

# IFRIC Review.

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## This publication summarises the meeting of the IFRS Interpretations Committee on 8-9 September 2011

### Key decisions

#### ***IAS 37 Provisions, Contingent Liabilities and Contingent Assets* – Levies charged for participation in a market on a specified date**

The Committee received a request to clarify whether *IFRIC 6 Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment* should be applied by analogy to other levies charged for participation in a market on a specified date to identify the event that gives rise to a liability. The request for clarification relates to when a liability should be recognised for levies that are conditional on an entity participating in an activity on a specified date.

At the July 2011 meeting, the Committee discussed identifying the obligating event as either the participation in an activity on the date specified by the legislation or whether other preceding events create an earlier obligation.

At the September 2011 meeting, the Committee continued its discussions and decided that any guidance developed on this issue should be limited in scope to levies charged by public authorities. The guidance would not address payments related to private contractual arrangements. A constructive obligation, and thus, a liability under *IAS 37*, would not be created when an entity has an economic compulsion to participate in the market in the next period. Likewise, the obligation to pay a levy does not automatically create an asset.

The Committee directed the staff to research the following items for discussion at the next meeting:

- In clearly distinguishing recognition and measurement of the liability, does the obligating event arise at a point in time or progressively over time in certain circumstances?
- When the obligation is associated with an activity over multiple periods, what is the obligating event that creates the present obligation under *IAS 37*?
- In clearly distinguishing between exchange and non-exchange transactions with public authorities, in which circumstances will the obligation to pay a levy be associated with an asset as compared to an expense?
- Can a distinction be made between payments that are analogous to taxes and those that are analogous to licences?
- Are the principles in *IAS 12 Income Tax* relevant to levies?

## **IFRS 10 Consolidated Financial Statements – Transitional requirements, meaning of ‘the date of initial application’**

The Committee received a request to clarify the meaning of ‘the date of initial application’ in the transitional requirements of IFRS 10. The issue considered whether the date of initial application in IFRS 10 refers to the beginning of the first reporting period in which the entity adopts IFRS 10 (i.e., the current reporting period) or the beginning of the earliest period presented in the first financial statements in which the entity adopts IFRS 10.

The Committee noted that the general transition requirements in IFRS 10 require retrospective application, and because there are no exceptions, the Committee would expect the application of IFRS 10 from the beginning of the earliest period presented. The Committee observed that there is no definition of ‘the date of initial application’ in IFRS 10 and suggested that the IASB provide an exception if that was their intent when drafting IFRS 10. Therefore, the Committee decided that it would be best for the IASB to address this issue as a separate amendment to IFRS 10 as opposed to addressing it through an annual improvement. The Committee also suggested that the IASB should provide a definition for ‘the date of initial application’ to the Glossary of Terms.

### **Agenda decisions**

#### ***Issues not added to the Committee agenda:***

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

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

IFRS 3 *Business Combinations* – Acquirer in a reverse acquisition

IAS 27 *Consolidated and Separate Financial Statements* – Group reorganisations in separate financial statements

### **Tentative agenda decisions**

#### ***Issues tentatively not added to the Committee agenda:***

IAS 12 *Income Tax* – Rebuttable presumption to determine the manner of recovery

IAS 12 *Income Tax* – Corporate wrapper

### **Other issues considered**

#### ***Issues recommended to the IASB for amendment to existing IFRSs***

IFRS 1 *First-time Adoption of IFRSs* – Prospective application provisions for first-time adopters

#### ***Issues recommended for further discussion with the IASB***

IFRS 8 *Operating Segments* – Aggregation of operating segments and identification of the chief operating decision maker

#### ***Issues not recommended to the IASB as an Annual Improvements project***

IFRS 16 *Property, Plant and Equipment* – Recognition of compensation when it ‘becomes receivable’

### **Work in process issues**

IFRS 3 *Business Combinations* – Definition of a business

IFRS 11 *Joint Arrangements* – Acquisition of interest in a joint operation

IAS 7 *Statement of Cash Flows* – Classification of business combination cash flows

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## Summary of Committee discussions

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

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

The Committee noted that the specific fact pattern involving the creation of a newly formed entity is too broad to be addressed through an interpretation or through an annual improvement. Although the Committee believes that the issue of accounting for business combinations under common control is widespread with diversity in practice, they believe that the accounting for business combinations under common control would be best handled by the IASB as part of a broader project on common control transactions.

Consequently, the Committee decided not to add this issue to its agenda and recommended the specific fact pattern be considered by the IASB as part of its expected future project on common control transactions.

