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STAFF PAPER

July 2013

IFRS Interpretations Committee Meeting

Project	IFRS 10 *Consolidated Financial Statements* IFRS 11 *Joint Arrangements*		
Paper topic	Transitional provisions—Impairment, foreign exchange and borrowing costs		
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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. 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. Decisions made by the IFRS Interpretations Committee are reported in IFRIC *Update*. The approval of a final Interpretation by the Board is reported in IASB *Update*.

Introduction

1. In January 2013, the IFRS Interpretations Committee (the 'Interpretations Committee') received a request to clarify the transitional provisions of IFRS 10 *Consolidated Financial Statements* and IFRS 11 *Joint Arrangements*. The transitional provisions of IFRS 10 and IFRS 11 provide relief from retrospective application in specific circumstances. However, the submitter observes that IFRS 10 and IFRS 11 do not provide specific relief from retrospective application in respect of the application of IAS 36 *Impairment of Assets*, IAS 21 *The Effects of Changes in Foreign Exchange Rates* or IAS 23 *Borrowing Costs*. The submitter thinks that retrospective application of these Standards could be problematic when first applying IFRS 10 and IFRS 11. The submission is shown in Appendix A of this paper.

Purpose of the paper

2. The purpose of this paper is to:

(a) provide a summary of the transitional provisions in IFRS 10 and IFRS 11;

(b) provide an analysis of the issues raised in the submission;

(c) make a recommendation that the Interpretations Committee should not take this issue onto its agenda (we propose a draft tentative agenda decision in this paper); and

(d) ask the Interpretations Committee whether it agrees with the staff recommendation.

Staff analysis and recommendation

Analysis of the transitional provisions in IFRS 10

3. We acknowledge that IFRS 10 does not provide specific transition relief in respect of the application of IAS 21, IAS 23 or IAS 36. We note that changes in the consolidation conclusion on transition to IFRS 10 are likely to affect the application of other Standards (such as IAS 21, IAS 23 and IAS 36) in cases where an investor:

   (a) would have to retrospectively consolidate an investee that was not previously consolidated; or

   (b) would have to retrospectively 'deconsolidate' an investee that was previously consolidated.

   Indeed, in those cases, retrospective changes in the consolidation conclusion of investees would, for example, affect past impairment tests of goodwill or, in some cases, may require complex calculations in relation to foreign exchange and borrowing costs.

4. As a result, we agree with the submitter that if it would be considered that retrospective application of the requirements of other Standards was always required when first applying IFRS 10, this may be burdensome for preparers.

5. We note that the submitter refers to situations where it would be considered that the investor should apply IFRS 10 retrospectively and, as a consequence, should also apply other Standards retrospectively in order to comply with the requirements of IFRS 10.

6. We observe that IFRS 10 (paragraphs C4A and C5A) provides relief from retrospective application in two specific cases:

   (a) if an investor concludes that it should have consolidated an investee that was not previously consolidated, it is not required to consolidate that investee retrospectively if measuring the investee's assets, liabilities and non-controlling interests from the date when the investor obtained control on the basis of IFRS 10 is impracticable (as defined in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*). In that case, the investor should consolidate the investee as of the deemed acquisition date, ie as of the beginning of the earliest period for which application of IFRS 10 is practicable, which may be the current period.

   (b) if an investor concludes that it should not have consolidated an investee that was previously consolidated, it is not required to 'deconsolidate' that investee retrospectively if measuring the interest in the investee is impracticable. In that case, an investor should apply the requirements of IFRS 10 at the beginning of the earliest period for which application of IFRS 10 is practicable, which may be the current period.

7. It should be noted that the impact of the initial application of IFRS 10 should be recognised as an adjustment to equity at the beginning of the annual period immediately preceding the date of initial application (unless the beginning of the earliest period for which application of the requirements of IFRS 10 is practicable is the current period, in which case the adjustment to equity should be recognised at the beginning of the current period).

8. We note that in order to be able to measure the investee's assets, liabilities and non-controlling interests, as described in paragraph C4 of IFRS 10, or the interest in the investee, as described in paragraph C5 of IFRS 10, and be able to determine

the adjustment to be recognised to equity when first applying IFRS 10, the investor should apply other Standards retrospectively (such as IFRS 3, IAS 21, IAS 23 and IAS 36). As a result, we think that if it is impracticable to make the measurements as required by IFRS 10 because the retrospective application of those other Standards is impracticable, then the transitional provisions of IFRS 10 provide a relief from retrospective application. In other words, the 'impracticability' criterion would apply to other Standards that should be applied retrospectively when making the measurements required by IFRS 10. The definition of the word 'impracticable' is shown in Appendix D.

