IFRIC Update

From the IFRS Interpretations Committee

IFRS

March 2014

Welcome to the IFRIC Update

IFRIC Update *is the newsletter of the IFRS Interpretations Committee (the Interpretations Committee). All conclusions reported are tentative and may be changed or modified at future Interpretations Committee meetings.*

Decisions become final only after the Interpretations Committee has taken a formal vote on an Interpretation or a Draft Interpretation, which is confirmed by the IASB.

The Interpretations Committee met in London on **25 March 2014**, when it discussed:

items on the current agenda;

item recommended to the IASB for addressing through a narrow-scope amendment;

Interpretations Committee agenda decisions;

Interpretations Committee tentative agenda decisions; and

other matters.

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Future IFRS Interpretations Committee meetings

The next meetings are:
13 and 14 May 2014
15 and 16 July 2014
16 and 17 September 2014
11 and 12 November 2014

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

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Items on the current agenda

At this meeting, the Interpretations Committee discussed the following items on its current agenda.

IFRS 11 *Joint Arrangements*—analysis of implementation issues

The Interpretations Committee received several requests with regard to the application of the requirements of IFRS 11 *Joint Arrangements*.

At this meeting, the Interpretations Committee discussed how and why 'other facts and circumstances' might create rights and obligations that result in a joint arrangement being classified as a joint operation. The Interpretations Committee considered an analysis of various examples aimed at illustrating the application of the related guidance in IFRS 11 and noted that the analysis can be useful in understanding the guidance in IFRS 11. However, the Interpretations Committee noted that the examples are fact-specific and thought that adding illustrative examples to IFRS 11 might not be the most effective way of clarifying the issues raised.

The Interpretations Committee noted that 'other facts and circumstances' need to be assessed when the joint arrangement is structured through a separate vehicle, but neither the legal form of that vehicle nor the contractual agreement result in the parties having direct rights to the assets and direct obligations for the liabilities of the joint arrangement. It noted that the purpose of assessing 'other facts and circumstances' is to consider whether the substance of the joint arrangement gives the parties rights to the assets and obligations for the liabilities relating to the joint arrangement. Some members of the Interpretations Committee described this as a 'substance over form' approach.

The Interpretations Committee, when considering the concept of 'substance over form', observed that in order for 'other facts and circumstances' to result in the parties having obligations for the liabilities of a joint arrangement, it is necessary to demonstrate that cash cascades from the parties through legal or contractual obligations to ensure the settlement of the liabilities of the joint arrangement on a continuous basis. The Interpretations Committee therefore thought that the parties' intention to support the joint arrangement was insufficient to establish obligations for the liabilities of the joint arrangement. Notwithstanding this observation, the Interpretations Committee noted that the concept of 'substance over form' may not be consistently understood or applied in practice. Consequently, the Interpretations Committee decided to consult the IASB on this matter before progressing this issue further.

The staff will report the result of the consultation with the IASB at a future meeting.

IAS 12 *Income Taxes*—recognition of deferred tax assets for unrealised losses

At this meeting, the Interpretations Committee decided to recommend to the IASB a proposed amendment to IAS 12 that would clarify the accounting for deferred tax assets for unrealised losses on debt instruments measured at fair value.

The draft amendment 12 consists mainly of an illustrative example that explains the following aspects of the application of the principles of IAS 12:

a. An unrealised loss on a debt instrument measured at fair value gives rise to a deductible temporary difference even if the debt instrument holder expects to recover its carrying amount by holding it to maturity and collecting all of the contractual cash flows and if the loss is not tax-deductible until realised.

b. An entity assesses the utilisation of deductible temporary differences related to unrealised losses on debt instruments measured at fair value in combination with other deductible temporary differences. If tax law, however, restricts the utilisation of deductible temporary differences so that an entity can only utilise certain tax deductions against taxable profits of a specific type (for example, if capital losses are deductible only against capital gains), the entity still assesses utilisation of such a deductible temporary difference in combination with other deductible temporary differences, but only of the appropriate type.

