

# Beyond the GAAP

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## Editorial

As we foresaw, the FASB and the IASB have decided to introduce amendments to their twin standards ASC 606 and IFRS 15 on revenue recognition. Although the amendments (and their due process) are likely to differ between the two Boards, the FASB taking a more prescriptive approach, they should not affect the principles of the standard, or the convergence achieved between the two accounting frameworks on the recognition of revenue.

In this edition, Beyond the GAAP will return to the main decisions taken by the Boards on the changes to be made to these standards before their first application.

We also welcome the appointment of M. Patrick de Cambourg (Honorary Chairman of Mazars) as president of the Board of the French accounting standards setter, the Autorité des normes comptables (ANC). The whole editorial team at Beyond the GAAP is convinced that he will be able to bring all the accounting skills of France together to make a valuable contribution to European and international accounting debates.

Enjoy your reading!

Michel Barbet-Massin      Edouard Fossat

# IFRS

## Amendment to IAS 1 on classification of current and non-current liabilities

On 10 February 2015 the IASB published an exposure draft aiming to clarify the criteria for classifying liabilities as either current or non-current on the balance-sheet. This exposure draft takes the form of a limited draft amendment to IAS 1 -Presentation of Financial Statements.

Readers will recall that in May 2012 the IASB published a draft IAS 1 amendment as part of its Annual Improvements programme. The standard-setter proposed to create a link between the classification of a liability as current or non-current and the provisions on the 'derecognition' of a financial liability in IAS 39. This proposal was abandoned as a result of the comments received during the written consultation process.

The 2015 exposure draft clarifies that the classification of the liability is based on the entity's rights at the end of the reporting period; the liability is only classified as non-current if at that date there is a right to defer settlement for at least 12 months after the reporting period.

If the obligation is refinanced, this right - as we understand it - may result either from a clause existing from inception in the initial loan contract, or from an amendment to the initial arrangement concluded before the reporting date (that is, when renegotiating the term of the initial loan).

The draft amendment also clarifies that the settlement of the liability may take any of the following forms: cash, equities, or other assets or services which extinguish the liability.

The exposure draft proposes that the amendment should be applicable retrospectively with effect from an as-yet undecided date. The comments period runs until 10 June 2015.

## The IASB work programme

Following its February meeting, the IASB updated its work programme. This included changing the name of the greenhouse gas emissions research programme (the Emissions trading schemes project), in response to January's decision by the IASB to start again from scratch on this project and to cancel all the previous tentative decisions taken by the Board.

To mark this new start it will in future be known as the "Pollutant pricing mechanisms" project.

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>

## Leases: how will they be defined in the future standard?

On 24 February, the IASB staff published a Project Update on the definition of a lease. This document sets out the consequences of decisions taken by the two Boards in the course of their redeliberations of the scope of the future standard.

In particular, it clarifies that a lease is a contract that conveys to the customer the right to use an asset for a period of time in exchange for consideration. For there to be a lease within the meaning of the future standard, the contract must:

- relate to an identified item, and
- convey to the customer the right to use the item for the specified period of time, which entails exclusive use of the item and control over the way it is used.

Contracts not meeting this definition will be classified as service contracts. The Project Update contains six hypothetical examples illustrating how to distinguish a lease from a service contract.

This document can be consulted on the IASB site at the following address:

<http://www.ifrs.org/Current-Projects/IASB-Projects/Leases/Documents/Leases-Project-Update-February-2015.pdf>

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# A Closer Look

## New standard on revenue recognition: the IASB and the FASB review the guidance on licences and performance obligations

During their February 2015 joint meeting, the IASB and the FASB discussed some implementation issues of the new standards on revenue recognition (IFRS 15 and ASC 606 respectively) identified during the meetings of the Transition Resource Group (TRG).

The discussions focused on:

- The recognition of licences of intellectual property granted to customers;
- The identification of performance obligations.

These discussions led the IASB and the FASB to tentatively decide to amend some aspects of the standard. However, their decisions are not strictly identical, due to divergent views on the necessity of providing answers to the practical implementation issues already raised.

The IASB takes the line that it would be dangerous to re-open specific issues, since this could have unintended consequences for other aspects of the standard. The IASB also believes at this stage that most of the topics raised in the TRG are a matter of applying judgment to principles which are sufficiently clear.

However, the FASB is under pressure from US stakeholders to provide more guidance on the principles of the new standard. As expected, abandoning numerous, familiar and consistently applied rules is proving to be a complex matter. Hence the FASB has decided to clarify the new standard whenever required in the light of the issues raised, without calling into question the underlying principles. At this stage therefore, it seems that the convergence between the IFRS and US texts will be maintained overall.

