STAFF PAPER

November 2012

IFRS Interpretations Committee Meeting

Project	IFRS Interpretations Committee Work In Progress		
CONTACT(S)	Michael Stewart	mstewart@ifrs.org	+44 (0)20 7246 6922

Objective of this paper

1. The objective of this paper is to update the IFRS Interpretations Committee (the Interpretations Committee) on the current status of issues that are in progress but that are not to be discussed by the Committee in the **November 2012** meeting.

2. We have split the analysis of the work in progress into three broad categories:

   (a) **ongoing issues:** submissions that the Committee is actively working on but the issue was not presented in this meeting;

   (b) **issues on hold:** submissions that the Interpretations Committee will discuss again at a future meeting but for some reason has decided to temporarily suspend work on the issue, for example, because there is an IASB project that might have a knock-on impact to the Interpretations Committee's discussions; and

   (c) **new issues:** submissions that have been received but have not yet been presented to the Interpretations Committee. Where this is the case, the submission has been attached as an appendix to this paper for information purposes only.

3. The following table summarises the work in progress that will be discussed at a future meeting:

Ongoing Issues			
Ref.	**Topic**	**Brief description**	**Progress**
IFRS 3-10	*Business Combinations:* Definition of a business	Request for 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.	At the September 2011 meeting, the Interpretations Committee observed that the difficulty in determining whether an acquisition meets the definition of a business in Appendix A of IFRS 3 is not limited to the acquisition of investment property. The Committee noted that this broader issue goes beyond the scope of its activities and should be addressed by the Board as part of its post-implementation review of IFRS 3. However, the Committee considered it to be useful for the Board's post-implementation review if it contributes to that review its experience and the results from the discussions on this issue. Consequently, the Committee directed the staff to continue their discussions with the staff of the US accounting standard-setter, the Financial Accounting Standards Board, and to continue their outreach to interested parties from other industry sectors with the aim of providing the IASB with relevant information for its post-implementation review.

Ongoing Issues			
Ref.	**Topic**	**Brief description**	**Progress**
IFRS 3-10	*Business Combinations:* Definition of a business (cont.)		Currently, we are asking preparers and industry sector groups what practical difficulties they have encountered when applying the definition of a business in Appendix A of IFRS 3 (revised 2008) and the related application guidance in paragraphs B7-B12 of IFRS 3 (revised 2008). In the outreach to preparers and industry sector groups we also ask for observations on specific fact patterns. Afterwards we want to discuss the results from our outreach with the staff of the FASB and the Post Implementation Review Team of the Financial Accounting Foundation. We plan to present an analysis of the outreach results and an update on our discussions with the staff of the FASB and the Post Implementation Review Team of the Financial Accounting Review Team of the Financial Accounting Foundation at a future meeting.

Ongoing Issues			
Ref.	**Topic**	**Brief description**	**Progress**
IAS 12-11	*Income Taxes:* Recognition of deferred tax for a single asset in a corporate wrapper.	Request for clarification of the calculation of deferred tax in circumstances in which the entity holds a subsidiary which has a single asset within it. Specifically, the question asked was whether the tax base that was described in paragraph 11 of IAS 12 and used to calculate the deferred tax should be the tax base of the (single) asset within the entity which holds it, or the tax base of the shares of the entity holding the asset.	At the May 2012 meeting, the Interpretations Committee noted significant diversity in practice in accounting for deferred tax when tax law attributes separate tax bases to the asset inside and the parent's investment in the shares and when each tax base is separately deductible for tax purposes. The Interpretations Committee also noted that the current IAS 12 requires the parent to recognise both the deferred tax related to the asset inside and the deferred tax related to the shares, if tax law considers them to be two separate assets and if no specific exceptions in IAS 12 apply. However, considering the concerns raised by commentators in respect of these requirements in the current IAS 12, the Interpretations Committee decided in the May 2012 meeting to not recommend the IASB to address this issue through an Annual Improvement, but instead to explore further options to address this issue that would result in a different accounting for this specific type of transaction. Consequently, the Interpretations Committee directed the staff to analyse whether the requirements of IAS 12 should be amended in response to the concerns raised by commentators. We plan to present this analysis at a future meeting.

Ongoing Issues			
Ref.	**Topic**	**Brief description**	**Progress**
IAS 7-8	*Statement of Cash Flows*—definitions of operating, investing and financing	The IASB asked the Interpretations Committee to review requests that it had received in relation to IAS 7 with a view to determining whether it could look collectively at issues that the Committee had recently discussed regarding the classification of cash flows under IAS 7. At the March 2012 meeting the IFRS Interpretations Committee observed that the primary principle behind the classification of cash flows in IAS 7 is that cash flows should be classified in accordance with the nature of the activity in a manner that is most appropriate to the business of the entity, in accordance with the definitions of operating, investing and financing activities in paragraph 6 of IAS 7. The Committee noted that it would use this as a guiding principle when analysing future requests on the classification of cash flows.	At the July 2012 meeting the Interpretations Committee discussed some fact patterns to illustrate the application of the identified primary principle behind the classification of the cash flows in an attempt to consider how to develop further guidance on the application of the primary principle. Those discussions revealed that the existing guidance did not lead to consistent applications of the principle. The Interpretations Committee directed the staff to consider how the description of operating, investing and financing cash flows can be made clearer and thus lead to more consistency in the application of the primary principle. The Interpretations Committee asked the staff to consider the relevance of the counterparty and the timing of the cash flows to their classification. The Interpretations Committee also asked the staff to consider the feedback received through the outreach performed on the Financial Statement Presentation Project (FSP) and also the comments received on the IASB's 2011 agenda consultation that relate to IAS 7. The staff has summarised the feedback received from the FSP project and the comments received from the agenda consultation. The staff has analysed the definitions of operating, investing and financing in paragraph 6 of IAS 7 and has identified some amendments to propose to improve these definitions. The staff will present the results of this further work at the January 2013 meeting.

