As is clear from the updated IASB work plan, the second half of 2011 will be quite exceptional in the history of the international standard setter. No fewer than four new standards will be published, two will be amended and the final vote on the content of four future major standards will be taken. Though there can be no doubt that the IASB and the FASB will make every effort to meet the objective set by the G20, it is nevertheless hard to believe that discussions on the financial instruments project in particular could be concluded by 30 June 2011 at midnight, when the call for comments on all the phases of the project is still current. Whatever happens, the next few weeks will be fascinating!

Enjoy your reading!

Michel Barbet-Massin
Jean-Louis Lebrun
The IASB updates its work plan

On 28 March 2011, the IASB once again updated its work plan to take into account the progress of the active projects.

April 2011 should thus be the month which will (at last!) see the publication of:
- IFRS 10 (replacement of IAS 27 and SIC-12),
- IFRS 11 (replacement of IAS 31),
- IFRS 12 (Disclosure of Interests in Other Entities),
- IFRS 13 (Fair Value Measurement).

April should also see the publication of amendments to IAS 1 (Presentation of Other Comprehensive Income). The amendments to IAS 19 (Defined Benefit Plans) are expected between the end of April and mid-May.

The joint projects on financial instruments, revenue recognition, leases and insurance contracts should all be completed by 30 June 2011 at the latest, when the ballot timetable has been set (i.e. all the Board’s decisions will have been taken by this date and will have been subjected to a formal vote).

The final texts on these projects, however, will be published during the second half of 2011. The IASB and the FASB have therefore allowed themselves some additional time for the final editorial phase.

Effective date of future standards

During March, the IASB and the FASB took a number of decisions regarding the mandatory effective dates of future standards, after analysis of the comments received following the “Request for views” published in October 2010.

These decisions follow those taken in February concerning the texts on consolidation (see Beyond the GAAP no 42).
Meeting between EFRAG and IASB to discuss the progress of the convergence work plan

On 18 March 2011, the EFRAG and the IASB met to discuss the progress of the IASB’s work as regards convergence with the FASB.

Discussions focused on the outstanding joint projects: financial instruments, revenue recognition, leases and insurance contracts.

The EFRAG indicated that the publication of standards for the revenue recognition and lease projects in particular would entail very significant costs for European preparers.

From the EFRAG point of view, these costs could only be justified by the benefit of a positive US decision on the adoption of IFRSs, and by significant improvements of the existing standards.

The EFRAG and the IASB both expressed their wish to see the publication of high quality standards and a process that reflects input from all stakeholders.

A further meeting will be organised in the second half of 2011.


ESMA (formerly CESR): 10th extract from the database of enforcement

ESMA (The European Securities and Markets Authority), formerly known as CESR, has recently published the 10th extract from its database of enforcement.

The decisions of European regulators thus published (nine in total) concern the following areas:

- Classification of financial liabilities as current/non-current - breach of covenants and events after the end of the reporting period;
- Classification of government grants – green power certificates;
- Presentation of financial instruments;
- Accounting treatment of income tax adjustments;
- Classification of foreign exchange losses in the cash-flow statement;
- Disclosure of intangible assets – transfers costs of football players;
- Share-based payments.

This 10th extract from the database of enforcement can be consulted at http://www.esma.europa.eu/popup2.php?id=7492

Subscribe

Beyond the GAAP, MAZARS’ monthly newsletter on accounting standards is 100% free.

To subscribe, send an e-mail to doctrine@mazars.fr including:
  Your first and last name,
  Your company,
  Your e-mail address

You will begin receiving Beyond the GAAP the following month by e-mail in pdf format.

If you no longer wish to receive Beyond the GAAP, send an e-mail to doctrine@mazars.fr with “unsubscribe” as the subject of your message.
In August 2010, the IASB and the FASB published an exposure draft as part of their joint project on leases. The analysis of the many comment letters received induced the two Boards to draft a timetable for redeliberations (see Beyond the GAAP no 41).

To meet their ambitious schedule, the two Boards have considered a number of major subjects since last February (see Beyond the GAAP no 42):

- definition of a lease;
- determining the lease term; and
- the recognition of variable lease payments.

