STAFF PAPER

15 - 16 July 2013

IFRS Interpretations Committee Meeting

Project	IFRS Interpretations Committee Work In Progress		
CONTACT(S)	Michael Stewart	mstewart@ifrs.org	+44 (0)20 7246 6922

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*.

Objective of this paper

1. The objective of this paper is to update the IFRS Interpretations Committee (the Interpretations Committee) on the current status of issues that are in progress but that are not to be discussed by the Interpretations Committee in the July 2013 meeting.

2. We have split the analysis of the work in progress into three broad categories:

   (a) **ongoing issues:** submissions that the Interpretations Committee is actively working on but the issue was not presented in this meeting;

   (b) **issues on hold:** submissions that the Interpretations Committee will discuss again at a future meeting but for some reason has decided to temporarily suspend work on the issue, for example, because there is an IASB project that might have a knock-on effect on the Interpretations Committee's discussions; and

   (c) **new issues:** submissions that have been received but have not yet been presented to the Interpretations Committee.

3. Submissions received since the May meeting relating to new issues are attached as appendices to this paper for information purposes only.

Ongoing issues

4. The following table summarises the work in progress that will be discussed at a future meeting:

Ongoing Issues			
Ref.	**Topic**	**Brief description**	**Progress**
IAS 1-10	*Presentation of Financial Statements:* Current /non-current classification of liabilities	Request to clarify one of the criteria for the classification of liabilities as current or non-current in paragraph 69(d) of IAS 1, when read with paragraph 73 of IAS 1.	The ED *Annual Improvements to IFRSs 2010–2012 Cycle* proposed amending paragraph 73 of IAS 1 to clarify that a liability is classified as non-current if an entity expects, and has the discretion, to refinance or roll over an obligation for at least twelve months after the reporting period under an existing loan facility *with the same lender, on the same or similar terms*. After considering the comments received from respondents, the Interpretations Committee decided to recommend to the IASB that it should not confirm the proposed amendment to IAS 1 in its current form because the proposed amendment proposes to tie the classification requirements of financial liabilities in IAS 1 to the derecognition requirements of financial liabilities in IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 9 *Financial Instruments*, which it thought was not appropriate. At its March 2013 meeting, the IASB agreed not to proceed with the proposed amendments as part of Annual Improvements to IFRSs 2010–2012 Cycle. It decided to ask the Interpretations Committee to reconsider what clarifications could be made to IAS 1 to address this issue. We will bring a paper to the Interpretations Committee at a future meeting.

IAS 2-1	*Inventories:* Long-term prepayments in inventory supply contracts.	Request for clarification on the accounting for long-term supply contracts of raw materials when the purchaser of the raw materials agrees to make prepayments to the supplier. The question is whether the purchaser/supplier should accrete interest on long-term prepayments by recognising interest income/expense, resulting in an increase of the cost of inventories/revenue.	At the January 2012 Interpretations Committee meeting, the Interpretations Committee noted that the Exposure Draft (ED) *Revenue from Contracts with Customers*, published in November 2011, contains requirements regarding the time value of money. Provided that the requirements on the time value of money are not changed in the final revenue standard, this would apply in the seller's financial statements when prepayments are received. The Interpretations Committee observed that the principles regarding accounting for the time value of money in the seller's financial statements are similar to those in the purchaser's financial statements. The Interpretations Committee decided to ask the IASB whether it agrees with the Interpretations Committee's observation, and, if so, whether there should be amendments made in the IFRS literature in order to align the purchaser's accounting with the seller's accounting. At the February 2012 IASB meeting, the IASB agreed that a financing component contained in a purchase transaction should be identified and recognised separately. As a result, interest would be accreted on long-term prepayments made in a financing transaction. However, the IASB noted that payments made when entering into a long-term supply contract might include premiums paid for securing supply or for fixing prices. The IASB noted that in such cases, it is not appropriate to accrete interest on these payments. Consequently, the IASB tentatively decided that it should be made clear that the clarifications proposed should only apply to financing transactions, ie transactions in which prepayments are made for assets to be received in the future. The IASB asked the Interpretations Committee to consider addressing the diversity in accounting, not by amending the current literature as part of a separate IASB project, but by clarifying the purchaser's accounting through an interpretation. We will prepare a paper to be presented at a future IFRS Interpretations Committee meeting, where we will consider the result of the IASB's redeliberations on the ED on revenue.

