IFRIC Update

From the International Financial Reporting Interpretations Committee

November 2009

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

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

The IFRIC met in London on 5 and 6 November, when it discussed:

- Accounting for production stripping costs
- Extinguishing financial liabilities with equity instruments
- Agenda decisions
- Tentative agenda decisions
- Work in progress

Other information

- Future IFRIC meetings 2010
- Past issues of IFRIC *Update*

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Accounting for production stripping costs

The IFRIC received a request for guidance on accounting for stripping costs incurred in the production phase of a mine.

The staff prepared two papers on the topic, discussed in two separate IFRIC sessions. In the first session, the preliminary discussion paper was introduced, including a brief discussion on the nature of stripping costs and current practice that has been observed relating to the accounting for stripping costs. Niall Weatherstone, Chief Adviser - Evaluation from Rio Tinto, made a presentation giving some additional background on the mechanics of and economic considerations within the mining industry, and answered questions from the IFRIC members on related issues.

In the second session, the staff presented a paper where methods of accounting for production stripping costs under various frameworks were analysed. The accounting methods are as follows:

1. Expense production stripping costs as incurred.
2. Capitalise stripping costs as a cost of inventory, as variable production costs.
3. Capitalise stripping costs and attribute to reserves benefited in a systematic and rational manner.
4. Capitalise stripping costs using a strip ratio.

In their discussions, the IFRIC noted that, in general, mine development costs qualify for capitalisation. Further, the IFRIC noted that, in principle, where production stripping activities create a future benefit for the entity, the related costs would qualify for recognition of, or as part of the carrying amount of, an asset. The IFRIC discussed each of the four accounting methods presented in the paper.

The IFRIC agreed with the submission that significant diversity exists in practice on this issue. The IFRIC concluded that this diversity exists because the issue is not addressed in IFRS, and other frameworks (eg, US GAAP and Canadian GAAP) contain differing guidance on the issue. This has a significant effect on international financial reporting. The IFRIC also concluded that the issue is sufficiently narrow in scope to be capable of interpretation within the confines of IFRS.

Although this issue is within the scope of the IASB's project on *Extractive Activities*, the IFRIC noted that the project would not provide definitive guidance on production stripping costs in the foreseeable future. Therefore, the IFRIC decided to add the issue to its agenda and directed the staff to develop a paper for discussion at the January 2010 meeting, with a focus on defining the scope of the interpretation.

Go to the top of this page

Extinguishing financial liabilities with equity instruments

The IFRIC completed its redeliberations of draft Interpretation D25 *Extinguishing Financial Liabilities with Equity Instruments* at this meeting. The IFRIC considered a revised draft Interpretation and basis for conclusions prepared by the staff that addressed the issues raised by respondents during the comment letter process.

Redeliberations

During the meeting the IFRIC redeliberated the scope of the draft Interpretation, and the conclusions reached in the IFRIC's consensus.

Scope

The IFRIC noted that in response to D25, certain respondents requested clarification of the scope in the final Interpretation. In redeliberating at this meeting the IFRIC clarified that the scope excludes transactions when:

- the creditor is also a direct or indirect shareholder, and is acting in its capacity as a direct or indirect existing shareholder, or
- the creditor and the entity are controlled by the same party or parties before and after the transaction and the substance of the transaction includes an equity distribution from or contribution to the entity, or
- the extinguishment of the financial liability by issuing equity shares is in accordance with the original terms of the liability.

How should the equity instruments be measured?

In the draft Interpretation, the IFRIC proposed that equity instruments issued to extinguish a financial liability should be measured initially at the fair value of the equity instruments issued or the fair value of the liability extinguished, whichever is more reliably determinable. However, many respondents proposed that a preferred measurement basis should be determined to avoid an 'accounting choice' developing in practice.

In its redeliberations, the IFRIC noted that respondents had mixed views on whether the preferred measurement basis should be the fair value of the equity instruments issued or the fair value of the financial liability extinguished. The IFRIC concluded that the fair value of the equity instruments issued should be the preferred measurement basis. This reflects the IFRIC's view that this measurement basis:

- is consistent with the consensus that the issue of an entity's equity instruments is 'consideration paid', and
- best reflects the measurement of consideration paid to extinguish the financial liability, which often includes a premium that the holder requires to enter into the debt for equity swap.

The IFRIC concluded that if the fair value of the equity instruments issued is not reliably determinable, measurement should reflect the fair value of the liability extinguished.

The IFRIC also clarified that:

- paragraph 49 of IAS 39 *Financial Instruments: Recognition and Measurement* is not applied in measuring the fair value of all or part of a financial liability extinguished that includes a demand feature, because the extinguishment transaction suggests that the demand feature is no longer substantive.
- the fair value of the equity instruments issued should be measured at the transaction date, consistent with the guidance in IFRS 3 *Business Combinations*.

