IFRIC Update

From the IFRS Interpretations Committee

November 2015

Welcome to the IFRIC Update

IFRIC Update *is the newsletter of the IFRS Interpretations Committee (the 'Interpretations Committee'). All conclusions reported are tentative and may be changed or modified at future Interpretations Committee meetings.*

Decisions become final only after the Interpretations Committee has taken a formal vote on an Interpretation or a Draft Interpretation, which is confirmed by the IASB.

The Interpretations Committee met in London on **10 and 11 November 2015**, when it discussed:

- **Items on the current agenda:**
  - IFRS 9 *Financial Instruments* and IAS 28 *Investments in Associates and Joint Ventures*—Measurement of interests in associates and joint ventures that, in substance, form part of the net investment (Agenda Paper 5)
  - IAS 12 *Income Taxes*—Accounting for income tax consequences of interest payments on, and issuing costs of, financial instruments that are classified as equity (Agenda Paper 8)
  - IFRIC 12 *Service Concession Arrangements*—Payments by an operator to a grantor in a service concession arrangement in the scope of IFRIC 12 (Agenda Paper 2C)
  - IFRIC 12 *Service Concession Arrangement*—Accounting for combined service concession and lease arrangements (Agenda Paper 13)
- **Interpretations Committee's tentative agenda decisions:**
  - IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement*—Derecognition of modified financial assets (Agenda Paper 4)
  - IFRS 9 *Financial Instruments*—Determining hedge effectiveness for net investment hedges (Agenda Paper 11)
  - IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*—Variable payments for asset purchases (Agenda Papers 2–2B)
  - IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*—Accounting for recoverable cash payments (Agenda Paper 7)
  - IAS 32 *Financial Instruments: Presentation*—Offsetting and cash pooling (Agenda Paper 10)
  - IAS 36 *Impairment of Assets*—Recoverable amount and carrying amount of a cash-generating unit (Agenda Paper 14)
- **Other matters:**

Contact us

IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH
United Kingdom

Tel: +44 (0)20 7246 6410
Fax: +44 (0)20 7246 6411
E-mail: **ifric@ifrs.org**
Website: **www.ifrs.org**

Future IFRS Interpretations Committee meetings

The next meetings are:
12 January 2016
22 and 23 March 2016
10 and 11 May 2016
12 July 2016
6 and 7 Septemner 2016
8 and 9 November 2016

Meeting dates, tentative agendas and additional details about the next meeting will be posted to the IASB **website** before the meeting. Further information about the activities of the IFRS Interpretations Committee can be found **here**. Instructions for submitting requests for Interpretations are given on the IASB website **here**.

Archive of IFRS Interpretations Committee Newsletter

For archived copies of past issues of IFRIC Update **click here**.

- Definition of a business—Update on IASB proposals (Agenda Paper 3)
- 2015 Agenda Consultation (Agenda Paper 9)
- Interpretations Committee work in progress update (Agenda Paper 15)

- **Interpretations Committee's agenda decision:**
  - IAS 2 *Inventories*—Prepayments in long-term supply contracts

Items on the current agenda

At this meeting, the Interpretations Committee discussed the following items on its current agenda:

IFRS 9 *Financial Instruments* and IAS 28 *Investments in Associates and Joint Ventures*—Measurement of interests in associates and joint ventures that, in substance, form part of the net investment (Agenda Paper 5)

The Interpretations Committee continued its discussions relating to the interaction between IFRS 9 *Financial Instruments* and IAS 28 *Investments in Associates and Joint Ventures* with respect to the measurement of long-term interests that in substance form part of the net investment in the associate or joint venture (the 'long-term interests').

At its September meeting, the Interpretations Committee considered that an amendment would be required to clarify the issue because it noted that there were divergent views on how to account for the impairment of the long-term interests and that the issue was widespread. It also noted that the interaction between the requirements of IFRS 9 and IAS 28 in relation to this issue was unclear.