Ongoing Issues			
Ref.	**Topic**	**Brief description**	**Progress**
IAS 12-8	*Income Taxes:* Recognition of deferred tax for unrealised losses.	The Interpretations Committee received a request to clarify the accounting for deferred tax assets when an entity: • has deductible temporary differences relating to unrealised losses on debt instruments that are classified as available-for-sale financials assets and measured at fair value; • is not allowed to deduct unrealised losses for tax purposes; • has the ability and intention to hold the debt instruments until the unrealised loss reverses; and • has insufficient taxable temporary differences and no other probable taxable profits against which the entity can utilise those deductible temporary differences.	At its meeting in May 2013, the Interpretations Committee decided to recommend to the IASB that it should amend IAS 12 to clarify that deferred tax assets for unrealised losses on debt instruments are recognised, unless recovering the debt instrument by holding it until an unrealised loss reverses does not reduce future tax payments and instead only avoids higher tax losses. The Interpretations Committee understood that its recommendation would not always achieve an outcome for deferred tax accounting that would be consistent with the one that was recently discussed and proposed by the FASB. It expects that this will be the case if recovering the debt instrument by holding it until an unrealised loss reverses does not reduce future tax payments and instead only avoids higher tax losses. The Interpretations Committee noted that: • its recommended amendment to IAS 12; and • an amendment that achieves an outcome for deferred tax accounting that would be consistent with the one that was recently discussed and proposed by the FASB would be significantly different. The Interpretations Committee decided to consult with the IASB on theapproach that is to be the basis for the amendment before discussing further details and drafting a proposed amendment. Following consultation with the IASB, the staff will present an analysis discussing analysis discussing further details, a recommendation and a draft proposed amendment to IAS 12 in a future meeting.
IAS 12-11	*Income Taxes:* Recognition of deferred tax for a single asset in a	Request for clarification of the calculation of deferred tax in circumstances in which the entity holds a subsidiary which has a	At the May 2012 meeting, the Interpretations Committee noted significant diversity in practice in accounting for deferred tax when tax law

	corporate wrapper.	single asset within it. Specifically, the question asked was whether the tax base that was 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.	attributes separate tax bases to the asset inside and the parent's investment in the shares and when each tax base is separately deductible for tax purposes. The Interpretations Committee also noted that the current IAS 12 requires the parent to recognise both the deferred tax related to the asset inside and the deferred tax related to the shares, if tax law considers them to be two separate assets and if no specific exceptions in IAS 12 apply. However, considering the concerns raised by commentators in respect of these requirements in the current IAS 12, the Interpretations Committee decided in the May 2012 meeting to not recommend the IASB to address this issue through an Annual Improvement, but instead to explore further options to address this issue that would result in a different accounting for this specific type of transaction. Consequently, the Interpretations Committee directed the staff to analyse whether the requirements of IAS 12 should be amended in response to the concerns raised by commentators. We plan to present this analysis at a future meeting.
IAS 29-4	IAS 29 – *Financial* Reporting in Hyperinflationary Economies: Applicability of IAS 29	Request to clarify whether an entity whose functional currency is the currency of a hyperinflationary economy as described in IAS 29 *Financial Reporting in Hyperinflationary Economies* needs to apply IAS 29 to its financial statements prepared under the concept of financial capital maintenance defined in terms of constant purchasing power units rather than nominal monetary units.	The staff are developing analysis on the issue raised in the submission and an additional issue identified after the receipt of the submission. The staff plan to bring the analysis to a future Interpretations Committee meeting.
IFRS 2-12	IFRS 2 – *Share based payment*: Share based payment transactions where the manner of settlement is	Request for clarification on the classification and measurement of share based payment transactions in which the manner of settlement is contingent on future events. More specifically, the submitter is seeking clarification on how to	In May 2013, the Interpretations Committee revisited these issues, which Interpretations Committee had decided not to address in January 2010. In the May 2013 meeting, the Interpretations Committee noted that

	contingent on future events	classify share-based payment transactions for which the manner of settlement is contingent on either: a. a future event that is outside the control of both the entity and the counterparty; or b. a future event that is within the control of the counterparty. The submitter states that IFRS 2 provides guidance on the classification of a share-based payment transaction in cases in which either the entity or the counterparty can choose whether the transaction is settled in cash (or other assets) or by issuance of equity instruments (paragraphs 34-43 of IFRS 2). However, the submitter argues that there is no clear guidance on the two transactions described above and therefore, there are divergent views on both of them.	paragraph 34 of IFRS 2 indicates a principle that an entity is required to account for a share-based payment transaction, or the components of that transaction, as a cash-settled share based payment transaction if, and to the extent that, the entity has incurred a liability to settle in cash or other assets. The Interpretations Committee noted, however, that IFRS 2 does not provide specific guidance on a share-based payment transaction in which the manner of settlement is contingent on a future event that is outside the control of both the entity and the counterparty. In addition, the Interpretations Committee observed that it is unclear which guidance in other Standards and the Conceptual Framework would be the best analogy for such a share-based payment transaction. The Interpretations Committee noted significant diversity in accounting for the share-based payment transaction in which the manner of settlement is contingent on a future event that is outside the control of both parties. The Interpretations Committee therefore asked the staff to explore approaches to providing guidance for the classification of the share-based payment transaction. The staff plan to bring the analysis on approaches to providing guidance to a future meeting.

Issue on hold

5. The following issue is on hold for the reasons stated:

Issues on hold			
Ref.	**Topic**	**Brief description**	**Progress**
IAS 39-32	IAS 39 *Financial Instruments: Recognition and Measurement*—Income and expenses arising on financial instruments with a negative yield—presentation in the statement of comprehensive income	The demand of investors for 'safe harbour' assets has increased to a degree that the yield on some assets (on some of the remaining high quality government bonds) has turned negative. This raises the question of how the income or expense that results from negative interest rates should be presented in the statement of comprehensive income .	In September 2012 and January 2013, the IFRS Interpretations Committee discussed the ramifications of the economic phenomenon of negative effective interest rates for the presentation of income and expenses in the statement of comprehensive income. In September 2012, the Interpretations Committee reached a tentative decision on how amounts of income and expense arising from a negative yield on a financial instrument should be presented in the Statement of Profit or Loss and published a tentative agenda decision for comment. In January 2013, the Interpretations Committee was concerned that finalising the tentative agenda decision could have unintended consequences on the classification of financial assets in accordance with IFRS 9 *Financial Instruments* which is currently subject to a project to consider limited scope amendments. The Interpretations Committee therefore decided to refrain from finalising the tentative agenda decision until the IASB has completed its redeliberations on the Exposure Draft *Classification and Measurement: Limited Amendments to IFRS 9.*