Analysis of the transitional provisions in IFRS 11

9. We note that IFRS 11 does not provide relief from retrospective application if an investor concludes that it has joint control of an investee under IFRS 11, but concluded that it did not have joint control of that investee under IAS 31. However, although the definition of control has changed in IFRS 10, the definition of joint control provided in IFRS 11 is similar to the definition of joint control in IAS 31 *Interest in Joint Ventures* (2003). We therefore do not think that the assessment of whether an investor has joint control of a joint arrangement would be different under IFRS 11 and IAS 31 in most cases.

10. As a result, when first applying IFRS 11, the only changes resulting from the initial application of IFRS 11 would typically be to change from proportional consolidation to equity accounting or from equity accounting to recognising a share of assets and a share of liabilities. Those changes are linked to the assessment of whether a joint arrangement is a joint venture or a joint operation. In those situations, IFRS 11 already provides relief from retrospective application, ie an entity should not retrospectively reconstruct what equity accounting or the share of assets and liabilities would have been from the date of its first involvement with the joint arrangement. As a result, we do not think that the initial application of IFRS 11 should raise issues in respect of the application of other Standards (such as IAS 21, IAS 23 and IAS 36).

Staff recommendation

11. We do not think that the Interpretations Committee needs to propose amending the transitional provisions of IFRS 10 and IFRS 11. We think that the transitional provisions of IFRS 10 and IFRS 11 provide sufficient guidance and relief from retrospective application in order to address the issues raised by the submitter. We think that the Interpretations Committee can issue an agenda decision in the *IFRIC Update* that will explain how it thinks the transitional provisions of IFRS 10 and IFRS 11 should be applied. On the basis of our assessment of the Interpretations Committee's agenda criteria (see Appendix B), and also on the basis of our analysis in this paper, we recommend the Interpretations Committee to not take this issue onto its agenda. We propose the following wording for the tentative agenda decision:

IFRS 10 *Consolidated Financial Statements* and IFRS 11 *Joint Arrangements*—Transitional provisions in respect of impairment, foreign exchange and borrowing costs

The IFRS Interpretations Committee (the 'Interpretations Committee') received a request to clarify the transitional provisions of IFRS 10 *Consolidated Financial Statements* and IFRS 11 *Joint Arrangements*. The transitional provisions of IFRS 10 and IFRS 11 provide relief from retrospective application in specific circumstances. However, the submitter observes that IFRS 10 and IFRS 11 do not provide specific relief from retrospective application in respect of the application of IAS 21 *The Effects of Changes in Foreign Exchange Rates,* IAS 23 *Borrowing Costs* or IAS 36 *Impairment of Assets*. The submitter thinks that retrospective application of these Standards could be problematic when first applying IFRS 10 and IFRS 11.

The Interpretations Committee noted that when IFRS 10 is applied for the first time, it must be applied retrospectively, except for the specific circumstances for which transitional provisions are given. It also noted that when IFRS 10 is applied retrospectively, there may be consequential accounting requirements arising from other Standards (such as IAS 21, IAS 23 and IAS 36) that must also be applied retrospectively

in order to measure the investee's assets, liabilities and non-controlling interests, as described in paragraph C4 of IFRS 10, or the interest in the investee, as described in paragraph C5 of IFRS 10. The Interpretations Committee observed that if retrospective application of the requirements of IFRS 10 is impracticable because it is impracticable to apply retrospectively the requirements of other Standards, then IFRS 10 (paragraphs C4A and C5A) provides relief from retrospective application.

The Interpretations Committee noted that the definition of joint control provided in IFRS 11 is similar to the definition provided in IAS 31 *Interest in Joint Ventures* (2003). It therefore does not think that the assessment of whether an investor has joint control of a joint arrangement would be different under IFRS 11 and IAS 31 in most cases. As a result, the Interpretations Committee observed that the only changes resulting from the initial application of IFRS 11 would typically be to change from proportional consolidation to equity accounting or from equity accounting to recognising a share of assets and a share of liabilities. In those situations, IFRS 11 already provides relief from retrospective application. The Interpretations Committee concluded that the initial application of IFRS 11 should not raise issues in respect of the application of other Standards in most cases.