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

The Committee received a request for guidance on accounting for common control transactions. Specifically, the fact pattern outlined in the request considered by the Committee illustrated a transaction in which a parent company (Entity A), which is wholly owned by Shareholder A, transfers a business (Business A) to a new entity (Newco) which is also wholly owned by Shareholder A. The submission requested clarification on both the accounting at the time of the transfer of the business to Newco and whether an IPO that might occur after the formation of Newco is considered relevant in analysing the transaction.

Although the Committee believes that the issue of accounting for common control transactions is widespread with diversity in practice, they believe that the accounting for common control transactions is too broad to be addressed through an interpretation or annual improvement and would be best handled by the IASB as part of a broader project on common control transactions.

Consequently, the Committee decided not to add this issue to its agenda and recommended the specific fact pattern be considered by the IASB as part of its expected future project on common control transactions.

### **IFRS 3 Business Combinations – Acquirer in a reverse acquisition**

The Committee received a request for guidance as to whether a business that is not a legal entity could be considered the acquirer in a reverse acquisition under IFRS 3, citing guidance in paragraph B19 of IFRS 3 implying an acquirer needs to be a 'legal entity'.

The Committee indicated that the IFRSs and the IASB's *Conceptual Framework* do not require a 'reporting entity' to be a legal entity and an acquirer that is a reporting entity but not a legal entity can be considered to be the acquirer in a reverse acquisition.

The Committee does not believe that this issue is widespread and therefore decided not to add this issue to its agenda.

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## **IAS 27 Consolidated and Separate Financial Statements – Group reorganisations in separate financial statements**

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

The Committee noted that the guidance in paragraphs 38B and 38C of IAS 27 (amended 2008) or paragraphs 13 and 14 of IAS 27 (revised 2011) cannot be applied directly to reorganisations of groups that result in the new intermediate parent having more than one direct subsidiary because the assets and the liabilities of the new group and the original entity or group are not the same immediately before and after the reorganisation. Application of paragraphs 38B and 38C of IAS 27 (amended 2008) or paragraphs 13 and 14 of IAS 27 (revised 2011) is limited to cases when the assets and liabilities of the new group and the original group (or original entity) are the same before and after the reorganisation. Furthermore, the Committee noted that the guidance in paragraphs 38B and 38C of IAS 27 (amended 2008) or paragraphs 13 and 14 of IAS 27 (revised 2011) cannot be applied to reorganisations that result in the new intermediate parent having more than one direct subsidiary by analogy, because this guidance is an exception to the normal basis for determining the cost of an investment in a subsidiary under paragraph 38(a) of IAS 27 (amended 2008) or paragraph 10(a) of IAS 27 (revised 2011). Therefore, for the reorganisation described in the request, the normal basis for determining the cost of an investment in a subsidiary under paragraph 38(a) of IAS 27 (amended 2008) or paragraph 10(a) of IAS 27 (revised 2011) must be applied.

Given the guidance in IAS 27 (amended 2008) and IAS 27 (revised 2011), the Committee decided not to add this issue to its agenda.

## **IAS 12 Income Tax – Rebuttable presumption to determine the manner of recovery**

The Committee received a request for clarification of circumstances in which the presumption of manner of recovery of investment property can be rebutted in accordance with paragraph 51C of IAS 12 (revised 2010). Specifically, paragraph 51C notes that if a deferred tax asset or liability arises from investment property that is measured using the fair value model in IAS 40, there is a rebuttable presumption that the carrying amount of the investment property will be recovered through sale. The Committee received a request to clarify whether that presumption can be rebutted in cases other than the case described in paragraph 51C.

The Committee observed that the presumption can be rebutted when there is sufficient evidence to overcome the presumption. Given that paragraph 51C is expressed as a rebuttable presumption and does not preface the rebuttal presumption by stating ‘if and only if’, the Committee believes that the presumption can be rebutted in circumstances other than those described in paragraph 51C, provided that sufficient evidence is available to support that conclusion.

The Committee observed that the purpose of introducing a rebuttable presumption in paragraph 51C was to remove the subjectivity in determining the expected manner of recovery in paragraph 51. As a result, the Committee believes that, if the presumption is rebutted, the resulting deferred tax should reflect recovery of the entire carrying amount of the asset through use, rather than be based on any dual purpose analysis (i.e., bifurcated recovery of the carrying amount through use and through sale).

The Committee believes that IAS 12 is clear and that diversity in practice on this issue should not emerge. Consequently, the Committee tentatively decided not to add this issue to its agenda. The Committee will reconsider this tentative decision at the November 2011 Committee meeting.

