HKFRS / IFRS UPDATE 2017/08

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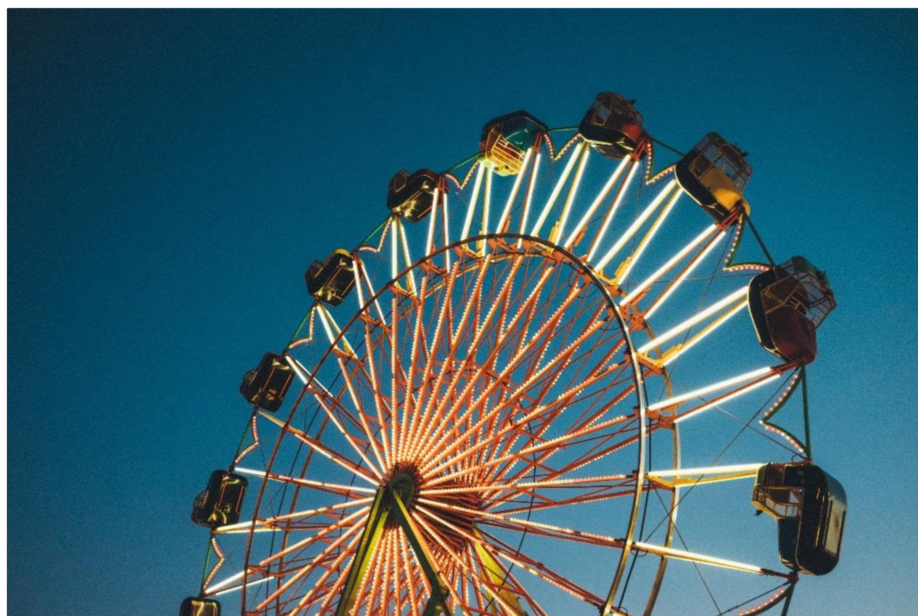
IFRS INTERPRETATIONS COMMITTEE - AGENDA DECISIONS (JUNE 2017)



STATUS

Final

EFFECTIVE DATE

Immediate

ACCOUNTING IMPACT

Clarification of IFRS requirements.

May lead to changes in practice.

Background

This Update summarises issues that the IFRS Interpretations Committee (the Interpretations Committee) decided not to take onto its agenda at its June 2017 meeting, which were reported in its public newsletter (the IFRIC Update). Although these agenda decisions 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 decisions, and may need to modify their accounting approach. More detailed background about agenda decisions 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.

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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, 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.

Given that HKFRS is fully converged with IFRS, these agenda decisions are also informative and persuasive to HKFRS financial statements preparers. HKFRS has identical financial reporting standards and paragraph references as IFRS. For example, if a reference is made to "paragraph A14 of IAS 33" the equivalent HKFRS paragraph is "paragraph A14 of HKAS 33".

Agenda decisions that were finalised at the June 2017 meeting

IAS 33	*Earnings per Share – Tax arising from payments on participating equity instruments*
IAS 19	*Employee Benefits – Discount rate in a country that has adopted another country's currency*
IAS 32	*Financial Instrument: Presentation – Centrally cleared client derivatives*
IAS 41	*Agriculture – Biological assets growing on bearer plants*

Tentative agenda decisions at the June 2017 meeting

IFRS 3	*Business Combinations – Acquisition of a group of assets that does not constitute a business*
IAS 37	*Provisions, Contingent Liabilities and Contingent Assets – Costs considered in assessing whether a contract is onerous*
IAS 38	*Intangible Assets – Goods acquired for promotional activities*
IAS 28	*Investments in Associates and Joint Ventures – Acquisition of an associate or joint venture from an entity under common control*

Agenda decisions that were finalised at the June 2017 meeting – Wide Application

IAS 33 Earnings per Share – Tax arising from payments on participating equity instruments

The Committee received a request to clarify how an entity determines profit attributable to ordinary shareholders when calculating basic earnings per share (EPS). In the fact pattern described in the submission:

- the entity has two classes of equity instruments - ordinary shares and participating equity instruments. Participating equity holders participate in dividends together with ordinary shareholders according to a predetermined formula;
- applying IAS 32 *Financial Instruments: Presentation*, the entity classifies the participating equity instruments as equity. Dividends are paid to participating equity holders only when they are paid to ordinary shareholders; and
- the dividends on participating equity instruments are deductible for tax purposes. Accordingly, such payments reduce taxable income and thus reduce income taxes payable to the taxation authorities (tax benefit).

