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This publication summarises the meeting of the IFRS Interpretations Committee on 10 July 2012

Key decisions

IFRS 10 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures* (revised 2011) – Accounting for the loss of control of a group of assets or a subsidiary between an investor and its associate or joint venture

The Committee considered a request to clarify whether a business meets the definition of a 'non-monetary asset' in the context of identifying whether the requirements of SIC-13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers* and IAS 28 (revised 2011) apply. The submitter believes that there is an inconsistency between the guidance in IAS 27 *Consolidated and Separate Financial Statements* (revised 2008) and SIC-13 for transactions in which a parent contributes interests in a subsidiary to a joint venture (JV) (as defined in IFRS 11 *Joint Arrangements*)/jointly controlled entity (JCE) (as defined in IAS 31 *Interests in Joint Ventures*) and this contribution results in a loss of control in the subsidiary by the parent. Paragraph 5 of SIC-13 restricts gains and losses arising from contributions of non-monetary assets to a JCE to the extent of the interest attributable to the other equity holders in the JCE. However, paragraph 34 of IAS 27 (revised 2008) requires full profit or loss recognition on the loss of control of the subsidiary. This inconsistency will remain when IFRS 10 replaces IAS 27 (revised 2008) and SIC-13 is withdrawn and its requirements incorporated into IAS 28 (revised 2011).

In previous meetings, the Committee discussed various alternatives to address the inconsistency between the requirements in IAS 27 (revised 2008) and those in SIC-13. While the Committee acknowledged that both IAS 27 (revised 2008) and SIC-13 have been superseded by IFRS 10 and IAS 28 (revised 2011), the Committee hoped that timely resolution of this issue may allow the Committee to address the inconsistencies present in IAS 27 (revised 2008) and SIC-13 before the new IFRSs become mandatorily effective. The Committee concluded that it would ask the Board whether it wanted the Committee to consider further how to resolve the inconsistency between IAS 27 (revised 2008) and SIC-13 on the basis of alternatives discussed.

At the May 2012 Board meeting, the Committee discussed this inconsistency with the IASB and outlined three alternatives for resolution:

- Alternative 1: account for all contributions in accordance with the rationale developed in IAS 27 (revised 2008).

- Alternative 2: account for all contributions of businesses (whether housed in a subsidiary or not) in accordance with IAS 27 (revised 2008) and account for all other contributions in accordance with SIC-13.

- Alternative 3: account for all contributions to a JCE/JV or an associate in accordance with SIC-13.

Board members acknowledged the merits of addressing the inconsistencies present in IAS 27 (revised 2008) and SIC-13 given that neither IFRS 10 nor IAS 28 (revised 2011) are mandatorily effective. In deliberating the alternatives, Board members noted the conceptual merits of Alternative 1 but expressed concern that cross-cutting issues associated with this alternative could not be resolved timely. As a result, the majority of the Board expressed support for Alternative 2.

At its July 2012 Committee meeting, the Committee elected to propose amendments to IAS 28 (revised 2011) and IFRS 10 in accordance with Alternative 2. The Committee tentatively decided not to amend IAS 27 (revised 2008) and SIC-13 given that these standards would be superseded before any proposed amendments became effective.

The Committee decided that the proposed amendments to IAS 28 (revised 2011) should affect the sale or contribution of all types of assets that do not constitute a business between an investor and its associate or joint venture. The staff will present the revised proposed amendments to the IASB at the September 2012 IASB meeting.

IAS 19 *Employee Benefits* – Accounting for contribution-based promises (Reconsideration of draft Interpretation D9 *Employee Benefit Plans with a Promised Return on Contribution or Notional Contributions*)

At a previous meeting, in considering a narrow question regarding the impact of the 2011 revisions to IAS 19 on the accounting for contribution-based promises, the Committee acknowledged a broader question about how to account for contribution-based promises. The Committee previously considered this issue and published IFRIC draft Interpretation D9 in 2004 which considered the accounting for contribution-based promises within its scope. However, the Committee suspended this project in 2006 and instead referred the issue to the IASB to be included in the IASB's project on post-employment benefits. The IASB later deferred work on this issue to a future broader project on employee benefits. Therefore, the Committee decided at its May 2012 meeting to reconsider the work it had done when it published D9.

