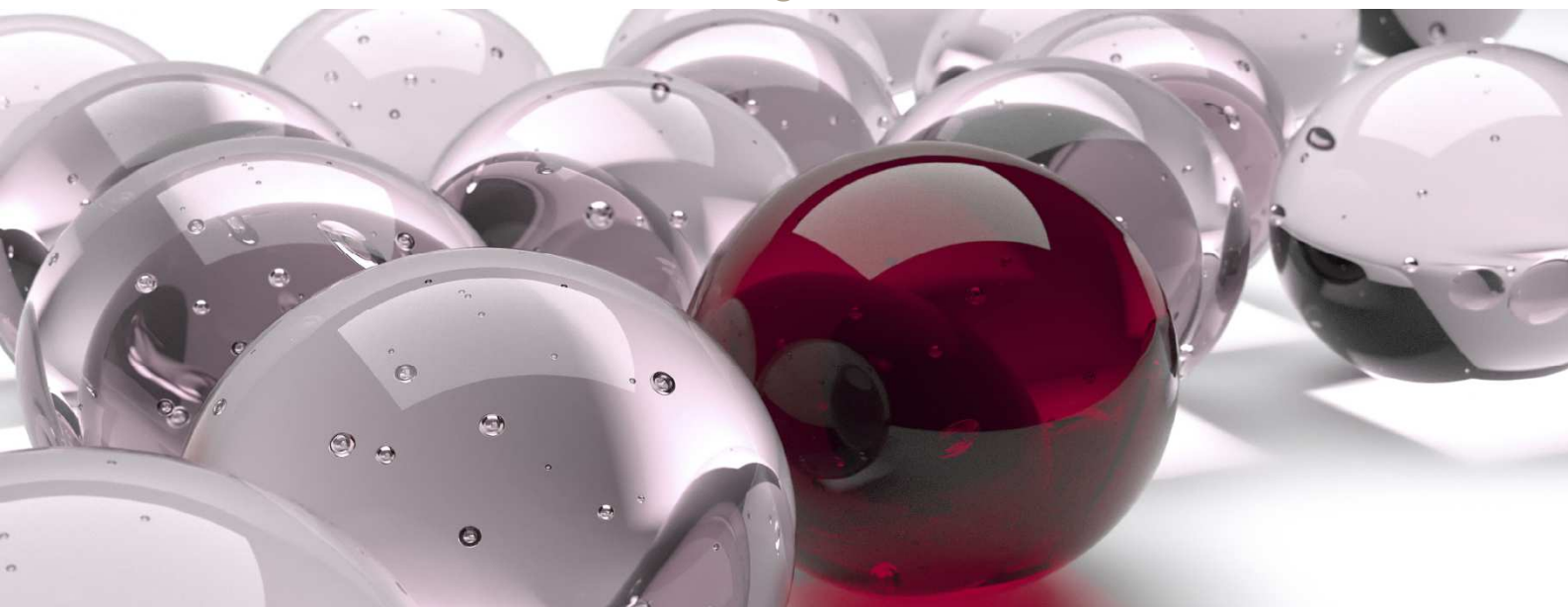


# Beyond the GAAP

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Mazars' newsletter on accounting standards



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## Editorial

As expected, following the FASB decision to defer the mandatory effective date of Topic 606, the IASB has now followed in its wake. An exposure draft will shortly be published proposing to defer the effective date of IFRS 15 to 1 January 2018. These decisions are a consequence of the work conducted in the TRG on the implementation difficulties of these twin standards, which will result in the upcoming publication of proposed amendments.

The IASB has replicated the TRG model to the impairment of financial instruments. The IFRS Transition Resource Group for Impairment of Financial Instruments (ITG) held the first of its quarterly meetings in April.

However, unlike the TRG, this discussion forum will focus exclusively on IFRSs, since the IFRS 9 model differs from the US model. It will therefore not be subject to the agenda of US regulators in reaching its decisions.

As in the case of IFRS 15, Beyond the GAAP will keep you up to date with the discussion held in this group.

Enjoy your reading!