Ongoing Issues			
Ref.	**Topic**	**Brief description**	**Progress**
IAS 40-1	IAS 40 – *Investment Property*: Accounting for a structure that appears to lack the physical characteristics of a building	Request for clarification on whether telecommunication towers in a jurisdiction should be accounted for as property, plant and equipment (PP&E), in accordance with IAS 16 *Property, Plant and Equipment*, or as an investment property, in accordance with IAS 40 *Investment Property*. The request describes a circumstance in which an entity owns telecommunication towers and receives rent revenue in exchange for leasing spaces in the towers to telecommunication operators to which they attach their own devices. The entity provides some basic services to the telecommunication operators such as maintenance services. In this request, the submitter is specifically seeking a clarification on: a. whether a telecommunication tower should be viewed as a 'building' and thus 'property', as described in paragraph 5 of IAS 40; and b. how the service element in the leasing agreement and business model of the entity should be taken into consideration when analysing this issue.	At the September 2012 meeting, the Interpretations Committee noted that central to this issue is the meaning of the term 'building' in paragraph 5 of IAS 40, which could determine whether the tower meets the definition of investment property for the purpose of IAS 40. The Interpretations Committee observed that the tower in the submission has some of the characteristics of investment property, in that spaces in the tower are let to tenants to earn rentals. However, the Interpretations Committee questioned whether the tower qualifies as a 'building' because it lacks features usually associated with a building such as walls, floors and a roof. The Interpretations Committee observed that the same question could arise about other structures, such as gas storage tanks and advertising billboards. The Interpretations Committee understands that the rental of spaces in telecommunication towers appears to be an emerging business model. On the basis of the discussions above, the Interpretations Committee requested the staff to analyse this issue further and to consider whether amendments to the scope of IAS 40 could or should be made. The analysis will be discussed at a future meeting. We plan to present this analysis at the January 2013 meeting.

Issues on hold			
Ref.	**Topic**	**Brief description**	**Progress**
IAS 2-1	*Inventories:* Long-term prepayments in inventory supply contracts.	Request for clarification on the accounting for long-term supply contracts of raw materials when the purchaser of the raw materials agrees to make prepayments to the supplier. The question is whether the purchaser/supplier should accrete interest on long-term prepayments by recognising interest income/expense, resulting in an increase of the cost of inventories/revenue.	At the January 2012 Interpretations Committee meeting, the Interpretations Committee noted that the Exposure Draft (ED) *Revenue from Contracts with Customers*, published in November 2011, contains requirements regarding the time value of money. Provided that the requirements on the time value of money are not changed in the final revenue standard, this would apply in the seller's financial statements when prepayments are received. The Interpretations Committee observed that the principles regarding accounting for the time value of money in the seller's financial statements are similar to those in the purchaser's financial statements. The Interpretations Committee decided to ask the IASB whether it agrees with the Interpretations Committee's observation, and, if so, whether there should be amendments made in the IFRS literature in order to align the purchaser's accounting with the seller's accounting. At the February IASB meeting, the IASB agreed that a financing component contained in a purchase transaction should be identified and recognised separately. As a result, interest would be accreted on long-term prepayments made in a financing transaction. However, the IASB noted that payments made when entering into a long-term supply contract might include premiums paid for securing supply or for fixing prices. The IASB noted that in such cases, it is not appropriate to accrete interest on these payments. Consequently, the IASB tentatively decided that it should be made clear that the clarifications proposed should only apply to financing transactions, ie transactions in which prepayments are made for assets to be received in the future. The IASB asked the Interpretations Committee to consider addressing the diversity in accounting, not by amending the current literature as part of a separate IASB project, but by clarifying the purchaser's accounting through an interpretation. We will prepare a paper to be presented at the January 2013 IFRS Interpretations Committee meeting, after the IASB has redeliberated on the ED on revenue.

New issues			
Ref.	**Topic**	**Brief description**	**Progress**
IFRS 10-2	IFRS 10 *Consolidated Financial Statements:* Protective rights and continous assessment of control under IFRS 10	Request for clarification of how the concept of ‘protective rights’ affects the control assessment made in IFRS 10. The submitter thinks that it is unclear whether that control assessment is changed when rights that are otherwise protective are ‘activated’ (ie become exercisable). The submitter questions whether the fact that protective rights become exercisable warrants a reassessment of the control conclusion which might lead to a change in the consolidation conclusion.	The staff will bring this issue to the January 2013 Interpretations Committee meeting. The submission is included in **Appendix A** of this paper.
IAS 39-33	IAS 39 – *Financial Instruments: recognition and Measurement* Mandatory convertible debenture issued by a joint venture	Request for clarification of the accounting for a convertible feature of a mandatory convertible debenture in a 50:50 joint venture if the conversion does not result in a change of ownership interest in the joint venture. According to the submitter, under current practice, such an instrument is in the scope of IAS 39, which requires the holder of the instrument to account for the convertible feature as an embedded derivative separately from the host contract. The submitter thinks that, as a consequence of accounting for the instrument as an embedded derivative, an investor would result in double counting profit or loss—from a change in the fair value of the embedded derivative and a change in the entity’s share of the net assets of the joint venture (which is recognised through the equity method). The submitter is concerned that such accounting could provide a structuring opportunity. If the instrument is converted, the convertible feature that has been measured at fair value as an embedded derivative, will form part of the investment in the joint venture. The submitter notes that, according to the definition of the equity method set out in IAS 28, the investment is initially recognised at cost.	The original submission is included in **Appendix B** of this paper. The staff will bring this issue to a future Interpretations Committee meeting.

