



Philippine Interpretations Committee

Guidance on Financial Reporting

Q&As on Philippine Financial Reporting
Standards

June 2021



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Introduction

When it comes to accounting for their transactions and disclosing the required information in their financial statements, companies in the Philippines have been consistently applying Philippine Financial Reporting Standards or PFRSs since the adoption of these standards in 2005. However, preparers of financial statements oftentimes encounter instances where there is no explicit guidance in the PFRSs applicable to specific transactions. Thus, there is a need to supplement PFRSs through the issuance of PIC Q&As which are approved and adopted by the Financial Reporting Standards Council (FRSC).

To further provide guidance on recurring financial reporting issues, the PIC has decided to issue this Financial Reporting Guidance (FRG), which is, in large part, based on the final decisions and rejection notices of the IFRS Interpretations Committee (IFRIC), the interpretations body supporting the IASB. Through this FRG, the PIC aims to:

- Provide continuous and up-to-date guidance on emerging issues elevated to the IASB or the IFRIC and for which these two bodies have already expressed their views;
- Provide additional guidance to both the preparers and the users of the financial statements, including those in the academe, about complex financial reporting issues; and,
- Provide guidance, with a simplified discussion of the basis for the final decisions reached by the IASB and IFRIC, for ease of reference and understanding.

This FRG is meant to be 'organic' in the sense that it will change and adapt accordingly as our financial reporting landscape evolves. We anticipate that this document will be updated on an annual basis to keep readers up-to-date on any future changes in our financial reporting framework.



Philippine Interpretations Committee

Date approved by PIC: June 30, 2021

(Original signed)

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PFRS 2, *Share-based Payment*

PFRS 2 – Price difference between the institutional offer price and the retail offer price for shares in an initial public offering

Issue

Should an entity account for a price difference between the institutional offer price and the retail offer price for shares issued in an initial public offering (IPO) within the scope of PFRS 2, *Share-based Payment*?

Background

In an IPO, the final retail price could be different from the institutional price because of:

- a. an unintentional difference arising from the book-building process; or
- b. an intentional difference arising from a discount given to retail investors by the issuer of the equity instruments as indicated in the prospectus.

There are situations in which the issuer needs to fulfil a minimum number of shareholders to qualify for a listing under the stock exchange's regulations in its jurisdiction. In achieving this minimum number, the issuer may offer shares to retail investors at a discount from the price at which shares are sold to institutional investors.

Consensus

To consider whether the transaction is a share-based payment transaction within the scope of PFRS 2, it must involve the receipt of identifiable or unidentifiable goods or services from the retail shareholder group.

Paragraph 13A of PFRS 2 requires that if consideration received by the entity appears to be less than the fair value of the equity instruments granted or liability incurred, then this situation typically indicates that other consideration (i.e. unidentified goods or services) has been (or will be) received by the entity.

Applying this guidance requires judgment and consideration of the specific facts and circumstances of each transaction.

In the circumstances underlying the transaction, the entity issues shares at different prices to two different groups of investors (retail and institutional) for the purpose of raising funds, and that the difference, if any, between the retail price and the institutional price of the shares in the fact pattern appears to relate to the existence of different markets (one that is accessible to retail investors only and another one accessible to institutional investors only) instead of the receipt of additional goods or services, because the only relationship between the entity and the parties to whom the shares are issued is that of investee-investors.

Consequently, the guidance in PFRS 2 is not applicable because there is no share-based payment transaction.



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In the fact pattern considered, the listing is not received from the institutional or retail shareholders. The fact that a regulatory requirement is met by virtue of issuing the retail shares does not indicate that unidentifiable goods or services were received from the purchasers.



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PFRS 3, *Business Combinations*

PFRS 3 and PFRS 2 – Accounting for reverse acquisitions that do not constitute a business

Issue

How should transactions in which the former shareholders of a non-listed operating entity become the majority shareholders of the combined entity by exchanging their shares for new shares of a listed non-operating entity be accounted for?

The transaction is structured such that the listed non-operating entity acquires the entire share capital of the non-listed operating entity.

Background

The transaction has some features of a reverse acquisition under PFRS 3, *Business Combinations*, because the former shareholders of the legal subsidiary obtain control of the legal parent.

In the absence of a Standard that specifically applies to the transaction, it is appropriate to apply by analogy, in accordance with paragraphs 10-12 of PAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, the guidance in paragraphs B19–B27 of PFRS 3 for reverse acquisitions.

Application of the reverse acquisitions guidance by analogy would result in the non-listed operating entity being identified as the accounting acquirer, and the listed non-operating entity being identified as the accounting acquiree. In applying the reverse acquisition guidance in paragraph B20 of PFRS 3 by analogy, the accounting acquirer is deemed to have issued shares to obtain control of the acquiree.

If the listed non-operating entity qualifies as a business on the basis of the guidance in paragraph B7 of PFRS 3, PFRS 3 would be applicable to the transaction. However, if the listed non-operating entity is not a business, the transaction is not a business combination and is therefore not within the scope of PFRS 3.

Consensus

Based on the above discussion, the transaction is not within the scope of PFRS 3 and is therefore a share-based payment transaction which should be accounted for in accordance with PFRS 2, *Share-based Payment*.

On the basis of the guidance in paragraph 13A of PFRS 2, any difference in the fair value of the shares deemed to have been issued by the accounting acquirer and the fair value of the accounting acquiree's identifiable net assets represents a service received by the accounting acquirer.

Regardless of the level of monetary or non-monetary assets owned by the non-listed operating entity, the entire difference should be considered to be payment for a service of a stock exchange listing for its shares, and that no amount should be considered a cost of



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raising capital. The service received in the form of a stock exchange listing does not meet the definition of an intangible asset because it is not “identifiable” in accordance with paragraph 12 of PAS 38 (i.e. it is not separable). The service received also does not meet the definition of an asset that should be recognized in accordance with other Standards and the Conceptual Framework.

On the basis of the guidance in paragraph 8 of PFRS 2 which states that “when the goods or services received or acquired in a share-based payment transaction do not qualify for recognition as assets, they shall be recognized as expenses”, the cost of the service received is recognized as an expense.

PFRS 3 – Continuing employment

Issue

In accordance with PFRS 3, *Business Combinations*, what is the accounting for contingent payments to selling shareholders in circumstances in which those selling shareholders become, or continue as, employees?

Background

Paragraph B55(a) of PFRS 3 states that:

“The terms of continuing employment by the selling shareholders who become key employees may be an indicator of the substance of a contingent consideration arrangement. The relevant terms of continuing employment may be included in an employment agreement, acquisition agreement or some other document. A contingent consideration arrangement in which the payments are automatically forfeited if employment terminates is remuneration for post-combination services. Arrangements in which the contingent payments are not affected by employment termination may indicate that the contingent payments are additional consideration rather than remuneration.”

Some asked for clarification whether paragraph B55(a) of PFRS 3 is conclusive in determining that payments to an employee that are forfeited upon termination of employment are remuneration for post-combination services and not part of the consideration for an acquisition. The question arose because they asserted that paragraph B55 introduces subparagraphs (a) - (h) as indicators, but paragraph B55(a) uses conclusive language stating that the arrangement described is remuneration for post-combination services.



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Consensus

An arrangement in which contingent payments are automatically forfeited if employment terminates would lead to a conclusion that the arrangement is compensation for post-combination services rather than additional consideration for an acquisition, unless the service condition is not substantive. This conclusion is reached on the basis of the conclusive language used in paragraph B55(a) of PFRS 3.

PFRS 3 – Identification of the acquirer in accordance with PFRS 3 and the parent in accordance with PFRS 10, *Consolidated Financial Statements*, in a stapling arrangement

Issue

Is an acquirer identified for the purpose of PFRS 3 (as revised 2008) considered a parent for the purpose of PFRS 10 in circumstances in which a business combination is achieved by contract alone, such as a stapling arrangement, with no combining entity obtaining control of the other combining entities?

Background

PFRS 3 (as revised 2008) defines a business combination as “a transaction or other event in which an acquirer obtains control of one or more businesses”. In addition, PFRS 3 (as revised 2008) refers to PFRS 10 for the meaning of the term ‘control’. PFRS 10 states that an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. It is observed that an investment is not needed in order for an entity to control another entity.

The definition of a business combination in PFRS 3 (as revised 2008) includes transactions in which an acquirer obtains control of one or more businesses. It also includes transactions that are sometimes referred to as ‘true mergers’ or ‘mergers of equals’. In other words, it includes transactions in which none of the combining entities obtains control of the other combining entities. If the stapling arrangement combines separate entities and businesses by the unification of ownership and voting interests in the combining entities, then such a transaction is a business combination as defined by PFRS 3 (as revised 2008).

Consensus

Notwithstanding the fact that PFRS 3 (as revised 2008) includes business combinations in which none of the combining entities obtains control of the other combining entities, paragraph 6 of PFRS 3 (as revised 2008) requires that one of the combining entities in a business combination must be identified as the acquirer. Paragraphs B14–B18 of PFRS 3 (as revised 2008) provides additional guidance for identifying the acquirer if the guidance in PFRS 10 does not clearly indicate which combining entity is the acquirer.



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Paragraph B15(a) of PFRS 3 (as revised 2008) provides guidance on identifying the acquirer by assessing the relative voting rights in the combined entity after the combination – this guidance explains that the acquirer is usually the combining entity whose owners, as a group, receive the largest portion of the voting rights in the combined entity. This guidance is consistent with the observation that the definition of a business combination includes transactions in which none of the combining entities or businesses is identified as having control of the other combining entities. This guidance would be relevant to identifying which of the combining entities is the acquirer in the stapling transaction considered.

The intended interaction between PFRS 3 (issued in 2004) and PAS 27 *Consolidated and Separate Financial Statements* is that an entity that is identified as the 'acquirer' of another entity in accordance with PFRS 3 (issued in 2004) is a 'parent' for the purposes of PAS 27. The meaning of the term 'acquirer' has not changed since 2004 and that the term 'control' is used consistently between PFRS 3 (as revised in 2008) and PFRS 10. It also noted that the notion in PFRS 3 (as revised in 2008) that a business combination could occur even if none of the combining entities obtains control of the other combining entities has not changed from PFRS 3 (issued in 2004). Accordingly, the interaction between PFRS 3 (issued in 2004) and PAS 27 remains valid in respect of the interaction between PFRS 3 (as revised in 2008) and PFRS 10. Consequently, the combining entity in the stapling arrangement that is identified as the acquirer for the purpose of PFRS 3 (as revised in 2008) should prepare consolidated financial statements of the combined entity in accordance with PFRS 10.



PFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*

PFRS 5 – Classification in conjunction with a planned IPO, but where the prospectus has not been approved by the securities regulator

Issue

Would a disposal group qualify as held for sale before the prospectus is approved by the securities regulator, assuming that all of the other criteria in PFRS 5, *Non-current Assets Held for Sale and Discontinued Operations* have been fulfilled?

Background

This Q&A deals with the application of the guidance in PFRS 5 regarding the classification of a non-current asset (or disposal group) as held for sale, in the case of a disposal plan that is intended to be achieved by means of an initial public offering (IPO), but where the prospectus (i.e., the legal document with an initial offer) has not yet been approved by the securities regulator.

Consensus

Paragraph 7 of PFRS 5 requires that the asset (or disposal group) must be available for immediate sale in its present condition, subject only to terms that are usual and customary for sales of such assets (or disposal groups) and its sale must be highly probable.

An entity should apply the guidance in paragraphs 8-9 of PFRS 5 to assess whether the sale of a disposal group by means of an IPO is highly probable. Terms that are "usual and customary" is a matter of judgment based on the facts and circumstance of each sale.

The following criteria in paragraph 8 of PFRS 5 represent events that must have occurred:

- a. the appropriate level of management must be committed to a plan to sell the asset (or disposal group);
- b. an active programme to locate a buyer and complete the plan must have been initiated; and
- c. the asset (or disposal group) must be actively marketed for sale at a price that is reasonable in relation to its current fair value.

The following criteria would be assessed based on expectations of the future, and their probability of occurrence would be included in the assessment of whether a sale is highly probable:

- a. the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification (except as permitted by paragraph 9);
- b. actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn; and



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- c. the probability of shareholders' approval (if required in the jurisdiction) should be considered as part of the assessment of whether the sale is highly probable.



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PFRS 9, *Financial Instruments*

PFRS 9 – Income and expenses arising on financial instruments with a negative yield – presentation in the statement of comprehensive income

Issue

How should an expense arising on a financial asset because of a negative effective interest rate be presented in the statement of comprehensive income?