At this meeting, the Interpretations Committee discussed measurement alternatives along with the interaction issues that would arise under each alternative, but it did not reach a consensus.

The Interpretations Committee noted that:

a. the key difference arising from the alternatives is whether the long-term interests are subject to the IFRS 9 impairment requirements; and
b. the scope exception in IFRS 9 is not clear in this respect.

Consequently, the Interpretations Committee decided to consult the IASB about whether and how the IASB would expect the scope exception in IFRS 9 to apply to such long-term interests in associates and joint ventures.

Next steps

The staff will present a paper to the IASB at a future meeting that will seek the views of the IASB with respect to this issue.

IAS 12 *Income Taxes*—Accounting for income tax consequences of interest payments on, and issuing costs of, financial instruments that are classified as equity (Agenda Paper 8)

The Interpretations Committee received a request to clarify an issue relating to the application of the requirements in IAS 12 *Income Taxes*. More specifically, the issue relates to accounting for tax consequences of payments on, and issuing costs of, financial instruments that are classified as equity, and whether they should be recognised in profit or loss, or directly in equity.

The Interpretations Committee noted that the interaction between the requirements in paragraph 52B and those in paragraphs 58 and 61A of IAS 12 was not clear with respect to this issue.

Consequently, the Interpretations Committee directed the staff to analyse the issue further, focussing on what circumstances the requirements in paragraphs 52A and 52B try to capture.

Next steps

The staff will present its analysis at a future meeting.

IFRIC 12 *Service Concession Arrangements*—Payments by an operator to a grantor in a service concession arrangement in the scope of IFRIC 12 (Agenda Paper 2C)

The Interpretations Committee received a request to clarify the accounting for contractual payments that are to be made by an operator to a grantor under a service concession arrangement within the scope of IFRIC 12 *Service Concession Arrangements*.

The Interpretations Committee had noted in previous meetings that when the payments to be made by the operator are variable and the intangible asset model in IFRIC 12 is applicable to the arrangement, the issue is linked to the broader issue of variable payments for asset purchases.

The Interpretations Committee noted that it had reached a conclusion at this meeting that the accounting for variable payments for asset purchases was too broad an issue for the Interpretations Committee to address (see Tentative Agenda Decision - IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*—Variable payments for asset purchases (Agenda Papers 2–2B).

Consequently, the Interpretations Committee considered whether a solution could be developed to address the accounting for payments made by an operator to a grantor without the need to address the broader issue of variable payments for asset purchases. However, members of the Interpretations Committee expressed mixed views on this approach. Some members were of the view that the issue could not be addressed without addressing the broader issue of accounting for variable payments for asset purchases. Other members were of the view that service concession arrangements represent a unique type of arrangement that shares some characteristics with lease contracts. These members were of the view that the Interpretations Committee could consider developing guidance by utilising principles similar to those developed by the IASB for the accounting for variable payments in lease contracts.

However, on balance the Interpretations Committee concluded that the issue was also too broad for it to address and directed the staff to prepare a tentative agenda decision for consideration at a future meeting.

Next steps

The Interpretations Committee will discuss the proposed wording for a tentative agenda decision at a future meeting.

IFRIC 12 *Service Concession Arrangements*—Accounting for combined service concession and lease arrangements (Agenda Paper 13)

The Interpretations Committee received a request to clarify an issue relating to application of IFRIC 12 *Service Concession Arrangements*. More specifically, the issue relates to the scope, recognition, presentation and measurement of a service concession arrangement in which the infrastructure used in the arrangement is leased from a leasing company which may or may not be related to the grantor.

The submitter asked the following three questions relating to an arrangement in which the infrastructure is leased in two scenarios. In one scenario, the lessor of the infrastructure is under common control with the grantor, and in the other scenario the lessor is unrelated to the grantor. The questions asked were:

a. Issue 1—whether an arrangement in which there are no construction or upgrade services can fall within the scope of IFRIC 12; if so
b. Issue 2—whether the operator has to recognise a liability with respect to the lease arrangement with a corresponding asset at the beginning of the service concession arrangement; and
c. Issue 3—whether the operator acts as an agent with respect to the lease arrangement and if so, whether acting as an agent affects the measurement and presentation of the recognised assets and liabilities.