New issues			
Ref.	**Topic**	**Brief description**	**Progress**
		Consequently, the submitter thinks that such an instrument should be scoped out from IAS 39 and should not be measured at fair value.	
IAS 28-9	IAS 28 – *Investment in Associates:* Associates and common control	Request for clarification on whether it is appropriate to apply the scope exception for business combinations under common control by analogy to the acquisition of an interest in an associate or a joint venture from an entity under common control. The submitter notes that diversity in practice seems to have arisen, because: • Some entities apply IAS 28 and account for these transactions at cost. Therefore, any difference between the cost of the investment and the investor's share of the net fair value of the investee's identifiable assets and liabilities is accounted for as either goodwill (included in the carrying amount of the investment) or as a gain. • Other entities apply the IFRS 3 scope exception by analogy and account for the acquired assets and liabilities at predecessor carrying amounts. Therefore, the difference between the cost of the investment and the aggregate book value of the acquiree's assets and liabilities is accounted for in equity.	The original submission is included in **Appendix C** of this paper. The staff will bring this issue to a future Interpretations Committee meeting
IAS 29-4	IAS 29 –*Financial* Reporting in Hyperinflationary Economies: Applicability of IAS 29	The Conceptual Framework states that for the purposes of assessing whether profit is earned, financial capital maintenance can be measured in either nominal monetary units or units of constant purchasing power. IAS 29 *Financial Reporting in Hyperinflationary Economies* notes that reporting an entity's operating result and financial position in a hyperinflationary economy is not helpful unless local currency values are restated. The Standard requires that historical cost and current costfinancial statements should be restated in terms of the measuring unit current at the end of the reporting period (IAS 29.8). The submitter raises queries about whether it is correct that IAS 29 is *not* required during hyperinflation when financial statements are prepared in terms of	The original submission is included in **Appendix D** of this paper. The staff will bring this issue to a future Interpretations Committee meeting

New issues			
Ref.	**Topic**	**Brief description**	**Progress**
		financial capital maintenance, in units of constant purchasing power, since all items in such financial statements would already be stated at the measuring unit current at the end of the reporting period.	
IAS 7-9	IAS 7 *Statement of Cash Flows*—Definition of cash equivalents	IAS 7 requires that the classification of an investment as a 'cash and cash equivalent' is based on the date of the acquisition of the investment. A submission has been received in which the submitter argues that the classification of investments as cash equivalents based on the remaining period to maturity as at the balance sheet date would lead to a more consistent classification than the current focus on the instrument's maturity from its acquisition date.	The original submission is included in **Appendix E** of this paper. We are planning to send an outreach request to gather evidence of the extent of the issue and diversity in practice. An analysis of the outreach results and of the issue will be presented at the January 2013 Interpretations Committee meeting.

4. This paper does not include requests on issues that are still at a preliminary research stage, including where further information is being sought from the submitter, or other parties, to define the issue more clearly.

5. The work in progress paper presented at the September 2012 Interpretations Committee meeting (refer to agenda paper 17) included an IAS 32 *Financial Instruments: Presentation* issue relating to a request for clarification on whether, in order to qualify for balance sheet offsetting, the counterparty (or counterparties) to a netting arrangement is required to have an equivalent right of set-off to that of the reporting entity.

6. This issue has since been withdrawn by the submitter. Before it was withdrawn, we conducted outreach to the International Forum of Accounting Standard Setters (IFASS) and various regulators to assess how widespread the issue is. In general the responses received to that outreach request indicated that while it would be helpful to have the wording in the Basis for Conclusions for IAS 32 clarified in respect of this issue, there wasn't such diversity observed in practice to classify

this issue as urgent. Consequently, following the withdrawal of the submission, we do not intend to bring this issue to the Interpretations Committee in the future.

7. We are reproducing in **Appendices A-E** the new requests that we have received. All information has been copied without modification. We deleted details that would identify the submitter of those requests.

Question
Does the Interpretations Committee have any questions or comments on the Interpretations Committee Outstanding Issues List?

Appendix A –IFRS 10 *Consolidated Financial Statements* Protective rights and continous assessment of control under IFRS 10

IFRIC potential agenda item request

This letter describes an issue that we believe should be added to the IFRIC's agenda. We have included a summary of the issue, a range of possible views and an assessment of the issue against IFRIC's agenda criteria.

The issue: protective rights and continuous assessment of control under IFRS 10

IFRS 10 *Consolidated Financial Statements* explicitly introduces the concept of protective rights. However, we believe that the application of the concept is unclear when rights that are otherwise protective are 'activated' – i.e. become exercisable. As explained in the rest of this letter, the fundamental issue is whether or not a change in the control conclusion is appropriate as a result of such rights becoming exercisable.