Partial extinguishment

Many respondents requested clarification of the guidance on partial extinguishments included in the draft Interpretation. During redeliberations, the IFRIC clarified that the issue of an entity's equity instruments may reflect consideration paid for both the extinguishment of part of a financial liability and the modification of the part of the liability that remains outstanding.

To reflect this, an entity shall allocate consideration paid between the part of the liability extinguished and the part of the liability that remains outstanding. The entity shall consider this allocation in determining the profit or loss to be recognised on the part of the liability extinguished and in its assessment of whether the terms of the remaining liability have been substantially modified.

Respondents to the draft Interpretation also requested that additional guidance be provided on determining whether the part of the financial liability that remains outstanding has been substantially modified. The IFRIC concluded that such guidance is outside the scope of this Interpretation.

Vote to confirm consensus

The IFRIC considered whether the changes from the draft Interpretation were such that re-exposure was required in accordance with the IFRIC Due Process Handbook. The IFRIC noted that these changes provide clarification that the constituents requested, specifically in the scope, identifying a preferred measurement basis and clarifying guidance on partial extinguishment situations.

However, the IFRIC concluded that the fundamental requirements of the Interpretation have not changed from those exposed for comment and consequently decided that re-exposure was not required.

The IFRIC decided that the Interpretation shall be applied for annual periods beginning on or after 1 April 2010 with earlier application permitted. Retrospective application is required only from the beginning of the earliest comparative period presented.

The IFRIC voted and confirmed the consensus, subject to its final review of drafting changes, and submitted the Interpretation to the Board for ratification at the Board's meeting in November 2009.

[Go to the top of this page]

IFRIC agenda decisions

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

IFRS 3 *Business Combinations* - Measurement of NCI

The IFRIC received requests to clarify whether an entity should apply the measurement choice in paragraph 19 of IFRS 3 (as revised in 2008) to all components of non-controlling interest (NCI). Paragraph 19 states that, for each business combination, the acquirer shall measure any NCI in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets.

In addition to minority interests as defined in IFRS 3 (issued in 2004), the definition of NCI includes, for example, options or warrants over an acquiree's own shares that are classified as equity and the equity component of a convertible instrument. Some believe that if an entity chooses to measure NCI as a proportionate share of the acquiree's identifiable net assets, it should apply this measurement to all components of the acquiree's equity. The consequence would be that instruments other than those equivalent to minority interest would be measured at nil on acquisition.

The IFRIC noted that it would be appropriate that the measurement choice should apply only to instruments currently entitled to a proportionate share of the acquiree's net assets. However, because IFRSs do not provide sufficient guidance to resolve this issue an amendment to revised IFRS 3 is required. Therefore, the IFRIC decided not to add the issue to its agenda but to recommend that the Board amend IFRS 3 to address the issues identified as a part of the annual improvements project.

IFRS 3 *Business Combinations* - Unreplaced and voluntarily replaced share-based payment awards

The IFRIC received requests to clarify the measurement of unreplaced and voluntarily replaced share-based payment awards of an acquiree in a business combination. IFRS 3 (as revised in 2008) contains requirements for outstanding acquiree share-based payment awards that the acquirer is obliged to replace or that expire as a consequence of the business combination. However, IFRSs do not provide requirements for other acquiree share-based payment awards. As a consequence, divergent interpretations have developed in practice as to how those awards should be accounted for.

The IFRIC noted that when an acquirer does not replace unexpired share-based payment awards of the acquiree or voluntarily issues share-based payment awards to replace such awards, at least some portion of the amount recognised for those awards should be regarded as part of the consideration transferred in the business combination. However, because IFRSs do not provide sufficient guidance to resolve this issue an amendment to IFRS 3 (as revised in 2008) is required. Therefore, the IFRIC decided not to add the issue to its agenda. However, the IFRIC recommended that the Board amend revised IFRS 3 to address the issues identified as a part of the annual improvements project.

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* - Write-down of a disposal group

The IFRIC received a request for guidance on how a disposal group should be recognised at the lower of its carrying amount and fair value less costs to sell when the difference between the carrying amount and fair value less costs to sell exceeds the carrying amount of non-current assets.

The IFRIC noted paragraph 23 of IFRS 5 requires the impairment loss recognised for a disposal group to be allocated to reduce the carrying amount of the non-current assets of the group that are within the measurement requirements of IFRS 5. This can result in a conflict between IFRS 5's requirement to recognise the disposal group at fair value less costs to sell and its limitation on the assets to which that loss can be allocated. Consequently, the IFRIC noted that divergence could arise in practice.