At its July 2012 Committee meeting, the Committee was presented with comment letter analysis of the responses on D9 originally prepared in 2005 and the 2008 discussion paper *Preliminary Views on Amendments to IAS 19 Employee Benefits* originally prepared in 2008 regarding the accounting for contribution-based promises. This information was used to aid the Committee in preliminary discussions regarding a revised scope of D9 and measurement options of plans covered by D9. The Committee had considered both scope and measurement in its redeliberations of D9 in 2005 without making any decisions at that time.

The Committee tentatively decided to continue working towards limited scope proposals on accounting for contribution-based promises. The Committee also tentatively decided that the scope of the proposals should be similar to the scope of D9, but clarified that an employee benefit plan would fall within the scope of the proposals if the employer has a legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay for all employee benefits relating to employee service in the current and prior periods in respect of a promised return on actual or notional contributions or any other benefit guarantee based on the value of one or more underlying assets.

The Committee requested that the staff undertake further outreach on scope in response to a general concern that the scope of the proposals was not sufficiently narrow. The Committee also tentatively decided that the scope of its work should include not only post-retirement benefits but also other long-term benefits.

The Committee discussed measurement options for contribution-based promises and provided the staff with input for consideration. However, no tentative decisions were made. The staff intend to bring proposals on measurement to the September 2012 Committee meeting.

Summary of Committee discussions

Agenda decisions

IAS 1 *Presentation of Financial Statements* and IAS 12 *Income Taxes* – Presentation of payments of non-income taxes

The Committee considered a request to clarify the presentation of production-based royalty payments payable to one taxation authority that are claimed as an allowance against taxable profit of another taxation authority. The request for clarification relates to whether these costs should be recognised as an operating expense or a tax expense in the statement of comprehensive income and whether the production-based royalty payment can be viewed as prepayment of the income tax payable. The request included an assumption that the production-based royalty payments are, in themselves, outside the scope of IAS 12 while the income tax payable to the other taxing authority is within the scope of IAS 12. The Committee used the same assumption when discussing the issue.

The Committee observed that paragraph 82(d) of IAS 1 is intended to require an entity to present taxes that meet the definition of income taxes under IAS 12 within the 'tax expense' line item. Similarly, the Committee noted that the basis of calculation should be considered rather than the manner of settlement of a tax liability or the factors relating to recipients of the tax.

The Committee noted that the production-based royalty payments outlined in the submission should not be treated differently from other expenses outside the scope of IAS 12, all of which may reduce income tax payable. As such, the Committee noted that it is inappropriate to consider the royalty payments to be prepayment of the income tax payables. Likewise, the Committee concluded that since the production-based royalty payments do not meet the definition of an income tax, the royalty payments should not be presented as an income tax expense in the statement of comprehensive income.

The Committee believed the existing requirements in IAS 1 and IAS 12 were clear for the specific fact pattern provided and therefore decided not to add this issue to its agenda.

IAS 12 *Income Taxes* – Accounting for market value uplifts introduced by a new tax regime

The Committee considered a request to clarify the accounting for market value uplifts introduced in a proposed jurisdictional tax regime. The request included a specific fact pattern where entities, in calculating taxable profit under the proposed tax regime falling within the scope of IAS 12, are permitted to calculate tax depreciation for certain mining assets using the market value of the assets as of a particular date as the 'starting base allowance', rather than the cost or carrying value of the assets. If there is insufficient profit against which the annual tax depreciation can be used, it is carried forward and is able to be used as a deduction against taxable profit in future years.

The Committee noted that the starting base allowance, including the part that is attributable to the market value uplift, is attributed to the related assets under the tax regime and will become the basis for depreciation expense for tax purposes. Consequently, the market value uplift forms part of the related asset's 'tax base', as defined in paragraph 5 of IAS 12. The Committee observed that IAS 12 requires an entity to reflect an adjustment to the tax base of an asset that is due to an increase in the deductions available as a deductible temporary difference. Therefore, the Committee noted that a deferred tax asset should be recognised to the extent it meets the recognition criteria in paragraph 24 of IAS 12.

The Committee believed the existing requirements in IAS 12 were clear for the specific fact pattern provided and therefore decided not to add this issue to its agenda.

Tentative agenda decisions

IAS 18 *Revenue,* IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IAS 39 *Financial Instruments: Recognition and Measurement* – Regulatory assets and liabilities

The Committee considered a request to clarify whether a regulatory asset or regulatory liability should be recognised when a regulated entity is permitted to recover costs or required to refund some amounts, independently of the delivery of future services. The request for clarification specifically questions whether the population of customers can be regarded as a single unit of account and, if so, whether it is acceptable to recognise an asset or liability.

