IFRIC Update

From the IFRS Interpretations Committee

September 2011

Welcome to the IFRIC Update

IFRIC Update is published as a convenience for the IASB's constituents. All conclusions reported are tentative and may be changed or modified at future IFRS Interpretations Committee meetings.

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

The Interpretations Committee met in London on 8 and 9 September 2011, when it discussed:

- Current agenda:
  - IAS 37 Provisions, Contingent Liabilities and Contingent Assets—levies charged for participation in a market on a specified date
- IFRS Interpretations Committee agenda decisions
- IFRS Interpretations Committee tentative agenda decisions
- IFRS Interpretations Committee other issues considered
- Issues considered for *Annual Improvements*
- IFRS Interpretations Committee work in progress

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Future IFRS Interpretations Committee meetings

The next meetings are:
3 and 4 November 2011
17 and 18 January 2012
13 and 14 March 2012
15 and 16 May 2012
10 and 11 July 2012
18 and 19 September 2012
13 and 14 November 2012

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Current agenda:

The Interpretations Committee discussed the following issue, which is on its current agenda.

IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*—levies charged for participation in a market on a specified date

The Interpretations Committee received a request to clarify whether, under certain circumstances, IFRIC 6 *Liabilities arising from participating in a specific market—Waste Electrical and Electronic Equipment* should be applied by analogy to identify the event that gives rise to a liability for other levies charged for participation in a market on a specified date. The concern relates to when a liability should be recognised and to the definition of a present obligation in IAS 37.

At the July 2011 meeting, the Committee discussed whether the obligating event is the participation in the market on a specified date specified by the legislation, or whether other factors create an earlier obligation. The Committee decided to add this issue to its agenda with the aim of developing guidance.

The Committee also tentatively concluded that IFRIC 6 is not directly applicable, but because IFRIC 6 is an interpretation of IAS 37, any conclusions drawn on the application of IAS 37 to the levies should be consistent with the conclusions drawn in IFRIC 6.

At the September 2011 meeting, the Committee continued its discussions and noted the following:

- Any guidance developed on this matter should only address levies charged by public authorities. The guidance should not address payments related to private contractual arrangements.
- Economic compulsion to participate in the market in the next period does not create a constructive obligation and does not cause the recognition of a liability in IAS 37. The Committee will consider whether any guidance developed could or should also clarify this point.
- The obligation to pay a levy does not automatically create an asset.

The Committee directed the staff to further analyse:

- Whether the obligating event arises at a point in time or whether in certain circumstances the obligating event arises progressively over time. The Committee also asked the staff to clearly distinguish recognition of the liability from measurement of the liability.
- Circumstances in which the obligation is associated with an activity in multiple periods; the staff were asked to identify the obligating event that creates the present obligation in accordance with IAS 37.
- With regard to the question of the 'debit' side of the liability, the Committee noted that the obligation to pay a levy may be associated with an expense or with an asset, depending on the characteristics of each levy. The Committee directed the staff to further analyse in which circumstances the obligation to pay a levy might be associated with an expense or an asset. In particular, the Committee asked the staff to distinguish between exchange and non-exchange transactions with public authorities.
- Whether a distinction can be made between payments that are analogous to taxes and those that are analogous to licences.
- Whether the principles in IAS 12 applicable to income taxes may be relevant to the analysis of the accounting treatment applicable to the levies.

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IFRS Interpretations Committee agenda decisions

The following explanation is published for information only and does not change existing IFRS requirements. *Committee agenda decisions are not Interpretations. Interpretations are determined only after extensive deliberation and due process, including a formal vote. Interpretations become final only when approved by the IASB.*

IFRS 3 *Business Combinations*—business combinations involving newly formed entities: factors affecting the identification of the acquirer

The Interpretations Committee received a request for guidance on the circumstances or factors that are relevant when identifying an acquirer in a business combination under IFRS 3. More specifically, the submitter described a fact pattern in which a group plans to spin off two of its subsidiaries using a new entity ('Newco'). Newco will acquire these subsidiaries for cash from the parent company (Entity A) only on condition of the occurrence of Newco's initial public offering (IPO). The cash paid by Newco to Entity A to acquire the subsidiaries is raised through the IPO. After the IPO occurs, Entity A loses control of Newco. If the IPO does not take place, Newco will not acquire the subsidiaries.