New issues

6. This table summarises those issues that have been received but not yet presented to the Interpretations Committee:

New issues			
Ref.	**Topic**	**Brief description**	**Progress**
IFRS 2-21	IFRS 2 –*Share-based Payment*: IPO dual pricing issue	The submitter requests the Interpretations Committee to clarify how an entity should account for a price differential between the institutional offer price and the retail offer price for shares in an initial public offering (IPO). The submitter refers that the final retail price could be different from the institutional price due to: (a) an unintentional difference arising from the book building process; or (b) an intentional difference arising from a discount given to retail investors as indicated in the prospectus. The submitter observes that two views have arisen in practice. Some think that in the event the consideration received by an entity for the issue of equity instruments is lower than the fair value of the equity instruments, the entity is deemed to have received or will receive unidentifiable goods or services in accordance with IFRS 2 *Share-based Payment*. Others think that the price differential is not due to any goods or services received and consequently IFRS 2 would not apply.	The original submission is included in **Appendix A** of this paper. We will bring this issue to a future Interpretations Committee meeting.
IFRS 11-2	IFRS 11 – *Joint Arrangements* Classification of joint arrangements under IFRS 11 – One party obliged to purchase 100per cent of	The submitter requests the Interpretations Committee to provide clarification with respect to the classification of a joint arrangement in which one party is obliged to purchase all of the arrangement's output. The submitter thinks that the Standard does not specify whether	The original submission is included as **Appendix B** of this Agenda Paper. We will bring this issue to a future Interpretations Committee meeting.

New issues			
Ref.	**Topic**	**Brief description**	**Progress**
	output	the assessment of whether a joint arrangement is a joint venture or a joint operation should be made at the level of the parties as a group or by each party in isolation.	
IFRS 11-3	IFRS 11 – *Joint Arrangements* Classification of joint arrangements under IFRS 11 – Other facts and circumstances	The submitter requests the Interpretations Committee to provide clarification with respect to the classification of a joint arrangement in the following circumstances: • Under the other facts and circumstances test, do the parties require a contract (i.e. legally enforceable rights and obligations) to purchase substantially all of the output of the arrangement in order to achieve classification as a joint operation? • Under the other facts and circumstances test, does the availability of third party finance preclude classification as a joint operation?	The original submission is included as **Appendix C** of this Agenda Paper. We will bring this issue to a future Interpretations Committee meeting.
IAS 17	*IAS 17 Leases*: Interpretation and use of the term "incremental costs" in relation to initial direct costs as specified in IAS17	Request for guidance on whether fixed staff costs–employees on payroll who spend all (or substantially all) of their time on the negotiation, arranging and creation of new transactions (leases and loans)–can qualify as "incremental costs" in terms of initial direct costs as specified in IAS17. According to the submission, it is unclear how the requirements in IAS 17 are applied and therefore there are two alternative views being applied in practice.	The original submission is included in **Appendix D** of this paper. We will bring this issue to a future Interpretations Committee meeting.
IFRS 2-19	IFRS 2: *Share-based Payments*: Accounting for cash-settled share-based payment arrangements that include a performance condition	Request for guidance on the measurement of cash-settled share-based payment transactions that include a performance condition. This is because according to the submitter, the lack of specific guidance in IFRS 2 is leading to different interpretations and diversity in practice.	The original submission is included in Appendix C of Agenda Paper 8 of the May meeting. We will bring this issue to a future Interpretations Committee meeting.

New issues			
Ref.	**Topic**	**Brief description**	**Progress**
		The submitter observes that current practice is mixed. Some entities measure cash-settled share-based payment transactions that include a performance condition in the same way as equity settled share-based payment transactions and others measure the fair value of the instrument, taking into account the impact of all conditions and all possible outcomes on a weighted-average basis.	
IFRS 3-16	IFRS 3 –*Business Combinations*: Acquisition of control over joint operations	Request to provide guidance on whether previously held interest in the assets and liabilities of a joint operation should be remeasured to fair value on acquiring control over the joint operation. According to the submitter IFRS 3 does not contain any specific guidance on accounting for acquisition of control over a joint operation whose activities constitute a 'business' as defined in IFRS 3. According to the submitter, joint operations are not generally conducted through legal entities and the operators do not have equity interests in joint operation. Instead, they have rights to their share of assets and obligation for their share of liabilities relating to the joint operation. In such cases, it is not clear whether the previously held interest in the joint operation should be re-measured to fair value on acquiring control over the joint operation.	The original submission is included as Appendix A of Agenda Paper 17 of the March 2013 meeting of the Interpretations Committee. We will bring this issue to a future Interpretations Committee meeting

7. This paper does not include requests or issues that are still at a preliminary research stage. It will exclude, therefore, those issues for which further information is being sought from the submitter or other parties to define the issue more clearly.