Background

This Q&A discusses the ramifications of the economic phenomenon of negative interest rates for the presentation of income and expenses in the statement of comprehensive income.

Consensus

Interest resulting from a negative effective interest rate on a financial asset reflects a gross outflow, instead of a gross inflow, of economic benefits. Also, this amount is not an interest expense because it arises on a financial asset instead of on a financial liability of the entity.

Consequently, the expense arising on a financial asset because of a negative effective interest rate should not be presented as interest revenue or interest expense, but in some other appropriate expense classification. In accordance with paragraphs 85 and 112(c) of PAS 1, *Presentation of Financial Statements*, the entity is required to present additional information about such an amount if that is relevant to an understanding of the entity's financial performance or to an understanding of this item.

PFRS 9 – Accounting for embedded foreign currency derivatives in host contracts

Issue

Is an embedded foreign currency derivative in a license agreement closely related to the economic characteristics of the host contract, on the basis that the currency in which the license agreement is denominated is the currency in which commercial transactions in that type of license agreement are routinely denominated around the world (i.e., the 'routinely-denominated' criterion in paragraph B.4.3.8dii of PFRS 9)?



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Consensus

It can be noted that the issue is related to a contract for a specific type of item. The assessment of the routinely-denominated criterion is based on evidence of whether or not such commercial transactions are denominated in that currency all around the world and not merely in one local area.

The assessment is a question of fact and is based on an assessment of available evidence.

PFRS 9: Financial assets eligible for the election to present changes in fair value in other comprehensive income

Issue

Can an entity avail of the presentation election in paragraph 4.1.4 of PFRS 9 for financial instruments which the issuer would classify as equity after applying paragraphs 16A–16D of PAS 32?

The presentation election in paragraph 4.1.4 of PFRS 9 permits the holder of particular investments in equity instruments to present subsequent changes in fair value of those investments in other comprehensive income, rather than in profit or loss.

Consensus

A financial instrument that has all the features and meets the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D of PAS 32 is not eligible for the presentation election in paragraph 4.1.4 of PFRS 9. This is because such an instrument does not meet the definition of an equity instrument in PAS 32.

PFRS 9 – Physical settlement of contracts to buy or sell a non-financial item

Issue

In accounting for the physical settlement of contracts to buy or sell a non-financial item, is an entity permitted or required to make an additional journal entry that would:

- a. reverse the accumulated gain or loss previously recognized in profit or loss on the derivative (even though the fair value of the derivative is unchanged); and
- b. recognize a corresponding adjustment to either revenue (in the case of the sale contract) or inventory (in the case of the purchase contract)?



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Background

An entity has the following contracts:

- a. a contract to purchase a non-financial item (specifically, a commodity) in the future for a fixed price (purchase contract); and
- b. a contract to sell a non-financial item (specifically, a commodity) in the future for a fixed price (sale contract).

The entity has concluded that both contracts are within the scope of PFRS 9 because they are not held for the purpose of receipt or delivery in accordance with the entity's expected purchase, sale or usage requirements (do not meet the own use scope exception under PFRS 9). Consequently, the entity accounts for the contracts as if they were financial instruments and recognizes them as derivatives measured at FVPL. The entity does not designate the contracts as part of a hedging relationship for accounting purposes.

At the settlement date, the entity physically settles the contracts by either delivering or taking delivery of the commodity. In accounting for that settlement, the entity records the cash paid (in the case of the purchase contract) or received (in the case of the sales contract) and derecognizes the derivative. The entity:

- a. recognizes inventory at the market price of the commodity on the settlement date (in the case of the purchase contract); or
- b. recognizes revenue at the market price of the commodity at the settlement date (in the case of the sale contract).

Consensus

The additional journal entry described in the request would effectively negate the requirement in PFRS 9 to account for the contracts as derivatives without any basis to do so. The additional journal entry would also result in the recognition of income or expenses on the derivative that do not exist. Consequently, PFRS 9 neither permits nor requires an entity to make the additional journal entry described above.

PFRS 9 – Credit enhancement in the measurement of expected credit losses

Issue

Can the cash flows expected from a financial guarantee contract or any other credit enhancement that is integral to the contractual terms of a loan be included in the measurement of expected credit losses if the credit enhancement is required to be separately recognized in accordance with PFRSs?

Background

A bank originates a loan with a borrower. The loan agreement does not explicitly refer to the fact that the bank will obtain a third-party guarantee in connection with this loan. However, at



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the origination date, in accordance with its business practices, the bank mitigates its credit risk in respect of the loan by obtaining a financial guarantee from a third party for which it pays a fee to the guarantor.

Consensus

For the purposes of measuring expected credit losses (ECL), paragraph B5.5.55 of PFRS 9 requires the estimate of expected cash shortfalls to reflect the cash flows expected from collateral and other credit enhancements that **are part of the contractual terms and are not recognized separately by the entity**.

In December 2015, the Transition Resource Group for Impairment of Financial Instruments (ITG) discussed the inclusion of cash inflows from collateral and other credit enhancements in the measurement of ECL, and what is meant by credit enhancements that are 'part of the contractual terms'. The ITG observed that credit enhancements included in the measurement of ECL should not be limited to those that are explicitly part of the contractual terms. Entities should use judgement in assessing whether a credit enhancement is integral to the contractual terms, taking into account all relevant facts and circumstances. The ITG members also noted that an entity must not include cash flows from credit enhancements in the measurement of ECL if the credit enhancement is accounted for separately, in order to avoid double counting.

Therefore, if a credit enhancement is required to be recognized separately by PFRSs, an entity cannot include the cash flows expected from it in the measurement of expected credit losses, accordance with paragraph B5.5.55 of PFRS 9.

PFRS 9 – Curing of a credit-impaired financial asset

Issue

How does an entity present amounts recognized in the statement of profit or loss when a credit-impaired financial asset is subsequently cured (i.e., paid in full or no longer credit-impaired)?

Background

When a financial asset becomes credit-impaired, paragraph 5.4.1(b) of PFRS 9 requires an entity to calculate interest revenue by applying the 'effective interest rate to the amortized cost of the financial asset'. This results in a difference between (a) the interest that would be calculated by applying the effective interest rate to the gross carrying amount of the credit-impaired financial asset; and (b) the interest revenue recognized for that asset. The issue is whether an entity can present this difference as interest revenue or, instead, is required to present it as a reversal of impairment losses.

Consensus

Appendix A to PFRS 9 defines a credit loss as 'the difference between all contractual cash flows that are due to an entity in accordance with the contract and all the cash flows that the entity expects to receive (i.e., all cash shortfalls), discounted at the original effective interest



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rate...'. Appendix A also defines the gross carrying amount as 'the amortized cost of a financial asset, before adjusting for any loss allowance.' Based on the definitions in Appendix A to PFRS 9, the gross carrying amount, amortized cost and loss allowance are discounted amounts, and changes in these amounts during a reporting period include the effect of the unwinding of the discount.

Paragraph 5.5.8 of PFRS 9 requires an entity to 'recognize in profit or loss, as an impairment gain or loss, the amount of expected credit losses (or reversal) that is required to adjust the loss allowance at the reporting date to the amount that is required to be recognized in accordance with this Standard.'

In applying paragraph 5.5.8 of PFRS 9, an entity recognizes in profit or loss as a reversal of expected credit losses the adjustment required to bring the loss allowance to the amount that is required to be recognized in accordance with PFRS 9 (zero if the asset is paid in full). The amount of this adjustment includes the effect of the unwinding of the discount on the loss allowance during the period that the financial asset was credit-impaired, which means the reversal of impairment losses may exceed the impairment losses recognized in profit or loss over the life of the asset.

Paragraph 5.4.1 specifies how an entity calculates interest revenue using the effective interest method. Applying paragraph 5.4.1(b), an entity calculates interest revenue on a credit-impaired financial asset by applying the effective interest rate to the amortized cost of the financial asset, and thus interest revenue on such a financial asset does not include the difference described in the request.

Accordingly, in the statement of profit or loss, an entity is required to present the difference described above as a reversal of impairment losses following the curing of a credit-impaired financial asset.



PFRS 10, *Consolidated Financial Statements*

PFRS 10: Investment Entities Amendment – The definition of investment-related services or activities

Issue

Can 'tax optimization' be considered as investment-related services or activities?

Background

An investment entity provides investment-related services or activities, either directly or through a subsidiary. If an investment entity provides investment-related services or activities through a subsidiary, the investment entity shall consolidate that subsidiary.

Some investment entities establish wholly-owned intermediate subsidiaries in some jurisdictions, which own all or part of the portfolio of investments in the group structure. The sole purpose of the intermediate subsidiaries is to minimize the tax paid by investors in the 'parent' investment entity. There is no activity within the subsidiaries and the tax advantage comes about because of returns being channeled through the jurisdiction of the intermediate subsidiary. A question was raised on whether such 'tax optimization' should be considered investment-related services or activities.

According to paragraph BC272 of PFRS 10, *Consolidated Financial Statements*, the fair value measurement of all of an investment entity's subsidiaries would provide the most useful information, except for subsidiaries providing investment-related services or activities. One of the characteristics of 'tax optimization' subsidiaries is "that there is no activity within the subsidiary".

Consensus

Accordingly, the parent should not consolidate such subsidiaries, because they do not provide investment-related services or activities, and do not meet the requirements to be consolidated in accordance with paragraph 32 of PFRS 10. The parent should therefore account for such an intermediate subsidiary at fair value.



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PFRS 10 – Classification of puttable instruments that are non-controlling interests

Issue

How should puttable instruments that are issued by a subsidiary but that are not held, directly or indirectly, by the parent be classified in the consolidated financial statements of a group?

Background

This Q&A deals with puttable instruments classified as equity instruments in the financial statements of the subsidiary in accordance with paragraphs 16A-16B of PAS 32 ('puttable instruments') that are not held, directly or indirectly, by the parent. This discusses whether these instruments should be classified as equity or liability in the parent's consolidated financial statements.

Some claim that paragraph 22 of PFRS 10 is not consistent with paragraph AG29A of PAS 32, because:

- a) PFRS 10 defines non-controlling interests (NCI) as equity in a subsidiary not attributable, directly or indirectly, to a parent;
- b) according to paragraph 22 of PFRS 10 a parent shall present non-controlling interests (NCI) in the consolidated statement of financial position within equity; but
- c) according to paragraph AG29A of PAS 32, instruments classified as equity instruments in accordance with paragraphs 16A-16D of PAS 32 in the separate or individual financial statements of the subsidiary that are NCI are classified as liabilities in the consolidated financial statements of the group.

Consensus

Paragraphs 16A-16D of PAS 32 state that puttable instruments and instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation meet the definition of a financial liability. These instruments are classified as equity in the financial statements of the subsidiary as an exception to the definition of a financial liability if all relevant requirements are met. Paragraph AG29A clarifies that this exception applies only to the financial statements of the subsidiary and does not extend to the parent's consolidated financial statements. Consequently, these financial instruments should be classified as financial liabilities in the parent's consolidated financial statements.



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PFRS 10 – Effect of protective rights on an assessment of control

Issue

Should the assessment of control be reassessed when facts and circumstances change in such a way that rights, previously determined to be protective, change (for example upon the breach of a covenant in a borrowing arrangement that causes the borrower to be in default) or whether, instead, such rights are never included in the reassessment of control upon a change in facts and circumstances?

Background

This Q&A deals with the guidance relating to protective rights and the effect of those rights on the power over the investee.

Consensus

Paragraph 8 of PFRS 10, *Consolidated Financial Statements*, requires an investor to reassess whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control.

A breach of a covenant that results in rights becoming exercisable constitutes such a change. It noted that PFRS 10 does not include an exemption for any rights from this need for reassessment.

The intention of PFRS 10 was that rights initially determined to be protective should be included in a reassessment of control whenever facts and circumstances indicate that there are changes to one or more of the three elements of control.

Accordingly, the conclusion about which party controlled the investee would need to be reassessed after the breach occurred. It also noted that the reassessment may or may not result in a change to the outcome of the assessment of control, depending on the individual facts and circumstances.



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PFRS 10 – Non-cash acquisition of a non-controlling interest by a controlling shareholder in the consolidated financial statements

Issue

What is the accounting for the purchase of a non-controlling interest (NCI) by the controlling shareholder when the consideration includes non-cash items? Should the difference between the fair value of the consideration given and the carrying amount of such consideration be recognized in equity or in profit or loss?

