IFRIC® *Update*

From the IFRS® Interpretations Committee

November 2017

Welcome to the November 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 **20 November 2017**, and discussed:

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Next IFRS Interpretations Committee meeting

The next meeting is:

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

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Items on the current agenda

Subsidiary as a first-time adopter (IFRS 1 *First-time Adoption of International Financial Reporting Standards*)—Agenda Paper 6

At its meeting in September 2017 the Committee published an agenda decision concluding that paragraph D16 of IFRS 1 does not permit a subsidiary to recognise cumulative translation differences at the amount that would be included in its parent's consolidated financial statements, based on the parent's date of transition to IFRSs.

At this meeting, the Committee recommended to the Board that it propose an amendment to IFRS 1 to provide a subsidiary that applies paragraph D16(a) with additional practical relief for cumulative translation differences.

Next steps

The Board will discuss the Committee's recommendation at a future Board meeting. That discussion will include consideration of whether to allow or require a subsidiary that applies paragraph D16(a) to measure cumulative translation differences using the amounts reported by the parent, based on the parent's date of transition to IFRSs.

Costs considered in assessing whether a contract is onerous (IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*)—Agenda Paper 5

The Committee discussed a request asking which costs an entity considers when assessing whether to recognise an onerous contract provision applying paragraph 68 of IAS 37.

The Committee decided to add a project to its standard-setting agenda to clarify the meaning of the term 'unavoidable costs' in the IAS 37 definition of an onerous contract.

Next steps

The Board will discuss the Committee's decision 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 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 its standard-setting agenda, at a future meeting. The Committee encourages interested parties to submit their responses on the Open for comment page by 29 January 2018. The Committee will place all such correspondence on the public record unless the writer specifically requests it remain confidential. In that case, the writer must support the request with good reason, for example, commercial confidentiality.

Presentation of interest revenue for particular financial instruments (IFRS 9 *Financial Instruments* and IAS 1 *Presentation of Financial Statements*)—Agenda Paper 3

The Committee received a request about the effect of the consequential amendment that IFRS 9 made to paragraph 82(a) of IAS 1. That consequential amendment requires an entity to present separately, in the profit or loss section of the statement of comprehensive income or in the statement of profit or loss, interest revenue calculated using the effective interest method. The request asked whether that requirement affects the presentation of fair value gains and losses on derivative instruments that are not part of a designated and effective hedging relationship (applying the hedge accounting requirements in IFRS 9 or IAS 39 *Financial Instruments: Recognition and Measurement*).

Appendix A to IFRS 9 defines the term 'effective interest method' and other related terms. Those interrelated terms pertain to the requirements in IFRS 9 for amortised cost measurement and the expected credit loss impairment model. In relation to financial assets, the Committee observed that the effective interest method is a measurement technique whose purpose is to calculate amortised cost and allocate interest revenue over the relevant time period. The Committee also observed that the expected credit loss impairment model in IFRS 9 is part of, and interlinked with, amortised cost accounting.

The Committee noted that amortised cost accounting, including interest revenue calculated using the effective interest method and credit losses calculated using the expected credit loss impairment model, is applied only to financial assets that are subsequently measured at amortised cost or fair value through other comprehensive income. In contrast, amortised cost accounting is not applied to financial assets that are subsequently measured at fair value through profit or loss.

Consequently, the Committee concluded that the requirement in paragraph 82(a) of IAS 1 to present separately an interest revenue line item calculated using the effective interest method applies only to those assets that are subsequently measured at amortised cost or fair value through other comprehensive income (subject to any effect of a qualifying hedging relationship applying the hedge accounting requirements in IFRS 9 or IAS 39).

The Committee did not consider any other presentation requirements in IAS 1 or broader matters related to the presentation of other 'interest' amounts in the statement of comprehensive income. This is because the consequential amendment that IFRS 9 made to paragraph 82(a) of IAS 1 did not affect those matters. More specifically, the Committee did not consider whether an entity could present other interest amounts in the statement of comprehensive income, in addition to presenting the interest revenue line item required by paragraph 82(a) of IAS 1.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to apply paragraph 82(a) of IAS 1 and present separately, in the profit or loss section of the statement of comprehensive income or in the statement of profit or loss, interest revenue calculated using the effective interest method. Consequently, the Committee [decided] not to add this matter to its standard-setting agenda.

Revenue recognition in a real estate contract that includes the transfer of land (IFRS 15 *Revenue from Contracts with Customers*)—Agenda Paper 2A

The Committee received a request about revenue recognition in a contract for the sale of land and a building to be constructed on the land. The land represents all of the area on which the building will be constructed. Specifically, the request asked (a) about the identification of performance obligations in the contract and (b) for each performance obligation identified, whether the real estate developer (entity) recognises revenue over time or at a point in time.