The following example is used to illustrate the issue:

> An operating company has all of its shares owned by another entity (the investor), which has held them for many years. The operating company enters into a loan arrangement with a bank, which contains several covenants. If a covenant is breached, then the bank has rights to veto major business decisions (considered to be the relevant activities of that company) and to call the loan. At the outset of the loan, the investor concludes that the bank's rights are protective, because they are designed to protect the interests of the bank without giving the bank power over the company. The investor continues to consolidate the company.
>
> After a period of time, due to its deteriorating financial position, the company breaches a covenant. The bank does not call the loan, although it retains the right to do so, and now also has the right to veto any major business decisions – i.e. it has veto rights over the relevant activities of the company. In some cases such a situation may be resolved in the short-term (covenants renegotiated), and in others it may not.

At the point in time at which the bank's right to call the loan and to veto any major business decisions becomes exercisable, what are the consolidation implications for the investor and the bank?

- The consolidation conclusion is or may be changed because there has been a change as to how decisions about relevant activities are made.
- The consolidation conclusion is not changed, because once rights are assessed as being protective they continue to be classified as protective throughout their lives, and protective rights are not taken into account in the control assessment. [1]

These outcomes are explored further below.

Current practice

[1] The issues set out in the two bullet points would also be relevant to the bank even if there was no investor that owned all of the shares of the borrower company – e.g. if the borrower company was listed.

There is currently no established practice because IFRS 10 is not yet in effect. However, we believe that this issue is likely to establish itself as a practice issue once entities begin to apply the standard. We believe that IFRIC should consider the issue because the potential outcomes (consolidate vs do not consolidate) could have a significant effect on the statement of financial position of entities, particularly lenders, and that consistency in this area is desirable.

Here we outline what we believe are the different approaches that an entity could take.

View 1: Consolidation conclusion is reassessed and may change

View 1 proceeds from the premise that IFRS 10 is based on the concept of ‘continuous assessment’. When protective rights become exercisable, there is a change in facts and circumstances, which warrants a reassessment of the control conclusion. In the example above this will, or may, lead the majority investor to conclude that it no longer controls the company and for the bank to conclude that it controls it. This is based on IFRS 10.8 and BC149-BC153.

Supporters of View 1 argue the following based on IFRS 10:

- Paragraph 8 takes precedence in assessing (reassessing) control, because it establishes the overall principle underlying the consolidation model. Therefore, even if the guidance in Appendix B can be read (explicitly or implicitly) to support View 2, this was not the Board’s intent.

- While BC152 refers to changes in market conditions not leading to a change in control, the text refers to market conditions *alone*. However, in accordance with BC153, if a change in market conditions triggers a consequential change in one of the three elements of control, then control should be reassessed.

Paragraph BC85 of IFRS 12 *Disclosure of Interests in Other Entities* states that traditional operating entities whose financing was restricted following a downturn in activities were not meant to be structured entities – i.e. entities that are controlled by rights other than voting rights. Supporters of View 1 believe that this statement is made solely in the context of disclosure, and was not intended to indicate that no reassessment of control is required in such circumstances.

View 2: Consolidation conclusion would not change even if reassessed

View 2 is based on the premise that protective rights are excluded from the control assessment and that rights that were originally determined to be protective do not stop being protective solely because the rights become exercisable due to the occurrence of the exceptional circumstances to which they relate. Accordingly, a reassessment of control at this point would lead to the same control conclusion as arrived at initially.

This view is supported by the following analysis of IFRS 10:

- Paragraph B26 has a direct definition of protective rights. Paragraph B27 states the consequence of meeting this definition, being that such rights do not lead to power.

- There is nothing in IFRS 10 to specify the fact that rights cease to be protective on the occurrence of the exceptional circumstances to which they relate. In fact, B27 refers to protective rights as being so by design, supporting that it is the initial set-up and purpose of rights that is the focus of application of the definition and not any later activation.

- Accordingly, if rights meet the definition of protective when they are initially set up, then they do not lose their protective character if they subsequently become exercisable.

Supporters of View 2 argue that there would be no purpose to having categorised rights as protective when they are dormant at the outset, only to reverse that once they become exercisable:

- At the outset it would be uncontentious that dormant protective rights could not affect the consolidation assessment, and this would be so without needing a special designation of those rights as 'protective'.

- The protective designation would then be withdrawn on the occurrence of the exceptional circumstances for which they are designed.

So, if View 2 does not apply, then at no time would the concept of protective rights have had any practical consequences.

Supporters of View 2 would also note the following points:

- View 2 is not denying the principle of continuous assessment. It is not trying to prevent a re-performance of the assessment in order to avoid a consequent change in the consolidation conclusion. Rather, it is saying that even if the assessment were re-performed, it would not result in a different conclusion because the rights are still protective.

- It may be important to consider the relationship between substantive and protective rights. For example, if substantive and protective rights were mutually exclusive categories, then that might support View 1 – on activation the rights become substantive and therefore can no longer be protective. However, supporters of View 2 would argue that B22, B25 and B26 of IFRS 10 appear clear that protective rights are also substantive – i.e. they are a subset of substantive rights. In effect, they would argue that the steps of analysis required by IFRS 10 are: (1) disregard any rights that are not substantive (B22); (2) some of the remaining substantive rights may be protective (B25); (3) so identify those substantive rights that are protective as defined (B26) and disregard them (B27).

