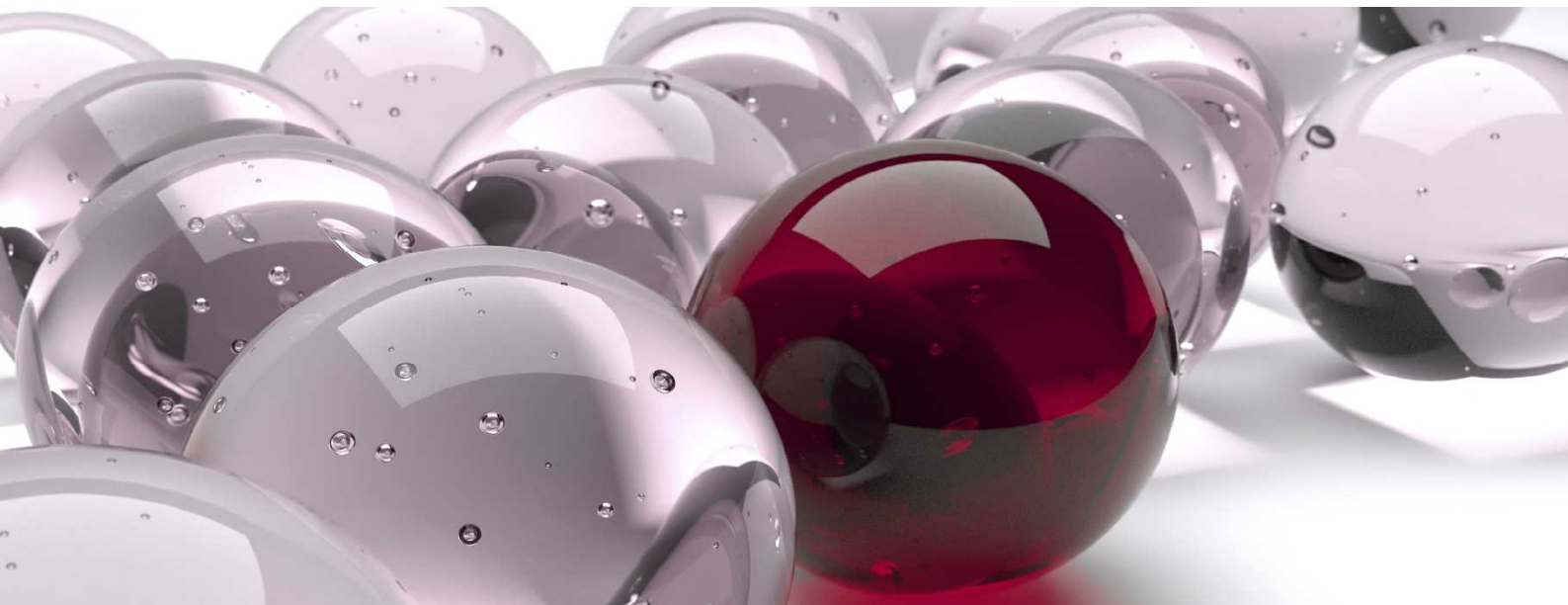


# Beyond the GAAP

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Mazars' newsletter on accounting standards



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## Editorial

As entities begin to analyse the future impact of IFRS 15, the IASB and the FASB have published the report of the first meeting of the Transition Resource Group (TRG), charged with identifying any application problems that deserve the attention of the Boards. This is an opportunity for Beyond the GAAP to return to these discussions, and to the items on the agenda of the second meeting of the TRG.

In parallel, and as happens every year around this time, ESMA has published its priorities for 2014 financial statements. The regulator focuses on the impact of the first application of the new consolidation standards in Europe, and on the importance of providing disclosures that are material, specific and relevant to understanding the performance and financial situation of the issuer. In this edition, Beyond the GAAP will guide you through these recommendations.

Enjoy your reading!

