STAFF PAPER

10 –11 September 2013

IFRS Interpretations Committee Meeting

Project	IFRS Interpretations Committee Work In Progress		
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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 July 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 12-14	*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 the approach 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	*Income Taxes:*	Request for clarification of the	At the May 2012 meeting, the

12-11	Recognition of deferred tax for a single asset in a corporate wrapper.	calculation of deferred tax in circumstances in which the entity holds a subsidiary which has a 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.	Interpretations Committee noted significant diversity in practice in accounting for deferred tax when tax law 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.

5. The Interpretations Committee decided in January 2013 to recommend to the IASB that the proposed amendment to IAS 1 *Presentation of Financial Statements*: Current/non-current classification of liabilities, should not be included in the Annual Improvements to IFRSs 2010-2012 Cycle. The IASB agreed with this recommendation and at its March 2013 meeting asked the Interpretations Committee to consider what clarifications could be made to IAS about this issue. Since this meeting, the IASB has formed the Disclosure Initiative in response to messages reported in its Feedback Statement: Discussion Forum- Financial Reporting Disclosure (May 2013). This issue will now be considered as part of the first stage of the Disclosure Initiative: Narrow-focus Amendments to IAS 1 *Presentation of Financial Statements*. These proposals are expected to be published for comment in December 2013.

Issue on hold

6. 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.*

Issues on hold			
Ref.	**Topic**	**Brief description**	**Progress**
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.

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**
IFRIC 21-1	IFRIC 21–*Levies*	The submitter requests the Interpretations Committee to clarify whether an obligating event for a levy that is subject to a minimum annual threshold can occur before that threshold is reached. The submitter describe two different circumstances as examples in which the legislations require an entity to pay levies that are subject to minimum annual thresholds as well as 'pro-rata' threshold if the entity starts or stops the relevant activities that give rise to the levies in the middle of the annual assessment period. The submitter stated that there is a concern as to how 'the activity that triggers the payment of the levy' in paragraph 8 of IFRIC 21 should be interpreted in identifying an obligating event. The submitter states that they are aware of three different views on an activity that triggers the payment of the levies in such circumstances; 1) the activity is passing the annual threshold, 2) the activity is passing the 'pro-rata' threshold, and 3) the activity is provision of relevant services (ie prior to passing the annual and 'pro-rata' threshold').	The original submission is included in **Appendix A** of this paper. We will bring this issue to a future Interpretations Committee meeting.
IAS 32-16	IAS 32 Classification of an instrument that is mandatorily converted, subject to a cap and floor	During the discussion of Agenda Paper 17 at the July 2013 meeting, the Interpretations Committee asked the staff to analyse the accounting for a financial instrument that is mandatorily convertible into a variable number of the issuer's own equity instruments, subject to a cap and a floor on the number of equity instruments to be delivered. The Interpretations Committee asked the staff to analyse how the issuer of	This issue was identified by the Interpretations Committee at its July 2013 meeting for further analysis. We will bring this issue to a future Interpretations Committee meeting.

New issues			
Ref.	**Topic**	**Brief description**	**Progress**
		such an instrument should classify it in accordance with IAS 32 *Financial Instruments: Presentation*. The Interpretations Committee noted that this instrument is similar to the instrument described in Agenda Paper 17, but excludes the issuer's option to settle early by delivering a fixed number of equity instruments.	
IAS 8-2	IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*: Distinction between a change in accounting estimate and a change in accounting policy	The submitter requests the Interpretations Committee to clarify the distinctions between changes in accounting policies and changes in accounting estimates, in relation to the application of IAS 8 – *Accounting Policies, Changes in Accounting Estimates and Errors.* The submitter stated that enforcers have identified divergent practices regarding the assessment of whether a change qualifies as a change in an accounting policy or as a change in an accounting estimate in accordance with lAS 8. The submitter pointed out that the distinction between a change in accounting estimate and a change in accounting policy is important because IFRS requires a different accounting treatment resulting in application of the changes prospectively for a change in accounting estimate and retrospectively for a change in accounting policy. Moreover, IAS 8 sets out stricter criteria for changes in accounting polices than for changes in accounting estimates. According to paragraph 14(b) of IAS 8, in order to change an accounting policy the issuer should be able to justify that the change provides more relevant information, whereas there is no such explicit requirement for a change in accounting estimate.	The original submission is included in **Appendix B** of this paper. We will bring this issue to a future Interpretations Committee meeting.
IFRS 11-2	IFRS 11 – *Joint Arrangements*	The submitter requests the Interpretations Committee to provide clarification with respect to the	The original submission is included as Appendix B of