8. We have reproduced in **Appendices A-D** the new requests that we have added to the above list since the May 2013 agenda paper was prepared. All information has been copied without modification, but we have deleted details that would identify the submitter of that request to preserve their anonymity.

Question
Does the Interpretations Committee have any questions or comments on the Interpretations Committee Outstanding Issues List?

Appendix A: IFRS 2-21 – IPO dual pricing issue

Issues paper on Scope of IFRS 2 *Share-based Payment*

Fact pattern in Malaysia

In Initial Public Offerings (“IPO”), there are various methods used to determine the offer price for the offer shares.

Usually for the smaller offerings, there is only one offer price, which is decided by the Issuer and the Managing Underwriter through various valuation techniques.

For the larger offerings, it is usually split into retail and institutional tranches. The offer price for the institutional tranche is typically determined through a book building exercise/process, while the offer price for the retail tranche is usually tagged to the institutional offer price. Where there are two offer tranches (i.e. retail and institutional), there is a possibility that the final offer price for the retail tranche could be lower than the offer price for the institutional tranche.

The issue

There are divergent views whether the issue of shares for the retail tranche at a consideration lower than the institutional offer price (some has referred this different as a “discount” to retail investors) is within the scope of IFRS 2 *Share-based Payment*.

Mechanism to determine the institutional offer price and retail offer price

Institutional offer price

After the issuance of an IPO prospectus, the institutional offer price is typically determined through a book building exercise[1].

During the book building exercise, the prospective investors will be invited to bid for portions of the institutional offering by specifying the price and number of offer shares that they would be prepared to acquire. Upon completion of the book building exercise, the institutional offer price will be fixed in consultation with the “bookrunners” or “global coordinators”, where relevant. This price fixing event occurs after the close of the offer.

Settlement by the institutional investors is only required after they have been informed of their allocation.

[1] In cases where there are cornerstone investors, this may create different sub-institutional price.

Retail offer price

Unlike the institutional tranche, retail investors are required to pay for the shares at the time of application. A refund will be made if they are unsuccessful.

The retail price is required to be stated in the prospectus. This precedes the fixing of the institutional price. As such, the retail offer price stated in the prospectus is an indicative retail offer price, i.e. in the event the institutional offer price is lower, a refund will be made (so that the final retail offer price will be equal to the institutional offer price).

However, in the event the institutional offer price is higher, the indicative retail offer price represents the ceiling price that a retail investor is required to pay for the shares. This is because it is not practical (in terms of timing or logistics) to request for additional payment from retail investors.

As such, to fix the indicative retail offer price, the Managing Underwriter will carry out a price discovery process, where a research on the demand of the shares offered in the market is conducted. The indicative retail offer price is determined and agreed after taking into consideration factors like the nature of business, operating history, competitive strengths, business strategies and the results of the price discovery process.

Although the final retail offer price is typically set at a price equal to the lower of the institutional price and the indicative retail offer price (thus the indicative retail offer price is always the ceiling price for reasons stated above), there could be circumstances the Issuer may wish to give a small discount to the retail investors (comparative to the institutional investors) so as to encourage subscriptions from the public if the Issuer wants a larger retail investors profile[2]. Under such circumstances, the final retail offer price will be set at a price equal to the lower of the indicative retail offer price and (100% - x%) of the institutional offer price.

In summary, the final retail price could be different from the institutional price due to the following two situations:

(a) Situation 1 – unintentional difference arising from the book building process.

(b) Situation 2 – intentional difference arising from discount given to retail investors as indicated in the prospectus.

<u>Situation 1 – unintentional difference</u>

[2] An applicant must have at least 25% of the total number of shares or units for which listing is sought in the hands of a minimum number of 1,000 public shareholders or unit holders holding not less than 100 shares or units each (source: Bursa Malaysia Main Market Listing Requirements Chapter 3 Admission).

The final retail offer price is set at a price equal to the lower of the indicative retail offer price and the institutional offer price

> ***Illustration***
>
> An IPO comprise of the following offers:
>
> - Institutional offering at the price to be determined by way of book building; and
> - Retail offering at the lower of RM4.80 per share and 100% of the institutional offer price.
>
> Assuming that the institutional offer price is set at RM5.00 per share by way of book building, the retail offer price shall remain at RM4.80 per share, being the lower of RM4.80 and 100% of the institutional offer price (RM5.00 x 100% = RM5.00).
>
> In this situation, there is no refund to the retail investors.

Issue:

Does the price differential of RM0.20 [RM5.00-RM4.80] represent payment for goods or services received?

Situation 2 – intentional difference

The final retail offer price is set at a price equal to the lower of the indicative retail offer price and a fixed percentage, say 95%, of the institutional offer price

> ***Illustration***
>
> An IPO comprise of the following offers:
>
> - Institutional offering at the price to be determined by way of book building; and
> - Retail offering at the lower of RM4.80 per share and 95% of the institutional offer price.
>
> Assuming that the institutional offer price is set at RM5.00 per share by way of book building, the final retail offer price will be RM4.75 per share, being the lower of RM4.80 and 95% of the institutional offer price (RM5.00 x 95% = RM4.75).
>
> In such situation, RM0.05 per share will be refunded to the retail investors.

