# Beyond the GAAP

## Mazars' newsletter on accounting standards

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## Contents



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## Editorial

After a pause of several months, the IASB has started the year by presenting its annual improvements in a short exposure draft, with the next consultations expected as of April. It is also continuing to offer support on new standards, publishing an article on IFRS 16 – *Leases*, noting in passing that there are some decisions to be taken and judgments to be made, and urging entities not to delay the launch of their transition process.

For its part, ESMA has published extracts from its enforcement database for the 20th time, bringing the number of decisions published up to a total of 223 over a little more than a decade.

This month's special study takes a look at the recent work from the IFRS Interpretations Committee on foreign currency transactions and advance consideration, to enable our readers to get to grips with any changes that will apply to them.

Enjoy your reading!

Edouard Fossat Isabelle Grauer-Gaynor

# IFRS Highlights

## Improvements to IFRSs – 2015-2017 Cycle

On 12th January 2017, the IASB published its draft Improvements to IFRSs – 2015-2017 Cycle

- IAS 12 – *Income taxes* Removal of paragraph 52B – on the obligating event and the recognition of the tax consequences of the distribution of dividends – from the Measurement section (paragraphs 46-56) to the Recognition section (paragraphs 57 et seq.). This reclassification seems logical, and does not alter the fact that the tax consequences of the distribution should only be accounted for at the date the liability for the dividend is recognised, and generally in profit or loss;
- IAS 23 – *Borrowing costs* Clarification that when a qualifying asset is complete, an entity treats any outstanding borrowing made specifically to obtain that qualifying asset as part of the funds that it has borrowed for general purposes;
- IAS 28 – *Investments in Associates and Joint Ventures:* the Board proposes to clarify that an entity is required to apply IFRS 9, including its impairment requirements, to long-term interests in an associate or joint venture that, in substance, form part of the net investment in the associate or joint venture but to which the equity method is not applied.

This exposure draft can be consulted at: http://www.ifrs.org/Current-Projects/IASB-Projects/Annual-Improvements/Pages/Exposure-draft-and-comment-letters.aspx The comment period closes on 12th April 2017.

## IFRS 9: The IASB announces a narrow-scope amendment for financial assets with symmetric prepayment options

At its meeting in January 2017, the IASB examined the case of symmetric prepayment options, brought before it by the IFRS IC (see Beyond the GAAP no 105 of November 2016).

In the event that a borrower decided to exercise the prepayment option, these symmetric options may, under some market conditions, cause the lending bank to incur what is effectively negative compensation (and hence incur a cost). This clause, which leads entities "forced" to accept prepayment to pay compensation, has been judged to be "not basic" or "not SPPI" on a literal interpretation of IFRS 9. This requires the recognition of the financial asset at fair value through profit or loss, without taking account of the business model concerned.

In January 2017, the IASB confirmed its intention to put forward a narrow-scope amendment on this subject. Financial assets with symmetric prepayment options would be considered as 'SPPI' and eligible to be measured at amortised cost, or at fair value through recyclable other comprehensive income, if they meet the following two conditions:

- the symmetric nature of the prepayment option is the only feature of the financial asset which does not meet the 'solely payment of principal and interest' criterion (i.e., without this feature the instrument would be SPPI as set out in paragraph B4.1.11(b) of IFRS 9) and
- when the entity initially recognises the financial asset, the fair value of the symmetric prepayment feature is insignificant.

It was also decided to propose that:

- the effective date for this amendment should correspond with the effective date of IFRS 9 (i.e. annual periods beginning on or after 1st January 2018), and
- that it would be applied retrospectively.

The amendment will be the subject of an exposure draft which will be published in April. This exposure draft is likely to have a shortened comment period so that the timeframe will be compatible with application to reporting periods opening as of 1st January 2018.

This keenly-awaited text will be studied closely by stakeholders in order to identify its real scope and its impact on other types of prepayment options, including options for prepayment at fair value.

