

IFRS news

Revenue redeliberations: some decisions; more to come

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The IASB and FASB met on last month to discuss their joint project on revenue recognition. We outline the key decisions below.

The boards reached tentative decisions on certain topics relating to the constraint on recognising variable consideration, collectibility, time value of money, and distributor and reseller arrangements.

The staff will conduct further analysis on certain items including aspects of the variable consideration constraint and presentation issues relating to collectibility. Other key issues still to be redeliberated include licences, contract modifications, allocation of transaction price, disclosures and transition.

What were the key decisions?

Constraint on recognising variable consideration

Variable consideration that is recognised as revenue will be constrained, under the proposed model, to the amount the entity is ‘reasonably assured’ to be entitled to. This constraint applies to contracts with a variable price and to those contracts with a fixed price where it is uncertain whether the entity will be entitled to that consideration even after the performance obligation is satisfied.

The boards discussed enhancements to the guidance for determining when an entity’s experience is predictive of the amount of variable consideration to which it will be entitled. Further discussions are expected at a future meeting after additional outreach.

Collectibility

Initial and subsequent impairments of receivables should be presented in the same financial statement line item. The boards did not conclude, however, on where the impairment should be presented in the income statement. This debate also raised once again the question of whether collectibility should be a threshold for recognising revenue. The staff will perform further analysis including evaluating the potential consequences of a collectibility threshold, and whether it would be consistent with the core principles of the proposed model. Further discussion is planned for a future meeting.

The boards also considered when revenue should be recognised for contracts with non-recourse, seller-based financing. They agreed to provide additional implementation guidance about whether a contract with a customer exists, based on when the parties may or may not be committed to perform their obligations under the contract.

Time value of money

The boards agreed to retain the proposed guidance that requires adjustment to the transaction price for the effect of time value of money if the contract has a significant financing component. They will, however, consider at a future meeting some additional implementation guidance for inclusion in the final standard. They also decided to retain the practical expedient

that does not require an adjustment for the time value of money if the time difference between performance and payment is one year or less.

An entity does not need to reflect the effect of time value of money for advance payments when the timing of the transfer of goods or services is at the discretion of the customer.

Contract combinations for distributor and reseller arrangements

Promised goods or services in a contract might include offers to provide goods or services that the customer can resell or provide to its customer. These promises are performance obligations even if they are satisfied by another party, and are different from promises to pay cash to the customer, which are accounted for as a reduction of the transaction price.

Is convergence achieved?

Convergence is expected for revenue recognition, as the same principles will be

applied to similar transactions under both IFRS and US GAAP. Differences might continue to exist to the extent that the guidance requires reference to other standards before applying the guidance in the revenue standard.

Who's affected?

The proposal will affect most entities that apply IFRS or US GAAP. Entities that currently follow industry-specific guidance should expect the greatest impact.

What's the effective date?

We anticipate the final standard to have an effective date no earlier than 2015.

What's next?

The boards' timeline indicates that they will issue a final standard in the first half of 2013. They will continue to redeliberate over the next several months and perform targeted outreach on some of the more significant changes.

Leases – it's the wolf!

Partner in PwC's Accounting Consulting Services in the UK, Peter Hogarth, provides an update on the leasing project and tells of his hopes for things to come.



Once upon a time, a namesake of mine annoyed his village neighbours by repeatedly telling them that the wolf was here. It never was, and so nobody believed him. We all know what happened to him, so it is with some nervousness that I tell you that the revised leases exposure draft should be here soon.

The IASB and FASB ('the boards') proudly announced in July that they had substantially completed their discussions and that a revised leases exposure draft would be published by the end of the year ('It's the wolf!'). It didn't take long for that deadline to slip to the first quarter of next year ('I think I can see a wolf-like dot on

the horizon'), but nevertheless the boards do seem to be approaching the end of this phase of the project.

One of the principal criticisms of their 2010 proposals on expense recognition was that they would result in a front-loaded expense profile for lessees, regardless of the payment profile. The boards spent several fruitless months last year in search of a solution, but the issue refused to go away, even when the impact was reduced following decisions concerning lease terms and contingent rentals. The lobbying continued, and the boards have now agreed on an approach that will result in different expense

recognition for different types of leases: some will apply the approach proposed in 2010, similar to today's finance lease accounting with its resultant expense front-loading; others will apply a straight-line expense recognition pattern, similar to current operating lease accounting.

