



# On the Horizon for IFRS

February 16, 2010

## **IFRIC issues January 2010 meeting highlights**

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## **IFRIC issues January 2010 meeting highlights**

*All decisions reached at IFRIC meetings are tentative and may be changed or modified at future meetings. Committee decisions become final only after completion of a formal vote on an Interpretation or Draft Interpretation, which is confirmed by the IASB.*

The International Financial Reporting Interpretations Committee has issued the January 2010 [IFRIC Update](#), which summarizes the Committee's meeting in London on January 7-8, 2010. Highlights of the meeting are discussed below.

### Key Issues

At its January 2010 meeting, the IFRIC:

- Determined the scope for its issue on accounting for production stripping costs
- Added an issue on vesting and non-vesting conditions to its agenda
- Confirmed its November 2009 decisions to not add to its agenda issues on:
  - Classification and measurement of share-based payment transactions with contingent settlement
  - Scope of investments in real estate investment trusts
  - Recognition of equity dividends as revenue
  - Combined financial statements in carve-outs
  - Presentation of comparatives in business combinations between entities under common control
  - Application of the *fixed-for-fixed* condition
  - Amortization of intangible assets
- Made tentative decisions to not add to its agenda issues on:
  - Determining the functional currency of an investment holding company
  - Distinguishing between liability and equity for a financial instrument where shareholders have discretion over the payment
  - Interaction of impairment guidance with the transition requirements of IFRS 8
  - The unit of account for forward contracts with volumetric optionality
- Confirmed proposed amendments in the *Annual Improvements* project:

- Fair value or revaluation as deemed cost exemption in IFRS 1
- Transition requirements for contingent consideration in business combinations
- Measurement of non-controlling interests in business combinations
- Clarification of disclosures for financial instruments
- Partial use of fair value for measurement of associates
- Reporting significant events and transactions in interim financial statements
- Proposed removal of amendments from the *Annual Improvements* project:
  - Bifurcation of embedded foreign currency derivative
  - Application of the fair value option
  - Impairment of investment in subsidiaries, jointly controlled entities, and associates in the separate financial statements of the investor
- Directed the staff to research further an issue on the accounting for costs included in self-constructed assets on transition

### Accounting for production stripping costs

In November 2009, the IFRIC decided to add this issue to its agenda. (For details on that decision, see the [February 3, 2010 On the Horizon for IFRS](#)). At the January 2010 meeting, the IFRIC accepted the project plan for the proposed interpretation. The IFRIC then deliberated the scope of the proposed interpretation. The main issues discussed were whether to:

- Include all extractive industries or only the extraction of minerals
- Focus on the mining industry or the activity of overburden removal
- Include all stages of mining or just the production stage
- Focus only on surface mining or all types of mining

*Whether to include all extractive industries or only the extraction of minerals.* Although the stripping technique is most commonly used in surface mining activities, the extraction of oil deposits in sands and shale can involve a process similar to stripping. Rather than expand the scope to include oil and gas extraction, the IFRIC left the scope more narrowly defined to the extraction of minerals.

*Whether to focus on the mining industry or the activity of overburden removal.* Given that the scope would be limited to extraction of minerals, it wouldn't make sense to focus on the mining industry, which covers more than just extracting minerals. The IFRIC believes it is more appropriate to focus on the activity of overburden removal.

*Whether to include all stages of mining or just the production stage.* The IFRIC elected to confine the scope to the production stage of the life cycle of the mine. Development stage costs are already capitalized in practice, based on IAS 16, *Property, Plant and Equipment*. Exploration and evaluation stage costs are covered by IFRS 6, *Exploration for and Evaluation of Mineral Resources*.

*Whether to focus only on surface mining or all types of mining.* The IFRIC limited the scope to surface mining. Some costs incurred in underground mining may be considered similar in nature, such as constructing a new shaft in an underground mine after production has commenced in order to access minerals in future periods.

The IFRIC decided to use the following wording for the scope concept:

“Accounting for the costs of removal of waste material in a surface mining activity during the production phase.”

The staff will present papers at the March 2010 meeting discussing the costs to be considered by this interpretation and related definitions. The staff will also

present papers discussing the accounting for such costs including recognition, measurement, and attribution/amortization of any asset that may arise.

### **Vesting and non-vesting conditions**

Under IFRS 2, *Share-based Payment*, vesting conditions determine whether an entity receives the services of the counterparty in a share-based payment arrangement. Vesting conditions are either service conditions or performance conditions. Service conditions require the counterparty to complete a specified period of service. Performance conditions require completion of a specified period of service and achievement of specified performance targets. A non-vesting condition is neither a service condition nor a performance condition but is a feature of the award.

The IFRIC received a request to clarify how vesting conditions, especially performance conditions, can be distinguished from non-vesting conditions. Specifically, the IFRIC was asked how to distinguish between a service condition, a performance condition, and a non-vesting condition.

Two application issues were presented to the IFRIC:

- Does there need to be a direct link between a performance target and an individual employee's service in order for that target to be a performance condition? Some believe that the performance condition must relate directly to the services being provided in order to qualify as a vesting condition, such as sales volume for a salesperson. Others believe that there is an indirect relationship between a performance target specific to the entity during a required service period and an employee's contributions toward meeting that target. This allows targets for EPS or return on investment to be considered as performance conditions.

