The 2011 reporting date is drawing near! It is likely to be a tricky exercise, not because of the new accounting standards but because of the sovereign debt crisis. More than ever, issuers must be meticulous in their valuations and the quality and clarity of the information they publish.

Meanwhile the IASB continues working on its major projects, as witnessed by the publication of the second exposure draft on revenue recognition.

Enjoy your reading!

Michel Barbet-Massin
Edouard Fossat

Editors in chief:
Michel Barbet-Massin, Edouard Fossat

Columnists:

Contact us:
Mazars
Exaltis, 61, rue Henri Régnauld
92 075 – La Défense – France
Tel.: +33 (0)1 49 97 60 00
www.mazars.com

Application of IFRS 8 in Europe

On 10 November 2011, the European Securities and Markets Authority (ESMA) published a report on its post-implementation review of IFRS 8.

This report presents the main conclusions of the European authority on the implementation of IFRS 8, and outlines ESMA’s tentative recommendations to enhance the application of this standard.

ESMA notes that the implementation of IFRS 8 resulted in a fairly similar level of disclosures compared to the previous standard IAS 14, Segment reporting.

ESMA stresses that there is a certain consistency in the difficulties facing issuers in the application of IFRS 8, and that these result from a combination of weaknesses in the standard and the inability of issuers to comply fully with its requirements.

The ESMA report on the application of IFRS 8 can be accessed on the ESMA site at http://www.esma.europa.eu/index.php?page=home_detail s&id=615
The mandatory effective date of IFRS 9 will be put back to 1 January 2015

At its November plenary sessions, the IASB confirmed its intention to amend IFRS 9, delaying the date of its mandatory first-time application to 1 January 2015, rather than 1 January 2013 as currently adopted by the IASB.

The early application option would be retained.

The IASB also proposed the following transitional arrangements:

- entities with an initial application date before 1 January 2012 would not be subject to the requirements for restated comparative information and disclosures;
- entities with an initial application date of 1 January 2012 until 31 December 2012 would be offered a choice between restating their comparative information and presenting disclosures in the notes;
- entities with an initial application date of 1 January 2013 or thereafter would only be required to present the disclosures.

Finally, it should be reminded that IFRS 9 has not yet been endorsed by the European Union, so this standard cannot yet be applied early by preparers of financial statements, in Europe at least.

The IASB clarifies IFRS 10 transitional provisions

In September, the IFRS Interpretations Committee (formerly referred to as IFRIC) examined three requests to clarify the transitional provisions in IFRS 10 published in May 2011.

At the end of this meeting, the Committee recommended that the IASB should consider these issues as a separate exposure draft, rather than as part of the Annual improvements.

The November meeting was thus an opportunity for the IASB to discuss these issues and to bring clarifications to the transitional provisions in IFRS 10.

Macro hedging: the latest discussions

On 16 November 2011, the IASB resumed its work on the development of an accounting model for macro hedging. The IASB considered two types of approaches to reduce the accounting mismatch resulting from the measurement of derivative hedging instruments at fair value through profit or loss while some of the hedged risk positions are measured at amortised cost:

- The first approach proposes changing the accounting treatment of the hedging instrument, and could give rise to an exception to the general IFRS principle of measuring derivative instruments at fair value;
- The second approach proposes instead changing the accounting treatment of the hedged risk position, for example by remeasuring it at fair value through profit or loss.

The board has tentatively expressed its preference for the second alternative.

Financial instruments: reopening the Phase 1 of IFRS 9

On 15 November, the IASB decided to undertake a limited reconsideration of IFRS 9 provisions on the classification and measurement of financial instruments (Phase 1). The exact content of the future amendment is not yet known.

According to the IASB, this amendment should be fairly limited and would mainly affect the interactions between the accounting for financial assets under IFRS 9 and the treatment of insurance liabilities according to the insurance contract project intended to replace IFRS 4.

The IASB may also take this opportunity to address some application difficulties that some preparers have incurred with specific instruments when early adopting or undergoing implementation efforts of IFRS 9.

These future amendments may also increase the level of convergence between the IASB’s and the FASB’s financial instruments projects.

Beyond the GAAP will be sure to keep you informed of these amendments as soon as there are more details available from the IASB.
Inter alia, the IASB stated that date of initial application of IFRS 10 would be the beginning of the reporting period in which the standard is applied for the first time (this means the 1 January 2013, for entities that apply IFRS 10 for the first time in 2013 and whose reporting period coincides with the calendar year).

