not the same as that used in IAS 39 for determining if a transfer qualifies for derecognition: continuous involvement in IFRS 7, says the AMF, includes, for example, the risk of dilution. Therefore, as the dilution risk is only rarely transferred, this amendment should cover the majority of transfers of assets.

➲ What stands out from this first financial year of application of the IFRS 7 amendment?

The first lesson to be drawn from this survey concerns the proportion of issuers affected by transfers of financial assets, since almost half of them mention the subject (33 of the 71 entities in our sample, or 46%).

While, unsurprisingly, all the banks have provided disclosures on their transfer operations, nearly a third of industrial and service entities have done so, and have reported assignments of receivables, usually via securitisation operations.

One of the main features introduced by this IFRS 7 amendment is the mandatory publication of disclosures on fully derecognised operations. This has had a genuine impact, two-thirds of the 19 entities that reported such operations having significantly improved their disclosures on this subject by comparison with last year. Seven others also mentioned such operations that previously went unnoticed. All the entities disclosing these operations this time provided at least the nature and the carrying value of the transferred assets. However, the levels of information given on the nature and the evaluation of the risks to which the entity remains exposed are somewhat uneven, not least in terms of the importance of these operations to the entity. Thus the presentation of some of the information required by the standard, such as the dates of transfers of assets which resulted in derecognition or the cash outflows required for any re-purchase of derecognised assets, is not systematic.

Our survey allowed us to identify some examples of good practice for both disclosures of financial assets which were transferred but not derecognised, and disclosures of financial assets which were transferred and fully derecognised.

Frequently asked questions

- Accounting for customer loyalty programmes (IFRIC 13/IAS 18);
- Application of the IFRS 7 amendment to offsetting securities borrowing and lending arrangements;
- Counterparty risk in the valuation of derivatives;
- Hedging the exchange rate risk generated by the issue of dual currency bonds;
- Accounting treatment of an inflation-indexed debt in the interim accounts.

Upcoming meetings of the IASB, IFRS Interpretations Committee and EFRAG

IASB	Committee	EFRAG
14 - 21 June 2013	16 - 17 July 2013	12 - 14 June 2013
18 - 26 July 2013	10 - 11 September 2013	15 - 17 July 2013
12 - 20 September 2013	12 - 13 November 2013	4 - 6 September 2013

Beyond the GAAP is published by Mazars. The purpose of this newsletter is to keep readers informed of accounting developments. Beyond the GAAP may under no circumstances be associated, in whole or in part, with an opinion issued by Mazars. Despite the meticulous care taken in preparing this publication, Mazars may not be held liable for any errors or omissions it might contain.

The drafting of the present edition was completed on 24 June 2013

MAZARS