Michel Barbet-Massin      Edouard Fossat

## IFRS Highlights

### ITG starts its discussion of implementation issues related to the impairment of financial instruments under IFRS 9

22 April saw the first technical meeting of the expert group appointed to analyse implementation issues raised by the new impairment model in IFRS 9. This discussion forum, known as the ITG (the IFRS Transition Resource Group for Impairment of Financial Instruments), will inform the IASB of the issues raised, and its members will share their views. The ITG will not however issue guidance on IFRS 9. This task remains with the IASB, which alone will determine the best way to address any difficulties identified.

The following subjects were discussed on 22 April:

- Methods of incorporating forecasts of future economic conditions when measuring expected credit losses;
- The scope of loan commitments to which the new impairment model will apply;
- The measurement date for expected credit losses;
- The assessment of significant increase in credit risk for guaranteed debt instruments;
- The maximum period to consider when measuring expected credit losses;
- The application of the new impairment model to revolving credit facilities;
- Measurement of expected credit losses for an issued financial guarantee contract.
- Measurement of expected credit losses in respect of a modified financial asset.

The documents prepared by the IASB staff describing these issues are available on the IASB site at:

<http://www.ifrs.org/Meetings/Pages/ITG-meeting-April-2015.aspx>.

The next ITG meetings are scheduled for 16 September and 11 December 2015. They can be followed live via a webcast by anyone interested in the subject.

### FASB published its strategic plan

On 9 April 2015, the US accounting standard setter, the FASB, published its Strategic Plan in conjunction with its counterpart the Governmental Accounting Standards Board (GASB) and their oversight body, the Financial Accounting Foundation (FAF), after consultation with their respective stakeholders.

Their collective vision is to be a recognised leader in financial accounting and reporting.

This vision translates into a mission to:

- establish and improve financial accounting and reporting standards to provide useful information to investors and other users of financial reports; and
- educate stakeholders on how to most effectively understand and implement those standards.

In strategic terms, the FASB aims:

- to promote excellence in standard setting;
- to participate actively in the development of IFRSs; and
- to enhance its relationships with other national and regional standard setters, as long as these relationships are beneficial and contribute to reducing unnecessary differences among standards used internationally. However, the FASB may conclude that the best interests of its own capital markets outweigh the goal of completely converged accounting standards.

The FASB's Strategic Plan is available at the following address:

[http://www.accountingfoundation.org/cs/ContentServer?c=Document\\_C&pagename=Foundation%2FDocument\\_C%2FFAFDocumentPage&cid=1176165920376](http://www.accountingfoundation.org/cs/ContentServer?c=Document_C&pagename=Foundation%2FDocument_C%2FFAFDocumentPage&cid=1176165920376)

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## Coming soon: an exposure draft to defer the effective date of IFRS 15 to 1 January 2018.

On 28 April 2015, the IASB announced the publication of an exposure draft proposing a one year deferral of the effective date of IFRS 15, originally set at 1 January 2017. Unsurprisingly, the Board has followed its staff's recommendation and, in particular, the FASB's tentative decision on Topic 606 at the beginning of the month (cf. Beyond the GAAP, March 2015).

As well as the desire to keep the effective date of the IASB's and the FASB's revenue Standards aligned, this deferral can also be explained by the fact that the IASB expects to publish an exposure draft proposing clarifications to the standard, stemming from the TRG discussions.

The comment period should be short, the IASB expecting to reach a final decision on the effective date during its July meeting.

## IASB unveils its mission statement

On 15 April 2015, during the meeting of IFRS Foundation Trustees in Toronto, the IASB unveiled its mission statement, which is summarised in the following terms:

“Our mission is to develop International Financial Reporting Standards (IFRSs) that bring transparency, accountability and efficiency to financial markets around the world. Our work serves the public interest by fostering trust, growth and long-term financial stability in the global economy.”

Accordingly, IFRS:

- brings transparency by enhancing the international comparability and quality of financial information, enabling investors and other market participants to make informed economic decisions;
- strengthens accountability by reducing the information gap between the providers of capital and the people to whom they have entrusted their money, and to regulators;
- contributes to economic efficiency by helping investors to identify opportunities and risks across the world. For businesses, the use of a single, trusted accounting language lowers the cost of capital and reduces international reporting costs.