The Committee observed that the accounting for a fact pattern involving the creation of a newly formed entity is too broad to be addressed through an interpretation or through an annual improvement. The Committee determined that the specific fact pattern submitted would be better considered within the context of a broader project on accounting for common control transactions, which the Board is planning to address at a later stage.

Consequently, the Interpretations Committee decided not to add the issue to its agenda and recommended the Board to consider the fact pattern described in the submission as part of its project on common control transactions.

IFRS 3 ***Business Combinations***—business combinations involving newly formed entities: business combinations under common control

The Interpretations Committee received a request for guidance on accounting for common control transactions. More specifically, the submission describes a fact pattern that illustrates a type of common control transaction in which the parent company (Entity A), which is wholly owned by Shareholder A, transfers a business (Business A) to a new entity (referred to as 'Newco') also wholly owned by Shareholder A. The submission requests clarification on (a) the accounting at the time of the transfer of the business to Newco; and (b) whether an initial public offering (IPO) of Newco, which might occur after the transfer of Business A to Newco, is considered to be relevant in analysing the transaction under IFRS 3.

The Committee observed that the accounting for common control transactions is too broad to be addressed through an interpretation or through an annual improvement. The Committee also noted that the issues raised by the submitter have previously been brought to the Board's attention. The Committee determined that the specific fact pattern submitted would be better considered within the context of a broader project on accounting for common control transactions, which the Board is planning to address at a later stage.

Consequently, the Interpretations Committee decided not to add the issue to its agenda and recommended the Board to consider the fact pattern described in the submission as part of its project on common control transactions.

IFRS 3 ***Business Combinations***—acquirer in a reverse acquisition

The Interpretations Committee received a request for guidance asking whether a business that is not a legal entity could be considered to be the acquirer in a reverse acquisition under IFRS 3.

The Committee noted that in accordance with paragraph 7 of IFRS 3, the acquirer is 'the entity that obtains control of the acquiree' and, in accordance with Appendix A of IFRS 3, the acquiree is 'the business or businesses that the acquirer obtains control of in a business combination'. Paragraph B19 in IFRS 3 states that '...The entity whose equity interests are acquired (the legal acquiree) must be the acquirer for accounting purposes for the transaction to be considered a reverse acquisition.'

The Committee observed that IFRSs and the current Conceptual Framework do not require a 'reporting entity' to be a legal entity. Consequently, the Committee noted that an acquirer that is a reporting entity, but not a legal entity, can be considered to be the acquirer in a reverse acquisition.

The Committee noted that this issue is not widespread. Consequently, the Committee decided not to add this issue to its agenda.

IAS 27 ***Consolidated and Separate Financial Statements***—group reorganisations in separate financial statements

The Interpretations Committee received a request asking for clarification of whether paragraphs 38B and 38C of IAS 27 (amended 2008) or paragraphs 13 and 14 of IAS 27 (revised 2011) apply either directly or by analogy to reorganisations of groups that result in the new intermediate parent having more than one direct subsidiary. The request addresses the accounting of the new intermediate parent for its investments in subsidiaries when it accounts for these investments in its separate financial statements at cost in accordance with paragraph 38(a) of IAS 27 (amended 2008) or paragraph 10(a) of IAS 27 (revised 2011).