Reasons for the IFRIC to address the issue

a) ***Is the issue widespread and practical?*** Yes. Protective rights are common in contractual arrangements, especially loans, and given the ongoing economic environment, we expect this issue to be very widespread.

b) ***Does the issue involve significantly divergent interpretations?*** Yes. Depending on the interpretation applied, the decision to consolidate vs not consolidate by a majority investor and a lender could have a significant effect on an entity's statement of financial position.

c) ***Would financial reporting be improved through elimination of the diversity?*** Yes. The comparability of financial statements will be improved if entities apply the concept of substantive vs protective rights on the same basis.

d) ***Is the issue sufficiently narrow…?*** Yes. We believe that the issue is capable of interpretation within the confines of IFRS 10. It is concerned with specific concepts in IFRS 10.

e) ***If the issue relates to a current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project?*** The issue does not relate to a current or planned IASB project.

Appendix B –IAS 39 *Financial Instruments: Recognition and Measurement* : Mandatory convertible debenture issued by a joint venture

Dear Sir / Madam,

We would like to put forward the below mention issue for IFRIC consideration which we believe will result in the improvement of financial reporting by eliminating inconsistencies.

<u>The Issue –</u>

How should the holder (also the equity investor) of the mandatory convertible debenture in a 50-50% joint venture, account for the convertible feature of the instrument when the conversion feature doesn't result in the change of the ownership interest in the joint venture i.e., both the investor holds equal amount of the convertible debenture and the ownership interest remain same pre and post conversion?

The issue can be illustrated by way of the following example –

A 50-50% Joint Venture has issued equal amount of mandatory convertible debenture to both of its investors, the instrument bears the coupon rate of 10% and term of 5 year, it will be converted into fixed number of equity shares upon maturity (i.e., 5 years) at a predetermined price. Both the investor holds same ownership interest (50%) before and after the conversion of the debenture, there is no change in the profit allocation and voting power.

<u>Current Practice –</u>

These types of instruments are currently within the scope of IAS 39 and the standard require the holder of the instrument to treat the conversion feature as an embedded derivative. Thus, the embedded feature is required to be separated from the host contract (debt instrument) and measured at fair value through profit and loss. The host contract will continue to be measured at amortised cost.

<u>Reason for IFRIC to address the issue –</u>

We believe that the treatment of such conversion feature as embedded derivate and measuring it at fair value through profit and loss results in the following inconsistencies –

- The change in the fair value of the embedded derivative is accounted through the income statement, the primary reason for the change in the fair value is the increase / decrease in the profit / loss of the JV, these changes have already been incorporated by the investor in its results by way of the equity accounting, as there is no change in the ownership interest after conversion - the % of equity accounting will remain same. Thus recording the change in the fair value through income statement over and above the equity pick up is resulting in double accounting of the same profit.

- Post conversion the embedded derivative portion of the contract will be treated as part of the investment in the joint venture, as the derivative have been measured at fair value and not the original price paid to acquire it. How does it meet the cost measurement criteria requirement under the equity accounting ?

- An ‘option to buy equity shares’ has an inherent fair value, as upon exercise it gives the holder a right to buy shares at a certain price / value. Hence it is right to recognise the same as an embedded derivative. However, the same may not be said of a ‘mandatorily convertible debenture’ as there is no such option and it is not providing any additional ownership interest in the above mentioned scenario.

- Such accounting may provide structuring opportunities where investor may initially require the JV to issue convertible instrument in order to take the MTM through income statement and then eventually converting it into equity instrument and carry at equity method.

These types of instrument which eventually doesn’t result in the change in the ownership interest should also be scoped out of IAS 39 by virtue of existing IAS 27 IG 7 and should not be accounted as fair value through profit and loss.

For any clarification or discussion please do not hesitate to contact me.

Appendix C–IAS 28 –*Investment in Associates*: Associates and common control

IFRS IC Potential Agenda Item

The issue

IAS 28 does not include a scope exemption for accounting for the acquisition of an interest in an associate or a joint venture from a party under common control. An entity may acquire an interest in an associate or a joint venture from another entity and both the acquirer and the vendor are controlled by the same party or parties both before and after the transaction.

IFRS 3.2(c) includes a scope exemption for business combinations between parties under common control. Two approaches for accounting for common control business combinations have developed that have broad support as acceptable in the financial reporting community. In practice, the first is seldom applied and the majority of business combinations under common control are accounted for under the predecessor approach described below.

These approaches are:

a) applying the principles of IFRS 3; or

b) recording the acquired assets and liabilities at predecessor carrying values (hereinafter referred to as ' the predecessor method'). In this approach, the assets and liabilities are not restated to their fair values and no goodwill is recognised. The difference between the consideration paid and aggregate book value of the acquiree's assets and liabilities is usually reflected in a component of equity such as retained earnings or a separate reserve.

IAS 28 requires that on initial recognition the interest in an associate or a joint venture is recognised at cost. Any difference between the cost of the investment and the investor's share of the net fair value of the investee's identifiable assets and liabilities is accounted for as either goodwill which is included in the carrying value of the investment or as a gain in the income statement (hereinafter referred to as ' the IAS 28 approach'). The absence of a scope exemption would seem to indicate that this approach should be applied to the acquisition of an interest in an associate or a joint venture from a party under common control.