## Putting IFRS 16 into practice: practical advice from the IASB

In early January, the IASB published on its website an article in which four of its members (Sue Lloyd, Gary Kabureck, Darrel Scott and Stephen Cooper) offered some practical advice to entities about putting IFRS 16 – *Leases* into practice.

They looked at the following aspects:

- transition options and their respective benefits;
- early planning and practical steps;
- judgements and discount rates;
- investor expectations and lease disclosures between now and 2019.

The article can be consulted on the IASB website at the following address: http://www.ifrs.org/Current-Projects/IASB-Projects/leases-implementation/Documents/IFRS16-Leases-Article-Jan2017.pdf

# European Highlights

## ESMA: 20th extract from the enforcement database

On 5th January 2017, the European Securities and Markets Authority, ESMA, published the 20th extract from its enforcement database, containing 14 decisions taken by European regulators on the following topics:

1. Qualitative disclosures of the risks arising from financial instruments (IFRS 7)
2. Disclosure of significant judgments and assumptions in determining the existence of significant influence (IFRS 12)
3. Disclosures relating to determination of value in use (IAS 36)
4. Recognition of losses on loans upon conversion to shares (IAS 39)
5. Presentation of equal and opposite gains and losses in the statement of profit or loss and other comprehensive income for the period (IAS 1)
6. Reclassification of capitalised milestone payments by a pharmaceutical company to the statement of profit or loss (IAS 8 and IAS 38)
7. Legal requirements that prevent a shareholder from exercising its rights (IFRS 10)
8. Determining whether an entity is an investment entity (IFRS 10)
9. Depreciation of vessels in the oil and gas industry (IAS 16)
10. Application of value in use methodology in impairment testing (IAS 8 and IAS 36)
11. Recognition of onerous contract provisions (IAS 36 and IAS 37)
12. Identification of cash-generating units (IAS 36)
13. Purchase of a car fleet with an agreed buyback agreement (IAS 8, IAS 17, IAS 32 and IFRIC 4)
14. Recognition of deferred tax assets for unused tax losses (IAS 12)

This 20th extract from ESMA's enforcement database can be consulted at:
https://www.esma.europa.eu/press-news/esma-news/esma-publishes-extract-enforcement-decisions-financial-statements-0

## Crossword: last month's solution

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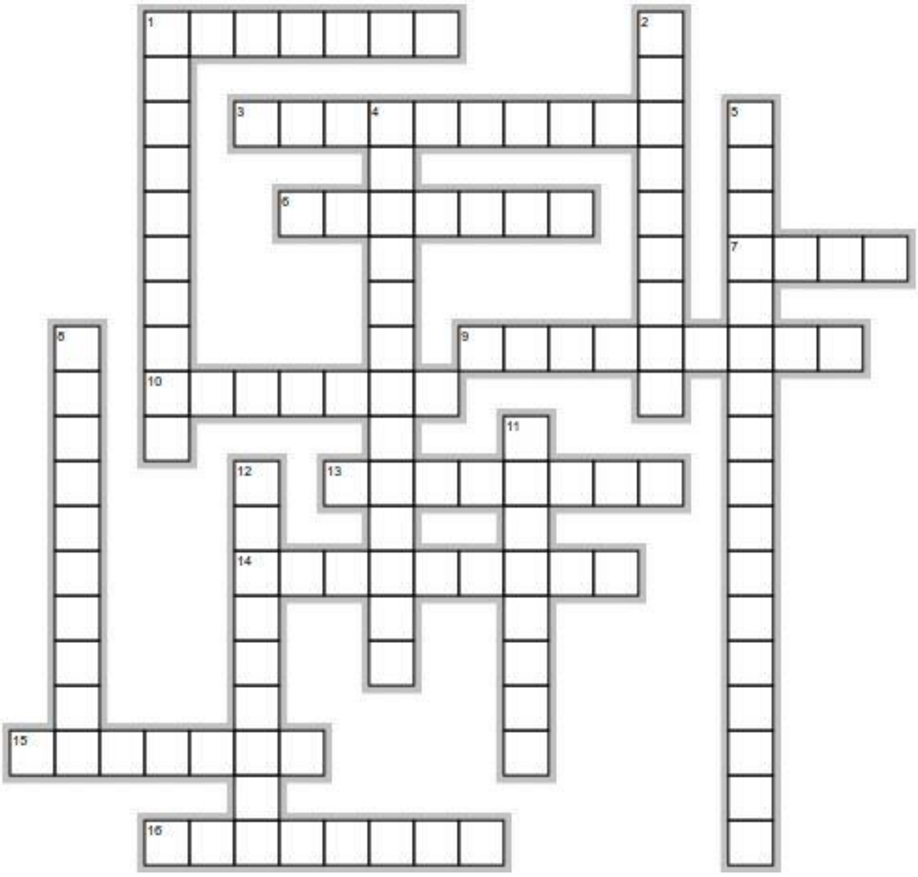
# Crossword
# Accounting for foreign currency in IFRS



