International Financial Reporting Standards

GPF meeting, 5 March 2015
Agenda paper 2

IFRS Interpretations Committee

Update

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.

Agenda

- IAS 2 *Inventories* / IAS 38 *Intangible Assets* — April Pitman
  - – Should interest be accreted on prepayments for long-term supply contracts?
- IAS 16 *Property, Plant and Equipment* — Koichiro Kuramochi
  - – Accounting for proceeds and costs of testing of PPE
- IAS 12 *Income Taxes* — Akemi Miura
  - – Reflecting uncertainty in the recognition and measurement of income taxes

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International Financial Reporting Standards

IAS 2 *Inventories*

Should interest be accreted on pre-payments for long-term supply contracts?

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Purpose of the session

- We'd like to receive information about a very specific type of supply contract in which the purchaser agrees to make pre-payments to a supplier for raw materials.
  - The example in the submission was a 10-year prepayment
- The prepayments are non-refundable and are offset against future orders for raw materials.
- The submitter asked whether interest should be accreted to the profit and loss on these prepayments

Accretion of interest on long-term prepayments IAS 2

- Discussed by IFRS IC in Jan 2012; IASB in Feb 2012
  - IASB asked the IC to consider addressing through an Interpretation
- Interpretation would consider requirements in
  - IAS 16 (cost as cash price at date of recognition)
  - IAS 23 (capitalisation of borrowing costs on acquisition of asset)
  - IFRS 15 (cash price of revenue)
- November 2014 IASB asked the staff to collect more information about the nature of these contracts

Accretion of interest on long-term prepayments IAS 2

- Diversity in practice
  - some entities accrete interest, some do not.
  - is this because there are two types of prepayments?
- IFRS 15 clarifies that accrete interest only if the contract has a significant financing component
  - objective of IFRS 15 is to recognise the cash price at the date of transfer
- Prepayment might not be (solely) for finance purposes
  - protection against credit risk
  - ensures security of supply
  - sharing investment risk

Questions to GPF members

Question 1 to GPF members

Prepayments in long-term supply contracts:

In your experience: how common are these types of transactions?

Question 2 to GPF members

What is the nature of these types of transaction-financing or operational?

Why would a purchaser make prepayments in long-term supply contracts?

IAS 16 *Property, Plant and Equipment*

Accounting for proceeds and costs of testing of PPE

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Purpose of the session

- To receive feedback on the issue discussed at the Interpretations Committee, in relation to recognition and measurement of Property, Plant and Equipment (PPE).
- To hear GPF members' practical experiences of deducting revenue from PPE cost before the asset becomes available for use (revenue earned before an asset is ready for its intended use is often referred to as pre-commissioning revenue).
- To hear GPF members' views on the meaning of 'testing' in paragraph 17(e) of IAS 16.

Introduction

- During the construction phase of an item of property, plant and equipment (PPE), an entity might test the operation of the PPE before concluding that the asset is capable of operating in the manner intended by management.
- The costs of testing form part of the cost of constructing the asset.
- The proceeds received from selling the products produced during testing is deducted from the cost of the asset – but are there limits to the amount of proceeds that can be deducted?
- Should any other proceeds received during construction, that aren’t connected with testing, also be deducted from the cost of the asset?

Background – Paragraph 17(e) of IAS 16

- Paragraph 17(e) of IAS 16 states as follows:

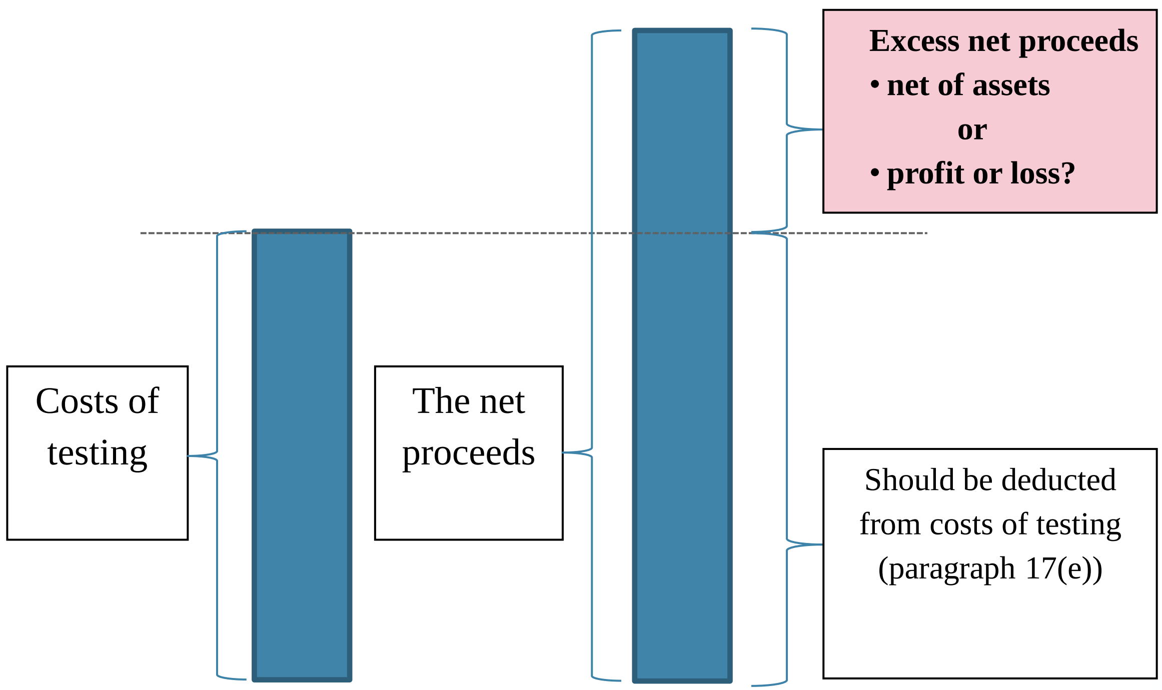
  17 Examples of directly attributable costs are:

  (e) costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment)

- US GAAP does not explicitly allow deducting pre-commissioning revenue (including testing proceeds), except for some specific US industry guidance that expressly permits netting of proceeds (for example, certain pre-commissioning revenue for property developed for rental or sale).