In the fact pattern described in the request, the contract includes the following features:

a. the entity and the customer enter into a non-cancellable contract for the sale of a building yet to be constructed by the entity that will comprise residential units.
b. at contract inception, the entity irrevocably transfers to the customer legal title to the land on which the entity will construct the building. The contract specifies a price for the land, which the customer pays on signing the contract.
c. the entity and the customer agree upon the structural design and specification of the building before the contract is signed. As the building is being constructed:
    i. if the customer requests changes to the structural design or specification, the entity prices the proposed changes based on a methodology specified in the contract; the customer then decides whether to proceed with the changes. The entity can reject the customer's request for changes only for a limited number of reasons, such as when the change would breach planning permission.
    ii. the entity can request changes to the structural design or specification only if not doing so would lead to an unreasonable increase in costs or delay to construction. The customer must approve those changes.
d. the customer is required to make milestone payments throughout the construction period. However, these payments do not necessarily correspond to the amount of work completed to date.

Identifying performance obligations in the contract

Applying paragraphs 22–30 of IFRS 15, an entity identifies as a performance obligation each promise to transfer to the customer a good or service (or a bundle of goods or services) that is distinct, or a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

Paragraph 27 of IFRS 15 specifies that a good or service promised to a customer is distinct if (a) the customer can benefit from the good or service on its own or together with other resources readily available to the customer (ie the good or service is capable of being distinct); and (b) the entity's promise to transfer the good or service is separately identifiable from other promises in the contract (ie the promise to transfer the good or service is distinct within the context of the contract). The assessment of the criteria in paragraph 27 requires judgement.

Paragraph BC100 explains that an entity assesses the criterion in paragraph 27(a) based on the characteristics of the goods or services themselves. Accordingly, an entity disregards any contractual limitations that might preclude the customer from obtaining readily available resources from a source other than the entity.

Paragraph 29 explains that the objective underlying the criterion in paragraph 27(b) is to determine whether the nature of the promise, within the context of the contract, is to transfer each of the promised goods or services individually or, instead, to transfer a combined item to which those goods or services are inputs. Paragraph 29 also specifies some factors that indicate that two or more promises to transfer goods or services are not separately identifiable.

The Board explained in paragraphs BC105, BC116J and BC116K that the notion of 'separately identifiable' in paragraph 27(b) is influenced by the notion of separable risks (ie whether the risk an entity assumes to fulfil its obligation to transfer one of those promised goods or services to the customer is a risk that is inseparable from the risk relating to the transfer of the other promised goods or services). The evaluation of whether an entity's promise is separately identifiable considers the relationship between the various goods or services within the contract in the context of the process of fulfilling the contract. Therefore, an entity considers the level of integration, interrelation or interdependence among the promises to transfer goods or services. Rather than considering whether one item, by its nature, depends on the other (ie whether two items have a functional relationship), an entity evaluates whether there is a transformative relationship between the two items in the process of fulfilling the contract.

Application of paragraph 27 to the fact pattern in the request

The identification of performance obligations in a contract requires an entity to assess the particular facts and circumstances of the contract. The Committee observed that that assessment may involve judgement and the outcome depends on those particular facts and circumstances.

In the fact pattern described in the request, the land and the building are each capable of being distinct and thus the Committee observed that the criterion in paragraph 27(a) is met. The customer could benefit from the land on its own or together with other resources readily available to it. For example, the customer could hire another developer to construct a building on the land. Similarly, the customer could benefit from the construction of the building on its own or together with other resources readily available to it. For example, the customer could obtain the construction services from the entity or another developer without any transfer of land.

When assessing the criterion in paragraph 27(b) and its underlying objective explained in paragraph 29—ie determining whether the nature of the promise, within the context of the contract, is to transfer the land and the building individually or, instead, to transfer a combined item to which the land and building are inputs, the Committee observed that the entity considers the following:

a. is there a transformative relationship between the transfer of the land and the construction of the building? In other words, would the entity's performance in constructing the building be any different had the customer already purchased the land from another party and vice versa? There is a functional relationship between the land and the building—the building cannot exist without the land; its foundations will be built into the land. However, this does not necessarily mean that the risks to which the entity is exposed in transferring the land to the customer are inseparable from the risks of constructing the building.

b. would the entity be able to fulfil its promise to transfer the land even if the customer purchased the construction services from another developer, and would it be able to fulfil its promise to construct the building even if the customer had purchased the land from another party?