Background

According to paragraph B96 of PFRS 10 *Consolidated Financial Statements*, the difference described should be recognized in equity, whereas applying Philippine Interpretation IFRIC-17, *Distributions of Non-cash Assets to Owners*, by analogy the difference should be recognized in profit or loss.

Consensus

Paragraph B96 of PFRS 10 deals solely with the difference between the carrying amount of NCI and the fair value of the consideration given; this difference is required to be recognized in equity. This paragraph does not deal with the difference between the fair value of the consideration given and the carrying amount of such consideration.

The difference between the fair value of the assets transferred and their carrying amount arises from the derecognition of those assets. PFRSs generally require an entity to recognize, in profit or loss, any gain or loss arising from the derecognition of an asset.



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PFRS 10 and PFRS 11 – Transition provisions in respect of impairment, foreign exchange and borrowing costs

Issue

What are the transition provisions in PFRS 10 and 11 in respect of impairment, foreign exchange and borrowing costs?

Background

The transition provisions of PFRS 10 and PFRS 11 include exemptions from retrospective application in specific circumstances. However, PFRS 10 and PFRS 11 do not provide specific exemptions from retrospective application in respect of the application of PAS 21, *The Effects of Changes in Foreign Exchange Rates*, PAS 23 *Borrowing Costs* or PAS 36, *Impairment of Assets*.

Consensus

When PFRS 10 is applied for the first time, it must be applied retrospectively, except for the specific circumstances for which exemptions from retrospective application are given. When PFRS 10 is applied retrospectively, there may be consequential accounting requirements arising from other Standards (such as PAS 21, PAS 23 and PAS 36). These requirements must also be applied retrospectively in order to measure the investee's assets, liabilities and non-controlling interests, as described in paragraph C4 of PFRS 10, or the interest in the investee, as described in paragraph C5 of PFRS 10. If retrospective application of the requirements of PFRS 10 is impracticable because it is impracticable to apply retrospectively the requirements of other Standards, then PFRS 10 (paragraphs C4A and C5A) provides exemption from retrospective application.

Although the meaning of the term 'joint control' as defined in PFRS 11 is different from its meaning in PAS 31, *Interests in Joint Ventures (2003)*, because of the new definition of 'control' in PFRS 10, nevertheless the outcome of assessing whether control is held 'jointly' would in most cases be the same in accordance with PFRS 11 as it was in accordance with PAS 31. As a result, typically, the changes resulting from the initial application of PFRS 11 would be to change from proportionate consolidation to equity accounting or from equity accounting to recognizing a share of assets and a share of liabilities. In those situations, PFRS 11 already provides exemption from retrospective application.



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PFRS 10 – Single-asset, single lessee lease vehicles

Issue

Should the lessee (or lender in the case of a finance lease) consolidate a Structured Entity that was created to lease a single asset to the said lessee (or lender)?

Background

A Structured Entity (SE) is created on behalf of a manufacturer. The SE holds a single asset manufactured by the manufacturer, which is subsequently leased to a single customer.

If the lease is considered an operating lease, the question was whether the lessee should consolidate the SE. If the lease is considered a finance lease, the question was whether the lender should consolidate the SE.

Consensus

Paragraph 10 of PFRS 10 states that an investor has power over an investee when the investor has existing rights that give the investor the current ability to direct the relevant activities, or those activities that significantly affect the investee's returns.

Upon entering into a lease, regardless of whether such a lease is a finance or an operating lease, the SE or the lessor would have the following rights:

1. A right to receive lease payments; and,
2. A right to the residual value of the leased asset at the end of the lease

Consequently, the SE's relevant activities would be those that relate to managing the returns derived from these rights (e.g., managing the credit risk associated with the lease payments or managing the leased asset at the end of the lease term). How the decision-making relating to those activities would significantly affect the SE's returns would depend on the specific facts and circumstances.

By itself, the lessee's right to use the leased asset over a period of time would not typically give the lessee (or the lender) decision-making rights over the relevant activities of the SE. However, this does not mean that a lessee (or lender) can never control the lessor. The lessee (or lender) would need to consider all of the rights that it has in relation to the SE to determine whether it has power over the SE. This would include rights in contractual arrangements other than the lease contract (i.e., contractual arrangements for loans made to the SE), as well as rights included within the lease contract. These rights include those that go beyond simply providing the lessee (or lender) with the right to use the land.

PFRS 10 – Investment entities and subsidiaries



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Issues

1. Does an entity qualify as an investment entity if it possesses all three elements described in paragraph 27 of PFRS 10, but does not have one or more of the typical characteristics of an investment entity listed in paragraph 28 of PFRS 10?
2. Does an entity provide investment management services to investors (as specified in paragraph 27(a) of PFRS 10) if it outsources the performance of these services to a third party?
3. To what extent can an investment entity provide investment-related services, itself or through a subsidiary, to third parties?
4. Does a subsidiary provide services that relate to its parent investment entity's investment activities (as specified in paragraph 32 of PFRS 10) by holding an investment portfolio as beneficial owner?

Consensus

Issue 1

Paragraph 27 of PFRS 10 lists the three elements an entity must possess to qualify as an investment entity. Paragraph 28 of PFRS 10 lists typical characteristics that an entity considers in assessing whether it possesses all three elements in paragraph 27, and says that the absence of any of these characteristics does not necessarily disqualify an entity from being an investment entity. Paragraph B85N of PFRS 10 clarifies that the absence of one or more of the typical characteristics of an investment entity listed in paragraph 28 of PFRS 10 indicates that additional judgement is required in determining whether the entity is an investment entity.

Accordingly, an entity that possesses all three elements of the definition of an investment entity in paragraph 27 of PFRS 10 is an investment entity. This is the case even if that entity does not have one or more of the typical characteristics of an investment entity listed in paragraph 28 of PFRS 10.

Issue 2

Paragraph 27(a) of PFRS 10 requires an investment entity to provide investors with investment management services. PFRS 10 does not specify how the investment entity must provide these services, and does not preclude it from outsourcing the



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performance of these services to a third party. Accordingly, an investment entity responsible for providing investment management services to its investors can engage another party to perform some or all of these services on its behalf (i.e., it can outsource the performance of some or all of these services).

Issue 3

Paragraph 27(b) of PFRS 10 requires that the business purpose of an investment entity is to invest solely for capital appreciation, investment income, or both.

Paragraph B85C of PFRS 10 says that an investment entity may provide investment-related services, either directly or through a subsidiary, to third parties as well as to its investors (even if those activities are substantial to the entity), subject to the entity continuing to meet the definition of an investment entity.

Accordingly, an investment entity may provide investment-related services to third parties, either directly or through a subsidiary, as long as those services are ancillary to its core investing activities and thus do not change the business purpose of the investment entity.

Issue 4

An investment entity does not consider the holding of investments by a subsidiary as beneficial owner (and recognized in the subsidiary's financial statements) to be a service that relates to the parent investment entity's investment activities because such activity does not constitute investment-related service in accordance with paragraph 32 of PFRS 10.

PFRS 11, *Joint Arrangements*

PFRS 11 – Classification of joint arrangements

Issue

How should the assessment of ‘other facts and circumstances’ described in PFRS 11, *Joint Arrangements* affect the classification of a joint arrangement as a joint operation or a joint venture?

Background

It was considered whether the assessment of ‘other facts and circumstances’ should be undertaken with a view only towards whether those facts and circumstances create enforceable rights to the assets and obligations for the liabilities or whether that assessment should also consider the design and purpose of the joint arrangement, the entity’s business needs and the entity’s past practices.

Paragraph 14 of PFRS 11 requires the classification of a joint arrangement as a joint operation or a joint venture to depend on rights to the assets and obligations for the liabilities of the parties to the arrangement, and that rights and obligations, by nature, are enforceable.

Paragraph B30 of PFRS 11 describes that when ‘other facts and circumstances’ give the parties rights to the assets, and obligations for the liabilities, relating to the arrangement, the assessment of ‘other facts and circumstances’ would lead to the joint arrangement being classified as a joint operation.

Consensus

The assessment of ‘other facts and circumstances’ should focus on whether those facts and circumstances create rights to the assets and obligations for the liabilities.

PFRS 11 – Classification of joint arrangements: the assessment of ‘other facts and circumstances’

Issue

How should the assessment of ‘other facts and circumstances’ as noted in paragraph 17 of PFRS 11 be performed? Should the assessment of ‘other facts and circumstances’ be undertaken with a view only towards whether those facts and circumstances create enforceable rights to the assets and obligations for the liabilities, or whether that assessment should also consider the design and purpose of the joint arrangement, the entity’s business needs and the entity’s past practices?



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Background

Paragraph 14 of PFRS 11 requires the classification of a joint arrangement as a joint operation or a joint venture to depend on each party's rights to the assets and obligations for the liabilities of the joint arrangement, and that the rights and obligations are enforceable. Paragraph B30 of PFRS 11 explains that the assessment of other facts and circumstances would lead to the joint arrangement being classified as a joint operation when those other facts and circumstances give each party both rights to the assets, and obligations for the liabilities, relating to the arrangement.

Consensus

Consequently, the assessment of other facts and circumstances should focus on whether those facts and circumstances create enforceable rights to the assets and obligations for the liabilities.

The following paragraphs describe how and why particular facts and circumstances create rights to the assets and obligations for the liabilities.

How and why particular facts and circumstances create rights and obligations that result in the joint arrangement being classified as a joint operation, when the joint arrangement is structured through a separate vehicle whose legal form causes the separate vehicle to be considered in its own right.

The assessment of other facts and circumstances is performed when there is no contractual arrangement to reverse or modify the rights and obligations conferred by the legal form of the separate vehicle through which the arrangement has been structured. The assessment of other facts and circumstances thus focuses on whether the other facts and circumstances establish, for each party to the joint arrangement, rights to the assets and obligations for the liabilities relating to the joint arrangement.

Paragraphs B31–B32 of PFRS 11 state that parties to the joint arrangement have rights to the assets of the joint arrangement through other facts and circumstances when they:

- a. have rights to substantially all of the economic benefits (for example, 'output') of assets of the arrangement; and
- b. have obligations to acquire those economic benefits and thus assume the risks relating to those economic benefits (for example, the risks relating to the output).

Paragraphs B14 and B32–B33 of PFRS 11 state that parties to the joint arrangement have obligations for liabilities of the joint arrangement through other facts and circumstances when:



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- (a) as a consequence of their rights to, and obligations for, the assets of the joint arrangement, they provide cash flows that are used to settle liabilities of the joint arrangement; and
- (b) settlement of the liabilities of the joint arrangement occurs on a continuous basis.

On the basis of these paragraphs, when each party to a joint arrangement meets the criteria and therefore has both rights to the assets of the joint arrangement and obligations for the liabilities of the joint arrangement through other facts and circumstances, a joint arrangement structured through a separate vehicle is a joint operation.

Consequently, in order to classify the joint arrangement as a joint operation as a result of assessing other facts and circumstances, it is necessary to demonstrate that:

- (a) each party to the joint arrangement has rights and obligations relating to economic benefits of the assets of the arrangement; and
- (b) each party is obliged to provide cash to the arrangement through enforceable obligations, which is used to settle the liabilities of the joint arrangement on a continuous basis.

Implication of 'economic substance'

Some observed that the concept of 'economic substance' may not be consistently understood or applied in practice with regard to the assessment of other facts and circumstances.

As discussed above, the assessment of other facts and circumstances should focus on whether each party to the joint arrangement has rights to the assets, and obligations for the liabilities, relating to the joint arrangement. Consequently, in reference to paragraph BC43 of PFRS 11, it is noted that the consideration of other facts and circumstances is not a test of whether each party to the joint arrangement is closely or fully involved with the operation of the separate vehicle, but is instead a test of whether other facts and circumstances override the rights and obligations conferred upon the party by the legal form of the separate vehicle.

On the basis of this analysis, the assessment of other facts and circumstances should be undertaken with a view towards whether those facts and circumstances create enforceable rights to assets and obligations for liabilities.



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PFRS 11 – Classification of joint arrangements: application of ‘other facts and circumstances’ to specific fact patterns

Issue

How should ‘other facts and circumstances’ be applied to some specific fact patterns?

Background

This Q&A identified four different cases and considered how particular features of those fact patterns would affect the classification of the joint arrangement when assessing other facts and circumstances.

Consensus

1. Output sold at a market price

This case discusses whether the fact that the output from the joint arrangement is sold to the parties of the joint arrangement at a market price prevents the joint arrangement from being classified as a joint operation, when assessing other facts and circumstances.