The Committee did not address the two specific questions raised in the submission. Instead, the Committee considered the question of recognition of regulatory assets and liabilities more broadly. The Committee acknowledged a previous conclusion in 2005 on the subject of whether or not it would be appropriate to recognise a regulatory asset; ultimately concluding that an entity should only recognise assets that qualify for recognition in accordance with the IASB's conceptual framework and with relevant IFRSs such as IAS 11 *Construction Contracts,* IAS 18, IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*. The Committee noted a lack of consequential amendments to these IFRSs subsequent to reaching is previous conclusion, and thus, concluded that its past conclusion on this issue is still valid.

The Committee also acknowledged that as part of the IASB's now paused project on rate-regulated activities, the IASB concluded that the issue could not be resolved quickly. Given the status reached by the Board, the Committee observed that this issue is too broad for the Committee to address within the confines of existing IFRSs and the conceptual framework. However, the Committed observed that as part of the Board's May 2012 meeting, the Board unanimously supported giving priority to developing a standards-level proposal for rate-regulated activities.

On the basis of this analysis, the Committee tentatively decided not to add this issue to its agenda. The Committee will reconsider this tentative decision at a future meeting.

IAS 39 *Financial Instruments: Recognition and Measurement* – Scope of paragraph AG5

The Committee considered a request for guidance on several accounting issues that resulted from the restructuring of Greek government bonds (GGBs) in 2012. The Committee previously tentatively concluded that the GGBs surrendered in March 2012 should be derecognised where the new GGBs received as part of the debt restructuring are recognised as new assets. At this meeting, the Committee considered whether paragraph AG5 of IAS 39 could apply when determining the effective interest rate on initial recognition of those new GGBs. Applying paragraph AG5 of IAS 39 means that the effective interest rate would be determined at initial recognition using estimated cash flows that take into account incurred credit losses.

The Committee noted that paragraph AG5 of IAS 39 applies to acquired assets, which includes both purchased and originated assets. Even though an origination of a debt instrument with an incurred loss is unusual, the Committee identified situations in which such transactions occur. For example, transactions can arise that involve originations of debt instruments outside the normal underwriting process as a result of significant financial distress by an obligor to a pre-existing relationship. This could result in derecognition of the original financial asset and recognition of a new financial asset that has incurred losses on initial recognition. The Committee concluded that the assessment of whether an incurred loss exists on initial recognition of an asset requires judgement.

On the basis of this analysis, the Committee tentatively decided not to add this issue to its agenda. The Committee will reconsider this tentative decision at a future meeting.

Other issues considered

IFRS 3 *Business Combinations* – Continuing employment

The Committee considered a request for guidance on the accounting for contingent payments to selling shareholders in circumstances in which those selling shareholders become employees. The request for clarification relates to whether IFRS 3 should be conclusive in determining that an arrangement in which payments to an employee are forfeited upon termination is remuneration for post-combination services and not part of the consideration for an acquisition, or whether this is an indicator but not, on its own, determinative that the payment is compensation.

In a previous meeting, the Committee noted that IFRS 3 is a converged standard with the US Financial Accounting Standards Board (FASB) and the staff were instructed to consult both the IASB and FASB to determine whether IFRS 3 (IFRSs only) and Topic 805 *Business Combinations* (US GAAP only) should be conclusive in the fact pattern described above.

At its July 2012 Committee meeting, the Committee was advised that the preliminary view of many Board members is that they would prefer that IFRS 3 be indicative, but not, on its own, determinative that the payment is compensation. However, Board members shared the Committee's concern regarding creating divergence with US GAAP.

The staff noted they would provide the Committee with an update on the results of its consultation with FASB members as part of the September 2012 meeting. Dependent on the results of that consultation, the Committee will seek direction from the IASB as to whether and how IFRSs should be amended.

IAS 7 *Statement of Cash Flows* – Examples illustrating the classification of cash flows

At its January 2012 meeting, the Board discussed two different issues that had been considered by the Committee regarding cash flow classification under IAS 7: classification of cash payments for deferred and contingent consideration arising from a business combination within the scope of IFRS 3 and classification of cash flows for an operator in a service concession arrangement within the scope of IFRIC 12 *Service Concession Arrangements*. The Board decided that in advance of considering whether these issues should be addressed through the annual improvements process, it would direct the Committee to collectively analyse these two issues, as well as all of the previous IAS 7 issues that the Committee has discussed regarding the classification of cash flows, and consider whether these issues could be dealt with collectively.