The Committee noted that the normal basis for determining the cost of an investment in a subsidiary under paragraph 38(a) of IAS 27 (amended 2008) or paragraph 10(a) of IAS 27 (revised 2011) has to be applied to reorganisations that result in the new intermediate parent having more than one direct subsidiary. Paragraphs 38B and 38C of IAS 27 (amended 2008) or paragraphs 13 and 14 of IAS 27 (revised 2011) apply only when the assets and liabilities of the new group and the original group (or original entity) are the same before and after the reorganisation. The Committee observed that this condition is not met in reorganisations that result in the new intermediate parent having more than one direct subsidiary and that therefore these paragraphs in IAS 27 do not apply to such reorganisations, such as the reorganisations presented in the submission. Furthermore, the Committee noted that the Board explained in paragraph BC66Q of IAS 27 (amended 2008) and paragraph BC27 of IAS 27 (revised 2011) that paragraphs 38B and 38C of IAS 27 (amended 2008) and paragraphs 13 and 14 of IAS 27 (revised 2011), respectively, do not apply to other types of reorganisations. In addition, the Committee noted that the guidance in paragraphs 38B and 38C of IAS 27 (amended 2008) or paragraphs 13 and 14 of IAS 27 (revised 2011) cannot be applied to reorganisations that result in the new intermediate parent having more than one direct subsidiary by analogy, because this guidance is an exception to the normal basis for determining the cost of an investment in a subsidiary under paragraph 38(a) of IAS 27 (amended 2008) or paragraph 10(a) of IAS 27 (revised 2011).

As a result, the Committee noted that there is already sufficient guidance in IAS 27 (amended 2008) and IAS 27 (revised 2011). Consequently, the Committee decided not to add this issue to its agenda.

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IFRS Interpretations Committee tentative agenda decisions

The Interpretations Committee reviewed the following matters and tentatively decided that they should not be added to the Committee's agenda. These tentative decisions, including recommended reasons for not adding the items to the Committee's agenda, will be reconsidered at the Committee meeting in November 2011. Constituents who disagree with the proposed reasons, or believe that the explanations may contribute to divergent practices, are encouraged to e-mail those concerns by ***17 October 2011*** *to:* ifric@ifrs.org *. Communications will be placed on the public record unless the writer requests confidentiality, supported by good reason, such as commercial confidence.*

IAS 12 *Income Tax*—rebuttable presumption to determine the manner of recovery

Paragraph 51C of IAS 12 contains a rebuttable presumption, for the purposes of recognising deferred tax, that the carrying amount of an investment property measured at fair value will be recovered through sale. The Committee received a request to clarify whether that presumption can be rebutted in cases other than the case described in paragraph 51C.

The Interpretations Committee noted that a presumption is a matter of policy in applying a principle (or an exception) in IFRSs in the absence of acceptable reasons to the contrary and that it can be rebutted when there is sufficient evidence to overcome the presumption. Because paragraph 51C is expressed as a rebuttable presumption and because the sentence explaining the rebuttal of the presumption does not express the rebuttal as 'if and only if', the Committee thinks that the presumption in paragraph 51C of IAS 12 can be rebutted in other circumstances as well, provided that sufficient evidence is available to support that rebuttal. However, the Committee understands that the Board's intention on introducing a rebuttable presumption in paragraph 51C was to remove the subjectivity in the determination of the expected manner of recovery in paragraph 51. As a result, the Committee thinks that, if the presumption is rebutted, the resulting deferred tax should reflect recovery of the carrying amount entirely through use, rather than be based on any dual purpose analysis.

The Committee thinks that the standard is clear and that diversity in practice on the rebuttal of the presumption should not emerge. Consequently, the Committee [decided] not to add this issue to its agenda.

IAS 12 *Income Tax*—corporate wrapper

The Interpretations Committee received a request for clarification of the calculation of deferred tax in circumstances where an entity holds a subsidiary which has a single asset within it. Specifically, the question asked was whether the tax base described in paragraph 11 of IAS 12 and used to calculate the deferred tax should be the tax base of the (single) asset within the entity which holds it, or the tax base of the shares of the entity holding the asset. The submission explained that the question arises because it is common that the asset will be realised by selling the shares of the entity that holds the asset, rather than selling the asset on its own.