c. When assessing the probability that future taxable profit will be available for the purpose of recognising deferred tax assets, an entity's estimate of future taxable profit assumes that it will recover an asset for more than its carrying amount, provided such a recovery is probable.

d. Probable future taxable profit against which existing deductible temporary differences are assessed for utilisation excludes tax deductions represented by those deductible temporary differences.

e. The example should illustrate the assessment of the utilisation of deductible temporary differences when all three sources of taxable profits (ie future reversal of existing taxable temporary differences, future taxable profits, and tax planning opportunities) are available but are insufficient in total to support recognition of deferred tax assets for all of the deductible temporary differences.

f. The example should explain how an entity should determine the amount of deferred tax to recognise in other comprehensive income compared with the amount to recognise in profit or loss, when the entity cannot recognise all deferred tax assets because of having insufficient future taxable profits. The Interpretations Committee noted that this determination should be on a reasonable pro-rata allocation, unless tax law requires a different allocation.

The illustrative example should explain the application of IAS 12 to debt instruments measured at fair value in accordance with IAS 39 as well as those measured at fair value in accordance with IFRS 9.

The Interpretations Committee also recommends to the IASB that it should propose an amendment to paragraphs 24 and following of IAS 12 that clarifies item (d) in the preceding list.

The staff will revise the draft illustrative example that they presented at this meeting, taking into consideration comments from Interpretations Committee members. The Interpretations Committee asked the staff to consider how the draft illustrative example can be simplified when making the revisions. The staff will present the Interpretations Committee's recommendations at a future IASB meeting.

IAS 16 *Property, Plant and Equipment* and IAS 2 *Inventories*—'core inventories'

The Interpretations Committee received a request for clarification on whether 'core inventories' held in an entity's own facilities are accounted for as inventories or as property, plant and equipment.

The submitter defined core inventories as a minimum amount of material that:

a. is necessary to permit a production facility to start operating and to maintain subsequent production;

b. cannot be physically separated from other inventories; and

c. can be removed only when the production facility is finally decommissioned or at considerable financial charge.

The Interpretations Committee discussed the definition of 'core inventories' and the views presented in the Staff Paper.

The Interpretations Committee noted that there is significant diversity in practice in respect of this issue. The Interpretations Committee also noted that the scope of what is considered as core inventories is not clear. Analysis is needed to consider its applicability to a range of industries.

Consequently, the Interpretations Committee concluded that the issue should be added to its agenda. It tentatively decided to develop an interpretation on the accounting for core inventories. The staff will present further analysis for this project at a future meeting.

Item recommended to the IASB for addressing through a narrow-scope amendment

IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*—distinction between a change in an accounting policy and a change in an accounting estimate

The Interpretations Committee received a request to clarify the distinction between a change in an accounting policy and a change in an accounting estimate, in relation to the application of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. The submitter stated that securities regulators 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. Moreover, the submitter pointed out that IAS 8 sets out stricter criteria for changes in accounting polices than those for changes in accounting estimates. According to paragraph 14(b) of IAS 8, a voluntary change to an accounting policy is permitted only if that change provides reliable and more relevant information. IAS 8

does not explicitly include an equivalent requirement for a change in an accounting estimate. The submitter suggests that the IASB should clarify whether an entity is required to justify a change in accounting estimate and, if so, on what basis.

The Interpretations Committee noted that a change in an accounting estimate may encompass a change in the method used to develop an estimate, as well as a change in inputs to the method, both of which result in a change in the amount of the estimate. The Interpretations Committee observed that it would be helpful if clear guidance was given about the circumstances in which changes in the method of estimation may be made. The Interpretations Committee thinks that a change in the method used to develop an estimate should only be made if that change produces a reliable and equally or more relevant estimate.