On the basis of the analysis above, the Interpretations Committee determined that, in the light of the existing transitional requirements of IFRS 10 and IFRS 11, sufficient guidance or relief from retrospective application exists and that neither an Interpretation nor an amendment to a Standard was necessary and consequently [decided] not to add this issue to its agenda.

Questions for the Interpretations Committee

1. Does the Interpretations Committee agree with the staff analysis presented in this paper?
2. Does the Interpretations Committee agree with the staff recommendation not to take the issue presented in this paper onto its agenda?
3. Does the Interpretations Committee have any comments on the drafting of the tentative agenda decision presented in this paper?

Appendix A: submission

Dear Mr Upton,

Suggested agenda item: Transitional provisions of IFRS 10 and IFRS 11 – Impairment, foreign exchange and borrowing costs

Neither IFRS 10 nor IFRS 11 provides transitional relief in respect of the application of IAS 36 *Impairment of Assets*, IAS 21 *The Effects of Changes in Foreign Exchange Rates* or IAS 23 *Borrowing Costs*. As described below, retrospective application of each of these standards could prove problematic.

We are seeking clarification of this issue by the Committee or, ideally, via amendments to those standards.

The Issue – Impairment

IFRS 10 and IFRS 11 do not provide any transitional relief in respect of IAS 36. Accordingly, the requirements of IAS 36 related to the impairment of assets would need to be considered from the date at which control was obtained (in the case of IFRS 10) or from the inception of a joint arrangement (in the case of IFRS 11) for individual assets and goodwill not previously recognised in the financial statements.

A further issue arising from the retrospective application of the standards relates to how the change in the accounting basis of an investment in the group accounts impacts the historical CGU determinations of the consolidated group (and for which periods).

A change in the composition of the group arising from a newly consolidated investee, recognition of assets of a joint operation, deconsolidation of an investee or the derecognition of assets of a proportionately consolidated JCE could, by adding or removing assets, liabilities and cash flows of investees from the consolidated group, affect the allocation of goodwill within the group and the determination of the CGUs that collectively support goodwill. This would appear to impact, and potentially require changes to, historical impairment assessments.

Reperforming historical impairment testing could be challenging, particularly with respect to avoiding the use of hindsight. It is unclear whether this issue was considered in developing the standards; however, we believe that transition relief should be provided to allow impairment testing reflecting any changes to the composition of a group to begin at a fixed date (for example, at the start of the year of application, or the immediately preceding period).

Example

Three subsidiaries, each a CGU, collectively support a specific goodwill balance. Upon the adoption of IFRS 10, one of the three subsidiaries is no longer consolidated. As part of the retrospective application of the standards, a portion of the goodwill is allocated to the unconsolidated subsidiary, which is now accounted for as an associate. The remaining goodwill is now supported by the two remaining CGUs.

In the absence of any transitional relief, this change in the composition of the group seems to necessitate reperformance of annual goodwill impairment tests from the

earliest comparative period presented onwards. However, the standard does not provide guidance about recasting the CGUs and groups of CGUs which support goodwill.

The issue – Foreign exchange and borrowing costs

Similarly, IFRS 10 and IFRS 11 provide no transitional relief from retrospective application of IAS 21 and IAS 23. Application of those standards from the date that control was obtained or from the inception of a joint arrangement may require complex calculations and access to data from a number of periods which may not be available to a preparer at the date of transition to IFRS 10 and 11.

Reason for IFRIC to Address the Issue

We believe that this issue should be addressed in a timely manner. With the adoption of IFRS 10 and IFRS 11 in the first quarter of 2013 in many jurisdictions, this could result in a significant issue for many entities in first quarter of 2013. The timely provision of guidance for an area in which there is currently none could reduce the potential for diversity in practice.

Appendix B: agenda criteria assessment

B1. According to paragraph 5.16 of the *IFRS Foundation Due Process Handbook*, the Interpretations Committee should address issues:

a. that have widespread effect and have, or are expected to have, a material effect on those affected;

b. where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods; and

c. that can be resolved efficiently within the confines of existing IFRSs and the *Conceptual Framework for Financial Reporting*.

