IFRS news

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Tax accounting and the research agenda– all quiet on the western front?

The IASB discussed the research project on income taxes and decided to delete it from the work plan. Anna Schweizer from Accounting Consulting Services looks into the finer details of the issues around IAS 12 *Income Taxes*, which news we can expect in the near future and which not.

Accounting for income taxes has been on and off the IASB agenda over the last ten years. The IASB rejected a proposed replacement for IAS 12 following the unsuccessful convergence project with the FASB. Income taxes was then added as a longer-term research project to the work plan. Following some initial work on this project, the IASB held an educational session at their May meeting and decided to remove the project from its research pipeline as well.

We explore the potential areas to watch out for, and summarise what changes there may be in accounting for income taxes in the near future.

Main causes for practise issues arising in applying IAS 12

Some constituents question the conceptual merits of the current income tax accounting model because it does not measure taxes on a discounted or cash flow basis. Many others say the model is too complex and results in accounting that is difficult to understand and costly to produce. The IASB staff summarised a range of deficiencies on both a conceptual level and an application level.

Concerns with the existing model

Investors and other users of financial statements place importance on the effective tax rate reported. They are also interested in understanding entities' tax-related cash flows and expectations. This may include cash tax rates and risks related to future income tax cash flows and the economic value of expected income tax obligations or benefits.

Today's standard (or "model") does not readily convey this information and often results in detailed disclosures that are not easily understood. This causes investors to ignore much of what is reported or to search for alternative information.

Complexity and cost of reporting

Today's model tracks differences between the book and tax balances of assets and liabilities under the theory that such differences represent future taxable income or deductions. The model then calculates and records the future taxes that are to be paid (or reduced) because of those differences at the statutory tax rate.

Since the model was introduced, changes in accounting standards and tax laws have made those differences more numerous

and complex. Businesses have also expanded across more geographic markets and are subject to a wider range of tax laws.

The model also contains many intricate rules and a variety of exceptions designed to compensate for unintended consequences or impracticalities.

Entities need employees with deep knowledge of income tax laws and financial reporting standards to support their income tax accounting. The processes typically rely on spreadsheets that are outside of general ledger systems. Management often turns to outside service providers for help, increasing the cost of financial statement preparation. Yet accounting errors and control problems persist.

Economic faithfulness

One criticism of the current model is that it may not show an economic measure of income tax costs or benefits. For example, deferred income tax amounts shown on an entity's balance sheet are not discounted and are not risk-adjusted to account for the probability of realising a future tax benefit or incurring a future tax cost. The amounts therefore do not reflect the economic value of expected future cash flows, particularly when future recovery or settlement periods are prolonged.

Some constituents question whether deferred taxes faithfully represent an actual future cash inflow or outflow. For example, they suggest that, as long as management expects to continually reinvest in capital equipment, the related deferred tax liability will replenish, thereby deferring cash settlement indefinitely. However, others believe that a deferred tax liability represents a future cash outflow even though future investments may give rise to a similar liability.

The model's asymmetric treatment of deferred tax assets and liabilities is also a concern. That is, assets must be supported by the likelihood of having future taxable income, whereas liabilities are recorded even when future losses are anticipated.

The treatment of economically equivalent tax law changes can vary depending on how legislation is written. Tax rate changes produce an immediate adjustment to deferred taxes and tax expense, whereas tax credits and deductions are sometimes not recognised until the tax benefit is claimed.

Lastly, one of the more significant shortcomings of the existing standard is the absence of any guidance related to income tax uncertainties.

Change ahead?

Research agenda

In July the IASB reviewed its research process and decided upon the following:

- The Board does not start a standard-setting project before carrying out research to gather sufficient evidence that an accounting problem exists, that the problem is sufficiently important that standard-setting is required and that a feasible solution can be found.
- The objective of a research project is to gather evidence to establish whether standard-setting is required. In contrast, the objective of a standard-setting project is to develop or amend a Standard.
- Research projects do not automatically have a lower priority than standard-setting projects.
- The research pipeline lists all the research projects on which the Board expects to carry out work before the next Agenda Consultation, which is expected to start around 2021. If circumstances change, for example if significant new issues emerge, the Board may need to add to the pipeline.
- In 2015, the Board introduced a distinction between assessment-stage research projects and development-stage research projects. Introducing that distinction highlighted some important questions, but the distinction has proved too rigid to be useful for classifying research projects.
- To avoid burdening the stakeholders unnecessarily, the Board is unlikely to seek public feedback on research findings of all projects. The Board will seek such feedback only if it is needed.
- The evidence obtained from research projects will be summarised concisely and visibly, and made readily retrievable.