The Committee noted that paragraphs 15 and 24 of IAS 12 require that deferred taxes be recognised for all temporary differences associated with an asset except when certain conditions are satisfied. The

Committee also noted that paragraph 39 of IAS 12 requires that deferred tax is recognised for all temporary differences associated with investments in a subsidiary that holds the underlying asset unless certain conditions are satisfied. The Committee also noted that paragraphs 7 and 38 of IAS 12 require that the tax bases used to calculate those temporary differences are those relating to both the underlying asset and the investment in the shares of the entity that holds the underlying asset. As a result, the Committee notes that entities are unable to avoid recognising deferred tax for temporary differences relating to underlying assets even if the entity does not expect to dispose of the asset separately from the entity which holds it. The only exception to the recognition of deferred tax would be in the circumstances in which the initial recognition exceptions in paragraphs 15 or 24 of IAS 12 apply.

Although the Committee thinks that the requirements of IAS 12 in respect of this issue are clear, it acknowledges that there are other broader concerns relating to this issue and that these concerns need to be resolved by the Board through a broader reconsideration of its principles. Consequently, the Committee [decided] not to add this issue to its agenda.

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IFRS Interpretations Committee other issues considered

IFRS 1 ***First-time Adoption of IFRSs***—prospective application provisions for first-time adopters

The Interpretations Committee was informed about a request that had been received by the IASB to amend IFRS 1 to allow first-time adopters of IFRSs the same prospective application provisions in certain IFRSs as has been afforded to existing preparers of IFRS financial statements. The request notes that while some of the recent Annual Improvements to IFRSs required or permitted prospective application for existing IFRS preparers, no corresponding amendments were made to IFRS 1 for the benefit of first-time adopters. The staff had identified one particular amendment to IAS 20 Accounting for government grants and disclosure of government assistance that they thought required amendment to IFRS 1.

The staff described their plans to propose to the Board that an amendment should be made to IFRS 1 to allow first time adopters to apply paragraph 10A of IAS 20 prospectively, as was permitted for existing IFRS preparers. The staff plan to request that the Board should make the amendment separately, rather than including it in the annual improvements project, in order to progress the issue quickly enough to permit entities adopting IFRS in 2011 to take advantage of the amendment. The staff noted that the amendment would be in the form of an optional exemption, such that other entities that have already transitioned to IFRS in 2011 and produced quarterly reports would not be required to amend their annual financial statements.

The Committee discussed the staff proposals and agreed with the proposal to recommend that the Board amend IFRS 1.

IFRS 8 ***Operating Segments***—aggregation of operating segments and identification of the chief operating decision maker

At the July 2011 meeting, the Committee discussed an issue regarding the application of the aggregation criteria and the identification of the chief operating decision maker (CODM). At that meeting, the Committee decided not to propose amendments to IFRS 8 in respect of the issues raised but to recommend to the IASB that it should consider the issues in its post implementation review of IFRS 8 (further information can be found in the July 2011 edition of IFRIC Update).

At the September 2011 meeting, the Committee discussed a comment letter received from the submitter on its previous decision. That letter encouraged the Committee to address both issues as part of the annual improvements project, before a post-implementation review of IFRS 8 takes place.

The Committee noted that the following aspects in IFRS 8 could be the subject of future clarification:

a. the meaning of ‘similar economic characteristics’ in paragraph 12
b. the criteria for identifying similar segments in subparagraphs 12 (a–e); and

c. whether the definition of the CODM included in paragraph 7 should explicitly exclude non executives from the CODM group.

The staff will update the Board with the results of the Committee's discussion at its meeting in September 2011.