- When determining whether the target qualifies as a performance condition, does it matter whether the specified service period is shorter or longer than the period over which the performance target should be met? Performance conditions require both a specified period of service and a performance target. If those two components correspond to different periods, an issue arises as to whether the performance conditions determine the period over which the entity receives services. For example, if a sales target must be met over a three year period, but the employee must remain employed for four years, does the sales target determine whether the entity is receiving services in the fourth year? Or if the sales target must be met over four years, but the employee only needs to remain employed for three years, does the entity receive services in the fourth year if the employee leaves after the third year?

The IFRIC noted that there is a lack of clarity in the definition of vesting conditions and revised guidance included in *Vesting Conditions and Cancellations (Amendment to IFRS 2)* issued in January 2008. As such, there may be diversity in practice when distinguishing between vesting conditions and non-vesting conditions.

The IFRIC concluded that the consistency of application would be improved by clarifying the distinction between service conditions, performance conditions, and non-vesting conditions. Therefore, the IFRIC decided to add the issue to its agenda and directed the staff to develop a paper for discussion at the March 2010 meeting.

#### **IFRIC agenda decisions**

IFRIC agenda decisions are not Interpretations, which are determined only after deliberation and due process, including a formal vote. IFRIC Interpretations become final only when approved by the IASB.

At the November 2009 meeting, the IFRIC tentatively decided to defer a decision on whether to add seven issues to the agenda. The IFRIC reconsidered these issues at the January 2010 meeting.

#### **IFRS 2, Share-based Payment – Transactions where the manner of settlement is contingent on future events**

The IFRIC received a request to clarify the classification and measurement of share-based payment transactions for which the manner of settlement is contingent on a future event that is either:

- Outside the control of both the entity and the counterparty
- Within the control of the counterparty

The IFRIC noted that paragraphs 34 - 43 of IFRS 2 provide guidance on share-based payment transactions where the terms of the arrangement provide either the counterparty or the entity with a choice of settlement. IFRS 2 does not provide guidance on share-based payment transactions for which the manner of settlement is contingent on a future event that is outside the control of both the entity and the counterparty.

The IFRIC noted that many other issues have been raised concerning the classification and measurement of share-based payments as cash settled or equity settled. The IFRIC decided not to add these issues to its agenda and recommended that they be dealt with by the IASB in a post-implementation review of IFRS 2.

#### **IFRS 4, Insurance Contracts and IAS 32 Financial Instruments: Presentation – Scope issue for REITs**

In some jurisdictions, a Real Estate Investment Trust (REIT) is a tax designation used to describe an entity that meets certain criteria for preferential income tax status. The contractual terms of the ownership units of a REIT require it to distribute 90% of the Total Distributable Income

(TDI) to its investors. The remaining 10% of TDI may be distributed at the discretion of management. The IFRIC received a request to provide guidance on whether the discretion to distribute the remaining 10% of TDI met the definition of a Discretionary Participation Feature (DPF) as defined in IFRS 4. A DPF is a contractual right to receive additional benefits as a supplement to guaranteed benefits:

- That are likely to be a significant portion of the total contractual benefits;
- Whose amount or timing is contractually at the discretion of the issuer; and
- That are contractually based on:
  - The performance of a specified pool of contracts or a specified type of contract;
  - Realized and/or unrealized investment returns on a specified pool of assets held by the issuer; or
  - The profit or loss of the company, fund or other entity that issues the contract

If the DPF definition is met, IFRS 4 permits the ownership units to be classified as a liability rather than classified into debt and equity components in accordance with IAS 32.

The IFRIC noted that the objective of IFRS 4 is to specify the financial reporting for insurance contracts. The definition of DPF in Appendix A of IFRS 4 requires, among other things, that the instrument provides the holder with guaranteed benefits and that the DPF benefits are supplemental to those guaranteed benefits. Further, guaranteed benefits are payments or other benefits to which a particular policyholder or investor has an unconditional right that is not subject to the contractual discretion of the issuer. One view is that the 10% of TDI under management's discretion is not an additional benefit but rather a

distribution of the holders' interest. If not distributed, those amounts contribute to equity, increasing the holders' share in net assets upon liquidation. In contrast, typical financial instruments with a DPF could result in distributions where the benefit is different for some of the unit holders. That discretion does not exist in the distribution of TDI.

The IFRIC noted that providing guidance on this issue would be in the nature of application guidance, rather than interpretative guidance. Therefore, the IFRIC decided not to add the issue to its agenda.

#### IAS 18, Revenue – Receipt of a dividend of equity instruments

The IFRIC received a request for guidance on how to recognize a dividend in the form of an investee's own equity instruments.

The IFRIC noted that current IFRS provide guidance on when revenue arising from dividends is recognized. Paragraph 29(a) of IAS 18 states that revenue arising from dividends is recognized when "it is probable that the economic benefits associated with the transaction will flow to the entity." When all ordinary shareholders are issued a dividend of an investee's own equity instruments on a pro-rata basis there is no change in the financial position or economic interest of any of the investors. The value of their investment and the ownership share they hold in the investee remains unchanged. In this situation, in accordance with IAS 18.29(a), the dividend is not recognized as revenue because it is not probable that there is an economic benefit associated with the transaction that will flow to the investor.

The IFRIC concluded that any guidance it could provide would be in the form of application guidance. Therefore, the IFRIC decided not to add this issue to its agenda.