- A project resulting from a Post-implementation Review (PIR) may, depending on the nature of the topic and the extent of the evidence provided by the PIR, be a standard-setting project, a research project or a maintenance project.

Draft work plan

The Board confirmed that the focus of its activities should now move from transaction-specific standards-level projects to placing greater emphasis on:

- Supporting the implementation and consistent application of standards,
- Enhancing consistency between individual standards and the Conceptual Framework,
- Promoting better communication in financial reporting, and
- Keeping the research programme realistic and achievable.

What does this mean for tax?

The good news first: having learned from the 2011 Agenda Consultation, the IASB made a conscious decision to keep the list of active research projects short enough to be realistic (or at least more realistic than the previous one).

The comments received on the 2015 agenda consultation did not reveal a consistent message from a majority asking for the prioritisation of major change to the model. Thus the income tax research project was removed from the current work plan. Only the following changes are expected in the near future:

- A summary of the feedback received on the Exposure Draft on uncertain tax positions was discussed in July. The IC is expected to issue the final interpretation in the near future.
- The Annual Improvements cycle 2015-2017 is expected to include an amendment to the standard on the accounting for income tax consequences of payments on financial instruments that are classified as equity. The Exposure Draft is expected in Q3 2016.

Variable payments for the separate acquisition of PPE and intangible assets

The IC declined to address the accounting in such cases. The current diverse practice is expected to continue. This article looks at the impact and provides an insight into the issue.

The issue has been subject to discussions at the IC and the IASB for several years. Given the IC's conclusion that the issue was too broad for it to address, how should entities account for such transactions in the absence of further guidance?

Impact

Variable payments occur in a number of industries; the purchaser makes an initial payment to acquire an asset and promises subsequent payments to the vendor. The additional payments may be triggered, for example, by the occurrence or non-occurrence of future events, the performance of the asset, the financial return earned by the purchaser or the existence and quantity of natural resources.

There are two key accounting questions to consider:

1. Should a financial liability be recognised for variable payments on initial recognition of the related asset?
2. Are subsequent changes in the liability recognised in profit or loss or as adjustments to the cost of the asset?

There are two broad approaches applied in practice to accounting for variable payments. The effect on the balance sheet and the income statement could be material depending on the accounting approach selected.

Financial liability approach

The first approach is to apply a financial liability model, with the liability recognised at fair value at the date of recognition of the asset and subsequently remeasured through the income statement at every reporting date. The measurement of the liability is impacted by changes in the amount of payment, the likelihood of payment and the timing of payment. Significant income statement volatility may result as subsequent increases or reversals of the liability hit profit or loss.

Cost accumulation approach

The second approach is a cost accumulation model. A liability is recognised for estimated additional payments at the date of recognition of the asset. The liability is not remeasured until the change becomes highly probable or virtually certain. The adjustment to the liability is added to (or deducted from) the carrying amount of the related asset. This approach can expose assets to a greater risk of impairment as the cost accumulates.

Insight

Who is affected?

The issue is relevant for entities in a number of industries: pharmaceuticals, mining, oil and gas, telecommunications, entertainment and real estate, among others.

Examples of arrangements with variable payment terms include the purchase of a licence, purchase of a complex piece of equipment, acquisition of an in-process research and development project for a new drug, and service concession agreements.

What's next?

A company should choose a measurement approach that is appropriate for the type of transactions it does and then apply that approach consistently to all similar transactions. The approach followed should be clearly disclosed and may in some circumstances rise to the level of a critical judgement under IAS 1.

Impact of a decommissioning liability in determining the recoverable amount of a CGU

The IC declined to address this accounting issue for impairment tests under the fair value less costs of disposal approach. This article looks at the impact and provides an insight into the issue.

Most liabilities are ignored when calculating recoverable amounts in impairment testing. However, certain liabilities, such as decommissioning and restoration liabilities, cannot be separated from the related assets. This presents challenges when applying both the “fair value less costs of disposal” (FVLCOD) approach and the “value in use” (VIU) approach.

