IFRS INTERPRETATIONS COMMITTEE - AGENDA REJECTIONS (MARCH 2016)

INTERNATIONAL FINANCIAL REPORTING BULLETIN 2016/05

Background

This Bulletin summarises issues that the IFRS Interpretations Committee (the Interpretations Committee) decided not to take onto its agenda at its March 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 March 2016 meeting

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

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

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

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

Tentative agenda decisions at the March 2016 meeting

IFRS 11 *Joint Arrangements and IFRS 10 Consolidated Financial Statements – Accounting for loss of control transactions*

Item recommended to the Board to address through and amendment at the March 2016 meeting

IAS 12 *Income Taxes – Accounting for income tax consequences of payments on financial instruments classified as equity*

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

Agenda decisions at the March 2016 meeting – wide application

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

The question received by the Interpretations Committee related to how an entity should determine hedge effectiveness when accounting for net investment hedges in accordance with IFRS 9 *Financial Instruments.* It was 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. Taking into account the guidance in paragraphs 6.5.13 and 6.5.11 on IFRS 9, 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. It was noted that such an outcome would be consistent with the requirements of IAS 21 *The Effects of Changes in Foreign Exchange Rates.*

It was also noted that no 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 had been identified. Few entities had yet adopted the hedging requirements in IFRS 9. Therefore, it was too early to assess whether the issue is widespread.

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, in a transaction that is not part of a business combination.

It was observed that significant diversity in practice in accounting for these variable payments exists. The Interpretations Committee discussed the accounting, 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 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. In addition, no consensus was reached 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* and the deliberations of the Board on its project on leases.

It was noted that the during the deliberations of the Board on its project on leases it 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 the definition only at the time that the related performance or use occurs.

Thus, it was concluded that the Board should address the accounting for variable payments comprehensively. It was also determined that this issue is too broad to be addressed by the Interpretations Committee within the confines of the existing IFRS Standards.

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

The Interpretations Committee discussed how an entity would classify a liability arising from the issue of a prepaid card, and how the entity should account for any unspent balance on a card with the following terms:

- No expiry date
- Cannot be refunded, redeemed or exchanged for cash
- Redeemable only for goods or services
- Redeemable only at specified third party merchants, and depending upon the card programme, ranges from a single merchant to all merchants that accept a specific card network. On redemption at a merchant(s), the entity makes a cash payment to the merchant(s).

The Interpretations Committee observed that a financial liability arises when the prepaid card is issued because:

- The entity has a contractual obligation to deliver cash to one of the selected merchants on behalf of the cardholder if the prepaid card is used to purchase items from one of those merchants.
- The entity does not have an unconditional right to avoid delivering cash.

The entity would subsequently apply IFRS 9 (or IAS 39) to determine whether and when to derecognise the liability for a 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 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 address an issue related to whether certain cash pooling arrangements would meet the requirements for offsetting under IAS 32 *Financial Instruments: Presentation,* 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 a cash pooling arrangement involving a number of subsidiaries within a group, each of which have legally separate bank accounts. 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) as highlighted in paragraph 46 of IAS 32, 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 net settle, an entity should consider normal business practices, the requirements of the financial markets and other circumstances that may limit the ability to settle net.

It was 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. The Interpretations Committee observed that in the example presented it is stated that prior to the next net settlement date the period end balances may change as group entities place further cash on deposit or withdraw cash to settle other obligations. As it is not expected to settle the period end balances on a net basis due to the expected future activity prior to the next net settlement date, the Interpretations Committee noted that it would not be appropriate for the entity to assert that it had the intention to settle the entire period-end balances on a net basis. Therefore, 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 practice. However, it was also observed that in other cash pooling arrangements, an entity may not expect the period end balances to change prior to the next settlement date and consequently it was noted that an entity would be required to apply its judgement in determining whether there was an intention to settle on a net basis in those circumstances.

It was also observed that outreach indicated that the particular type of cash – pooling arrangement described by the submitter was not widespread. Furthermore, it was noted that many different types of cash – pooling arrangements exist and that the determination of what constitutes an intention to settle on a net basis would depend on the individual facts and circumstances of each case. It was also 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 IFRS requirements, the Interpretations Committee decided that neither an Interpretation nor an amendment to a Standard was necessary. Consequently it decided not to add the issue to its agenda.

Tentative agenda decisions at the March 2016 meeting – wide application

IFRS 11 *Joint Arrangements and IFRS 10 Consolidated Financial Statements – Accounting for loss of control transactions*

It was 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 this case, 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.

It was 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. However, IFRS 10 *Consolidated Financial Statements* specifies that an entity should remeasure any retained interest when it loses control of a subsidiary, which could be viewed as conflicting with IFRS 11 requirements.

The Interpretations Committee observed that the IASB had issued amendments to IFRS 10 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures* in September 2014 to address a similar conflict. After issuing the amendments a number of other related issues were considered. Because these issues will be addressed as part of the Board's research project on equity accounting. the Board also decided to defer the effective date of the amendments to IFRS 10 and IAS 28.

Due to the similarity between the transaction being considered by the Interpretations Committee and a sale or contribution of assets to an associate or joint venture, it was concluded that the accounting for both transactions should be considered by the Board. Thus, it was decided not to add this issue to the Interpretations Committee's agenda and instead recommend to the Board that it should consider this issue at the same time as the accounting for the sale or contribution of assets to an associate or a joint venture is considered.

Item recommended to the Board to address through and amendment at the March 2016 meeting – wide application

IAS 12 *Income Taxes – Accounting for income tax consequences of payments on financial instruments classified as equity*

The presentation of income tax relating to tax deductible payments on financial instruments classified as equity was discussed by the Interpretations Committee. It was observed that the circumstances to which the requirements in paragraph 52B of IAS 12 *Income Taxes* apply are unclear.

Consequently, it was decided to propose an amendment to IAS 12 *Income Taxes* to clarify that the presentation requirements in paragraph 52B 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.

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

www.bdointernational.com