IFRIC Update

IFRS

From the IFRS Interpretations Committee

March 2016

Welcome to the IFRIC *Update*

IFRIC[®] Update *is a summary of the tentative decisions reached by the IFRS Interpretations Committee*[®] *('the Interpretations Committee') in its public meetings. 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 then confirmed by the International Accounting Standards Board[®] *(the 'Board').*

The Interpretations Committee met in London on **22 March 2016**, and discussed:

Contact us

IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH
United Kingdom

Tel: +44 (0)20 7246 6410
Fax: +44 (0)20 7246 6411
E-mail: **ifric@ifrs.org**
Website: **www.ifrs.org**

Future IFRS Interpretations Committee meetings

The next meetings are:

10 May 2016
12 July 2016
6 and 7 September 2016
8 and 9 November 2016

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**.

Archive of IFRS Interpretations Committee Newsletter

For archived copies of past issues of IFRIC Update **click here**.

Items on the current agenda

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

IFRS 9 *Financial Instruments* and IAS 28 *Investments in Associates and Joint Ventures*—Measurement of long-term interests (Agenda Paper 15)

The Interpretations Committee continued its discussions relating to the interaction between IFRS 9 *Financial Instruments* and IAS 28 *Investments in Associates and Joint Ventures* with respect to the measurement of long-term interests that, in substance, form part of the net investment in an associate or a joint venture and to which the equity method is not applied ('long-term interests'). Specifically, the Interpretations Committee considered (a) whether the requirements of IFRS 9, including the impairment requirements, apply to long-term interests and, if so, (b) how the requirements in IFRS 9 and IAS 28 interact.

During the discussion, the Interpretations Committee raised some further questions about the accounting for long-term interests, specifically relating to the interaction between the measurement requirements of IFRS 9 and the loss allocation and impairment requirements in IAS 28.

Next steps

The Interpretations Committee will consider this issue further at a future meeting.

IAS 16 *Property, Plant and Equipment*—Accounting for proceeds and costs of testing of PPE (Agenda Paper 2)

The Interpretations Committee received a request to clarify the accounting for net proceeds from selling items produced before an item of property, plant and equipment (PPE) is capable of operating as intended by management. The submitter asked whether an entity recognises the amount by which the net proceeds received exceed the costs of testing in profit or loss or as a deduction from the cost of PPE.

The Interpretations Committee discussed the following approaches for the recognition of proceeds from selling items produced before the item of PPE is capable of operating as intended by management:

a. restricting the amount of proceeds that an entity deducts from the cost of PPE to only those proceeds arising from testing activities, and clarifying that the net proceeds deducted should not exceed the costs of testing included as part of the cost of PPE.
b. prohibiting the deduction of any proceeds from the cost of PPE.

The Interpretations Committee tentatively decided to propose a narrow-scope amendment to IAS 16 *Property, Plant and Equipment* to prohibit the deduction of proceeds from selling items produced before the item of PPE is capable of operating as intended by management from the cost of PPE (approach b. above).

Next steps

At a future meeting, the Interpretations Committee will consider:

a. whether the disclosure requirements in existing IFRS Standards are sufficient to provide useful information in the context of the proposed amendment; and
b. the transition requirements relating to the proposed amendment.

IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*—Accounting for recoverable cash payments (Agenda Paper 7)

The Interpretations Committee continued its discussions on how to account for a cash payment received from a government to help finance an entity's research and development project. The cash payment received from the government is repayable in cash if the entity decides to exploit and commercialise the results of the research phase of the project. If the entity decides not to exploit and commercialise the results of the research phase, the cash payment is not repayable and, instead, the entity must transfer to the government the rights to the research.

The Interpretations Committee considered the comments received on its tentative agenda decision published in November 2015 and concluded that, in the fact pattern submitted, the cash payment received from the government gives rise to a financial liability for the entity. The Interpretations Committee also decided to remove from the tentative agenda decision any reference to the arrangement also potentially meeting the definition of a forgivable loan.

The Interpretations Committee directed the staff to perform further analysis on how an entity accounts for any difference between the cash payment received from the government and the carrying amount of the financial liability at initial recognition.

Next steps

The Interpretations Committee will consider this issue further at a future meeting.

IFRIC 12 *Service Concession Arrangements*—Accounting for service concession arrangements for which the infrastructure is leased (Agenda Paper 6)

The Interpretations Committee continued its discussion on how an operator accounts for a service concession arrangement for which:

a. the infrastructure is leased; and
b. the operator is not required to provide construction or upgrade services with respect to the infrastructure.

During the discussions, the Interpretations Committee raised some further questions on the recognition and presentation issues described in the submission, in particular for arrangements in which the lessor and the grantor are controlled by the same governmental body.