## Down

1. The currency of the main economic environment in which an entity conducts its business
2 Describes the currency used to present the financial statements
4. How the impacts of a change in functional currency are accounted for
5. Describes an economy with a very high inflation rate
8. Exchange rate differences are this, but actuarial differences are not
11. When these items are denominated in foreign currency, they must be translated at the closing exchange rate when preparing the financial statements
12. Except in exceptional cases, their distribution does not automatically allow recycling of exchange differences through profit or loss

## Across

1. IAS 21 sets out the accounting principles applicable to transactions in this type of currency
3. Term for one of the possible methods of translation for multi-tiered subsidiaries
6. Exchange rate at which foreign currency monetary items are translated
7. Acronym for the European authority which reminded entities that, with Brexit in mind, the use of an average exchange rate for the translation of foreign currency in the 2016 financial statements was not appropriate if the exchange rate fluctuated significantly
9. Result which, under IFRIC 22, will no longer be affected by exchange rate fluctuations between the date of an advance payment in foreign currency and the date revenue recognised
10. Such payments in a foreign currency transaction has an impact on the amount of revenue recognised for the transaction, according to the IFRIC 22 interpretation published in December 2016
13. An operation triggering the recycling through profit or loss of exchange differences in a subsidiary
14. Country where a hyperinflationary economy required the application of IAS 29 to individual financial statements in 2016
15. IAS 21 does not apply to the recognition of this type of relationships for items in foreign currency
16. The cumulative post-initial consolidation impacts of the translation of the accounts of a subsidiary whose functional currency is different from the reporting currency are known as the “foreign currency translation ___________”

# A Closer Look

## IFRIC 22 – Foreign currency transactions and advance consideration

On 8th December 2016, the IASB published IFRIC 22 – *Foreign currency transactions and advance consideration* in order to clarify the accounting treatment of foreign currency transactions that include advance payments.

This interpretation supplements IAS 21 – *The effects of changes in foreign exchange rates* for transactions of this type, and could overturn the practices of some entities.

### 1. Why publish this interpretation?

In the case of foreign currency transactions with advance payments, IAS 21 is clear as to the method of accounting for a non-monetary asset or liability corresponding to a prepayment (whether paid or received) in foreign currency. It is less clear about how to account for the asset, expense or income resulting from the transaction as a whole once it is complete.

IAS 21 requires, for the initial recognition of a foreign currency transaction in the entity's functional currency, to apply the spot exchange rate between the two currencies at the date of the transaction. This date is the date on which the transaction is recognised for the first time in the financial statements.