In March, the Boards turned to the following areas:

- the “right of use” model
- the scope,
- the distinction between a lease and a sale or purchase,
- the recognition of purchase options,
- short-term leases,
- the date of initial recognition,
- the discount rate,
- initial direct costs,
- separating lease and non-lease components of a contract,
- sale and leaseback transactions.

In this edition, we present the main still-tentative positions which were reached during March and which are likely to serve as the basis of the future standard.

**The “right of use” model**

The two Boards have affirmed the decision to apply the right of use model for lessee, that is to say the recognition of an asset representing the right to use an underlying asset and a liability representing its obligation to make lease payments.

The application of this approach to lessor accounting will be discussed later.

**Scope**

Similarly, the Boards have also confirmed, with no further explanations than in the ED, the exclusion of all intangible assets from the scope of the future leases standard.
Distinguishing between a lease and a purchase or a sale

The two Boards have finally decided that the standard will contain no guidance for distinguishing a lease from a purchase or a sale.

The exposure draft excluded from its scope contracts which were in substance the sale or purchase of the underlying asset, and also indicated how this distinction should operate in practice.

The Boards have now stated that if an arrangement does not contain a lease, it should be accounted for in accordance with other applicable standards (for example, property, plant, and equipment or revenue recognition).

Accounting for purchase options

Entities should include the exercise price of a purchase options in measuring lease payments (i.e. in estimating the lease assets and lease liabilities) if the lessee has a significant economic incentive to exercise the purchase option.

The exposure draft states that contracts which include a bargain purchase option are not genuine leases, but rather contracts for the sale/purchase of the underlying asset. The Boards therefore need to indicate what is meant by a “significant economic incentive”, apart from the bargain purchase option, in order to identify the leases to which this will apply.

In the case of leases which include such a purchase option, the right of use must be amortised over the economic life of the underlying asset.

Finally, the IASB and the FASB discussed whether purchase options should be reassessed during the course of the lease. At this stage, the Boards appear to favour an approach similar to that proposed for renewal options.

It will be recalled that last February, the two Boards tentatively decided that options to extend or terminate a lease should be reassessed only when a significant event occurs altering the initial decision to exercise these options.

Short-term leases

The Boards unanimously decided that a short term lease would be defined as:

| A lease that, at the date of commencement of the lease, has a maximum possible term, including any options to renew, of 12 months or less. |

This definition should apply to both lessees and lessors.

The accounting treatment proposed for lessee accounting had been sharply criticised, since no one could see any simplification where an asset and a liability had to be recognised.

The IASB and the FASB seem to have taken these comments on board, since they now propose to allow both lessors and lessees to account for all short-term leases by not recognising a lease asset or a lease liability.

This choice of accounting principle would apply per class of asset. Thus, an entity which opts to recognise short-term warehouse leases in the statement of financial position might opt not to account for vehicle leases in the same way.
Date of initial recognition

Many commentators had expressed their concerns as to the relationship between the date of initial recognition, according to the ED the commencement date of the lease (the date on which the lessee acquires the right of use) and the initial measurement date, which corresponds in the ED to the date the lease is signed.

The Boards decided that:

- A lessee and a lessor would recognise and measure lease assets and lease liabilities at the date of commencement of the lease, and
- The discount rate used when measuring the current value of lease assets and lease liabilities should be calculated at the date of commencement of the lease.

The Boards also decided that the standard would contain application guidance on the accounting treatment of:

- Lease payments made and costs incurred by the lessee before the date of commencement of the lease, and
- Incentives provided by the lessor to the lessee, which should be deducted from the initial measurement of the right-of-use asset.

Finally, the IASB and the FASB discussed the accounting for a lease contract between the date of inception and the date of commencement, and confirmed the exposure draft proposal to exclude lease contracts that meet the definition of an onerous contract between these two dates. Such leases should be accounted for in accordance with IAS 37 (rather than in accordance with the leases standard).