The IASB also clarified how an issuer shall retrospectively adjust comparative periods when the consolidation conclusion changes between IAS 27/SIC 12 and IFRS 10:

- An issuer must retrospectively apply IFRS 10 and adjust the comparative periods if the consolidation conclusion changes at 1 January 2013 (the application of IFRS 10 causes the deconsolidation of an entity which was previously consolidated under IAS 27/SIC 12, or instead leads to the consolidation of an entity which was previously unconsolidated under IAS 27/SIC 12);
- No specific transition provisions apply if the consolidation conclusion does not change at 1 January 2013 (i.e.: the consolidation conclusion is identical between IAS 27/SIC 12 and IFRS 10).

Finally, the IASB indicated that an entity would not be required to make adjustments to the accounting for its involvement with an entity that was disposed of, or whose control was lost, in the comparative period(s). In practice an issuer will therefore not be required to adjust the comparative periods if an entity which was not consolidated under IAS 27/SIC 12 but which would have been consolidated under IFRS 10 (or vice versa) has been disposed of before 1 January 2013.

European matters

ESMA public statement on sovereign debt in IFRS financial statements


This statement follows on from the statement of 28 July 2011 in which ESMA stressed the importance, under the current circumstances, of enhanced transparency in the financial information provided by preparers on their exposure to sovereign debt.

This second public statement consists of two sections:

- Section 1 discusses accounting issues related to sovereign debt in IFRS annual financial statements ending 31 December 2011. This section highlights the elements that should be considered by the issuers and their auditors in relation to exposure to sovereign debt when preparing their financial statements for upcoming year-end.
- Section 2 contains an ESMA Opinion “Accounting for Exposure to Greek Sovereign Debt – Considerations with respect to IFRS Interim Financial Statements for Accounting Periods ended on 30 June 2011.” The Opinion provides a summary of the accounting treatment applied and the financial information provided by a sample group of 53 listed European financial institutions with exposure to Greek sovereign debt in their half-year financial statements as of 30 June 2011.


Europe endorses the amendments to IFRS 7: Disclosures - Transfers of Financial Assets

On 22 November the European Commission endorsed the amendments to IFRS 7 published by the IASB in October 2010.

These amendments require to provide more disclosures on the transfers of financial assets. These amendments aim to help users of financial statements better evaluate the risk exposure relating to transfers of financial assets and the effect of those risks on an entity’s financial position.

Entities shall apply these amendments as from the commencement date of its first financial year starting after 30 June 2011. Early application is permitted.

Standards and interpretations applicable at 31 December 2011

Now that accounts are being finalised for 31 December 2010, Beyond the GAAP presents an overview of the IASB’s most recent publications. For each text, we clarify whether it is mandatory for this closing of accounts, or whether early application is permitted, based on the status of the European adoption process, as updated on 28 November 2011.

As a reminder, the following principles govern the first application of IASB’s standards and interpretations:

- IASB’s draft standards cannot be applied as they do not form part of the published standards.
- IFRIC’s draft interpretations may be applied if the two following conditions are met:
  - The draft does not conflict with currently applicable IFRSs;
  - The draft does not modify an existing interpretation which is currently mandatory.
- Standards published by the IASB but not yet adopted by the European Union may be applied if the European adoption process is completed before the date when the financial statements are authorised for issue, by the relevant authority (i.e. usually the board of directors).
- Interpretations published by the IASB but not yet adopted by the European Union at the end of the reporting period may be applied unless they conflict with standards or interpretations currently applicable in Europe.

It should also be noted that the financial statements disclosures of an entity applying IFRSs must include the list of standards and interpretations published by the IASB but not yet effective that have not been early applied by the entity. In addition to this list, the entity must provide an estimate of the impact of the application of those standards and interpretations.

**Update on the European adoption process for standards and amendments published by the IASB**

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<th>Standard</th>
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<tr>
<td>Standard</td>
<td>Subject</td>
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<td><strong>Annual improvements</strong></td>
<td>Annual improvements to various standards (text published by the IASB in May 2010)</td>
<td>Varies for individual amendments (earliest 1/07/2010)</td>
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<td>IAS 12</td>
<td>Recovery of Underlying Assets</td>
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<td>Awaiting adoption by the EU (expected in Q2 2012)</td>
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<td>Adoption process suspended by the Commission</td>
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<td>Joint Arrangements</td>
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<td>01/01/2013 Early application permitted</td>
<td>Awaiting adoption by the EU (expected in Q3 2012)</td>
<td>Not permitted but an entity may voluntarily provide information required by IFRS 12 (in addition to information required by current standards)</td>
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<tr>
<td>IAS 27R</td>
<td>Separate Financial Statements</td>
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<tr>
<td>IAS 28R</td>
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<tr>
<td>IAS 1</td>
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### Amendments to IAS 19

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### IFRS 13

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### Amendments to IFRS 1

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**Update on the European adoption process for interpretations published by the IFRS Interpretations Committee**