It is concluded that the sale of output from the joint arrangement to the parties at market price, on its own, is not a determinative factor for the classification of the joint arrangement. The parties would need to consider, among other things, whether the cash flows provided to the joint arrangement through the parties’ purchase of the output from the joint arrangement at market price, along with any other funding that the parties are obliged to provide, would be sufficient to enable the joint arrangement to settle its liabilities on a continuous basis.

Exercising judgment is needed in this situation in order to determine whether the arrangement is a joint operation based on other facts and circumstances.

2. Financing from a third party

This case discusses whether financing from a third party prevents a joint arrangement from being classified as a joint operation.

If the cash flows to the joint arrangement from the sale of output to the parties, along with any other funding that the parties are obliged to provide, satisfy the joint arrangement’s liabilities, then third-party financing alone would not affect the classification of the joint arrangement, irrespective of whether the financing occurs at inception or during the course of the joint arrangement’s operations. In this situation, the joint arrangement will, or may, settle some of its liabilities using cash flows from third-



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party financing, but the resulting obligation to the third-party finance provider will, in due course, be settled using cash flows that the parties are obliged to provide.

3. Nature of output (i.e. fungible or bespoke output)

This case discusses whether the nature of the output (i.e. fungible or bespoke output) produced by the joint arrangement determines the classification of a joint arrangement when assessing other facts and circumstances.

It is concluded whether the output that is produced by the joint arrangement and purchased by the parties is fungible or bespoke is not a determinative factor for the classification of the joint arrangement. The focus of 'obligation for the liabilities' in PFRS 11 is on the existence of cash flows flowing from the parties to satisfy the joint arrangement's liabilities as a consequence of the parties' rights to, and obligations for, the assets of the joint arrangement, regardless of the nature of the product (i.e. fungible or bespoke output).

4. Determining the basis for 'substantially all of the output'

This case discusses whether volumes or monetary values of output should be the basis for determining whether the parties to the joint arrangement are taking 'substantially all of the output' from the joint arrangement when assessing other facts and circumstances.

Referring to paragraphs B31–B32 of PFRS 11, parties to the joint arrangement have rights to the assets of the joint arrangement through other facts and circumstances when they:

- (a) have rights to substantially all of the economic benefits (for example, 'output') of the assets of the arrangement; and
- (b) have obligations to acquire those economic benefits and thus assume the risks relating to those economic benefits (for example, the risks relating to the output).

It is also noted from paragraphs B31–B32 of PFRS 11 that in order to meet the criteria for classifying the joint arrangement as a joint operation through the assessment of other facts and circumstances:

- (a) the parties to the joint arrangement should have rights to substantially all the economic benefits of the assets of the joint arrangement; and
- (b) the joint arrangement should be able to settle its liabilities from the 'cash flows' received as a consequence of the parties' rights to and obligations for the assets of the joint arrangement, along with any other funding that the parties are obliged to provide.



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Therefore, the economic benefits of the assets of the joint arrangement would relate to the cash flows arising from the parties' rights to, and obligations for, the assets. Consequently, it noted that the assessment is based on the monetary value of the output, instead of physical quantities.

PFRS 11 – Classification of joint arrangements: consideration of two joint arrangements with similar features that are classified differently

Issue

Can two joint arrangements with similar features, apart from the fact that one is structured through a separate vehicle and the other is not (in circumstances in which the legal form confers separation between the parties and the separate vehicle) be classified differently?

Background

Two such joint arrangements could be classified differently because:

- (a) the legal form of a joint arrangement structured through a separate vehicle must be overridden by other contractual arrangements or specific other facts and circumstances for the joint arrangement to be classified as a joint operation; but
- (b) a joint arrangement that is not structured through a separate vehicle is classified as a joint operation.

Consensus

PFRS 11 could lead to two joint arrangements being classified differently if one is structured through a separate vehicle and the other is not, but in other respects they have apparently similar features. This is because the legal form of the separate vehicle could affect the rights and obligations of the parties to the joint arrangement. The legal form of the separate vehicle is relevant in assessing the type of joint arrangement, as noted, for example, in paragraphs B22 and BC43 of PFRS 11.

Such different accounting would not conflict with the concept of economic substance. This is because, according to the approach adopted in PFRS 11, the concept of economic substance means that the classification of the joint arrangement should reflect the rights and obligations of the parties to the joint arrangement and the presence of a separate vehicle plays a significant role in determining the nature of those rights and obligations.

The requirements of PFRS 11 provide the principles necessary for determining the classification of joint arrangements, including assessing the impact of a separate vehicle.



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The assessment of the classification would depend on specific contractual terms and conditions and requires a full analysis of features involving the joint arrangement.

PFRS 11 – Accounting by the joint operator: recognition of revenue by a joint operator

Issue

Should a joint operator recognize revenue in relation to the output purchased from the joint operation by the parties?

Background

This issue relates to the application of paragraph 20(d) of PFRS 11, which requires a joint operator to recognize its share of the revenue from the sale of the output by the joint operation.

Consensus

Examining paragraph 20(d) of PFRS 11, it is noted that if the joint arrangement is structured through a separate vehicle and the assessment of other facts and circumstances results in the joint arrangement being classified as a joint operation, in circumstances in which the parties take all the output of the joint arrangement in proportion to their rights to the output, the application of paragraph 20(d) of PFRS 11 would not result in the recognition of revenue by the parties. This is because, if the joint operators purchase all the output from the joint operation in proportion to their rights to the output, they would recognize ‘their revenue’ only when they sell the output to third parties.

In other words, the joint operators would not recognize any amount in relation to the ‘share of the revenue from the sale of the output by the joint operation’. This is because a joint operator that has an obligation to purchase the output from the joint operation has rights to the assets of the joint operation. Accordingly, the sale of the output by the joint operation to the joint operator would mean selling output to itself and, therefore, the joint operator would not recognize a share of the revenue from the sale of that output by the joint operation.

Consequently, paragraph 20(d) of PFRS 11 would result in the recognition of revenue by a joint operator only when the joint operation sells its output to third parties. For this purpose, third parties do not include other parties who have rights to the assets and obligations for the liabilities relating to the joint operation.



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PFRS 11 – Accounting by the joint operator: the accounting treatment when the joint operator’s share of output purchased differs from its share of ownership interest in the joint operation

Issue

What is the accounting treatment in the circumstance in which the joint operator’s share of the output purchased differs from its share of ownership interest in the joint operation?

Background

This Q&A considered a fact pattern in which the joint arrangement is structured through a separate vehicle and for which the parties to the joint arrangement have committed themselves to purchase substantially all of the output produced at a price designed to achieve a break-even result. In this fact pattern, the parties to the joint arrangement would be considered to have rights to the assets and obligations for the liabilities. Such a joint arrangement is presented in Example 5 of the application guidance to PFRS 11 and is classified as a joint operation. A variation of such a fact pattern could (and does) arise in circumstances in which the parties’ percentage ownership interest in the separate vehicle differs from the percentage share of the output produced, which each party is obliged to purchase.

Consensus

Referring to paragraph 20 of PFRS 11, it can be noted that the joint operators of such a joint operation would account for their assets, liabilities, revenues and expenses in accordance with the shares specified in the contractual arrangement. However, when an assessment of other facts and circumstances has concluded that the joint arrangement is a joint operation, and the joint arrangement agreement does not specify the allocation of assets, liabilities, revenues or expenses, the question arises about what share of assets, liabilities, revenue and expenses each joint operator should recognize. Specifically, should the share of assets, liabilities, revenue and expenses recognized reflect the percentage of ownership of the legal entity, or should it reflect the percentage of output purchased by each joint operator?

There could be many different scenarios in which the joint operator’s share of the output purchased differs from its share of ownership interest in the joint operation: for example, when the share of output purchased by each party varies over the life of the joint arrangement. A key issue that arises in this situation is over what time horizon should the share of output be considered.

If the joint operators made a substantial investment in the joint operation that differed from their ownership interest, there may be other elements of the arrangements that could explain why there is a difference between the percentage of ownership interest and the percentage share of the output produced, which each party is obliged to purchase. The identification of



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the other elements may provide relevant information to determine how to account for the difference between the two.

Consequently, it is important to understand why the share of the output purchased differs from the ownership interests in the joint operation. Judgment will therefore be needed to determine the appropriate accounting.

PFRS 11 – Accounting in separate financial statements: accounting by the joint operator in its separate financial statements

Issue

How should a joint operator account for in its separate financial statements its share of assets and liabilities of a joint operation when that joint operation is structured through a separate vehicle?

Consensus

PFRS 11 requires the joint operator to account for its rights and obligations in relation to the joint operation. It also noted that those rights and obligations, in respect of that interest, are the same regardless of whether separate or consolidated financial statements are prepared, by referring to paragraph 26 of PFRS 11. Consequently, the same accounting is required in the consolidated financial statements and in the separate financial statements of the joint operator.

PFRS 11 requires the joint operator to account for its rights and obligations, which are its share of the assets held by the entity and its share of the liabilities incurred by it. Accordingly, the joint operator would not additionally account in its separate or consolidated financial statements its shareholding in the separate vehicle, whether at cost in accordance with PAS 27 *Separate Financial Statements* or at fair value in accordance with PFRS 9 *Financial Instruments*.



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PFRS 11 – Accounting by the joint operation: accounting by the joint operation that is a separate vehicle in its financial statements

Background and Issue

A joint operator recognizes in both its consolidated and separate financial statements its share in the assets and liabilities of a joint operation that is a separate vehicle. Should the joint operation recognize the same assets and liabilities in its own financial statements?

Consensus

PFRS 11 applies only to the accounting by the joint operators and not to the accounting by the separate vehicle that is a joint operation. The financial statements of the separate vehicle would therefore be prepared in accordance with the applicable PFRS.

Company law often requires a legal entity/separate vehicle to prepare financial statements. Consequently, the reporting entity for the financial statements would include the assets, liabilities, revenues and expenses of that legal entity/separate vehicle. However, when identifying the assets and liabilities of the separate vehicle, it is necessary to understand the joint operators' rights and obligations relating to those assets and liabilities and how those rights and obligations affect those assets and liabilities.

PFRS 11 and PFRS 10 – Transition provisions in respect of impairment, foreign exchange and borrowing costs

Issue

What are the transition provisions in PFRS 10 and 11 in respect of impairment, foreign exchange and borrowing costs?

Background

The transition provisions of PFRS 10 and PFRS 11 include exemptions from retrospective application in specific circumstances. However, PFRS 10 and PFRS 11 do not provide specific exemptions from retrospective application in respect of the application of PAS 21 *The Effects of Changes in Foreign Exchange Rates*, PAS 23 *Borrowing Costs* or PAS 36 *Impairment of Assets*.

Consensus

When PFRS 10 is applied for the first time, it must be applied retrospectively, except for the specific circumstances for which exemptions from retrospective application are given. When PFRS 10 is applied retrospectively, there may be consequential accounting requirements arising from other Standards (such as PAS 21, PAS 23 and PAS 36). These requirements must also be applied retrospectively in order to measure the investee's assets, liabilities and



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non-controlling interests, as described in paragraph C4 of PFRS 10, or the interest in the investee, as described in paragraph C5 of PFRS 10. If retrospective application of the requirements of PFRS 10 is impracticable because it is impracticable to apply retrospectively the requirements of other Standards, then PFRS 10 (paragraphs C4A and C5A) provides exemption from retrospective application.

Although the meaning of the term 'joint control' as defined in PFRS 11 is different from its meaning in PAS 31 *Interests in Joint Ventures (2003)* because of the new definition of 'control' in PFRS 10, nevertheless the outcome of assessing whether control is held 'jointly' would in most cases be the same in accordance with PFRS 11 as it was in accordance with PAS 31. As a result, typically, the changes resulting from the initial application of PFRS 11 would be to change from proportionate consolidation to equity accounting or from equity accounting to recognizing a share of assets and a share of liabilities. In those situations, PFRS 11 already provides exemption from retrospective application.



PFRS 12, *Disclosure of Interests in Other Entities*

PFRS 12 – Disclosure of summarized financial information about material joint ventures and associates

Issues

1. How should an entity apply the disclosure requirements in paragraph 21(b)(ii) of PFRS 12 on summarized financial information on material joint ventures and associates? How do the disclosure requirements interact with the aggregation principle in paragraphs 4 and B2-B6 of PFRS 12?
2. Would an investor be excused from disclosing summarized financial information when the information relates to a listed joint venture or associate, and local regulatory requirements prevent the investor from disclosing such information until the joint venture or associate has released its own financial statements?

Background

Paragraph 21(b)(ii) of PFRS 12 requires an entity to disclose summarized financial information about the joint venture or associate as specified in paragraphs B12 and B13.