Issue:

Does the price differential of RM0.25 [RM5.00-RM4.75] represent goods or services received?

View 1: The price differential represents goods or services received

Proponents of View 1 believe that in the event the consideration received by an entity for the issue of equity instruments is lower than the fair value of the equity instruments, the entity is deemed to have received or will receive other consideration which could not be clearly identified. Such other consideration is termed as unidentifiable goods or services in IFRS 2.

Paragraph 2 of IFRS 2 states that in the absence of specifically identifiable goods or services, other circumstances may indicate that goods or services have been (will be) received, in which case IFRS 2 applies. BC18C of IFRS 2 also indicated the IASB position that it is not necessary to identify the specific goods and services received in return for the equity instruments granted to conclude that goods or services have been or will be received. Unidentifiable goods or services, by nature, are not specifically identifiable. Instead, it appears very much like a form of intangible benefits received or to be received by the entity which translates into “the reason” for the entity to issue equity instruments below its fair value.

By offering the shares to the retail investors at a price lower than the institutional investors, it may assist the Company to meet the minimum public shareholding spread of 1,000 public shareholders required under the Stock Exchange. This is an unidentifiable service. An expense should therefore be recognised.

As stated in paragraph 3A of IFRS 2, it appears that the price differential for both Situations 1 and 2 would fall within the scope of IFRS 2 unless there is clear evidence that the equity instruments are issued for a purpose other than for goods or services.

View 2: The price differential does not represent goods or services received

Proponents of View 2 believe that IFRS 2 does not “automatically” apply when the consideration received appears to be less than the fair value of the equity instruments granted.

It is a rebuttable presumption which can be overcome if it is clear that no goods and services were received. For this purpose the reason for the discount needs to be understood to determine whether there are goods and services involved. If there are none, IFRS 2 does not apply.

Situation 1 – unintentional difference

The indicative retail offer price is set prior to the determination of the institutional offer price and therefore the price differential (if any) is not considered as a discount given to the retail investors.

If the institutional offer price is set above the indicative retail offer price, this is probably due to a “misjudgement” by the Company and its advisor during the price discovery process. Furthermore, there is about a 3 week gap between the 2 events and market could have moved during that time thus resulting in a different risk appetite of the investors. Had the Company and its advisor been able to estimate the retail offer price accurately (i.e. indicative retail offer price equals to the institutional offer price), then there will be no price differential.

Given that the retail offer price is determined using judgment based on best available information and estimates, it is common for price differential to exist. This price differential is not due to any goods or services received from retail investors. Instead, it arose as a result of the inherent risk in the process of estimating the future value of the shares.

Situation 2 – intentional difference

The primary objective of the IPO is for the issuer to obtain financing and the discount is to attract the retail investors to subscribe for the shares so as to ensure that the public shareholding spread of 1,000 public shareholders will be met and hence ensuring the success of the IPO. Also, in some cases, the Issuer may want a larger retail investors profile.

The transaction is a transaction with shareholders, whereby, under IFRS 10 *Consolidated Financial Statements*, when a parent of a 100% own subsidiary sells 20% of its interest in the subsidiary without loss of control, that transaction is considered as a transaction with shareholders in their capacity as shareholders (even though the buyer of this 20% interest was not a shareholder of this subsidiary at the point in time of the disposal transaction) - such transaction is clearly excluded from the scope of IFRS 2 (paragraph 4).

Accordingly, such “discount” is clearly not for goods or services and therefore does not meet IFRS 2 ‘share-based payment transactions’ definition.

IFRS 2 Share-based Payment [emphasis add

Paragraph 2

An entity shall apply this IFRS in accounting for all share-based payment transactions, whether or not the entity can identify specifically some or all of the goods or services received, including:

(a) *equity-settled share-based payment transactions*,

(b) *cash-settled share-based payment transactions*, and

(c) transactions in which the entity receives or acquires goods or services and the terms of the arrangement provide either the entity or the supplier of those goods or services with a choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments,

except as noted in paragraphs 3A - 6. In the absence of specifically identifiable goods or services, other circumstances may indicate that goods or services have been (or will be) received, in which case this IFRS applies.

Paragraph 3A

A share-based payment transaction may be settled by another group entity (or a shareholder of any group entity) on behalf of the entity receiving or acquiring the goods or services. Paragraph 2 also applies to an entity that

(a) receives goods or services when another entity in the same group (or a shareholder of any group entity) has the obligation to settle the share-based payment transaction, or

(b) has an obligation to settle a share-based payment transaction when another entity in the same group receives the goods or services

unless the transaction is clearly for a purpose other than payment for goods or services supplied to the entity receiving them.

Paragraph 4

For the purpose of this IFRS, a transaction with an employee (or other party) in his/her capacity as a holder of equity instruments of the entity is not a share-based payment transaction. For example, if an entity grants all holders of a particular class of its equity instruments the right to acquire additional equity instruments of the entity at a price that is less than the fair value of those equity instruments, and an employee receives such a right because he/she is a holder of equity instruments of that particular class, the granting or exercise of that right is not subject to the requirement of this IFRS.