With respect to Issue 1, irrespective of whether or not the lessor is related to the grantor, the Interpretations Committee noted that an assessment of whether a particular arrangement falls within the scope of IFRIC 12 requires judgement and, therefore, entities should consider all the facts and circumstances in making an assessment on whether the concession arrangement meets the control conditions in paragraph 5 of IFRIC 12 and the condition relating to the infrastructure in paragraph 7 of IFRIC 12.

The Interpretations Committee also noted that it is not necessary for the operator to provide construction or upgrade services in relation to the infrastructure for the arrangement to fall within the scope of IFRIC 12, as long as the scope requirements are met.

With respect to Issues 2 and 3, the Interpretations Committee noted that an agenda decision would likely be appropriate for these issues, but decided to continue its discussion at a future meeting.

Next steps

The staff will present a paper at a future meeting to explore further Issues 2 and 3 and to consider proposed wording for a tentative agenda decision for all three issues.

Interpretations Committee's tentative agenda decisions

The Interpretations Committee reviewed the following matters and tentatively decided that they should not be added to its agenda. These tentative decisions, including recommended reasons for not adding the items to the Interpretations Committee’s agenda, will be reconsidered at the Interpretations Committee meeting in March 2016. Interested parties who disagree with the proposed reasons, or believe that the explanations may contribute to divergent practices, are encouraged to email those concerns by 21 January 2016 to ***ifric@ifrs.org****. Correspondence will be placed on the public record unless the writer requests confidentiality, supported by good reason, such as commercial confidence.*

IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement*—Derecognition of modified financial assets (Agenda Paper 4)

The Interpretations Committee discussed whether to progress a potential narrow-scope project to clarify the guidance in IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement* about when a modification or exchange of financial assets results in the derecognition of the original asset.

Many Interpretations Committee members observed that, in their experience, the circumstances in which financial assets that have been modified or exchanged should be derecognised is an issue that arises in practice. However, the Interpretations Committee noted that, because of the broad nature of the issue, it could not be resolved through an Interpretation and instead would require an amendment to the Standards. Consequently, the Interpretations Committee [decided] not to progress further consideration of such a project at this time.

IFRS 9 *Financial Instruments*—Determining hedge effectiveness for net investment hedges (Agenda Paper 11)

The Interpretations Committee received a request to clarify how hedge effectiveness should be determined when accounting for net investment hedges in accordance with IFRS 9 *Financial Instruments*. Specifically, the submitter asked whether the ‘lower of’ test that is required for cash flow hedges should also be applied for determining the effective portion of the gains or losses arising from the hedging instrument when accounting for net investment hedges.

The Interpretations Committee observed that:

a. paragraph 6.5.13 of IFRS 9 states that ‘Hedges of a net investment in a foreign operation … shall be accounted for similarly to cash flow hedges …’. Paragraph 6.5.13 (a), which focusses on net investment hedges, also has a reference to paragraph 6.5.11, which deals with the accounting for cash flow hedges; this includes the ‘lower of’ test. This indicates that the ‘lower of’ test should be applied when determining the effective portion of the gains or losses arising from the hedging instruments when accounting for net investment hedges.
b. the application of the ‘lower of’ test for determining the effective portion of the gains or losses

arising from the hedging instruments when accounting for net investment hedges avoids the recycling of exchange differences arising from the hedged items that have been recognised in other comprehensive income prior to the foreign operation being disposed of. The Interpretations Committee noted that such an outcome would be aligned to the requirements and principles of IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

In addition, the Interpretations Committee noted the following:

a. it received no evidence of significant diversity by entities using IAS 39 *Financial Instruments: Recognition and Measurement* when determining the effective portion of the gains or losses arising from the hedging instruments by applying the 'lower of' test when accounting for net investment hedges.
b. few entities have yet adopted the hedging requirements in IFRS 9; consequently, it is too early to assess whether the issue is widespread. However, the Interpretations Committee did not expect significant diversity to arise when IFRS 9 is adopted more widely.