Paragraph 4 of PFRS 12 requires an entity to consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the requirements in PFRS 12. It shall aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics (see paragraph B2-B6 of PFRS 12).

Some assert that there are two ways to interpret the application of those paragraphs. Either the information required in paragraph 21(b)(ii) of PFRS 12 can be disclosed in aggregate for all material joint ventures or such information should be disclosed individually for each material joint venture or associate.

Paragraph BC50 of PFRS 12's Basis for Conclusions states that:

“The Board observed that the requirement to present the amounts on a '100 per cent' basis would be appropriate only when the information is disclosed for individual joint ventures and associates. This is because presenting the financial information on a '100 per cent' basis when aggregating that information for all joint ventures or associates would not result in useful information when the entity holds different percentage ownership interests in its joint ventures or associates. In addition, some users and respondents to ED 9 recommended that the disclosures for associates should be aligned with those for joint ventures because investments in associates can be material and are often strategic to an investor with significant influence. Accordingly, the Board decided that summarized financial information should also be provided for each material associate.”



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Consensus

1. **How should an entity apply the disclosure requirements in paragraph 21(b)(ii) of PFRS 12 on summarized financial information on material joint ventures and associates? How do the disclosure requirements interact with the aggregation principle in paragraphs 4 and B2-B6 of PFRS 12?**

It is expected that the requirement in paragraph 21(b)(ii) of PFRS 12 shall lead to the disclosure of summarized information on an individual basis for each joint venture or associate that is material to the reporting entity.

This also reflects the intentions of the International Accounting Standards Board (IASB or the Board) as described in paragraph BC50 of PFRS 12's Basis for Conclusions.

2. **Would an investor be excused from disclosing summarized financial information when the information relates to a listed joint venture or associate, and local regulatory requirements would prevent the investor from disclosing such information until the joint venture or associate has released its own financial statements?**

There is no provision in PFRS 12 that permits non-disclosure of the information required in paragraph 21(b)(ii) of PFRS 12.

PFRS 12 – Disclosures for a subsidiary with a material non-controlling interest

Issue

Should the information required by paragraphs 12(e) - (g) of PFRS 12 should be provided:

- i. at the subsidiary level (i.e. the 'legal' entity) and be based on the separate financial statements of the individual subsidiary; or
- ii. at a subgroup level for the subgroup of the subsidiary together with its investees and be based either on
 - (i) the amounts of the subgroup included in the consolidated financial statements of the reporting entity; or
 - (ii) the amounts included in consolidated financial statements of the subgroup; noting that transactions and balances between the subgroup and other entities outside the subgroup would not be eliminated.

Background

Paragraph 12 (e) – (g) of PFRS 12 state that:

An entity shall disclose for each of its subsidiaries that have non-controlling interests that are material to the reporting entity:

...

- (e) the profit or loss allocated to non-controlling interests of the subsidiary during the reporting period.



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- (f) accumulated non-controlling interests of the subsidiary at the end of the reporting period.
- (g) summarized financial information about the subsidiary.

Consensus

Within the context of the disclosure objective in paragraph 10 of PFRS 12, materiality should be assessed by the reporting entity on the basis of the consolidated financial statements of the reporting entity. In this assessment, a reporting entity would consider both quantitative considerations (i.e. the size of the subsidiary) and qualitative considerations (i.e. the nature of the subsidiary).

The decision on which approach is used to present the disclosures required by paragraphs 12(e)–(g) should reflect the one that best meets the disclosure objective of paragraph 10 of PFRS 12 in the circumstances. According to this objective, 'An entity shall disclose information that enables users of its consolidated financial statements to understand (i) the composition of the group; and (ii) the interest that non-controlling interests have in the group's activities and cash flows'.

This judgment would be made separately for each subsidiary or subgroup that has a material non-controlling interest.

Disclosures required by paragraphs 12(e) and (f) of PFRS 12

A reporting entity would meet the requirements in paragraphs 12(e) and (f) by disclosing disaggregated information from the amounts included in the consolidated financial statements of the reporting entity in respect of subsidiaries that have non-controlling interests that are material to the reporting entity. A reporting entity should apply judgment in determining the level of disaggregation of this information; that is, whether:

- (a) the entity presents this information about the subgroup of the subsidiary that has a material non-controlling interest (present the required information on the basis of the subsidiary together with its investees); or
- (b) it is necessary in achieving the disclosure objective in paragraph 10 of PFRS 12 to disaggregate the information further to present information about individual subsidiaries that have material non-controlling interests within that subgroup.



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Disclosures required by paragraph 12(g) of PFRS 12

It is observed that:

- (a) paragraph 12(g) requires summarized information about the subsidiaries that have non-controlling interests that are material to the reporting entity;
- (b) paragraph B10(b) states that an entity shall disclose 'summarized financial information about the assets, liabilities, profit or loss and cash flows of the subsidiary that enables users to understand the interest that non-controlling interests have in the group's activities and cash flows. That information might include but is not limited to, for example, current assets, non-current assets, current liabilities, non-current liabilities, revenue, profit or loss and total comprehensive income'; and
- (c) paragraph B11 states that the 'summarized financial information required by paragraph B10(b) shall be the amounts before inter-company eliminations'.

In order to meet the disclosure objective in paragraph B10(b), that information would need to be prepared on a basis that was consistent with the information included in the consolidated financial statements of the reporting entity. This is understood to mean that the information would be prepared from the perspective of the reporting entity. For example, if the subsidiary was acquired in a business combination, the amounts disclosed should reflect the effects of the acquisition accounting.

It is further observed that in providing the information required by paragraph 12(g) the entity would apply judgment in determining whether:

- (a) the entity presents this information about the subgroup of the subsidiary that has a material non-controlling interest (i.e., it presents the required information on the basis of the subsidiary together with its investees); or
- (b) it is necessary in achieving the disclosure objective in paragraph 10 of PFRS 12 to disaggregate the information further to present information about individual subsidiaries that have material non-controlling interests within that subgroup.

However, the information provided in respect of paragraph 12(g) would include transactions between the subgroup/subsidiary and other members of the reporting entity's group without elimination in order to meet the requirements in paragraph B11 of PFRS 12. The transactions within the subgroup would be eliminated.



PFRS 13, *Fair Value Measurement*

PFRS 13 – Fair value hierarchy when third-party consensus prices are used

Issue

Under what circumstances prices that are provided by third parties would qualify as Level 1 in the fair value hierarchy in accordance with PFRS 13 *Fair Value Measurement*?

Consensus

When assets or liabilities are measured on the basis of prices provided by third parties, the classification of those measurements within the fair value hierarchy will depend on the evaluation of the inputs used by the third party to derive those prices, instead of on the pricing methodology used. In other words, the fair value hierarchy prioritizes the inputs to valuation techniques, not the valuation techniques used to measure fair value. In accordance with PFRS 13, only unadjusted quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date qualify as Level 1 inputs.

Consequently, a fair value measurement that is based on prices provided by third parties may only be categorized within Level 1 of the fair value hierarchy if the measurement relies solely on unadjusted quoted prices in an active market for an identical instrument that the entity can access at the measurement date.



PFRS 15, Revenue on Contracts with Customers

PFRS 15 – Compensation for delays or cancellations

Issue

How should an airline's obligation to compensate customers for delayed or cancelled flights be accounted for:

- a. as variable consideration applying paragraphs 50-59 of PFRS 15, *Revenue from Contracts with Customers*; or
- b. applying PAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, separately from its performance obligation to transfer a flight service to the customer?

Background

The following fact pattern are considered:

- a. The legislation gives a flight passenger (customer) the right to be compensated by the flight provider (entity) for delays and cancellations subject to specified conditions in the legislation. The legislation stipulates the amount of compensation, which is unrelated to the amount the customer pays for a flight.
- b. The legislation creates enforceable rights and obligations, and forms part of the terms of a contract between the entity and a customer.
- c. Applying PFRS 15 to a contract with a customer, the entity identifies as a performance obligation its promise to transfer a flight service to the customer.

Paragraph 47 of PFRS 15 requires an entity to 'consider the terms of the contract and its customary business practices in determining the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer...The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both'. Paragraph 51 of PFRS 15 lists examples of common types of variable consideration—'discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or other similar items'.

Paragraph B33 of PFRS 15 specifies requirements for an entity's obligation to pay compensation to a customer if its products cause harm or damage. An entity accounts for such an obligation applying PAS 37, separately from its performance obligation in the contract with the customer.

Consensus

In the fact pattern described, the entity promises to transport the customer from one specified location to another within a specified time period after the scheduled flight time. If the entity fails to do so, the customer is entitled to compensation. Accordingly, any compensation for delays or cancellations forms part of the consideration to which the entity



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expects to be entitled in exchange for transferring the promised service to the customer; it does not represent compensation for harm or damage caused by the entity's products as described in paragraph B33 of PFRS 15. The fact that legislation, rather than the contract, stipulates the compensation payable does not affect the entity's determination of the transaction price—the compensation gives rise to variable consideration in the same way that penalties for delayed transfer of an asset give rise to variable consideration as illustrated in Example 20 of the Illustrative Examples accompanying PFRS 15.

Consequently, compensation for delays or cancellations, in this fact pattern, is variable consideration in the contract. Accordingly, the entity applies the requirements in paragraphs 50-59 of PFRS 15 in accounting for its obligation to compensate customers for delays or cancellations.



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PFRS 15 – Training Costs to Fulfil a Contract

Issue

How should an entity account for training costs incurred to fulfil a contract with a customer?

Fact pattern

An entity enters into a contract with a customer that is within the scope of PFRS 15, *Revenue from Contracts with Customers*. The contract is for the supply of outsourced services. To be able to provide the services to the customer, the entity incurs costs to train its employees so that they understand the customer's equipment and processes.

The training costs are as described in paragraph 15 of PAS 38 *Intangible Assets* - the entity has insufficient control over the expected future economic benefits arising from the training to meet the definition of an intangible asset because employees can leave the entity's employment. Applying PFRS 15, the entity does not identify the training activities as a performance obligation.

The contract permits the entity to charge to the customer the costs of training (i) the entity's employees at the beginning of the contract, and (ii) new employees that the entity hires as a result of any expansion of the customer's operations.

Consensus

Paragraph 95 of PFRS 15 requires an entity to recognize an asset from the costs incurred to fulfil a contract with a customer if the costs are not within the scope of another PFRS Standard, and only if those costs meet all three criteria specified in paragraph 95. Consequently, before assessing the criteria in paragraph 95, the entity first considers whether the training costs incurred to fulfil the contract are within the scope of another PFRS Standard.

Paragraphs 2-7 of PAS 38 describe the scope of that Standard - paragraph 5 explicitly includes expenditure on training within PAS 38's scope, stating that PAS 38 'applies to, among other things, expenditure on advertising, training, start-up, research and development activities'.

Accordingly, the entity applies PAS 38 in accounting for the training costs incurred to fulfil the contract with the customer. Application of PAS 38 Paragraph 69(b) of PAS 38 includes expenditure on training activities as an example of expenditure that is incurred 'to provide future economic benefits to an entity, but no intangible asset or other asset is acquired or created that can be recognized'. Consequently, paragraph 69 states that such expenditure on training activities is recognized as an expense when incurred. Paragraph 15 of PAS 38 explains that 'an entity usually has insufficient control over the expected future economic



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benefits arising from a team of skilled staff and from training for these items to meet the definition of an intangible asset'.

In addition, in explaining the requirements in PFRS 15 regarding costs to fulfil a contract, paragraph BC307 of PFRS 15 states that 'if the other Standards preclude the recognition of any asset arising from a particular cost, an asset cannot then be recognized under PFRS 15'.

Accordingly, the entity recognizes the training costs to fulfil the contract with the customer as an expense when incurred. The entity's ability to charge to the customer the costs of training does not affect the accounting.



PFRS 16, Leases

PFRS 16 – Meaning of ‘incremental costs’

Issue

Can salary costs of permanent staff involved in negotiating and arranging new leases qualify as ‘incremental costs’ within the context of PFRS 16, *Leases*?

Background

PFRS 16 defines initial direct costs as incremental costs of obtaining a lease that would not have been incurred if the lease had not been obtained, except for such costs incurred by a manufacturer or dealer lessor in connection with a finance lease.

Consensus

Internal fixed costs (e.g., salary costs of permanent staff involved in negotiating and arranging new leases) do not qualify as incremental costs. Only those costs that would not have been incurred if the entity had not negotiated and arranged a lease meet the definition of incremental costs.