Now, you might want to pause here and get yourself a strong cup of tea before reading on...

This might sound as if several years of debate have resulted in the status quo adjusted only for the capitalisation of operating leases. Actually, that is not too far from the reality, but importantly the new model will include a different basis for determining when each type of lessee accounting should be applied. In principle, the new 'bright-line' will depend on whether the lessee acquires or consumes more than an insignificant portion of the underlying asset. But this might be quite difficult to work out, so the boards have decided on a couple of presumptions depending on the nature of the underlying asset:

- Leases of property should be accounted for using a straight-line expense recognition pattern, unless the lease term is for the major part of the underlying asset's economic life or the present value of the fixed lease payments accounts for substantially all of the fair value of the underlying asset; and
- Leases of assets other than property (such as vehicles or equipment) should apply the approach proposed in the 2010 exposure draft, unless the lease term is an insignificant portion of the underlying asset's economic life or the present value of the fixed lease payments is insignificant relative to the fair value of the underlying asset.

The same 'bright line' tests would be applied by lessors.

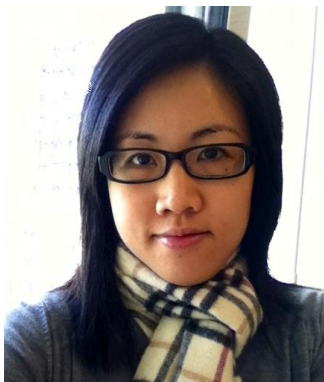


Hopefully that strong cup of tea helped...

References to the leased asset's useful life and fair value compared to the present value of the fixed lease payments might sound familiar, but the new test will be different, especially for equipment leases. And in order to accommodate a straight-line expense while measuring the lease liability by an effective interest method, asset amortisation will in practice be a balancing figure. Early signs are that stakeholders involved with equipment leases have not warmed to the model. A few members of IASB and FASB don't sound too keen either.

As I mentioned, we have been told to expect a revised exposure draft early next year. But if that doesn't happen, I promise I did once see a wolf!

IFRS quiz: deferred tax



Deferred tax – you either know it or you don't. Test yourself against one of our specialists, Cynthia Leung. You can find guidance to help you with the answers in our [topic summary on taxation](#), on [pwcinform.com](#)

Q1: Deferred tax assets or liabilities that will be recovered within 12 months are presented as current assets or current liabilities in the balance sheet. True or false?

- (a) True
- (b) False

Q2: When the carrying amount of an asset is more than its tax base, is there a:

- (a) Taxable temporary difference (that is, a deferred tax liability)?
- (b) Deductible temporary difference (that is, a deferred tax asset)?

Q3: Interest payable has a carrying amount of C100. The related interest expense is taxed on a cash basis. What is the tax base of the interest payable?

- (a) C100?
- (b) C nil?

Q4: Which of the following disclosures are required by IAS 12?

- (i) The amount of each type of deferred tax asset and liability (for example, tax losses or accelerated tax depreciation).
 - (ii) The amount of unused tax losses for which no deferred tax asset is recognised.
 - (iii) The amount of undistributed profits of subsidiaries, associates or joint ventures for which no deferred tax liability is recognised.
- (a) (i) and (ii)
 - (b) (i) and (iii)
 - (c) All of the above

Q5: When is a deferred tax liability recognised in a business combination?

- (a) When there is a temporary difference on goodwill that is not tax deductible.
- (b) When there is temporary difference on acquisition accounting adjustments to the carrying value of identifiable assets and liabilities
- (c) When there are temporary differences both on goodwill that is not tax deductible and on acquisition accounting adjustments to the carrying value identifiable assets and liabilities.

Q6: When is a deferred tax liability recognised in consolidated financial statements for the temporary differences associated with investments in subsidiaries and associates?

- (i) When the parent is able to control the dividend policy of the subsidiary, and the temporary difference will not reverse in the foreseeable future.
 - (ii) When management of an associate states it does not intend to distribute any dividend in the current year.
 - (iii) When the parent's management has announced a plan to sell the subsidiary within two years.
- (a) (i) and (ii)
 - (b) (ii) and (iii)
 - (c) (i) and (iii)
 - (d) All of the above

Q7: A change in tax rate from 30% to 20% is enacted on 31 December 20x1. The new tax rate takes effect on 1 April 20x2. An entity has an accounting year end on 31 December 20x1. How should the deferred tax be measured on temporary

differences that are expected to reverse after 1 April 20x2?