**IAS 27, Consolidated and Separate Financial Statements – Combined financial statements and redefining the reporting entity**

The IFRIC received a request for guidance on whether a reporting entity has the ability to present financial statements in accordance with IFRS that include selected entities that are under common control, rather than being restricted to a parent/subsidiary relationship defined by IAS 27. Such financial statements might be necessary when a group entity carves out some entities or parts of entities which are then sold or included in a separate initial public offering.

The IFRIC noted that the ability to include entities within a set of IFRS financial statements depends on the interpretation of *reporting entity* in the context of common control transactions. The IFRIC noted that in December 2007 the Board added a project to its research agenda to examine the definition of common control and the methods of accounting for business combinations under common control in the acquirer's consolidated and separate financial statements. The IFRIC also noted that describing the reporting entity is the objective of Phase D of the Board's Conceptual Framework project.

The IFRIC also received a request for guidance on whether a reporting entity can be redefined to exclude from comparative periods entities or businesses that have been carved out of a group. There is some fairly restrictive guidance in the U.S. on this subject in SEC Staff Accounting Bulletin Topic 5.Z.7, *Accounting for the Spin-off of a Subsidiary*. The IFRIC noted that the Board's common control project referred to above will also consider the accounting for demergers, such as the spin-off of a subsidiary or business.

Therefore, the IFRIC decided not to add this issue to its agenda.

**IAS 27, Consolidated and Separate Financial Statements – Presentation of comparatives when applying the “pooling of interests” method**

The IFRIC received a request for guidance on the presentation of comparative financial statements prepared in accordance with IFRS when applying the *pooling*

*of interests* method for business combinations between entities under common control. Some entities report combined operations from the beginning of the period, which is consistent with specific guidance in U.S. GAAP. Others report combined operations only from the date of the common control transaction, based on guidance in IAS 27.26 that precludes the reporting of combined results for the pre-combination period in the receiving entity's financial statements.

The IFRIC noted that IFRS 3, *Business Combinations* (revised 2008) excludes from its scope “a combination of entities or businesses under common control.” The IFRIC believes that resolving the issue would require interpreting the interaction of multiple IFRS. In December 2007 the Board added a project to its research agenda to examine the definition of common control and the methods of accounting for business combinations under common control in the acquirer's consolidated and separate financial statements. Therefore, the IFRIC decided not to add this issue to its agenda.

**IAS 32, Financial Instruments: Presentation – Application of the “fixed for fixed” condition**

The IFRIC received requests for guidance on the application of paragraph 22 of IAS 32 which states that “except as stated in paragraph 22A, a contract that will be settled by the entity (receiving or) delivering a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument.” This is often referred to as the *fixed-for-fixed* condition.

The IFRIC identified that diversity may exist in the application of the fixed-for-fixed condition to situations other than the specific situations identified in the requests.

The IFRIC noted that the Board is currently undertaking a project to improve and simplify the financial reporting requirements for financial instruments with characteristics of equity. A key objective of this project is to develop a better distinction between equity and non-equity instruments, including consideration of the current fixed-for-fixed condition in IAS 32. That project is expected to issue guidance in the first part of 2010. Therefore, the IFRIC decided not to add this issue to its agenda.

#### IAS 38, Intangible Assets – Amortization method

The IFRIC received requests for guidance on the meaning of *consumption of economic benefits* when determining the appropriate amortization method for an intangible asset with a finite useful life. The methods considered in the submissions are the straight-line method and the unit of production method, including a revenue-based unit of production method. Also at issue is whether to look to revenue generated from the asset or to the asset itself when determining economic benefits to be amortized.

The IASB discussed intangible asset amortization methods in March 2008 during its deliberations on the *Annual Improvements* Exposure Draft published in 2007. Constituents had raised concerns about which method best reflects the consumption of future economic benefits. The IASB considered that amortization is an estimate that requires judgment and therefore the methods selected may differ. The IASB then concluded that the principle in IAS 38.98 is sufficiently clear.

At its November 2009 meeting the IFRIC noted that IAS 38.98 states that “the method used is based on the expected pattern of consumption of the expected future economic benefits embodied in the asset...” The determination of the amortization method is therefore a matter of judgment. In addition, in accordance with paragraph 122 of IAS 1, *Presentation of Financial Statements*,

significant judgments made in determining the amortization methods should be disclosed in the notes to the financial statements.

At its January 2010 meeting the IFRIC considered comments received on its tentative agenda decision. Some members believed that an interpretation could assist in reducing diversity in implementation of this principle, while others considered that any guidance would be in the nature of application guidance. Given the diversity of views expressed, the IFRIC concluded that it would not be able to reach a consensus on the issue on a timely basis. Therefore, the IFRIC decided not to add the issue to its agenda.

#### Tentative agenda decisions

After reviewing the following issues, the Committee made the following tentative decisions. These issues will be reconsidered at the March 2010 meeting.

#### IAS 21, The Effects of Changes in Foreign Exchange Rates – Determination of functional currency of an investment holding company

The IFRIC received a request for guidance on whether the underlying economic environment of its subsidiaries should be considered when determining, in its separate financial statements, the functional currency of an investment holding company.

IAS 21 requires each individual entity in a group to determine its own functional currency. There is no concept of a group functional currency. IAS 21.8 defines *functional currency* as “the currency of the primary economic environment in which the entity operates.” The primary economic environment is where the entity primarily generates and expends cash (IAS 21.9). IAS 21 includes primary and secondary factors to consider when determining the functional currency. The primary factors to consider concern the currency that mainly influences sales prices and costs. The secondary

factors to consider concern the currency in which funds from financing activities are generated and in which receipts from operations are retained.