In the light of the existing IFRS requirements the Interpretations Committee determined that neither an Interpretation nor an amendment to a Standard was necessary and therefore [decided] not to add this issue to its agenda.

IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*—Variable payments for asset purchases (Agenda Papers 2–2B)

The Interpretations Committee received a request to address the accounting for variable payments to be made for the purchase of an item of property, plant and equipment or an intangible asset outside of a business combination. The Interpretations Committee discussed this issue over several meetings between 2011 and 2013. Because the accounting for variable payments was being considered by the IASB as part of its projects on Leases and a revised *Conceptual Framework*, the issue was put on hold pending completion of the redeliberations on the proposals in the Exposure Draft *Leases* (published in May 2013). Subsequently, the Interpretations Committee revisited this issue at its meetings in September and November 2015.

The Interpretations Committee could not reach a consensus on whether the variable payments that depend on the purchaser's future activity should be recognised as a liability until that activity is performed and what the initial measurement of this liability should be. Some members of the Interpretations Committee were of the view that all variable payments met the definition of a liability and should be initially recognised and measured at fair value. Other members did not think that variable payments that depend on the purchaser's future activity met the definition of a liability for the purchaser until the activity occurs.

The Interpretations Committee considered the additional concepts proposed for the definition of a liability in the *Conceptual Framework* Exposure Draft (published in May 2015) and also observed that during the deliberations on the proposals in the Exposure Draft *Leases*, members of the IASB had expressed mixed views on whether variable payments linked to future performance or use of the underlying asset in a lease met the definition of a liability. Some members of the IASB did not think that such payments met the definition of a liability for the lessee until the performance or use occurs while other members were of the view that all variable lease payments met the definition of a liability for the lessee. The Interpretations Committee noted that the IASB did not conclude on whether these variable payments met the definition of a liability.

The Interpretations Committee observed that this issue is too broad for the Interpretations Committee to address within the confines of existing IFRSs and consequently [decided] not to add this issue to its agenda.

IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*—Accounting for recoverable cash payments (Agenda Paper 7)

The Interpretations Committee received a request to clarify whether cash payments made by a government to help an entity finance a research and development project should be accounted for as a liability when received (on the basis that it is a forgivable loan as defined in IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*) or recognised in profit or loss when received (on the basis that it is a government grant as defined in IAS 20). The cash payment received from the government is repayable in cash only if the entity decides to exploit and commercialise the results of the research phase of the project. The terms of the repayment can result in the government receiving up to twice the amount of the original cash payment if the project is successful. If the entity decides not to proceed with the results from the research phase, the cash payment is not refundable and the entity must transfer to the government the rights to the research.

The Interpretations Committee noted that the entity had obtained financing for its research & development project and the appropriate accounting would depend on the specific terms and conditions of the cash payment received. The Interpretations Committee observed that the arrangement described in the submission was a financial liability within the scope of IFRS 9 *Financial Instruments*. Many members of the Interpretations Committee thought that the arrangement also met the definition of a forgivable loan as defined in IAS 20. The Interpretations Committee observed that judgement would be required in making this assessment and in determining when there is reasonable assurance that the entity will meet the terms for forgiveness of the loan.

The Interpretations Committee noted that there was sufficient guidance in the Standards to help determine the appropriate accounting for the cash payment received from a government. The Interpretations Committee observed that diversity in practice appeared to be limited based on the feedback it had received from its outreach activities.

In the light of existing IFRS requirements and the feedback received from its outreach activities, the Interpretations Committee determined that neither an Interpretation nor an amendment to a Standard was necessary and therefore [decided] not to add this issue to its agenda.

