



# IFRS news

## In this issue:

- 1 **Revenue recognition**  
Proposed clarifications and expedients; FASB deferral
- 2 **Leasing**  
New standard approved for ballot
- 4 **IFRS 15 implementation issues**  
March Revenue TRG meeting
- 5 **Cannon Street Press**  
IC discussion of IFRS 11 Leasing project  
Disclosure initiative  
Conceptual framework
- 6 **Questions and answers**  
'Y' for Yields
- 8 **The bit at the back...**

For further information or to subscribe, contact us at [corporatereporting@uk.pwc.com](mailto:corporatereporting@uk.pwc.com) or register online.

## Boards propose changes for revenue; FASB delays effective date one year

**The IASB and FASB continued to discuss implementation issues related to the new revenue standard in March. The FASB met separately to delay mandatory effective date for US GAAP by one year to 2018 with early adoption permitted in 2017.**

Revenue recognition continues to make headlines this March as the FASB and IASB continue to debate issues arising from implementation of the new joint revenue recognition standard. Both boards will propose a new practical expedient to provide relief on transition. The boards agreed other clarifications and expedients but were not fully aligned on their approach to these issues.

The FASB also decided in a separate meeting to defer the effective date by one year. The IASB will discuss the effective date later this month.

### Key decisions

#### US GAAP Effective date

The FASB voted to delay the effective date by one year. The new standard will be effective for public entities for years beginning after 15 December 2017 (private companies – 15 December 2018). Early adoption as of 15 December 2016 (the original US GAAP effective date) will be permitted.

#### Transition—contract modifications and completed contracts

The FASB and IASB will both propose a practical expedient that permits an entity to account for a modified contract based on the transaction price at the date of initial application. The entity would then perform a single standalone selling price allocation (with the benefit of hindsight) to all of the

satisfied and unsatisfied performance obligations in the contract from inception.

The expedient eliminates the requirement to account separately for each contract modification for the entire life of the contract. This relief has been proposed in response to stakeholder concerns about the cost and complexity of applying the contract modification guidance to long term contracts with several modifications.

The IASB will also propose an expedient under the full retrospective approach that will allow entities not to restate contracts that were completed under an entity's previous policies before the earliest period presented. This is similar to the relief given to first time adopters of IFRS that do not need to apply the new revenue standard to contracts completed under previous GAAP even if they would not be completed under the new revenue standard. The FASB will not propose this expedient.

#### Presentation of sales taxes collected from customers

The FASB agreed to propose a practical expedient allowing an entity to either (1) elect net presentation for all taxes or (2) apply the new revenue standard to assess which taxes are levied on the entity and which should be excluded from revenue. The IASB decided against providing this expedient. IFRS reporters are already required to assess sales taxes under existing guidance.

### *Noncash consideration*

The FASB agreed to clarify that noncash consideration should be measured at contract inception and that the variable consideration constraint applies only to variability resulting from reasons other than the form of the consideration. The proposals would require subsequent changes in the fair value of noncash consideration to be recognised in profit or loss (that is, excluded from revenue from contracts with customers). This could mean a significant change from existing practice for US GAAP preparers.

The IASB did not propose standard setting and will monitor the FASB's actions and revisit the topic in the future, if necessary.

### *Collectability*

The FASB agreed to clarify the guidance on collectability, but not to change the principles. They will propose to clarify that the collectability assessment is not based on collecting all the consideration promised in the contract. Rather, entities should consider the probability of collecting the consideration to which they will be entitled in exchange for the goods or services that will be transferred to the customer. They will also propose a clarification to the meaning of contract

termination in the context of determining when non-refundable payments can be recognised as revenue.

The IASB appeared to support the direction of the FASB but will make decisions at a future meeting about whether and how to clarify the collectability guidance.

### *Principal versus agent considerations*

The FASB and IASB staff provided an update on ongoing outreach regarding principal versus agent, but the boards did not make any decisions on this topic.

### *What's next?*

The IASB will incorporate the amendments that were agreed during the meeting into a package of proposed amendments that will be exposed later this year.

The FASB plans to issue an Accounting Standards Update with a 45-day comment period that includes the proposals described above. This is in addition to the planned proposals reflecting the FASB's decisions on licenses of intellectual property and identifying performance obligations.

More details are available on the [March board meeting](#) and the [FASB deferral](#) at the linked publications.

## *Balance sheets to swell as new lease proposal ready for ballot*

**Jessica Taurae, Partner in Accounting Consulting Services, looks at the status of the IASB's long running project on leasing.**

The IASB agreed in March that all due process steps have been completed and thereby gave the staff permission to start drafting the final standard. This decision comes almost 20 years after the G4+1 published *Accounting for Leases: A New Approach* suggesting that all leases should be accounted for as finance leases. The IASB is going to require just that when a final standard is issued later this year.