Michel Barbet-Massin      Edouard Fossat

## IFRS Highlights

### Leases: further redeliberations

The IASB and the FASB are continuing to redeliberate the proposals in the May 2013 Exposure Draft Leases. Final publication is now expected in the second half of 2015.

During the October meeting, the two Boards again discussed the definition of a lease. The Boards defined the lessor's substantive right to substitute the asset, and clarified when a lessee has the right to direct the use of the asset (the power to decide how and for what purpose the asset is used, including the right to change the way the asset is used throughout the period of use), if neither the lessor nor the lessee controls how and for what purpose the asset is used throughout the period of use.

### The IASB updated its work plan

At the end of its October meeting, the IASB updated its work plan. This included:

- The postponement of the publication of the Leases standard, now expected in the second half of 2015 (rather than at the end of 2014); and
- The postponement of the publication of the Disclosure Initiative Discussion Paper, now expected in Q2 2015 (rather than Q1).

The IASB work plan can be consulted on the IASB site at:

<http://www.ifrs.org/Current-Projects/IASB-Projects/Pages/IASB-Work-Plan.aspx>

## EUROPEAN highlights

### EFRAG feedback on the additional public consultation and outreach event on the Leases project

On 15 October 2014, EFRAG posted on its website a report that summarises the main findings from the additional public consultation and outreach event on the Leases project.

Readers will recall that last June, EFRAG and the standard setters in France (ANC), Germany (ASCG), Italy (OIC) and the United Kingdom (FRC) launched an additional public consultation on the Leases draft standard. On 15 September, EFRAG also organised an outreach event in Brussels to present the preliminary findings of the public consultation, and a debate was launched on the definition of a lease and the two accounting approaches supported by the IASB and the FASB respectively.

EFRAG presents the lessons of these events in these reports. The findings include:

- the majority of respondents (27 of the 42 who responded to this question) said that they would prefer to maintain or improve the existing IAS 17, claiming that the recognition of leases based on exposure to risks and rewards properly depicted their economic substance;
- of the 42 respondents that indicated their preference, 14 supported the IASB's approach, 12 supported the FASB's approach, and 16 supported neither the IASB's approach nor the FASB's approach;
- of respondents who expressed an opinion as to which approach was less complex and costly to implement, 20 identified the IASB's approach, 12 identified the FASB's approach and 6 believed that both approaches are complex and costly;
- respondents said that there should be further work on the scope of the future standard and/or on the definition of a lease.

In publishing these reports, EFRAG and the main European standard-setters seem to be sending to the IASB and the FASB the message that the joint project is not unanimously welcomed, and will upset many.

For more details about these reports, visit the EFRAG site at: <http://www.efrag.org/Front/n1-1395/EFRAG-s-feedback-report-on-the-additional-public-consultation-and-outreach-event-on-the-IASB-ED-Leases.aspx>

# A Closer Look

## IFRS 15 Transition Resource Group: what were the first topics discussed?

Last July, the joint working group set up by the FASB and the IASB to consider the potential implementation issues of IFRS 15 *Revenue Recognition*, the Transition Resource Group (TRG), met for the first time. The official report of this meeting was published by the IASB and the FASB at the end of October, just before the second group meeting on 31 October. An opportunity for Beyond the GAAP to return to the subject of the TRG and the first official discussions about the application of IFRS 15 on Revenue Recognition.

### 1. What is the TRG?

Readers will recall that the IASB and the FASB set up the TRG following the publication of IFRS 15 last May. The aim of the TRG is to keep the two Boards informed about the practical difficulties of applying IFRS 15 between now and its effective date at the beginning of 2017.