The Interpretations Committee also noted that paragraph 39 of IAS 8 requires disclosure of the nature and amount of a change in accounting estimate, and that such disclosure would include information about a change in the method used. The Interpretations Committee observed that information about the change in the method used would need to be disclosed in accordance with paragraph 39 of IAS 8 or, in the case of a change in valuation technique for a fair value measurement, in accordance with paragraph 93(d) of IFRS 13.

The staff will present the Interpretations Committee's recommendations to the IASB at a future meeting.

Interpretations Committee agenda decisions

The following explanations are published for information only and do not change existing IFRS requirements. Interpretations Committee agenda decisions are not Interpretations. *Interpretations are determined only after extensive deliberations and due process, including a formal vote, and become final only when approved by the IASB.*

IFRS 10 *Consolidated Financial Statements: Investment Entities Amendments*—the definition of investment-related services or activities

The Interpretations Committee received a request to clarify the definition of ‘investment-related services or activities’ as it relates to subsidiaries that act as intermediate holding companies ('intermediate subsidiaries') and are established for ‘tax optimisation’ purposes.

An investment entity is permitted to provide investment-related services or activities, either directly or through a subsidiary. If an investment entity provides investment-related services or activities through a subsidiary, the investment entity shall consolidate that subsidiary.

Some investment entities establish wholly-owned intermediate subsidiaries in some jurisdictions, which own all or part of the portfolio of investments in the group structure. The sole purpose of the intermediate subsidiaries is to minimise the tax paid by investors in the ‘parent’ investment entity. There is no activity within the subsidiaries and the tax advantage comes about because of returns being channelled through the jurisdiction of the intermediate subsidiary. The submitter asked whether the ‘tax optimisation’ described should be considered investment-related services or activities.

The Interpretations Committee noted that, according to paragraph BC272 of IFRS 10, the IASB thinks that fair value measurement of all of an investment entity’s subsidiaries would provide the most useful information, except for subsidiaries providing investment-related services or activities. In addition, the Interpretations Committee noted that the IASB had considered requiring an investment entity to consolidate investment entity subsidiaries that are formed for tax purposes, but had decided against this.

The Interpretations Committee noted that one of the characteristics of ‘tax optimisation’ subsidiaries described in the submission is “that there is no activity within the subsidiary”. Accordingly, the Interpretations Committee considers that the parent should not consolidate such subsidiaries, because they do not provide investment-related services or activities, and do not meet the requirements to be consolidated in accordance with paragraph 32 of IFRS 10. The parent should therefore account for such an intermediate subsidiary at fair value.

On the basis of the analysis above, the Interpretations Committee considered that in the light of the existing IFRS requirements, neither an interpretation nor an amendment to a Standard was necessary and consequently decided not to add the issue to its agenda.

IAS 17 *Leases*—meaning of ‘incremental costs’

The Interpretations Committee received a request for clarification about IAS 17 *Leases*. The submission relates to the meaning of ‘incremental costs’ within the context of IAS 17.

The submitter asks whether the salary costs of permanent staff involved in negotiating and arranging new leases qualify as 'incremental costs' within the context of IAS 17 and should therefore be included as initial direct costs in the initial measurement of the finance lease receivable.

The Interpretations Committee noted that internal fixed costs do not qualify as 'incremental costs'. Only those costs that would not have been incurred if the entity had not negotiated and arranged a lease should be included in the initial measurement of the finance lease receivable.

On the basis of the analysis above, the Interpretations Committee determined that, in the light of the existing IFRS requirements, neither an Interpretation nor an amendment to a Standard was necessary and consequently decided not to add this issue to its agenda.