Next steps

The Interpretations Committee will consider this issue further at a future meeting.

Item recommended to the Board to address through an amendment

IAS 12 *Income Taxes*—Accounting for income tax consequences of payments on financial instruments classified as equity (Agenda Paper 5)

The Interpretations Committee continued its discussions on the presentation of income tax relating to tax deductible payments on financial instruments classified as equity. The Interpretations Committee observed that the circumstances to which the requirements in paragraph 52B of IAS 12 *Income Taxes* apply are unclear. Nonetheless, the Interpretations Committee decided that the applicability of the requirements in paragraph 52B relating to the presentation of any income tax consequences of dividends should not be limited to only those circumstances described in paragraph 52A (ie circumstances in which there are different tax rates for distributed and undistributed profits).

Consequently, the Interpretations Committee decided to propose an amendment to IAS 12 to clarify that the presentation requirements in paragraph 52B of IAS 12 apply to all payments on financial instruments classified as equity that are distributions of profits, and are not limited to the circumstances described in paragraph 52A of IAS 12.

Next steps

The Board will consider the amendment proposed by the Interpretations Committee at a future meeting.

Interpretations Committee's tentative agenda decision

*The Interpretations Committee reviewed the following matter and tentatively decided that it should not be added to its agenda. This tentative decision, including recommended reasons for not adding the item to the Interpretations Committee's agenda, will be reconsidered at a future Interpretations Committee meeting. 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 6 June 2016 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.*

IFRS 11 *Joint Arrangements* and IFRS 10 *Consolidated Financial Statements*—Accounting for loss of control transactions (Agenda Paper 3)

The Interpretations Committee discussed whether an entity should remeasure its retained interest in the assets and liabilities of a joint operation when the entity loses control of an asset or group of assets. In the transaction discussed, the entity either retains joint control of a joint operation or is a party to a joint operation (with rights to assets and obligations for liabilities) after the transaction. The asset, or group of assets, over which the entity loses control may or may not constitute a business.

The Interpretations Committee noted that paragraphs B34–B35 of IFRS 11 *Joint Arrangements* specify that an entity recognises gains or losses on the sale or contribution of assets to a joint operation only to the extent of the other parties' interests in the joint operation. The requirements in these paragraphs could be viewed as conflicting with the requirements in IFRS 10 *Consolidated Financial Statements*, which specify that an entity should remeasure any retained interest when it loses control of a subsidiary.

The Interpretations Committee observed that the Board had issued amendments to IFRS 10 and IAS 28 *Investments in Associates and Joint Ventures* in September 2014 to address the accounting for the sale or contribution of assets to an associate or a joint venture. Those amendments address a similar conflict that exists between the requirements in IFRS 10 and IAS 28. After issuing the amendments, the Board considered a number of other related issues. The Board decided to address these issues as part of its research project on equity accounting, and also decided to defer the effective date of the amendments to IFRS 10 and IAS 28.

Because of the similarity between the transaction being considered by the Interpretations Committee and a sale or contribution of assets to an associate or a joint venture, the Interpretations Committee concluded that the accounting for the two transactions should be considered concurrently by the Board. Consequently, the Interpretations Committee [decided] not to add this issue to its agenda but, instead, to recommend to the Board that the issue is considered at the same time that the Board further considers the accounting for the sale or contribution of assets to an associate or a joint venture.

Interpretations Committee agenda decisions

IFRS 9 *Financial Instruments*—Determining hedge effectiveness for net investment hedges

The Interpretations Committee received a request to clarify how an entity should determine hedge effectiveness when accounting for net investment hedges in accordance with IFRS 9 *Financial Instruments*. Specifically, the submitter asked whether, when accounting for net investment hedges, an entity should apply the 'lower of' test required for cash flow hedges in determining the effective portion of the gains or losses arising from the hedging instrument.

The Interpretations Committee observed that:

a. paragraph 6.5.13 of IFRS 9 states that 'hedges of a net investment in a foreign operation … shall be accounted for similarly to cash flow hedges …'. Paragraph 6.5.13 (a), which focusses on net investment hedges, also references paragraph 6.5.11, which deals with the accounting for cash flow hedges; this includes the 'lower of' test. This indicates that, when accounting for net investment hedges, an entity should apply the 'lower of' test in determining the effective portion of the gains or losses arising from the hedging instrument.
b. in determining the effective portion of the gains or losses arising from the hedging instrument when accounting for net investment hedges, the application of the 'lower of' test avoids the recycling of exchange differences arising from the hedged item that have been recognised in other comprehensive income before the disposal of the foreign operation. The Interpretations Committee noted that such an outcome would be consistent with the requirements of IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

In addition, the Interpretations Committee noted the following:

a. it did not receive evidence of significant diversity among entities applying IAS 39 *Financial Instruments: Recognition and Measurement* in determining the effective portion of the gains or losses arising from the hedging instrument by applying the 'lower of' test when accounting for net investment hedges.
b. few entities have yet adopted the hedging requirements in IFRS 9; consequently, it is too early to assess whether the issue is widespread. However, the Interpretations Committee expects no significant diversity to arise when IFRS 9 is adopted more widely.