New issues			
Ref.	**Topic**	**Brief description**	**Progress**
	Classification of joint arrangements under IFRS 11 – One party obliged to purchase 100per cent of output	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 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.	Agenda Paper 19 of the July 2013 meeting. We will bring this issue to a future Interpretations Committee meeting.
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 Agenda Paper 19 of the July 2013 meeting. We will bring this issue to a future Interpretations Committee meeting.
IAS 17 -10	*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 as Appendix D of Agenda Paper 19 of the July 2013 meeting. 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 **Appendix A** and **B** new requests that we have added to the above list since the July 2013 agenda paper was prepared. Both requests have been copied without modification, the submitters having waived anonymity.

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

Appendix A: IFRIC 21–Levies

Australian Government

Australian Accounting Standards Board

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26 July 2013

Mr Wayne Upton
Chairman
IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Dear Wayne

Clarification of accounting for levies that are subject to a minimum activity threshold

We are writing to raise some concerns in relation to the accounting for levies that are subject to a minimum activity threshold. We note that minimum threshold issues were not addressed in the draft IFRIC that led to IFRIC 21 *Levies*, but were added in response to constituents' comments.

Although this issue has arisen in Australia primarily in relation to payroll taxes and the carbon tax, we believe the issue is relevant to how to account for levies that are subject to a minimum activity threshold more broadly. We think the issue may also be relevant to other jurisdictions internationally that have, or introduce, regimes with the same or similar characteristics. Please note that we are not raising concerns about whether such levies are within the scope of IFRIC 21.

In summary, our concerns arise from the lack of clarity in IFRIC 21 as to whether the obligating event for a levy that is subject to a minimum threshold can occur before that threshold is reached. These concerns arise from the interpretation of the phrase "the activity that triggers the payment of the levy" in paragraph 8 of the Interpretation. This issue has arisen in applying the principles of IFRIC 21 to circumstances in which a liability to pay a levy arises as a result of activity during a period (such as employee service or carbon emission), but is not payable until a minimum annual threshold is reached.

We are particularly concerned that IFRIC 21 might be interpreted by some as not allowing the recognition of a liability when relevant activity occurs, which might be many years before the strict liability to pay arises. An example of this may be the dumping of putrescible waste as landfill that will eventually emit carbon and result in an obligation of a landfill operator to pay carbon tax in, say, 50 years' time when the carbon is released into the atmosphere. In such circumstances the emission of the carbon is a certain event that will occur due to the entity's past action of dumping the waste. That is, the obligation is unavoidable.

In addition, we are concerned that the principle in IFRIC 21 appears to be inconsistent with a number of other analogous scenarios such as the recognition of liabilities that arise from contingent rent payments, unvested long service leave and pension entitlements. Further, the principle in IFRIC 21 appears to be inconsistent with the existing guidance in IAS 34 *Interim Financial Statements*, including, specifically, paragraph B1 addressing employer payroll taxes and paragraph B7 addressing contingent rents. Whilst we acknowledge that this issue was identified in the deliberations on the Interpretation, the issuance of the Interpretation did not amend IAS 34, consequently it is not clear which principle should be applied when considering levies such as payroll taxes.

Because of the above concerns, consistent with the Committee's process for considering issues, we have provided a more detailed explanation of the issue, possible alternative accounting treatments and reasons for the Committee to address the issue in the form of a more formal Committee potential agenda request in Appendix A to this letter.

If you require further information on the matters raised above or in Appendix A, please contact me or Nikole Gyles (ngyles@aasb.gov.au).

Yours sincerely

K M. Stevenson

Kevin M. Stevenson
Chairman and CEO

Appendix A: Potential agenda item request

Issue

The issue we are requesting the Committee clarify is whether the obligating event for a levy that is subject to a minimum annual threshold can occur before that threshold is reached. This issue arises from the interpretation of the phrase "the activity that triggers the payment of the levy" in paragraph 8 of the Interpretation in circumstances in which a levy arises as a result of activity during a period (such as employee service or carbon emission), but is not payable until a minimum annual threshold is reached.

Two examples of circumstances in which this issue arises are described below. Note that we are not requesting the Committee consider whether such levies would be within the scope of IFRIC 21 *Levies*. For the purposes of this request the Committee is asked to assume that the principles in IFRIC 21 are being applied.