This mission statement is available at the following address:  
<http://www.ifrs.org/About-us/Pages/IFRS-Foundation-and-IASB.aspx>

## EUROPEAN highlights

### EFRAG recommends the endorsement of IFRS 9

On 4 May 2015, EFRAG published its draft endorsement advice on IFRS 9 *Financial Instruments*, calling for comments by 30 June 2015.

In its letter, EFRAG says that it believes the standard:

- meets the requirements for providing relevant, reliable, comparable and understandable financial information needed for supporting the decisions of the users of financial statements;
- would lead to prudent accounting;
- would not be contrary to the true and fair view principle; and
- would be conducive to the European public good.

EFRAG therefore recommends that the standard be endorsed.

For more details, see the EFRAG site at:

<http://www.efrag.org/Front/n1-1473/EFrag-requests-comments-on-its-draft-endorsement-advice-on-IFRS-9-Financial-Instruments.aspx>

# A closer look

## An overview of the main subjects discussed by the TRG at its March 2015 meeting

On 30 March 2015, the TRG met once more to discuss issues raised by stakeholders in the course of implementing IFRS 15.

The questions discussed in this fourth meeting addressed the following subjects:

1. Series of distinct goods or services;
2. Consideration payable to a customer (this subject is to be investigated further by the FASB staff);
3. Warranties;
4. Significant financing components;
5. Allocation of the transaction price for discounts and variable consideration
6. Granting the customer a material right to acquire options for additional goods and services;
7. Partial satisfaction of performance obligations prior to identifying the contract in accordance with criteria in step 1.

Because of technical problems, London-based TRG members and members in New York were only able to discuss some of these topics together (all of point 5 above, and part of point 6). The vice-chairman of the IASB and the vice-chairman of the FASB agreed to get together at the end of the meeting to update each other on the views expressed on either side of the Atlantic. While awaiting the official summary of this meeting, which will be distributed ahead of the next meeting scheduled on 13 July, Beyond the GAAP here takes the opportunity to report on some of the issues raised by stakeholders and the initial responses of TRG members in London (unofficial summary).

### 1. Series of distinct goods or services

IFRS 15 states that a series of distinct goods or services which are substantially the same and have the same pattern of transfer to the customer (i.e. transfer to the customer of control over these goods or services over time, and a consistent method of measuring progress) corresponds to a single performance obligation (rather than to several performance obligations for each of the distinct goods or services in the series).

However, the accounting consequences are not always the same as in the situation where an entity has determined that it has only one single performance obligation, but that this is because the promised goods or services are not “distinct in the context of the contract” (for example, because the goods or services are highly interrelated or customised, and the customer buys them as a bundle).

For example, the provisions on contract modifications do not have the same impact if the additional goods and services are distinct from the goods and services initially provided. In practice, the addition of a good to a series (meeting the definition of a single performance obligation) is accounted for on a prospective basis if the price for this good does not reflect its stand-alone price, while the modification of a partly-satisfied performance obligation corresponding to a bundle of goods or services that are not distinct will be treated on a cumulative catch-up basis at the modification date (if the modification price does not reflect the stand-alone price of the item added or removed).

Two questions were put to the TRG:

- Do the series provisions apply when there is a gap or an overlap in the entity’s performance (for example in the entity’s delivery of goods or performance of services, given the pattern of delivery or performance)? The word ‘consecutively’ appeared in the draft versions of the standard but was not taken up in the final version except in the basis for conclusions. Stakeholders therefore questioned whether it was necessary to have delivered the goods or performed the services ‘consecutively’ in order to apply the series guidance (which is mandatory if the conditions stipulated in IFRS 15 are satisfied).
- Should the application of the series provisions lead to the same accounting result as if these had not been applied?

On the first question, the TRG acknowledged that the basis for conclusions could create a contradiction with the standard itself. However, since the standard does not explicitly state that the goods or services must be delivered or performed consecutively, this does not seem to be a prior condition for the application of the series provisions.

On the second question, TRG members confirmed the staffs' view that the accounting effects when applying the series guidance were not necessarily identical to those resulting from the recognition of several distinct goods or services each corresponding to a performance obligation (for example, in the case of the effect of a learning curve).