Some have asserted that application of the IAS 28 approach may not be appropriate in common control transactions where consideration may not be the fair value of what is acquired (see Appendix A for an illustration). IAS 28.26 indicates that the principles underlying the procedures used in accounting for the acquisition of a subsidiary are used in accounting for the acquisition of an associate or a joint venture. This provision is referenced as support for applying the business combination scope exemption by analogy in the guidance published by at least two of the major accounting firms (see Appendix B)

Significant diversity in accounting for the acquisition of an interest in an associate from a party under common control seems to have arisen. Some entities account for these transactions using the IAS 28 approach while others apply the predecessor method relying on an analogy to the scope exemption in IFRS 3. This diversity reduces the comparability of financial statements.

Question:

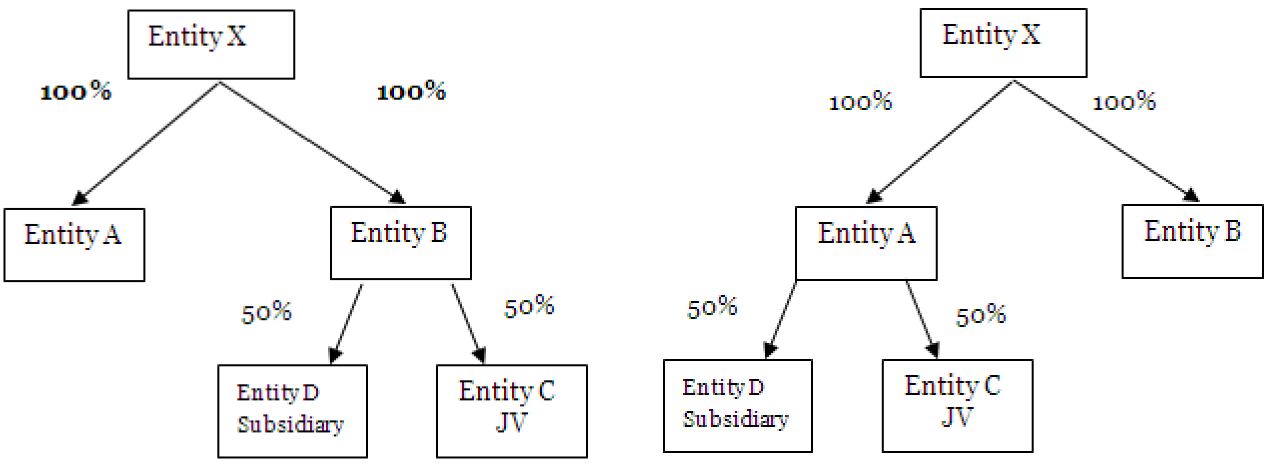
Is it appropriate to apply the scope exemption for business combinations under common control by analogy to the acquisition of an interest in an associate or a joint venture under common control? Application of the scope exemption would allow entities to develop an appropriate policy following the requirements of IAS 8.

Criteria	**Assessment**
Is the issue widespread and practical?	Yes. The issue affects all entities that acquire associates under common control transactions.
Does the issue involve significantly divergent interpretations (either emerging or already existing in practice)?	Yes. There is existing diversity in practice.
Would financial reporting be improved through elimination of the diversity?	Yes.
Is the issue sufficiently narrow in scope to be capable of interpretation within the confines of IFRSs and the Framework for the Preparation and Presentation of Financial Statements, but not so narrow that it is inefficient to apply the interpretation process?	Yes. The issue relates specifically to acquisition of associates under common control transactions. We however, acknowledge that there are broader issues around accounting for common control transactions.
If the issue relates to a current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project?	Not applicable.

Appendix A

Applying the IAS 28 approach in a common control transaction

Before transaction **After transaction**



Entity X has two wholly owned subsidiaries A and B. B has 50% interest in C (a joint venture) and D (a subsidiary). The remaining 50% interest in C and D is held by third parties (not related to X, A or B).

Both A and B are required to prepare and publish IFRS financial statements as does Entity X.

The carrying value of C and D in B's consolidated financial statements is CU 1,500 each. The net fair value of identifiable assets and liabilities of C and D (equalling the fair value of these investments) is CU 2, 500 each.

Entity B sells C and D to Entity A at carrying value and Entity A settles this by way of cash payment. The third party investors in C and D remain the same before and after the transaction.

As Entity B has control over Entity D, the transfer is a business combination under common control. Two approaches have developed in practice to account for these transactions. A will either record D as per IFRS 3 at fair value of CU2,500 generating a gain of CU1,000 or follow the predecessor method i.e. at the carrying value of CU 1,500 with no goodwill being recorded. In practice most would choose the predecessor method. Entity C is a joint venture and not a subsidiary. Entity A applies the IAS 28 approach. C is initially recognised at cost i.e. at CU 1,500 and then a gain of CU 1,000 (being the difference between the cost of investment and A's share of net fair value of identifiable assets and liabilities of C) will be recorded by Entity A. The substance of the transaction is the same (re-organisation of the group) but the accounting treatment could vary significantly.

Further, had Entity X transferred Entity B, C and D to Entity A instead of transferring only C and D, the common control exemption would have applied (because A would obtain control over B which is a business). Entity A would then record the transaction at predecessor values including Entity C which is a joint venture.

This illustrates that with a non-substantive change in the fact pattern, the accounting results could vary significantly.