IAS 21.11 addresses determining the functional currency of a foreign operation and whether it should be the same as the reporting entity's functional currency. Generally, if the reporting entity and its foreign operations have a high level of integration in the way they operate, frequent intercompany transactions, and a material degree of co-dependency of cash flow and funding, it may make sense for the reporting entity and its foreign operations to have the same functional currency.

Paragraph 11 considers the influence of the reporting parent on the foreign operation in determining the functional currency of the subsidiary. IAS 21 does not address whether the subsidiary foreign operation would influence the determination of the functional currency of the parent.

Investment holding companies have some unique features that may make determination of the functional currency under IAS 21 more challenging. Unlike many entities providing goods and services, investment holding companies have low operating expenses and earn revenue in the form of dividends from their investments. The holding company's investments are typically operating subsidiaries. When those operating subsidiaries are foreign operations they could have a functional currency that is different from the local currency of the holding company.

The actual submission to the IFRIC discussed a situation where the investment holding company is located in Hong Kong and all its operating subsidiaries are in mainland China. The concern was whether it was not appropriate to use the Hong Kong dollar (HKD) as the functional currency of the investment holding company when all the operating subsidiaries had as their functional currency the

Renminbi, even though the dividends to the holding company had to be received in HKD or converted to HKD on receipt due to currency restrictions.

The IFRIC noted that IAS 21 paragraph 12 states that when the "indicators are mixed and the functional currency is not obvious, management uses its judgment to determine the functional currency that most faithfully represents the economic effects of the underlying transactions, events and conditions." Consequently, how an entity applies IAS 21 for the purpose of determining its functional currency - whether it is an investment holding company or any other type of entity - requires the exercise of judgment. IAS 1, *Presentation of Financial Statements* requires disclosure of significant accounting policies and judgments that are relevant to an understanding of the financial statements.

The IFRIC believes that any guidance it could provide would be in the nature of application guidance rather than an interpretation. Consequently, the IFRIC decided not to add the issue to its agenda.

#### **IAS 32, Financial Instruments: Presentation – Shareholder discretion**

The IFRIC received a request for guidance on whether a financial instrument in the form of a preference share (preferred stock) that includes a contractual obligation to deliver cash is a financial liability or equity, if the payment is at the ultimate discretion of the issuer's shareholders.

The IFRIC agreed that diversity may exist in practice in assessing whether an entity has an unconditional right to avoid delivering cash if the contractual obligation is at the ultimate discretion of the issuer's shareholders, and consequently whether a financial instrument should be classified as a financial liability or equity.

Generally, if an entity has discretion over whether to deliver cash it can avoid liability treatment. IAS 32.19 explains that if an entity does not have an unconditional right to avoid delivering cash or another financial asset to settle a contractual obligation, that obligation is a financial liability. Similarly, IAS 32.AG26 states that when distributions to holders of preference shares are at the discretion of the issuer, the shares are equity instruments.

The request to the IFRIC potentially raises broader issues around the relationship between an entity and its shareholders. There is no specific guidance in IFRS on whether a decision made at the discretion of shareholders is within the control of the entity or within the control of its shareholders. That determination would require judgment, based on the specific facts and circumstances. For example, a change of control that requires shareholder approval could be assessed differently when share holdings are widely held than when one or two individuals hold a majority of the votes. In the former case, shareholder approval may be a substantive term while in the latter situation it may be more of a formality.

Although IFRS do not contain an overall principle to address how the financial statements should reflect the actions of the shareholders, there is specific guidance in different IFRS. Sometimes the actions of the entity are subordinate to shareholders, sometimes shareholder actions are subordinate, and sometimes it depends on the capacity in which the shareholder is acting. For example, IFRIC 17, *Distribution of Non-cash Assets to Owners*, requires approval (e.g. by shareholders) before a liability is recognized for the dividend. In contrast, paragraph 8 of IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*, only requires consideration of the probability of shareholder approval in assessing whether a sale is highly probable. Further, IFRIC 19, *Extinguishing Financial Liabilities with Equity Instruments*, includes transactions with shareholders, except when they are acting in their capacity as shareholders.

Ultimately it will depend on the specific facts and circumstances and professional judgment to determine the proper accounting for transactions and events when shareholder discretion is involved.

The IFRIC noted that the Board is currently undertaking a project to improve and simplify the financial reporting requirements for financial instruments with characteristics of equity. The main objectives of this project are to develop a better distinction between equity and non-equity instruments and to converge IFRS and U.S. GAAP. On the issue of the impact of shareholder discretion on liability or equity classification for a financial obligation U.S. GAAP generally requires that any provision that would require the entity to settle in cash would preclude equity accounting.

On this issue, the IFRIC concluded that the Board's current project on *Financial Instruments with Characteristics of Equity* is expected to address the distinction between equity and non-equity instruments on a timely basis. The IFRIC therefore decided not to add this issue to its agenda.

#### **IAS 36, Impairment of Assets – Interaction with transition requirements of IFRS 8**

The IFRIC received a request for guidance on the transition requirements in IFRS 8, *Operating Segments* and its interaction with IAS 36, *Impairment of Assets*.

