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HKFRS / IFRS UPDATE 2017/04

IFRS INTERPRETATIONS COMMITTEE - AGENDA REJECTIONS (MARCH 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 March 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.

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.

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 27 of IFRS 10" the equivalent HKFRS paragraph is "paragraph 27 of HKFRS 10".

Agenda decisions that were finalised at the March 2017 meeting

IFRS 10	*Consolidated Financial Statements - Investment entities and subsidiaries*
IAS 12	*Income Taxes - Recognition of deferred taxes when acquiring a single-asset entity that is not a business*
	Commodity loans
IAS 28	*Investments in Associates and Joint Ventures - Fund manager's assessment of significant influence*

Tentative agenda decisions at the March 2017 meeting

IFRS 1	*First-time Adoption of International Financial Reporting Standards – Subsidiary as a first-time adopter*
IFRS 9	*Financial Instruments – Modifications or exchanges of financial liabilities that do not result in derecognition*
IAS 12	*Income taxes – Interest and penalties related to income taxes*
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*

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

IFRS 10 Consolidated Financial Statements - Investment entities and subsidiaries

The Interpretations Committee discussed four issues concerning the application of IFRS 10 Consolidated Financial Statements, concluding in each case not to add them to its agenda.

Firstly, the Interpretations Committee considered whether an entity qualifies as an investment entity if it meets all three of the conditions specified in paragraph 27 of IFRS 10 to be classified as an investment entity, but does not have one or more of the typical characteristics of an investment entity specified in paragraph 28. It concluded that such an entity would be classified as an investment entity, although additional judgement would be required in making that determination.

Secondly, it considered whether an entity can conclude that it provides investment management services if it outsources those services to a third party. The Interpretations Committee noted that IFRS 10 does not specify how the investment entity must provide these services, and as such does not preclude it from outsourcing the performance of these services to a third party.

Thirdly, it considered the extent to which an investment entity can provide investment-related services, either itself or through a subsidiary, to third parties. It was noted that paragraph B85C of IFRS 10 states that an investment entity may provide investment-related services, either directly or through a subsidiary, to third parties as well as to its investors, subject to the entity continuing to meet the definition of an investment entity. Consequently, the Interpretations Committee concluded that an investment entity can provide such services to third parties as long as those services are ancillary to its core investing activities. If extensive investment-related services are provided to third parties, then this could result in a conclusion that the business purpose of the entity is not to invest solely for capital appreciation and/or investment income meaning that one of the necessary conditions of being an investment entity set out in paragraph 27 of IFRS 10 would not be met.

Lastly, it considered whether a subsidiary of an investment entity provides services related to its parent's investment activities by holding an investment portfolio as beneficial owner. In line with a similar issue that had arisen at its meeting in March 2014, the Interpretations Committee concluded that an investment entity does not consider that the holding of investments by a subsidiary as a beneficial owner (and hence recognised in the subsidiary's financial statements) to be a service that relates to the parent's investment activities. Consequently, the subsidiary should be accounted for at fair value through profit or loss by the parent investment entity and not consolidated on a line-by-line basis.

For all four issues, the Interpretations Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis to enable an entity to determine

the appropriate accounting. Consequently, it decided not to add this matter to its standard-setting agenda.

IAS 12 Income Taxes - Recognition of deferred taxes when acquiring a single-asset entity that is not a business

The Interpretations Committee received a request to clarify how an entity accounts, in its consolidated financial statements, for a transaction in which an entity acquires all of the shares of another entity that has an investment property as its only asset. In the fact pattern submitted, the acquiree had recognised in its statement of financial position a deferred tax liability arising from measuring the investment property at fair value. The amount paid for the shares was less than the fair value of the investment property because of the associated deferred tax liability. The transaction was not a business combination because the acquired entity was not a business. The acquiring entity applies the fair value model in IAS 40 Investment Property.

