IFRS INTERPRETATIONS COMMITTEE - AGENDA REJECTIONS (JANUARY 2016)

INTERNATIONAL FINANCIAL REPORTING BULLETIN 2016/04

Background

This Bulletin summarises issues that the IFRS Interpretations Committee (the Interpretations Committee) decided not to take onto its agenda at its January 2016 meeting, which were reported in its public newsletter (the IFRIC Update). Although these agenda rejections do not represent authoritative guidance issued by the International Accounting Standards Board (IASB), in practice they are regarded as being highly persuasive. All entities that report in accordance with IFRS need to be aware of these agenda rejections, and may need to modify their accounting approach. More detailed background about agenda rejections is set out below.

The Interpretations Committee is the interpretative body of the IASB. The role of the Interpretations Committee is to provide guidance on financial reporting issues which have been identified and which are not specifically addressed in IFRS, or where unsatisfactory or conflicting interpretations either have developed, or appear likely to develop.

Any party which has an interest in financial reporting is encouraged to submit issues to the Interpretations Committee when it is considered to be important that the issue is addressed by either the Interpretations Committee itself, or by the IASB. When issues are raised, the Interpretations Committee normally consults a range of other parties, including national accounting standard setting bodies, other organisations involved with accounting standard setting, and securities regulators.

At each of its meetings, the Interpretations Committee considers new issues that have been raised, and decides whether they should be added to its agenda. For those issues that are not added to the agenda, a tentative agenda decision is published in the IFRIC Update newsletter which is issued shortly after each of the Interpretations Committee's meetings. These tentative agenda decisions are open to public comment for a period of 60 days, after which point they are taken back to the Interpretations Committee for further consideration in the light of any comment letters which have been received and further analysis carried out by the Staff. The tentative agenda decision is then either confirmed and reported in the next IFRIC Update, or the issue is either subjected to further consideration by the Interpretations Committee's agenda or referred to the IASB.

Interpretations Committee agenda decisions do not represent authoritative guidance. However, they do set out the Interpretations Committee's rationale for not taking an issue onto its agenda (or referring it to the IASB). It is noted on the IFRS Foundation's website that they 'should be seen as helpful, informative and persuasive'. In practice, it is expected that entities reporting in accordance with IFRS will take account of and follow the agenda decisions and this is the approach which is followed by securities regulators worldwide.

STATUS
Final

EFFECTIVE DATE
Immediate

ACCOUNTING IMPACT
Clarification of IFRS requirements.
May lead to changes in practice.

Agenda decisions that were finalised at the January 2016 meeting

IFRS 5	*Non-current Assets Held for Sale and Discontinued Operations – To what extent can an impairment loss be allocated to non-current assets within a disposal group?*
IFRS 5	*Non-current Assets Held for Sale and Discontinued Operations – How to present intragroup transactions between continuing and discontinued operations*
IFRS 5	*Non-current Assets Held for Sale and Discontinued Operations – Other various IFRS-related issues*
IFRS 9	*Financial Instruments – Transition issues relating to hedging*
IFRS 11	*Joint Arrangements – Remeasurement of previously held interests*
IAS 12	*Income Taxes – Recognition of deferred taxes for the effect of exchange rate changes*
IAS 39	*Financial Instruments: Recognition and Measurement – Separation of an embedded floor from a floating rate host contract in a negative interest rate environment*

Tentative agenda decisions at the January 2016 meeting

IFRIC 12	*Service Concession Arrangements – Payments made by an operator to a grantor in a service concession arrangement*

Each of these is discussed below, split between those which are expected to have wide application and those which are narrower in focus.

Agenda decision at the January 2016 meeting – wide application

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations – To what extent can an impairment loss be allocated to non-current assets within a disposal group?*

The question received by the Interpretations Committee related to a measurement requirement of IFRS 5. Specifically, the Interpretations Committee was asked to clarify whether the allocation of an impairment loss recognised for a disposal group can reduce the carrying amount of non-current assets in the disposal group (that are within the scope of measurement requirements of IFRS 5) to an amount that is lower than their fair value less costs of disposal or their value in use.