The TRG consists of 19 members representing financial statements preparers (including the sole French representative, Emmanuelle Cordano, Accounting Standards Director at Sanofi), auditors and users of financial statements from all backgrounds, although the prominence of Americans in this group is noteworthy. The TRG's debates are public, and are chaired by the vice presidents of the IASB and of the FASB. Representatives of the IOSCO, the SEC, the PCAOB and the AICPA also attend the TRG's meetings as observers. When it was set up, it was decided that the group would hold six meetings, two in 2014 (18 July and 31 October) and four in 2015 (26 January, 30 March, 13 July and 9 November).

The topics discussed by the TRG arise from the questions submitted during the consultation procedure set up by the IASB and the FASB. On the basis of these discussions, the IASB and the FASB assess whether additional research is necessary on any given topic, and whether IFRS 15 will need clarification or amendment.

### 2. Topics discussed at the July meeting and the next steps planned

During the first meeting in July, the TRG discussed four topics:

#### The recognition of gross versus net revenue when determining whether an entity is a principal or an agent:

While IFRS 15 carried over the indicators in the IAS 18 implementation guidance on the agent / principal distinction, it is not clear whether the previous conclusions can be reconsidered in the light of the general approach of the new standard, which states that an entity is a principal if it controls the promised good or service before its transfer to the customer. The implementation of this principle may be particularly complex in the case of Internet transactions involving intangible goods.

Members of the TRG noted that the current standards already required the use of significant judgment, and this would continue to be the case with IFRS 15. However, members were divided as to the possible impact of IFRS 15 on these judgments. At first sight, some TRG members thought that the outcomes under the new guidance were unlikely to be changed, given the replication in the new standard of the indicators in the existing standards (in IFRSs and US GAAP). However, other members suggested that the new general principle of recognising revenue based on the transfer of control could undermine the previous analyses.

Given this divergence, the members of Boards instructed the staff to perform additional research on the topic. The purpose of this research is to understand whether any improvements could be made to IFRS 15 to assist stakeholders with making judgments about the principal versus agent distinction. This topic will be readdressed when this research is complete.

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### **The presentation of specific amounts billed to customers as revenue or as a reduction of costs**

This issue concerned the re-billing of taxes levied on some sales and collected on behalf of government authorities, and amounts billed that included some out-of-pocket expenses (e.g. transport costs) incurred on behalf of the customer and not directly due to the delivery of the service.

Members of the TRG decided that IFRS 15 provides sufficient guidance on how to determine the appropriate presentation of amounts invoiced to customers in the income statement.

Because it is not expected that stakeholders will experience any difficulty in implementing this guidance, the Boards do not plan any further action at this time.

### **Application of the guidance on the recognition of the revenue from sales-based and usage-based royalties promised in exchange for a license of intellectual property**

Where contracts transfer not only an intellectual property licence but also other goods or services to a customer, the question arises of the interaction between two conflicting principles of revenue recognition within a single contract. IFRS 15 contains specific guidance on how to treat sales-based and usage-based royalties promised in exchange for a license of intellectual property. The revenue may only be recognised in the income statement when the further sale or use in question occurs. Now, the general principle for estimating variable consideration in a contract for the sale of goods or services (i.e. one which does not concern royalties relating to a license of intellectual property) is that the revenue (and therefore its recognition) must reflect the amount that is highly probably to be due to the entity.

TRG members had different views about how to interpret the scope of the IFRS 15 provision on the recognition of royalties arising from an intellectual property licence. More broadly, questions were raised about the treatment of licences under IFRS 15, and were put on the agenda for the meeting of 31 October. After this second TRG meeting, the two Boards will provide stakeholders with an update about their plan for addressing both the royalties issue and any additional license issues discussed.

### **Impairment testing of capitalised contract costs**

IFRS 15 states that, to determine whether capitalised costs should be impaired, entities should estimate the remaining amount of consideration that it expects to receive in exchange for the goods and services to which the asset relates. In practice, the question is whether entities should take account of contract extensions or renewals, since the standard is not clear on this topic (whereas it is clear as to the period to be considered when amortising assets of this type).

TRG members considered that an entity should in fact take account of contract renewals and extensions to determine the remaining amount of consideration it expects to receive.

