IFRIC® *Update*

From the IFRS® Interpretations Committee

IFRS

June 2017

Welcome to the June IFRIC *Update*

The 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 **13 June 2017**, and discussed:

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Future IFRS Interpretations Committee meetings

The next meetings are:

12 and 13 September 2017
20 and 21 November 2017

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 the IFRS Interpretations Committee can be found **here**.

Archive of IFRIC *Update*

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Items on the current agenda

The Committee discussed the following items on its current agenda:

IFRS 9 *Financial Instruments*—Modification or exchange of financial liabilities that do not result in derecognition (Agenda Paper 6E)

The Committee received a request regarding the accounting for a modification or exchange of a financial liability measured at amortised cost that does not result in derecognition of the financial liability. More specifically, the request asked whether, applying IFRS 9, an entity recognises any adjustment to the amortised cost of the financial liability arising from such a modification or exchange in profit or loss at the date of the modification or exchange.

The Committee discussed the staff recommendation to finalise an agenda decision. Although agreeing with the technical analysis summarised in the tentative agenda decision published in March 2017, the Committee decided to refer the matter to the Board in the light of the comments received.

IAS 23 *Borrowing costs*—Borrowing costs on completed qualifying assets (Agenda Paper 7)

The Committee discussed feedback on the proposed amendments to IAS 23 that were included in the Exposure Draft *Annual Improvements to IFRS Standards 2015-2017 Cycle*. The amendments seek to clarify that when a qualifying asset is ready for its intended use or sale, an entity treats any outstanding borrowing made specifically to obtain that qualifying asset as part of its general borrowings.

The Committee recommended that the Board finalise the proposed amendments subject to drafting changes. In finalising the amendments, it recommended that the Board clarify that an entity includes funds borrowed specifically to obtain an asset other than a qualifying asset as part of its general borrowings.

Next steps

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

Committee's tentative agenda decisions

The Committee discussed the following matters and tentatively decided not to add them to its standard-setting agenda. Instead, each tentative agenda decision includes, to the extent possible, explanatory material referring to the relevant principles and requirements in IFRS Standards. The Committee will reconsider these tentative decisions, including the reasons for not adding the items to the 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 2017. The Committee will place all such correspondence received on the public record unless the writer specifically requests that it remain confidential. In that case, the writer must support the request with a good reason, for example, commercial confidentiality.

IFRS 3 *Business Combinations*—Acquisition of a group of assets that does not constitute a business (Agenda Paper 2)

The Committee received a request to clarify how an entity accounts for the acquisition of a group of assets that does not constitute a business (the group). More specifically, the submitter asked for clarity on how to allocate the transaction price to the identifiable assets acquired and liabilities assumed when:

a. the sum of the individual fair values of the identifiable assets and liabilities is different from the transaction price; and
b. the group includes identifiable assets and liabilities initially measured both at cost and at an amount other than cost.

Paragraph 2(b) of IFRS 3 requires an entity to do the following on acquisition of a group of assets:

a. identify and recognise the individual identifiable assets acquired and liabilities assumed; and
b. allocate the cost of the group to the individual identifiable assets and liabilities based on their relative fair values at the date of the acquisition.

Other IFRS Standards include initial measurement requirements for particular assets and liabilities (for example, IFRS 9 *Financial Instruments* for financial instruments and IAS 40 *Investment Property* for investment property).

The Committee observed that if an entity initially considers that there might be a difference between the transaction price for the group and the sum of the individual fair values of the identifiable assets and liabilities, the entity first reviews the procedures it has used to determine those individual fair values to assess whether such a difference truly exists before allocating the transaction price.

The Committee then considered two possible ways of accounting for the acquisition of the group.

Applying the first approach, an entity accounts for the acquisition of the group as follows:

a. it identifies the individual identifiable assets acquired and liabilities assumed that it recognises at the date of the acquisition;
b. it determines the individual transaction price for each identifiable asset and liability by allocating the cost of the group based on the relative fair values of those assets and liabilities at the date of the acquisition; and then
c. it applies the initial measurement requirements in applicable Standards to each identifiable asset acquired and liability assumed. The entity accounts for any difference between the amount at which the asset or liability is initially measured and its individual transaction price applying the relevant requirements.