The Committee identified two classification principles used to support its previous decisions: cash flows in IAS 7 should be classified in accordance with the nature of the activity to which they relate following the definitions in paragraph 6 of IAS 7; and cash flows in IAS 7 should be classified consistently with the classification of the related or underlying item in the statement of financial position.

The Committee concluded the primary principle behind the classification of cash flows in IAS 7 is that cash flows should be classified in accordance with the nature of the activity to which they relate having regard to an entity's business model. The Committee noted that it would use this as a guiding principle when analysing future requests on the classification of cash flows. However, it directed the staff to provide illustrations of the application of the identified primary principle behind the classification of cash flows in order to assist the Committee in developing guidance to further support the principle.

At its July 2012 Committee meeting, the Committee analysed some of the staff illustrations and noted inconsistent application of the principle amongst Committee and staff members. Therefore, the Committee requested that the staff consider how the description of operating, investing and financing cash flows can be made clearer and thus result in more consistent application of the primary principle. The Committee also asked the staff to consider the relevance of the counterparty and the timing of the cash flows to their classification. Additionally, the Committee requested that the staff consider constituent feedback received as part of the Financial Statement Presentation Project and the IASB's 2011 agenda consultation that relate to IAS 7 in the development of future staff papers.

The staff will present the results of this work at a future meeting.

Review of issues previously referred to the IASB

The Committee received a report on issues which have been referred to the IASB between January 2008 and May 2012 and not yet addressed, except for those recommended by the Committee to be addressed through the annual improvements process.

The Committee asked the staff to update the analysis and outreach on the following issues so that the Committee can discuss, at future meetings, whether or not to add these issues to its agenda:

- IAS 28 *Investments in Associates* issue to clarify how impairment of an investment in an associate should be determined in the separate financial statements of the investor.

- IFRS 2 *Share-based Payments* issues to clarify:

  – how to classify and measure share-based payment transactions for which the manner of settlement is contingent on a future event that is either outside the control of the entity and/or the counterparty or within the control of the counterparty.

  – how to classify a share-based payment transaction in which the entity is required to withhold a specified portion of the shares that would otherwise be issued to the counterparty upon exercise (or vesting) of the share-based payment award in order to settle the counterparty's tax obligation.

  – how to measure and account for a share-based payment in situations in which a cash-settled award is cancelled and is replaced by a new equity-settled award and the replacement award has a higher fair value than the original award.

- IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* issues to clarify:

  – how a disposal group should be recognised when the difference between the carrying amount and fair value less costs to sell exceed the carrying amount of non-current assets.

  – whether an impairment loss for a disposal group classified as held for sale can be reversed if it relates to the reversal of an impairment loss recognised for goodwill.

In addition, the Committee discussed issues previously raised relating to IAS 32 *Financial Instruments: Presentation* and IAS 39. The Committee requested that the staff discuss these issues with the Financial Instruments project team to determine whether it is appropriate for the Committee to address any of these issues at future meetings.

Administrative session

Committee outstanding issues report

The Committee deferred work on three new issues and five outstanding issues which will be discussed at a future meeting.

The new issues include:

- IAS 19 issue to clarify the scope of paragraph 93 of IAS 19 (revised 2011).

- IFRS 3 issue to provide clear guidelines for Special Purpose Acquisition Company (SPAC)-related merger transactions.

- IAS 27 (revised 2008) and IFRIC 17 *Distribution of Non-cash Assets to Owners* issue to clarify the accounting for the purchase of a non-controlling interest when the consideration includes non-cash items.

The outstanding issues include:

- IFRS 3 issue to clarify whether an asset with relatively simple associated processes meets the definition of a business in accordance with IFRS 3.

- IAS 12 issue to clarify the calculation of deferred tax in circumstances where the entity holds a subsidiary which has a single asset within it.

- IAS 41 *Agriculture* issue to clarify paragraph 25 of IAS 41 regarding the use of a residual method to arrive at the fair value of biological assets physically attached to land if the biological assets have no separate market but an active market exists for the combined assets.

- IAS 16 issue to clarify how to account for contingent pricing for the outright purchase of a single item of property, plant and equipment or an intangible asset. The staff are monitoring this issue in the context of developments on the IASB's leases project.

- IAS 2 *Inventories* issue to clarify the accounting for long-term supply contracts of raw materials when the purchaser of the raw materials agrees to make prepayments to the supplier. The staff are monitoring this issue in the context of developments on the IASB's revenue recognition project.

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