The Interpretations Committee was asked to consider whether the requirements in paragraph 15(b) of IAS 12 permit the acquiring entity to recognise a deferred tax liability as part of the initial recognition of the transaction and, if not, whether those requirements should be amended.

The Interpretations Committee noted that:

a) because the transaction is not a business combination, paragraph 2(b) of IFRS 3 requires the acquiring entity, in its consolidated financial statements, to allocate the purchase price to the assets acquired and liabilities assumed; and

b) paragraph 15(b) of IAS 12 states that an entity does not recognise a deferred tax liability for taxable temporary differences that arise from the initial recognition of an asset or a liability in a transaction that is not a business combination and that, at the time of the transaction, affects neither accounting profit or loss nor taxable profit (tax loss).

Accordingly, on acquisition, the acquiring entity recognises only the investment property and not a deferred tax liability in its consolidated financial statements. The acquiring entity therefore allocates the entire purchase price to the investment property.

The Interpretations Committee concluded that the requirements in IFRS Standards provide an adequate basis to enable an entity to determine how to account for the transaction. Consequently, it [decided] not to add this issue to its agenda.

The Interpretations Committee also noted that the IASB had recently considered whether to add a project on IAS 12 Income Taxes to its agenda, but had decided not to do so. Consequently, the Interpretations Committee did not recommend that the IASB consider adding a project to its agenda on this topic.

Agenda decisions that were finalised at the March 2017 meeting –Narrow Application

Commodity loans

The Interpretations Committee received a request regarding how to account for a commodity loan transaction in which a bank borrows gold from a third party (Contract 1) and then lends that gold to a different third party for the same term and for a higher fee (Contract 2).

The Interpretations Committee was asked whether, for the term of the two contracts, the bank that borrows and then lends the gold recognises:

- an asset representing the gold (or the right to receive gold); or
- a liability representing the obligation to deliver gold.

The Interpretations Committee concluded that it would be unable to resolve the question efficiently within the confines of existing IFRS Standards. It noted that although particular IFRSs apply to certain transactions involving commodities, such as the purchase of commodities for use in a production process or the sale of commodities to customers, the transaction it had been asked about might not fall clearly within the scope of an IFRS standard. Consequently, an entity would need to look to IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors to develop an appropriate accounting policy taking into account the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Conceptual Framework. The accounting policy developed would need to result in information that is:

- relevant to the economic decision-making needs of users; and
- reliable, ie the chosen accounting policy represents faithfully the financial position, financial performance and cash flows; it reflects the economic substance of the transaction; and is neutral, prudent and complete in all material respects.

The IASB will discuss this issue at a future board meeting, with feedback in response to the tentative agenda decision previously published suggesting it should consider

undertaking a project on the accounting for commodity transactions.

IAS 28 Investment entities and subsidiaries - Fund manager's assessment of significant influence

The Interpretations Committee received a request to clarify whether and, if so, how, a fund manager assesses significant influence over a fund that it manages and in which it has an investment. In the scenario described in the submission, the fund manager applies IFRS 10 Consolidated Financial Statements and determines that it is an agent, and thus does not control the fund. The fund manager has also concluded that it does not have joint control of the fund.

The Interpretations Committee observed that a fund manager assesses whether it has control, joint control or significant influence over a fund that it manages by applying the relevant IFRS standard, which in the case of significant influence is IAS 28 Investments in Associates and Joint Ventures.

The Interpretations Committee noted that, unlike IFRS 10 in the assessment of control, IAS 28 does not contemplate whether and how decision-making authority held in the capacity of an agent affects the assessment of significant influence. It felt that developing any such requirements could not be undertaken in isolation of a comprehensive review of the definition of significant influence in IAS 28.

The Interpretations Committee therefore concluded that it would be unable to resolve the question efficiently within the confines of existing IFRS Standards. Consequently, it tentatively decided not to add the issue to its agenda.

The matter will be reported to the IASB for consideration as part of its equity research method.