Appendix B: IFRS 11-2 *Joint arrangements*

Dear Mr Upton,

Suggested agenda item: Classification of joint arrangements under IFRS 11 – One party obliged to purchase 100% of output

It has come to our attention that IFRS 11 is unclear with respect to the classification of a joint arrangement in which one party is obliged to purchase all of the arrangement's output.

We are seeking clarification of this issue by the Committee.

The Issue

In determining the classification of a joint arrangement, paragraph B29 of IFRS 11 states that "the parties shall consider other facts and circumstances to assess whether the arrangement is a joint operation or a joint venture." However, the Standard does not specify whether this assessment should be made at the level of the parties as a group or by each party in isolation. This distinction becomes significant for joint arrangements for which a requirement to purchase the output is entered into by some, but not all, of the parties. For example, when one of the parties is obliged to purchase all of the output of the joint arrangement.

Paragraph 11 of the basis of conclusions to IFRS 11 states that "[t]he accounting for joint arrangements required by the IFRS is not a function of an entity's accounting policy choice", however in the absence of guidance on how to classify such a joint arrangement an accounting policy choice could be argued to be available.

Example

A joint arrangement is entered into by two unrelated parties (A and B) for the purpose of manufacturing consumer goods[1].

[1] There may be circumstances in which an arrangement similar to the example described falls within the scope of either IFRIC 4 or IFRIC 12. However, it is assumed that in this example careful consideration has been given to the purpose and design of the arrangement and it has been concluded that neither interpretation applies.

The joint arrangement is conducted through a legal entity (C) that is owned by the two parties in the ratio 50:50, has legal personality and confers separation of its assets and liabilities from A and B. The contractual arrangement between the parties does not specify that the parties have rights to the assets or obligations for the liabilities of C.

However, A is contractually obliged to purchase all of the output of the joint arrangement for a fixed margin above cost.

A then sells the goods to third parties on its own account (retaining any profits or losses on those third party sales) and profits from the sales to A are retained by entity C to be distributed to each party in the ratio of their ownership interest as and when A and B

jointly decide that a dividend should be paid or that entity C should be liquidated.

Should the joint arrangement be classified based on a single assessment of the rights and obligations of the two entities as a group or by separate assessments of the rights and obligations of entity A and of entity B?

Alternative views

A single assessment should be performed at the level of the joint arrangement

Proponents of this view believe that performing a single assessment considering the parties as a group is consistent with the Standard's repeated references to classification of "the arrangement" (implying that the classification of an arrangement should be the same for all parties) and, specifically, with the wording of IFRS 11.B31-2 which refers to "the parties" (seemingly as a single unit) having rights to the economic benefits of the assets of the arrangement and obligations for its liabilities as a result of being the only source of cash flows contributing to its continuity.

In the example above, A and B collectively have those rights and obligations. As a result, proponents of this view would conclude that the arrangement is a joint operation and should be accounted for as such by both A and B.

Separate assessments should be performed by each party to the joint arrangement

Proponents of this view believe that to meet the stated objective of IFRS 11 (as described in IFRS 11.BC9) of reflecting "the rights and obligations that the parties have as a result of their interests in the arrangements", it is necessary for each party to assess its rights and obligations separately. In addition, proponents note that IFRS 11.BC11 indicates that "an entity" (in the singular) should apply the principles of the Standard to each of its joint arrangements and recognise, as a result, the rights and obligations arising from each of them and the statement in IFRS 11.B20 that whether a party is a joint operator or a joint venturer depends on "the party's" rights to the assets, and obligations for the liabilities, relating to the arrangement that are held in the separate vehicle (seemingly implying that the analysis is performed from the perspective of each party).

In the example above, A appears to have rights to the assets and obligations for the liabilities of the joint arrangements but B does not. Therefore, proponents of this view would conclude that A should account for an interest in a joint operation but B should account for an interest in a joint venture.

In addition, proponents note that under each view one or both of the parties to the joint arrangement would conclude that it has an interest in a joint operation in which its share of output differs from its ownership interest – raising the related question of how to treat this difference both at inception of the joint operation and on an ongoing basis.

Reason for IFRIC to Address the Issue

We believe that this issue should be addressed in a timely manner. With the adoption of IFRS 11 in the first quarter of 2013 in many jurisdictions, the classification of joint

arrangements will have a significant impact on the financial statements of many entities from the first quarter of 2013. As noted above, we believe that different views on the issue can be supported, which is likely to result in significant divergence in practice and a lack of consistency and comparability that could be avoided through clarification of this discrete question.

Appendix C: IFRS 11-3 *Joint Arrangements*

Classification of joint arrangements under IFRS 11 – Other facts and circumstances

Dear Mr Stewart

IFRIC potential agenda item request

This letter describes two related issues that we believe should be added to the agenda of the IFRIC. We have included a summary of the issues, a range of possible views and an assessment of the issues against the IFRIC's agenda criteria.

IFRS 11 *Joint Arrangements* includes the concept of classifying a joint arrangement as a joint operation based on 'other facts and circumstances', when these other facts and circumstances give the parties rights to assets and obligations for liabilities relating to that joint arrangement (B29-B32). However, we believe that there will be divergence in the application of this concept in the following circumstances:

• the parties intend to purchase substantially all of the output from the joint arrangement, but have no enforceable right and/or obligation to do so; and/or

• the joint arrangement itself has access to third party financing at some stage during its life.