Because stakeholders should be able to understand and apply the provisions of IFRS 15 as they stand, no further action is currently planned. Nonetheless, the two Boards have taken note of this point and will decide at a later date whether to make a technical correction or minor improvement to IFRS 15 to clarify their intent.

## **3. What topics were discussed at the second TRG meeting?**

The agenda for the October meeting of the TRG was as follows:

### **Customer options for additional goods and services and non-refundable upfront fees**

The question is how an entity should determine whether an option granted to a customer confers a material right which it would not obtain without concluding the contract. The consequence of conferring a material right is that the option gives rise to a separate performance obligation under the contract.

It also affects the recognition of non-refundable upfront fees. If these fees are an advance payment for future goods and services, they are recognised as revenue when the goods or services in question are transferred. When determining the timing of recognition, account must be taken of any contract renewal option if this option confers a material right on the customer. If so, the period over which the fee is recognized may extend beyond the initial contractual period.

### **Presentation of a contract as a contract asset or a contract liability**

IFRS 15 presents a new principle for presenting contract assets and liabilities in the statement of financial position. Readers will recall that, if one or other party to a contract has fulfilled its obligations, the entity shall present the contract on the statement of financial position as a contract asset or a contract liability, depending on the relationship between the entity's obligations and the payment made by the customer.

The questions at this stage are as follows: how should an entity determine the presentation of a contract that contains multiple performance obligations to be recognised separately? How should an entity determine the presentation of two or more contracts that have been combined in application of IFRS 15? When can an entity offset other balance sheet items against the contract asset or liability?

## Determining the nature of a license of intellectual property

The guidance on licenses in IFRS 15 raises a number of questions in practice. The new revenue recognition standard makes a distinction between ‘dynamic’ and “static” licences. This distinction affects the pattern of revenue recognition in the income statement, since:

- the grant of a licence which corresponds to a ‘right to access’ the entity’s intellectual property results in recognition of the related fees as revenue over time, i.e. as control of the license is transferred;
- the grant of a licence which corresponds to a ‘right to use’ the entity’s intellectual property results in recognition of the related fees as revenue at a point in time, that is, when the customer obtains control of the licence.

## Determining if the good or service provided is ‘distinct in the context of the contract’

This issue relates to one of the two criteria set out in the standard for determining whether a good or a service promised to a customer is distinct and should therefore result in a separately recognised performance obligation (where this good or service is not part of a series of distinct goods or services that meet the criteria given in IFRS 15 for recognition as a single performance obligation). The other criterion for determining whether a good or service is distinct is whether the customer can benefit from the good or service either on its own or together with other readily available resources (that is, the good or service is capable of being distinct).

IFRS 15 gives three indicators for determining whether a good or service is distinct in the context of the contract:

- Does the entity provide a significant service of integrating the good or service with other goods or services promised in the contract into a bundle of goods or services that represents the scope of the contract concluded with the customer?
- Does the good or service significantly modify or customize another good or service promised in the contract?
- Is the good or service highly dependent on, or highly interrelated with, other goods or services promised in the contract?

If the answer to one of these questions is yes, it may be concluded that the good or service provided is not distinct in the context of the contract and must not be recognised as a separate performance obligation.

In practice, several examples were brought before the TRG by stakeholders seeking guidance on how to apply these indicators and, in particular, how to determine whether the goods and services are highly interdependent. For example, in the case of the sale of a series of new goods for each of which the transfer of control occurs at a point in time (and which cannot therefore be a series of distinct goods corresponding to a single performance obligation under IFRS 15), does the existence of a learning curve affect the determination of whether goods or services are highly interrelated, which may imply that there is only one performance obligation?