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<td>Extinguishing Financial Liabilities with Equity Instruments</td>
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<tr>
<td>IFRIC 20</td>
<td>Stripping Costs in Production Phase of a Surface Mine</td>
<td>01/01/2013 Early application permitted</td>
<td>Awaiting adoption by the EU (expected in Q2 2012)</td>
<td>Permitted</td>
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</table>
As announced by the two boards in June 2011, on 14 November 2011 the IASB published a new exposure draft on revenue recognition entitled *Exposure Draft ED/2011/6, A revision of ED/2010/6 Revenue from Contracts with Customers*. This new exposure draft (referred to below as the ‘second ED’) is based on the ED which the IASB published on this subject on 24 June 2010 (the ‘first ED’), some aspects of which have been sharply criticised in almost a thousand comment letters, in particular:

- the concept of transfer of control, which was considered difficult to apply in practice to services and construction contracts;
- the principle of identifying the components of a contract (“performance obligations”), which was thought to entail an inappropriate and complex breakdown.

The aim of the draft is unchanged; the future standard on revenue recognition is still expected to replace IAS 18 *Revenue* and IAS 11 *Construction contracts* - and their subsequent interpretations - in 2012 (publication of the final standard is expected during the second half of the year). A single revenue recognition model is proposed, which could apply to construction contracts, sales of goods and the rendering of services regardless of the entity’s business or the markets in which it operates. Changes have nevertheless been made to the first ED to take account of the special features of long-term contracts.

The IASB has not yet set a mandatory effective date for this proposed standard. It has nevertheless decided that the standard would not be effective sooner than for annual reporting periods beginning on or after 1 January 2015. Early application should be permitted.

Application should be retrospective (in accordance with the provisions of IAS 8), practical expedients nevertheless being authorised at the initial application date.

The comments period runs until 13 March 2012. The IASB and the FASB are not seeking to obtain detailed comments on all the proposals in the second ED on revenue from contracts with customers. They consider that many proposals are substantially identical to those in the first ED. These have therefore already been the subject of extensive feedback. The two boards are mainly looking for feedback on:

- whether the proposed requirements as now drafted are clear and can be applied in a way that effectively communicates to users of financial statements the economic substance of an entity’s contracts with customers;
- whether stakeholders agree with the specific points in the second ED which have been significantly amended as compared to the first ED, i.e.:
  - the indicators for determining the transfer of control of goods or services which are transferred over time (i.e. continuously);
  - accounting for the effects of a customer’s credit risk;
  - accounting for variable consideration;
  - testing for onerous performance obligations;
  - disclosures about revenue recognition in interim financial reports under IAS 34;
  - methods of derecognition and of accounting for the transfer of non-financial assets that are not an output of an entity’s ordinary activities.

Beyond the GAAP here presents, in a Q&A form, the main aspects confirmed, modified and added to this second ED. Only the main principles of the second ED are addressed in this edition. More specific subjects, such as accounting for sales with a right of return or sales accompanied by warranties will be discussed in the December 2011 issue of Beyond the GAAP.

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1 For more details, see Beyond the GAAP No 36 July August 2010 (1st ED), No 40 December 2010 (summary of responses to the 1st ED) and Nos 41 to 46 of January to June 2011 (updates on monthly redeliberations).
1. What is the core principle underlying revenue recognition?

According to the second ED, revenue recognition must reflect the transfer of promised goods and services to customers for an amount that reflects the consideration to which the entity expects to be entitled, in exchange for these goods or services. In practice, the change in the wording of the core principle of the future revenue recognition standard (the first ED mentioned “the remuneration which the entity receives, or expects to receive”) has a particular impact on the accounting treatment of customer credit risk (see question 6).

This principle is applied as follows:

1. Identify the contract with a customer to which the provisions of the second ED apply;
2. Identify the separate performance obligations in the contract;
3. Determine the transaction price;
4. Allocate the transaction price to the separate performance obligations in the contract;
5. Recognise revenue when (or as) the entity satisfies a performance obligation, i.e. when the entity transfers control of the promised good or service.

The steps to follow in the recognition of revenue are therefore the same in both exposure drafts.

2. How should you identify the contracts to which the second ED applies?

An entity should apply the principles in the future standard on revenue recognition to each contract with a customer unless:

- this contract is part of a portfolio of contracts (or performance obligations) with similar characteristics, and applying the future standard to this portfolio of contracts, rather than to each contract taken individually, would not lead to a materially different result (a practical expedient introduced in the second ED);
- the entity should combine several contracts entered into at or near the same time with the same customer (or related parties). Several contracts should be combined and accounted for as a single contract, if one or more of the following criteria are met:
  - the contracts are negotiated as a package with a single commercial objective;
  - the amount of consideration to be paid in one contract depends on the price or performance of the other contract; or
  - the goods or services promised in the contracts (or some goods or services promised in the contracts) are a single performance obligation.