The Committee observed that the promise to transfer the land would be separately identifiable from the promise to construct the building on that land if the entity concluded that (a) its performance in constructing the building would be the same regardless of whether the customer had purchased the land from it or another party; and (b) it would be able to fulfil its promise to construct the building even if the customer had purchased the land from another party, and would be able to fulfil its promise to transfer the land even if the customer purchased the construction services from another developer.

In the fact pattern described in the request, the Committee observed that this would be the case and, thus, concluded that there are two performance obligations in the contract—ie a promise to transfer the land to the customer and a promise to construct the building on that land.

Application of paragraph 35 to the fact pattern in the request

For each performance obligation, the entity applies the criteria in paragraph 35 of IFRS 15 to determine whether to recognise revenue over time. If none of the criteria in paragraph 35 are met, the entity recognises revenue at a point in time.

Application of paragraph 35 to the promise to transfer land

In the fact pattern described in the request, the entity's performance delivers the land to the customer. The land is not consumed immediately and, thus, the criterion in paragraph 35(a) is not met. Nor does the entity's performance create or enhance the land, and, thus, the criteria in paragraphs 35(b) and 35(c) are not met.

Consequently, the Committee observed that the entity recognises revenue for the transfer of the land to the customer at a point in time applying paragraph 38 of IFRS 15.

Application of paragraph 35 to the promise to construct the building

The Committee discussed the application of paragraph 35 to a promise to construct a real estate unit in [September 2017]. The following observations made by the Committee in its [tentative] agenda decision 'Revenue recognition in a real estate contract (IFRS 15)' are also applicable to the promise to construct the building in the fact pattern described in the request:[1]

a. in a contract for the sale of a building that the entity constructs, the Committee observed that paragraph 35(a) is not applicable because the entity's performance creates an asset, ie the building, that is not consumed immediately.
b. paragraph BC129 of IFRS 15 explains that the Board included the criterion in paragraph 35(b) to 'address situations in which an entity's performance creates or enhances an asset that a customer clearly controls as the asset is created or enhanced'. Accordingly, the Committee observed that, in applying paragraph 35(b), an entity assesses whether there is evidence that the customer clearly controls the asset that is being created or enhanced (for example, the part-constructed building) as it is created or enhanced. An entity considers all relevant factors in making this assessment—no one factor is determinative.
c. in applying paragraph 35(b), it is important to apply the requirements for control to the asset that the entity's performance creates or enhances. In a contract for the sale of a building that the entity constructs, the asset created is the building itself. It is not, for example, the right to obtain the building in the future.

[The paragraph above will be updated depending on the outcome of the Committee's consideration of comment letters received on the IFRS 15 tentative agenda decision published in September 2017.]

In the fact pattern described in the request discussed in November 2017, the Committee observed that the criterion in paragraph 35(a) is not met. This is because the customer does not simultaneously receive and consume the benefits provided by the entity's construction of the building as the building is being constructed—the entity's performance creates an asset, the part-constructed building, that is not consumed immediately.

[1] The references to 'real estate unit' in the [tentative] agenda decision published in [September 2017] have been changed to 'building' in this [tentative] agenda decision.

In assessing the criterion in paragraph 35(b), the entity assesses whether, as the building is being constructed, the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the part-constructed building.

The Committee concluded that, in the fact pattern described in the request, the customer controls the part-constructed building as it is being constructed because the customer has the following:

a. the ability to direct the use of the building as it is being constructed. The customer has this ability through its control of the land, and by being able to change the structural design and specification of the building as it is being constructed. The contract also enables the customer to prevent the entity or others from directing the use of the building.
b. the ability to obtain substantially all of the remaining economic benefits from the building. The entity cannot redirect the building for another use or to another entity. Accordingly, on signing the contract, the customer has the ability to obtain substantially all of the remaining benefits from the building.

Accordingly, the criterion in paragraph 35(b) is met. The Committee noted the Board's observation in paragraph BC129 of IFRS 15 that 'in the case of a construction contract in which the entity is building on the customer's land, the customer generally controls any work in progress arising from the entity's performance'.

The Committee concluded that the principles and requirements in IFRS 15 provide an adequate basis for an entity to recognise revenue in the fact pattern described in the request. Consequently, the Committee [decided] not to add this matter to its standard-setting agenda.

Right to payment for performance completed to date (IFRS 15 *Revenue from Contracts with Customers*)—Agenda Paper 2B

The Committee received a request about whether to recognise revenue over time or at a point in time in relation to a contract for the sale of a unit in a residential multi-unit complex (real estate unit). Specifically, the request asked whether, in the fact pattern described in the request, the real estate developer (entity) has an enforceable right to payment for performance completed to date as described in paragraph 35(c) of IFRS 15.

For each performance obligation, an entity applies the criteria in paragraph 35 of IFRS 15 to determine whether to recognise revenue over time. If none of the criteria in paragraph 35 are met, the entity recognises revenue at a point in time.