## Contract enforceability and termination clauses

The question is how early termination clauses in a contract (which enable one or other of the parties to terminate the contract before the end of the contractual term) are evaluated in determining the duration of the contract under IFRS 15. This topic is particularly relevant to some telecommunications contracts which have a nominal duration but which can be shorter in practice, given the customer’s legal right to withdraw from the contract before it expires by paying an early cancellation fee.

The detailed discussions of all these topics, and an issue log summarising all the topics which the TRG has or will address in the light of current submissions, are available on the site of the IASB at the following address:

<http://www.ifrs.org/Meetings/Pages/Joint-TRG-for-Revenue-Recognition-October-2014.aspx>

Beyond the GAAP will keep you up to date with the TRG’s discussions on these and other topics, but also with the action plan introduced by the IASB and the FASB to resolve the practical difficulties of implementing IFRS 15.



# A Closer Look

## What are the ESMA priorities for 2014 financial statements?

On 28 October, ESMA published its priorities for 2014 financial statements:

<http://www.esma.europa.eu/content/Public-Statement-European-common-enforcement-priorities-2014-financial-statements>

In the introduction of this document, ESMA draws the attention of issuers to two topics of current interest, one specific to the banking sector and the other, more general, on disclosures in IFRS Financial Statements. These two topics are not explicit enforcement priorities but should be considered in preparation of 2014 financial statements.

For the banking sector, ESMA refers to the ECB's Comprehensive Assessment of the European banking sector that includes the Asset Quality Review (AQR), and expects that any material impacts of or following this exercise will be sufficiently explained.

On disclosures, ESMA emphasises the need to improve the quality and relevance of disclosures in the financial statements, and points out that this issue is at the heart of a number of discussions, including the IASB's Disclosure Initiative. ESMA underlines that the desired outcome is not a mechanical decrease in the number of items disclosed, but rather a level of disclosures that make them more relevant and useful to readers:

- *Focus the information on factors that are specific and relevant to understanding the issuer's financial position, its financial performance and its cash flows as well as the risks it incurs;*
- *Avoid, on the one hand, overloading financial statements with excessive detail that may not assist users of financial statements and, on the other hand, obscuring information as a result of too much aggregation.*

Beyond the GAAP presents the main ESMA's priorities, largely focus on the implementation of new standards, given the entry into force of the 'consolidated package'.

### 1. Presentation and preparation of consolidated financial statements (IFRS 10, IFRS 12)

#### The concept of control in IFRS 10

ESMA notes that, under IFRS 10, an investor controls another entity when it has power over the investee, is exposed to the variable returns of the investee, and is able to use its power to affect the reporting entity's returns.

ESMA indicates that it expects issuers to explain the judgments made in case of complex situations. Complex situations include the case where an investor holding less than a majority of voting rights controls an entity; such a case requires disclosures about the main judgments and

assumptions made in concluding that control exists within the meaning of IFRS 10.

#### Disclosures of non-controlling interests

After outlining the main requirements in IFRS 10 regarding the disclosures required about non-controlling interests (NCIs), ESMA encourages issuers to:

- *Mention to which operating segments the significant NCIs have been allocated;*
- *Disclose the profit or loss allocated to and dividends paid to NCIs;*
- *Disclose financial information about subsidiaries enabling users to understand the interests that NCIs have in the group's activities and cash flows;*
- *Clarify where applicable that none of the NCIs is individually significant, even if the overall amount of these NCIs is significant;*
- *Provide disclosures explaining how the significance of a NCIs has been determined.*

ESMA reminds that the summarised financial information presented should be the amounts before inter-company eliminations (IFRS 12.B11).