More generally, the discussion addressed the mandatory nature of the series guidance, which may appear to conflict with the idea of offering a practical expedient (as in the 2<sup>nd</sup> exposure draft in 2011). In practice, the fact that application of these provisions may have a different outcome from that which would otherwise have been the case may reinforce an understanding that the choice is left to preparers.

#### Key points

1. A contract for the delivery to the customer of a series of 'similar' goods may be considered as a single performance obligation even if the deliveries are not consecutive.
2. The analysis of a series as a single performance obligation or as a succession of distinct performance obligations is important, because it can lead to significant differences in the accounting treatment.

## 2. Warranties

IFRS 15 contains a number of provisions on the accounting treatment of warranties. These must either be recognised in accordance with IAS 37, in the case of statutory and similar warranties, or as a distinct performance obligation if the warranty is optional, or if it offers the customer a service in addition to the assurance that the product complies with agreed-upon specifications. In the second case, a proportion of the transaction price is allocated to the warranty from inception and is recognised over the warranty period. The standard lists the factors to be considered when determining this distinction.

A practical question was raised in the case where a product carries an unlimited warranty (a promise made by a luggage company to repair damaged or broken luggage free of charge for the lifetime of the luggage, whatever the cause of the damage) which was not separately priced in the contract. Is this a service distinct from the sale of the luggage?

TRG members spent very little time discussing this question, as they thought that the provisions of IFRS 15 are sufficiently clear and that, in the case at hand, a separate performance obligation should probably be identified for the warranty. However, other situations could present more complexities.

#### Key points

The TRG decided that there was no need for further guidance to help distinguish those warranties that should be accounted for as separate performance obligations.

## 3. Significant financing components

IFRS 15 requires the amount of consideration to be adjusted when the contract contains a significant financing component. The standard gives clear guidance as to the situations in which it is possible to say that a contract includes no significant financing component. This is the case where the difference between the promised consideration and the cash selling price of the good or service arises for reasons other than the provision of finance to either the customer or the entity, and the difference between those amounts is proportional to the reason for the difference (see IFRS 15.62(c)). For example, IFRS 15 suggests that the payment terms might provide the entity or the customer with protection from the other party failing to adequately fulfill some or all of its obligations under the contract.

One of the questions raised by stakeholders is whether this paragraph should be interpreted broadly, leading to the exclusion of many contracts from the scope of the provisions on the identification of a significant financing component, or should only be applied in strictly limited circumstances.

The staffs advised that a careful reading of the IFRS 15 provisions would lead entities to find a way between these extremes, and that it was a matter for judgment.

The TRG's discussions mainly addressed the changes that should follow the application of the provisions of IFRS 15 on the existence of a significant financing component in a contract. In practice, few transactions were previously adjusted to take account of financial effects. IFRS 15 contains much more detailed guidance, and treats identically the situations in which customers pay in advance and those where they pay in arrears. The application of paragraph 62(c) is a matter of judgement, knowing that in practice IFRS 15 does not give any guidance on how to conduct a breakdown between what genuinely relates to the financing of the transaction and what relates to something else.



## Key points

1. Many more contracts should be adjusted to take account of the effects of a significant financing component under IFRS 15;
2. However, the staff believe that cases where no financing component should be identified despite a significant gap between the date of payment and the date the obligation is performed will not be exceptional;
3. Judgment must be exercised to determine whether a financing component should be identified, and if so, how.

## 4. Granting the customer a material right to acquire options for additional goods and services

The main topic addressed by the TRG in March 2015 was the accounting treatment of a customer's exercise of a material right to acquire additional goods or services. Readers will recall that in such cases a part of the transaction price is assigned at inception to this right, which corresponds to a distinct performance obligation. How should we account, as an example, for a contract with a fixed tranche at inception and conditional- that is, optional - tranches, at the time where a conditional tranche, corresponding to a 'material right' under IFRS 15, is actually validated by the customer?