The decisions taken by the IASB and the FASB on each of the topics discussed in February, which remain tentative at this stage, should be confirmed at the end of the respective due processes conducted by these bodies. It appears that the FASB has decided to move fast and to publish updates to the standard as they are ready. The IASB has instead opted to wait for its June 2015 meeting to vote on the publication of an exposure draft bringing together all the suggested amendments to IFRS 15 that may have been identified by then.

The effective date for these amendments was not formally discussed but should reflect the effective date of the new standard on revenue recognition. This subject is under consideration by the FASB, which will probably announce its position on postponement by one year early in the second quarter of the year. The IASB has taken up no formal position, but has indicated that it will pay close attention to the FASB's decision on this subject. The February discussions suggest that the IASB is gradually becoming aware that postponement is more and more inevitable, especially if IFRS 15 is to undergo amendment before 1 January 2017.

Below, Beyond the GAAP presents the main tentative decisions taken during the February 2015 meeting.

### 1. Licences of intellectual property

#### Determining the nature of the entity's promise

IFRS 15 requires entities to determine whether a promise to grant a licence to a customer consists of granting a right to access the entity's intellectual property (a "dynamic" licence) or a right of use of its intellectual property (a "static" licence). In the first case, the revenue is recognised over time, as the obligation is satisfied. In the second case, the revenue is accounted for at a given point in time.

To make the distinction between dynamic and static licences, the revenue recognition standard imposes conditions for the identification of dynamic licences:

- the contract requires or the customer reasonably expects that the entity will undertake activities that significantly affect the intellectual property to which the customer has rights;
- the rights granted by the license directly expose the customer to any positive or negative effects of the entity's activities;
- those activities do not transfer a distinct good or service to the customer.

It is the first condition which raises the most practical questions. Stakeholders wonder about what type of activities are likely to significantly affect the intellectual property concerned by the contract with the customer. They also wonder how to assess the extent of this impact:

- is it a matter of the extent to which the form and functionalities of the underlying intellectual property are affected by the entity's activities?
- is it a matter of how far the value of this intellectual property is impacted? or
- should they consider how far both the form and functionalities of the intellectual property *and* its value are affected?

The two Boards have tentatively decided to clarify the guidance in this area. Hence the grant of a licence of intellectual property will be considered as a right of access to the intellectual property where the contract requires (or the customer reasonably expects) the entity to carry out activities (that do not transfer a good or service to the customer) that significantly affect the "utility" of the intellectual property to which the customer has rights.

This will be the case when:

- the expected activities of the entity are expected to change the form (for example, the design) or the functionality (for example, the ability to perform a function or task) of the intellectual property to which the customer has rights; or
- the value of the intellectual property to the customer is substantially derived from, or dependent upon, the expected activities of the entity. For example, the value of a brand or logo is typically derived from, and dependent upon, the entity's ongoing activities that support or maintain the intellectual property.

In addition, the Boards tentatively decided to clarify that when intellectual property has significant standalone functionality (that is, the ability to process a transaction, perform a function or task, or be played or aired), such as software or multimedia content, a substantial portion of its utility is derived from that functionality and is unaffected by activities of the entity that do not change that functionality (such as promotional activities).

The FASB also tentatively decided to clarify ASC 606 to indicate that when an entity grants a licence to "symbolic" intellectual property (that is, intellectual property that does not have significant standalone functionality, such as brands, team or trade names, or logos), it is presumed that the entity's promise to the customer in granting a licence includes undertaking activities that significantly affect the utility of the intellectual property to which the customer has rights. In other words, it will be assumed that licences of this type correspond to a right of access to the entity's intellectual property, with the revenue recognised over time.

### Determining when an entity should assess the nature of a licence

Under some circumstances, it may have been originally considered that the grant of a licence of intellectual property does not correspond to a performance obligation distinct from other goods or services promised in the contract.

In this instance, the TRG was asked whether the nature of the licence should nevertheless be assessed (see the previous point discussed by the two Boards) in order to determine how to recognise the revenue for a performance obligation including the grant of a licence of intellectual property, where this is a significant part of the performance obligation under consideration.

The IASB decided not to modify IFRS 15 in this respect, regarding the guidance currently provided in the standard, including the basis for conclusions, as adequate. In reaching this conclusion, the IASB refers in the IASB Update to paragraphs 59 to 64 of Agenda Paper 7B prepared by the staff for this meeting:

<http://www.ifrs.org/Meetings/MeetingDocs/IASB/2015/February/AP07B%20Revenue.pdf>

However, the FASB decided to clarify in Topic 606 that, in some cases, an entity would need to determine the nature of a licence that is not a separate performance obligation in order to apply satisfactorily the general principles of revenue recognition (i.e. a distinction must be made between revenue recognised over time and that recognised at a point in time) to a performance obligation that covers the transfer of several goods or services including the grant of a licence of intellectual property.