Background – Submission to the Interpretations Committee

- The submitter has asked whether the amount by which the net proceeds received exceed the costs of testing should be recognised in profit or loss or as a deduction from the cost of the PPE, because the Standard is not clear on that point.



Questions to GPF members

Question 1 to GPF members

- Do you have experience with the deduction of revenue from PPE, before the asset becomes available for use? If so, we would like to learn about:
  - the circumstances that lead to pre-commissioning revenue;
  - how material pre-commissioning revenue is;
  - the length of any pre-commissioning period; and
  - the basis for the judgement on the timing when the asset is available for use.

Question 2 to GPF members

- What do you consider the meaning of ‘testing’ in paragraph 17(e) of IAS 16?

Practice developed in different industries

- The Interpretations Committee performed outreach and noted that different practices have developed in different industries.

Mining

- There is no clear-cut timing for when the asset becomes ready for use; instead, development of the mine is a continuing process.
- It is common to deduct revenue earned before an asset is ready for its intended use (often referred to as pre-commissioning revenue) from the cost of PPE.
- Pre-commissioning phase can be less than a year, a couple of years or more. Pre-commissioning revenue deducted from the cost of PPE can be material.

Practice developed in different industries (continued)

Other industries

- In other industries, it is relatively clear when the asset becomes ready for use.
- We are told that an Oil & Gas industry group basically considers that, once the production reaches a relatively low minimum threshold (for example 10% of the level expected by management), they consider the asset is operating as intended by management and they cease capitalising at this point.
- Pre-commissioning phase tends to be much shorter than in the mining industry.
- Pre-commissioning revenue tends to be less significant.

Interpretations Committee's decisions

- The Interpretations Committee discussed the issue and decided to focus on the following aspects:

The meaning of 'testing'

- the reference to proceeds in IAS 16 is made only in relation to testing; and
- on this basis, the appropriate question is whether the activity that led to those proceeds was testing.

Disclosure

- including the judgements made, in relation to deducting the proceeds.

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IAS 12 Income Taxes

Reflecting uncertainty in the recognition and measurement of income taxes

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Purpose of the session

- To hear GPF members' practical experiences of accounting for a tax liability or asset when tax uncertainties exist.
- To receive feedback on the Interpretations Committee's decision to develop a draft Interpretation, for recognition and measurement of a tax liability or asset when tax uncertainties exist.

Background

- The Interpretations Committee received a request to clarify the recognition of an asset when an entity makes a payment to tax authorities for uncertain tax positions.

- The Interpretations Committee published an agenda decision on the recognition question in July 2014.
  – The Interpretations Committee noted that IAS 12, not IAS 37, is relevant to the question on recognition.

- The Interpretations Committee tentatively decided to develop an draft Interpretation when there are tax uncertainties.

Interpretations Committee's decisions

- The Interpretations Committee is developing a draft Interpretation, in line with its following tentative decisions:

Scope

– Apply to all income tax uncertainties when an entity recognises and measures income tax asset or liability.

– Apply to current and deferred tax.

Recognition threshold

– Recognise a tax asset or liability only if it is probable that it will pay the amount to, or recover the amount from, a tax authority.

Unit of account

– Make a judgement about the unit of account that provides relevant information for each uncertainty; ie account for tax uncertainties on a combined basis if that provides more relevant information.

Interpretations Committee's decisions (continued)

Examination by tax authorities

- Assume that the tax authorities will:
  - examine the amounts reported to it; and
  - have full knowledge of all relevant information.

Approach for measurement

- Use the expected value or the most likely amount, on the basis of which method it expects to predict better the amount that an entity will pay or recover.
  - More-likely-than-not amount used in the US guidance is not used in a draft Interpretation because:
    - no IFRSs refer to the amount; and
    - the US approach might conflict with a measurement principle of IAS 12.

Interpretations Committee's decisions (continued)

Guidance on disclosures

- Refer to existing IAS 1 disclosure requirements for uncertainties
  - Disclose the method that is used in the measurement.

Transition requirements

- Apply the Interpretation prospectively, recognising the cumulative effect of initially applying the Interpretation in retained earnings.
  - Retrospective application would be permitted.

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Questions to GPF members

Question 1 to GPF members

- In your experience:
  - how prevalent this issue is?
  - do you think that this issue on tax uncertainties is relevant to accounting for deferred tax, as well as for current tax?

Question 2 to GPF members

- Do you think that this Interpretation could be useful?
  - If yes, which guidance (eg recognition threshold) in this Interpretation would be particularly useful in practice?
  - If no, do you have any suggestions?

Thank you

questions
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individual views
comments
feedback
questions
feedback
questions or comments
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