IFRIC Update

From the IFRS Interpretations Committee

IFRS

July 2011

Welcome to the IFRIC Update

IFRIC Update is published as a convenience for the IASB's constituents. All conclusions reported are tentative and may be changed or modified at future IFRS Interpretations Committee meetings.

Decisions become final only after the Interpretations Committee has taken a formal vote on an Interpretation or Draft Interpretation, which is confirmed by the IASB.

The Interpretations Committee met in London on **7 and 8 July 2011**, when it discussed:

- Current agenda:
  - Accounting for stripping costs in the production phase of a surface mine
  - Use of IFRIC 6 by analogy
- IFRS Interpretations Committee agenda decisions
- IFRS Interpretations Committee tentative agenda decisions
- IFRS Interpretations Committee other issues considered
- IFRS Interpretations Committee work in progress

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Future IFRS Interpretations Committee meetings

The next meetings are:
8 and 9 September 2011
3 and 4 November 2011
17 and 18 January 2012
13 and 14 March 2012
15 and 16 May 2012
10 and 11 July 2012
18 and 19 September 2012
13 and 14 November 2012

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Current agenda:

The Interpretations Committee discussed the following issues, which are on its current agenda.

IAS 16 *Property, Plant and Equipment*: accounting for stripping costs in the production phase of a surface mine

The Interpretations Committee took this issue onto its agenda in November 2009 and, in August 2010, published for public comment a Draft Interpretation *Stripping Costs in the Production Phase of a Surface Mine*. At the January, March and May 2011 meetings, the Committee discussed the comments received on the draft interpretation, reconsidered the recognition and measurement principles and reviewed a revised draft of the Interpretation.

The staff brought a near final draft of the Interpretation to the July 2011 Committee meeting. The Committee discussed the near final draft and decided that re-exposure was not necessary because there were no significant changes in principle between the draft interpretation and the near final draft. The Committee also agreed the following:

- to amend the near final Interpretation to acknowledge that an entity might choose to apply the revaluation model to the subsequent measurement of its mine assets;

- not to provide guidance in the final Interpretation on when recognition of the stripping activity asset begins and ends;
- to clarify that, when an allocation basis is used to allocate production stripping costs between the inventory produced and the stripping activity asset, this basis should be based on a relevant production measure; and
- to recommend to the Board that the effective date of the Interpretation should be 1 January 2013, with earlier application permitted.

The Committee voted and confirmed that there was consensus, subject to its final review of drafting changes, and submitted the Interpretation to the Board for ratification at the Board's meeting in September 2011.

IAS 37 *Provisions, Contingent Liabilities and Contingent Assets and* IFRIC 6 *Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment*—use of IFRIC 6 by analogy

The Interpretations Committee received a request to clarify whether, under certain circumstances, IFRIC 6 should be applied by analogy to other levies charged for participation in a market on a specified date (the activity date/period) to identify the event that gives rise to a liability.

The concern relates to when a liability should be recognised: should it be recognised on the activity date/period or on the calculation date/period, being the date/period of the financial (or other) data used to calculate (measure) the amount of the liability?

At this meeting, the Committee reviewed a summary of views received from national standard setters and noted that the issue is widespread.

Based on views received, the Committee discussed in turn the two following issues:

- whether the obligating event is the participation in an activity on the date specified by the legislation, or whether other factors create an earlier obligation; and
- whether a liability should be recognised in an interim reporting period in situations where the activity date/period and the calculation date/period fall in the same annual financial reporting period.

Having assessed the issues against the agenda criteria, the Committee decided to add the first issue onto its agenda with a view to developing guidance, after which the Committee will consider whether such guidance would address the second issue and, if not, whether the second issue should be added to the agenda.

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IFRS Interpretations Committee agenda decisions

The following explanation is published for information only and does not change existing IFRS requirements. *Committee agenda decisions are not Interpretations. Interpretations are determined only after extensive deliberation and due process, including a formal vote. Interpretations become final only when approved by the IASB.*

IAS 16 *Property, Plant and Equipment*—cost of testing

The Interpretations Committee received a request to clarify the accounting for sales proceeds from testing an asset before it is ready for commercial production. The submitted fact pattern is that of an industrial group with several autonomous plants being available for use at different times. This group is subject to regulation that requires it to identify a 'commercial production date' for the whole industrial complex. The question asked of the Committee is whether the proceeds from those plants already in operation can be offset against the costs of testing those plants that are not yet available for use.

