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Project	Annual Improvements—2010–2012 cycle		
Topic	Issues that the Committee recommends should not lead to amendments within the scope of the Annual Improvements process – meaning of receivable		

Introduction

1. At its meeting in September 2011 the IFRS Interpretations Committee (the Committee) reviewed one issue for potential resolution through the Annual Improvements process for 2010-2012.
2. The Committee tentatively decided to recommend that the Board should not proceed through the Annual Improvements process with the issue regarding IAS 16 *Property, plant and Equipment*— recognition of compensation when it ‘becomes receivable’.

Purpose of this paper

3. The objective of this paper is to:
 - (a) present background information on these issues and give an overview of our analysis of them,
 - (b) explain the rationale for the Committee’s decision to recommend that the Board should not amend the relevant standards through Annual Improvements, and
 - (c) ask for the Board’s agreement with the Committee’s recommendation.

This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IASB. The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

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4. We received an unsolicited comment letter agreeing with the Committee's decision that clarification in IAS 16 is not needed. This letter has been attached to this paper.

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

5. The following is a summary of the analysis presented to the Committee in September 2011. Our full analysis was set out in [Agenda Paper 10](#), which can be found on the public website, and includes the text of the original submission.

Background information

6. In July 2011 the Committee received a request to clarify the timing of recognition of compensation for insured property plant and equipment (PPE) that has been impaired or lost (for example, as a result of a natural disaster).
7. The recognition requirements for this type of compensation are in paragraph 65 of IAS 16 *Property Plant and Equipment* but the submitter claims it is unclear the moment when this compensation 'becomes receivable', so that it can be recognised. Consequently, the submitter suggests clarifying the requirements in paragraph 65 of IAS 16 as part of the annual improvements project.
8. The submitter questions whether the term "receivable" in paragraph 65 of IAS 16 could be interpreted:
 - (a) as the point at which the insured loss occurs; or
 - (b) as the point when the reimbursement is agreed with the insurer. This treatment would be consistent with the requirements for reimbursements relating to liabilities within the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Paragraph 53 of IAS 37 states that such reimbursements should be recognised when it is virtually certain that they will be received.

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Summary of the staff's analysis

9. The staff acknowledged that two main views could arise in practice:
- (a) **View 1:** Clarification is needed in IAS 16.65 because it is unclear at what moment compensation 'becomes receivable'. We have identified three options on how this clarification could be made:
 - (i) **View 1A:** Clarify that 'becomes receivable' means 'when the insured loss occurs'..
 - (ii) **View 1B:** Align the wording in IAS 16.65 with IAS 37.53. In other words, the requirement in IAS 16 for the compensation to be recognised when it 'becomes receivable' should be replaced with a requirement for the compensation to be recognised when it is 'virtually certain to be received'.
 - (iii) **View 1C:** Await for the outcome of the agenda consultation review on the Liabilities project before proposing any change to IAS 16.65.
 - (b) **View 2:** Clarification is not needed in IAS 16.65 and it is clear that 'becomes receivable' means having a 'right to receive'.

View 1A – Compensation becomes receivable when the insured event occurs

10. Proponents of view 1A argue that compensation 'becomes receivable' when an insured loss occurs. They also think that the Board intended the requirements of IAS 16 to be different from those of IAS 37.
11. We think that circumstances in which insurance contracts compensate the policyholder for an event related to asset impairment or for lost profits (in accordance with paragraph 65 of IAS 16) so that compensation 'becomes receivable' are when:
- (a) an asset owner has a contractual right¹ to payment. This contractual right confirms that:

¹ Paragraph 11(c) in IAS 32 *Financial Instruments: Presentation* defines a financial asset as a contractual right to (i) receive cash or another financial asset from another entity; and (ii) exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity. In addition, in accordance with paragraph B3.1.2 of IFRS 9 *Financial Instruments*, "unconditional receivables and payables are recognised as assets or liabilities when the entity becomes a party to the contract and, as a consequence, has a legal right to receive or a legal obligation to pay cash"

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- (i) the insurance company has an obligation to pay the compensation and
 - (ii) the asset owner has a contractual unconditional right to payment.
 - (b) the event giving rise to an impairment or loss of the assets has occurred. The existence of this event means that an asset (compensation) has arisen in the form of a 'receivable' that an entity can claim from the insurer.
12. Proponents of view 1A could also argue that the requirements of IAS 16 are clearly different from those of paragraph 53 of IAS 37 which includes specific requirements for recognition of reimbursements received from another party, to settle a provision created by an entity. Consequently they would not support aligning the recognition requirements in IAS 16.65 with those in IAS 37.53.
13. The requirements of IAS 16 are different from those in IAS 37 in the following respect:
- (a) IAS 16.65 acknowledges that an unconditional (eg non-contingent) agreement has already been reached with the insurer to compensate the policyholder for an event related to asset impairment or for lost profits and that the recognition of the compensation right is only awaiting for that event to happen; whereas
 - (b) IAS 37.53 waits for the reimbursement to be agreed by a third party and for the policyholder to settle the obligation to which the compensation relates, to eliminate any avoidance of doubt (or uncertainty) that the reimbursement will be received if the entity settles the obligation.
14. Even though proponents of this view think that the meaning of the term 'receivable' in IAS 16.65 could be drawn from the description of a financial asset in IAS 32.11(c) and the timing for recognition of financial assets in IFRS 9.B3.1.2, they would suggest amending paragraph IAS 16.65 to clarify the Board's intent, as follows:
- 65 Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up shall be included in profit or loss when the insured loss occurs. ~~compensation becomes receivable.~~