The IFRIC also noted that the issue could be widespread in the current economic environment. The IFRIC concluded that the issue relates to the basic requirements of IFRS 5 and therefore could not be addressed by an interpretation. For this reason, the IFRIC decided not to add the issue to its agenda. However, the IFRIC recommended that the Board considers an amendment to IFRS 5 to address this issue.

IAS 23 *Borrowing Costs* - Meaning of 'general borrowings'

The IFRIC received a request for guidance on what borrowings comprise "general borrowings" for purposes of capitalisation of borrowing costs in accordance with IAS 23. IAS 23 paragraph 14 states that "*To the extent that an entity borrows funds generally and uses them for the purpose of obtaining a qualifying asset*, the entity shall determine the amount of borrowing costs eligible for capitalisation by applying a capitalisation rate to the expenditures on that asset. The capitalisation rate shall be the weighted average of the borrowing costs applicable to *the borrowings of the entity that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset*" (emphasis added). The request asked for guidance on the treatment of general borrowings used to purchase a specific asset other than a qualifying asset as defined in the standard.

The IFRIC noted that because paragraph 14 of IAS 23 refers only to qualifying assets, some conclude that borrowings related to specific assets other than qualifying assets cannot be excluded from

determining the capitalisation rate for general borrowings. Others note the general principle in paragraph 10 that the borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made. The IFRIC noted that paragraph 11 of IAS 23 states 'the determination of the amount of borrowing costs that are directly attributable to the acquisition of a qualifying asset is difficult and the exercise of judgement is required.'

The IFRIC noted that the standard itself acknowledges that judgement will be required in its application. In addition, the IFRIC concluded that any guidance it could provide would be in the nature of application guidance rather than an interpretation. The IFRIC also noted that the Board will consider whether to add this issue to the annual improvements project. At its meeting in July, the Board noted that IAS 23 excludes only debt used to acquire qualifying assets from the determination of the capitalisation rate. The Board decided not to include this issue in the annual improvements project.

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

Go to the top of this page

Tentative agenda decisions

*The IFRIC reviewed the following matters and tentatively decided that they should not be added to the IFRIC agenda. These tentative decisions, including recommended reasons for not adding the items to the IFRIC agenda, will be reconsidered at the IFRIC meeting in January 2010. Constituents who disagree with the proposed reasons, or believe that the explanations may contribute to divergent practices, are encouraged to communicate those concerns by 14 December 2009 by email to: **ifric@iasb.org**. Communications will be placed on the public record unless the writer requests confidentiality, supported by good reason, such as commercial confidence.*

IFRS 2 *Share-based Payment* - Transactions in which the manner of settlement is contingent on future events

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

- a future event that is outside the control of the entity or the counterparty; or
- a future event that is within the control of the counterparty.

The IFRIC noted that paragraphs 34-43 of IFRS 2 provide guidance only on share-based payment transactions in which the terms of the arrangement provide the counterparty or the entity with a choice of settlement.

The IFRIC noted that IFRS 2 does not provide guidance on share-based payment transactions for which the manner of settlement is contingent on a future event that is outside the control of either the entity or the counterparty. The IFRIC noted that many other issues have been raised concerning the classification and measurement of share based payments as cash settled or equity settled. The IFRIC therefore noted that it would be more appropriate for these issues to be considered collectively as part of a post implementation review of IFRS 2.

Therefore, the IFRIC [decided] not to add these issues to its agenda and recommended that those issues be dealt with by the IASB in a post-implementation review of IFRS 2.

IFRS 4 *Insurance Contracts* and IAS 32 *Financial Instruments Presentation* - Scope issue for investments in REITs

In some jurisdictions, a Real Estate Investment Trust (REIT) is a tax designation used for an entity investing in real estate that meets certain criteria to attain preferential income tax status. In some of these cases, the contractual terms of the ownership units of such REITs require it to distribute 90% of the Total Distributable Income (TDI) to the investors. The remaining 10% of TDI may be distributed at the discretion of management. The IFRIC received a request to provide guidance on whether the discretion to distribute the remaining 10% of TDI met the definition of a Discretionary Participation Feature (DPF) as defined in IFRS 4. If the DPF definition is met, IFRS 4 permits the ownership units to be classified as a liability rather than classified into debt and equity components in accordance with IAS 32.

The IFRIC noted that the objective of IFRS 4 is to specify the financial reporting for insurance contracts. The IFRIC noted that the definition of DPF in Appendix A of IFRS 4 requires, amongst other things, that the instrument provides the holder with guaranteed benefits and that the DPF benefits are additional to those guaranteed benefits. Further, the IFRIC noted that there must be guaranteed benefits to the holder for the definition to be met and that such guaranteed benefits referred to are typically those present in insurance activities.