In the light of the existing requirements in IFRS Standards, the Interpretations Committee decided that neither an Interpretation nor an amendment to a Standard was necessary. Consequently, the Interpretations Committee decided not to add this issue to its agenda.

IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*—Variable payments for asset purchases

The Interpretations Committee received a request to address the accounting for variable payments to be made for the purchase of an item of property, plant and equipment or an intangible asset that is not part of a business combination.

The Interpretations Committee observed significant diversity in practice in accounting for these variable payments. It discussed the accounting, both at the date of purchasing the asset and thereafter, for variable payments that depend on the purchaser's future activity as well as those that do not depend on such future activity.

The Interpretations Committee was unable to reach a consensus on whether an entity (the purchaser) recognises a liability at the date of purchasing the asset for variable payments that depend on its future activity or, instead, recognises such a liability only when the related activity occurs. The Interpretations Committee was also unable to reach a consensus on how the purchaser measures a liability for such variable payments.

In deliberating the accounting for variable payments that depend on the purchaser's future activity, the Interpretations Committee considered the proposed definition of a liability in the May 2015 Exposure Draft *The Conceptual Framework for Financial Reporting* as well as the deliberations of the Board on its project on leases. The Interpretations Committee observed that, during the Board's deliberations on its project on leases, the Board did not conclude on whether variable payments linked to future performance or use of the underlying asset meet the definition of a liability at commencement of a lease or, instead, meet that definition only at the time that the related performance or use occurs.

In addition, the Interpretations Committee noted that there are questions about the accounting for variable payments subsequent to the purchase of the asset. Accordingly, the Interpretations Committee concluded that the Board should address the accounting for variable payments comprehensively.

The Interpretations Committee determined that this issue is too broad for it to address within the confines of existing IFRS Standards. Consequently, the Interpretations Committee decided not to add this issue to its agenda.

IAS 32 *Financial Instruments: Presentation*—Classification of liability for a prepaid card in the issuer's financial statements

The Interpretations Committee received a request to clarify how an entity classifies the liability that arises when it issues a prepaid card in exchange for cash and how the entity accounts for any unspent balance on such a card. Specifically, the Interpretations Committee discussed a prepaid card with the following features:

a. no expiry date and no back-end fees, which means that any balance on the prepaid card does not reduce unless it is spent by the cardholder;
b. non-refundable, non-redeemable and non-exchangeable for cash;
c. redeemable only for goods or services to a specified monetary amount;
d. redeemable only at specified third-party merchants that, depending upon the card programme, range from a single merchant to all merchants that accept a specific card network. Upon redemption by the cardholder at a merchant(s) for goods or services, the entity delivers cash to the merchant(s).

The Interpretations Committee was asked to consider whether the liability for the prepaid card is a non-financial liability on the basis that the entity does not have an obligation to deliver cash to the cardholder.

The Interpretations Committee observed that the entity's liability for the prepaid card meets the definition of a financial liability. This is because the entity:

a. has a contractual obligation to deliver cash to the merchants on behalf of the cardholder, which is conditional upon the cardholder using the prepaid card to purchase goods or services; and
b. does not have an unconditional right to avoid delivering cash to settle this contractual obligation.

Consequently, an entity that issues such a card applies the requirements in IFRS 9 *Financial Instruments* (IAS 39 *Financial Instruments: Recognition and Measurement*) to account for the financial liability for the prepaid card.

The Interpretations Committee noted that customer loyalty programmes were outside the scope of its discussion on this issue.

In the light of the existing requirements in IAS 32 *Financial Instruments: Presentation* and IFRS 9 (IAS 39), the Interpretations Committee determined that neither an Interpretation nor an amendment to a Standard was necessary. Consequently, the Interpretations Committee decided not to add this issue to its agenda.

IAS 32 *Financial Instruments: Presentation*—Offsetting and cash-pooling arrangements

The Interpretations Committee received a request to clarify an issue related to IAS 32 *Financial Instruments: Presentation*.

The issue relates to whether a particular cash-pooling arrangement would meet the requirements for offsetting in accordance with IAS 32—specifically, whether the regular physical transfers of balances (but not at the reporting date) into a netting account would be sufficient to demonstrate an intention to settle the entire period-end account balances on a net basis in accordance with paragraph 42(b) of IAS 32.