In comparison to the first ED, the interdependence of the price of the different contracts in question is therefore no longer the basic principle for combining the contracts. Commentators have noted that in practice, this principle would have led to the combination of too many contracts and to the recognition of too many contract modifications on a cumulative basis.

The limitation on combining contracts in the second ED to contracts entered into with the same customer (or with related parties as defined in IAS 24) was absent from the first ED. It is contrary to the existing principles of IAS 11. The practical consequences of this limitation are not discussed by the two boards in the Basis for Conclusions accompanying the future standard.

Finally, it should be noted that the provisions for the segmentation of a contract have been removed in the second ED. The two boards have decided that these provisions duplicated the requirement to subsequently identify the various performance obligations in a given contract. This two-step analysis was judged to be pointlessly complicated to conduct.
3. How should contract modifications be treated?

As in the first ED, a contract modification corresponds to a change in the scope or price of a contract. However, it is now explicitly stated that this modification must have been approved by the parties to the contract.

If the parties to a contract have approved a change in the scope of the contract but have not yet determined the corresponding change in price, the contract modification is not taken into account until the entity has an expectation that the price of the modification will be approved.

If a contract modification results only in a change to the transaction price, an entity shall account for the modification as a change in the transaction price (see Question 7).

As in the case of combination of contracts, the second ED is no longer based on the principle of the interdependence of prices in order to determine whether a contract modification should be accounted for as a separate contract or not.

The second ED states that if the goods and services promised in the contract modification are distinct, i.e. if they correspond to an additional performance obligation, and the price of the modification is in line with this additional performance obligation, an entity should account for the contract modification as a separate contract. In this case, therefore, the recognition of the initial contract is unaffected by the modification.

If the contract modification does not correspond to a distinct contract, an entity should measure the remaining goods or services in the modified contract at the contract modification date and should account for the contract modification as follows, as applicable:

- If the remaining goods or services are distinct from the goods or services transferred on or before the date of the contract modification (but the price of the modification is not in line with this additional performance obligation), then the entity should allocate to the remaining separate performance obligations the amount of consideration received from the customer but not yet recognised as revenue plus the amount of any remaining consideration that the customer has promised to pay. In effect this means accounting for the contract modification as a termination of the original contract and the creation of a new contract;

- If the remaining goods or services are not distinct and are part of a single performance obligation that is partially satisfied at the date of the contract modification, then the entity should update the transaction price and the measure of progress towards complete satisfaction of the performance obligation. The entity should recognise the effect of the contract modification as revenue (or as a reduction of revenue) at the date of the contract modification on a cumulative catch-up basis. In effect, this means accounting for the contract modification as if it were a part of the original contract;

- If the remaining goods or services are a combination of goods and services which are both distinct (the first case above) and not distinct (the second case above), then the entity should allocate to the unsatisfied (including partially unsatisfied) separate performance obligations the amount of consideration received from the customer but not yet recognised as revenue, plus the amount of any remaining consideration that the customer has promised to pay. For a performance obligation satisfied over time, an entity should update the transaction price and the measure of progress. An entity should not reallocate consideration to, and adjust the amount of revenue recognised for, separate performance obligations that are completely satisfied on or before the date of the contract modification.

The examples accompanying the second ED clarify the practical impact of these measures.

4. How should the separate performance obligations in the contract be identified?

The principle of identifying the components of a contract ("performance obligations") set out in the first ED attracted criticism, as it was thought to entail an inappropriate and complex breakdown. The IASB and the FASB have listened to these criticisms and have amended their proposal in the second ED.
What did the first ED say?

Under the first ED, if an entity undertakes to transfer several goods or services within a contract, at different dates, the entity must recognise each good or service as an independent performance obligation if it is distinct. A good or service (or a bundle of goods and services) is distinct if:

- the entity, or another entity, sells identical or similar goods and services separately; or
- the entity could sell the good or service separately because it fulfils the following two criteria:
  - it has a distinct function. A good or a service has a distinct function when it can be used either on its own or together with other goods and services that the customer has acquired from the entity or that are sold separately by the entity or by another entity; and
  - it has a distinct profit margin. A distinct profit margin exists if that good or service is subject to distinct risks and the entity can separately identify the resources needed to provide the good or service.

What does the second ED say?

Where a contract concerns the transfer of more than one promised good or service, an entity should account for each promised good or service as a separate performance obligation if:

- the pattern of transfer to the customer of this good or service is different from the pattern of transfer to the customer of other goods and services, and
- the promised good or service is distinct.

A good or service is distinct if either of the following criteria is met:

- the entity regularly sells the good or service separately, or
- the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer.