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### **IAS 12 Income Tax – Corporate wrapper**

The Committee received a request to consider whether an entity that holds a subsidiary with a single asset should calculate deferred tax using the tax base described in paragraph 11 of IAS 12 or the tax base of the shares of the entity holding the asset. This question arises because it is common that the asset will be realised by selling the shares of the entity that holds the asset, rather than selling the asset on its own.

The Committee noted paragraphs 15 and 24 of IAS 12 require recognition of deferred taxes for all temporary differences associated with an asset except when certain conditions are met. The Committee also observed that paragraph 39 of IAS 12 requires recognition of deferred tax for all temporary differences associated with investments in a subsidiary that holds the underlying asset unless certain conditions are met. Finally, the Committee noted that paragraphs 7 and 38 of IAS 12 require that the tax bases used to calculate those temporary differences are those relating to both the underlying asset and the investment in the shares of the entity that holds the underlying asset. Consequently, the Committee believes that entities cannot avoid recognising deferred taxes for temporary differences relating to underlying assets even if the entity does not expect to dispose of the asset separately from the entity which holds the asset unless the initial recognition exceptions apply.

The Committee believes that the requirements of IAS 12 are clear in this area but acknowledged the broader concerns of this issue would be best addressed by the IASB. Consequently, the Committee tentatively decided not to add this issue to its agenda and will reconsider this tentative decision at the November 2011 Committee meeting.

### **IFRS 1 First-time Adoption of IFRSs – Prospective application provisions for first-time adopters**

The IASB asked the Committee to review a request to amend IFRS 1 to allow first-time adopters of IFRSs the same prospective application provisions in certain IFRSs as has been afforded to existing preparers of IFRS financial statements. For example, some of the recent annual improvements to IFRSs require or permit prospective application for existing IFRS preparers but there were no corresponding amendments made to IFRS 1.

An example identified by the staff relates to amendments to IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, which did not amend IFRS 1. The Committee discussed whether to recommend amendment to IFRS 1 to allow first-time adopters to apply paragraph 10A of IAS 20 prospectively, consistent with the same prospective application afforded to existing IFRS preparers. The staff would plan to request an amendment to IFRS 1 be done outside the annual improvements project to expedite the process so that entities adopting IFRS in 2011 can benefit from the amendment. The amendment would be in the form of an optional exemption, such that other entities that have already transitioned to IFRS in 2011 and produced quarterly reports would not be required to amend their annual financial statements.

The Committee decided to recommend that the IASB amend IFRS 1 in accordance with the staff's proposals.

### **IFRS 8 Operating Segments – Aggregation of operating segments and identification of the chief operating decision maker**

At the July 2011 meeting, the Committee reviewed a request received by the IASB for improvements to IFRS 8 in applying the aggregation criteria and identifying the chief operating decision maker (CODM). The Committee decided not to propose amendments to IFRS 8, but to recommend to the IASB that this issue should be considered in its post-implementation review of IFRS 8.

At the September 2011 Committee meeting, the Committee discussed constituent feedback that encouraged inclusion of the issue as part of the annual improvements project in order to progress the issue more quickly. The Committee considered potential components of IFRS 8 for possible inclusion in the annual improvements project including: (a) the meaning of 'similar economic characteristics' in paragraph 12; (b) the criteria for identifying similar segments in subparagraphs 12 (a-e); and (c) whether the definition of the CODM included in paragraph 7 should explicitly exclude non-executives from the CODM group.

The staff will update the IASB with the results of the Committee's deliberations at the IASB's September 2011 meeting.

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### **IAS 16 Property, Plant and Equipment – Recognition of compensation when it ‘becomes receivable’**

The Committee received a request to clarify the timing of recognition of compensation for insured property, plant and equipment (PPE) that has been impaired or lost (e.g., as a result of a natural disaster). The recognition requirements for this type of compensation are outlined in paragraph 65 of IAS 16. However, the request noted a lack of clarity as to when this compensation ‘becomes receivable’.

The Committee observed that the term ‘becomes receivable’ is sufficiently understood within IFRSs and that the term does not need to be clarified. The Committee also noted that there is neither significant diversity in practice, nor does it expect significant diversity in practice to emerge in the future. Consequently, the Committee decided to propose that the IASB should not add this issue to the annual improvements project.