The IASB made a consequential amendment to IAS 36 when it issued IFRS 8 in November 2006. The consequential amendment replaced the reference to “segments” (as determined in accordance with IAS 14, *Reporting Segments*) to “operating segments” (as determined in accordance with IFRS 8). In particular, paragraph 80(b) of IAS 36 was amended to refer to IFRS 8 when setting the limit for aggregating cash-generating units (CGUs) when testing for goodwill impairment, instead of referring to the segment definition in IAS 14, which IFRS 8 superseded. This change in the definition of segments

means that potentially smaller segments would be used to set the aggregation limits. As a result of the change, some entities might need to recognize an impairment of goodwill. In particular, when goodwill was previously tested at the level of a geographical segment, identification of smaller segments based on the activities the entity is engaged in might change the grouping of CGUs for purposes of testing goodwill for impairment.

Although IFRS 8 includes specific transition requirements, there are no specific transition provisions that pertain to the consequential amendment to IAS 36.80(b). IFRS 8.36 specifies that, upon transition, segment information for comparative periods is presented as required by IFRS 8 unless the information is not available and the cost to produce it would be excessive. The issue is further complicated by an amendment in April 2009 to IAS 36.80(b) that was part of the annual *Improvements to IFRSs*, which slightly refined the definition of the unit to which goodwill is allocated. That amendment is to be applied prospectively for annual periods beginning on or after January 1, 2010, although earlier application is permitted.

The question asked of the IFRIC is whether any incremental goodwill impairment loss determined as a result of retrospective application of the change from IAS 14 to IFRS 8 should be presented as a prior period adjustment or a current period event.

The different treatments seem to depend on whether the impairment charge resulting from the change in the definition of segments is considered to be a change in accounting policy or a change in the application of that policy. If the change in the definition of a segment is a change in policy, then IAS 8.19b would apply, calling for retrospective application. Retrospective application could lead to practical difficulties when estimating the recoverable amounts of an operating segment as of a date in an earlier period because it would require

the use of hindsight, which is generally discouraged. Further, the amendment of IAS 36 in IFRS 8 does not require reperformance of measurements called for by IAS 36. If there has been no change in the accounting policy for testing goodwill for impairment, but only a change in the application of that policy, the resulting impairment charge would be recognized as a current year charge in profit or loss.

In its deliberations on the April 2009 amendment, the Board added paragraph BC228A to IAS 36 that specifically discussed transition provisions. The Board expressed its concern with the potential to involve “hindsight in determining fair values of the cash-generating units at the end of a past reporting period.” That concern led to the prospective application in the later period beginning on or after January 1, 2010, even though the effective date of IFRS 8 was January 1, 2009.

The IFRIC noted that IFRS 8 is applicable for annual periods ending December 31, 2009 and thereafter. Based on the required due process procedures included in the IFRIC *Due Process Handbook*, the IFRIC would not be able to provide guidance on a timely basis. Consequently, the IFRIC decided not to add the issue to its agenda.

#### **IAS 39, Financial Instruments: Recognition and Measurement – Unit of account for forward contracts with volumetric optionality**

The IFRIC received a request to add an item to its agenda on providing guidance on whether a contract that both:

- Obliges an entity to deliver (sell) at a fixed price a fixed number of units of a non-financial item that is readily convertible to cash; and

- Provides the counterparty with the option to purchase, also at a fixed price, a fixed number of additional units of the same item

can be assessed as two separate contracts for the purpose of applying paragraphs 5 - 7 of IAS 39, *Financial Instruments: Recognition and Measurement*.

This issue was discussed in the [February 3, 2010 On the Horizon for IFRS](#) on the November 2009 IFRIC meeting. At that meeting, the IFRIC did not decide whether to take the issue onto its agenda, but instead directed the staff to research the issue further. In particular the staff was asked to confirm whether there is diversity in practice and whether the issue is relevant for industries other than the energy industry. In its outreach to accounting firms and a preparer, the staff confirmed that diversity did exist in practice and the issue was broader in scope than just affecting energy companies. These contracts are used in other industries that use commodities such as chemicals and precious metals in their production processes.

Although the IFRIC recognized that diversity exists in practice, it noted that the Board has accelerated its project to develop a replacement for IAS 39 and expects to issue a comprehensive replacement standard by the end of 2010. The Board will consider the scope of IAS 39, including the guidance about contracts to buy or sell non-financial items in paragraphs 5 - 7 of IAS 39, as part of the replacement for that standard. Even in the unlikely event that the IFRIC could complete its due process and issue an interpretation before then, it is unlikely to have an effective date sooner than the replacement for IAS 39. Consequently, the IFRIC decided not to add this issue to its agenda.

#### **Annual improvements**

The IFRIC assists the IASB in its *Annual Improvements* project by reviewing proposed improvements to IFRS and making recommendations to the Board. Specifically, the IFRIC reviews and deliberates issues for inclusion in future

exposure drafts of proposed *Improvements to IFRSs* and deliberates the comments received on the exposure drafts. When the IFRIC reaches a consensus on an issue included in the *Annual Improvements* project, the recommendation (including finalization of the proposed amendment or removal from the project) will be presented to the Board for ratification, in a public meeting, before being finalized. Approved *Improvements to IFRSs* (including exposure drafts and final standards) are issued by the Board.

At its meeting in January 2010, the IFRIC deliberated comments received on seven proposed amendments included in the Exposure Draft of proposed *Improvements to IFRSs* published in August 2009. The IFRIC also deliberated the two remaining proposed amendments included in the Exposure Draft of proposed *Improvements to IFRSs* published in August 2008.

#### **Confirmed proposed amendments**

The IFRIC confirmed six of the proposed amendments, subject to its final review of drafting changes, and submitted the proposed amendments to the Board for ratification at a future Board meeting.