IAS 32 *Financial Instruments: Presentation*—Offsetting and cash pooling (Agenda Paper 10)

The Interpretations Committee received a request to address an issue related to IAS 32 *Financial Instruments: Presentation*.

The issue relates to whether certain cash pooling arrangements would meet the requirements for offsetting under IAS 32—specifically, whether the regular physical transfers of balances (but not at the reporting date) into a netting account would be sufficient to demonstrate an intention to settle the entire period-end account balances on a net basis in accordance with paragraph 42(b) of IAS 32.

For the purposes of the analysis, the Interpretations Committee considered a cash pooling arrangement involving a number of subsidiaries within a group, each of which have legally separate bank accounts. Both the bank and the group have the necessary legally enforceable right to set off balances in these bank accounts in accordance with paragraph 42(a) of IAS 32. Interest is calculated on a notional basis using the net balance of all the separate bank accounts. In addition, the group instigates regular physical transfers of balances into a single netting account. However, such transfers are not required under the terms of the arrangement and are not performed at the reporting date. Furthermore, based on expected activity, the period end balances may change prior to the next net settlement date as group entities place further cash on deposit or withdraw cash to settle other obligations.

In considering whether the group could demonstrate an intention to settle on a net basis in accordance with paragraph 42(b) of IAS 32, the Interpretations Committee observed that:

a. as highlighted in paragraph 46 of IAS 32, net presentation more appropriately reflects the amounts and timings of the expected future cash flows only when there is an intention to exercise a legally enforceable right to set off; and
b. in accordance with paragraph 47 of IAS 32, when assessing whether there is an intention to net settle, an entity should consider normal business practices, the requirements of the financial markets and other circumstances that may limit the ability to settle net.

Consequently, within the context of the particular cash pooling arrangement described by the submitter, the Interpretations Committee noted that the entity should consider the guidance above in order to assess whether, at the reporting date, there is an intention to settle individual account balances on a net basis or whether the intention is for various entities within the group to use those individual account balances for other purposes prior to the next net settlement date. In this regard, the Interpretations Committee observed that in the example presented, it is stated that prior to the next net settlement date the period end balances may change as group entities place further cash on deposit or withdraw cash to settle other obligations. Because the entity does not expect to settle the period end balances on a net basis due to the expected future activity prior to the next net settlement date, the Interpretations Committee noted that it would not be appropriate for the entity to assert that it had the intention to settle the entire period-end balances on a net basis. This is because presenting these balances net would not appropriately reflect the amounts and timings of the expected future cash flows, taking into account the entity's normal business practice. However, the Interpretations Committee also observed that in other cash pooling arrangements, an entity may not expect the period end balances to change prior to the next net settlement date and consequently it was noted that an entity would be required to apply its judgement in determining whether there was an intention to settle on a net basis in those circumstances.

The Interpretations Committee also observed that the results of the outreach did not suggest that the particular type of cash pooling arrangement described by the submitter was widespread. Furthermore, it was noted that many different variations of cash pooling arrangements existed in practice and consequently the determination of what constitutes an intention to settle on a net basis would depend on the individual facts and circumstances of each case. In the light of this and given the existing IFRS requirements, the Interpretations Committee considered that neither an amendment to IAS 32 nor an interpretation was necessary and consequently [decided] not to add the issue to its agenda.

IAS 36 *Impairment of Assets*—Recoverable amount and carrying amount of a cash-generating unit (Agenda Paper 14)

The Interpretations Committee received a request to clarify the application of paragraph 78 of IAS 36 *Impairment of Assets*. This paragraph sets out the guidance for considering recognised liabilities for determining the recoverable amount of a cash-generating unit (CGU) within the context of an impairment test for a CGU.

The submitter observed that the approach set out in paragraph 78 of IAS 36 for making the CGU's carrying amount comparable with its recoverable amount produces a null result, because the recognised liability is required to be deducted both from the CGU's carrying amount and from its value in use (VIU). The submitter asked whether an alternative approach should be required.