Therefore, in the case of foreign currency transactions with advance consideration, the related non-monetary asset or liability is initially recognised at the spot exchange rate at the payment date. It is not remeasured to reflect fluctuations in the exchange rates (IAS 21.23). It is derecognised when the conditions for the recognition of the asset, expense or revenue resulting from the contract as a whole are fulfilled, i.e. when the transaction has taken place in accordance with the relevant IFRSs.

The question then arises of what exchange rate to use when recognising this asset, expense or income resulting from the contract as a whole.

The IFRS Interpretations Committee was asked in 2014 to clarify the exchange rate to be used when recognising revenue on a foreign currency transaction in which an entity receives non-refundable advance consideration.

In discussing the issue, the IFRS IC observed both that divergent practices existed, and that the subject also concerned transactions other than the sale of goods and services. It therefore extended the question to the exchange rate to be used in all these cases.

### 2. Three approaches were analysed

#### Approach 1: Recognising the revenue at the spot exchange rate on the date of conclusion of the contract

Supporters of this approach believe that the conclusion of the contract, the payment of the advance and the recognition of the revenue are interdependent and constitute a single transaction.

Therefore, in application of IAS 21 provisions concerning the transaction date, the revenue should be recognised at the spot exchange rate on the date the contract is concluded (or on the date on which it becomes enforceable, if later).

#### Approach 2: Recognising the revenue at the spot exchange rate on the date of the advance payment

Supporters of this approach believe that the date on which the transaction is recognised, in accordance with IAS 21 paragraph 21, is the first date on which the transaction has an impact on the financial statements, which is the case when one of the parties satisfies one of its obligations.

A payment received before the revenue is recognised (delivery of goods or services), therefore, is recognised as a non-monetary liability at the spot exchange rate on the payment date. The related revenue is recognised at the same rate when the conditions are satisfied. In this approach, the transaction date under IAS 21 is the date on which payment is received.

This treatment reflects the fact that after receiving the advance payment in foreign currency, the entity is no longer exposed to exchange rate fluctuations for that part of the revenue.

#### Approach 3: Accounting for the revenue at the spot exchange date on the date of recognition

Supporters of this approach believe that the transfer of goods or services (leading to the recognition of revenue) constitutes in itself the transaction which is the object of the contract.

The revenue is therefore accounted for on the date of its recognition.

## 3. Approach adopted by the IFRS Interpretations Committee

After analysing these approaches, the Committee came to the conclusion that the exchange rate to be used is the rate on the date the advance payement is made. Its reasons are as follows:

- An entity is no longer exposed to foreign exchange risk after it has received advance consideration,
- The obligation to transfer goods or services (reflected in the recognition of a liability on the date the payment is received) and the subsequent fulfilment of that obligation (which gives rise to recognition of revenue) are part of the same transaction, and
- This treatment is consistent with the treatment of non-monetary assets and non-monetary liabilities in application of paragraph 23(b) of IAS 21, because an entity does not subsequently update the translated amounts of such items.

Consequently, the exchange rate to be used when accounting for a foreign currency transaction (giving rise to an asset, an expense or income) that includes advance consideration is the earlier of the following two dates:

- the date of initial recognition of the advance payment (as an asset or a liability), and
- the date on which the object of the contract is recognised in the financial statements (income, asset, expense).

If the foreign exchange transaction includes several advance payments, an entity must then determine a transaction date for each payment or receipt.

If the foreign exchange transaction includes advance payments and a deferred payment, the revenue will be calculated by applying the spot rate on each advance payment date, and the spot rate on the revenue recognition date for the part corresponding to the deferred payment. The receivable corresponding to the deferred payment is then treated as a monetary asset and will be remeasured in accordance with IAS 21.

## 4. Initial application

This interpretation does not apply when an entity initially measures the related asset, expense or income at fair value, and entities are not required to apply it to income taxes or insurance contracts.

IFRIC 22 is applicable for annual periods beginning on 1st January 2018, subject to endorsement in Europe. Early application is authorised.