The IC considered how to apply the current guidance to a VIU calculation and declined to take the issue on to the agenda, as the guidance on VIU is clear. Neither an Interpretation nor an amendment to IAS 36 was therefore necessary. This article looks at the impact and provides an insight into the issue.

Impact

The scope of the IC agenda decision is limited to VIU calculations and particularly to the guidance in IAS 36 *Impairment of Assets*, paragraph 78. The standard requires the carrying amount of a recognised liability to be deducted from both the carrying amount of a CGU and the amount determined under VIU without the cash outflows associated with the liability. The IC observed this approach makes the comparison of the carrying amount and the recoverable amount meaningful. The agenda decision does not address how to incorporate the decommissioning obligation in a FVLCOD approach. We look at the challenges that arise in practice under VIU and FVLCOD below.

Insight

Who is affected?

The agenda decision is not relevant to the majority of liabilities, only those where the liability cannot be separated from the asset because a purchaser could not, or would not, acquire the asset or business without the liability. Thus, debt, working capital liabilities, deferred tax and other provisions are not relevant. The most common form of a non-separable liability is a decommissioning or restoration provision. These are most frequently seen in the mining, oil and gas and power generation industries although they appear elsewhere as well. They are usually associated with long-lived assets.

How does it work in practice in VIU?

The recoverable amount of the asset is determined under the VIU cash flow model approach described in IAS 36 *Impairment of Assets* in paragraphs 30 to 57. The VIU cash flow model excludes the cash outflows for decommissioning provision. The recorded amount of the provision is deducted from the amount determined in the VIU model to produce a net recoverable amount. The net recoverable amount is then compared to the carrying amount of the cash-generating unit including the decommissioning provision under IAS 37.

It is not appropriate to include the cash outflows for the decommissioning obligation in the VIU cash flow model. The model uses a discount rate that is specific to the assets being tested, reflects the time value of money and the return investors would require to invest in the asset. The performance of the asset will have a number of uncertainties associated with it; demand, price and operational risk among others.

The cash outflows associated with the decommissioning obligation have different uncertainties associated with them, but these are more around amount and timing rather than occurrence or performance risk. Future sales might be uncertain but the need to restore at the end of the asset's life is not. The effect of discounting these cash outflows using the asset rate rather than the risk free rate required by IAS 37 is likely to materially decrease the amount of the liability; this effect is known as the "discount rate cushion".

How does it work in practice in FVLCOD?

The impairment standard has little specific guidance on determining FVLCOD generally and none on using how to use FVLCOD as the recoverable amount for a cash-generating unit with a non-separable liability. Fair value is almost always developed using a cash flow model to produce an enterprise value unless there is a binding offer in place to sell the relevant asset or business. Fair value is defined in IAS 36 as the price that would be paid to sell an asset or assume a liability. The challenge arises from both the different approaches that might be taken to measure assets and liabilities at fair value as well as the practical approach often used by valuers.

Valuation practice is to produce a single cash flow model that produces a fair value for the business (cash generating unit) that includes the cash outflows for the liability. This approach is consistent with how a market participant would think about determining the fair value of the business. The core asset may have a very long life and decommissioning or restoration is many years in the future. Cash outflows for an obligation that will commence in twenty years in the future would seldom be specifically modelled, even by a party looking to buy the assets, but would be incorporated in a terminal value in the cash flow model.

However, if the mine or power plant is coming to the end of its life and the cash flows are imminent (say expected to begin within the next five years or the period covered by the specific projections) then a market participant may take a different approach to consider at what price it is willing to transact for the assets and the non-separable liabilities.

An alternative approach would be to calculate the fair value of the asset excluding the cash outflows to satisfy the liability and discount those using a market participant discount rate. Separately, the liability would be calculated using market participant assumptions, rather than an IAS 37 approach. The liability measurement should reflect the amount

the entity would need to pay a third party to assume the obligation. This would include a profit margin for the third party, plus a margin for estimation risk (that it might be underestimated) and similar market participant type assumptions. This is likely to produce a higher value for the liability than under IAS 37. The amount determined for the liability would then be deducted from the amount determined for the asset to produce a "net" fair value.

The recoverable amount determined under FVLCOD under either of the valuation approaches described is then compared to the carrying amount of the CGU including the decommissioning obligation measured under IAS 37.