The Board will include ratified amendments in the *Improvements to IFRSs* expected to be issued in April 2010. The six confirmed proposed amendments are:

- IFRS 1, *First-time Adoption of International Financial Reporting Standards* – Fair value or revaluation as deemed cost exemption - paragraph D8
- IFRS 3, *Business Combinations* – Transition requirements for contingent consideration from a business combination that occurred before the effective date of the revised IFRS 3
- IFRS 3, *Business Combinations* – Measurement of non-controlling interests
- IFRS 7, *Financial Instruments: Disclosures* – Clarifications of disclosures

- IAS 28, *Investments in Associates* – Partial use of fair value for measurement of associates
- IAS 34, *Interim Financial Reporting* – Significant events and transactions

Each is discussed below.

**IFRS 1, First-time Adoption of International Financial Reporting Standards – Fair value or revaluation as deemed cost exemption - paragraph D8**

In Appendix D of IFRS 1, which covers exemptions from other IFRS, there is a section covering fair value as deemed cost. Paragraph D8 addresses the situation where a first-time adopter (FTA) establishes a deemed cost in accordance with previous GAAP by measuring assets and liabilities at fair value because of an event such as a privatization or an initial public offering (IPO). The FTA may use those fair values as deemed cost at the date of that measurement.

In 2009 the Board received a request to extend the exemption in paragraph D8 for a continuing business that is restructured in a privatization and subsequent IPO because local law requires the newly formed entity to revalue its assets and liabilities to fair value and treat that as deemed cost. Without an exemption, the new entity would have to prepare two sets of figures – one from its transition values under IFRS and another to comply with local requirements for deemed cost at the date of the restructuring event. In extending the scope of the exemption to be applicable to events occurring after the transition date, the entity would be able to use the event-driven fair value measurement as deemed cost for IFRS from then onward, obviating the need for two sets of figures.

In the comment process, respondents suggested a *work back* approach for comparative presentation purposes. This approach adjusts the event-driven fair value measurement backwards to the date of transition for items such as depreciation, amortization, additions, disposals, and impairment. The advantage

is that assets and liabilities are consistently measured from the transition date onward.

The IASB rejected the work back approach because in some circumstances its use could have a significant effect on results, such as when the event-driven fair value is significantly different than fair value on the transition date. A draft Basis for Conclusions notes that work back adjustments were objected to because those adjustments require hindsight and the computed amounts for the date of transition are neither historical cost nor fair value as of that date. The Board's decision means that entities will be required to present historical cost or amounts otherwise permitted by IFRS 1 at the transition date.

The IFRIC confirmed the proposed amendment to extend the scope of the exemption in paragraph D8 to be applicable to events occurring after the transition date, but before the end of the entity's first IFRS reporting period. As part of its deliberations on the comments received, the IFRIC decided to include minor modifications to the proposed amendment to specify how the event-driven revaluation is recognized and to clarify the effective date. The adjustments for the event-driven revaluation are recognized directly in retained earnings or another category of equity, if appropriate, at the event date. Entities that applied IFRS 1 in a previous period may apply this new amendment retrospectively in the first annual period after the amendment is effective.

**IFRS 3, Business Combinations – Transition requirements for contingent consideration from a business combination that occurred before the effective date of the revised IFRS 3**

Prior to the 2008 revision to IFRS 3, contingent consideration arising in a business combination was not within the scope of IAS 39, *Financial Instruments: Recognition and Measurement*, even if that contingent consideration

was in the form of a financial asset or a financial liability. When IFRS 3 (revised 2008) removed the IAS 39 scope exception for contingent consideration it did not specify whether it should be applied prospectively or retrospectively. It also did not specify whether IAS 39 should be applied only to contingent consideration balances that arose from combinations accounted for under IFRS 3 (revised 2008) or also to balances remaining from earlier combinations. Generally, adjustments to contingent consideration balances were adjustments to the cost of the business combination prior to applying IFRS 3 (revised 2008). Adjustments might be related to items such as maintaining a specified level of profit or market price of common shares. Subsequent to the revision of IFRS 3, accounting for those financial instruments under IAS 39 would not result in an adjustment to the cost of the combination.

The IFRIC confirmed the proposed amendment to clarify that for existing users of IFRS the financial instruments standards (IFRS 7, IAS 32, and IAS 39) do not apply to contingent consideration arising from a business combination whose acquisition date preceded the application of IFRS 3 (revised 2008).

The *Annual Improvements* Exposure Draft proposed to include within the financial instruments standards a reference to IFRS 3 (issued 2004) for the accounting for contingent consideration from a business combination that occurred prior to the application of IFRS 3 (revised 2008). Some comments pointed out that a reference to a superseded standard could be problematic and potentially nonauthoritative. In some jurisdictions when a revised IFRS is legally adopted the old standard is withdrawn such that preparers cannot legally use the requirements in the superseded standard.

Having considered the comments received, the IFRIC decided to modify the proposed amendment to reproduce the superseded requirements from IFRS 3 (issued 2004) on accounting for contingent consideration after paragraph 65

within the transition section in IFRS 3 (revised 2008), and refer to this guidance in the transition sections of IFRS 7, IAS 32, and IAS 39. The IFRIC decided that this guidance shall be applied to all contingent consideration balances arising from acquisitions prior to the date the entity first applied IFRS 3 (revised 2008).