Discount rate

After discussion of the discount rate used when measuring the current value of lease payments, the Boards proposed that:

- The lessee would use the rate charged by the lessor when that rate is available; otherwise the lessee would use its incremental borrowing rate;
  
  It will be recalled that the ED had proposed that the lessee should use its incremental borrowing rate, or the rate applied by the lessor if that could be easily determined.
- The lessor would use the rate charged to the lessee, which could be the lessee’s incremental borrowing rate, the rate implicit in the lease, or, for property leases, the yield on the property.

The ED had only mentioned the rate charged to the lessee.

The Boards also tentatively decided to provide application guidance for the determination of the discount rate.

Initial direct costs

Initial direct costs were tentatively defined as “Costs that are directly attributable to negotiating and arranging a lease that would not have been incurred had the lease transaction not been made”.

The Boards also confirmed that these costs should be capitalised and added to the carrying amount of the asset, i.e.

- The right of use, for the lessee
- The right to receive lease payments, for the lessor.
Separating lease and non-lease components of a contract

The Boards tentatively decided that an entity should be required to separate the lease and the non-lease components (services etc.) of a contract as follows:

- The lessor should allocate payments due under the different components of the lease in accordance with the guidance on revenue recognition;
- The lessee should allocate payments due under the different components of the lease as follows:
  - If the purchase price of each component is observable, the lessee would allocate the payments on the basis of the relative purchase prices of individual components;
  - If the purchase price of one or more, but not all, of the components is observable, the lessee would allocate the payments on the basis of a residual method, that is by allocating a residual value to the component(s) the purchase price of which is not observable;
  - If there are no observable purchase prices, the lessee would account for all the payments required by the contract as a lease.

Finally, the future standard should include application guidance on what a lessee should understand as an observable price.

Sale and leaseback transactions.

Sale and leaseback transactions were another area of concern to stakeholders. The Boards affirmed the proposals in the Leases exposure draft in relation to the definition of leaseback transactions:

- If a sale has occurred, the transaction will be accounted for as a sale and then a lease;
- If a sale has not occurred, the transaction will be accounted for as a financing;
- Where the transaction is not at a market price, the assets, liabilities, gains or losses are adjusted to reflect market rentals.

The Boards tentatively decided that an entity should apply the control criteria described in the revenue recognition project to determine whether a sale has occurred.

Finally, the IASB and the FASB confirmed their preference for the “whole asset” approach, which deems that the seller/lessee in a sale and leaseback transaction sells the entire underlying asset and leases back a right-of-use asset relating to part of the underlying asset.
IASB and FASB continue their redeliberations on the Revenue Recognition project

In June 2010, as part of a joint project with the FASB, the IASB published an exposure draft on revenue recognition (Revenue from Contracts with Customers). After analysing the comment letters, the two Boards have drawn up an ambitious timetable of the issues which require redeliberations during the first half of 2011, with a view to the publication of a final standard in June 2011.

The decisions taken by the two Boards during March and described below have not yet been the subject of a formal vote. At this stage, they are tentative decisions, but they are likely to provide the basis for the final standard.

It should be remembered that the tentative decisions taken during January and February (see Beyond the GAAP no 41 and no 42) substantially amended the definitions and principles which had been proposed in the ED, bringing them closer to current revenue recognition practice.

During March, the Board addressed the following topics:

- Onerous contracts;
- Collectibility;
- Discounting the consideration.

**Onerous contracts**

The Boards decided that the onerous nature of a contract containing several performance obligations would be determined in relation to the contract as a whole (and not for each performance obligation, as proposed in the ED. See Beyond the GAAP no 42).

The Boards tentatively decided that the onerous test should apply to all contracts, including those that are intentionally priced at a loss in the expectation of profits to be generated on subsequent contracts.

They confirmed that the costs to be included in measuring an onerous liability should be the costs that relate directly to satisfying the remaining performance obligations.

Finally, the costs to be included when measuring an onerous liability would correspond to the amount that the entity would pay to cancel the contract (i.e. cancellation penalties) only where the seller is committed to cancelling a contract and has the contractual right to do so. Discussions on this last point should be followed, insofar as, in our mind, this provision would require the recognition of an onerous liability even if the seller can cancel the contract without penalties but has no intention of doing so (for example for commercial reasons).