The Interpretations Committee noted that the recognition of impairment for a disposal group is addressed in paragraph 23 of IFRS 5, and refers only to paragraphs 104 and 122 of IAS 36 *Impairment of Assets* which contain guidance for the order of allocation of impairment losses to non-current assets. The Interpretations Committee also observed that the restriction in paragraph 105 of IAS 36, not to reduce the carrying amount of an asset below the higher of its fair value less costs of disposal, its value in use and zero, does not apply when allocating an impairment loss for a disposal group to the non-current assets that are within the scope of the measurement requirements of IFRS 5.

Therefore the Interpretations Committee took this to mean that the amount of an impairment that should be recognised for a disposal group would not be restricted by the fair value less costs of disposal or value in use of those non-current assets that are within the measurement requirements of IFRS 5.

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.

BDO comment

The agenda decision clarifies that the 'higher of test' in paragraph 105 of IAS 36 does not apply when allocating an impairment loss to the non-current assets of a disposal group classified as held for sale in accordance with IFRS 5.

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations – How to present intragroup transactions between continuing and discontinued operations*

The request received by the Interpretations Committee referred to the presentation of intragroup transactions between continuing and discontinued operations.

Paragraph 30 of IFRS 5 requires an entity to present and disclose information that enables users of financial statements to evaluate the financial effects of discontinued operations and disposals of non-current assets (or disposal groups), but IFRS 5 does not contain guidance setting out how intragroup transactions between continuing and discontinued operations should be eliminated.

The Interpretations Committee noted that there are no requirements or guidance in IFRS 5 or IAS 1 *Presentation of Financial Statements* in relation to the presentation of discontinued operations that override the consolidation requirements in IFRS 10 *Consolidated Financial Statements*.

It was also noted that paragraph B86(c) of IFRS 10 requires the elimination of income/expenses of intragroup transactions and not only intragroup profit. Accordingly, an entity would be required to eliminate intragroup sales and purchases in their entirety.

In light of the above analysis and the requirements of paragraph 30 of IFRS 5, the Interpretations Committee observed that entities may have to provide additional disclosures in the notes to their financial statements so users are capable of evaluating the financial effects of discontinued operations.

It was noted that IFRS 5 was described as a possible research project in the *Request for Views* on the 2015 Agenda Consultation. Consequently, the Interpretations Committee decided not to add this issue to its agenda.

BDO comment

The decision illustrates the importance of providing useful disclosures in financial statements to enable users to evaluate the financial effects of transactions.

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations – Various other IFRS-related issues*

The following issues relating to the application of IFRS 5 requirements were discussed by the Interpretations Committee:

Scope

a) The issue relates to whether certain types of planned loss of control events, other than loss of control through sale or distribution, can result in a held-for-sale classification in accordance with IFRS. For example, loss of control of a subsidiary due to dilution of the shares held by the entity, or call options held by a non-controlling shareholder or a modification of a shareholders' agreement.
b) The issue relates to whether IFRS 5 applies to a disposal group that consists mainly, or entirely, of financial instruments that are within the scope of IFRS 9 *Financial Instruments*.

Measurement

c) The issue relates to a situation where the difference between the carrying amount and the fair value less costs to sell of a disposal group exceeds the carrying amount of the non-current assets in the disposal group. In this situation, should the amount of impairment losses be limited to the carrying amount of:
   (i) Non-current assets within the scope of the measurement requirements of IFRS 5
   (ii) The net assets of a disposal group
   (iii) The total assets of a disposal group; or
   (iv) The non-current assets with a liability being recognised for the excess, if any?
d) The issue relates to the reversal of an impairment loss of goodwill in a disposal group. Specifically, should the allocation of all or part of a previous impairment loss to goodwill limit the amount of an impairment reversal that can be recognised against other assets in the disposal group?

Presentation

e) The issue relates to how the definition of 'discontinued operation' should be interpreted, especially with regard to the notion of 'separate major line of business or geographical area of operations'.
f) The issue relates to a situation where there has been a change to a plan to dispose of a disposal group, which consists of both a subsidiary and other non-current assets, resulting in the disposal group no longer being classified as held for sale. The issue that arises relates to paragraph 28 of IFRS 5, which indicates that the remeasurement adjustments relating to the subsidiary and the other non-current assets should be recognised in different accounting periods. A related issue is whether any retrospective amendment should apply to presentation as well as to measurement.
g) The issue relates to how best to eliminate and reflect transactions between continuing and discontinued operations on the face of the statement of profit or loss, when there are significant transactions between them.