Another inconsistency related to the measurement of contingent consideration involves the guidance in paragraph 58 of IFRS 3 (revised 2008). That paragraph requires that contingent consideration that is a financial instrument within the scope of IAS 39 be accounted for at fair value through profit or loss or through other comprehensive income in accordance with IAS 39. However, many financial liabilities within the scope of IAS 39 are measured at amortized cost. Because IAS 39 does not specifically address the measurement of contingent consideration, contingent consideration balances within the scope of IAS 39 would also be subject to measurement guidance in IFRS 3.58, a potential conflict.

The IFRIC recommended that the Board consider, as part of its project to replace IAS 39, bringing together in one IFRS the measurement guidance for contingent consideration that is a financial instrument.

#### **IFRS 3, Business Combinations – Measurement of non-controlling interests**

This issue arises because of a change in terminology in IFRS 3 (revised 2008), which used the term *non-controlling interest* (NCI) to replace the previously used *minority interest* (MI). NCI as defined includes equity instruments other than ordinary shares that are not attributable to the shareholders of the parent entity. Those instruments, such as share-based payments, were not included in the definition of MI.

Paragraph 19 of IFRS 3 (revised 2008) provides a choice when measuring NCI between fair value or the NCI's proportionate share of the acquiree's

identifiable net assets. This choice raises a measurement issue for those instruments that do not meet the previous definition of MI, because they are not present ownership interests and as such do not share in any identifiable net assets in a business combination. As a result, options over an entity's own shares classified as equity or the equity component of a convertible instrument could be valued at nil on acquisition. If that were to happen, third party economic interests in the acquiree would not be reflected in the acquisition accounting.

The Board has clarified that it intended that the measurement choice would apply only to equity components that would have met the previous definition of MI. The Board did not intend to change the accounting for other equity instruments now included in the definition of NCI. To clarify this, the *Annual Improvements* Exposure Draft proposed to modify the wording in IFRS 3.19. The IFRIC confirmed the proposed amendment to paragraph 19 of IFRS 3 (revised 2008) to clarify that the choice for measuring the NCI in an acquiree applies only to “components of non-controlling interests that are present ownership instruments and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation.” Other present ownership instruments that are classified as NCI should be measured “at fair value, unless another measurement basis is required by IFRSs.”

The IFRIC also asked the staff to prepare examples to be included in the confirmed proposed amendment that would illustrate the application of the requirement.

IFRS 7, Financial Instruments: Disclosures – Clarifications of disclosures

This issue relates to disclosures about the nature and extent of risks arising from financial instruments. The IFRIC confirmed the proposed amendment to IFRS 7 that clarifies and amends the qualitative, quantitative, and credit risk

disclosures included in paragraphs 33 - 38. As part of its deliberations on the comments received, the IFRIC decided to include minor modifications to the proposed amendment.

The IASB had concluded that an explicit emphasis on the interaction between qualitative and quantitative disclosures would contribute to improving disclosures. Commenters pointed out that proposed paragraph 33A could suggest that qualitative disclosures are subordinate to quantitative disclosures. The new paragraph 35A emphasizes the interaction between qualitative and quantitative disclosures so as to contribute to the objective of disclosing information in a way that better enables users to evaluate an entity's exposure.

Another change to IFRS 7 involved the removal of references to materiality in paragraph 34 (on quantitative disclosures) and in the Introduction. Materiality is discussed in the *Framework* and in IAS 1, *Presentation of Financial Statements*. Including a reference to materiality in IFRS 7 could imply that disclosures that are not material are required by other provisions of the standard that don't include a materiality qualifier.

The other proposed changes to IFRS 7, on exposure to credit risk, financial effect of collateral, renegotiated financial instruments, and foreclosed collateral, were not modified by the IFRIC.

#### **IAS 28, Investments in Associates – Partial use of fair value for measurement of associates**

This amendment addresses the situation when a group reporting entity has two subsidiaries with investments in an associate, and one of the subsidiaries qualifies for the scope exclusion in IAS 28.1. The scope exclusion applies to venture capital funds, mutual funds, unit trusts and similar entities whose investments in associates are initially designated as at fair value through profit or loss or held for trading. Those investments are accounted for at fair value

in accordance with IAS 39, *Financial Instruments: Recognition and Measurement*. One subsidiary would be required to use the equity method; the other subsidiary would be required to use fair value. The issue is whether those different measurement bases should be retained in consolidation, or whether the group should apply IAS 28 to the entire investment in the associate.

One view in current practice is that the entire investment is accounted for under IAS 28 unless the entire investment qualifies for the IAS 28.1 scope exclusion. Another view in current practice is to first identify all direct and indirect investments in the associate, then use the scope criteria in IAS 28 to determine the proper accounting treatment for the different portions of the investment, which is consistent with the business purposes for which the portions of the investment are held. As reflected in the *Annual Improvements* Exposure Draft, the Board agreed with the latter view.

The IFRIC confirmed the proposed amendment to clarify that different measurement bases can be applied to portions of an investment in an associate when part of the investment is designated at initial recognition as at fair value through profit or loss in accordance with the scope exception in paragraph 1 of IAS 28. The IFRIC confirmed that an entity first determines whether it has significant influence over an associate in accordance with paragraphs 6 - 10 of IAS 28. Next the entity measures the portion of the investment in the associate to which the scope exception applies at fair value through profit or loss. The remaining investment in the associate is accounted for in accordance with IAS 28.