An entity should also account for a bundle of goods and services as a single performance obligation if both of the following criteria are met:

- the entity provides a significant service by integrating the highly interrelated goods or services into a single item; and
- the bundle of goods or services is significantly modified or customised to fulfil the contract.

In our view, most construction contracts and contracts for the provision of complex services can be analysed as consisting of a single performance obligation, with the exception of distinct post-construction services such as maintenance.

5. When should the revenue allocated to a performance obligation be recognised?

The future standard on revenue recognition states that revenue should be recognised when (or as) an entity satisfies a performance obligation by transferring a promised good or service to a customer. An asset is transferred when (or as) the customer obtains control of that asset. Remember that transfer of control may be continuous.

Although the second ED confirms the principle of the transfer of control, the new proposals should lead to an accounting treatment which is close to existing practice, whereas the measures set out in the first ED led to fears that some contracts would be recognised on completion and no longer as work progresses, as it is the case today.

To respond to criticisms, two lists of indicators were drafted analysing the transfer of control:

- one list of indicators for performance obligations which are satisfied over time;
- the other one for performance obligations which are satisfied at a point in time.
These two lists depend on the description of what constitutes control: the control of an asset resides in the capacity to direct its use and to obtain almost all the residual economic benefits of the asset. Control of an asset also entails the ability to restrict third party access.

For performance obligations satisfied over time, the second ED states that an entity should recognise revenue continuously (and therefore as work progresses) if at least one of the following two criteria is met:

- the entity’s performance creates or enhances an asset that the customer controls as the asset is created or enhanced; or
- the entity’s performance does not create an asset with an alternative use to the entity (for example, the asset could not be sold to another customer, or significant costs would be required to modify the asset in order to sell it to another customer) and at least one of the following criteria is met:
  - the customer simultaneously receives and consumes the benefits of the entity’s performance as the entity performs, or
  - another entity would not need to substantially re-perform the work completed to date if that other entity were required to fulfil the remaining obligation to the customer; or
  - the entity has a right to payment for performance completed to date and it expects to fulfil the contract with the customer as promised.

In the case of performance obligations which are satisfied at a point in time (rather than continuously over time), the boards have decided in the second ED to maintain most of the provisions on control from the first exposure draft, in particular, a not exhaustive list of indicators of the transfer of control, with some amendments:

- the following indicators have been added:
  - the customer has the significant risks and rewards of ownership of the asset (this is a criterion for revenue recognition in IAS 18);
  - the customer has accepted the asset;
- the following indicators have been maintained:
  - the customer has an unconditional obligation to pay for the good or service;
  - the customer has legal title to the asset;
  - the customer has physical possession of the asset;
- the indicator stating that “the design or function of the good or service is customer-specific” has been removed.

If the transfer of control is continuous, the revenue will be recognised using methods which may be based on:

- production, works carried out or services rendered to date, expressed as a percentage of the total production, works or services (‘output methods’);
- costs incurred to date relative to total costs, excluding costs due to wastage (‘input methods’);
- the passage of time as long as it represents a reasonable measure of progress.

6. How should the transaction price be determined?

The second ED defines the transaction price as the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer. This amount excludes amounts collected on behalf of third parties (as in IAS 18).

When determining the transaction price, an entity must consider the effects of the following, as appropriate:

- variable consideration (discounts, rebates and refunds, performance bonuses etc.)
- the time value of money;
- non-cash consideration received from the customer;
the consideration payable to the customer, where this relates to a reduction in the transaction price and not to the acquisition of a distinct good or service.

The collectibility of revenue is no longer to be taken into consideration when determining the transaction price. This is a major change from the first ED, the proposal in which was sharply criticised. In future, collectibility will be accounted for by applying IAS 39 (or IFRS 9). Any impairment would be presented as a separate line item in profit or loss, adjacent to the revenue line item (the same for reversals). Revenue would thus no longer be subject to the effects of customer credit risk, in contrast to what was proposed in the first ED. The future presentation required in profit or loss will however make it a simple matter to compare the revenue level with the amount of impairment recognised for customer receivables or contract assets.

Determining the transaction price in the case of variable consideration

When taking account of variable consideration, the future revenue recognition standard states that an entity should estimate the total amount to which it would be entitled in exchange for transferring the promised goods or services to a customer.

To estimate the transaction price where the consideration is uncertain (and therefore conditional), an entity shall use either of the following methods, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled:

- determination of an “expected value” corresponding to the sum of probability-weighted amounts in a range of possible consideration amounts. This method is appropriate where an entity has entered into large number of contracts with similar characteristics;
- determination of the “most likely amount”: this amount is the single most likely amount in a range of possible consideration amounts. The most likely amount may be an appropriate estimate of the transaction price if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not).