Current IC rejections

Ruth Preedy and Anna Schweizer from Accounting Consulting Services examine some of the issues the IC recently rejected.

IAS 20 Government Grants – Accounting for repayable cash receipts

Cash received by the government repayable if exploit Research and Development (R&D)

The IC was asked to clarify if cash received from the government to perform R&D should be recorded as a government grant or a forgivable loan.

The fact pattern submitted was:

- Government gives cash to an entity to perform research.
- The cash is repayable if the entity decides to exploit and commercialise the results of the R&D.
- The IP is transferred to the government if the entity decides to abandon the project.

Financial liability under IFRS 9

The IC concluded that this arrangement was a financial liability. The entity can only avoid delivering cash by settling with a non-financial obligation (the IP.) The IC stated that the cash receipt was not in the scope of IAS 20 as the loan would not be forgiven. The entity would repay in cash or assets.

A financial liability is recorded at fair value initially. Any difference between the cash received and fair value could be treated under IAS 20.

The IC rejected the issue as the outreach showed limited diversity in practise and that IFRS was clear.

Practical implications

There are often funding arrangements in the Pharmaceutical and life science industry so whilst this fact pattern was very specific it could have broader implications. A venture capitalist might lend a Pharma company cash for R&D and request repayment if the drug is commercialised. The IP would be transferred if the Pharma Company chose to abandon the research. This rejection would suggest this should be treated as a financial liability.

IFRS 11 Joint Arrangements and IFRS 10 Consolidated Financial Statements – Accounting for loss of control transaction

The IC discussed whether an entity should remeasure its retained interest in the assets and liabilities of a joint operation when the entity loses control of a business, or an asset or group of assets that is not a business.

The submitter pointed out a potential conflict between the guidance in IFRS 11, which specifies that an entity recognised gains or losses on the sale or contribution of assets to a joint operation only to the extent of the other parties' interests in the joint operation, and the guidance in IFRS 10, which specifies that an entity remeasures any retained interest when it loses control of the subsidiary.

The IASB has recently deferred the effective date of suggested amendments to IFRS 10 and IAS 28 *Investments in associates* and decided to consider a number of related issues at a later date.

On this basis, the IC observed that the Post-implementation Review of IFRS 10

and IFRS 11 would provide the Board with an opportunity to consider loss of control transactions and a sale or contribution of assets to an associate or a joint venture.

Reporting entities should develop an accounting policy for these transactions and apply it consistently. The policy choice should be disclosed in the financial statements.

IFRIC 12 Service concession arrangements – Payments made by an operator to a grantor in a service concession arrangement

The IC received a request to clarify how an operator accounts for payments it makes to a grantor in a service concession arrangement (SCA) within the scope of IFRIC 12.

The IC observed the following in circumstances other than those in which the operator is collecting amounts (for example, sales taxes) on behalf of, and remitting them to, the grantor:

a. If payments are for a right to a good or service that is separate from the SCA, then the operator accounts for those payments applying the applicable IFRS Standard(s);

b. If payments are for the right to use an asset that is separate from the infrastructure within the scope of IFRIC 12, then the operator assesses whether the arrangement contains a lease, in which case IFRS 16 *Leases* (IAS 17 *Leases*) applies;

c. If payments are not for the right to a separate good or service or a separate right-of-use that is a lease, then the operator accounts for those payments as follows:

   i. If the SCA results in the operator having only a contractual right to receive cash from the grantor, the operator applies IFRS 15 (IAS 18) and accounts for those payments as a reduction of the transaction price;

   ii. If the SCA results in the operator having only a right to charge users of the public service, the operator has received an intangible asset in exchange for construction/upgrade services and the payments to be made to the grantor. Consequently, IAS 38 *Intangible Assets* applies; and

   iii. If the operator has both a right to charge users of the public service and a contractual right to receive cash from the grantor, the operator considers whether those payments represent payments made for the intangible asset, or consideration payable to a customer, or both.

The IC noted that it had determined in March 2016, that the issue of accounting for variable payments for asset purchases is too broad for it to address. It also noted that variable payments to the grantor when the intangible asset model applied is linked to the broader question of variable payments for asset purchases. It therefore decided not to add the issue to its agenda.

The IC agenda decision means that the current diversity in practice in accounting for variable payments when the intangible asset applies will continue.