**Collectibility**

The two Boards finally decided that the credit risk should not be reflected in the measurement of revenue. This is a significant change from the position in the ED. Revenue would therefore correspond to the transaction price agreed in the contract (discounted where necessary), as in the existing standards.
However, they have decided that impairments (provision/write backs) of receivables arising from contracts with customers should be presented in profit or loss as a separate line item adjacent to the revenue line item.

Finally, the final revenue standard should not include a revenue recognition criterion that requires an assessment of the customer’s ability to pay the consideration (in contrast to the existing provisions of IAS 18).

**Discounting the consideration**

The Boards tentatively decided that an entity should adjust the promised amount of consideration to reflect the time value of money if the contract includes a significant financing component. A significant financing component exists where:

- the amount paid would be substantially different if the customer paid in cash at the time of transfer of the goods or services;
- the period between when goods or services are transferred and the date of payment is long;
- the interest rate that is explicit or implicit within the contract is significant.

In practice, an entity should not be required to assess whether a contract has a significant financing component if the period between payment and the transfer of the goods or services is one year or less.

These arrangements should not therefore amend the existing practice.

**Next steps**

In April, the two Boards will discuss the following topics:

- Uncertain consideration;
- Allocation of the transaction price to performance obligations;
- Costs;
- Licences and rights to use;
- Disclosures;
- Scope.
At its March 2011 meeting, the IFRS Interpretations Committee (ex IFRIC) continued its discussions of put options written on non-controlling interests and examined a project for the amendment of IAS 32.

- The Committee proposes an IAS 32 scope exclusion for some puts...

Put options meeting certain precise criteria would be excluded from the scope of IAS 32 and would therefore be accounted for in accordance with IAS 39 (as derivative instruments; see Beyond the GAAP no 37).

IAS 32 currently requires a group to recognise a liability, because of the obligation to purchase shares covered by a put option, regardless of the characteristics of the option in question.

Even in the case of an option with an exercise price based on fair value, i.e. an option which exposes an entity to no risk (the risk of ‘overpaying’), a liability nevertheless has to be recognised for the discounted amount of the option exercise price.

- ... after rejecting an alternative path (accounting for changes in the value of the put liability in equity).

The alternative path, accounting for changes in the liability in equity, was not considered acceptable by a majority of Committee members at previous meetings on this matter.

This alternative would have made it possible to:

- respect the initial objective of IAS 32 which is to account for a liability (i.e. demonstrate the disbursements which the group might be forced to make in the event that minority shareholders exercised their option to sell), and also
- take into account the fact that IAS 27 now requires that any positive or negative difference between the amount paid by the group and the carrying value of the NCIs purchased should be accounted for in equity, where these transactions between shareholders do not affect the control exercised by the group.

- Which put options would be excluded from the scope of IAS 32?

This exclusion from the scope of IAS 32 would only apply to consolidated financial statements. In practice, options which have all the following features would be excluded from the scope of IAS 32 (and hence included in the scope of IAS 39 as derivatives):

- only put options would be affected (i.e. not forward contracts);
- the put options must be separate (i.e. not embedded in a larger contract, for example puttable shares);
- the puts must relate to shares in a subsidiary (i.e. not puts on shares in the parent company);
- the puts must result in physical settlement (i.e. no ‘net settlement’).
However, in contrast to the initial proposals on this subject, the benefit of this amendment would not depend on the date the NCI put was granted (i.e. it does not matter whether the puts were written in a business combination or not).

The measurement of puts in accordance with IAS 39 (i.e. as derivatives) would result in the disappearance of the liability (as such, though this would not stand in the way of recognition of a derivative liability) and all changes in fair value would be accounted for in profit or loss.

