IFRIC® *Update*

From the IFRS® Interpretations Committee

June 2018

Welcome to the June 2018 IFRIC *Update*

IFRIC *Update* is a summary of the decisions reached by the IFRS Interpretations Committee (Committee) in its public meetings.

Decisions on an IFRIC Interpretation become final only after the Committee has taken a formal vote on the Interpretation. IFRIC Interpretations require ratification by the International Accounting Standards Board (Board).

The Committee met in London on **12 June 2018**, and discussed:

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Next IFRS Interpretations Committee meeting

The next meeting will be held on:

11–12 September 2018

Meeting dates, tentative agendas and additional details about the next meeting will be posted to the IFRS **website** before the meeting. Further information about the activities of the IFRS Interpretations Committee and instructions for submitting requests to it can be found **here**.

Archive of IFRIC *Update*

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Items on the current agenda

Deferred tax: tax base of assets and liabilities (IAS 12 *Income Taxes*)—Agenda Paper 5

The Committee continued its discussion about the recognition of deferred tax when a lessee (entity) recognises an asset and liability at the commencement date of a lease applying IFRS 16 *Leases*. A similar question arises when an entity recognises a liability and includes in the cost of an item of property, plant and equipment the costs of decommissioning that asset. The request describes a fact pattern in which the lease payments and decommissioning costs are deductible for tax purposes when paid.

The Committee decided to recommend that the Board should propose a narrow-scope amendment to IAS 12. That narrow-scope amendment would propose that the initial recognition exemption in paragraphs 15 and 24 of IAS 12 does not apply to transactions that give rise to both deductible and taxable temporary differences to the extent that an entity would otherwise recognise a deferred tax asset and deferred tax liability of the same amount in respect of those temporary differences.

Next steps

The Board will discuss the Committee's recommendations at a future meeting.

Costs considered in assessing whether a contract is onerous (IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*)—Agenda Paper 6

In November 2017, the Committee decided to add a narrow-scope standard-setting project to its agenda. The objective of the project is to clarify the meaning of the term 'unavoidable costs' in the definition of an onerous contract in IAS 37.

At this meeting, the Committee discussed whether to propose any specific disclosure requirements and transition requirements for the proposed amendments to IAS 37.

The Committee recommended that the Board should propose:

a. no additional disclosure requirements;
b. that entities already using IFRS Standards apply a 'modified retrospective' approach, ie entities would apply the proposed amendments to contracts existing at the date of initial application; and
c. no specific transition requirements for first-time adopters.

Next steps

The Board will discuss the Committee's recommendations at a future meeting.

Committee's tentative agenda decisions

The Committee discussed the following matters and tentatively decided not to add them to its standard-setting agenda. The Committee will reconsider these tentative decisions, including the reasons for not adding the items to its standard-setting agenda, at a future meeting. The Committee encourages interested parties to submit their responses on the open for comment page by 21 August 2018. The Committee will place all such correspondence on the public record unless a responder specifically requests that its response should remain confidential. Such requests must be made for a good reason, for example, commercial confidentiality.

Determination of the exchange rate when there is a long-term lack of exchangeability (IAS 21 *The Effects of Changes in Exchange Rates*)—Agenda Paper 2

The Committee considered the determination of the exchange rate an entity uses to translate the results and financial position of a foreign operation into its presentation currency applying IAS 21. The Committee considered this matter in the following circumstances:

(a) the exchangeability of the foreign operation's functional currency with other currencies is administered by jurisdictional authorities. This exchange mechanism incorporates the use of an exchange rate set by the authorities (official exchange rate).

(b) the foreign operation's functional currency is subject to a long-term lack of exchangeability with other currencies—ie the exchangeability is not temporarily lacking as described in paragraph 26 of IAS 21 and has not been restored after the end of the reporting period.

(c) the lack of exchangeability with other currencies has resulted in the foreign operation being in effect unable to access foreign currencies using the exchange mechanism described in (a) above.

The Committee observed that those circumstances currently exist in Venezuela.

The Committee discussed whether, in those circumstances, an entity is required to use an official exchange rate in applying IAS 21.

The Committee observed that an entity translates the results and financial position of a foreign operation into its presentation currency applying the requirements in paragraphs 39 and 42 of IAS 21. Those paragraphs require an entity to translate:

(a) the assets and liabilities of the foreign operation at the closing rate; and

(b) income and expenses of the foreign operation at the exchange rates at the dates of the transactions if the functional currency of the foreign operation is not the currency of a hyperinflationary economy, or otherwise at the closing rate.