Have you seen the latest PwC IFRS blogs

Jessica Taurae discusses the impact of the Brexit on financial reports

Mary Dolson and Arjan Brouwer discuss OCI – should it be a recycle-bin or an elephant's graveyard?

Difficulties in translating IFRS

IFRS has greatly contributed to bringing transparency, comparability, and efficiency to financial markets. However, as the guidance is written in English, the risk of incorrect translation is likely (or is it probable?). Sam King-Jayawardana explores the current research

In July the Australian Accounting Standards Board (AASB) and the Korean Accounting Standards Board (KASB) published their findings on inconsistencies in interpreting IFRS resulting from different cultural backgrounds and languages in a joint research project. The project focused on the different terms of likelihood in IFRS and how these may be interpreted different in Korea and Australia.

What are "terms of likelihood"?

"Terms of likelihood" explain the probability of a transaction or event occurring. IFRS contains at least 35 of these terms. Each variant of these terms has, in the minds of auditors and preparers, a different percentage or range of probability. As a result, differences in interpretation can have a significant impact, determining the recognition (or not), and extent of assets and liabilities.

What terms were selected?

Thirteen terms of likelihood were selected, covering the full range of probability from the highest ("virtually certain") to the lowest ("remote").

What differences were identified?

The report highlights two main reasons for divergence: translation into other languages, and differing cultural interpretations.

The research identified that many of the subtleties of the English language are lost, with terms such as "probable" and "likely", "virtually certain" and "reasonably certain", and "highly unlikely" and "extremely unlikely", all being translated into one single Korean term, respectively. As each of these in commercial practice has an associated level of probability, it may result in an asset not being recognised in Australia (as the realization of income is, for example, not "virtually certain"), while another jurisdiction may recognise such an asset as a lower threshold is applied.

Similarly, different jurisdictions ascribe a different level of numerical probability to each term of likelihood. For example, in Australia, "probable" and "reasonably possible" are interpreted with a numerical probability of 10% lower compared to the same terms in Korea. Conversely, "unlikely" and "highly unlikely" are interpreted with a 10% greater probability in Australia than their Korean equivalents. This may result in the recognition of a transaction in one jurisdiction, while an identical transaction would not be recognised in another.

What actions will result from this research?

The research recommends that, among other things, the IASB reduce the number of different terms of likelihood used and establish a limited set of such terms. Additionally, it encourages standard-setting outreach and consultative process to specifically seek input on translation and interpretation issues in different jurisdictions.

Finally, in redeliberating the Conceptual Framework, consideration should be given to the level of conservatism factored in by preparers and auditors. Current proposals regarding the recognition criteria may result in probability being removed, potentially narrowing interpretation of this probability term. However, this may still result in some standards retaining likelihood criteria, resulting in potential divergence in application. Furthermore, even if probability is removed from the Conceptual Framework, a high degree of judgement might still be required to determine whether an asset or liability should be recognised.

Cannon Street Press

Applying IFRS 9 Financial Instruments with IFRS 4 Insurance contracts

The IASB tentatively decided to simplify the disclosures applicable to entities applying the temporary exemption to align the scope of the fair value disclosures with the scope of the credit-risk disclosures. Accordingly, an entity should disclose the fair value at the end of the reporting period and the change in the fair value during the reporting period for the following two groups of financial assets separately:

- Financial assets with contractual cash flows that are solely principal and interest, excluding financial assets held for trading or managed on a fair value basis, and
- All other financial assets. That is, any financial assets:
  - With contractual cash flows that are not solely principal and interest, or
  - That are held for trading or managed on a fair value basis.

The Board expects to issue the final amendments in September 2016.

IAS 40 Investment property: Transfers of investment property

The IASB considered an analysis of comments on the Exposure Draft and tentatively decided to proceed with finalising the proposed amendments subject to the following revisions:

- Clarifying that a change in management's intentions, in isolation, provides no evidence of a change in use,
- Amending two examples so they could refer to property under construction or development as well as to completed property,
- Emphasising in the Basis for Conclusions that an entity should use judgement in assessing whether a property meets, or ceased to meet, the definition of investment property,
- Allowing an entity to apply either of two transition approaches, and
- Requiring entities to disclose information about any reclassification of property as a result of applying the simplified transition approach.