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

IAS 18 *Revenue* - Receipt of a dividend of equity instruments

The IFRIC received a request for guidance on the recognition as revenue of a dividend in the financial statements of an investor when the dividend is in the form of an investee's own equity instruments.

The IFRIC noted that current IFRSs provide guidance on when revenue arising from dividends shall be recognised. The IFRIC noted that when all ordinary shareholders are issued a dividend of an investee's own equity instruments on a pro-rata basis there is no change in the financial position or

economic interest of any of the investors. In this situation, in accordance with paragraph 29(a) of IAS 18, the dividend is not recognised as revenue because it is not probable that there is an economic benefit associated with the transaction that will flow to the investor.

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

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

The IFRIC received a request for guidance on whether a reporting entity has the ability in accordance with IFRS to present financial statements that include a selection of entities that are under common control, rather than being restricted to a parent/subsidiary relationship defined by IAS 27.

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

The IFRIC also received a request for guidance on the ability in accordance with IFRS for a reporting entity to be redefined to exclude from comparative periods entities/ businesses that have been carved-out of a group. The IFRIC noted that the Board's common control project referred to above will also consider the accounting for demergers, such as the spin-off of a subsidiary or business.

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

IAS 27 *Consolidated and Separate Financial Statements* - Presentation of comparatives when applying the 'pooling of interests' method

The IFRIC received a request for guidance on the presentation of comparatives when applying the 'pooling of interests' method for business combinations between entities under common control when preparing financial statements in accordance with IFRS.

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

IAS 32 *Financial Instruments: Presentation* - Application of the 'fixed-for-fixed' condition

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

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

The IFRIC noted that the Board is currently undertaking a project to improve and simplify the financial reporting requirements for financial instruments with characteristics of equity. A key objective of this project is to develop a better distinction between equity and non-equity instruments. This includes consideration of the current fixed-for-fixed condition in IAS 32.

Consequently, the IFRIC concluded that the Board's current *Financial Instruments with Characteristics of Equity* project is expected to address issues relating to the fixed-for-fixed condition on a timely basis. Therefore, the IFRIC [decided] not to add this issue to its agenda.

IAS 38 *Intangible Assets* - Amortisation method

The IFRIC received requests for guidance on the meaning of 'consumption of economic benefits' when determining the appropriate amortisation method for an intangible asset with a finite useful life. The methods considered in the submissions are the straight-line method and the unit of production method (including a revenue-based unit of production method).

The IFRIC noted that paragraph 98 of IAS 38 states that 'the method used is based on the expected pattern of consumption of the expected future economic benefits embodied in the asset...' It also noted that the determination of the amortisation method is therefore a matter of judgement. In addition, in accordance with paragraph 122 of IAS 1 *Presentation of Financial Statements*, significant judgements made in determining the amortisation methods should be disclosed in the notes to the financial statements.

The IFRIC noted that any guidance it could give on making the judgements necessary to determine the amortisation method would be in the nature of application guidance rather than an interpretation. Therefore, the IFRIC [decided] not to add the issue to its agenda.

Go to the top of this page

IFRIC work in progress

IFRS 2 *Share-based Payment* - Classification of vesting conditions

The IFRIC received a status update on the requests for clarification on the classification of vesting conditions in a share-based payment. The staff anticipates bringing this issue to the January 2010 meeting for further consideration by the IFRIC.

IAS 39 *Financial Instruments Recognition and Measurement* - Unit of account for forward contracts with volumetric optionality

The IFRIC received a request to add an item to its agenda on providing guidance on whether a contract that (a) obliges an entity to deliver (sell) at a fixed price a fixed number of units of a non-financial item that is readily convertible to cash and (b) provides the counterparty with the option to purchase also at a fixed price a fixed number of additional units of the same item can be assessed as two separate contracts for the purpose of applying paragraphs 5-7 of IAS 39.

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

IFRIC outstanding issues update

The IFRIC reviewed a summary of outstanding issues. With the exception of two issues, all requests received and considered by the staff were discussed at this meeting, will be discussed at a future IFRIC meeting or are being considered by the Board.

Go to the top of this page

Future IFRIC meetings 2010

The IFRIC's meetings are expected to take place in London, UK as follows:

7 and 8 January

4 and 5 March

6 and 7 May

8 and 9 July

2 and 3 September

4 and 5 November

In addition to the meetings listed above, the IFRIC may hold meetings for a preliminary discussion of some staff papers. Attendance by IFRIC members at these meetings is voluntary and no decisions on technical issues will be made. If the IFRIC holds a preliminary meeting, it will normally take place on the Wednesday afternoon before the IFRIC meeting.

Meeting dates, tentative agendas and additional details about the next meeting will also be posted to the **IASB website** before the meeting. Instructions for submitting requests for Interpretations are given on the IASB website - **click here**.

Go to the top of this page

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Go to the top of this page

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