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Issues considered for ***Annual Improvements***

The Interpretations Committee assists the IASB in Annual Improvements by reviewing proposed improvements to IFRSs and making recommendations to the Board. Specifically, the Committee's involvement includes reviewing and deliberating issues for their inclusion in future exposure drafts of proposed Improvements to IFRSs *and deliberating the comments received on the exposure drafts. When the Committee has reached consensus on an issue included in Annual Improvements, the recommendation (including finalisation of the proposed amendment or removal from Annual Improvements) will be presented to the Board for discussion, in a public meeting, before being finalised. Approved* Improvements to IFRSs *(including exposure drafts and final standards) are issued by the Board.*

Issues with recommendations not to be added to Annual Improvements

The Interpretations Committee deliberated two additional issues for consideration within Annual Improvements. The Committee decided not to recommend that the Board should add the following issues to Annual Improvements, but decided to recommend that the Board should consider the issue relating to the transitional requirements in IFRS 10 for separate amendment.

IFRS 10 ***Consolidated Financial Statements***—transitional requirements, meaning of 'the date of initial application'

The Interpretations Committee received a request to clarify the meaning of 'the date of initial application' in the transitional requirements of IFRS 10 *Consolidated Financial Statements*. IFRS 10 does not provide a definition of the date of initial application and the submission received noted that this term is used with different meanings in different IFRSs. The issue considered by the Committee is whether the date of initial application in IFRS 10 is:

a. the beginning of the reporting period in which the entity adopts IFRS 10; or
b. the beginning of the earliest period presented in the financial statements in which the entity adopts IFRS 10.

The Committee noted that the general transition requirements in IFRS 10 are for retrospective application, and in the absence of any exceptions, the Committee would expect this to result in application of all the requirements of IFRS 10 from the beginning of the earliest period presented, ie that the date of initial application should be the beginning of the earliest period presented in the financial statement in which the entity adopts IFRS 10.

The Committee noted the lack of definition of 'the date of application' of IFRS 10 and suggested that if the intention of the staff when drafting IFRS 10, and the intention of the Board when finalising the standard, was to provide an exception to the retrospective application for the involvement in entities that are disposed of or whose control is lost in the comparative period(s), then an exception should be added to the transitional requirements in IFRS 10 to make this clear.

The Committee decided that rather than attempting to address this issue through an annual improvement, it would be best to recommend that the Board should consider this issue for separate amendment.

The Committee also suggested to the Board that it should add a definition for 'the date of initial application' to the Glossary of Terms.

IAS 16 ***Property, Plant and Equipment***—recognition of compensation when it 'becomes receivable'

The Interpretations Committee received a request to clarify the guidance in paragraph 65 of IAS 16 concerning when the compensation for property, plant and equipment that has been impaired, lost or given up (for example, as a result of a natural disaster) becomes receivable.

The Committee observed that the term ‘becomes receivable’ is sufficiently understood within IFRSs to enable an entity to identify when compensation from third parties for such items of property, plant and equipment should be recognised and therefore does not need to be clarified.

The Committee also noted that there is no significant diversity in practice, nor does it expect significant diversity in practice to emerge in the future. Consequently, the Committee decided to propose that the Board should not add this issue to the Annual Improvements project.

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IFRS Interpretations Committee work in progress

IFRS 3 ***Business Combinations***—definition of a business

The Interpretations Committee received a request seeking clarification on whether an asset with relatively simple associated processes meets the definition of a business in accordance with IFRS 3. More specifically, the question was whether the acquisition of a single investment property, with lease agreements with multiple tenants over varying periods and associated processes, such as cleaning, maintenance and administrative services such as rent collection, constitutes a business as defined in IFRS 3.

The Committee observed that IFRS 3 and IAS 40 are not mutually exclusive. An entity acquiring an investment property should consider whether it meets the definition of a business as defined in Appendix A of IFRS 3. The Committee noted that the guidance in paragraphs 11 14 of IAS 40 on ancillary services is intended to delineate an investment property from owner occupied property, and not to delineate a business combination from the acquisition of a single asset. Investment property acquired in a business combination is recognised on the acquisition date at fair value in accordance with IFRS 3. An investment property acquired outside a business combination is recognised at cost in accordance with IAS 40.