IAS 39 *Financial instruments: Recognition and Measurement*—accounting for term-structured repo transactions

The Interpretations Committee received a request to clarify: (Issue 1) whether an entity (Entity A) should account for three transactions separately or aggregate and treat them as a single derivative; and (Issue 2) how to apply paragraph B.6 of Guidance on Implementing IAS 39 *Financial Instruments: Recognition and Measurement* ('IG B.6 of IAS 39') in addressing Issue 1. Some key features of the three transactions are as follows:

a. Transaction 1 (bond purchase): Entity A purchases a bond (the bond) from another entity (Entity B).

b. Transaction 2 (interest rate swap): Entity A enters into interest rate swap contract(s) with Entity B. Entity A pays a fixed rate of interest equal to the fixed coupon rate of the purchased bond in Transaction 1 and receives a variable rate of interest.

c. Transaction 3 (repurchase agreement): Entity A enters into a repurchase agreement with Entity B, in which Entity A sells the same bond in Transaction 1 on the same day it purchases the bond and agrees to buy back the bond at the maturity date of the bond.

The Interpretations Committee noted that in order to determine whether Entity A should aggregate and account for the three transactions above as a single derivative, reference should be made to paragraphs B.6 and C.6 of Guidance on Implementing IAS 39 and paragraph AG39 of IAS 32 *Financial Instruments: Presentation*.

The Interpretations Committee also discussed Issue 2, ie, how to apply paragraph IG B.6 of IAS 39 in addressing Issue 1. The Interpretations Committee noted that application of the guidance in paragraph IG B.6 of IAS 39 requires judgement. It also noted that the indicators in paragraph IG B.6 of IAS 39 may help an entity to determine the substance of the transaction, but that the presence or absence of any single specific indicator alone may not be conclusive.

The Interpretations Committee noted that providing additional guidance would result in the Interpretations Committee attempting to specify the accounting for a specific transaction, and that this would not be appropriate.

On the basis of the analysis above, the Interpretations Committee determined that, in the light of the existing IFRS requirements, neither an Interpretation nor an amendment to a Standard was necessary and consequently decided not to add this issue to its agenda.

IFRIC 21 *Levies*—identification of a present obligation to pay a levy that is subject to a pro rata activity threshold as well as an annual activity threshold

In May 2013, the IASB issued IFRIC 21 *Levies*, which is effective for annual periods beginning on or after 1 January 2014, with earlier application permitted. IFRIC 21 provides an interpretation of the requirements in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* for the recognition of liabilities for obligations to pay levies that are within the scope of IFRIC 21.

The Interpretations Committee received a request to clarify how the requirements in paragraph 8 of IFRIC 21 should be interpreted in identifying an obligating event for a levy. The Interpretations Committee discussed regimes in which an obligation to pay a levy arises as a result of activity during a period but is not payable until a minimum activity threshold, as identified by the legislation, is reached. The threshold is set as an annual threshold, but this threshold is reduced, pro rata to the number of days in the year that the entity participated in the relevant activity, if its participation in the activity started or stopped during the course of the year. The request asks for clarification on how the thresholds stated in the legislation should be taken

into consideration when deciding “the activity that triggers the payment of the levy” in paragraph 8 of IFRIC 21.

The Interpretations Committee noted that in the circumstance described above, the payment of the levy is triggered by the reaching of the annual threshold as identified by the legislation. The Interpretations Committee also noted that the entity would be subject to a threshold that is lower than the threshold that applies at the end of the annual assessment period if, and only if, the entity stops the relevant activity before the end of the annual assessment period. Accordingly, the Interpretations Committee observed that in the light of the guidance in paragraph 12 of IFRIC 21, the obligating event for the levy is the reaching of the threshold that applies at the end of the annual assessment period. The Interpretations Committee noted that there is a distinction between a levy with an annual threshold that is reduced pro rata when a specified condition is met and a levy for which an obligating event occurs progressively over a period of time as described in paragraph 11 of IFRIC 21; until the specified condition is met, the pro rata reduction in the threshold does not apply.

On the basis of the discussions above, the Interpretations Committee thought that the guidance in IFRIC 21 and IAS 37 is sufficient and noted that it is unlikely that significant diversity in interpretation on this issue will emerge. Accordingly, the Interpretations Committee decided not to add this issue to its agenda.