This second method is a new proposal introduced in the second ED. In some circumstances, it can produce a better estimate of the variable consideration than a systematic application of the first method. Nevertheless, the two boards have refused to entertain the proposal that revenue should be estimated on the basis of the best management estimate.

According to the first ED, and in contrast to the existing practice, the conditional revenue should have been recognised on the basis of revisable estimates (based on the expected value of the various possible outcomes), the only authorised method.

The chosen method should be applied consistently throughout the contract. All the information (historical, current and forecasted) that is reasonably available to the entity must be taken into account.

The amount recognised as revenue at a given date (i.e. on account of all the performance obligations satisfied for a given contract) should not exceed the amount of variable consideration to which the entity is “reasonably assured to be entitled”. An entity is reasonably assured to be entitled to the amount of consideration allocated to satisfied performance obligations only if both of the following conditions are met:

- the entity has experience with similar types of performance obligations; and
- this experience (or any other evidence) is predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations.

Indicators that an entity’s experience is not predictive of the amount of consideration to which the entity will be entitled include situations in which the amount of consideration depends on a great extent on factors outside the entity’s influence (for example, weather conditions, or a high risk of obsolescence of the promised good or service). However, the presence of one of these indicators does not necessarily mean that the entity is not reasonably assured to be entitled to an amount of consideration.
Thus, unlike the first ED, which required conditional consideration to be recognised on the basis of each performance obligation accounted for separately, the second ED clarifies that this limit will in future apply to the cumulative amount of revenue recognised at a given date in respect of a contract.

Further, whereas the first ED made the recognition of revenue conditional on the capacity to estimate each performance obligation reasonably, the second ED combines the different performance obligations and replaces the capacity for reliable estimate by the notion of reasonably assured consideration.

Revenue recognition on the sole basis that the estimate was reliable had been criticised, inter alia, in those cases where the revenue was improbable (the recognition of revenue arising only from the use of ‘expected value’).

In the case in which it was considered that additional revenue of 10,000 could be achieved in one case in a hundred, while there would be no revenue in the 99 other cases, the use of the ‘expected value’ would have led to recording a revenue of 100 (10,000 x 1%), which may well be reasonably estimated (the concept in the first ED) but which is not reasonably certain (second ED).

In the case of fees from intellectual property (e.g. licences to patents and trademarks) and when the amount of consideration is based on the customer’s subsequent sales of a good or service (e.g. royalties), the consideration can only be recognised as the customer’s subsequent sales occur.

The board thus implicitly assumes that the revenue is not reasonably certain in all cases (and does not allow entities to exercise their judgement in this matter).

Accounting for the time value of money

The transaction price of a contract must reflect the time value of money in the event of deferred payment, but only if the financing component is significant to the contract. This marks a change from the first ED. The ED lists factors to be considered when determining whether the financing component is significant.

For practical reasons, the boards now propose that an entity should not be obliged to measure the time value of money when the payment takes place a maximum of one year before or after the transfer of the promised goods or services.

7. How should the transaction price be allocated to the separate performance obligations?

The second ED retains the general principle that the transaction price should be allocated to each separate performance obligation. As proposed in the first ED, therefore, the transaction price must be allocated proportionally to the different performance obligations to reflect the amount of consideration to which the entity expects to be entitled in exchange for satisfying each separate performance obligation.

To achieve this allocation, an entity must determine the stand-alone selling price of each good or service relating to each separate performance obligation. The best evidence of a stand-alone selling price is the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers.

If a stand-alone selling price is not directly observable, it should be estimated. The second ED proposes three estimation methods, the last of which, the residual method, did not appear in the first ED. The list is non-exhaustive:

- the adjusted market assessment approach, adjusting market prices where necessary to reflect the structure of costs and margins in the entity;
- the expected cost plus a margin approach, in which an entity could forecast the costs of satisfying a performance obligation and then add an appropriate margin for that good or service;
- the residual approach, if the selling price of a good or service underlying a separate performance obligation is highly variable or uncertain. In this case, the entity should:
  - first, allocate the transaction price to the separate performance obligations the prices of which can be directly observed;
secondly, allocate the residual transaction price to the performance obligation the price of which cannot be reasonably estimated.

This new proposal represents a significant change from the position in the first ED, and is close to existing practices.

If the sum of the stand-alone selling prices of the promised goods or services in the contract includes a discount (i.e. the total amount is less than the sum of the selling prices normally applied to the performance obligations), the second ED allows an entity to allocate that discount to one (or some) separate performance obligation(s) rather than allocating it pro rata to the selling prices of all the performance obligations, if both of the following criteria are met:

- the entity regularly sells each good or service in the contract on a stand-alone basis, and
- the observable selling prices from those stand-alone sales provide evidence of the performance obligation(s) to which the entire discount in the contract belongs.