The request specifically asked about the application of paragraph 35(c) of IFRS 15. Applying paragraph 35(c), an entity recognises revenue over time if (i) the asset created by an entity's performance does not have an alternative use to the entity; and (ii) the entity has an enforceable right to payment for performance completed to date.

Paragraph 37 of IFRS 15 states that, to have an enforceable right to payment, at all times throughout the duration of the contract, the entity must be entitled to an amount that at least compensates the entity for performance completed to date if the contract is terminated for reasons other than the entity's failure to perform as promised.

Paragraph B9 of IFRS 15 states that an amount that would compensate an entity for performance completed to date would be an amount that approximates the selling price of the goods or services transferred to date, rather than compensation for only the entity's potential loss of profit if the contract were to be terminated. Accordingly, if an entity is entitled only to compensation for loss of profit, it does not have an enforceable right to payment for performance completed to date and, thus, the criterion in paragraph 35(c) is not met.

Application of paragraph 35(c)—enforceable right to payment—to the fact pattern in the request

The assessment of whether an entity has an enforceable right to payment for performance completed to date requires an entity to consider the rights and obligations created by the contract, taking into account the legal environment within which the contract is enforceable. Accordingly, the Committee observed that the outcome of an entity's assessment depends on the particular facts and circumstances of the contract.

In the fact pattern described in the request, the contract for the real estate unit includes the following features:

a. the entity and the customer enter into a contract for the sale of a real estate unit in a residential multi-unit complex before the entity constructs the unit. The entity's obligation under the contract is to deliver the completed real estate unit as specified in the contract. The entity retains legal title to the real estate unit (and any land attributed to it) until construction is complete.

b. the customer pays 10% of the purchase price for the real estate unit at contract inception, and pays the remainder of the purchase price to the entity after construction is complete.
c. the customer has the right to cancel the contract at any time before construction is complete. If the customer cancels the contract:
    i. the entity is legally required to make reasonable efforts to resell the real estate unit to a third party. On resale, the entity enters into a new contract with the third party—ie the original contract is not novated to the third party. If the resale price to be obtained from the third party is less than the original purchase price (plus selling costs), the customer is legally obliged to pay the difference to the entity.
    ii. the customer does not have any rights to sell, use or develop the real estate unit.

The Committee observed that the principle in paragraph 31 of IFRS 15 for the recognition of revenue is about the relationship between the entity and the customer. The Committee also observed that, in the fact pattern described in the request, the objective in applying paragraph 35(c) is to assess whether the customer obtains control of the real estate unit as it is being constructed. It is, therefore, the payment the entity is entitled to receive from (or on behalf of) the customer relating to performance under the contract with the customer that is relevant in determining whether the entity has a right to payment for performance completed to date. The consideration received by the entity from the third party in the resale contract is consideration relating to that resale contract—it is not payment for performance under the contract with the customer.

The Committee observed that, based on the fact pattern described in the request, the nature of the payment from the customer to which the entity has a right under the contract is a payment for the difference between the resale price and the original purchase price (plus selling costs). Accordingly, the entity has a right to compensation for loss of profit on termination of the contract—it does not have an enforceable right to payment for performance completed to date as described in paragraph 35(c) of IFRS 15.

The Committee concluded that the principles and requirements in IFRS 15 provide an adequate basis for an entity to determine whether it has an enforceable right to payment for performance completed to date. Consequently, the Committee [decided] not to add this matter to its standard-setting agenda.

Committee's agenda decisions

Acquisition of a group of assets (IFRS 3 *Business Combinations*)—Agenda Paper 4

The Committee received a request asking 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 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).

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 would apply its reading of the requirements consistently to all acquisitions of a group of assets that does not constitute a business. An entity would also disclose the selected approach applying paragraphs 117–124 of IAS 1 *Presentation of Financial Statements* if that disclosure would assist users of financial statements in understanding how those transactions are reflected in reported financial performance and financial position.

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 noted that any such project would not be narrow in scope. With this in mind, the Committee observed that it had not obtained sufficient 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 concluded that a project would not result in an improvement in financial reporting that would be sufficient to outweigh the costs. The Committee therefore decided not to add this matter to its standard-setting agenda.

Agenda Paper 4: Monitor the matter

The Committee observed that the forthcoming amendment to the definition of a business in IFRS 3 is likely to increase the population of transactions that constitute the acquisition of a group of assets. Accordingly, this matter will be monitored after the forthcoming amendments to IFRS 3 become effective.

Other matters

Committee work in progress—Agenda Paper 7

The Committee received a report on three requests for consideration at a future meeting.

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ISSN 1477-206X