Current practice

There is currently no established practice because IFRS 11 only came into effect on 1 January 2013. However, we believe that these issues have started to establish themselves as practice issues as entities seek to finalise their accounting policies under the new standard. We believe that the IFRIC should consider the issues because the potential outcomes (joint venture vs joint operation classification) could have a significant effect on financial statements, and consistency in this area is desirable.

Issue 1: Under the other facts and circumstances test, do the parties require a contract (i.e. legally enforceable rights and obligations) to purchase substantially all of the output of the arrangement in order to achieve classification as a joint operation?

Here we outline what we believe are the different interpretations that are emerging.

View 1 – Yes, a contract is required

View 1 is based on the premise that for the parties to be considered to have rights to the assets and obligations for the liabilities of an arrangement, those rights and obligations need to be enforceable by law. Without an enforceable contract in place, the parties have no rights to assets (the arrangement could choose not to sell to the parties) or obligations for the liabilities (the parties could choose not to take and pay for the output).

Integral to View 1 is that the contract is for substantially all of the arrangement's remaining economic life, because this ensures that the parties have rights to *substantially all* of the economic benefits of the underlying assets, i.e. not just a portion of the benefits.
Supporters of View 1 note the following:

• The definition of joint control is based on a contract (IFRS 11.Appendix A). Therefore, it follows that any application of that definition must also be based on a contract. As a consequence, enforceable rights and obligations (i.e. a contract) are needed in order to meet the other facts and circumstances test.

• This interpretation is supported by both Application Example 5 and Illustrative Example 3.

− Application Example 5 refers to the parties having an *obligation* to purchase all of the output, and *rights* to all of the output. The use of these phrases clearly indicates more than an intention on the part of the parties.

− Illustrative Example 3 refers to a *commitment* of the parties under the framework agreement to purchase all of Product P. The use of word 'commitment' implies more than an intention on the part of the parties.

View 2 – No, a contract is not required, but there should be economic compulsion on the joint arrangement to sell to the parties and on the parties to purchase the output from the arrangement

View 2 is based on the premise that a contract is not required in all cases. For example, some arrangements are designed so that realistically the joint arrangement can only sell to the parties and the parties are compelled to purchase the output. This could be the case if a joint arrangement is designed to produce a specialised component that is essential to the parties' own operations. As long as the parties and the arrangement are economically compelled to transact with each other, they are in a position that is economically equivalent to the parties having contractual rights to the assets and contractual obligations for the liabilities of the arrangement.

Supporters of View 2 note the following:

• The notion of economic compulsion is consistent with the reference to 'design' in IFRS 11.B31-B32. If the parties and the arrangement are economically compelled to transact with each other, then the activities of the arrangement are primarily designed for the provision of output to the parties and the parties will have access to the output provided by the arrangement.

• If the parties are economically compelled to purchase output provided by the arrangement, then they have an in-substance obligation for the liabilities of the arrangement. The parties will suffer adverse economic consequences if they do not do so. This is consistent with the reference to 'in substance' in IFRS 11.B32.

In discussing Agenda Paper 2 *IAS 37 Provisions, Contingent Liabilities and Contingent Assets – Levies charged for participation in a market on a specified date* at the November 2011 IFRIC meeting, it was noted, "An entity does not have a constructive obligation to pay a levy that arises from operating in a future period, even if the entity is economically compelled to continue operating in that future period." However, supporters of View 2 note that IFRS 11.B32 in effect introduces the concept of an in-substance obligation, which is not present in IAS 37 and arguably different from a 'constructive' obligation.

View 3 – No, a contract is not required; intention alone is sufficient

View 3 is based on the premise that the parties' intention to take output is sufficient to achieve classification as a joint operation, because the parties have joint control of the arrangement; this means that the parties can ensure that the arrangement directs substantially all of the output to

them. The other facts and circumstances test is an in-substance test and therefore intention evidenced through design is sufficient to meet the test on its own.

Supporters of View 3 note the following:

• IFRS 11.B31-B32 focus on the *design* of the arrangement. No mention is made of the need for a contract (the premise for View 1) or even for economic compulsion or similar (the premise for View 2).

• IFRS 11.B31 is drafted as an observation rather than a requirement when it notes that parties "*often* ensure their access to the outputs provided by the arrangement by preventing the arrangement from selling output to third parties." [Emphasis added]

Issue 2: Under the other facts and circumstances test, does the availability of third party finance preclude classification as a joint operation?

Here we outline what we believe are the different interpretations that are emerging.

View 1 – No, not if it is guaranteed by the parties

View 1 is based on the premise that the guarantee is an in-substance obligation.
Supporters of View 1 believe that IFRS 11.B32 requires the parties to be substantially the only source of cash flows contributing to the continuity of operations of the arrangement. The guarantee provided by the parties means that in substance the liability will be settled by the parties, either through cash flows from the purchase of output or by making good on the guarantee.

View 2 – No, not if it is during the pre-production, construction phase

View 2 is based on the premise that either:

• pre-production activities are not relevant, because the focus of the other facts and circumstances test is on the production phase, i.e. when output is produced and is available for purchase. Therefore, only facts and circumstances in the production phase should be considered; or

• both the current (construction) and future (production) phases are relevant. However, as long as the requirements are met in the production phase, the joint operation classification is not precluded because ultimately the construction phase liabilities will be settled by production phase cash flows, which will come from the parties.

