HKFRS / IFRS UPDATE 2018/04

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IFRS INTERPRETATIONS COMMITTEE - AGENDA DECISIONS (JUNE 2018)

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 2018 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, subjected to further consideration by the Interpretations Committee 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 8 of IAS 7" the equivalent HKFRS paragraph is "paragraph 8 of HKAS 7".

Agenda decisions that were finalised

IAS 7 Statement of Cash Flows – Classification of short-term loans and credit facilities

Tentative agenda decisions

IAS 21 The Effects of Changes in Foreign Exchange Rates - Determination of the exchange rate when there is a long-term lack of exchangeability

IAS 23 Borrowing Costs – Expenditures on a qualifying asset

IAS 23 Borrowing costs on land

Agenda decisions that were finalised – Wide Application

IAS 7 Statement of Cash Flows – Classification of short-term loans and credit facilities

The Interpretations Committee received a request asking about the types of borrowings an entity includes in its statement of cash flows as a component of cash and cash equivalents. In the fact pattern described in the request:

- the entity has short-term loans and credit facilities (short-term arrangements) that have a short contractual notice period (eg 14 days);
- the entity uses the short-term arrangements for cash management; and
- the balance of the short-term arrangements does not often fluctuate from being negative to positive.

The Committee observed that:

- applying paragraph 8 of IAS 7, an entity generally considers bank borrowings to be financing activities. An entity, however, includes a bank borrowing as a component of cash and cash equivalents only in the particular circumstances described in paragraph 8 of IAS 7, ie the banking arrangement is a bank overdraft that is both repayable on demand, and forms an integral part of the entity's cash management.
- cash management includes managing cash and cash equivalents for the purpose of meeting short-term cash commitments rather than for investment or other purposes (paragraphs 7 and 9 of IAS 7). Assessing whether a banking arrangement is an integral part of an entity's cash management is a matter of facts and circumstances.
- if the balance of a banking arrangement does not often fluctuate from being negative to positive, then this indicates that the arrangement does not form an integral part of the entity's cash management and, instead, represents a form of financing.

In the fact pattern described in the request, the Interpretations Committee concluded that the entity does not include the short-term arrangements as components of cash and cash equivalents because they are not repayable on demand. Additionally, the short-term arrangements are a form of financing rather than an integral part of the entity's cash management because the balance does not often fluctuate from being negative to positive.

The Committee also noted that paragraphs 45 and 46 of IAS 7 require an entity to:

- disclose the components of cash and cash equivalents and present a reconciliation of the amounts in its statement of cash flows with the equivalent items reported in its statement of financial position; and
- disclose the policy which it adopts in determining the composition of cash and cash equivalents.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to assess whether to include in its statement of cash flows the short-term arrangements described in the request as components of cash and cash equivalents. Therefore, it decided not to add this matter to its standard-setting agenda.

Tentative agenda decisions – Wide Application

IAS 23 Borrowing Costs – Expenditures on a qualifying asset

The Interpretations Committee received a request about the amount of borrowing costs eligible for capitalisation when an entity uses general borrowings to obtain a qualifying asset.

In the fact pattern described in the request:

- an entity constructs a qualifying asset;

- the entity has no borrowings at the start of the construction of the qualifying asset.
- Partway through construction, it borrows funds generally and uses them to finance the construction of the qualifying asset; and
- the entity incurs expenditures on the qualifying asset both before and after it incurs borrowing costs on the general borrowings.

The request asked whether an entity includes expenditures on a qualifying asset incurred before obtaining general borrowings in determining the amount of borrowing costs eligible for capitalisation.

The Interpretations Committee observed that the entity would not begin capitalising borrowing costs until it incurs them because it is one of the three conditions in paragraph 17 of IAS 23 that must be met before capitalisation begins (ie it cannot capitalise interest in relation to periods before the date on which borrowings were taken and on which borrowing costs were actually incurred).

The Interpretations Committee also observed that in determining the expenditures to which an entity applies the capitalisation rate, an entity is not restricted by paragraph 14 of IAS 23 to include only those expenditures on the qualifying asset incurred after it incurs borrowing costs. It therefore does not disregard expenditures on the qualifying asset incurred before the entity obtains the general borrowings.

The Interpretations Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to determine the amount of borrowing costs eligible for capitalisation in the fact pattern described in the request. Consequently, the Committee decided not to add this matter to its standard-setting agenda.