The drafting stage could take several months, but new accounting for leases now

seems inevitable. The accounting requirements for lessors remain largely unchanged under the new standard. Not so for lessees.

### *How will the new standard affect reported results for lessees?*

Lessees are required to recognise a right of use asset and a liability (obligation to pay for that right i.e. financing) on balance sheet for all leases. However, short term leases with a term of 12 months or less and leases of small assets (for example, laptops or



other small assets) are not required to gross up their balance sheet. The IASB has not defined 'small' but is expected to give an indication on the basis that this includes an item whose value when new is less than approximately US\$5,000.

A lessee will measure the liability at the present value of future lease payments and then recognise interest expense on an effective interest method similar to other financial liabilities. The asset is initially measured at the same amount as the lease liability and then depreciated similar to other assets such as PPE.

The most notable effect other than a bigger balance sheet will be higher interest expense in earlier years of a lease. This in combination with the usual straight-line depreciation of lease assets results in a total lease expense that is higher than straight-line operating lease expense in the first half of the lease term.

#### *What is a lease?*

The definition of a lease becomes critical in the IASB's new model as it is the difference between on or off balance sheet accounting and the knock-on consequences to financial results and ratios. This line between an operating lease and a service has not been tested before as there are minimal accounting consequences of the distinction under existing guidance. So whereas in the

past the critical judgment was between finance and operating leases, now the critical judgement will be whether something is a lease in the first place.

#### *What happened to convergence?*

The IASB and FASB have continued to work together to improve lease accounting but the new standards will not be entirely converged. The FASB will also require that all leases are on the balance sheet; however the most significant difference to the IASB's model is that the income statement for lessees will be more similar to today's model. That is, the FASB has retained a distinction between finance and operating leases for the lessee income statement that is broadly consistent with IAS 17.

#### *What's next?*

The IASB recently published a few project updates, one on the [definition of a lease](#) and one on [practical applications of the new model](#) with a comparison between IASB and FASB models.

Every analyst should read the IASB's second and most recent document on the practical applications of the new model. This will help them understand the model, the differences between the FASB and the IASB models as well as the expected effects of both models compared with today's practice.



#### *Fair value A Sonnet by Ruth Preedy*

*I dream of a world where all values are fair  
Robust, objective not just floating in the air  
Based on cash flows with realistic growth  
Supportable, maintainable in fact a bit of both  
Risk reflected in the discount rate  
Not too low or you will miss-state  
Don't forget you must disclose  
Or you and your regulator could come to blows  
Let me leave you with a parting fact  
As in valuation tis hard to be exact  
Always cross check to market figures  
Then twill stand up to your reviewers' rigour*

## Revenue TRG continues debate

**The Revenue Transition Resource Group (TRG) met for the fourth time in March to discuss implementation issues related to the new revenue standard.**

There continues to be steady stream of IFRS 15 implementation issues. The boards have begun to take action but the list is growing. The TRG discussed eight issues in March.

The boards will consider the feedback from the TRG at a future meeting and, in particular, whether additional standard setting is required. For more details, see [In transition](#).

### **Potential areas for further consideration**

#### ***Consideration payable to a customer***

The TRG discussed three issues related to consideration payable to a customer. The first issue is whether to consider all payments made to a customer within the broader 'customer relationship' (similar to current US GAAP) or only those in a specific contract. Some TRG members suggested an approach not as broad as today's US GAAP, but not so narrow to exclude payments that have no economic substance unless combined with another contract.

The second issue is whether the guidance on consideration payable to a customer applies only to payments to a customer and its customers in the distribution chain, or more broadly to any 'customer's customer.' Some TRG members observed that there is conflicting guidance and the analysis depends on who is the entity's 'customer'.

The final issue discussed the timing of recognition. Some observed that recognising consideration payable to a customer when the entity makes a promise appears to conflict with the variable consideration guidance which considers the entity's intent.

#### ***Series of distinct goods and services***

TRG members observed that the series guidance applies to various types of goods and services transferred over time, beyond just repetitive services. Some thought the guidance could create complexity and US

TRG members suggested that application of the guidance should be optional.

### ***Other topics discussed***

Other topics were discussed where further standard setting is not expected.

***Exercise of material rights.*** TRG members generally agreed that the exercise of an option is a continuation of the contract, but observed that there could be more than one practical accounting approach.

***Significant financing component.*** TRG members generally observed that entities should not presume that a timing difference between payment and performance indicates a financing component. This assessment requires judgment. TRG members also discussed other practical questions about applying the guidance.

***Variable discounts.*** TRG members observed that an entity should first apply the guidance on allocating variable consideration and then the guidance on allocating discounts to any remaining discount that is not variable.