In contrast, the first ED required a strictly proportionate allocation of the discount to the different performance obligations, a point which was criticised on the grounds that it did not necessarily reflect the economic substance of the transaction.

It should be noted that the allocation of the contract transaction price to each performance obligation should make it possible to determine a separate margin on each performance obligation, even if the price has been negotiated for the bundle of elements. This point constitutes a significant change from the current provisions. Nevertheless, the fact of having to break the contract down into fewer performance obligations (see Question 4), is likely to limit this consequence in practice.

Finally, in the event of changes in the transaction price after contract inception, an entity should allocate these changes to the separate performance obligations on the same basis as at contract inception. Amounts allocated to a satisfied performance obligation should be recognised as revenue, or as a reduction of revenue, in the period in which the transaction price changes.

8. What principles apply to onerous contracts?

The second ED states that the onerous nature of a contract containing several performance obligations would be determined in relation to each performance obligation. This is identical to the proposals in the first ED which was sharply criticised.

Nevertheless, the scope of the onerous performance obligations test would be limited:

- only the performance obligations that an entity expects to satisfy over a period of time greater than one year would be tested (i.e. long-term contracts), whereas the first ED proposed that all performance obligations should be tested;
- additionally, the total amount of costs to be taken into account for the test would be the lower of:
  - the costs that relate directly to satisfying the performance obligation, and
  - the amount that the entity would pay to exit the performance obligation if the entity is contractually permitted to do so other than by transferring the promised goods or services.

A performance obligation would be thus be regarded as onerous if the price allocated to it is lower than the lowest cost of settling the performance obligation.

This remains a major change from current practice, since the onerous nature is generally evaluated on the basis of the contract as a whole.

Nevertheless, because of reduced requirement to disaggregate contracts into different performance obligations in the second ED (see Question 4), and the proposed limits on the scope of the impairment test, the practical impact of the boards’ proposals on onerous performance obligations should, in our view, be limited.
9. How are costs incurred in a contract recognised?

Costs incurred to fulfil a contract

Costs incurred which do not meet the definition of an asset under IAS 2 (Inventories), IAS 16 (Property, plant and equipment) or IAS 38 (Intangible assets), would be recognised only if they fulfil all of the following criteria:

- the costs relate directly to a contract (or a specific anticipated contract);
- they generate or enhance resources of the entity that will be used in satisfying performance obligations in the future; and
- they will probably be recovered.

Costs incurred in obtaining a contract

An entity should recognise as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs (i.e., in our view, if it is probable that the contract will be obtained and will be profitable).

This is a return to the principle set out in IAS 11, whereas the first ED proposed that these costs (costs incurred in sales, advertising and marketing) should be recognised systematically in expenses.

Note, however, that only incremental costs would be recognised as assets. In the case of internal costs, the costs eligible for capitalisation would be limited to sales commissions paid. In contrast, IAS 11 refers to the broader concept of costs directly attributable to the contract.

In practice, the costs of obtaining contracts may be recognised as an expense when incurred if the amortisation period of the asset that the entity otherwise would have recognised is one year or less.

As in the first ED, the vendor should amortise the asset arising from the capitalisation of costs of either obtaining or fulfilling a contract on a systematic basis consistent with the pattern of transfer of the goods or services to which the asset relates.

However, the two boards have clarified that the asset may relate to goods or services to be transferred under future contracts (for example in the case of renewal options).

An entity should recognise an impairment loss to the extent that the carrying amount of an asset exceeds the remaining amount of consideration to which an entity expects to be entitled in exchange for the goods or services to which the asset relates, less the remaining costs to be incurred.

10. How must the contract assets and liabilities be presented?

The provisions for the presentation of contract assets and liabilities remain unchanged since the first ED.

Thus, if an entity performs an obligation by transferring goods or services to a customer before the customer pays consideration, the entity should present the contract as either a contract asset or as a receivable. It would be presented as a receivable if this asset represents an entity’s unconditional right to consideration, i.e. nothing other than the passage of time is required before payment of that consideration is made (recognition as in IAS 39/IFRS 9).

Conversely, if the customer pays consideration or an amount of consideration is due before the vendor performs by transferring a good or service; the entity should present the contract as a contract liability.

An entity may use other terms to designate contract assets and liabilities.

Liabilities recognised for onerous performance obligations should be presented separately from contract assets or contract liabilities.
11 What disclosures should be provided in the notes?

The disclosures required in the notes were confirmed by the two boards in the course of their redeliberations, apart from a few clarifications and amendments, despite the criticisms (mainly from preparers and auditors) of the significant costs involved in the publication of much more extensive disclosures than is the case today.