Payroll tax

Payroll tax is a State tax calculated on wages paid or payable by an employer to its employees and deemed employees and applies in all States and Territories of Australia. For example, in the State of Victoria, payroll tax is currently payable at a rate of 4.90 per cent. Payroll tax is payable when an employer's wages exceed a certain annual amount. In Victoria, this amount is $550,000.

Most employers are required to self-assess their liability on a monthly basis, and all perform an annual reconciliation at the end of each financial year (1 July to 30 June). Employers pay tax by the seventh day of the month following the month in which their wages exceed a pro-rata threshold level (currently in Victoria this amount is $45,833 (i.e. $550 000 ÷ 12). If a business starts or stops employing within a financial year it does not get a full threshold entitlement. The business will be subject to a pro-rata of the threshold equal to the ratio of the number of days they employ to the number of days in the financial year.

The annual reconciliation reconciles actual amounts payable for the whole financial year against payments previously made (including the June return). Any over payments of payroll tax are refunded to the entity, and any shortfall of tax is payable by the entity at this time.

Fixed price phase of the Carbon Pricing Mechanism (CPM)

The fixed price phase of the CPM (the carbon levy) began on 1 July 2012 and is applicable until 30 June 2014. From 1 July 2012, entities with emissions exceeding 25,000 tonnes of carbon dioxide equivalent (CO_2-e) are required to pay a carbon tax. Specifically, an entity will be a "liable entity" and subject to the levy in circumstances when the emissions from the facility exceed:

- A threshold of 25,000 tonnes of Co_2-e in the financial year if the entity is liable for the whole financial year, or

- A pro-rata threshold, if the entity is liable for part of the financial year, which is calculated by multiplying 25,000 by the proportion of the year for which the entity is liable.

Where a person has operational control over a facility for part of the year, the threshold to determine whether they are a liable entity is applied on a pro-rata basis. A person might have operational control for part of a year where:

- there is a change in ownership of a facility during the year; or
- a facility permanently closes down part way through the year. (However, if a person has operational control over a facility that operates intermittently throughout the compliance year, this is not considered permanent stoppage of production.)

If a person has operational control over a facility for part of a year, the threshold is calculated using the following formula:

> The facility passes the threshold test if the total amount of covered emissions from the operation of the facility had a carbon dioxide equivalence of not less than *25,000 tonnes x Number of control days/number of days in the eligible financial year.*

For example, if a person has operational control over a facility for one month (30 days) and the facility emits 2,055 tonnes of CO2-e or more of covered emissions during this period, the person with operational control will be obligated to pay for this amount of emissions as this exceeds the pro-rata threshold of 30 x 25000/365 or 2054.79 tonnes.

In the case where a facility operates intermittently throughout the compliance year the annual threshold for the levy is 25,000 tonnes, as if the facility's intermittent emissions were made over the whole compliance year.

As noted above, the question we are seeking clarification from the Committee on is whether the obligating event for a levy that is subject to a minimum annual threshold can occur before that threshold is reached. Specifically, how "the activity that triggers the payment of the levy" should be interpreted in paragraph 8 of IFRIC 21 in assessing when a liability should be recognised.

Alternative accounting treatments

View 1: The activity that triggers the payment of the levy is passing the annual threshold

Those supporting view 1 are of the view that the activity that triggers the payment of the levy is passing the annual threshold. This view is formed on the basis that a levy that is only payable if a threshold is passed is not a liability until the annual threshold is passed. Passing the annual threshold is the "activity that triggers" as, until such time as that threshold is passed, the entity retains discretion to avoid the obligation (however remote). In both the payroll tax and CPM examples provided above, the existence of a "pro-rata" threshold is not relevant in determining whether a liability exists as, in order for a liability to arise, the entity would need to close down a facility / stop paying wages. This is considered to be a separate event that would need to occur prior to an entity incurring a liability. Those supporting this view particularly cite paragraph 12 of IFRIC 21 as well as the variation to Example 4 of IFRIC 21 as support for their view.

View 2: The activity that triggers the payment of the levy can occur prior to the annual threshold

View 2A: The activity that triggers the payment of the levy is passing the pro-rata threshold (i.e. prior to passing the annual threshold)

Those supporting view 2A are of the view that the activity that triggers the obligation is the provision of service by employees/emission of CO2-e[1]. Entities that assess that they have exceeded the pro-rata threshold and consider that it is probable that the annual threshold will be exceeded would begin accruing a liability once they exceed the pro-rata threshold. That is, a provision would, in particular circumstances, be recognised prior to reaching the annual threshold. Supporters of this view particularly refer to paragraph 11 and Example 1 of IFRIC 21 as support for their view.

