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HKFRS / IFRS UPDATE 2016/07

IFRS INTERPRETATIONS COMMITTEE - AGENDA REJECTIONS (MAY 2016)

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 May 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.

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 78 of IAS 36" the equivalent HKAS paragraph is "paragraph 78 of HKAS 36".

Agenda decisions that were finalised at the May 2016 meeting

IFRS 9/IAS 39	*Financial Instruments/Financial Instruments: Recognition and Measurement – Derecognition of modified financial assets*
IAS 20	*Accounting for Government Grants and Disclosure of Government Assistance – Accounting for repayable cash receipts*
IAS 36	*Impairment of Assets – Recoverable amount and carrying amount of a cash-generating unit*

Tentative agenda decisions at the May 2016 meeting

IFRS 9/IAS 39	*Financial Instruments/Financial Instruments: Recognition and Measurement – Fees and costs included in the '10 per cent' test for the purpose of derecognition*
IAS 32	*Financial Instruments: Presentation – Accounting for a written put option over non-controlling interests to be settled by a variable number of the parent's shares*
IFRIC 12	*Service Concession Arrangements – Accounting for service concession arrangements for which the infrastructure is leased*

Agenda decisions at the May 2016 meeting – wide application

IFRS 9/IAS 39 Financial Instruments/Financial Instruments: Recognition and Measurement – Derecognition of modified financial assets

The Interpretations Committee discussed whether to progress a potential narrow-scope project to clarify the guidance about when a modification or exchange of financial assets results in the derecognition of the original asset.

Many members of the Interpretations Committee observed that the circumstances in which financial assets that have been modified or exchanged should be derecognised is an issue that arises frequently in practice. However, it was noted that, because of the broad nature of the issue, it could not be resolved in an efficient manner.

Consequently, it was decided not to further consider such a project.

IAS 20 Accounting for Government Grants and Disclosure of Government Assistance – Accounting for repayable cash receipts

The issue received by the Interpretations Committee related to whether cash payments made by a government to help an entity finance a research and development project should be accounted for as a liability when received (on the basis that it is a forgivable loan as defined in IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance)* or recognised in profit or loss when received (on the basis that it is a government grant as defined in IAS 20). The cash payment received from the government is repayable in cash only if the entity decides to exploit and commercialise the results of the research phase of the project. The terms of the repayment can result in the government receiving up to twice the amount of the original cash payment if the project is successful. If the entity decides not to proceed with the results from the research phase, the cash payment is not refundable and the entity must transfer the rights to the research to the government.

The Interpretations Committee noted that the entity had obtained financing for its research and development project and observed that the cash receipt gives rise to a financial liability (IAS 32p20(a)) because the entity can avoid a transfer of cash only by settling a non-financial obligation (by transferring the rights to the research to the government). It was also noted that, in the arrangement described in the submission, the cash received from the government does not meet the definition of a forgivable loan in IAS 20. This is because the government does not undertake to waive repayment of the loan, but rather to require settlement in cash or by transfer of the rights of the research. In this fact pattern part of the cash received (the difference between the cash received and the fair value of the financial liability) may represent a government grant under IAS 20.

It was noted that the requirements in IFRS Standards provide an adequate basis to enable an entity to account for the cash received from the government.

The Interpretations Committee decided that, in the light of existing IFRS requirements, neither an Interpretation nor an amendment to a Standard was necessary and therefore decided not to add this issue to its agenda.

IAS 36 Impairment of Assets – Recoverable amount and carrying amount of a cash-generating unit

The Interpretations Committee was requested to clarify the application of paragraph 78 of IAS 36 *Impairment of Assets*. This paragraph sets out the guidance for considering recognised liabilities for determining the recoverable amount of a cash-generating unit (CGU) within the context of an impairment test for a CGU.

The submitter observed that this approach for making the CGU's carrying amount comparable with its recoverable amount has no effect, because the recognised liability is required to be deducted both from the CGU's carrying amount and from its value in use (VIU). The Interpretations Committee was asked whether an alternative approach should be required.

The Interpretations Committee observed that when a CGU's fair value less costs of disposal (FVLCD) takes a recognised liability into account, paragraph 78 requires both the CGU's carrying amount and its VIU to be adjusted by the carrying amount of the liability. This is a straightforward and cost effective way of making a comparison of recoverable amount to carrying value meaningful.

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

Tentative agenda decisions at the May 2016 meeting – wide application

IFRS 9/IAS 39 Financial Instruments/Financial Instruments: Recognition and Measurement – Fees and costs included in the '10 per cent' test for the purpose of derecognition

The Interpretations Committee was requested to clarify the requirements in IAS 39 and IFRS 9 relating to which fees and costs should be included in the '10 per cent' test for the purpose of derecognition of a financial liability.