Applying the second approach, for any identifiable asset or liability initially measured at an amount other than cost, an entity initially measures that asset or liability at the amount specified in the applicable IFRS Standard. The entity deducts from the transaction price of the group the amounts allocated to the assets and liabilities initially measured at an amount other than cost, and then allocates the residual transaction price to the remaining identifiable assets and liabilities based on their relative fair values at the date of the acquisition.

The Committee concluded that a reasonable reading of the requirements in paragraph 2(b) of IFRS 3 on the acquisition of a group of assets that does not constitute a business results in one of the two approaches outlined in this agenda decision. The Committee observed that an entity applies its reading of the requirements consistently to all such acquisitions.

In the light of its analysis, the Committee considered whether to add a project on the acquisition of a group of assets to its standard-setting agenda. The Committee has not obtained evidence that the outcomes of applying the two approaches outlined in this agenda decision would be expected to have a material effect on the amounts that entities report. Consequently, the Committee [decided] not to add this matter to its standard-setting agenda.

IAS 28 *Investments in Associates and Joint Ventures*—Acquisition of an associate or joint venture from an entity under common control (Agenda Paper 8)

The Committee discussed a request to clarify how to account for the acquisition of an interest in an associate or joint venture from an entity under common control. In particular, the submitter asked whether it is appropriate to apply by analogy the scope exception for business combinations under common control in paragraph 2(c) of IFRS 3 *Business Combinations*.

The Committee observed that IAS 28 does not include a scope exception for the acquisition of an interest in an associate or joint venture from an entity under common control. Accordingly, an entity applies the requirements in IAS 28 when it acquires such an interest. The Committee concluded that the entity does not apply by analogy the scope exception for business combinations under common control in IFRS 3. In doing so, the Committee noted that the requirements in paragraph 26 of IAS 28 on the procedures used in accounting for an interest in an associate or joint venture should not be used as a basis to apply paragraph 2(c) of IFRS 3 by analogy.

The Committee observed that in accounting for the acquisition of the interest, the entity would assess whether the transaction includes a transaction with owners in their capacity as owners—if so, the entity determines the cost of the investment taking into account that transaction with owners.

The Committee concluded that the requirements in IFRS Standards provide an adequate basis for an entity to account for the acquisition of an interest in an associate or joint venture from an entity under common control. Consequently, the Committee [decided] not to add this matter to its standard-setting agenda.

IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*—Costs considered in assessing whether a contract is onerous (Agenda Paper 4)

The Committee received a request to clarify which costs an entity considers when assessing whether to recognise an onerous contract provision applying IAS 37. In particular, the submitter asked about the application of IAS 37 to contracts with customers previously within the scope of IAS 11 *Construction Contracts*.

As noted in paragraphs 5(g) of IAS 37 and BC296 of IFRS 15 *Revenue from Contracts with Customers*, an entity applies paragraphs 66–69 of IAS 37 in assessing whether a contract to which it applies IFRS 15 is onerous. Accordingly, the Committee concluded that, when determining which costs to include in assessing whether such a contract is onerous, the entity does not apply the previous requirements in IAS 11 on contract costs, nor does it apply the requirements in IFRS 15 on costs that relate directly to a contract.

Paragraph 68 of IAS 37 includes the definition of an onerous contract. In assessing whether a contract is onerous, an entity compares the unavoidable costs of meeting the obligations under the contract to the economic benefits expected to be received under it. The unavoidable costs under the contract are the lower of the cost of fulfilling the contract and any compensation or penalties arising from failure to fulfil the contract.

The Committee discussed two possible ways of applying the requirements in paragraph 68 of IAS 37 relating to the unavoidable costs of fulfilling the contract:

a. unavoidable costs are the costs that an entity cannot avoid because it has the contract (for example, an entity would include an allocation of overhead costs if those costs are incurred for activities required to complete the contract).
b. unavoidable costs are the costs that an entity would not incur if it did not have the contract (often referred to as 'incremental costs').

The Committee concluded that a reasonable reading of the requirements in paragraph 68 of IAS 37 on unavoidable costs of fulfilling a contract results in one of the two approaches outlined in this agenda decision. The Committee observed that an entity applies its reading of the requirements consistently to all applicable contracts.