The closing rate and the rates at the dates of the transactions

Paragraph 8 of IAS 21 defines (a) the 'closing rate' as the spot exchange rate at the end of the reporting period; and (b) the 'spot exchange rate' as the exchange rate for immediate delivery. In the light of those definitions, the Committee concluded that the closing rate is the rate to which an entity would have access at the end of the reporting period through a legal exchange mechanism.

Accordingly, the Committee observed that in the circumstances described above an entity assesses whether the official exchange rate meets the definition of the closing rate—ie is it the rate to which the entity would have access at the end of the reporting period? Similarly, if the foreign operation's functional currency is not the currency of a hyperinflationary economy, the entity also assesses whether the official exchange rate represents the exchange rates at the dates of the transactions in applying paragraph 39(b) of IAS 21.

Continuous assessment of facts and circumstances

In the circumstances described above, economic conditions are in general constantly evolving. Therefore, the Committee highlighted the importance of reassessing at each reporting date whether the official exchange rate meets the definition of the closing rate and, if applicable, the exchange rates at the dates of the transactions.

Disclosure requirements

An entity is required to provide information that is relevant to an understanding of an entity's financial statements (paragraph 112 of IAS 1 *Presentation of Financial Statements*). The Committee highlighted the importance of disclosing relevant information in the circumstances described above. In particular, the Committee observed that the following disclosure requirements may be relevant to an understanding of an entity's financial statements:

(a) significant accounting policies, and judgements made in applying those policies that have the most significant effect on the amounts recognised in the financial statements (paragraphs 117–124 of IAS 1);

(b) sources of estimation uncertainty that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year, which may include sensitivity analysis (paragraphs 125–133 of IAS 1); and

(c) the nature and extent of significant restrictions on an entity's ability to access or use assets and settle liabilities of the group, or in relation to its joint ventures or associates (paragraphs 10, 13, 20 and 22 of IFRS 12 *Disclosures of Interests in Other Entities*).

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to assess whether, in the circumstances described above, it uses the official exchange rate to translate into its presentation currency the results and financial position of a foreign operation. Consequently, the Committee [decided] not to add this matter to its standard-setting agenda.

Research

IAS 21 includes requirements for the translation of the results and financial position of a foreign operation into a reporting entity's presentation currency. The Committee noted that those requirements do not however include explicit requirements on the exchange rate a reporting entity uses when the spot exchange rate (as defined in IAS 21) is not observable.

Accordingly, in addition to publishing the tentative agenda decision above the Committee decided to research possible narrow-scope standard-setting aimed at addressing this matter. The Committee will consider this research at a future meeting.

Expenditures on a qualifying asset (IAS 23 *Borrowing Costs*)—Agenda Paper 3A

The Committee received a request about the amount of borrowing costs eligible for capitalisation when an entity uses general borrowings to obtain a qualifying asset.

In the fact pattern described in the request:

(a) an entity constructs a qualifying asset;

(b) the entity has no borrowings at the start of the construction of the qualifying asset. Partway through construction, it borrows funds generally and uses them to finance the construction of the qualifying asset; and

(c) the entity incurs expenditures on the qualifying asset both before and after it incurs borrowing costs on the general borrowings.

The request asked whether an entity includes expenditures on a qualifying asset incurred before obtaining general borrowings in determining the amount of borrowing costs eligible for capitalisation.

The Committee observed that an entity applies paragraph 17 of IAS 23 in determining the commencement date for capitalising borrowing costs. The paragraph requires an entity to begin capitalising borrowing costs when it meets all the following conditions:

(a) it incurs expenditures for the asset;

(b) it incurs borrowing costs; and

(c) it undertakes activities that are necessary to prepare the asset for its intended use or sale.

Applying paragraph 17 of IAS 23 to the fact pattern described in the request, the entity would not begin capitalising borrowing costs until it incurs borrowing costs.

The Committee also observed that in determining the expenditures on a qualifying asset to which an entity applies the capitalisation rate (paragraph 14 of IAS 23), the entity does not disregard expenditures on the qualifying asset incurred before the entity obtains the general borrowings.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to determine the amount of borrowing costs eligible for capitalisation in the fact pattern described in the request. Consequently, the Committee [decided] not to add this matter to its standard-setting agenda.

Borrowing costs on land (IAS 23 *Borrowing Costs*)—Agenda Paper 3B

The Committee received a request about when an entity ceases capitalising borrowing costs on land.