- (a) At 20%
- (b) At 30%
- (c) At an average tax rate based on 20% and 30%

Q8: Where is the adjustment to the deferred tax balances arising from the change in tax rates in question 7 above recognised?

- (a) In profit or loss, as it arises from a change in tax law that is independent of the activities of the entity.
- (b) In equity, as it relates to deferred taxes arising prior to the change in tax rates.
- (c) Either in profit or loss, other comprehensive income or equity depending on where deferred tax was previously recognised.

Q9: Entity A has unused tax losses of C500 with no expiry date. Management believes that future taxable profit of C200 is probable and there are taxable temporary differences of C400. The tax rate is 20%. What deferred tax asset is recognised?

- (a) C80 (C400 x 20%)
- (b) C40 (C200 x 20%)
- (c) C100 (C500 x 20%)

Q10: The income tax rate for undistributed profits is 30%. The tax rate for distributed profits is 40%. For many years, the entity has distributed 50% of its profits. How should the deferred tax of undistributed profits be measured when no dividends have been declared?

- (a) At 30%
- (b) At 40%
- (c) At an average tax rate based on 30% and 40%

Answers

Question 1: B – IAS 1 states that deferred tax assets and liabilities are presented as non-current on the balance sheet. IAS 1 also requires the disclosure of the amount of deferred tax assets or liabilities expected to be recovered or settled within 12 months from the balance sheet date.

Question 2: A – When the carrying amount of an asset exceeds its tax base, the taxable economic benefit from recovering the asset will exceed the amount allowed as a deduction for tax purposes, creating a taxable temporary difference; and the obligation to pay additional income taxes in future periods is a deferred tax liability.

Question 3: B – The interest paid in cash will be deductible in the subsequent period. There will be no tax deduction. The tax base is therefore nil. The tax base of a liability is the carrying amount - future taxable amount

CU nil	=	CU100	-	CU100
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Question 4: C – IAS 12 requires the disclosures for the amount of unused tax losses and undistributed profits of subsidiaries, associates or joint ventures. Disclosing the deferred tax actually recognised does not meet this requirement.

Question 5: B – IAS 12 requires deferred tax to be recognised for all temporary differences, subject to limited exceptions. Deferred tax is not recognised, however, on any temporary difference on goodwill arising in a business combination that is not tax deductible. Deferred tax is recognised on temporary differences arising on identifiable assets and liabilities recognised at fair value at the date of acquisition.

Question 6: B – A deferred tax liability is not recognised for undistributed profits in consolidated financial statements when the parent controls the reversal of the temporary difference and reversal is not expected in the foreseeable future. No deferred tax is therefore recognised in situation (i).

Answers (continued)

The investor has significant influence over the associate in situation (ii), but does not have control the distribution policy. In the absence of an agreement requiring that the profits of the associate will not be distributed in the foreseeable future, an investor should recognise a deferred tax liability.

A deferred tax liability is recognised for the taxable temporary difference in situation (iii) because the parent controls the reversal of the temporary difference but expects the difference to reverse in the foreseeable future because of the sale.

Question 7: A – IAS 12 requires deferred tax assets and liabilities to be measured using tax rates that have been enacted or substantively enacted at the balance sheet date and will apply when the temporary differences reverse. An enacted change in rate is part of the tax law. When the legislative process is not finalised, it is necessary to consider whether the change is substantively enacted, which occurs when there are no future steps in the enactment process that could change the outcome.

Question 8: C – IAS 12 requires the change in deferred tax to be recognised in profit or loss, except to the extent that it relates to items that were previously recognised outside profit or loss. This is referred to as ‘backwards-tracing’.

Question 9: C – IAS 12 requires deferred tax assets to be recognised for unused tax losses to the extent that it is probable that future taxable profits will be available against which the unused tax losses can be utilised. It is presumed that taxable temporary differences that reverse in an appropriate period create taxable profits against which the tax losses can be utilised.

Question 10: A – The tax rates for distributed and undistributed profits are different in some jurisdictions. IAS 12 requires deferred tax to be measured at the tax rate applicable to undistributed profits until dividends are declared.

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