The Committee also observed that paragraph 69 of IAS 37 requires an entity to recognise any impairment loss on assets dedicated to a contract before establishing a separate provision for an onerous contract.

In the light of its analysis, the Committee considered whether to add a project to its standard-setting agenda to eliminate one of the possible ways of reading the requirements. The Committee decided that amendments could not be developed for some of the requirements on onerous contracts without conducting a comprehensive review of all of those requirements. With this in mind, the Committee concluded that it would be unable to resolve the matter efficiently within the confines of existing IFRS Standards. Consequently, it [decided] not to add this matter to its standard-setting agenda.

IAS 38 *Intangible Assets*—Goods acquired for promotional activities (Agenda Paper 3)

The Committee received a request to clarify how an entity accounts for goods that it distributes as part of its promotional activities. The submitter described a situation in which a pharmaceutical entity acquires goods (such as refrigerators, air conditioners and watches) to distribute to doctors as part of its promotional activities. The submitter asked how the entity accounts for any such goods that remain undistributed at its reporting date.

If an entity acquires goods to be used to undertake advertising or promotional activities, paragraph BC46B of IAS 38 explains that such goods have no other purpose than to undertake those activities. In other words, the only benefit of those goods for the entity is to develop or create brands or customer relationships, which in turn generate revenues. However, applying IAS 38, the entity does not recognise internally generated brands or customer relationships as assets.

Accordingly, paragraph 69 of IAS 38 requires an entity to recognise any expenditure on such goods acquired solely for promotional activities as an expense when the entity has a right to access the goods. Paragraph 69A of IAS 38 states that an entity has a right to access goods when it owns them. The entity, therefore, recognises any expenditure on these goods as an expense when it owns the goods, or otherwise has a right to access them regardless of when it distributes the goods.

The Committee concluded that the requirements in IFRS Standards provide an adequate basis for an entity to account for the goods described in the submission. Consequently, the Committee [decided] not to add this matter to its standard-setting agenda.

Committee's agenda decisions

IAS 19 *Employee Benefits*—Discount rate in a country that has adopted another country's currency (Agenda Paper 6B)

The Committee received a request to clarify how an entity determines the rate used to discount post-employment benefit obligations (discount rate) in a country (Ecuador) that has adopted another currency as its official or legal currency (the US dollar). The entity's post-employment benefit obligation is denominated in US dollars. The submitter says there is no deep market for high quality corporate bonds denominated in US dollars in the country in which the entity operates (Ecuador).

The submitter asked whether, in that situation, the entity considers the depth of the market in high quality corporate bonds denominated in US dollars in other markets or countries in which those bonds are issued (for example, the United States). If there is no deep market in high quality corporate bonds denominated in US dollars, IAS 19 requires the entity to use the market yield on government bonds denominated in US dollars when determining the discount rate. The submitter asked whether the entity can use market yields on bonds denominated in US dollars issued by the Ecuadorian government, or whether instead the entity is required to use market yields on bonds denominated in US dollars issued by a government in another market or country.

The Committee observed, applying paragraph 83 of IAS 19, that:

a. an entity with post-employment benefit obligations denominated in a particular currency assesses the depth of the market in high quality corporate bonds denominated in that currency. This means that the entity does not limit this assessment to the market or country in which it operates, but also considers other markets or countries in which high quality corporate bonds denominated in that currency are issued.
b. if there is a deep market in high quality corporate bonds denominated in that currency, the entity determines the discount rate by reference to market yields on high quality corporate bonds at the end of the reporting period. It does so even if there is no deep market in such bonds in the market or country in which the entity operates. In this situation, the entity does not use market yields on government bonds to determine the discount rate.
c. if there is no deep market in high quality corporate bonds denominated in that currency, the entity determines the discount rate using market yields on government bonds denominated in that currency.
d. the entity applies judgement to determine the appropriate population of high quality corporate bonds or government bonds to reference when determining the discount rate. The currency and term of the bonds should be consistent with the currency and estimated term of the post-employment benefit obligations.

The Committee noted that the discount rate does not reflect the expected return on plan assets. Paragraph BC130 of IAS 19 says that the measurement of the obligation should be independent of the measurement of any plan assets actually held by a plan.