PFRS 16 – Refundable security deposit related to lease

Issue

How should the excess of the principal amount of a refundable security deposit over its fair value be accounted for?

Background

In most lease contracts, a lessee is required to pay a deposit to the lessor at the inception of the lease. The deposit is refundable at the termination of the contract, to the extent that it has not been applied by the lessor to remedy the breach of any provisions in the contract or to indemnify any consequential costs or losses related to the leased property that are properly chargeable to the lessee. During the term of the lease contract, the lessee will not receive any interest for its deposit or, if there is any interest, the interest rate is lower than the market interest rate.

Consensus

The refundable security deposit meets the definition of a financial asset (for the lessee) and a financial liability (for the lessor) under Paragraph 11 of PAS 32, *Financial Instruments: Presentation*, thus, it is within the scope of PFRS 9, *Financial Instruments*, and must initially be accounted for at fair value in accordance with paragraph 5.1.1 of that standard. The fair value of the deposit is determined based on the prevailing market rate of interest for a similar loan, considering the credit worthiness of the lessor and, depending on facts and circumstances, any additional security available to the lessee.



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The excess of the principal amount of the deposit over its fair value is within the scope of PFRS 16, *Leases*. Appendix A of PFRS 16 defines lease payments as “payments made by a lessee to a lessor relating to the right to use an underlying asset during the lease term...”. Such excess amount is therefore regarded as an additional amount payable by the lessee / receivable by the lessor. From the lessee’s perspective, this amount is capitalized as part of the cost of the right-of-use asset (PFRS 16.24 and 26). On the other hand, the lessor treats this as an income to be recognized either on a straight-line basis or another systematic basis if that basis is more representative of the pattern in which benefit from the use of the underlying asset is diminished (PFRS 16.81).

PFRS 16 – Lessee’s incremental borrowing rate

Issue

Under PFRS 16, *Leases*, is a lessee’s incremental borrowing rate required to reflect the interest rate in a loan with both a similar maturity to the lease and a similar payment profile to the lease payments?

Background

Paragraph 26 of PFRS 16 states that a lessee uses its incremental borrowing rate in measuring a lease liability when the interest rate implicit in the lease cannot be readily determined. Appendix A to PFRS 16 defines a lessee’s incremental borrowing rate as ‘the rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment’.

Paragraph BC162 of PFRS 16 provides that the lessee’s incremental borrowing rate is therefore a lease-specific rate defined ‘to take into account the terms and conditions of the lease’. In determining its incremental borrowing rate, depending on the nature of the underlying asset and the terms and conditions of the lease, a lessee may be able to refer to a rate that is readily observable as a starting point. A lessee would then adjust such an observable rate as is needed to determine its incremental borrowing rate as defined in PFRS 16.

Consensus

The definition of a lessee’s incremental borrowing rate requires a lessee to determine its incremental borrowing rate for a particular lease considering the terms and conditions of the lease, and determine a rate that reflects the rate it would have to pay to borrow:

- a. over a similar term to the lease term;
- b. with a similar security to the security (collateral) in the lease;
- c. the amount needed to obtain an asset of a similar value to the right-of-use asset arising from the lease; and
- d. in a similar economic environment to that of the lease.



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The definition of a lessee's incremental borrowing rate in PFRS 16 does **not** explicitly require a lessee to determine its incremental borrowing rate to reflect the interest rate in a loan with a similar payment profile to the lease payments. Nonetheless, in applying judgement in determining its incremental borrowing rate as defined in PFRS 16, it would be consistent with the definition of incremental borrowing rate for a lessee to refer as a starting point to a readily observable rate for a loan with a similar payment profile to that of the lease.



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PFRS 16 – Definition of a Lease - Decision-making Rights

Issue

How does an entity assess whether it has the right to direct the use of an identified asset throughout the term of a contract?

Fact pattern

An entity (customer) enters into a contract with a ship owner (supplier) for the exclusive use of a ship (specified in the contract) for a five-year period to transport coal to region 'S'.

Some of the relevant decisions about how and for what purpose the ship is used are predetermined in the contract, for example, the capacity of the ship per voyage, consecutive voyage condition, types of voyages (only from three specified locations to region 'S'), shipment distance and duration per type of voyage and price per ton of coal transported per type of voyage. However, the customer has the right to determine the order of voyages throughout the period of use (i.e. from where the ship sails for each voyage) based on its annual and quarterly shipment plans. The customer does not have the right to operate or maintain the ship and did not design the ship.

Based on the above fact pattern, it is assessed that:

- there is an identified asset (the ship) applying paragraphs B13-B20 of PFRS 16.
- the customer has the right to obtain substantially all the economic benefits from use of the ship throughout the five-year period of use applying paragraphs B21-B23 of PFRS 16.
- The customer's decision-making right (as discussed above) is relevant because it affects the economic benefits to be derived from use of the ship.

Consensus

Paragraph B24 of PFRS 16 specifies when a customer has the right to direct the use of an identified asset throughout the period of use. Paragraph B24(b) applies only when the relevant decisions about how and for what purpose the asset is used are predetermined. It can be noted in paragraph BC121 of PFRS 16 that 'it would expect decisions about how and for what purpose an asset is used to be predetermined in relatively few cases'.

In the fact pattern above, because not all relevant decisions about how and for what purpose the ship is used are predetermined, the customer considers paragraph B24(a) of PFRS 16 in assessing whether it has the right to direct the use of the ship.

Paragraph B24(a) specifies that a customer has the right to direct the use of an identified asset throughout the period of use if it has 'the right to direct how and for what purpose the asset is used throughout the period of use (as described in paragraphs B25-B30)'.

Paragraph B25 provides that to have the right to direct how and for what purpose the asset is used, within the scope of its right of use defined in the contract, the customer must be able to change how and for what purpose the asset is used throughout the period of use. In assessing whether that is the case, an entity considers rights to make decisions during the



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period of use that are most relevant to changing how and for what purpose the asset is used throughout that period. Decision-making rights are relevant when they affect the economic benefits to be derived from use.

Paragraph B29 further provides that an entity does not consider decisions that are predetermined before the period of use unless the conditions in paragraph B24(b)(ii) exist.

Paragraph B26 includes examples of decision-making rights that, depending on the circumstances, grant the right to change how and for what purpose the asset is used. Paragraph 27 provides that rights limited to operating or maintaining the asset do not grant the right to change how and for what purpose it is used.

It can be observed that the customer has the right to direct how and for what purpose the ship is used throughout the period of use. The customer has the right to make decisions about the use of the ship during the period of use that affect the economic benefits to be derived from that use. Therefore, within the scope of its right of use defined in the contract, the customer can change how and for what purpose the ship is used. The predetermination in the contract of many decisions about how and for what purpose the ship is used defines the scope of the customer's right of use - within that scope, the customer has the right to make the decisions that are most relevant to changing how and for what purpose the ship is used.

Although the operation and maintenance of the ship are essential to its efficient use, the supplier's decisions in this regard do not give it the right to direct how and for what purpose the ship is used.

It can be concluded that the customer has the right to direct the use of the ship throughout the period of use. Consequently, the contract contains a lease.



PFRS 16 – Sale and Leaseback with Variable Payments

Issue

How does a seller-lessee measure the right-of-use asset and determine the amount of any gain or loss recognized in a sale and leaseback transaction with variable payments?

Fact pattern

An entity (seller-lessee) enters into a sale and leaseback transaction whereby it transfers an item of property, plant and equipment (PPE) to another entity (buyer-lessor) and leases the asset back for five years. The transfer of the PPE satisfies the requirements in PFRS 15 *Revenue from Contracts with Customers* to be accounted for as a sale of the PPE. The amount paid by the buyer-lessor to the seller-lessee in exchange for the PPE equals the PPE's fair value at the date of the transaction.

The payments for the lease (which are at market rates) include variable payments, calculated as a percentage of the seller-lessee's revenue generated using the PPE during the five-year lease term. The seller-lessee has determined that the variable payments are not in-substance fixed payments as described in IFRS 16.

Consensus

Paragraph 100 of PFRS 16 states that 'if the transfer of an asset by the seller-lessee satisfies the requirements of PFRS 15 to be accounted for as a sale of the asset: (a) the seller-lessee shall measure the right-of-use asset arising from the leaseback at the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee. Accordingly, the seller-lessee shall recognize only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor. ...'.

Consequently, to measure the right-of-use asset arising from the leaseback, the seller-lessee determines the proportion of the PPE transferred to the buyer-lessor that relates to the right of use retained – it does so by comparing, at the date of the transaction, the right of use it retains via the leaseback to the rights comprising the entire PPE. PFRS 16 does not prescribe a method for determining that proportion.

In the above fact pattern, the seller-lessee could determine the proportion by comparing, for example, (a) the present value of expected payments for the lease (including those that are variable), with (b) the fair value of the PPE at the date of the transaction.

The gain or loss the seller-lessee recognizes at the date of the transaction is a consequence of its measurement of the right-of-use asset arising from the leaseback. Because the right of use the seller-lessee retains is not remeasured as a result of the transaction (it is measured as a proportion of the PPE's previous carrying amount), the amount of the gain or loss recognized relates only to the rights transferred to the buyer-lessor.

Applying paragraph 53(i) of PFRS 16, the seller-lessee discloses gains or losses arising from sale and leaseback transactions. The seller-lessee also recognizes a liability at the date of the transaction, even if all the payments for the lease are variable and do not depend on an index or rate. The initial measurement of the liability is a consequence of how the right-of-



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use asset is measured – and the gain or loss on the sale and leaseback transaction determined – applying paragraph 100(a) of IFRS 16.



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Illustrative example

Seller-lessee enters into a sale and leaseback transaction whereby it transfers an asset (PPE) to Buyer lessor, and leases that PPE back for five years. The transfer of the PPE satisfies the requirements in PFRS 15 to be accounted for as a sale of the PPE.

The carrying amount of the PPE in Seller-lessee's financial statements at the date of the transaction is CU1,000,000, and the amount paid by Buyer-lessor for the PPE is CU1,800,000 (the fair value of the PPE at that date). All the payments for the lease (which are at market rates) are variable, calculated as a percentage of Seller-lessee's revenue generated using the PPE during the five-year lease term. At the date of the transaction, the present value of the expected payments for the lease is CU450,000. There are no initial direct costs.

Seller-lessee determines that it is appropriate to calculate the proportion of the PPE that relates to the right of use retained using the present value of expected payments for the lease. On this basis, the proportion of the PPE that relates to the right of use retained is 25%, calculated as CU450,000 (present value of expected payments for the lease) ÷ CU1,800,000 (fair value of the PPE). Consequently, the proportion of the PPE that relates to the rights transferred to Buyer-lessor is 75%, calculated as (CU1,800,000 – CU450,000) ÷ CU1,800,000.

Applying paragraph 100(a), Seller-lessee:

- a. measures the right-of-use asset at CU250,000, calculated as CU1,000,000 (previous carrying amount of the PPE) × 25% (proportion of the PPE that relates to the right of use it retains).*
- b. recognizes a gain of CU600,000 at the date of the transaction, which is the gain that relates to the rights transferred to Buyer-lessor. This gain is calculated as CU800,000 (total gain on sale of the PPE (CU1,800,000 – CU1,000,000)) × 75% (proportion of the PPE that relates to rights transferred to Buyer-lessor).*

Applying paragraph 100(a), the right-of-use asset would not be measured at zero at the date of the transaction because zero would not reflect the proportion of the previous carrying amount of the PPE (CU1,000,000) that relates to the right of use retained by Seller-lessee.

At the date of the transaction, Seller-lessee accounts for the transaction as follows:

<i>Dr. Cash</i>	<i>CU1,800,000</i>
<i>Dr. Right-of-use asset</i>	<i>CU250,000</i>
<i> Cr. PPE</i>	<i>CU1,000,000</i>
<i>Cr. Liability</i>	<i>CU450,000</i>
<i>Cr. Gain on rights transferred</i>	<i>CU600,000</i>



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PAS 1, *Presentation of Financial Statements*

PAS 1 – Disclosure requirements relating to assessment of going concern

Issue

Are disclosures required for judgments made in relation to material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern?

Background

This Q&A deals in a situation in which management of an entity has considered events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern.

Having considered all relevant information, including the feasibility and effectiveness of any planned mitigation, management concluded that there are no material uncertainties that require disclosure in accordance with paragraph 25 of PAS 1, *Presentation of Financial Statements*. However, reaching the conclusion that there was no material uncertainty involved significant judgment.

Paragraph 25 of PAS 1 requires that when preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.