Entities applying IFRIC 22 for the first time may choose one of the following options:

- Retrospective application in accordance with IAS 8;
- Prospective application to the recognition of all assets, expenses and income recognised on or after:
  - the beginning of the reporting period in which the entity first applies the interpretation; or
  - the beginning of the comparative period.

If an entity opts for prospective application, the amounts recognised before the start of the prospective period, and relating to transactions that carry on into periods to which IFRIC 22 applies, are not restated. However, items recognised subsequently arising from these transactions are accounted for in accordance with IFRIC 22.

## 5. Impact on entities

The consequences of IFRIC 22 will depend on whether an entity accounts for the effects of exchange rate fluctuations (between the date of the advance payment and the date on which it recognises the asset, expense or income arising from the transaction as a whole) in the financial result or the operating result:

- in the first case, the consequences will be greater, since several line items and aggregates on the income statement will be affected (revenue or operating costs, operating result and financial result).
- In the second case, the main aggregates will not be impacted.

Additionally, some entities will need to alter their accounting software in order to take account of this interpretation.

## 6. Illustrative examples

The following examples (inspired by those provided by IFRIC 22) illustrate how an entity accounts for a foreign exchange transaction that includes advance consideration.

### A) Purchase of a machine on a given date

On 1st April 20X1, an entity whose functional currency is the local currency (LC) entered into a contract with a supplier to purchase a machine for FC (foreign currency) 1,000, which was paid the same day.

The machine was delivered on 15th April 20X1.

On 1st April 20X1, entity A recognises a non-monetary asset, translating FC 1,000 at that day's spot exchange rate.

On 15th April 20X1, the non-monetary asset is derecognised and the machine is recognised as an asset for FC 1,000 using the spot exchange rate at the date the price was paid (1st April 20X1).

*In some entities, current practice allows translation of the asset recognised on 15th April 20X1 at that day's spot rate, leading to an exchange difference impacting the income statement.*

### B) Sale of services over a period of time

On 1st June 20X1, an entity whose functional currency is the LC concludes a contract with a customer to supply cleaning services over the period July-December 20X1.

The cost of the transaction is FC 600, of which FC 200, covering the services performed in July and August, is paid on 15th June 20X1. The remainder is paid on 31st December 20X1.

On 15th June 20X1 the entity recognises a non-monetary liability of FC 200 at that day's spot exchange rate.

This non-monetary liability is derecognised gradually over the period July-August and the entity recognises revenue of FC 200 in profit or loss for the period at the 15th June spot rate (the date on which the advance consideration was received).

In the period 1st September–31st December 20X1, the entity recognises revenue gradually at the rate of FC 100 per month, using the average exchange rate for each month, as the services are supplied, and a foreign exchange gain or loss (for the monetary receivable corresponding to the revenue) until the FC 400 is received.

**Key points**

IFRIC 22 will apply to any foreign currency transactions satisfying the following conditions:

- Consideration for the transaction is denominated in a foreign currency;
- A non-monetary asset or liability is recognised for advance consideration before the transaction;

According to the new interpretation:

- For the purposes of determining the exchange rate, the transaction date is the date the non-monetary asset or liability is first recognised;
- If there are multiple payments or receipts, the transaction date must be determined for each stage.

# Events and FAQ

## Frequently asked questions

### IFRS

- Non-transferability discount on a share-based payment plan
- Research tax credit prefinancing contract;
- Classification of an early retirement plan: severance pay or post-employment benefits;
- Accounting for a long-term incentive plan with progressive vesting;
- Accounting for a group of assets held for sale;
- Accounting classification: current or non-current;
- Contingent liability recognised when accounting for a business combination.

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

| IFRS | | EFRAG | |
|---|---|---|---|
| **IASB** | **Committee** | **Board** | **TEG** |
| 20-24 February | 14-15 March | 7 February | 23 February |
| 20-24 March | 3 May | 16 March | 29-31 March |
| 24-28 April | 13-14 June | 11 April | 10-12 May |



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