The submitter asked whether, in determining profit attributable to the ordinary shareholders (ie the numerator) in the basic EPS calculation, the entity reflects the tax benefit that would arise from the hypothetical distribution of profit to participating equity holders.

As paragraph A14 of IAS 33 requires an entity to allocate profit or loss for the period to each class of share as if all of the profit or loss for the period had been distributed (ie the hypothetical distribution), the Interpretations Committee concluded that:

- the entity should adjust profit or loss attributable to ordinary shareholders for the portion of any tax benefit attributable to those ordinary shareholders in its calculation of basic earnings per share. This is because the tax benefit is a direct consequence of the hypothetical distribution of profit to the participating equity holders;
- the entity should apply this accounting treatment regardless of whether it recognises the tax benefit in equity or in profit or loss; and
- this treatment is also consistent with the objective of basic EPS outlined in paragraph 11 of IAS 33 to provide a measure of the interests of each ordinary share in the performance of the entity over the reporting period.

The Committee concluded that the principles and requirements in IAS 33 provide an adequate basis for an entity to calculate basic EPS in the fact pattern described in the submission. Consequently, the Committee decided not to add this matter to its standard-setting agenda.

Agenda decisions at the June 2017 meeting – Narrow Application

IAS 19 Employee Benefits – Discount rate in a country that has adopted another country's currency

The Interpretations Committee received a request to clarify how an entity determines the rate to discount post-employment benefit obligations denominated in US dollars when there is no deep market for high quality corporate bonds denominated in US dollars in the country in which the entity operates (Ecuador). The submitter asked whether, in that case, the entity needs to consider the depth of the market for high quality corporate bonds denominated in US dollars in other markets or countries in which those bonds are issued (such as the United States). The submitter also asked whether, if it is concluded that there is no deep market in high quality corporate bonds denominated in US dollars, following the guidance in IAS 19 the entity could instead use market yields on US dollar denominated bonds issued by the Ecuadorian government or whether the entity is required to use market yields on bonds denominated in US dollars issued by a government in another market or country.

Noting the requirement in paragraph 83 of IAS 19 that, for liabilities denominated in currencies for which there is no deep market in high quality corporate bonds, the market yields on government bonds should be used instead, the Interpretations Committee observed that:

- the assessment of the depth of the market in high quality corporate bonds of a particular currency is not limited to the market or country in which an entity operates. Therefore, if there is a deep market in high quality corporate bonds denominated in the currency of, and of similar term to, the post-retirement liability elsewhere, the entity should use the rate on those high quality corporate bonds and not market yields on government bonds; and
- the entity applies judgement to determine the appropriate population of high quality corporate bonds or government bonds to reference when determining the discount rate. However, the currency and term of the bonds must be consistent with the currency and estimated term of the post-employment obligations.

The Interpretations Committee concluded that the requirements in IAS 19 provide an adequate basis to determine the discount rate and therefore decided not to add this matter to its standard-setting agenda.

IAS 32 Financial Instrument: Presentation – Centrally cleared client derivatives

Some jurisdictions mandate the clearing of particular derivative products through a central clearing counterparty (CCP). To clear through a CCP, an entity must be a clearing member.

The Interpretations Committee received a request to clarify the accounting for centrally cleared derivative contracts from the perspective of the clearing member, concluding that:

- if the transaction results in contracts that are within the scope of IFRS 9 *Financial Instruments* (or IAS 39 *Financial Instruments: Recognition and Measurement*) then the clearing member should apply the requirements of those standards to those contracts. It should also present recognised financial assets and financial liabilities separately unless the requirements for offsetting set out in paragraph 42 of IAS 32 are met.
- If the transaction is not within the scope of those standards and another IFRS does not specifically apply, only then would the clearing member apply the hierarchy in paragraphs 10-12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to determine an appropriate accounting policy for the transaction.