A number of views were presented by the staffs:

- **View A:** The exercise of a material right should be accounted for as a continuation of the contract because the current contract contemplates the additional goods or services subject to the material right. In practice, an entity should account for the exercise as a change in the transaction price of a contract in accordance with paragraphs 87 to 90 of the standard, allocating the additional consideration to the underlying performance obligation and recognising it when the performance obligation is satisfied.
- **View B:** The exercise of a material right should be accounted for as a contract modification, considering that the additional transaction price received and/or the additional goods and services provided when the material right is exercised represent a change in the price and/or the scope of the contract. The provisions on contract modifications in paragraphs 18 to 21 of IFRS 15 should thus be applied. In some cases, if the exercise of the right modifies a performance obligation that is partly satisfied at the modification date, these provisions would require an entity to recognise a cumulative catch-up adjustment to revenue with immediate effect on the modification date. In other and generally more frequent cases, the modification would be treated on a prospective basis, usually producing the same result as View A;

- **View C:** The exercise of a material right should be accounted for as variable consideration, in accordance with the IFRS 15 provisions in paragraphs 50 to 54 and 56 to 58.

The staffs believe that the guidance provided in IFRS 15 may lead to the application of either View A or View B. However, they also note that the nature of the material rights granted to customers may vary considerably from one entity to the next (for example, loyalty programmes, vouchers for acquiring future purchases or renewal options in contracts) and that judgment will be required to determine the most relevant accounting treatment in practice.

Overall, TRG members confirmed that the standard was not necessarily very clear in its guidance for such circumstances. View A nevertheless seemed the most intuitive solution, and the easiest to apply, although it was not possible to formally exclude View B. But they indicated that this should not be a policy election for the entity: the application of View A or View B must depend on the facts and circumstances.

## Key points

The TRG's discussions apparently give priority to the treatment of a customer's exercise of a material right to acquire additional optional goods or services as a part of the price of these additional goods or services. The value allocated to the material right is then recognised as revenue when the additional obligation is satisfied.

However, given the debates, it would be wise to wait for the official TRG summary of the meeting for confirmation.

## 5. Partial satisfaction of performance obligations before identifying the contract in accordance with criteria in step 1

IFRS 15 lists a number of criteria for identifying the date at which a contract with a customer comes into existence for the purposes of the standard. It may come about that an entity will carry out some activities before concluding a contract in accordance with IFRS 15. Let's take the example of a real estate development, where construction does not start until 60% of the development has been sold. How should we account for the revenue and costs for those contracts, representing the remaining 40% of the development, which will be signed subsequently (but for which work is incurred as soon as construction begins)?

The TRG quite quickly came to agree with the staffs' opinions that:

- Revenue for contracts for which activities commenced before the contract establishment date (CED) meaning the date on which criteria under step 1 are first met should be recognised on a cumulative catch-up basis at the date on which the contract criteria are satisfied, to reflect the performance obligations already satisfied or partly satisfied at that date;
- Costs incurred should be capitalised as costs to fulfil an expected contract (provided that the criteria in paragraph 95 of the standard are satisfied) until the date at which a contract exists under IFRS 15. These costs would be expensed immediately at the date at which the criteria for identifying a contract are met if they relate to costs incurred for goods or services transferred to the customer at that date. Otherwise, the asset would be amortised during the period over which the remaining goods or services are delivered or performed.

According to the staffs, this approach would result, at the CED and in future periods, in the same cumulative result (in terms of recognition of income and expenses, and hence the margin) as a contract that had met the IFRS 15 criteria from inception (that is, when the activities to fulfil the contract began).

#### Key points

1. The activities carried out by an entity in fulfilment of a contract, before this contract has satisfied the criteria for recognition under IFRS 15, give rise to the recognition of an asset.
2. This asset is accounted for in a manner which is consistent with the recognition of the associated revenue, once the contract criteria are satisfied, when or as the corresponding performance obligations are satisfied.
3. Where control is transferred over time, the revenue corresponding to all the activities already performed is recognised on the date at which the contract criteria are met.

# Events and FAQ

## Frequently asked questions

### IFRSs

- Possibility of suspending the amortisation of an asset during (major) redevelopment works;
- Revenue recognition pattern in the case of the sale of software with associated services;
- Distinction between debts and equity in the case of the issue of bonds redeemable for shares.

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

IFRS		EFRAG	
IASB	Committee	Board	TEG
18-20 May	12 May	3 June	10-12 June
22-26 June	14-15 July	24 June	8-10 July
20-24 July	8-9 September	22 July	9-11 September

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