### Sales-based or usage-based royalties

The IASB and the FASB have both decided to clarify the scope and applicability of the application guidance on sales-based or usage-based royalties received in exchange for a licence of intellectual property. This guidance is an exception to the general approach to estimating variable consideration that states that an entity shall recognise such revenue only to the extent that it is 'highly probable' that a significant reversal in the amount of cumulative revenue recognised to date will not occur. An entity shall recognise revenue for a sales-based or usage-based royalty promised in exchange for a licence of intellectual property only when (or as) the later of the following events occurs:

- the sale or usage occurs; and
- the performance obligation to which the sales-based or usage-based royalty is allocated has been satisfied (or partially satisfied).

The two Boards have tentatively decided that:

- where a contract concluded with a customer includes the grant of a licence of intellectual property and the transfer of other goods or services, an entity should not split a single royalty into a portion subject to the sales-based or usage-based royalties exception and a portion subject to the general guidance on variable consideration (including the constraint on variable consideration);
- the sales-based or usage-based royalties exception should apply whenever the predominant item to which the royalty relates is a licence of intellectual property.

## 2. Identifying performance obligations

### Identification of the promises in contracts concluded with customers

See Beyond the GAAP no 85 for a description of the issues discussed in the TRG meeting of January 2015.

The IASB decided not to make changes to IFRS 15 on the grounds that the standard is clear and that judgment is required to assess whether a promise to transfer a good or service to a customer is sufficiently material for an entity to apply the guidance on the 'distinct' nature of this good or service.

However, the FASB tentatively decided that an entity is not required to identify goods or services promised to the customer that are immaterial in the context of the contract. Nor would an entity be required to assess the materiality of all of these elements at the level of the entity's financial statements.

### Assessment of a "distinct" good or service within the context of the contract

This subject continues the TRG discussions of October 2014 (see Beyond the GAAP no 82).

There are practical questions about how to apply the condition in paragraph 27(b) of IFRS 15 (how to assess whether an entity's promise to transfer a good or service to the customer can be identified separately from the other promises in the contract?) and the factors listed in paragraph 29 (for example, does the entity provide a significant service of integrating the goods or services promised in the contract?).

The IASB and the FASB have tentatively decided to add some illustrative examples to clarify how to apply the guidance in IFRS 15 and Topic 606. Unlike the FASB, the IASB has decided not amend the aforementioned paragraphs of the standard. The FASB has said that it will incorporate amendments to clarify the principle of a good or service that is distinct "within the context of the

contract" and the factors to be taken into account to assess this principle will be adapted accordingly.

In its February 2015 Update the IASB nevertheless noted that the discussion and the analysis of the issues presented in paragraphs 34 to 43 of Agenda Paper 7C could help educate and inform practice. This paper is available at the following address:

<http://www.ifrs.org/Meetings/MeetingDocs/IASB/2015/February/AP07C%20Revenue.pdf>

### Shipping and handling activities

The FASB has been asked whether the activities carried out by entities in the course of shipping and handling a good should be considered as promises to customers to transfer specific services within a contract (in which case it would be necessary to allocate to them revenue that could only be recognised when the obligation is satisfied) or whether these activities correspond to the costs of performing the contract.

The FASB indicated that it would amend Topic 606 to clarify that:

- shipping and handling activities that occur before the customer obtains control of the related good are activities that an entity must carry out to fulfil the contract ("fulfilment activities"), and no revenue is therefore allocated to them as no additional service is transferred to the customer;
- an entity may, as an accounting policy election, account for shipping and handling activities that occur after the customer has obtained control of a good as fulfilment activities. In other words, some revenue should generally be allocated to these activities in this case, but a practical expedient should be available to enable entities to avoid the allocation of revenue to potentially immaterial elements of a contract.

The IASB has so far taken no decision on this issue, since it does not yet know whether the matter has arisen for stakeholders applying IFRSs.

# Events and FAQ

## Frequently asked questions

### IFRSs

- Treatment of acquisition costs when exercising the purchase option in a leasing contract (in IFRS);
- Accounting for uncalled subscription commitments in IFRS;
- Impairment test: impact of options recognised in “Other elements of non-controlling interests” when accounting for a business combination;
- Shared-based payments (IFRS 2) settled by the majority shareholder: how are these accounted for in the financial statements of the entity receiving the services?

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

IFRS		EFRAG	
IASB	Committee	Board	TEG
16-20 March	24-25 March	11 March	31 March – 2 April
27-30 April	12-13 May	22 April	6-8 May
18-22 May	14-15 July	24 June	10-12 June

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