To avoid confusion on the interrelation of IFRS 3 and IAS 40, the Committee directed the staff to analyse whether a clarification can be made to IAS 40 through the annual improvements process.

The Committee also observed that the difficulty in determining whether an acquisition meets the definition of a business in Appendix A of IFRS 3 is not limited to the acquisition of investment property. The Committee noted that this broader issue goes beyond the scope of its activities and should be addressed by the Board as part of its post-implementation review on IFRS 3.

However, the Committee considered it to be useful for the Board’s post-implementation review if it contributes to that review its experience and the results from the discussions on this issue. Consequently, the Committee directed the staff to continue their discussions with the staff of the US accounting standard setter, the Financial Accounting Standards Board, and to continue their outreach to interested parties from other industry sectors with the aim of providing the Board with relevant information for its post-implementation review.

The staff will present the results of this further work at a future meeting.

IFRS 11 ***Joint Arrangements***—acquisition of interest in a joint operation

The Committee received a request to clarify the application of IFRS 3 by:

- joint operators for the acquisition of interests in joint operations as defined in IFRS 11; and
- venturers for the acquisition of interests in jointly controlled operations or assets as specified in IAS 31 *Interests in Joint Ventures*

in circumstances where the activity of the joint operation or the activity of the jointly controlled operations or assets constitutes a business, as defined in IFRS 3 and it is therefore concerned that there will be diversity in practice under IFRS 11.

The Committee observed that uncertainty exists in accounting for the acquisition of an interest in a joint operation in circumstances where the activity of the joint operation constitutes a business as defined in IFRS 3.

The Committee discussed, but did not arrive at a conclusion on, a view that IFRS 3 is not required to be applied to the particular assets and liabilities of a joint operation in circumstances where the joint operator acquires an interest in a joint operation in which the activity of the joint operation constitutes a business as defined in IFRS 3. This is because IFRS 3 applies to business combinations and in the acquisition of an interest in a joint operation the acquirer does not obtain control of the business.

In order to avoid significant diversity in practice after the adoption of IFRS 11 and to address the concerns raised in the submission, the Committee directed the staff to analyse whether a premium paid for synergies can be recognised as a separate asset under another standard, eg IAS 38 Intangible Assets in circumstances when an entity acquires an interest in a joint operation that contains a business, or whether IFRS 3 could be applied by analogy, and whether further guidance should be developed on this issue.

The Committee also noted that the Board did not change the wording of the scope exclusion in paragraph 2(a) of IFRS 3 for ‘the formation of a joint venture’ when it decided to replace IAS 31 by IFRS 11, although the Committee understands that the Board did not want to change the scope of IFRS 3. Consequently, the Committee observes that paragraph 2(a) of IFRS 3 should have been amended to say ‘the formation of a joint arrangement’ because IFRS 11 redefined and renamed the different types of joint arrangements. Under IFRS 11 a ‘joint venture’ is one specific type of joint arrangement whereas under IAS 31 it included every type of joint arrangement. The Committee directed the staff to consider whether this issue can be addressed through the annual improvements process.

The staff will present the analysis and a draft annual improvement at a future meeting.

IAS 7 ***Statement of Cash Flows***—classification of business combination cash flows

The Interpretations Committee received a request for guidance on the classification of cash payments for deferred and contingent considerations under IAS 7 *Statement of Cash Flows*. More specifically, the submitter asked the Committee to clarify whether: (i) the settlement of contingent consideration should be classified as an operating, an investing or a financing activity in the statement of cash flows; and (ii) whether the subsequent settlement of a deferred consideration for a business combination should be classified as an investing or a financing activity in the statement of cash flows.

The Committee noted that the issues are widespread and that divergence in practice exists. Consequently, the Committee directed the staff to do further analysis on these issues with the aim of assessing whether the issues could be solved through the annual improvements process. The staff will present further analysis at a future meeting.

Committee outstanding issues update

The Committee received a report on two outstanding issues. With the exception of those issues, all requests received and considered by the staff were discussed at this meeting.

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