In the fact pattern described in the request:

(a) an entity acquires and develops land and thereafter constructs a building on that land—the land represents the area on which the building will be constructed;

(b) both the land and the building meet the definition of a qualifying asset; and

(c) the entity uses general borrowings to fund the expenditures on the land and construction of the building.

The request asked whether the entity ceases capitalising borrowing costs incurred in respect of expenditures on the land (land expenditures) once it starts constructing the building or whether it continues to capitalise borrowing costs incurred in respect of land expenditures while it constructs the building.

The Committee observed that in applying IAS 23 to determine when to cease capitalising borrowing costs incurred on land expenditures:

(a) an entity considers the intended use of the land. Land and buildings are used for owner-occupation (recognised as property, plant and equipment applying IAS 16 *Property, Plant and Equipment*); rent or capital appreciation (recognised as investment property applying IAS 40 *Investment Property*); or for sale (recognised as inventory applying IAS 2 *Inventories*). The intended use of the land is not simply for the construction of a building on the land, but rather to use it for one of these three purposes.

(b) applying paragraph 24 of IAS 23, an entity considers whether the land is capable of being used for its intended purpose while construction continues on the building. If the land is not capable of being used for its intended purpose while construction continues on the building, the entity considers the land and building together to assess when to cease capitalising borrowing costs on the land expenditures. In this situation, the land would not be ready for its intended use or sale until substantially all the activities necessary to prepare both the land and building for that intended use or sale are complete.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to determine when to cease capitalising borrowing costs on land expenditures. Consequently, the Committee [decided] not to add this matter to its standard-setting agenda.

Committee's agenda decisions

Classification of short-term loans and credit facilities (IAS 7 *Statement of Cash Flows*)—Agenda Paper 4

The Committee received a request asking about the types of borrowings an entity includes in its statement of cash flows as a component of cash and cash equivalents. In the fact pattern described in the request:

(a) an entity has short-term loans and credit facilities (short-term arrangements) that have a short contractual notice period (eg 14 days);

(b) the entity says it uses the short-term arrangements for cash management; and

(c) the balance of the short-term arrangements does not often fluctuate from being negative to positive.

The Committee observed that:

(a) applying paragraph 8 of IAS 7, an entity generally considers bank borrowings to be financing activities. An entity, however, includes a bank borrowing as a component of cash and cash equivalents only in the particular circumstances described in paragraph 8 of IAS 7—ie the banking arrangement is a bank overdraft that (i) is repayable on demand, and (ii) forms an integral part of the entity's cash management.

(b) cash management includes managing cash and cash equivalents for the purpose of meeting short-term cash commitments rather than for investment or other purposes (paragraphs 7 and 9 of IAS 7). Assessing whether a banking arrangement is an integral part of an entity's cash management is a matter of facts and circumstances.

(c) if the balance of a banking arrangement does not often fluctuate from being negative to positive, then this indicates that the arrangement does not form an integral part of the entity's cash management and, instead, represents a form of financing.

In the fact pattern described in the request, the Committee concluded that the entity does not include the short-term arrangements as components of cash and cash equivalents. This is because these short-term arrangements are not repayable on demand. Additionally, the fact that the balance does not often fluctuate from being negative to positive indicates that the short-term arrangements are a form of financing rather than an integral part of the entity's cash management.

The Committee also noted that paragraphs 45 and 46 of IAS 7 require an entity to (a) disclose the components of cash and cash equivalents and present a reconciliation of the amounts in its statement of cash flows with the equivalent items reported in its statement of financial position; and (b) disclose the policy which it adopts in determining the composition of cash and cash equivalents.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to assess whether to include in its statement of cash flows the short-term arrangements described in the request as components of cash and cash equivalents. Consequently, the Committee decided not to add this matter to its standard-setting agenda.

Other matters

Proceeds before intended use (IAS 16 *Property, Plant and Equipment*)—Agenda Paper 7

The Committee provided advice on the staff's analysis of feedback on, and the next steps for, the Exposure Draft *Property, Plant and Equipment—Proceeds before Intended Use* (Proposed amendments to IAS 16).

The Board will consider the Committee's advice when it discusses the matter at a future meeting.

Committee work in progress—Agenda Paper 8

The Committee received a report on one request for consideration at a future meeting. In addition, the Committee was informed of two tentative agenda decisions for which the comment letter period has ended, and one ongoing matter. The Committee will discuss each of these at a future meeting.

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