In addition, the Committee considered the interaction between the requirements in paragraphs 75 and 83 of IAS 19. Paragraph 75 of IAS 19 requires actuarial assumptions to be mutually compatible. The Committee concluded that it is not possible to assess whether, and to what extent, a discount rate derived by applying the requirements in paragraph 83 of IAS 19 is compatible with other actuarial assumptions. Accordingly, the entity applies the requirements in paragraph 83 of IAS 19 when it determines the discount rate.

The Committee concluded that the requirements in IAS 19 provide an adequate basis for an entity to determine the discount rate when the entity operates in a country that has adopted another currency as its official or legal currency. Consequently, the Committee decided not to add this matter to its standard-setting agenda.

IAS 32 *Financial Instruments: Presentation*—Centrally cleared client derivatives (Agenda Paper 6D)

Some jurisdictions mandate the clearing of particular derivative products through a central clearing counterparty (CCP). To clear through a CCP, an entity must be a clearing member (sometimes referred to as a 'clearing broker'). The types of products required to be cleared, and the surrounding legal framework, vary across jurisdictions.

The Committee received a request to clarify the accounting for centrally cleared client derivative contracts from the perspective of the clearing member.

The Committee concluded that the clearing member first applies the requirements for financial instruments. More specifically, the Committee observed that:

a. if the transaction(s) results in contracts that are within the scope of IFRS 9 *Financial Instruments* (or IAS 39 *Financial Instruments: Recognition and Measurement*), then the clearing member applies the recognition requirements in paragraph 3.1.1 of IFRS 9 (paragraph 14 of IAS 39) to those contracts. The clearing member presents assets and liabilities separately applying IFRS 9 (or IAS 39) in the statement of financial position, unless net presentation is required pursuant to the offsetting requirements in paragraph 42 of IAS 32.
b. if the transaction(s) is not within the scope of IFRS 9 (IAS 39) and another IFRS Standard does not specifically apply, only then would the clearing member apply the hierarchy in paragraphs 10–12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to determine an appropriate accounting policy for the transaction(s).

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for a clearing member to account for centrally cleared client derivative contracts. Consequently, the Committee decided not to add this matter to its standard-setting agenda.

IAS 33 *Earnings per Share*—Tax arising from payments on participating equity instruments (Agenda Paper 6C)

The Committee received a request to clarify how an entity determines profit attributable to ordinary shareholders when calculating basic earnings per share (EPS). In the fact pattern described in the submission:

a. the entity has two classes of equity instruments—ordinary shares and participating equity instruments. Participating equity holders participate in dividends together with ordinary shareholders according to a predetermined formula.
b. applying IAS 32 *Financial Instruments: Presentation*, the entity classifies the participating equity instruments as equity. Dividends are paid to participating equity holders only when they are paid to ordinary shareholders.
c. the dividends on participating equity instruments are deductible for tax purposes. Accordingly, such payments reduce taxable income and thus reduce income taxes payable to the taxation authorities ('tax benefit').

The submitter asked whether, in determining profit attributable to ordinary shareholders (ie the numerator) in the basic EPS calculation, the entity reflects the tax benefit that would arise from the hypothetical distribution of profit to participating equity holders.

Paragraph A14 of IAS 33 requires an entity to allocate profit or loss to the different classes of shares and participating equity instruments in accordance with their dividend rights and other rights to participate in undistributed earnings. Paragraph A14 of IAS 33 also requires an entity to allocate profit or loss (after adjusting for cumulative dividends and dividends declared in the period) to ordinary shares and participating equity instruments to the extent that each instrument shares in earnings as if all of the profit or loss for the period had been distributed (ie the hypothetical distribution).

The Committee concluded that, when calculating basic EPS in the fact pattern described in the submission, the entity adjusts profit or loss attributable to ordinary shareholders for the portion of any tax benefit attributable to those ordinary shareholders. This is because the tax benefit is a direct consequence of the hypothetical distribution of profit to the participating equity holders required by paragraph A14 of IAS 33. The entity applies this accounting treatment regardless of whether it recognises the tax benefit in equity or in profit or loss.

The Committee observed that this treatment is also consistent with the objective of basic EPS outlined in paragraph 11 of IAS 33—namely, to provide a measure of the interests of each ordinary share in the performance of the entity over the reporting period.

The Committee concluded that the principles and requirements in IAS 33 provide an adequate basis for an entity to calculate basic EPS in the fact pattern described in the submission. Consequently, the Committee decided not to add this matter to its standard-setting agenda.