The effective date is expected to be 1 January 2018 with earlier application permitted. The Board instructed the staff to begin the balloting process and expects to issue the proposed amendments in Q4 2016.

Annual Improvements 2014-2016 cycle

The IASB considered comments received and tentatively decided to finalise the following:

- IFRS 1 *First-time adoption of IFRS*: Deletion of short-term exemptions for first-time adopters (1 January 2018).
- IFRS 12 *Disclosure of interests in other entities*: Clarification of the scope of the disclosure requirements (1 January 2017).
- IAS 28 *Investments in associates and joint ventures*: Measuring investees at fair value through profit or loss on an investment-by-investment basis. (1 January 2018).

The Board instructed the staff to begin the balloting process and expects to issue the proposed amendments in Q4 2016.

Conceptual Framework:

The Board tentatively decided to confirm the proposed definitions of an asset and a liability, and the approach to recognition. The IASB instructed the staff to present at a future meeting a revised discussion about how selecting a measurement basis might be influenced by the characteristics of an asset or a liability, and how an asset or a liability contributes to future cash flows.

At the September meeting the IASB will discuss further concepts and whether and how the CF should acknowledge that asymmetric treatment of gains (or assets) and losses (or liabilities) could be selected.

The leases lab

This month Professor Lee Singh investigates the new standard's possible impact on the Communications industry with the help of his assistant Maria Williams.

Hypothesis

IFRS 16 will have significant impact on the Communications industry, including how contracts are entered into and Key Performance Indicators (KPIs) in financial statements.

Testing and analysis

Most communications companies enter into lease agreements both as lessors and lessees. While lessor accounting remains largely unchanged under IFRS 16, the new standard introduces a single accounting treatment for lessees and the recognition of a right of use asset and lease liability for all leases.

IFRS 16 also introduces a new definition of a lease, which might result in a change in the types of arrangements that qualify as leases. Under IFRS 16, a contract contains a lease if fulfilment depends on an identified asset and the contract conveys the right to control the use of that identified asset through the ability to obtain substantially all of the economic benefits from the use of the asset.

Judgement will be required when evaluating the following types of arrangements to determine whether there is a lease under IFRS 16:

- Arrangements with other operators including indefeasible right of use arrangements or lease circuits;
- Leasing of space or capacity in exchanges;
- Sharing of assets including towers and radio access network sharing arrangements
- Provision of equipment to customers through which the operator delivers communications services such as set top boxes and modems, data centre services and other outsource arrangements; or
- Rental contracts for retail outlets whether individual outlets, high street locations or shops within department stores.

The level of detail included in each contract will affect the analysis of whether a contract contains a lease; for example, the practical

ability of a lessor to substitute an alternative asset, or the extent to which a portion of an asset is specifically identified.

IFRS 16 is also expected to affect a range of key financial metrics. The PwC Global Lease Capitalisation survey published in February 2016 indicated that a median debt increase of 21% is expected for communications companies and a median 8% increase in EBITDA (increases as rental expense is replaced by interest, depreciation and amortisation). Impacts are also expected on CAPEX (increases as right of use assets are recognised on the balance sheet), net debt and gearing ratios (increases as lease liability included in net debt) and other performance metrics. As a result, companies in the communications industry might need to renegotiate covenants and revise dividend policies.

Conclusion

IFRS 16 will have significant impact on the communications industry. Judgement will be required in applying the new definition of a lease to contracts and application of the new rules is expected to affect KPIs and future commercial negotiations.

Practical application

The new standard will not only result in the recognition of operating leases on the balance sheet but have wide ranging effects on business operations and performance metrics. We recommend early planning to assess the likely ramifications of the new standard.

See more of the Professor's analysis of the impact of IFRS 16 Leases on the communications industry in our Spotlight.

IFRIC Rejections in short - IAS 23

Rachel Pang of Accounting Consulting Services examines the practical implications of IC rejections related to IAS 23.

Looking for an answer? Maybe it was already addressed by the experts.

The Interpretations Committee (IC) regularly considers anywhere up to 20 issues at its periodic meetings. A very small percentage of the issues discussed result in an interpretation. Many issues are rejected; some go on to become an improvement or a narrow scope amendment. The issues that are not taken on to the agenda end up as "IFRIC rejections", known in the accounting trade as "not an IFRIC" or NIFRICs. The NIFRICs are codified (since 2002) and included in the "green book" of standards published by the IASB although they technically have no standing in the authoritative literature. This series covers what you need to know about issues that have been "rejected" by the IC. We go standard by standard and continue with IAS 23 as per below.