In addition, the IFRIC recommended that the Board consider including a similar amendment for accounting for interests in joint ventures, possibly by inclusion in the forthcoming IFRS on joint arrangements.

#### **IAS 34, Interim Financial Reporting – Significant events and transactions**

The IFRIC confirmed the proposed amendment to emphasize the existing disclosure principles in IAS 34 and to add further guidance to illustrate how to apply these principles. Although IAS 34 does not require specific disclosures, it does provide disclosure principles and examples of the types of transactions and events that would be significant. The amendment includes, among others, examples relating to fair value measurements. As part of its deliberations on the comments received, the IFRIC decided to include minor modifications to the proposed amendment, including an explanation in the Basis for Conclusions of the rationale for the removal of paragraph 18. The IFRIC believes that paragraph 18 essentially duplicates paragraph 10. Keeping paragraph 10 emphasizes disclosures that are required rather than those that are not.

#### **Proposed amendments recommended for removal, without finalization, from the Annual Improvements project**

The IFRIC confirmed that three of the proposed amendments should not be finalized, and should be formally removed from the *Annual Improvements* project. In reaching this conclusion, the IFRIC noted that the Board has an accelerated project to replace IAS 39, which is scheduled to be finalized in 2010. The IFRIC believes these issues should be reconsidered taking into account the broad IAS 39 replacement project rather than be considered on a piecemeal basis. The three proposed amendments were included in the Exposure Drafts of proposed Improvements to IFRSs published in the periods referenced below:

- IAS 39, *Financial Instruments: Recognition and Measurement* - Bifurcation of embedded foreign currency derivative (published August 2008). The proposal was to clarify that contracts denominated in foreign currencies that have one or more of the characteristics of a functional currency are

likely to be integral to the contractual arrangement and therefore closely related to the host contract, which prohibits separate accounting.

- IAS 39, *Financial Instruments: Recognition and Measurement* - Application of the fair value option (published August 2008). The proposal was to clarify that the fair value option only applies to financial instruments within the scope of IAS 39 that contain embedded derivatives.
- IAS 27, *Consolidated and Separate Financial Statements* - Impairment of investments in subsidiaries, jointly controlled entities and associates in the separate financial statements of the investor (published August 2009). The proposal was to amend IAS 27 to clarify that when an entity prepares separate financial statements it should apply IAS 39 for determining and measuring impairment losses on investments in subsidiaries, jointly controlled entities, and associates.

### **IFRIC work in progress**

#### **IFRS 1, First-time Adoption of International Financial Reporting Standards – Accounting for costs included in self-constructed assets on transition**

The IFRIC received two requests concerning the application of IFRS for an entity that has capitalized certain costs as part of self-constructed assets in accordance with a previous GAAP accounting policy. This previous GAAP accounting policy is also compliant with IFRS.

The requests focus on a change in accounting policy relating to actuarial gains and losses of defined benefit plans. Some of those gains and losses that would have been recognized in profit or loss had been appropriately capitalized within self-constructed assets as a component of labor cost. Under IFRS these costs could be part of plant and equipment, inventory, intangible assets, or construction contract costs if an entity applies the corridor approach to accounting for defined benefit plans. An IFRS preparer that recognizes all

actuarial gains and losses through other comprehensive income (OCI) would not capitalize any of these costs.

Upon first-time adoption of IFRS, entities may change their accounting policy for actuarial gains and losses from the corridor approach to a policy that recognizes those gains and losses through OCI. Paragraph D10 of IFRS 1 provides an exemption from allocating cumulative actuarial gains and losses between recognized and unrecognized components from inception of the employee benefit plan to the date of transition to IFRS. The first-time adopter (FTA) can elect to recognize all cumulative actuarial gains and losses in equity at the date of transition. If chosen, the election provides the FTA with relief from re-performing actuarial valuations.

Assuming that the amount of capitalized actuarial gains and losses included in other assets at the date of transition is material, the first issue is whether those assets require retroactive restatement. IFRS may not be clear on the appropriate treatment of the capitalized actuarial gains and losses when the entity changes its policy (from the corridor method to through OCI) at transition. The answer may depend on whether the change to no longer capitalizing these labor costs on transition to IFRS represents a change in accounting policy or a change in accounting estimate. If a change in policy, that would likely lead to a conclusion that the amounts should be restated; if a change in estimate, that would likely lead to a conclusion that restatement would be prohibited, with the change in estimate recognized prospectively.

Further, if retrospective restatement is not required, a second issue is whether the cumulative catch-up adjustment under the percentage of completion method in IAS 11, *Construction Contracts*, should be made directly to retained earnings at transition or recorded in profit or loss subsequent to transition. Again, the answer may depend on whether the cumulative catch-up

adjustment is viewed as a change in policy (retained earnings at transition) or a change in estimate (prospectively in profit or loss).

The IFRIC did not make any tentative decisions, but directed the staff to research the issues further.

#### **IFRIC outstanding issues update**

The IFRIC reviewed a summary of outstanding issues. With the exception of four issues, all requests received and considered by the staff were discussed at this meeting. The remaining four issues are expected to be discussed at the March 2010 IFRIC meeting. They are:

- IAS 19: Definition of plan assets
- IAS 21: Recycling of a currency translation adjustment on reduction of an investment in associate
- IAS 26: Accounting for plan assets in the financial statements of retirement benefit plans
- IAS 34: Disclosure of segment information on total assets

#### **Future Committee meetings**

The next Committee meeting is March 4-5, 2010.