For the purposes of the analysis, the Interpretations Committee considered the specific example included in the request, which describes a cash-pooling arrangement involving subsidiaries within a group, each of which have legally separate bank accounts. At the reporting date, the group has the legally enforceable right to set off balances in these bank accounts in accordance with paragraph 42(a) of IAS 32. Interest is calculated on a notional basis using the net balance of all the separate bank accounts. In addition, the group instigates regular physical transfers of balances into a single netting account. However, such transfers are not required under the terms of the cash-pooling arrangement and are not performed at the reporting date. Furthermore, at the reporting date, the group expects that its subsidiaries will use their bank accounts before the next net settlement date, by placing further cash on deposit or by withdrawing cash to settle other obligations.

In considering whether the group could demonstrate an intention to settle on a net basis in accordance with paragraph 42(b) of IAS 32, the Interpretations Committee observed that:

a. paragraph 46 of IAS 32 states that net presentation more appropriately reflects the amounts and timings of the expected future cash flows only when there is an intention to exercise a legally enforceable right to set off; and
b. in accordance with paragraph 47 of IAS 32, when assessing whether there is an intention to settle net, an entity considers normal business practices, the requirements of the financial markets and other circumstances that may limit the ability to settle net.

Consequently, within the context of the particular cash-pooling arrangement described by the submitter, the Interpretations Committee noted that the group should consider the principles above in order to assess whether, at the reporting date, there is an intention to settle its subsidiaries' bank account balances on a net basis or whether the intention is for its subsidiaries to use those individual bank account balances for other purposes before the next net settlement date. In this regard, the Interpretations Committee observed that the group expects cash movements to take place on individual bank accounts before the next net settlement date because the group expects its subsidiaries to use those bank accounts in their normal course of business. Consequently, the Interpretations Committee noted that, to the extent to which the group did not expect to settle its subsidiaries' period-end account balances on a net basis, it would not be appropriate for the group to assert that it had the intention to settle the entire period-end balances on a net basis at the reporting date. This is because presenting these balances net would not appropriately reflect the amounts and timings of the expected future cash flows, taking into account the group's and its subsidiaries' normal business practices. However, the Interpretations Committee also observed that in other cash-pooling arrangements, a group's expectations regarding how subsidiaries will use their bank accounts before the next net settlement date may be different. Consequently it was noted that, in those circumstances, the group would be required to apply judgement in determining whether there was an intention to settle on a net basis at the reporting date.

The Interpretations Committee also observed that the results of the outreach did not suggest that the particular type of cash-pooling arrangement described by the submitter was widespread. Furthermore, it was noted that many different types of cash-pooling arrangements exist in practice. Consequently, the determination of what constitutes an intention to settle on a net basis would depend on the individual facts and circumstances of each case. The Interpretations Committee further noted that an entity should also consider the disclosure requirements related to offsetting of financial assets and financial liabilities in the applicable IFRS Standards.

In the light of this and the existing requirements in IFRS Standards, the Interpretations Committee decided that neither an Interpretation nor an amendment to a Standard was necessary. Consequently, the Interpretations Committee decided not to add this issue to its agenda.

Other matters

Issues on the March 2016 meeting postponed to a future Interpretations Committee meeting

Discussion of the following issues was postponed to a future Interpretations Committee meeting:

- Agenda decisions to finalise:
  - IAS 36 *Impairment of Assets*—Recoverable amount and carrying amount of a cash-generating unit (Agenda Paper 11)
  - IFRS 9 *Financial Instruments*/IAS 39 *Financial Instruments: Recognition and Measurement*—Derecognition of modified financial assets (Agenda Paper 9)
- New issue:
  - IAS 12 *Income Taxes*—Expected manner of recovery when calculating deferred tax on indefinite lived intangible assets (Agenda Paper 12)

Interpretations Committee work in progress update (Agenda Paper 14A)

The Interpretations Committee received a report on six new issues for consideration at future meetings. The report also included one issue that is on hold and that will be considered again at a future meeting.

Interpretations Committee review of 2015 activity (Agenda Paper 14B)

The Interpretations Committee received a report on the number and types of activities undertaken over recent years and how those activities have evolved. This report included a summary of the Interpretations Committee's activities during 2015 and a comparison with respect to previous years.

Go to top

Disclaimer: The content of this Update does not represent the views of the International Accounting Standards Board or the IFRS Foundation and is not an official endorsement of any of the information provided. The information published in this newsletter originates from various sources and is accurate to the best of our knowledge.

Copyright © IFRIC *Update* is published after every IFRS Interpretations Committee meeting by the IFRS® Foundation.

ISSN 1477-206X