***Partially satisfied performance obligations.*** TRG members agreed with the staff observation that if an entity has already transferred goods or services at the date a contract is established, it is appropriate to recognise revenue for performance satisfied as at the date the contract is established.

***Warranties.*** TRG members acknowledged judgment will be required to assess whether a warranty is a separate performance obligation. Factors to be considered include whether the warranty is required by law, the length of the warranty, and the nature of the promises performed as part of the warranty.

***Contributions (US GAAP only).*** TRG members generally agreed that contributions received by a not-for-profit entity are not in the scope of the new revenue standard under US GAAP.

## Cannon Street Press

### Final IC decisions on IFRS 11

The IC finalised their decisions on a number of issues in their March 2015 meeting. The decisions were broadly consistent with the draft decisions discussed in November (as discussed [December/January IFRS News](#)), with significant confirmations including:

- The assessment of other facts and circumstances should focus on whether those facts and circumstances create enforceable rights to the assets and obligations for the liabilities.

- Judgement will be needed to determine the appropriate accounting where the share of output purchased by a joint operator differs from its share of ownership interest in the joint operation.
- Joint operators should only recognise revenue only when the joint operation sells its output to third parties.

Publication of the final decisions completes the IC discussions on IFRS 11. It is understood that a Post Implementation Review of IFRS 11 will commence in 2016.

### Leasing

The IASB finalised its deliberations on the Leasing project and decided that re-exposure was unnecessary because it would be unlikely to reveal any new information. (See page 1.)

The IASB tentatively decided on the following disclosures in a lessee's financial statements at initial application of the new standard:

- the weighted average incremental borrowing rate at the date of initial application, and
- an explanation of any differences resulting from applying the new standard.

Entities may also provide those disclosures in the interim financial statements following transition depending on the significance of the impact.

### Disclosure Initiative

#### Principles of Disclosure

The IASB has agreed on the basic principles that a general disclosure standard should provide guidance on:

- specification of 'primary financial statements',
- specification of the intended location of required disclosure, and
- the description of the role of primary financial statements).

It also tentatively decided not to undertake further work to reassess which individual statements make up the current set of primary financial statements. The IASB is planning to continue deliberations in April.

#### Materiality

The IASB expressed support for the direction of the proposed Practice Statement on the application of materiality. An ED is expected in June 2015.

### Conceptual Framework

The IASB expects to publish the ED in the second quarter of 2015. The IASB discussed issues that have arisen in drafting the ED and tentatively decided:

- to clarify how measurement uncertainty can affect the relevance of financial information,

- to use the terms 'statement of financial performance' and 'other comprehensive income', and
- to add more discussion about how to establish the boundary of a reporting entity that is not a legal entity.

The IASB expects to publish the ED in the second quarter of 2015.



## ***Know your IFRS ‘ABC’: Y is for Yields on government bonds and other discount rate issues***



**Frances White from PwC’s Accounting Consulting Services in Australia takes a look at discount rates for provisions and impairment, and the effect of an uncertain economic climate**

Increased volatility in global markets, falling commodity prices, political unrest, high unemployment and economic uncertainty can all affect discount rates. Unfortunately preparers can’t adopt a one size fits all approach to determining the appropriate discount rate. Different accounting standards have different requirements. In this article we take a deeper look at the requirements for discount rates for provisions and impairment.

### ***Provisions***

#### ***Discount Rate Basics***

IAS 37 requires provisions to be discounted where the time value of money is material. The discount rate used is a risk-free, pre-tax rate adjusted for risks specific to the liability. Common practice is to use a government bond ‘yield’ rate for the country in which the obligation arises, as this is typically a nominal risk-free pre-tax rate.

The discount rate should not reflect risks for which future cash flows have already been adjusted. In practice, it is sometimes difficult to determine an appropriate risk adjustment to the discount rate. Most entities adjust their cash flows for risk and then discount these cash flows using the risk-free government bond rates.

#### ***Changing economic conditions***

Government bond rates will typically change in line with market conditions. The effect of a change in government bond rates, and therefore the discount rate for provisions, can be particularly significant where the obligation is for costs to be incurred a long time into the future; for example, decommissioning obligations. The observable market rate at the end of the reporting period should be used as the basis for the discount rate. This is the case

regardless of whether there is market volatility or economic uncertainty. Rates using a different methodology (that is, taking a long-term average or reflecting the entity’s own cost of borrowings) should not be used as an alternative.

There might be an exception to this rule when the government bond rate is abnormally high or abnormally low (or even negative). For example, a significant increase in the probability of default or government policies intended to stimulate the economy (for example, quantitative easing) could indicate that it is no longer risk-free. In these circumstances, a different method may be required to determine an appropriate rate. However, simply having volatile rates after the year-end does not justify moving away from rates at the balance sheet date.