Appendix B

Summary of guidance included in the Ernst and Young manual

There are two approaches that can be applied for such transactions:

Preferred approach

IAS 28 does not exempt transactions that between entities under common control. Furthermore, the IFRS 3 exemption is clearly for business combinations involving entities under common control – the acquisition of an associate is not a business combination. Therefore, IAS 28 applies as it would to any other acquisition of an associate and the common control exemption given in IFRS 3 cannot be applied.

Acceptable alternative approach

While IAS 28 does not specifically scope out transactions of this nature between entities under common control, the economic substance of these transactions must be considered. Additionally, paragraph 20 of IAS 28 indicates that the concepts of accounting for the acquisition of a subsidiary apply when acquiring an associate. This means that IFRS 3 cannot be applied 'literally' – otherwise none of its subsidiary-related principles could be applied to associates. Instead, the underlying principles must be established and applied with appropriate modifications to the equity method. As these principles include exempting acquisitions of subsidiaries or business between entities under common control, this option should also be available for the acquisition of an associate.

On this basis, the IFRS 3 scope exemption for business combinations among entities under common control can be extended to transactions involving associates.

However, this alternative may only be adopted where equity accounting is seen by management as a form of consolidation rather than a valuation technique in aspects where IAS 28 is silent or ambiguous. This view must be applied consistently to such areas, for example, profit elimination on downstream transactions.

Summary of guidance included in the KPMG manual

In general IFRSs do not make specific provision for the accounting for common control transactions in the separate financial statements when the entity elects to account for investments in subsidiaries at cost in accordance with IAS 27. The only exception is the establishment of a new parent in certain circumstances. In our view, an entity may apply the common control scope exclusion in IFRS 3 by analogy to the accounting for common control transactions in separate financial statements. When the entity elects to account for investments in subsidiaries in accordance with IAS 39, the common control exemption is not relevant and the requirements of IAS 39 apply.

In our view, the common control exemption in accounting for business combinations also applies to the transfer of investments in associates and jointly controlled entities between investors under common control. Although neither IAS 28 nor IAS 31 includes an explicit exemption for common control transactions, both equity accounting and proportionate consolidation follow the methodology of acquisition accounting. Therefore, we believe that it is appropriate to extend the application of the common control exemption.

Appendix D – IAS 29 –*Financial Reporting in Hyperinflationary Economies:* Applicability of IAS 29

The Issue:

The Conceptual Framework (2010), Par. 4.59 states:

> 'Financial capital maintenance can be measured in either nominal monetary units or in units of constant purchasing power.'

Par. 4.59 (a) does not specifically indicate whether financial capital maintenance in units of constant purchasing power is applicable during low inflation, high inflation, hyperinflation or deflation.

IAS 29 Financial Reporting in Hyperinflationary Economies, Par. 8 states:

> 'The financial statements of an entity whose functional currency is the currency of a hyperinflationary economy, whether they are based on a historical cost approach or a current cost approach, shall be stated in terms of the measuring unit current at the end of the reporting period.'

As a result of the fact that it is currently generally accepted by accountants in countries implementing IFRS that IAS 29 is always required during hyperinflation, please indicate whether the following two statements are valid or not:

1. In terms of The Conceptual Framework (2010), Par. 4.59 (a), financial capital maintenance in units of constant purchasing power is applicable during low inflation, high inflation, hyperinflation and deflation.
2. In terms of IAS 29 Financial Reporting in Hyperinflationary Economies, Par. 8, this standard is only required for the restatement of historical cost and current cost financial statements and not in the case of financial capital maintenance in units of constant purchasing power during hyperinflation since all items in the latter financial statements would already be measured either
   - (a) in terms of the measuring unit current at the balance sheet date (e.g., the CPI); or
   - (b) in terms of IFRS-authorized measurement bases current at the end of the reporting period (e.g., fair value, net realizable value, recoverable value, present value, etc.), excluding nominal Historical Cost (updated Historical Cost to be used under financial capital maintenance in units of constant purchasing power), i.e., excluding the stable

measuring unit assumption which is never implemented under financial capital maintenance in units of constant purchasing power.

Current Practice:

It is currently generally accepted by accountants in countries implementing IFRS that IAS 29 is always required during hyperinflation.

Reasons for the IFRIC to address the issue:

(a) The issue is widespread: most accountants believe that IAS 29 is always required during hyperinflation.

(b) The issue involves significantly divergent interpretations since a proposed emerging practice, namely, the Argentinean Federation's 2010 proposal for a future replacement of IAS 29, in the form of a draft IFRS, entitled IFRS 'X' INFLATION, amended in January 2012 to IFRS 'X' CONSTANT ITEM PURCHASING POWER ACCOUNTING, is based on the core principle of financial capital maintenance in units of constant purchasing power at all levels of inflation and deflation, including during hyperinflation. The IASB voted unanimously in May 2012 to submit the replacement of IAS 29 to research.

(c) Financial reporting would be improved through the elimination of the diversity, namely, indicating now that financial capital maintenance in units of constant purchasing power during hyperinflation is already authorized in IFRS, namely, in The Conceptual Framework (2010), Par. 4.59 (a). In fact, it was authorized in April 1989, the date the original Framework (1989) was authorized.

(d) The issue is sufficiently narrow in scope to be capable of interpretation within the confines of IFRSs and the Conceptual Framework, but not so narrow that it is inefficient to apply the interpretation process.