Consensus

Paragraph 122 of PAS 1 requires that an entity shall disclose, in the summary of significant accounting policies or other notes, the judgments, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognized in the financial statements.

The disclosure requirements of paragraph 122 of PAS 1 shall apply to the judgments made in concluding that there remain no material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern.



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PAS 1 and PAS 12 – Presentation of payments on non-income taxes

Issue

Should production based royalty payments payable to one taxation authority that are claimed as an allowance against taxable profit for the computation of income tax payable to another taxation authority be presented as an operating expense or a tax expense in the statement of comprehensive income?

Background

On the basis of the assumption that the production-based royalty payments are, in themselves, outside the scope of PAS 12, *Income Taxes* while the income tax payable to the other taxation authority is within the scope of PAS 12, this Q&A clarifies whether the production-based royalty payments can be viewed as prepayment of the income tax payable.

Consensus

The line item of 'tax expense' that is required by paragraph 82(d) of PAS 1, *Presentation of Financial Statements*, is intended to require an entity to present taxes that meet the definition of income taxes under PAS 12.

It is the basis of calculation determined by the relevant tax rules that determines whether a tax meets the definition of an income tax. Neither the manner of settlement of a tax liability nor the factors relating to recipients of the tax is a determinant of whether an item meets that definition.

Production-based royalty payments should not be treated differently from other expenses that are outside the scope of PAS 12, all of which may reduce income tax payable. Accordingly, it is inappropriate to consider the royalty payments to be prepayment of the income tax payables. Because the production-based royalties are not income taxes, the royalty payments should not be presented as an income tax expense in the statement of comprehensive income.

PAS 1 – Presentation of liabilities or assets related to uncertain tax treatments

Issue

How should an entity present assets or liabilities related to uncertain tax treatments recognized applying Philippine Interpretation-IFRIC 23 *Uncertainty over Income Tax Treatments*?

Background

When there is uncertainty over income tax treatments, paragraph 4 of IFRIC 23 requires an entity to 'recognize and measure its current or deferred tax asset or liability applying the requirements in PAS 12, *Income Taxes* based on taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates determined applying IFRIC 23'.



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Paragraph 5 of PAS 12 defines:

- a. current tax as the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period; and
- b. deferred tax liabilities (or assets) as the amounts of income taxes payable (recoverable) in future periods in respect of taxable (deductible) temporary differences and, in the case of deferred tax assets, the carryforward of unused tax losses and credits.

It can be observed that uncertain tax liabilities or assets recognized applying IFRIC 23 are liabilities (or assets) for current tax as defined in PAS 12, or deferred tax liabilities or assets as defined in PAS 12.

Consensus

Neither PAS 12 nor IFRIC 23 contain requirements on the presentation of uncertain tax liabilities or assets. Therefore, the presentation requirements in PAS 1, *Presentation of Financial Statements* apply.

Paragraph 54 of PAS 1 states that 'the statement of financial position shall include line items that present:

- (n) liabilities and assets for current tax, as defined in PAS 12;
- (o) deferred tax liabilities and deferred tax assets, as defined in PAS 12...'

Paragraph 57 of PAS 1 states that paragraph 54 'lists items that are sufficiently different in nature or function to warrant separate presentation in the statement of financial position'. Paragraph 29 requires an entity to 'present separately items of a dissimilar nature or function unless they are immaterial'.

Accordingly, applying PAS 1, an entity is required to present uncertain tax liabilities as current tax liabilities or deferred tax liabilities and uncertain tax assets as current tax assets or deferred tax assets.



PAS 7, Cash Flow Statements

PAS 7 – Identification of cash equivalents

Issue

What is the basis of classification of investments as cash equivalents?

Background

This Q&A deals with the basis of classification of financial assets as cash equivalents in accordance with PAS 7.

Some argue that the classification of investments as cash equivalents on the basis of the remaining period to maturity as at the balance sheet date would lead to a more consistent classification rather than the current focus on the investment's maturity from its acquisition date.

Consensus

On the basis of paragraph 7 of PAS 7, financial assets held as cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. This paragraph further states that an investment is classified as a cash equivalent, only when it has a short maturity from the date of acquisition.

Paragraph 7 of PAS 7 promotes consistency between entities in the classification of cash equivalents.



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PAS 10, *Events after the Reporting Period*

PAS 10 – Reissuing previously issued financial statements

Issue

Does PAS 10, *Events after the Reporting Period*, permit only one date of authorization for issue (i.e. 'dual dating' is not permitted) when considered within the context of reissuing previously issued financial statements in connection with an offering document?

Background

This Q&A deals with the accounting implications of applying PAS 10, *Events after the Reporting Period*, when previously issued financial statements are reissued in connection with an offering document.

The issue arose in jurisdictions in which securities laws and regulatory practices require an entity to reissue its previously issued annual financial statements in connection with an offering document, when the most recently filed interim financial statements reflect matters that are accounted for retrospectively under the applicable accounting standards. In these jurisdictions, securities law and regulatory practices do not require or permit the entity, in its reissued financial statements, to recognize events or transactions that occur between the time the financial statements were first authorized for issuance and the time the financial statements are reissued, unless the adjustment is required by national regulation; instead security and regulatory practices require the entity to recognize in its reissued financial statements only those adjustments that would ordinarily be made to the comparatives in the following year's financial statements. These adjustments would include, for example, adjustments for changes in accounting policy that are applied retrospectively, but would not include changes in accounting estimates. This approach is called 'dual dating'.

Consensus

The scope of PAS 10 is the accounting for, and disclosure of, events after the reporting period and that its objective is to prescribe:

- a) when an entity should adjust its financial statements for events after the reporting period; and
- b) the disclosures that an entity should give about the date when the financial statements were authorized for issue and about events after the reporting period.

Financial statements prepared in accordance with PAS 10 should reflect all adjusting and non-adjusting events up to the date that the financial statements were authorized for issue.

PAS 10 does not address the presentation of re-issued financial statements in an offering document when the originally issued financial statements have not been withdrawn, but the re-issued financial statements are provided either as supplementary information or a re-presentation of the original financial statements in an offering document in accordance with regulatory requirements.



Philippine Interpretations Committee

PAS 12, *Income Taxes*

PAS 12 – Recognition of deferred tax for a single asset in a corporate wrapper

Issue

How should deferred tax be accounted for in the consolidated financial statements of the parent, when a subsidiary has only one asset within it (the asset inside) and the parent expects to recover the carrying amount of the asset inside by selling the shares in the subsidiary (the shares)?

Background

Paragraph 11 of PAS 12 requires the entity to determine temporary differences in the consolidated financial statements by comparing the carrying amounts of assets and liabilities in the consolidated financial statements with the appropriate tax base. In the case of an asset or a liability of a subsidiary that files separate tax returns, this is the amount that will be taxable or deductible on the recovery (settlement) of the asset (liability) in the tax returns of the subsidiary.

The requirement in paragraph 11 of PAS 12 is complemented by the requirement in paragraph 38 of PAS 12 to determine the temporary difference related to the shares held by the parent in the subsidiary by comparing the parent's share of the net assets of the subsidiary in the consolidated financial statements, including the carrying amount of goodwill, with the tax base of the shares for purposes of the parent's tax returns.

Consensus

Paragraphs 11 and 28 of PAS 12 require a parent to recognize both the deferred tax related to the asset inside and the deferred tax related to the shares, if:

- a) tax law attributes separate tax bases to the asset inside and to the shares;
- b) in the case of deferred tax assets, the related deductible temporary differences can be utilized as specified in paragraphs 24-31 of PAS 12; and
- c) no specific exceptions in PAS 12 apply.



Philippine Interpretations Committee

PAS 12 – Impact of an internal reorganization on deferred tax amounts related to goodwill

Issue

In accordance with PAS 12, *Income Taxes*, how should an entity calculate deferred tax following an internal reorganization transaction in its consolidated financial statements?

Background

An entity (Entity H) recognized goodwill that had resulted from the acquisition of a group of assets (Business C) that meets the definition of a business in PFRS 3, *Business Combinations*. Entity H subsequently recorded a deferred tax liability relating to goodwill deducted for tax purposes.

Against this background, Entity H effects an internal reorganization in which:

- a) Entity H sets up a new wholly-owned subsidiary (Subsidiary A);
- b) Entity H transfers Business C, including the related (accounting) goodwill to Subsidiary A; however,
- c) for tax purposes, the (tax) goodwill is retained by Entity H and not transferred to Subsidiary A.

Consensus

When entities in the same consolidated group file separate tax returns, separate temporary differences will arise in those entities in accordance with paragraph 11 of PAS 12. When an entity prepares its consolidated financial statements, deferred tax balances would be determined separately for those temporary differences, using the applicable tax rates for each entity's tax jurisdiction.

When calculating the deferred tax amount for the consolidated financial statements:

- a) the amount used as the carrying amount by the 'receiving' entity (in this case, Subsidiary A that receives the (accounting) goodwill) for an asset or a liability is the amount recognized in the consolidated financial statements; and
- b) the assessment of whether an asset or a liability is being recognized for the first time for the purpose of applying the initial recognition exception described in paragraphs 15 and 24 of PAS 12 is made from the perspective of the consolidated financial statements.

Transferring the goodwill to Subsidiary A would not meet the initial recognition exception described in paragraphs 15 and 24 of PAS 12 in the consolidated financial statements.

Consequently, deferred tax would be recognized in the consolidated financial statements for any temporary differences arising in each separate entity by using the applicable tax rates for each entity's tax jurisdiction (subject to meeting the recoverability criteria for recognizing deferred tax assets described in PAS 12).



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If there is a so-called 'outside basis difference' (i.e. a temporary difference between the carrying amount of the investment in Subsidiary A and the tax base of the investment) in the consolidated financial statements, deferred tax for such a temporary difference would also be recognized subject to the limitations and exceptions applying to the recognition of a deferred tax asset (in accordance with paragraph 44 of PAS 12) and a deferred tax liability (in accordance with paragraph 39 of PAS 12).

Transferring assets between the entities in the consolidated group would affect the consolidated financial statements in terms of recognition, measurement and presentation of deferred tax, if the transfer affects the tax base of assets or liabilities, or the tax rate applicable to the recovery or settlement of those assets or liabilities. Such a transfer could also affect:

- a) the recoverability of any related deductible temporary differences and thereby affect the recognition of deferred tax assets; and
- b) the extent to which deferred tax assets and liabilities of different entities in the group are offset in the consolidated financial statements.

PAS 12 – Recognition and measurement of deferred tax assets when an entity is loss-making

Issues

1. Does PAS 12, *Income Taxes*, require that a deferred tax asset be recognized for the carryforward of unused tax losses when there are suitable reversing taxable temporary differences, regardless of an entity's expectations of future tax losses?
2. How should the guidance in PAS 12 be applied when tax laws limit the extent to which tax losses brought forward can be recovered against future taxable profits?

In the tax systems considered for the second issue, the amount of tax losses brought forward that can be recovered in each tax year is limited to a specified percentage of the taxable profits of that year.

Consensus

According to paragraphs 28 and 35 of PAS 12:

- a) A deferred tax asset is recognized for the carryforward of unused tax losses to the extent of the existing taxable temporary differences, of an appropriate type, that reverse in an appropriate period. The reversal of those taxable temporary differences enables the utilization of the unused tax losses and justifies the recognition of deferred tax assets. Consequently, future tax losses are not considered.
- b) When tax laws limit the extent to which unused tax losses can be recovered against future taxable profits in each year, the amount of deferred tax assets recognized from unused tax losses as a result of suitable existing taxable temporary differences is restricted as specified by the tax law. This is because when the suitable taxable



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temporary differences reverse, the amount of tax losses that can be utilized by that reversal is reduced as specified by the tax law. Also, in this case future tax losses are not considered.

- c) In both cases, if the unused tax losses exceed the amount of suitable existing taxable temporary differences (after taking into account any restrictions), an additional deferred tax asset is recognized only if the requirements in paragraphs 29 and 36 of PAS 12 are met (i.e. to the extent that it is probable that the entity will have appropriate future taxable profit, or to the extent that tax planning opportunities are available to the entity that will create appropriate taxable profit).

PAS 12 – Accounting for market value uplifts on assets that are to be introduced by a new income tax regime

Issue

What is the accounting for market value uplifts introduced in a new income tax regime in a jurisdiction?

Background

In calculating taxable profit under the tax regime, entities are permitted to calculate tax depreciation for certain mining assets using the market value of the assets as of a particular date as the 'starting base allowance', rather than the cost or carrying amount of the assets. If there is insufficient profit against which the annual tax depreciation can be used, it is carried forward and can be used as a deduction against taxable profit in future years.