The Interpretations Committee concluded that the requirements in IFRS Standards provide an adequate basis for a clearing member to account for centrally cleared derivative contracts, and therefore decided not to add this matter to its standard-setting agenda.

IAS 41 Agriculture – Biological assets growing on bearer plants

The Interpretations Committee was asked whether fruit growing on oil palms is an example of a biological asset for which an entity might rebut the fair value presumption applying paragraph 30 of IAS 41.

In its deliberations, the Interpretations Committee:

- concluded that the reference to 'clearly unreliable' in paragraph 30 of IAS 41 indicates that, to rebut the presumption, an entity must demonstrate that any fair value measurement is clearly unreliable. Paragraph BC4C of IAS 41 suggests that, when developing the amendments to IAS 41 on bearer plants, the Board's expectation was that fair value measurements of produce growing on bearer plants might be clearly unreliable only when an entity encounters significant practical difficulties. However, the converse is not necessarily true, ie if an entity encounters significant practical difficulties, this does not necessarily mean that any fair value measurement of produce is necessarily clearly unreliable. In paragraph BC4C, the Board observed that, in this situation, an entity should consider whether it is clearly unreliable;
- observed that the submission appears to ask whether possible differences in supportable assumptions (which might result in significantly different valuations) constitutes 'significant practical difficulties' and concluded that this is not evidence of significant practical difficulties, and that it would not, in and of itself, result in fair value measurements that are clearly unreliable; and
- noted that paragraph 125 of IAS 1 Presentation of Financial Statements requires an entity to disclose information about assumptions and estimates for which there is a significant risk of a material

adjustment to the carrying amounts of assets and liabilities within the next financial year. In addition, paragraph 91 of IFRS 13 Fair Value Measurement requires an entity to disclose information that helps users of its financial statements understand the valuation techniques and inputs used to develop fair value measurements, and the effect of measurements that use Level 3 inputs.

It also noted that:

- the submission is ultimately about whether fair value measurements for a particular type of produce growing on bearer plants are clearly unreliable; and
- the Interpretations Committee's role is not to conclude upon very specific application questions, particularly when they relate to the application of the judgements required in applying IFRS Standards

Therefore, the Interpretations Committee decided not to add this matter to its standard-setting agenda.

Tentative agenda decisions at the June 2017 meeting – Wide Application

IFRS 3 Business Combinations – Acquisition of a group of assets that does not constitute a business

When assets and liabilities are purchased that together do not constitute a business, IFRS 3 paragraph 2(b) requires the purchaser to allocate the cost of purchase to the individual assets and liabilities on the basis of their relative fair values at the date of purchase.

The Interpretations Committee received a request to clarify how this requirement should be applied when:

- the sum of the individual fair values of the identifiable assets and liabilities is different from the transaction price; and
- the group includes identifiable assets and liabilities initially measured both at cost and at an amount other than cost.

The Interpretations Committee considered two possible ways of accounting for the transaction. Firstly, it could be accounted for by:

- identifying the individual identifiable assets acquired and liabilities assumed that it recognises at the date of the acquisition;
- determining 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
- applying the initial measurement requirements in applicable Standards to each identifiable asset acquired and liability assumed. The entity would account for any difference between the amount at which the asset or liability is initially measured and its individual transaction price applying the relevant requirements.

Alternatively, 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 Interpretations 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 could result in one of either of the two approaches being applied as an accounting policy choice (ie consistently to all such transactions); and
- it had not obtained evidence to suggest that the outcomes of applying the two approaches outlined would be expected to have a material effect on the amounts that entities report.

Consequently, the Committee tentatively decided not to add this matter to its standard-setting agenda.