(e) The issue relates to the current IASB research project regarding the replacement of IAS 29. There is a pressing need for guidance sooner than would be expected from the IASB research project regarding the replacement of IAS 29 especially with regard to hyperinflation in Venezuela and high inflation in, for example, countries like Ethiopia (20%), Tanzania (15.7%), Mongolia (15.6%), Nigeria (11.7%), Angola (10%) and Argentina (10 or 20%).

Appendix E – IAS 7 Statement of Cash Flows—Definition of cash equivalents

A discussion on Cash and Cash Equivalents

THE ISSUE : The present definition of cash and cash equivalent do not properly represent the current day business practice It needs to be updated as the definition etc continues to be same from 1992

CURRENT PRACTICE :

(A) DEFINITION : PARA 6 OF IAS 7 DEFINES ;
Cash **comprises cash on hand and demand deposits.**
Cash equivalents **are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.**

IAS 7 further says
Cash and cash equivalents
7 Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. For an investment to qualify as a cash equivalent it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition. Equity investments are excluded from cash equivalents unless they are, in substance, cash equivalents, for example in the case of preference shares acquired within a short period of their maturity and with a specified redemption date.

8 Bank borrowings are generally considered to be financing activities. However, where bank overdrafts which are repayable on demand form an integral part of an entity's cash management, bank overdrafts are included as a component of cash and cash equivalents. A characteristic of such banking arrangements is that the bank balance often fluctuates from being positive to overdrawn.

9 Cash flows exclude movements between items that constitute cash or cash equivalents because these components are part of the cash management of an entity rather than part of its operating, investing and financing activities. Cash management includes the investment of excess cash in cash equivalents

(B) CURRENT PRACTICE ;

1.As a part of Cash management the entities put their money in Fixed deposit with Banks. The banks give the right to the entities to withdraw these amounts at very short notice and sometimes across the counter . However a rider is put that it is subject to approval by the bank even though no approval is denied. However adjustment to actual interest paid is adjusted for the actual period it is run and based on the applicable rates for the period run

. This results in refund of interest originally earned. The deposit is in tact and full amount is refunded.

2.Such deposits are not treated as demand deposits and hence not qualified as Cash

3.Such deposits are treated as Cash equivalent and treated as Investment of Cash management in terms of para 9 as stated above

4 Once it is treated as cash equivalent, then the question arises whether it is a cash equivalent or bank deposit on the date of the balance sheet . The definition of cash equivalent recognizes an item as Cash equivalent only if the investment is fro the period of 3 months or less from the date of original deposit . Other wise it only a bank deposit

5. Suppose a deposit is made on 1st Jan for 13 months and another deposit is made on 1st November for 2 months. Both are maturing on the same day namely 31st January of next year. On the balance sheet date namely 31st December, the first deposit is treated as a bank deposit not qualifying for Cash and cash equivalent while the second deposit will qualify as cash and cash equivalent which is not correct .

6. Hence to qualify for cash equivalent, it should be judged from the date of the balance Sheet and not from the date of the original investment

7. Further the definition of Cash to be amended to *Cash* **comprises cash on hand and free bank deposits from the narrow definition of** *Cash* **comprises cash on hand and demand deposits**

8 Bank Deposits are the mode of modern cash management and to take advantage of interest differential one selects a particular period but retaining in substance the right to withdraw at any time with no loss or insignificant loss

9. Similarly the explanation to of cash and cash equivalent in para 7 of IAS 7 reading : Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition., should be amended to read :an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of Balance Sheet

10. The cash Flow statement as per IAS 7 prepared between two balance Sheet date and measurement of Cash and Cash equivalent is more relevant from the balance sheet date rather than the date of investment as this forms part of cash management rather than investment

REASON FOR THE INTERPRETATION COMMITTEE TO ADDRESS THIS ISSUE

1. The issue assumes importance as how to classify a bank deposit on the date of the Balance Sheet. Classification of cash and Cash equivalent is from the date of the original investment and current and non current classification is from the date of the balance sheet. Hence in the example given above one deposit will get classified as Cash and Cash equivalent and other deposit as bank balance even though both are maturing on the same day .HENCE THIS PROBLEM IS WIDESPREAD AND PRACTICAL

2. Definition of cash to be amended to include free bank deposits as the word demand is narrow in interpretation . All Bank deposits are generally demand deposits but not all demand deposits are cash and deposits may be made with other entities also . Only on paper it will remain as demand deposits but generally not paid immediately. On the other hand all bank deposits except where lien is marked are demand deposits only. Hence the definition should be amended. HENCE THIS PROBLEM IS WIDESPREAD AND PRACTICAL
3. In the example given above two deposit maturing on the same day , one is treated as cash and cash equivalent and other is treated as bank deposits . HENCE THIS ISSUE INVOLVE SIGNIFICANTLY DIVERGENT INTERPRETATION AS PRACTICE AND RULES OF CNTRAL BANK DIFFER FROM COUNTRY TO COUNTRY For example In India, banks have a technical right of approval early with drawl where as in Australia a mall penalty is levied
4. The Financial reporting will definitely improved and Cash Flow will show the facts .
5. The issue involves change of definition or an interpretation can issued by IFRIC
6. The issue does involve cash Flow which is currently planned by IASB
7. KINDLY CONSIDER IN THE FORTH COMING INTERPRETATION COMMITTEE METTING