The Interpretations Committee concluded that a broad-scope project on IFRS 5 might be warranted due to the number and variety of unresolved issues. Therefore, it was decided not to add these issues to the agenda.

BDO comment

In our comment letter in response to the IASB's 2015 Agenda Consultation, we supported the addition of a project relating to IFRS 5. The significant number of practical application issues which have been identified indicates that a wider project should be undertaken, rather than initiating a series of narrow scope amendments.

IFRS 11 *Joint Arrangements – Remeasurement of previously held interests*

The Interpretations Committee was asked to clarify whether an entity should remeasure previously held interests in the assets and liabilities of a joint operation when the asset or group of assets involved in such transactions do not meet the definition of a business in accordance with IFRS 3 *Business Combinations*, for the following transactions:

- Obtaining control of a joint operation, through either holding joint control in, or being a party to a joint operation prior to the transaction, and
- A change of ownership interests that results in a party to a joint operation obtaining joint control over the joint operation. Prior to the transaction taking place, the party to the joint operation would have had rights to the assets and obligations for the liabilities.

The Interpretations Committee noted that guidance on accounting for an asset acquisition, where the asset or group of assets do not meet the definition of a business, is included in paragraph 2(b) of IFRS 3. This paragraph requires a cost based approach to be followed, under which existing assets are generally not remeasured. It was also observed that no significant diversity in practice was identified.

Due to the above, the Interpretations Committee decided not to add this issue to its agenda.

BDO comment

The decision illustrates that any transaction that results in an entity gaining control of an entity that was previously a joint operation and where the assets or groups of assets involved do not constitute a business should be accounted for as an asset acquisition at their relative fair values.

IAS 12 *Income Taxes – Recognition of deferred taxes for the effect of exchange rate changes*

The request received by the Interpretations Committee related to the recognition of deferred taxes when the tax bases of an entity's non-monetary assets and liabilities are determined in a currency that is different from its functional currently. The question is whether deferred taxes that result from exchange rate changes on the tax bases of non-current assets are required to be recognised in profit or loss.

The Interpretations Committee noted that such deferred tax does not arise from a transaction or event that is recognised outside profit or loss and is therefore charged or credited to profit or loss in accordance with paragraph 58 of IAS 12. Such deferred tax charges or credits would be presented with other deferred taxes, and not together with foreign exchange gains or losses, in the statement of profit or loss.

It was also noted that, if the tax effect of changes in exchange rates represented a major component of the deferred tax charge or credit, disclosures may be required in accordance with paragraph 79 of IAS 12.

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

Agenda decision at the January 2016 meeting – narrow application

IFRS 9 *Financial Instruments – Transition issues relating to hedging*

The request for guidance received by the Interpretations Committee relates to the transition from IAS 39 *Financial Instruments: Recognition and Measurement* to IFRS 9 *Financial Instruments* and consists of the following two issues:

Issue 1 – Can an entity treat a hedging relationship as a continuing hedge relationship upon transition to IFRS 9 when the designation of a non-financial item changes?

The first issue the Interpretations Committee was asked to clarify was whether an entity is able to treat a hedging relationship as a continuing hedging relationship on transition from IAS 39 to IFRS 9 if that entity changes the hedged item in a hedging relationship from a non-financial item in its entirety (the designation permitted by IAS 39) to a component of the non-financial item (as permitted by IFRS 9), in order to align the hedge with the entity's risk management objective.

The Interpretation Committee noted that if, on transition to IFRS 9, an entity changes the hedged item in a hedging relationship from an entire non-financial item to a component of the non-financial item this must be accounted for on a prospective basis. It also observed that IFRS 9 prohibits (except in the limited circumstances described in paragraph 7.2.26 of IFRS 9) an entity from changing the hedged item while continuing the original hedging relationship since this would be equivalent to the retrospective application of the hedging accounting requirements .

Issue 2 – Can an entity continue with the original hedge designation of the entire non-financial item under IFRS 9?

The second issue the Interpretations Committee was asked to consider was whether an entity can continue with its original hedge designation of the non-financial item in its entirety when it transitions from IAS 39 to IFRS 9. The Interpretation committee noted that IFRS 9:

- Supports the use of hedge designations that are not exact copies of actual risk management ('proxy hedging') so long as they reflect risk management. In order for the 'proxy hedging' to reflect risk management it must relate to the same type of risk that is being managed as well as the same type of instruments that are being used for that purpose
- Does not appear to restrict the use of proxy hedging to cases where IFRS 9 prohibits an entity from designating hedged items in accordance with its actual risk management.