It observed the following:

(a) IAS 39 and IFRS 9 require the inclusion of 'any fees paid net of any fees received' in the '10 per cent' test when assessing whether the terms of an exchange or a modification of a financial liability are substantially different and lead to the derecognition of the original financial liability.

(b) In considering the items to include in the calculation of the effective interest rate, IAS 39 and IFRS 9 distinguish between 'fees and points paid or received between the parties to the contract' and 'transaction costs'. It was noted that the objective of the '10 per cent' test is to quantitatively assess the significance of any difference between the old and new contractual terms by analysing the effect of the changes in the contractual cash flows. Consequently, the 'fees' included in the '10 per cent' test are similar to the 'fees and points paid or received between the parties to the contract' included in the calculation of the effective interest rate. 'Any costs or fees' incurred relating to an exchange or a modification have a similar nature to 'transaction costs' in that they are incremental costs directly attributable to the exchange or modification.

Taking this into consideration, the Interpretations Committee concluded that, when applying paragraphs AG62 of IAS 39 and B3.3.6 of IFRS 9 in carrying out the '10 per cent' test, an entity includes only fees paid or received between the lender and the borrower or fees paid by, or on behalf of, the lender or the borrower.

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.

IAS 32 Financial Instruments: Presentation – Accounting for a written put option over non-controlling interests to be settled by a variable number of the parent's shares

The Interpretations Committee received a request regarding how an entity accounts for a written put option over non-controlling interests (NCI put) in its consolidated financial statements. The NCI put has a strike price that will, or may, be settled by the exchange of a variable number of the parent's own equity instruments.

The Interpretations Committee was asked to consider whether, in its consolidated financial statements, the parent recognises:

(a) a financial liability representing the present value of the option's strike price (a gross liability); or

(b) a derivative financial liability presented on a net basis measured at fair value.

It was noted that:

- the issue is too broad for the Interpretations Committee to address efficiently within the confines of existing IFRS Standards and the Conceptual Framework; and
- the Board is currently considering the requirements for all derivatives on an entity's own equity comprehensively as part of the FICE project.

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

IFRIC 12 Service Concession Arrangements – Accounting for service concession arrangements for which the infrastructure is leased

The request received relates to how an operator accounts for a service concession arrangement for which the infrastructure is leased. In this arrangement, the operator is not required to provide any construction or upgrade services with respect to the infrastructure.

The arrangement involves three parties: a grantor, an operator and a lessor. The operator enters into an arrangement with the grantor to operate a public service. The infrastructure in the arrangement is leased from the lessor. The lessor and the grantor may be controlled by the same governmental body. The operator is contractually required to pay the lessor for the lease of the infrastructure. The operator has an unconditional contractual right to receive cash from the grantor to reimburse those payments. The grantor also has an option to renew the lease at the end of the initial non-cancellable period of the contract.

The submitter asked the Interpretations Committee to clarify whether the arrangement is within the scope of IFRIC 12 *Service Concession Arrangements*. If the arrangement is within the scope of IFRIC 12, the submitter notes that the lease of the infrastructure is not within the scope of IFRS 16 *Leases* for the operator. The Interpretations Committee was also asked to clarify how the operator accounts for any assets and liabilities arising from the arrangement with the lessor.

With respect to the scope issue it was observed that:

(a) assessing whether a particular arrangement is within the scope of IFRIC 12 requires consideration of all facts and circumstances. In particular, the operator assesses whether the control conditions in paragraph 5 of IFRIC 12 and the condition relating to the infrastructure in paragraph 7 of IFRIC 12 apply; and

(b) the operator is not required to provide construction or upgrade services with respect to the infrastructure for the arrangement to be within the scope of IFRIC 12.

With respect to the recognition and presentation issues, if the arrangement is within the scope of IFRIC 12, it is the grantor and not the operator, that controls the right to use the infrastructure.

Accordingly, it was observed that:

(a) The operator assesses whether it is obliged to make payments to the lessor for the lease or whether the grantor has this obligation. If the grantor is obliged to make payments to the lessor, then in that case the operator is collecting cash from the grantor that it remits to the lessor on the grantor's behalf.

(b) If the operator is obliged to make payments to the lessor as part of the service concession arrangement, then the operator recognises a liability for this obligation when it is committed to the service concession arrangement and the infrastructure is made available by the lessor. At the time the operator recognises the liability, it also recognises a financial asset because the operator has a contractual right to receive cash from the grantor to reimburse those payments.

(c) The liability described in b) is a financial liability for the operator. The operator offsets the liability to make payments to the lessor against the corresponding receivable from the grantor only when the criteria for offsetting a financial asset and a financial liability in IAS 32 *Financial Instruments: Presentation* are met.

The Interpretations Committee noted that the requirements in IFRS Standards provide an adequate basis to enable an entity to determine how to account for the arrangement.

In the light of the existing 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.

BDO's support and assistance on HKFRS/IFRS

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