IAS 37 Provisions, Contingent Liabilities and Contingent Assets – Costs considered in assessing whether a contract is onerous

The Interpretations Committee received a request to clarify which costs an entity considers when assessing whether to recognise an onerous contract provision under IAS 37.

As noted in paragraphs 5(g) of IAS 37 and BC296 of IFRS 15 *Revenue from Contracts with Customers*, an entity applies paragraphs 66–69 of IAS 37 in assessing whether a contract to which it applies IFRS 15 is onerous. Accordingly, the Interpretations Committee concluded that, when determining which costs to include in assessing whether such a contract is onerous, the entity does not apply the previous requirements in IAS 11 on contract costs, nor does it apply the requirements in IFRS 15 on costs that relate directly to a contract.

Paragraph 68 of IAS 37 includes the definition of an onerous contract. In assessing whether a contract is onerous, an entity compares the unavoidable costs of meeting the obligations under the contract to the economic benefits expected to be received under it. The Interpretations Committee discussed two possible ways of applying the requirements in paragraph 68 of IAS 37 relating to the unavoidable costs of fulfilling the contract:

- unavoidable costs are the costs that an entity cannot avoid because it has the contract (for example, an entity would include an allocation of overhead costs if those costs are incurred for activities required to complete the contract).
- unavoidable costs are the costs that an entity

would not incur if it did not have the contract (often referred to as 'incremental costs').

The Interpretations Committee concluded that:

- a reasonable reading of the requirements in paragraph 68 of IAS 37 could result in either of the two approaches being applied as an accounting policy choice (ie consistently to all such transactions); and
- amendments could not be developed efficiently to eliminate one of the two possible ways of reading the requirements.

Consequently, it tentatively decided not to add this matter to its standard-setting agenda.

IAS 38 Intangible Assets – Goods acquired for promotional activities

The Interpretations Committee received a request to clarify how an entity accounts for goods that it distributes as part of its promotional activities. The submitter described a situation in which a pharmaceutical entity acquires goods (such as refrigerators, air conditioners and watches) to distribute to doctors as part of its promotional activities. The submitter asked how the entity accounts for any such goods that remain undistributed at its reporting date.

If an entity acquires goods to be used to undertake advertising or promotional activities, paragraph BC46B of IAS 38 explains that such goods have no other purpose than to undertake those activities. In other words, the only benefit of those goods for the entity is to develop or create brands or customer relationships, which in turn generate revenues. However, applying IAS 38, the entity does not recognise internally generated brands or customer relationships as assets.

Accordingly, paragraph 69 of IAS 38 requires an entity to recognise any expenditure on such goods acquired solely for promotional activities as an expense when the entity has a right to access the goods. Paragraph 69A of IAS 38 states that an entity has a right to access goods when it owns them. The entity, therefore, recognises any expenditure on these goods as an expense when it owns the goods, or otherwise has a right to access them regardless of when it distributes the goods.

The Interpretations Committee concluded that the requirements in IFRS Standards provide an adequate basis for an entity to account for the goods described in the submission. Consequently, the Committee tentatively not to add this matter to its standard-setting agenda.

Tentative agenda decisions at the June 2017 meeting – Narrow Application

IAS 28 Investments in Associates and Joint Ventures – Acquisition of an associate or joint venture from an entity under common control

Paragraph 2(c) of IFRS 3 *Business Combinations* specifically excludes from the scope of that standard combinations of entities or businesses under common control. The Interpretations Committee received a request to clarify whether it is appropriate to apply by analogy this scope exception to acquisitions of associates and joint ventures from an entity under common control

The Interpretations Committee:

- noted that IAS 28 does not include a similar scope exemption;
- concluded that IFRS 3 should not be applied by analogy in this regard;
- observed that in accounting for the acquisition of an interest in an associate or joint venture, the entity should assess whether the transaction constitutes a transaction with owners in their capacity as owners and, if so, factor this into the determination of the cost of investment; and
- concluded that the requirements in IFRS standards provide an adequate basis for an entity to account for the acquisition of an interest in an associate or joint venture from an entity under common control and therefore tentatively decided not to add this matter to its standard-setting agenda.

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