Interpretations Committee tentative agenda decisions

The Interpretations Committee reviewed the following matters and tentatively decided that they should not be added to its agenda. These tentative decisions, including recommended reasons for not adding the items to the Interpretations Committee’s agenda, will be reconsidered at the Interpretations Committee meeting in July 2014. Interested parties who disagree with the proposed reasons, or believe that the explanations may contribute to divergent practices, are encouraged to email those concerns by 9 June 2014 to ifric@ifrs.org. Correspondence will be placed on the public record unless the writer requests confidentiality, supported by good reason, such as commercial confidence.

IAS 1 *Presentation of Financial Statements*—disclosure requirements relating to assessment of going concern

The Interpretations Committee received a submission requesting clarification about the disclosures required in relation to material uncertainties related to events or conditions that may cast significant doubt upon the entity’s ability to continue as a going concern.

The Interpretations Committee proposed to the IASB that it should make a narrow-scope amendment to change the disclosure requirements in IAS 1 in response to this issue. At its meeting in November 2013 the IASB discussed the issue and considered amendments proposed by the staff, but decided not to proceed with these amendments.

The staff reported the results of the IASB’s discussion to the Interpretations Committee. When considering this feedback about the IASB’s decision, the Interpretations Committee discussed a situation in which management of an entity has considered events or conditions that may cast significant doubt upon the entity’s ability to continue as a going concern. Having considered all relevant information, including the feasibility and effectiveness of any planned mitigation, management concluded that there are no material uncertainties that require disclosure in accordance with paragraph 25 of IAS 1. However reaching this conclusion, that there was no material uncertainty, involved significant judgement.

The Interpretations Committee observed that paragraph 122 of IAS 1 requires disclosure of the judgements made in applying the entity’s accounting policies and that have the most significant effect on the amounts recognised in the financial statements. The Interpretations Committee also observed that in the circumstance discussed, the disclosure requirements of paragraph 122 of IAS 1 would apply to the judgements made in concluding that there remain no material uncertainties related to events or conditions that may cast significant doubt upon the entity’s ability to continue as a going concern.

IAS 12 *Income Taxes*—recognition of deferred tax for a single asset in a corporate wrapper

The Interpretations Committee received a request to clarify the accounting for deferred tax in the consolidated financial statements of the parent, when a subsidiary has only one asset within it (the asset inside) and the parent expects to recover the carrying amount of the asset inside by selling the shares in the subsidiary (the shares).

The Interpretations Committee noted that:

a. Paragraph 11 of IAS 12 requires the entity to determine temporary differences in the consolidated financial statements by comparing the carrying amounts of assets and liabilities in the consolidated financial statements with the appropriate tax base. In the case of an asset or liability of a subsidiary that files separate tax returns, this is the amount that will be taxable or deductible on the recovery (settlement) of the asset (liability) in the tax returns of the subsidiary.

b. The requirement in paragraph 11 of IAS 12 is complemented by the requirement in paragraph 38 of IAS 12 to determine the temporary difference related to the shares of the parent in the subsidiary by comparing the parent's share of the net assets of the subsidiary in the consolidated financial statements, including the carrying amount of goodwill, with the tax base of the shares for purposes of the parent's tax returns.

The Interpretations Committee also noted that these paragraphs require a parent to recognise both the deferred tax related to the asset inside and the deferred tax related to the shares, if:

- tax law attributes separate tax bases to the asset inside and the shares;
- in the case of deferred tax assets, the related deductible temporary differences can be utilised as specified in paragraphs 24-31 of IAS 12; and
- no specific exceptions in IAS 12 apply.

The Interpretations Committee noted that several concerns were raised with respect to the current requirements in IAS 12. However, analysing and assessing these concerns requires a broader project than the Interpretations Committee could perform on behalf of the IASB.

Consequently, the Interpretations Committee [decided] not to take the issue onto its agenda but instead to recommend to the IASB that it should analyse and assess these concerns in its research project on Income Taxes.