The Interpretations Committee observed that when the CGU's fair value less costs of disposal (FVLCD) considers a recognised liability, paragraph 78 requires adjusting both the CGU's carrying amount and its VIU by the carrying amount of the liability. This makes the comparison of recoverable amount to carrying value meaningful.

The Interpretations Committee observed that the approach in paragraph 78 of IAS 36 for considering recognised liabilities provides a straightforward and cost-effective method to perform a meaningful comparison of the measures involved in impairment testing. Moreover, it observed that this approach is consistent with the requirement in IAS 36 to reflect the risks specific to the asset in the present value measurement of the assets in the CGU and the requirement in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to reflect the risks specific to the liability in the present value calculation of the liability.

In the light of the existing IFRS requirements the Interpretations Committee determined that neither an Interpretation nor an amendment to a Standard was necessary and therefore [decided] not to add this issue to its agenda.

Other matters

Definition of a business—Update on IASB proposals (Agenda Paper 3)

The Interpretations Committee discussed the IASB's proposals on how to clarify the definition of a business and related application guidance. The Interpretations Committee noted that the proposed amendments to IFRS 3 *Business Combinations* would help solve the practical problems that had been raised with the Interpretations Committee about the definition of a business.

2015 Agenda Consultation (Agenda Paper 9)

The IASB is required to carry out a public consultation on its work plan every three years. The primary objective of that review is to seek formal public input on the strategic direction and balance of the IASB's work plan.

The Interpretations Committee noted that the current regular communication between it and the IASB means that the IASB is kept informed of the nature and extent of issues that were discussed by the Interpretations Committee. Nevertheless, the Interpretations Committee concluded that it would be helpful to inform the IASB of its views on the relative priorities of the issues that it has previously discussed.

The Interpretations Committee discussed the draft comment letter presented at the meeting. The Interpretations Committee agreed that it would like to submit a comment letter to the IASB. The Interpretations Committee thought, however, that the letter should focus more on those issues that had been referred to it since the 2011 Agenda Consultation and directed the staff to make the necessary revisions to the letter.

Interpretations Committee work in progress update (Agenda Paper 15)

The Interpretations Committee received a report on three new issues and three ongoing issues for consideration at future meetings. The report also included an issue that is on hold and that will be considered again at future meetings.

Interpretations Committee's agenda decision

IAS 2 *Inventories*—Prepayments in long-term supply contracts

The Interpretations Committee received a request seeking clarification on the accounting for long-term supply contracts for inventories when the purchaser agrees to make significant prepayments to the supplier. The question considered is whether the purchaser should accrete interest on long-term prepayments by recognising interest income, resulting in an increase in the cost of inventories and, ultimately, the cost of sales.

The Interpretations Committee discussed this issue and noted that paragraph 18 of IAS 2 *Inventories* requires that when an entity purchases inventories on deferred settlement terms, and the arrangement contains a financing element, the difference between the purchase price on normal credit terms and the amount paid is recognised separately as interest expense over the period of the financing. It also noted that IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* include similar requirements when payment for an asset is deferred. IFRS 15 *Revenue from Contracts with Customers*, issued in May 2014, additionally includes the requirement that the financing component of a transaction should be recognised separately in circumstances of both prepayment and deferral of payment.

The Interpretations Committee conducted outreach on this issue, but the outreach returned very limited results. In the absence of evidence about this issue, and of a broader range of information about the facts and circumstances relating to these transactions, the Interpretations Committee thought it would be difficult for it to address this topic efficiently and effectively. The Interpretations Committee observed, however, that when a financing component is identified in a long-term supply contract, that financing component should be accounted for separately. The Interpretations Committee acknowledged that judgement is required to identify when individual arrangements contain a financing component.

The Interpretations Committee concluded that this issue did not meet its agenda criteria and therefore it decided to remove this issue from its agenda.

Go to the top of this page

ISSN 1477-206X