The Committee noted that paragraph 17(e) of IAS 16 applies separately to each item of property, plant and equipment. It also observed that the 'commercial production date' referred to in the submission for the whole complex was a different concept from the 'available for use' assessment in paragraph 16(b)

of IAS 16. The Committee thinks that the guidance in IAS 16 is sufficient to identify the date at which an item of property, plant and equipment is 'available for use' and, therefore, is sufficient to distinguish proceeds that reduce costs of testing an asset from revenue from commercial production.

As a result, the Committee does not expect diversity to arise in practice and therefore decided not to add this issue to its agenda.

IAS 19 *Employee Benefits*—defined contribution plans with vesting conditions

The Interpretations Committee received a request seeking clarification on the effect that vesting conditions have on the accounting for defined contribution plans. The Committee was asked whether contributions to such plans should be recognised as an expense in the period for which they are paid or over the vesting period. In the examples given in the submission, the employee's failure to meet a vesting condition could result in the refund of contributions to, or reductions in future contributions by, the employer.

The Committee noted from the definition of a defined contribution plan in paragraph 7 of IAS 19 and the explanation in paragraph BC5 of IAS 19 that vesting conditions do not affect the classification of a plan as a defined contribution plan if the employer is not required to make additional contributions to cover shortfalls because of these vesting conditions. In addition, the Committee noted from the guidance in paragraph 43 of IAS 19 that accounting for defined contribution plans is based on accounting for the reporting entity's obligation to pay contributions to the separate entity that runs the plan, but not accounting for the obligation to the employees who benefit from the plan. As such, the Committee noted that accounting for defined contribution plans under IAS 19 focuses on the employer's obligation to make a contribution to the separate entity that runs the plan. Consequently, paragraph 44 of IAS 19 requires, and paragraph IN5 of IAS 19 explains, that each contribution to a defined contribution plan is to be recognised as an expense or recognised as a liability (accrued expense) over the period of service that obliges the employer to pay this contribution to the defined contribution plan. This period of service is distinguished from the period of service that entitles an employee to receive the benefit from the defined contribution plan (ie the vesting period), although both periods may be coincident in some circumstances. Refunds are recognised as an asset and as income when the entity/employer becomes entitled to the refunds, eg when the employee fails to meet the vesting condition.

The Committee noted that there is no significant diversity in practice in respect of the effect that vesting conditions have on the accounting for defined contribution post-employment benefit plans, nor does it expect significant diversity in practice to emerge in the future. Consequently, the Committee decided not to add this issue to its agenda.

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IFRS Interpretations Committee tentative agenda decisions

*The Interpretations Committee reviewed the following matters and tentatively decided that they should not be added to the Committee's agenda. These tentative decisions, including recommended reasons for not adding the items to the Committee's agenda, will be reconsidered at the Committee meeting in September 2011. Constituents who disagree with the proposed reasons, or believe that the explanations may contribute to divergent practices, are encouraged to e-mail those concerns by **15 August 2011** to: ifric@ifrs.org . Communications will be placed on the public record unless the writer requests confidentiality, supported by good reason, such as commercial confidence.*

IFRS 3 *Business Combinations*—business combinations involving newly formed entities: factors affecting identification of the acquirer

The Interpretations Committee received a request for guidance on the circumstances or factors that are relevant when identifying an acquirer in a business combination under IFRS 3. More specifically, the submitter described a fact pattern in which a group plans to spin off two of its subsidiaries using a new entity (Newco). Newco will acquire these subsidiaries for cash from the parent company (Entity A) only on condition of the occurrence of Newco's initial public offering (IPO). The cash paid by Newco to Entity A to acquire the subsidiaries is raised through the IPO. After the IPO occurs, Entity A loses control of Newco. If the IPO does not take place, Newco will not acquire the subsidiaries.

The Committee observed that paragraph B1 of IFRS 3 defines a business combination under common control as where "…all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory". The Committee observed that the specific fact pattern described in the submission cannot be a business combination under common control because, after the IPO, Entity A does not control Newco, and the subsidiaries are therefore not ultimately controlled by the same party or parties both before and after the business combination.

The Committee noted that this specific fact pattern is not widespread in many jurisdictions and, where this fact pattern does exist, the Committee does not expect significant diversity in practice. Consequently, the Interpretations Committee [decided] not to add the issue to its agenda.

IFRS 3 *Business Combinations* —business combinations involving newly formed entities: business combinations under common control

The Interpretations Committee received a request for guidance on accounting for business combinations under common control. More specifically, the submission describes a fact pattern that illustrates a type of common control transaction in which the parent company (Entity A), which is wholly owned by Shareholder A, transfers a business (Business A) to a new entity (referred to as 'Newco') also wholly owned by Shareholder A. The submission requests clarification on (a) the accounting at the time of the transfer of the business to Newco; and (b) whether an initial public offering (IPO) of Newco, which might occur after the transfer of Business A to Newco, is considered relevant in analysing the transaction under IFRS 3.