Appendix C: summary of the transitional provisions in IFRS 10 and IFRS 11

Transitional provisions in IFRS 10 (Appendix C)

C1. IFRS 10 is applicable to annual reporting periods beginning on or after 1 January 2013. The amendments made by *Investment Entities* are applicable to annual reporting periods beginning on or after 1 January 2014. An entity is generally required to apply IFRS 10 retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (see paragraph C2 of IAS 8). However, transitional provisions of IFRS 10 provide exceptions from retrospective application in the following cases:

a. an entity is not required to make adjustments to the previous accounting for its involvement with entities that were previously consolidated and continue to be consolidated, or entities that were previously unconsolidated and continue to be unconsolidated at the date of initial application of IFRS 10, ie at the beginning of the annual reporting period for which IFRS 10 is first applied (see paragraph C3 of IFRS 10).

b. an entity need only present the quantitative information required by paragraph 28(f) of IAS 8 for the annual period immediately preceding the date of initial application of the Standard (see paragraph C2A of IFRS 10). On the initial application of an IFRS, paragraph 28(f) of IAS 8 requires an entity to disclose, for the current period and for each period presented, the amount of any adjustment for each financial statement line item affected.

c. if, at the date of initial application, an investor concludes that it shall consolidate an investee that was not consolidated in accordance with IAS 27 *Separate Financial Statements* and SIC-12 *Consolidation–Special Purpose Entities*, the investor shall measure the assets, liabilities and non-controlling interests in that previously unconsolidated investee as if that investee had been consolidated (applying the acquisition method described in IFRS 3 *Business Combinations*) from the date when the investor obtained control of it on the basis of the requirements of IFRS 10 (see paragraph C4 of IFRS 10). However, if measuring the assets, liabilities

and non-controlling interests is **impracticable** (as defined in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*), an investor shall apply the acquisition method as of the deemed acquisition date, which is the beginning of the earliest period for which the application of paragraph C4 is practicable, which may be the current period (see paragraph C4A of IFRS 10).

d. if, at the date of initial application, an investor concludes that it will no longer consolidate an investee that was consolidated in accordance with IAS 27 and SIC-12, the investor shall measure its interest in the investee at the amount at which it would have been measured if the requirements of IFRS 10 had been effective when the investor became involved with (but did not obtain control of, in accordance with IFRS 10), or lost control of, the investee (see paragraph C5 of IFRS 10). However, if measuring the interest in the investee is **impracticable** (as defined in IAS 8), an investor shall apply the requirements of IFRS 10 at the beginning of the earliest period for which application of paragraph C5 is practicable, which may be the current period (see paragraph C5A of IFRS 10).

e. IFRS 10 provides relief from retrospective application in relation to certain amendments to IAS 27 (made in 2008) that have been carried forward into IFRS 10 (see paragraph C6 of IFRS 10).

Transitional provisions in IFRS 11 (Appendix C)

C2. IFRS 11 is applicable to annual reporting periods beginning on or after 1 January 2013. An entity is generally required to apply IFRS 11 retrospectively in accordance with IAS 8 (see paragraph C1B that refers to IAS 8). However, transitional provisions of IFRS 11 provide exceptions from retrospective application in the following cases:

a. an entity need only present the quantitative information required by paragraph 28(f) of IAS 8 for the annual period immediately preceding the first annual period for which the Standard is applied (see paragraph C1B of IFRS 11).

b. relief from full retrospective application is given in circumstances in which the accounting for a joint arrangement changes from proportionate consolidation to equity accounting. The entity should not retrospectively reconstruct what equity accounting would have been on the basis of applying that method from the date of its first involvement with the joint arrangement. Instead, the entity recognises its investment in the joint venture at the start of the immediately preceding period at the amount of the net assets that were previously recorded at that date under proportionate consolidation. In other words, the amounts previously recorded using proportionate consolidation are reflected as a single net amount at the date on which the entity commences equity accounting (see paragraphs C2–C6 of IFRS 11).

c. relief from full retrospective application is given in circumstances in which the accounting for a joint arrangement changes from equity accounting to recognising a share of assets and a share of liabilities. The approach is essentially the reverse of that described above when changing from proportionate consolidation to equity accounting, ie it is effectively an 'expansion' or 'gross-up' of the information previously reported using the equity method. However, there may be some adjustments required (see paragraphs C7–C11 of IFRS 11).

Appendix D: definition of the word 'impracticable' in IAS 8

D1. According to paragraph 5 of IAS 8, the definition of the word 'impracticable' is the following:

> *Impracticable* Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so. For a particular prior period, it is impracticable to apply a change in an accounting policy retrospectively or to make a retrospective restatement to correct an error if:
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> (a) the effects of the retrospective application or retrospective restatement are not determinable;
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> (b) the retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period; or
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> (c) the retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that:
>
> (i) provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognised, measured or disclosed; and
>
> (ii) would have been available when the financial statements for that prior period were authorised for issue from other information.