View 2B: The activity that triggers the payment of the levy is provision of service by employees/carbon emission (i.e. prior to passing the annual threshold and irrespective of a pro rata threshold)

Those supporting view 2B are of the view that the "activity that triggers" is the provision of service by employees/carbon emission[1]. The activity occurs over a period of time and consequently the liability to pay payroll tax / carbon tax would be recognised progressively. Entities that assess that it is probable they will exceed the annual threshold would begin accruing a liability as services are provided/emissions occur, irrespective of the existence of a pro rata threshold. That is, a provision would, in particular circumstances, be recognised prior to reaching the annual threshold. Supporters of this view refer to paragraph 11 of IFRIC 21 as well as the principles of IAS 34, including paragraph B1 addressing employer payroll taxes and paragraph B7 addressing contingent lease payments, as support for their view.

[1] Or even, in some cases, before emission, for example in the case of landfill operators. In some cases there may be significant separation between the activity occurring and the levy payment being required, for example dumping of putrescible waste as landfill that will eventually emit carbon in future years and result in an obligation of a landfill operator to pay carbon tax in future periods when the carbon is released into the atmosphere.

IFRS IC potential agenda item request:
Clarification of accounting for levies that are subject to a minimum activity threshold

Reasons for IFRS IC to address the issue

Criteria	Assessment
The issue is widespread and has practical relevance.	Yes. The issue affects all entities in Australia (and potentially other jurisdictions) subject to levies with minimum thresholds. The issue is also likely to affect entities in other jurisdictions that have introduced similar regimes.
The issue indicates that there are significantly divergent interpretations (either emerging or already existing in practice).	Yes. Based on queries raised by constituents in Australia the AASB is of the view that, in the absence of further guidance, diversity in practice could arise when IFRIC 21 becomes effective.
Financial reporting would be improved through the elimination of the diversity.	Yes. The accounting treatment in view 1 would provide a significantly different outcome to view 2. Therefore, eliminating or reducing the potentially diverse reporting methods would improve financial reporting.
The issue is a narrow implementation or application issue that can be resolved efficiently within the confines of existing IFRSs and the *Framework for the Preparation and Presentation of Financial Statements,* but not so narrow that it is inefficient to apply the interpretation process.	Yes. The issue relates to an interpretation of a specific application of IFRIC 21.
If the issue relates to a current or planned IASB project, there is a pressing need to provide guidance on a more timely basis than would be expected from that project.	There is no current relevant IASB project (on the active or research work plans).

Appendix B: IAS 8 Distinction between a change in accounting estimate and a change in accounting policy

esma European Securities and Markets Authority

The Chair

Date: 1 July 2013
ESMA/2013/854

Mr Wayne Upton
IFRS IC
Cannon Street 30
London EC4M 6XH
United Kingdom

Agenda item request: Application of IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors to distinguish between a change in accounting estimate and a change in accounting policy

Dear Mr Upton,

The European Securities and Markets Authority (ESMA) is an independent EU Authority that contributes to enhancing the protection of investors and promoting stable and well-functioning financial markets in the European Union (EU). ESMA achieves this aim by building a single rule book for EU financial markets and ensuring its consistent application across the EU. ESMA contributes to the regulation of financial services firms with a pan-European reach, either through direct supervision or through the active co-ordination of national supervisory activity.

As a result of the enforcement activities carried out by national competent authorities ESMA has identified an issue related to the application of IAS 8 – *Accounting Policies, Changes in Accounting Estimates and Errors*, which we would like to bring to the attention of the IFRS Interpretations Committee for adding it to its agenda.

A detailed description of the issue is set out in the appendix to this letter. We would be happy to further discuss this issue with you.

Yours sincerely,

Steven Maijoor
Chair
European Securities and Markets Authority

esma

APPENDIX – DETAILED DESCRIPTION OF THE ISSUE

1. Enforcers have identified divergent practices regarding the assessment of whether a change qualifies as a change in an accounting policy or as a change in an accounting estimate in accordance with IAS 8, as illustrated in the examples below.

Description of the issue

2. The distinction between a change in accounting estimate and a change in accounting policy is particularly important because IFRS requires a different accounting treatment resulting in application of the change prospectively or retrospectively.