IAS 23 covers recognition, measurement, and disclosure of borrowing costs. The IC has rejected two matters related to IAS 23 over the last decade.

Foreign exchange and capitalisable borrowing costs (January 2008)

The IC rejected a submission asking for guidance both on the treatment of foreign exchange gains or losses and on the treatment of any derivatives used to hedge such foreign exchange exposures.

The IC noted that the principle of IAS 23 *Borrowing costs* requires an entity to capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset.

The IC also noted that determining the borrowing costs directly attributable to the acquisition of a qualifying asset is difficult and judgement is required. Consequently, how an entity applies IAS 23 to foreign currency borrowings is a matter of accounting policy requiring the exercise of judgement. Clear disclosures of significant accounting policies and judgements are required by IAS 1. The IC concluded that it was unnecessary to provide application guidance.

The IC also noted that the IASB specifically considered this issue as part of its project to amend IAS 23 and decided not to develop further guidance in this area. The IC therefore rejected this issue.

The meaning of "general borrowings" (November 2009)

The IC received a request on what borrowings comprise "general borrowings" when capitalising borrowing costs. The request asked for guidance on the treatment of general borrowings used to purchase a specific asset other than a "qualifying asset".

The IC noted that only specific borrowings for the purpose of obtaining a qualifying asset can be excluded from determining the capitalisation rate for general borrowings. One might argue that borrowings related to specific assets other than qualifying assets cannot be excluded from determining the capitalisation rate for general borrowings. Alternatively, the general principle of the standard states that the borrowing costs directly attributable to the acquisition of a qualifying asset are borrowing costs that would have been avoided had the expenditure on the qualifying asset not been made.

The IC noted that determining the borrowing costs that are directly attributable to the acquisition of a qualifying asset is difficult and judgement is required when applying the standard. The IC also noted that the IASB would consider adding this issue to the annual improvements project.

The IASB noted that IAS 23 excludes only debt used to acquire qualifying assets from the determination of the capitalisation rate and decided not to include this issue in the annual improvements project. The IC therefore rejected this issue.

Fun stuff

Give your brain a workout and keep it buzzing during the quiet(er) summer months! Have fun with Ernesto Mendez' picture quiz and spot the five differences related to the new revenue standard.

Have you seen the latest news on Brexit?

In Depth: Accounting implications of UK's Brexit decision Volume 1

Webcast: Impact on accounting and reporting

Practice aide: A framework to guide disclosures

Solution:

1. Old (IAS 18 – Revenue) and new (IFRS 15 – Revenue from contracts) revenue standards.

2. The IASB announced the deferral of effective date of the IFRS 15 in 2015. The mandatory effective date is now 1 January 2018.

3. An entity is a principal if it controls a specified good or service before that good or service is transferred to a customer. In addition to possession, an entity obtains the control if either (a) it has right to direct another party to provide a good or service to the customer on its behalf; or (b) it provides a significant service of integrating goods or services provided by another party into the specified good or service for which the customer has contracted.