IAS 34 *Interim Financial Reporting*—condensed statement of cash flows

The Interpretations Committee received a request to clarify the application of the requirements regarding the presentation and content of the condensed statement of cash flows in the interim financial statements according to IAS 34 *Interim Financial Reporting*.

The submitter observed that there are divergent views on the presentation and content of the condensed statement of cash flows. One view is that an entity should present a detailed structure of the condensed statement of cash flows showing cash flows by nature. Another view is that an entity may present a three line condensed statement of cash flows showing only a total for each of operating, investing and financing cash flow activities.

The Interpretations Committee noted that a condensed statement of cash flows is one of the primary statements that is included as part of an interim financial report as prescribed by paragraph 8 of IAS 34. Paragraph 10 of IAS 34 specifies that each of the condensed statements shall include, at a minimum, each of the headings and subtotals there were included in the most recent annual financial statements. Paragraph 10 also requires additional line items to be included if their omission would make the interim financial statements misleading.

The Interpretations Committee also noted that in an interim financial report:

a. an entity shall include an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period. Information disclosed in relation to those events and transactions shall update the relevant information presented in the most recent annual financial report" (paragraph 15 of IAS 34).
b. the overriding goal is to ensure that an interim financial report includes all information that is relevant to understanding an entity's financial position and performance during the interim period (paragraph 25 of IAS 34).

In this respect, the Interpretations Committee noted that to meet the requirements in paragraphs 10, 15 and 25 of IAS 34 a condensed statement of cash flows should include all information that is relevant in understanding the entity's ability to generate cash flows and the entity's needs to utilise those cash flows, and that a three-line presentation would generally not meet the requirements in IAS 34.

On the basis of the analysis above, the Interpretations Committee determined that an interpretation or an amendment to IFRSs was not necessary. Consequently, the IFRS Interpretations Committee [decided] not

to add this issue to its agenda.

IAS 39 *Financial Instruments: Recognition and Measurement*—classification of a hybrid financial instrument by the holder

The Interpretations Committee received a request to clarify the classification by the holder of a hybrid financial instrument with a revolving maturity option, an early settlement option and a suspension of interest payments option (all at the option of the issuer). Specifically, the submitter raised the question of whether the host of such a financial instrument should be classified by the holder as an equity or as a debt instrument under IAS 39 *Financial Instruments: Recognition and Measurement*.

On the basis of the responses to the outreach request, the Interpretations Committee observed that the issue is not widespread. The Interpretations Committee also noted that the financial instrument described in the submission is specific and it would not be appropriate to provide guidance on this particular issue.

The Interpretations Committee noted that IFRS 9 *Financial Instruments* would resolve the question of whether the instrument should be classified before or after identifying the embedded derivatives, because it would not require bifurcation for hybrid contracts with financial asset hosts and a holder would be required to classify the instrument as a whole. As a result, the Interpretations Committee considered that developing accounting guidance on this issue would not be effective for a reasonable time period.

The Interpretations Committee considered that its agenda criteria are not met. Consequently, the Interpretations Committee [decided] not to add this issue to its agenda.

Other Matters

Interpretations Committee work in progress update

The Interpretations Committee had planned to discuss two additional matters at this meeting:

a. IFRIC 14 *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*—availability of refunds from a defined benefit plan managed by an independent trustee; and

b. IAS 19 *Employee Benefits*—remeasurement at a plan amendment or curtailment.

The Interpretations Committee did not discuss these issues because of a lack of time. These issues will be discussed at the next Interpretations Committee meeting.

The Interpretations Committee received a report on two new issues and two ongoing issues for consideration at future meetings. The report also included two issues that are on hold, and that will be considered again at future meetings. All requests received and considered by the staff were discussed at this meeting except for the six issues included in the work in progress report and the two matters described above.

Review of the Interpretations Committee's activity
The Interpretations Committee received a report of the number and types of issues undertaken over recent years and how those issues had been addressed. This report included a summary of its activities in 2013 and a comparison with respect to previous years. This analysis will be updated at the middle of 2014.

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