 الخامس: Accounting consequences (depending on put characteristics)

The accounting impacts can be summarised as follows:

- if the put exercise price is the same as the fair value of the interests in question, the put has no innate value (hence, in practice, no derivative will be recognised and there will be no impact in profit or loss);
- if the put exercise price is not equal to the fair value of the shares (whether the price is fixed, or based on a formula supposed to represent fair value such as multiples of EBIT or EBITDA), it will be necessary to:
  - determine the fair value of the put (corresponding to the sum of the intrinsic value and the time value of the put), and
  - recognise it through profit or loss.

In practice:

- if the exercise price is based on a formula, the fair value should a priori be low (at least initially).
  - In the case of long-term puts, vigilance will be necessary (i.e. EBIT multiples may evolve unfavourably for the entity, potentially leading to a significant value for the derivative liability).

- if the exercise price is fixed:
  - either the term is quite short (which reduces the risk of volatility, and hence the value of the derivative),
  - or the put is accompanied by a purchase option held by the group (in which case the transaction is generally analysed as an acquisition with deferred payment).

It is rather more unusual to encounter a long-term put with a fixed exercise price (because this would expose the group to a potentially significant risk).

What should we make of the proposed amendment?

Theoretically, the solution proposed by the Committee has some disadvantages, including:

- it excludes forward purchase contracts without obvious justification, while a synthetic forward, the combination of a put and a call (with the same characteristics in terms of price and exercise period) would benefit from this exception;
- it generates an impact in profit or loss for the sale of fixed-price puts (which are equity instruments) and
- it removes the liability (potentially useful information for readers of financial statements).

In practical terms, this proposed amendment of the scope of IAS 32 should nevertheless resolve most of the problems encountered by limiting the level and volatility of the impact on profit or loss (thus putting an end to almost five years of discussions on this topic).
The Committee believes that this approach would therefore provide a short-term solution to the problem of accounting for changes in the financial liability, without any fundamental changes to IAS 32.

In any event, as an amendment in the scope of a standard, with all its consequences in terms of accounting for these instruments exceeds its remit, the Committee intends to recommend the Board to amend IAS 32 in this way.
Events and FAQ

Events/publications

Seminars on “Current developments in IFRS”
Mazars’ Technical Department will host a number of seminars throughout 2011 dedicated to current developments in IFRS. These seminars, organised by Francis Lefebvre Formation, will be held on 24 June, 23 September and 9 December 2011.

To register, please contact Francis Lefèbvre Formation – www.flf.fr, +33 (0)1 44 01 39 99.

IMA France conferences
On Tuesday 17 May 2011, Laurence Rivat, a Deloitte partner, and Jean-Louis Lebrun, a Mazars partner, both members of the IFRS Interpretations Committee (formerly IFRIC), will jointly chair a breakfast debate in partnership with IMA France on recent developments in the IASB’s standards interpretation body.

On Tuesday 21 June 2011, Isabelle Sapet, a Mazars partner and Carole Masson, a Mazars Senior Manager, will jointly chair a breakfast debate in partnership with IMA France on half-yearly accounts.

You can register for these events (taking place in Paris) on the IMA France web site (www ima-france.com).

Frequently asked questions

IFRS

- Consolidation method for special purpose entities created to operate concession contracts
- Criteria for accounting for a restructuring provision
- Analysis of the deconsolidation effect of the disposal of financial assets in a construction contract
- Accounting treatment of a production sharing contract by an oil company
- Treatment of debt restructuring in a line of credit

Upcoming meetings of the IASB, IFRS Interpretations Committee and EFRAG

<table>
<thead>
<tr>
<th>IASB</th>
<th>Committee</th>
<th>EFRAG</th>
</tr>
</thead>
<tbody>
<tr>
<td>5 – 6 April 2011</td>
<td>5 – 6 May 2011</td>
<td>6 - 8 April 2011</td>
</tr>
<tr>
<td>11 - 15 April 2011</td>
<td>7 – 8 July 2011</td>
<td>11 - 13 May 2011</td>
</tr>
<tr>
<td>16 – 20 May 2011</td>
<td>8 – 9 September 2011</td>
<td>8 - 10 June 2011</td>
</tr>
</tbody>
</table>

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 11 April 2011
© Mazars - April 2011