As a result, the Interpretations Committee concluded that when an entity transitions to IFRS 9 a hedge designation of a non-financial item in its entirety could continue as long as it meets the qualifying criteria in IFRS 9.

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

IAS 39 *Financial Instruments: Recognition and Measurement – Separation of an embedded floor from a floating rate host contract in a negative interest rate environment*

The Interpretations Committee was asked to clarify the application of the embedded derivative requirements in IAS 39 (i.e. determining whether an embedded derivative is closely related to the host contract) when an entity is operating in a negative interest rate environment.

As part of its analysis, the Interpretations Committee considered whether paragraph AG33(b) of IAS 39 should apply to the above issue and, if so, how to determine the 'market rate of interest' referred to in that paragraph.

The Interpretations Committee observed that the IAS 39 does not make any distinction between negative or positive interest rates. For this reason an entity should apply paragraph AG33(b) of IAS 39 when determining whether to separate an embedded interest rate floor from a floating rate host contract when the entity is operating in a negative interest rate environment in the same way that it would be applied if the entity was operating in a positive interest rate environment.

The Interpretations Committee also observed that an entity applying paragraph AG33(b) of IAS 39 should determine the 'market rate of interest' by considering the specific terms of the contract, including the relevant credit or other spreads appropriate for the counterparty and the market in which it is operating. This is because the term 'market rate of interest' is linked to the concept of fair value as defined in IFRS 13 *Fair Value Measurement* and is described in paragraph AG64 of IAS 39 as the rate of interest 'for a similar instrument with a similar credit rating'.

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

BDO comment

Entities that hold financial instruments with this type of embedded feature may need to revisit their analysis, even if the financial instruments do not arise from a negative interest rate environment.

Tentative agenda decisions at the January 2016 meeting – narrow application

IFRIC 12 *Service Concession Arrangements – Payments made by an operator to a grantor in a service concession arrangement*

The Interpretations Committee received a request to clarify the accounting for contractual payments that are to be made by an operator to a grantor under a service concession arrangement within the scope of IFRIC 12 *Service Concession Arrangements.*

It was observed that, in some cases, the operator may be acting as an agent with respect to the contractual payments.

In cases in which the operator is acting as a principal with respect to the contractual payments:

a) if the contractual payments give the operator a right to a good or service that is separate from the service concession arrangement, the operator would account for that separate good or service in accordance with the applicable Standard;
b) if the contractual payments are linked to the right to use a tangible asset that is separate from the infrastructure, the operator would assess whether the arrangement contains a lease;
c) if the contractual payments do not give the operator a right to a separate good or service or a separate right of use that meets the definition of a lease, the contractual

terms of the service concession arrangement would determine the accounting for the contractual payments to be made by the operator to the grantor:

(i) if the service concession arrangement results in the operator having only a contractual right to receive cash from the grantor, the grantor is not different from a customer in an arrangement that gives rise to revenue (paragraphs 70-72 of IFRS 15 would be applicable);

(ii) if the concession arrangement results in the operator having only a right to charge users of the public service, the operator has received an intangible asset in exchange for construction/upgrade services and the contractual payments to the grantor, with those contractual payments representing additional consideration for the intangible asset (IAS 38 would be applicable)

(iii) if the operator has both a right to charge users of the public service and a contractual right to receive cash from the grantor, the entity should consider the substance of the contractual payments to determine whether it represents consideration for the concession right intangible asset or if it should be accounted for as consideration payable to the customer.

The Interpretations Committee noted that the payments to be made by an operator may be variable payments (in some cases within the control of the operator and in other cases outside its control). In addition, accounting for variable payments to be made by an operator in a service concession arrangement when the intangible asset model in IFRIC 12 applies, is linked to the broader issue of accounting for variable payments for asset purchases.

It was noted that for the broader issue, the Interpretations Committee had been unable to reach a conclusion on whether the variable payments that depend on the purchaser's future activity should be recognised as a liability before that activity is performed or on the initial measurement of the liability. Consequently, it was considered that the issue was too broad for the Interpretations Committee to address.

Therefore, it was decided not to take this issue onto the agenda.