Selecting a government bond rate that matches the maturity of the liability is also important. This helps to minimise the effects of distorted rates as abnormally low rates tend to be at the shorter durations where the discounting has less impact. For the longer term liabilities, the yields on longer term bonds tend to be both higher and less volatile.

Negative interest rates in the long-term are likely to be combined with deflation, limiting the extent to which real rates are negative. Otherwise they are likely to reflect factors other than time value of money.

### ***Impairment***

#### ***Discount Rate Basics***

The risk-free rate is only one of many inputs in determining discount rates used for impairment. The first consideration under IAS 36 is what model is being used for

impairment - Value in Use (VIU) or a Fair Value Less Costs of Disposal (FVLCD). The different models require different rates.

#### *Value in Use*

VIU considers the recoverable amount of an asset for its continued use and its ultimate disposal. As such, the discount rate used will be a pre-tax rate that reflects the rate of return that investors would expect from such an investment. This should incorporate the current market assessment of the time value of money and the risks specific to the asset for which the future cash flow estimates have not been adjusted.

This is often done by starting with WACC and then adjusting it to take into account the way in which the market would assess the risks associated with the asset. The WACC will normally take into account country and currency risk and will also be post tax. This however needs to be adjusted for the risks specific to the asset being tested to the extent they are not taken into account in the cash flows. The rate also needs to be adjusted to reflect the pre-tax rate.

#### *Fair Value less Costs of Disposal*

FVLCD considers the recoverable amount of an asset as the fair value at the end of the reporting period less costs of disposal. The fair value is covered by IFRS 13. The valuation incorporates assumptions that market participants would use in estimating the asset's fair value.

This means that some of the restrictions imposed by IAS 36 do not apply. Cash flows should reflect a hypothetical buyer in the principal market for the asset. For example, this might include restructuring if a market participant would be expected to undertake such an exercise. The discount rate should also be a post-tax rate.

#### *Changing economic conditions*

The discount rate incorporates risks specific to the asset and therefore, CGUs with different business or country risk profiles would typically use different discount rates. Different CGUs would therefore be expected to respond differently to economic uncertainty.

In the current economic conditions, a reduction in the risk-free rate based on government bonds is unlikely to result in an overall reduction in WACC as there will most likely be an offsetting increase in risk premiums; for example, due to increased country risk or risk associated with equities. In other words, we would not expect an asset to be worth more in a challenging environment. While the risk-free rate may have decreased, other risks associated with the asset and its uncertain economic climate will counteract a low risk-free rate.

Changing economic conditions increase risk and therefore also increase the rate of return potential buyers will require - in a struggling market, purchasers will be willing to pay less for an asset. As such, the discount rate in a fair value calculation may increase.

#### *Key messages*

In times of economic uncertainty, it's important to remember that changing economic conditions will affect discount rates. Remembering the following key messages will help you to determine which discount rates to apply:

- Discount rates are not a 'one size fits all'. Different accounting standards have different requirements. Whichever model is used, ensure risk is reflected, either through adjusting the cash flows or the discount rate
- Changing risk-free rates will affect impairment and provision calculations differently. Both will be affected by changing economic conditions, but care should be taken when assessing discount rates for both in times of market uncertainty or volatility.
- Discount rates should reflect the conditions at year-end. Post year-end volatility is a non-adjusting event, though additional disclosures may be required.

## *The bit at the back.....*



### **For further help on IFRS technical issues contact:**

#### **Business combinations and adoption of IFRS**

mary.dolson@uk.pwc.com: Tel: + 44 (0) 207 804 2930

#### **Financial instruments and financial services**

gail.l.tucker@uk.pwc.com: Tel: + 44 (0) 117 923 4230

jessica.taurae@uk.pwc.com: Tel: + 44 (0) 207 212 5700

gabriela.d.martinez@uk.pwc.com: Tel: + 44 (0) 207 804 4464

#### **Liabilities, revenue recognition and other areas**

tony.m.debell@uk.pwc.com: Tel: +44 (0) 207 213 5336

richard.davis@uk.pwc.com: Tel: +44 (0) 207 212 3238

a.allocco@uk.pwc.com: Tel: +44 (0) 207 212 3722

#### **IFRS news editor**

Andrea Allocco

a.allocco@uk.pwc.com: Tel: +44 (0) 207 212 3722

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. It does not take into account any objectives, financial situation or needs of any recipient; any recipient should not act upon the information contained in this publication without obtaining independent professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PricewaterhouseCoopers LLP, its members, employees and agents do not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it.

© 2015 PricewaterhouseCoopers. All rights reserved. PricewaterhouseCoopers refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.