#### Restrictions

ESMA reminds issuers that they must:

- *Disclose the nature and extend of any significant contractual or statutory restrictions (such as 'protective rights') on their ability to access or use assets and settle liabilities, in particular related to transfers of cash and dividends or others capital distributions;*
- *Disclose the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the group (IAS 7.48).*

#### Structured entities

ESMA draws issuers' attention to the specific disclosure requirements of IFRS 12 with respect to the nature of the risks associated with their interests in consolidated structured entities and unconsolidated structured entities, recommending that:

*When these risks can have a material impact on an entity's financial statements, issuers should consider the level of information and aggregation that are relevant for users.*

## 2. Financial reporting by parties to a joint arrangement (IFRS 11, IFRS 12)

### Classification of joint arrangements

After outlining the broad principles of IFRS 11 setting out the distinction between a joint venture and a joint operation, and the recent IFRS IC discussions on various aspects arising from this issue (including determining when the analysis of the 'other facts and circumstances' suggests the presence of direct rights and obligations in substance, and the question of special purpose entities), ESMA notes that a joint arrangement is classified as a joint operation when:

- the parties have direct obligations for the liabilities, and direct rights to the assets; and
- these rights and obligations are enforceable.

Therefore, ESMA recommends entities with interests in special purpose entities to:

- *Update their analysis and take account of the conclusions of the IFRS IC when preparing their statements, and*
- *Disclose the analysis carried out.*

### Disclosure related to joint arrangements

ESMA encourages issuers to:

- *Provide disclosures about significant judgments and assumptions made in determining the joint arrangements classification notably in circumstances when the arrangement has been structured through a separate vehicle;*
- *Disclose information that will enable users of its financial to evaluate the nature, extent and financial effects of the entity's interests in joint arrangements;*
- *Consider quantitative and also qualitative information to assess whether a joint venture is material venture (for example, its strategic importance);*
- *For material joint ventures, present additional information on the statement of financial position and the income statement (including current and non-current financial liabilities, cash flows, and items such as interest and amortisation), regarding liabilities relating to interests in the joint venture and for the operating segment concerned.*

## Significant changes resulting from the first-time adoption of IFRS 10 and IFRS 11

ESMA recommends that:

- *Where there has been a change in the nature of control, including where there has been no change in terms of capital ownership, issuers should describe its impact, the judgments and assumptions made (including the investee-specific factors which led to a reassessment of the nature of control);*
- *Issuers should describe and explain the impact of the first application of the new standards.*

## 3. Recognition and measurement of deferred tax assets

ESMA notes that, because of the financial crisis and the current period of low growth, issuers must pay special attention to the recognition and measurement of deferred tax assets, including those due to tax loss carryforwards.

Therefore, ESMA recommends issuers to:

- *Disclose the significant assumptions made in their business plans, as losses can be carried forward over very long periods and the business plans that support the existence of future taxable profits are based on assumptions that are often highly judgmental;*
- *Disaggregate disclosures based on the characteristics of the tax losses, e.g. considering different time limits during which tax losses must be used;*
- *Disclose the period used for the assessment of the recovery of a deferred tax asset, the judgments made when determining it and the amount of tax losses carried forward for which deferred tax assets were recognised compared to the total tax losses carried forward that are available for each material tax group or entity.*

Finally, in the case of uncertain tax positions and in the light of the ongoing discussions in the IFRS IC, ESMA recommends to issuers to :

- *Disclose their accounting policy related to material uncertain tax positions.*

# Events and FAQ

## Frequently asked questions

### IFRSs

- IFRS 1 - Establishing an opening balance on acquisition of an entity obliging a listed company to present consolidated IFRS accounts
- Business combinations: how to determine the consideration transferred in a reverse acquisition
- Analysis of the deconsolidating impact of a factoring agreement for future tax credits
- Accounting for the distributions of a venture capital fund
- Traditional employee share-ownership plan: valuation of the lock-in conditions on shares granted to employees

## Upcoming meetings of the IASB, IFRS Interpretations Committee and EFRAG

### IASB

16 to 24 October 2014  
13 to 21 November 2014  
14 to 18 December 2014

### Committee

11 and 12 November 2014  
27 and 28 January 2015  
24 and 25 March 2015

### EFRAG

8 to 10 October 2014  
5 to 7 November 2014  
1 to 4 December 2014

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