IAS 23 Borrowing Costs – Borrowing costs on land

The Interpretations Committee received a request about when an entity ceases capitalising borrowing costs on land.

In the fact pattern described in the request:

- an entity acquires and develops land and thereafter constructs a building on that land
- both the land and the building meet the definition of a qualifying asset; and
- the entity uses general borrowings to fund the expenditures on the land and construction of the building.

The request asked whether the entity continues or ceases capitalising borrowing costs incurred in respect of expenditures on the land while it constructs the building.

The Interpretations Committee observed that in applying IAS 23 to determine when to cease capitalising borrowing costs incurred on land expenditures an entity considers:

- the intended use of the land, which is not simply for the construction of a building, but rather to use it for one of three purposes:
    - owner-occupation (recognised as property, plant and equipment applying IAS 16 *Property, Plant and Equipment*);
    - rent or capital appreciation (recognised as investment property applying IAS 40 *Investment Property*); or
    - for sale (recognised as inventory applying IAS 2 *Inventories*).
- whether the land is capable of being used for its intended purpose while construction continues on the building. If the land is not capable of being used for its intended purpose while construction continues on the building, the entity considers the land and building together to assess when to cease capitalising borrowing costs on the land expenditures. In this situation, the land would not be ready for its intended use or sale until substantially all the activities necessary to prepare both the land and building for that intended use or sale are complete.

The Interpretations Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to determine when to cease capitalising borrowing costs on land expenditures. Consequently, the Committee decided not to add this matter to its standard-setting agenda.

Tentative agenda decisions – Narrow Application

IAS 21 The Effects of Changes in Foreign Exchange Rates - Determination of the exchange rate when there is a long-term lack of exchangeability

The Interpretations Committee considered the determination of the exchange rate an entity uses to translate the results and financial position of a foreign operation into its presentation currency applying IAS 21. Specifically it considered whether an entity is required to use an official rate in the following circumstances (which are currently applicable to Venezuela):

- the exchangeability of the foreign operation's functional currency with other currencies is administered by jurisdictional authorities. This exchange mechanism incorporates the use of an exchange rate set by the authorities (official exchange rate);
- the foreign operation's functional currency is subject to a long-term lack of exchangeability with other currencies—ie the exchangeability is not temporarily lacking as described in paragraph 26 of IAS 21 and has not been restored after the end of the reporting period; and
- the lack of exchangeability with other currencies has resulted in the foreign operation being in effect unable to access foreign currencies using the exchange mechanism described in (a) above.

The Interpretations Committee observed that in the circumstances described above an entity assesses whether the official exchange rate meets the definition of the closing rate in IAS 21 for the purposes of translating the assets and liabilities of the foreign operation, ie is it the rate to which the entity would have access at the end of the reporting period? Similarly, if the foreign operation's functional currency is not the currency of a hyperinflationary economy, the entity also assesses whether the official exchange rate represents the exchange rates at the dates of the transactions for the purposes of retranslating the foreign operation's income and expenses.

The Interpretations Committee also noted that in the circumstances described above

- economic conditions are in general constantly evolving. Therefore. it is important to reassess at each reporting date whether the official exchange rate meets the definition of the closing rate and, if applicable, the exchange rates at the dates of the transactions.; and
- the following disclosure requirements may be relevant to an understanding of an entity's financial statements and how it determined the exchange rate used to retranslate the foreign operations net assets and results:
  - significant accounting policies, and judgements made in applying those policies that have the most significant effect on the amounts recognised in the financial statements (paragraphs 117–124 of IAS 1);
  - sources of estimation uncertainty that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year, which may include sensitivity analysis (paragraphs 125–133 of IAS 1); and
  - the nature and extent of significant restrictions on an entity's ability to access or use assets and settle liabilities of the group, or in relation to its joint ventures or associates (paragraphs 10, 13, 20 and 22 of IFRS 12 Disclosures of Interests in Other Entities).

The Interpretations Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to assess whether, in the circumstances described above, it uses the official exchange rate to translate into its presentation currency the results and financial position of a foreign operation. Consequently, it tentatively decided not to add this matter to its standard-setting agenda. However, it also noted that those principles and requirements do not however include explicit requirements on the exchange rate a reporting entity uses when the spot exchange rate (as defined in IAS 21) is not observable. Therefore it decided to research possible narrow-scope standard-setting aimed at addressing this matter.

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