The IASB also proposes to amend IAS 34 in parallel, so that some information which is mandatory for annual reporting should also be required for interim reporting periods (see Beyond the GAAP No 49 October 2011). This subject was specifically addressed in the second ED.

An entity should therefore provide information on contracts entered into with customers in order to enable users of financial statements to understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. To achieve that objective, an entity should disclose qualitative and quantitative information about the following:

- its contracts with customers;
- the main judgements (and changes in judgements) underlying the amounts recognised;
- any assets recognised from the costs to obtain or fulfil a contract with a customer.

Disclosures on contracts with customers

The following information should be provided:

- a disaggregation of revenue for the period: for example, by type of good or service, contract duration, or sales channels;
- a reconciliation from the opening to the closing aggregate balance of contract assets and contract liabilities, presented in tabular form; and
- information about the entity’s performance obligations, including additional information about any onerous performance obligations. For contracts with an expected duration of more than one year, an entity should disclose the following information as of the end of the current reporting period:
  - the aggregate amount of the transaction price allocated to the remaining performance obligations;
  - an explanation of when the entity expects to recognise that amount as revenue (either on a quantitative basis per period, e.g. less than one year, 1-3 years, etc., or by using qualitative information).

Significant judgements in the application of the draft standard

As a minimum, an entity should provide the following disclosures:

- judgements used to determine the timing of satisfaction of performance obligations;
- judgements used to determine the transaction price and the amounts allocated to performance obligations (assumption, input data, etc.).

Assets recognised from the costs to obtain or fulfil a contract with a customer:

Information should be provided in the form of a reconciliation of the opening and closing balances of these assets, by main category of asset (for example, costs to obtain contracts with customers, precontract costs and set-up costs). Additions, amortisation, impairment losses, reversals of impairment losses and any other line items that may be needed to understand the change in the reporting period must be presented separately.

Qualitative information should be provided on the method used to determine amortisation for the period.
12 What are the transitional provisions in the second ED?

The boards decided that the future standard on revenue recognition should be applied retrospectively (in accordance with IAS 8), as had been proposed in the first ED, despite the criticisms that the transitional provisions would be very onerous to implement in practice. Some simplifications would nevertheless be authorised.

Thus, an entity may use one of the practical expedients set out below at the “initial application date” of the standard (the start of the reporting period in which an entity first applies the revenue recognition standard):

- For contracts completed before the date of initial application, an entity need not restate contracts that begin and end within the same annual reporting period. This should therefore restrict the number of contracts to be restated, in the case of short term contracts:

  Given the fact that interim periods before and after the effective date of the standard will not necessarily be comparable, the boards expect that this expedient will not be used if an entity operates in a sector in which comparability between different interim periods is very important for users of financial statements.

- For contracts completed before the date of initial application and that have variable consideration, an entity may use the transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods. Here the two boards are authorising the use of hindsight in order to simplify the restatement required for contracts entered into with customers;

- An entity need not evaluate whether a performance obligation is onerous before the date of initial application unless an onerous contract liability was recognised previously for that contract in accordance with the requirements that were effective before the date of initial application. If an entity recognises an onerous contract liability at the date of initial application, the entity should recognise a corresponding adjustment to the opening balance of retained earnings for that period.

- For all periods presented before the date of initial application, an entity would not need to disclose the amount of the transaction price allocated to remaining performance obligations. Nor would an entity need to give an explanation of when it expects to recognise that amount as revenue.

If an entity uses any of the practical expedients set out above, they must be applied consistently to all the comparative periods presented.

In addition, the entity should disclose the following information:

- the expedients that have been used on the first application date;
- to the extent reasonably possible, a qualitative assessment of the estimated effect of applying each of those expedients.
**Events and FAQs**

### Events/publications

**Seminars on “Current developments in IFRS”**

The seminar organised by Francis Lefèbvre Formation on 9 December 2011 brings to a close the 2011 seminars on IFRS, but the cycle of training seminars on current IFRS developments will resume next year. Throughout 2012 Mazars’ Doctrine team will lead a number of seminars on IFRSs. These seminars, organised by Francis Lefèbvre Formation, will take place on 23 March, 22 June, 21 September and 7 December 2012.

Applications for registration should be sent to: Francis Lefèbvre Formation: www.ffl.fr or 01 44 01 39 99.

### Frequently asked questions

**IFRS**

- Accounting for costs associated with setting up an employee share ownership plan;
- Impact of debt restructuring on hedging relationships (interest rate risk hedges);
- Accounting for puts and calls on shares of consolidated subsidiaries;
- IFRS 11 analysis of specific joint arrangements in the construction sector;
- Business combinations: how should a step acquisition be accounted for? Should it be considered as a single transaction or as several separate transactions?

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

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