Supporters of View 2 believe that this interpretation meets the requirements of IFRS 11.B31-B32, because those paragraphs focus on whether the arrangement is *designed* to provide substantially all of the output to the partners, and that the cash flow from these purchases is used to fund the continuity of operations. Therefore, the settlement of liabilities prior to the production phase is not relevant.

View 3 – Yes

View 3 is based on the premise that if the joint arrangement has the ability to draw on third parties for cash, for example to enable it to pay its liabilities to contractors, then the parties are not substantially the only source of cash flows contributing to the continuity of operations of the arrangement; and this is contrary to the requirement in IFRS 11.B32.

Supporters of View 3 note the following:

• It is clear in IFRS 11.B27 that a guarantee does not constitute a primary obligation for the liabilities of an arrangement. In addition, Illustrative Example 6 (IE50) indicates that providing a guarantee does not, by itself, impose on the parties an obligation for the liabilities of an arrangement. Instead, the parties have a separate liability, which is the guarantee to repay the liabilities if the arrangement defaults, i.e. a guarantee represents a secondary as opposed to a primary obligation.

• It cannot be the case that only the production phase is relevant; if that were so, then all joint arrangements could potentially be classified as joint operations in the construction phase, because no specific requirements apply to this phase; and this would raise similar questions about concurrent construction and production (e.g. expansion to or reconditioning of an existing in-production facility).

• If an arrangement's ability to access third party finance ceased (or conversely, if it obtained access to third party finance for the first time), then this would constitute a change in facts and circumstances and the classification of the arrangement would be reassessed in accordance with IFRS 11.19.

Reasons for the IFRIC to address the issues

a) Is the issue widespread and practical? Yes. Joint arrangements in which the parties to the arrangement take output (other than under a long-term contract) or in which the joint arrangement has direct access to third party finance are common in many sectors, especially energy and natural resources and real estate.

b) Does the issue involve significantly divergent interpretations? Yes. Depending on the interpretation applied, the decision to classify a joint arrangement as joint venture or joint operation could have a significant effect on an entity's financial statements.

c) Would financial reporting be improved through elimination of the diversity? Yes. The comparability of financial statements will be improved if entities apply the facts and circumstances test on the same basis.

d) Is the issue sufficiently narrow…? Yes. It is concerned with specific concepts in IFRS 11.

e) If the issue relates to a current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project? The issue does not relate to a current or planned IASB project.

Appendix D: IAS 17- Definition of Incremental Direct Costs (IDC)

Introduction

We are currently in discussion with our auditors about the correct interpretation and use of the term "Incremental costs" in relation to IDC as specified in IAS17. Our companies write lease and loan business and prepare annual statements and accounts under IFRS. In previous companies using the same accounting standards we have seen a wide interpretation by other auditors of what qualifies to be treated as "Incremental", including one of the top 4 audit firms.

Background

We have some employees (on payroll - not on contract) who spend all (or substantially all) of their time on the negotiating, arranging and creation of new transactions. However, these staff are permanent employees with fixed salaries. The new business consists of relatively high volumes of smaller transactions so that each employee deals with dozens of new contracts per month. It is the nature of the business that as the volume of business increases so will the number of employees required to process new leases. Similarly, if the business were to stop writing new business these employees would be rapidly made redundant / served notice (usually one month).

It is our belief that some of these fixed costs should be capitalised as Initial Direct Costs as the costs increase/decrease in line with the scale of the new business, even though no additional cost is incurred due to each individual transaction. We do not believe the treatment of these costs should differ if the costs are incurred via payroll rather than costs via a subcontractor under contract.

Technical Views

This was discussed with the technical team of a [national accounting institute] who appeared to agree with this view as long as there is a clear and auditable method of allocating the time worked by these staff to individual transactions and proposals.

[Our auditors] do not agree with our interpretation of incremental costs. Although IAS 17 does not include a definition of 'incremental', they have used a definition in the context of transaction costs for financial instruments in IAS 39 in forming their view. This definition defines transaction costs as 'Incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability.'

The definition then specifies that an incremental cost is one that '…would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.'

They note that the use of the singular ‘instrument’ is consistent with the definition of initial direct costs in IAS 17, which refers to ‘negotiating and arranging a lease’ (and not negotiating and arranging leases). Consequently, their analysis of what represents an incremental direct cost for the purposes of IAS 17 is based on costs associated with each separate lease contract. Therefore, their view is that it is not appropriate to look at the overall population of lease contracts that are entered into as a single unit of account and so the staff costs set out above should not be capitalised as IDC.

Reasons for IFRIC to address this issue

We believe that there is currently some divergence within the industry in the interpretation and application of “incremental“ in the context of IDC spreading under IAS 17. While we do not have access to detailed analysis on this point, informal conversations with finance employees of other leasing companies have led to the impression that a range of interpretations is being applied. Our discussions with different audit firms on this point over a number of years has also revealed a divergence of opinion on this policy. Therefore, it is our opinion that some additional guidance or clarification from IFRIC is necessary to provide the consistency that appears to be currently lacking.

I look forward to your response on this proposal and to hear further as the submission progresses through the IFRIC process.