The Committee noted that the fact pattern described by the submitter reflects a business combination under common control in accordance with paragraph B1 in IFRS 3 because it is the same party (Shareholder A) that controls the combining entities both before and after the transfer of Business A. The Committee also noted that the possibility of an IPO occurring after the transfer of Business A to Newco should not impact the classification of this transfer as a business combination under common control.

The Committee also observed that paragraph B1 in IFRS 3 explicitly excludes business combinations between entities under common control from its scope.

The Committee noted that the issues raised by the submitter are widespread and that diversity in practice exists. However, the Committee thinks that the accounting for business combinations under common control is too broad to be addressed through an interpretation and that the Board has planned to address the accounting for business combinations under common control at a later stage. Consequently, the Committee [decided] not to add this issue to its agenda.

IFRS 3 *Business Combinations*—acquirer in a reverse acquisition

The Interpretations Committee received a request for guidance asking whether a business that is not a legal entity could be considered to be the acquirer in a reverse acquisition under IFRS 3. The submitter refers to a view that the guidance in paragraph B19 of IFRS 3 states that an acquirer is an 'entity' and implies that the acquirer needs to be a 'legal entity'.

The Committee noted that in accordance with paragraph 7 of IFRS 3, the acquirer is 'the entity that obtains control of the acquiree' and, in accordance with Appendix A of IFRS 3, the acquiree is 'the business or businesses that the acquirer obtains control of in a business combination'. Paragraph B19 in IFRS 3 requires the entity whose equity interests are acquired (the legal acquiree) to be the acquirer for accounting purposes for the transaction to be considered a reverse acquisition.

The Committee observed that a 'reporting entity' (as defined in the International Accounting Standards Board's exposure draft *Conceptual Framework for Financial Reporting: The Reporting Entity*), need not be a legal entity. While this guidance is not final, the Committee thinks that it reflects current practice. Therefore, the Committee thinks that an acquirer that is a reporting entity but not a legal entity can be considered to be the acquirer in a reverse acquisition.

The Committee noted that this issue is not widespread. Consequently, the Committee [decided] not to add this issue to its agenda.

IAS 27 *Consolidated and Separate Financial Statements*—group reorganisations in separate financial statements

The Committee received a request asking for clarification on how entities that are established as new intermediate parents within a group determine the cost of their investments in subsidiaries when they account for these investments in their separate financial statements at cost in accordance with paragraph 38(a) of IAS 27 (amended 2008) or paragraph 10(a) of IAS 27 (revised 2011). The request addresses reorganisations of groups that result in the new intermediate parent having more than one subsidiary.

The Committee noted that the guidance in paragraphs 38B and 38C of IAS 27 (amended 2008) or paragraphs 13 and 14 of IAS 27 (revised 2011) requires that the assets and liabilities of the new group and the original group (or original entity) are the same before and after the reorganisation. The Committee observed that this condition is not met in reorganisations that result in the new intermediate parent having more than one subsidiary and therefore these paragraphs in IAS 27 do not apply to such reorganisations. In addition, the Committee noted that the guidance in paragraphs 38B and 38C of IAS 27 (amended 2008) or paragraphs 13 and 14 of IAS 27 (revised 2011) cannot be applied to such reorganisations by analogy because this guidance is an exception to the normal basis for determining the cost of an investment in a subsidiary under paragraph 38(a) of IAS 27 (amended 2008) or paragraph 10(a) of IAS 27 (revised 2011).

Consequently, the Committee [decided] not to add this issue to its agenda.

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IFRS Interpretations Committee other issues considered

IFRS 8 *Operating Segments*—aggregation of operating segments and identification of the chief operating decision maker

The International Accounting Standards Board (the Board) received a request to make improvements to IFRS 8, with regard to the application of the aggregation criteria and the identification of the chief operating decision maker (CODM). More specifically, the request asked the Board to:

a. include an additional disclosure in paragraph 22 of IFRS 8 requiring a brief description of both the operating segments that have been aggregated and the economic indicators that have been assessed in order to conclude that the operating segments have ‘similar economic characteristics’ in accordance with paragraph 12 of IFRS 8; and
b. emphasise in paragraph 7 of IFRS 8 the ‘operating nature’ of the function of the CODM and to clarify in paragraph 1 of IFRS 8 that there is a presumption that management reviews the information that is reported to it.

The Board asked the Interpretations Committee to consider this request and to make a recommendation to the Board on how it thought the Board should respond.