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View 1B – Align timing recognition requirements in IAS 16.65 and IAS 37.53

15. Proponents of this view would argue that it would be helpful to reword paragraph 65 of IAS 16 to align the wording with that in paragraph 53 of IAS 37.
16. The recognition requirements for reimbursements in paragraph 53 of IAS 37 are shown below: (emphasis added):
 - 53 Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, **the reimbursement shall be recognised when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation.** The reimbursement shall be treated as a separate asset. The amount recognised for the reimbursement shall not exceed the amount of the provision.
17. On the basis of that view, the wording in paragraph 65 of IAS 16 could be modified to state that compensation from third parties when an asset is impaired, lost or given up, is recognised when this compensation is *virtually certain to be received* (as described in paragraph 53 of IAS 37), instead of when compensation ‘becomes receivable’.
18. Proponents of this view think that aligning the recognition criterion in IAS 16.65 with the one in paragraph 53 of IAS 37 would:
 - (a) add clarity to the timing of recognition of compensation from third parties when an asset is impaired, lost or given up, because they perceive that the moment when the compensation right ‘becomes receivable’ is ambiguous;
 - (b) promote consistency with the recognition of reimbursements in paragraph 53 in IAS 37, which also represent compensation payments from third parties;
 - (c) make the requirements of IAS 16.65 more robust by avoiding recognition of highly uncertain amounts. Unlike other financial assets, rights to compensation for a loss can be subject to complicated conditions. Applying the ‘virtually certain’ threshold in IAS 37, compensation would be recognised only when there was reasonable certainty that:
 - (i) the entity had a valid claim against the insurer; and
 - (ii) the reimbursement/compensation can be reliably determined.
19. Proponents of aligning IAS 16 with IAS 37 are not persuaded that the Board intended the requirements of IAS 16 to be different from those of IAS 37 and would modify paragraph 65 of IAS 16 now. But they note that, even if the Board decides to

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recommence the project to replace IAS 37, its decisions on reimbursement rights are tentative. And even if these tentative decisions are confirmed in future, the new requirements will not be issued for some time, with an effective date likely to be at least 12 to 18 months later.

20. Proponents of this view suggest the following modifications to paragraph 65 in IAS 16 to align it with paragraph 53 of IAS 37 (proposed new text has been underlined and deleted text is struck through):

65 Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up shall be included in profit or loss when and only when, it is virtually certain that the compensation ~~becomes receivable~~ will be received.

View 1C –Await for the outcome of the agenda consultation review before proposing any change to IAS 16.65

21. Proponents of this view agree that the timing for recognition of compensations in paragraph 65 of IAS 16 is unclear and consider that a clarification to this paragraph is valid either through the amendment suggested by the proponents of View 1A or through the amendment suggested by the proponents of View 1B.
22. However, proponents of view 1C will wait for the outcome of the agenda consultation review before making any clarification to paragraph IAS.65, as there is uncertainty in the outcome being taken. If the Liabilities project (to replace IAS 37) is taken back on to the IASB's agenda, they think that the issue raised by the submitter could be dealt within a reasonable timescale as part of that project (as a consequential amendment to IAS 16 derived from IAS 37). If the project is not taken back onto the IASB's agenda, then the Committee could reconsider the issue with a view to choosing between option 1A and option 1B.

View 2 – Issue rejection wording that explains the meaning of 'becomes receivable' in IAS 16.65

23. Proponents of this view think that the objective of paragraph 65 of IAS 16 is to recognise compensation from third parties when it becomes *receivable* and that this term is clear enough. The latter might imply that an entity recognises a compensation right as soon as an event occurs and based on the fact that an asset owner has a contractual right to payment.

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24. Proponents of this view do not think that any clarification to IAS 16.65 is needed as the meaning of ‘receivable’ can be easily drawn from the description of a financial asset in IAS 32.11(c) and the timing for recognition of financial assets in IFRS 9.B3.1.2. Proponents of this view do not think that an alignment of the guidance for recognition of compensation (in paragraph 16 of IAS 65) with the guidance for recognition of reimbursements (in paragraph 53 of IAS 37) should be made either as this was not the Board’s original intent.
25. Consequently, those who support view 2 do not propose any amendment to paragraph 65 of IAS 16 at this or at a later stage (even despite the outcome of the Liabilities project that might propose a modification to the recognition of reimbursements).

Interpretations Committee’s recommendation to the Board

26. The Committee observes 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.
27. The Committee also noted that it does not 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.

Question to the Board**Question 1—Interpretations Committee’s recommendation**

1. Does the Board agree with the Committee’s recommendation not to propose an amendment to paragraph 65 of IAS 16 through Annual Improvements to provide further guidance 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?

International Financial Reporting Standards
Interpretations Committee
30 Cannon Street
London
EC4M 6XH

30 September 2011

Dear IFRS Interpretations Committee members,

Tentative Agenda Decision – IAS 16 *Property, Plant and Equipment* – recognition of compensation when it ‘becomes receivable’

The global organisation of Ernst & Young is pleased to submit its comments on the above Tentative Agenda Decision as published in the September 2011 IFRIC Update.

The IFRS Interpretations Committee was asked for clarification on the phrase ‘becomes receivable’ in paragraph 65 of IAS 16 *Property, Plant and Equipment*.

“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.”

We agree with the IFRS Interpretations Committee’s decision that clarification is not needed.

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas at the above address or on +44 (0)20 7951 3152.

Yours faithfully