3. Moreover, IAS 8 sets out stricter criteria for changes in accounting policy than for changes in accounting estimate. According to paragraph 14(b) of IAS 8, in order to change an accounting policy the issuer should be able to justify that the change provides more relevant information, whereas there is no such requirement for a change in accounting estimate.

4. Recent debates at the IFRS IC on the request for guidance on the determination of the rate used to discount post-employment benefit obligations show that IFRS IC members were divided on the qualification of a change of the way to determine a discount rate. The November 2012 IFRS IC Update[1] states that "*the Interpretations Committee briefly discussed, but did not conclude, on whether a change to the way in which an entity determines the discount rate would be a change in accounting policy or a change in estimate*".

5. ESMA is concerned that diversity in practice may exist regarding this qualification. ESMA provides the following examples to illustrate the ambiguities arising from the assessment whether a change qualifies as a change in accounting policy or as a change in accounting estimate.

Example A - Change in the own credit risk calculation

6. Historically, bank A computed its own credit risk for the measurement of its financial liabilities at fair value using credit default swap (CDS) curves. Following the financial crisis and the dislocation of the CDS market, bank A modified its methodology and assessed its own credit risk at year-end based on the spread of its most recent debt issuance.

[1] IFRS IC Update – November 2012, IFRS Foundation, November 2012

View 1

7. Supporters of view 1 believe that this change is a change in accounting policy, as the basis for determining the own credit risk changed from CDS curve method to a methodology based on the spread of the historical debt issuances.

View 2

8. Supporters of view 2 argue that this is a change in accounting estimate because the objective of the accounting policy related to the measurement of own credit risk has not changed. The method of valuation was modified as the CDS curve was no longer relevant. Hence, according to this view, this change is due to "*changes which occurred in the circumstances on which the estimate was based*" as referred to in paragraph 34 of IAS 8.

Example B – Change in the definition of High Quality Corporate Bonds

9. The subject was briefly discussed during the November IFRS IC meeting as part of the discussion on high quality corporate bonds (HQCB) in IAS 19 and IFRS IC members expressed diverging views on whether such change would qualify as a change in accounting policy or a change in accounting estimate.

View 1

10. Proponents of view 1 believe that a change in the reference used to determinate the discount rate is a change in accounting policy because the measurement basis used in determining the discount rate changed. If an issuer used in the past the yield of AA-rated bonds, switching to the yield of BBB-rated bonds is a change in the measurement basis.

11. They argue that the change is not a change in accounting estimate because the issuer had chosen AA-rated bonds as a definition for HQCB. Changing the definition of a concept cannot be a change in estimate.

View 2

12. Proponents of view 2 argue that this change is not a change in accounting policy because the objective which is to determine the discount rate with the reference to the yield of HQCB did not change (i.e. there was no change in measurement basis). The fact that the yield of HQCB was formerly evaluated using AA-rated bonds and is now evaluated using BBB rated bonds is a change in accounting estimate. The number of AA-rated entities is no longer sufficient and consequently it is more relevant to use BBB-rated bonds. Hence, this change is due to "*changes which occurred in the circumstances on which the estimate was based*" as referred to in paragraph 34 of IAS 8.

esma

Other examples

13. ESMA notes other examples where the assessment whether a change qualifies as a change in accounting policy or as a change in accounting estimate is difficult:

    a. a change in the "*significant or prolonged*" criteria which trigger impairment for Available for Sale equity instruments in accordance with paragraph 61 of IAS 39 - *Financial Instruments: Recognition and Measurement*,

    b. a change of method of credit value adjustment (CVA) calculation, from historical approach to determine the probability of default and the loss given default to market based approach,

    c. a change in the measurement formula of the cost of the inventories from first-in-first-out (FIFO) to weighted average cost.

Request

14. ESMA would suggest that the criteria to distinguish a change in accounting policy from a change in accounting estimate need to be clarified. In particular, ESMA suggests the IASB to clarify whether the reason to justify the change should be taken into account (e.g. voluntary change or change due to external circumstances) and if so on what basis.

15. Furthermore, ESMA finds that there might be a need to clarify the interaction between the following paragraphs in different IFRSs:

    - paragraph 66 of IFRS 13 - *Fair Value Measurement* which states that a change in a valuation methodology is a change in accounting estimate,

    - paragraph 35 of IAS 8 which notes that a change in the measurement basis applied is a change in accounting policy, and

    - paragraph 118 of IAS 1 - *Presentation of Financial Statements* which states that measurement bases (e.g. historical cost, current cost, net realisable value, fair value and recoverable amount) are accounting policies.