### **IFRS 3 Business Combinations – Definition of a business**

The Committee received a request for clarification as to whether an asset with relatively simple associated processes would meet the definition of a business under IFRS 3. The request highlighted an example of an 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 (e.g., rent collection). The request noted that while some consider the acquisition of such an investment property together with an obligation to render services to be a business combination as defined in IFRS 3, others believe that it is the acquisition of a single investment property.

The Committee observed that IFRS 3 and IAS 40 *Investment Property* are not mutually exclusive, and therefore, an entity acquiring an investment property should consider whether it meets the definition of a business as defined in Appendix A of IFRS 3. The Committee noted that ancillary service guidance in paragraphs 11 to 14 of IAS 40 are intended to define an investment property from owner occupied property, and not to define a business combination from the acquisition of a single asset. An investment property acquired in a business combination would be recognised on the acquisition date at fair value in accordance with IFRS 3, while an investment property acquired outside a business combination would be recognised at cost in accordance with IAS 40.

The Committee directed the staff to analyse whether a clarification can be made to IAS 40 through the annual improvements process to provide further clarity on this topic. The Committee also acknowledged confusion in the determination of whether an acquisition meets the definition of a business, beyond that specified in the scope of this request for investment property clarification. The Committee believes that this issue is a broad issue that extends beyond the scope of its activities and should be addressed by the IASB as part of its post-implementation review of IFRS 3. However, for the purpose of communicating insights to the IASB as part of its post-implementation review, 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 on the definition of a business.

The staff will present the results of this further work at a future meeting.

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### **IFRS 11 Joint Arrangements – Acquisition of interest in a joint operation**

The Committee received a request to clarify the accounting by venturers for the acquisition of interests in jointly controlled operations or assets in IAS 31 *Interests in Joint Ventures* and the accounting by joint operators for the acquisition of interests in joint operations, as defined in IFRS 11, when the activities and assets underlying the jointly controlled operations or assets, or the joint operation, constitute a business.

The Committee observed that uncertainty exists in accounting for the acquisition of an interest in a joint operation in circumstances where the activity of the joint operation constitutes a business as defined in IFRS 3. In deliberations, the Committee did not reach a conclusion as to whether IFRS 3 is required to be applied to the particular assets and liabilities of a joint operation in circumstances where the joint operator acquires an interest in a joint operation in which the activity of the joint operation constitutes a business. While IFRS 3 applies to business combinations, the acquirer does not obtain control of the business in the acquisition of an interest in a joint operation.

To limit expected future diversity in practice following the adoption of IFRS 11, the Committee directed the staff to analyse whether a premium paid for synergies can be recognised as a separate asset under another IFRS in circumstances when an entity acquires an interest in a joint operation that constitutes a business, or whether IFRS 3 could be applied by analogy, and whether further guidance should be developed on this issue.

Further, the Committee observed that the IASB did not change the wording of the scope exclusion in paragraph 2(a) of IFRS 3 for ‘the formation of a joint venture’ when it decided to supersede IAS 31 with IFRS 11. It is the Committee’s understanding that the IASB did not want to change the scope of IFRS 3 and paragraph 2(a) of IFRS 3 should have been amended to say ‘the formation of a joint arrangement’ because IFRS 11 redefined and renamed the different types of joint arrangements. The Committee directed the staff to consider whether this issue can be addressed through the annual improvements process.

The staff will present its analysis and a draft annual improvement at a future meeting.

### **IAS 7 Statement of Cash Flows – Classification of business combination cash flows**

The Committee received a request for guidance on the classification of cash payments for deferred and contingent considerations under IAS 7. The request asked for clarity as to whether the settlement of contingent consideration should be classified as an operating, an investing or a financing activity in the statement of cash flows and whether the subsequent settlement of deferred consideration for a business combination should be classified as an investing or a financing activity in the statement of cash flows.

The Committee considered the issue to be widespread with divergence in practice and directed the staff to perform further research on these issues to determine whether the issues can be solved through the annual improvements process. The staff will present further analysis at a future meeting.

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## **Administrative session**

### **Committee outstanding issues report**

The Committee deferred further work on two topics given the interrelationship of the topics to two projects currently being discussed by the IASB (the revenue and leasing projects). The deferred Committee topics include:

- IFRIC 15 *Agreements for the Construction of Real Estate*: Clarification of ‘continuous transfer’: The submission requests clarification of the meaning and application of the concept of continuous transfer in paragraph 17 of IFRIC 15 in the context of the sale of apartments off plan.
- IAS 16 *Property, Plant and Equipment*: Contingent pricing of PPE and intangible assets: The submission requests clarification on how to account for contingent pricing for the outright purchase of a single item of PPE or an intangible asset.

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