The Committee noted that the additional disclosure requested in the first issue appears to be designed to enhance the possibility of detecting non-compliance with the requirements in IFRS 8. However, it is not clear that such a disclosure is necessary to meet the objective of IFRS 8.

With regard to the second issue, the Committee observed that sometimes, in practice, the CODM’s functions (ie allocating resources and assessing performance) are carried out by multiple persons and that all such persons involved in those activities would be part of the CODM group. The Committee also noted that the CODM would not normally include non-executive directors because of the role of the CODM in making operating decisions, which non-executive directors typically do not participate in.

The Committee decided that rather than attempting to address these issues through an Interpretation or annual improvement, it would be best to recommend that the Board consider these issues as part of a future post-implementation review of IFRS 8.

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IFRS Interpretations Committee work in progress

IFRS 3 *Business Combinations*—definition of a business

The Committee received a request seeking clarification on whether an asset with relatively simple associated processes meets the definition of a business in accordance with IFRS 3. More specifically, the question was whether the acquisition of a single investment property, with lease agreements with multiple tenants over varying periods and associated processes, such as cleaning, maintenance and administrative services such as rent collection, constitutes a business as defined in IFRS 3.

The Committee reviewed views received from outreach with the national standard-setters group and noted that the issue is widespread, that it has practical relevance and that there is significant divergence in practice.

The Committee noted that the issue raises the question of whether there is any interaction between IAS 40 *Investment Property* and IFRS 3. It discussed services that are "ancillary services" (as discussed in paragraphs 11-14 of IAS 40) that are not so significant as to disqualify a property from being an investment property but could nonetheless be considered "processes" (as discussed in paragraphs B7-B12 of IFRS 3) that could result in the acquired set of activities constituting a business.

The Committee directed the staff to perform further analysis on the interaction of IAS 40 and IFRS 3 and the characteristics of a business when investment property is acquired. The Committee asked the staff to consider the following questions:

a. Are IFRS 3 and IAS 40 mutually exclusive? (Ie can the acquisition of an investment property be a business combination?)
b. Would it be possible to develop guidance on how to determine if and when an obligation incurred in order to provide services in association with the acquisition of an asset would lead to a business combination?

The staff will present the results of this further work at the meeting in September 2011.

IFRS 11 *Joint Arrangements*—acquisition of interest in a joint operation

The Committee received a request to clarify the application of IFRS 3 by

- joint operators for the acquisition of interests in joint operations as defined in IFRS 11; and
- venturers for the acquisition of interests in jointly controlled operations or assets as specified in IAS 31 *Interests in Joint Ventures*.

In circumstances where the activity of the joint operation or the activity of the jointly controlled operations or assets constitutes a business, as defined in IFRS 3.

The Committee noted that the issue raised the question of what unit of account (the joint arrangement or the interest in the joint arrangement) is to be considered for the application of IFRS 3 and whether the activities and assets related to that unit of account can constitute a business. More specifically, the question is whether, and how, to recognise goodwill, if present, on the acquisition of an interest in a joint operation as defined in IFRS 11 or jointly controlled operations or assets as specified in IAS 31. The submitted example was that of the acquisition of an undivided interest in an oil or natural gas producing field.

The Committee directed the staff to do further analysis on this issue with the aim of assessing whether the issue could be solved through an annual improvement. The staff will present further analysis at the meeting in September 2011.

Committee outstanding issues update

The Committee received a report on one outstanding issue.

With the exception of that issue, all requests received and considered by the staff were discussed at this meeting.

Review of Committee's activity statistics

The Committee reviewed the Committee's activity statistics. The Committee asked the staff to provide an update of such statistics on an annual basis. A summary of the activity statistics as of July 2011 is provided below:

	Total 2008	**Total 2009**	**Total 2010**	**2011 (Jan to May)**
Issues addressed through interpretation (final or draft)	4	2	1	1
Issues addressed through annual improvements	1	2	22	4
Issues addressed through stand alone projects	2	1	3	0
Subtotal–issues addressed	**7**	**5**	**26**	**5**
Issues considered for interpretation for which agenda criteria not met	14	28	20	3
Issues considered for annual improvements but for which no action recommended	0	0	13	4
Total issues considered by the Committee	**21**	**33**	**59**	**12**

The results for 2010 reflect a new role relating to annual improvements undertaken by the Committee on behalf of the Board. This included a review of comments received on the exposure draft of proposed annual improvements published by the IASB in 2009. The exposure draft of annual improvements scheduled for publication in August 2010 was deferred until June 2011 to allow the IASB's constituents time and space to respond to other exposure drafts published by the IASB in 2010. Accordingly, there have not been any comments for the Committee to review in respect of annual improvements in 2011.

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