Tentative agenda decisions at the March 2017 meeting – Wide Application

IFRS 1 First-time Adoption of International Financial Reporting Standards – Subsidiary as a first-time adopter

The Interpretations Committee received a request to clarify how a subsidiary entity adopting IFRS later than its parent should measure cumulative translation differences on its own foreign operations. Specifically, the request asked to clarify whether the subsidiary is permitted to recognise cumulative translation differences at the amount that would be included in the parent's consolidated financial statements, based on the parent's date of transition to IFRS.

Although paragraph D16 permits a subsidiary on first-time adoption of IFRS to measure assets and liabilities at the same amount as they are included in its parent's IFRS-compliant financial statements, cumulative translation differences recognised in equity are neither an asset nor a liability. Consequently, on its date of transition to IFRS, the subsidiary should either measure the separate component of equity for cumulative translation differences relating to its own foreign operations at

- zero (the transitional relief available to any first-time adopter); or
- on a retrospective basis as if it had always applied IFRS

The Interpretations Committee concluded that the requirements in IFRS provide an adequate basis for a first-time adopter to determine how to account for cumulative translation differences and therefore tentatively decided not to add this matter to its standard-setting agenda.

IFRS 9 Financial Instruments – Modifications or exchanges of financial liabilities that do not result in derecognition

The Interpretations Committee received a request regarding the accounting for a modification or exchange or a financial liability measured at amortised cost that does not result in derecognition of the financial liability on the basis that the terms are not substantially different

It concluded that paragraph B5.4.6 of IFRS 9 requires the entity to recalculate the amortised cost carrying amount by discounting the modified contractual cash flows using the original effective interest rate and recognising any difference in the resultant carrying amount of the liability immediately in profit or loss. It does not adjust the instrument's effective interest rate for any changes to the future cash flows arising from the different contractual terms.

Noting that the IFRS 9 has introduced additional wording compared to the requirements in IAS 39, if an entity changes its accounting policy for such modifications or exchanges of financial liabilities on adoption of IFRS 9 then it would need to restate the measurement of those financial liabilities retrospectively subject to the entity being able to make use of the impracticability relief contained in paragraph 7.2.11 of the transitional provisions of that standard.

The Interpretations Committee concluded that the principles and requirements in IFRS 9 provide an adequate basis for an entity to account for modifications and exchanges of financial liabilities that do not result in derecognition and, therefore, tentatively decided not to add this matter to its standard-setting agenda.

IAS 12 Income taxes – Interest and penalties related to income taxes

IFRS Standards do not specifically address the accounting for interest and penalties related to income taxes, specifically whether such amounts should be presented as part of the income tax charge or as either finance and operating items respectively. Therefore the Interpretations Committee considered whether to add a project on interest and penalties to its standard-setting agenda.

It tentatively decided not to do so because this topic is not a higher priority than other projects on the IASB's or its own agenda, noting that:

- if an entity determines that interest and penalties are income taxes, then it applies IAS 12 to those amounts, otherwise it applies IAS 37 Provisions, Contingent Liabilities and Contingent Assets;
- as paragraph 79 of IAS 12 requires an entity to disclose the major components of tax and paragraphs 84-85 of IAS 37 require a reconciliation of each class of provision to be disclosed, regardless of whether an entity applies IAs 12 or IAS 37 the entity would disclose information about interest and penalties if material; and
- paragraph 122 of IAS 1 Presentation of Financial Statements, requires disclosure of the judgements that management have made in the process of applying the entity's accounting policies.

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

Tentative agenda decisions at the March 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 tentatively 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 (CPP). To clear through a CPP, 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 principles and requirements in IFRS Standards provide an adequate basis for a clearing member to account for centrally cleared derivative contracts, and therefore tentatively 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 to be 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, i.e. if an entity encounters significant practical difficulties, this does not necessarily mean that any fair value measurement of produce is 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.

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

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