Illustrative Example

The Committee decided to publish an illustrative example as educational material to accompany the agenda decision.

IAS 41 *Agriculture*—Biological assets growing on bearer plants (Agenda Paper 6A)

The Committee received a request about the fair value measurement of produce growing on bearer plants. More specifically, the request asked whether the Committee considers fruit growing on oil palms to be an example of a biological asset for which an entity might rebut the fair value presumption applying paragraph 30 of IAS 41.

The Committee observed that:

a. paragraph 5C of IAS 41 says that produce growing on bearer plants is a biological asset. Accordingly, an entity accounts for fruit growing on oil palms applying IAS 41.
b. the recognition requirements in paragraph 10 of IAS 41 specify when an entity recognises the fruit growing on oil palms separately from the oil palms themselves. The entity accounts for the oil palms applying IAS 16 *Property, Plant and Equipment*. An entity recognises a biological asset when the entity controls the asset as a result of past events, it is probable that future economic benefits associated with the asset will flow to the entity and the fair value or cost of the asset can be measured reliably.
c. applying paragraph 12 of IAS 41, an entity measures a biological asset on initial recognition and at the end of each reporting period at its fair value less costs to sell, except as described in paragraph 30 of IAS 41.
d. paragraph 30 of IAS 41 contains a presumption that fair value can be measured reliably for a biological asset. However, that presumption can be rebutted only on initial recognition for a biological asset for which quoted market prices are not available and for which alternative fair value measurements are determined to be clearly unreliable. Paragraph 30 of IAS 41 says that once the fair value of such a biological asset becomes reliably measurable, an entity measures it at its fair value less costs to sell.

The Committee concluded that the reference to 'clearly unreliable' in paragraph 30 of IAS 41 indicates that, to rebut the presumption, an entity must demonstrate that any fair value measurement is clearly unreliable. Paragraph BC4C of IAS 41 suggests that, when developing the amendments to IAS 41 on bearer plants, the Board's expectation was that fair value measurements of produce growing on bearer plants might be clearly unreliable when an entity encounters significant practical difficulties. However, the Committee observed that the converse is not necessarily true—ie if an entity encounters significant practical difficulties, this does not necessarily mean that any fair value measurement of produce is clearly unreliable. In paragraph BC4C, the Board observed that in this situation, an entity should consider whether the measurement is clearly unreliable.

The Committee also observed that the submission appears to ask whether possible differences in supportable assumptions (which might result in significantly different valuations) constitute 'significant practical difficulties' as referred to in paragraph BC4C of IAS 41. The Committee concluded that this is not evidence of significant practical difficulties, and that it would not, in and of itself, result in fair value measurements that are clearly unreliable.

The Committee noted that paragraph 125 of IAS 1 *Presentation of Financial Statements* requires an entity to disclose information about assumptions and estimates that have a significant risk of a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In addition, paragraph 91 of IFRS 13 *Fair Value Measurement* requires an entity to disclose information that helps users of its financial statements understand the valuation techniques and inputs used to develop fair value measurements, and the effect of measurements that use Level 3 inputs.

The Committee observed that the submission asks the Committee to conclude whether fair value measurements for a particular type of produce growing on bearer plants are clearly unreliable. The Committee determined that its role is not to conclude upon very specific application questions, particularly when they relate to the application of the judgements required in applying IFRS Standards. Consequently, the Committee decided not to add this matter to its standard-setting agenda.

Agenda Paper 6A: Report to the Board

Feedback on the tentative agenda decision on the fair value of biological assets growing on bearer plants will be reported to the Board for consideration as part of its Post-implementation Review of IFRS 13.

Other matters

IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*—Accounting policy changes resulting from agenda decisions (Agenda Paper 5)

The Committee provided feedback on whether, and if so how, to address the challenges posed by the requirements in IAS 8 for voluntary changes in accounting policies—in particular, changes in accounting policies that result from agenda decisions published by the Committee.

The Board will consider feedback from Committee members when it discusses the issue at its June 2017 meeting.

Committee work in progress (Agenda Paper 9)

The Committee received a report on one new 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. An analysis of the comments received will be presented at a future meeting.

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ISSN 1477-206X