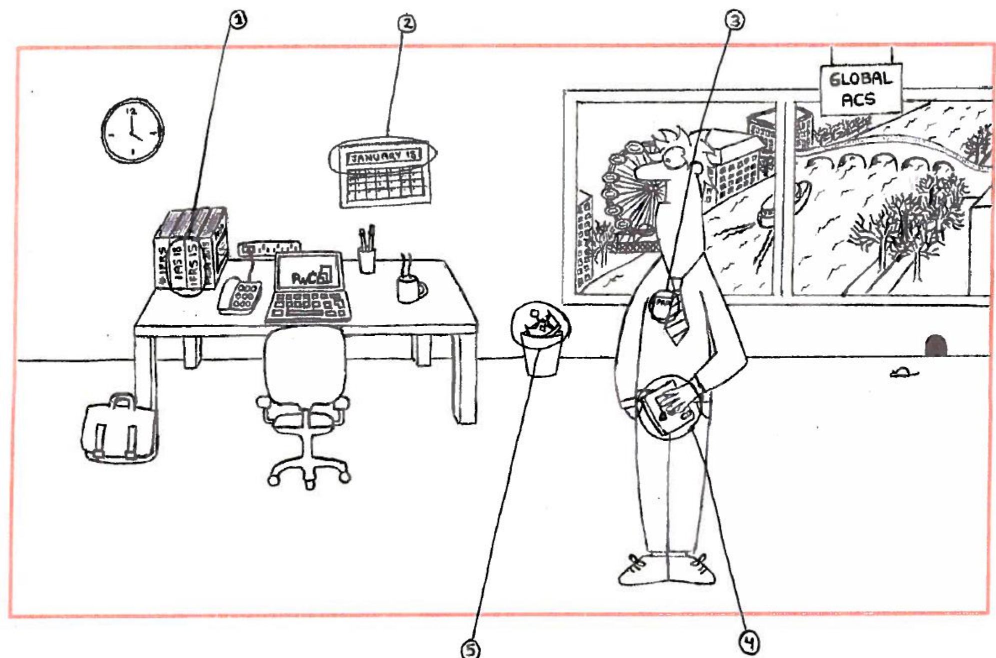
An entity is an agent if its performance obligation is to arrange for the provision of the specified good or service by another party.

4. The licence guidance applies when the promise to grant a licence is a separate performance obligation (PO) or a pre-dominant item within a combined PO(s). A promise to grant a licence is a promise to provide a right to access (recognise over time) if all of the following criteria are met:

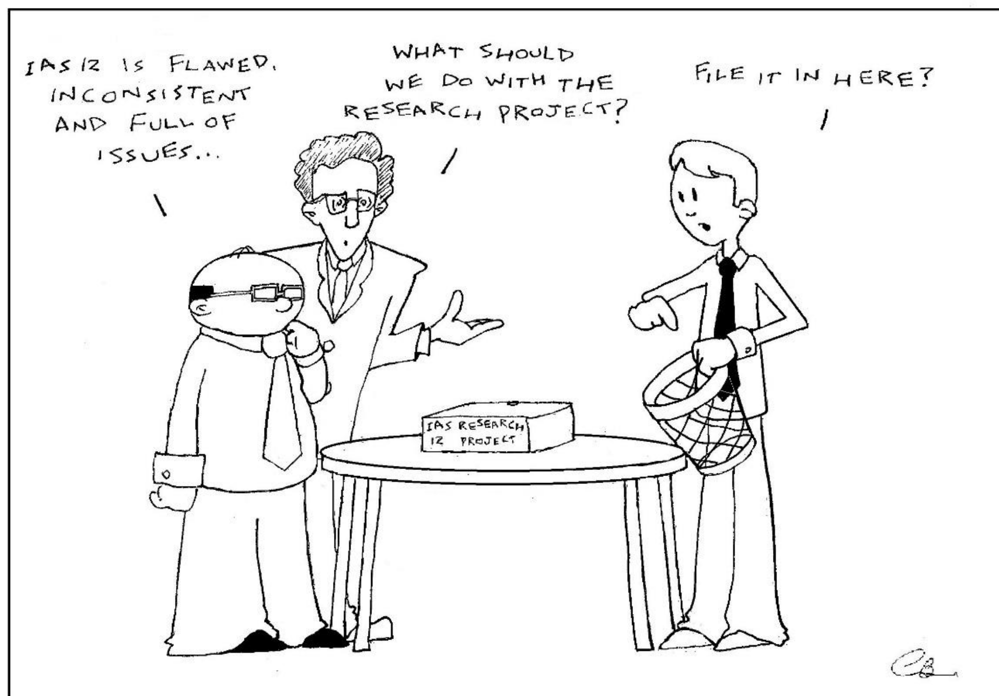
a. An entity is required or reasonably expected to undertake activities that significantly affect the intellectual property;
b. such rights granted directly expose the customer to any positive or negative effects of the entity's activities; and
c. those activities do not result in separate good or service transferred to the customer.

A licence is a right to use (recognised at point in time) if any of the above criteria are not met.

5. IFRS 15 provides an exception to the model for licences in connection with sales based royalties. An entity records sales or usage-based royalty revenue only when the related sales or usage occurs. This guidance is applicable to arrangements where the licence represents a separate PO or a pre-dominant item within a combined PO(s).



The bit at the back...



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