Consensus

The starting base allowance, including the part that is attributable to the market value uplift, is attributed to the related assets under the tax regime and will become the basis for depreciation expense for tax purposes.

Consequently, the market value uplift forms part of the related asset's 'tax base', as defined in paragraph 5 of PAS 12, *Income Taxes*. PAS 12 requires an entity to reflect an adjustment to the tax base of an asset that is due to an increase in the deductions available as a deductible temporary difference. Accordingly, a deferred tax asset should be recognized to the extent that it meets the recognition criteria in paragraph 24 of PAS 12.



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PAS 12 – Selection of applicable tax rate for the measurement deferred tax relating to an investment in an associate

Issue

What is the applicable tax rate for the measurement of deferred tax relating to an investment in an associate in a multi-tax rate jurisdiction?

Background

This Q&A discusses how the tax rate should be selected when local tax legislation prescribes different tax rates for different manners of recovery (for example, dividends, sale, liquidation, etc.). This Q&A describes a situation in which the carrying amount of an investment in an associate could be recovered by:

- (a) receiving dividends (or other distribution of profit);
- (b) sale to a third party; or
- (c) receiving residual assets upon liquidation of the associate.

Consensus

Paragraph 51A of PAS 12 states that an entity measures deferred tax liabilities and deferred tax assets using the tax rate and the tax base that are consistent with the expected manner of recovery or settlement.

Accordingly, the tax rate should reflect the expected manner of recovery or settlement. If one part of the temporary difference is expected to be received as dividends, and another part is expected to be recovered upon sale or liquidation (for example, an investor has a plan to sell the investment later and expects to receive dividends until the sale of the investment), different tax rates would be applied to the parts of the temporary difference in order to be consistent with the expected manner of recovery.



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PAS 12 – Recognition of deferred taxes when acquiring a single-asset entity that is not a business

Issue

Should an acquirer recognize, in its consolidated financial statements, deferred tax liability on initial recognition of an acquisition on entity that does not qualify as a business and only has a single asset (e.g., investment property)?

Background

An entity acquires all the shares of another entity that has an investment property as its only asset. The acquisition does not meet the definition of a business combination in PFRS 3, *Business Combinations*, because the acquired entity is not a business. The acquiring entity applies the fair value model in PAS 40, *Investment Property*.

Consensus

Because the transaction is not a business combination, paragraph 2(b) of PFRS 3, therefore, requires the acquiring to allocate, in its consolidated financial statements, the purchase price to the assets acquired and liabilities assumed. In addition, paragraph 15(b) of PAS 12 states that an entity does not recognize a deferred tax liability for taxable temporary differences that arise from the initial recognition of an asset or liability in a transaction that is not a business combination and that, at the time of the transaction, affects neither accounting profit or loss nor taxable profit or tax loss.

Accordingly, upon acquisition, the acquiring entity should only recognize the investment property and not a deferred tax liability in its consolidated financial statements. The entire purchase price should therefore be allocated to the investment property.



PAS 12 – Expected manner of recovery of intangible assets with indefinite useful lives

Issue

How should an entity determine the expected manner of recovery of an intangible asset with an indefinite useful life for the purposes of measuring deferred tax?

Consensus

Paragraph 51 of PAS 12 states that the measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that follow from the manner in which an entity expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

An intangible asset with an indefinite useful life is not a non-depreciable asset as envisaged by paragraph 51B of PAS 12. This is because a non-depreciable asset has an unlimited (or infinite) life, and PAS 38 explains that indefinite does not mean infinite. Hence, the requirements in paragraph 51B of PAS 12 do not apply to intangible assets with an indefinite useful life.

An entity does not amortize an intangible asset with an indefinite useful life not because there is no consumption of the future economic benefits embodied in the asset, but because there is no foreseeable limit on the period during which it expects to consume the future economic benefits embodied in the asset.

Accordingly, the recovery of the carrying amount of an asset does not depend on whether the asset is amortized. Further, the non-amortization of the asset does not necessarily mean that the entity will recover the carrying amount of that asset only through sale and not through use.

Consequently, an entity should apply the principle and requirements in paragraphs 51 and 51A of PAS 12 when measuring deferred tax on an intangible asset with an indefinite useful life. In applying these paragraphs, an entity determines its expected manner of recovery of the carrying amount of the intangible asset with an indefinite useful life, and reflects the tax consequences that follow from that expected manner of recovery.



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PAS 12 - Interest and penalties related to income taxes

Issue

How does an entity account for interest and penalties related to income taxes given that current PFRSs do not specifically address the accounting for such items?

Consensus

If an entity considers a particular amount payable or receivable for interest and penalties to be an income tax, then the entity applies PAS 12 to that amount. If an entity does not apply PAS 12 to a particular amount payable or receivable for interest and penalties, it applies PAS 37 to that amount. An entity discloses its judgement in this respect applying paragraph 122 of PAS 1 if it is part of the entity's judgements that had the most significant effect on the amounts recognized in the financial statements.



PAS 16, *Property, Plant and Equipment*

PAS 16 – Disclosure of carrying amounts under the cost model

Issue

Is an entity required to reflect the capitalization of borrowing costs to meet the disclosure requirement in paragraph 77(e) of PAS 16 *Property, Plant and Equipment*, for assets stated at revalued amounts for which borrowing costs are not capitalized in accordance with paragraph 4(a) of PAS 23, *Borrowing Costs*?

Background

Paragraph 77(e) of PAS 16 requires that if items of property, plant and equipment are stated at revalued amounts, the carrying amount that would have been recognized had the assets been carried under the cost model shall be disclosed for each revalued class of property, plant and equipment.

Paragraph 4(a) of PAS 23 states that an entity is not required to apply PAS 23 to borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset measured at fair value.

Some assert that the capitalization of borrowing costs for these assets to meet disclosure requirements is burdensome and suggested that it should not be a requirement of PAS 16 to capitalize these costs.

Consensus

The requirements in paragraph 77(e) of PAS 16 are clear. This paragraph requires an entity to disclose the amount at which assets stated at revalued amounts would have been stated at had those assets been carried under the cost model. The amount to be disclosed includes borrowing costs capitalized in accordance with PAS 23.



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PAS 19, *Employee Benefits*

PAS 19 – Pre-tax or post-tax discount rate

Issue

Is the discount rate used to calculate a defined benefit obligation a pre-tax or post-tax rate in accordance with PAS 19, *Employee Benefits* (Revised)?

Background

This Q&A deals with the guidance on the calculation of defined benefit obligations. In particular, this clarifies whether, in accordance with PAS 19, the discount rate used to calculate a defined benefit obligation should be a pre-tax or post-tax rate.

The tax regime considered in this Q&A can be summarized as follows:

- a) the entity receives a tax deduction for contributions that are made to the plan;
- b) the plan pays tax on the contributions received and on the investment income earned; but
- c) the plan does not receive a tax deduction for the benefits paid.

Consensus

It should be noted that:

- a) paragraph 76(b)(iv) of PAS 19 mentions only taxes on contributions and benefits payable within the context of measuring the defined benefit obligation;
- b) paragraph 130 of PAS 19 states that: “in determining the return on plan assets, an entity deducts the costs of managing the plan assets and any tax payable by the plan itself, other than tax included in the actuarial assumptions used to measure the defined benefit obligation”; and
- c) according to paragraph BC130 of PAS 19 the measurement of the obligation should be independent of the measurement of any plan assets actually held by a plan.

Consequently, the discount rate used to calculate a defined benefit obligation should be a pre-tax discount rate.



PAS 23, *Borrowing Costs*

PAS 23 – Overtime time transfer of constructed good

Issue

Can a real estate developer capitalize borrowing costs on the unsold units of a residential multi-unit real estate development (building) under construction described in the fact pattern below?

Fact pattern

A real estate developer constructs the building and sells the individual units in the building to customers. The developer borrows funds specifically for the purpose of constructing the building and incurs borrowing costs in connection with that borrowing.

Before construction begins, the developer signs contracts with customers for the sale of some of the units in the building (sold units). It intends to enter into contracts with customers for the remaining partially constructed units (unsold units) as soon as it finds suitable customers.

The terms of, and relevant facts and circumstances relating to, the developer's contracts with customers (for both the sold and unsold units) are such that, applying paragraph 35(c) of PFRS 15, *Revenue from Contracts with Customers*, the developer transfers control of each unit over time and, therefore, recognizes revenue over time. The consideration promised by the customer in the contract is in the form of cash or another financial asset.

Consensus

Applying paragraph 8 of PAS 23, an entity capitalizes borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. Paragraph 5 of PAS 23 defines a qualifying asset as 'an asset that necessarily takes a substantial period of time to get ready for its intended use or sale'.

Inventory for unsold units under construction (work-in-progress) that the developer recognizes is not a qualifying asset. This asset is ready for its intended sale in its current condition—i.e., the developer intends to sell the partially constructed units as soon as it finds suitable customers and, on signing a contract with a customer, will transfer control of any work-in-progress relating to that unit to the customer. Accordingly, no borrowing costs can be capitalized on such unsold real estate inventories.

PAS 24, *Related Party Disclosures*

PAS 24 – Definition of close members of the family of a person

Issue

Can parents of a person be considered as close members of the family of a person in accordance with paragraph 9 of PAS 24?

Background

The definition of close members of the family of a person in paragraph 9 of PAS 24 does not specify that the parents of a person could be included in this definition. Some think that this definition should include a person's parents, because in their view they are among the closest members of the family of a person who may be expected to influence, or be influenced by, that person in their dealings with the entity. Some observes that local regulations in some jurisdictions include the parents of a person within the definition of 'close members of the family of a person'.

Consensus

The definition of close members of the family of a person in paragraph 9 of PAS 24:

- is expressed in a principle-based manner and involves the use of judgment to determine whether members of the family of a person (including that person's parents) are related parties or not; and
- includes a list of family members that are always considered close members of the family of a person.

The list of family members in paragraph 9(a)–(c) of PAS 24 is not exhaustive and does not preclude other family members from being considered as close members of the family of a person.

Consequently, other family members, including parents or grandparents, could qualify as close members of the family depending on the assessment of specific facts and circumstances.



PAS 27, *Separate Financial Statements*

PAS 27 – Investment in a subsidiary accounted for at cost: Step acquisition

Issues

1. How does an entity determine the cost of an investment in subsidiary acquired through step acquisition in its separate financial statements?
2. How does an entity account for any difference between the fair value of the initial interest at the date of obtaining control of the subsidiary and its original consideration in the separate financial statements when applying the accumulated cost approach?

Background

The entity preparing separate financial statements:

- elects to account for its investments in subsidiaries at cost applying paragraph 10 of PAS 27.
- holds an initial investment in another entity (investee). The investment is an investment in an equity instrument as defined in paragraph 11 of PAS 32, *Financial Instruments: Presentation*. The investee is not an associate, joint venture or subsidiary of the entity and, accordingly, the entity applies PFRS 9, *Financial Instruments*, in accounting for its initial investment (initial interest).
- subsequently acquires an additional interest in the investee (additional interest), which results in the entity obtaining control of the investee—i.e., the investee becomes a subsidiary of the entity.

Consensus

PAS 27 does not define 'cost', nor does it specify how an entity determines the cost of an investment acquired in stages. Cost is defined in other PFRSs (for example, paragraph 6 of PAS 16, *Property Plant and Equipment*, paragraph 8 of PAS 38, *Intangible Assets*, and paragraph 5 of PAS 40, *Investment Property*).

A reasonable reading of the requirements in PFRSs could result in the application of either one of the two approaches in determining the cost of an investment in subsidiary acquired through step acquisition in an investor's separate financial statements: (1) fair value as deemed cost approach or (2) accumulated cost approach.

Under the fair value as deemed cost approach, the cost of the entity's investment in subsidiary is the sum of the fair value of the initial interest on the date the investor acquires control of the investee, plus the consideration paid for the additional interest. This approach is in the view that the investor is exchanging its initial interest (plus consideration paid for the additional interest) for a controlling interest in the investee (exchange view).

Under the accumulated cost approach, the cost of the entity's investment in subsidiary is the sum of the consideration paid for the initial interest when the investor acquired the initial interest (original consideration), plus the consideration paid for the additional interest. This



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approach is in the view that the investor is purchasing additional interest while retaining the initial interest (non-exchange view).

Choosing which approach to apply on transactions involving step acquisition transactions is an accounting policy choice that should be applied consistently.

When applying the accumulated cost approach, any difference between the fair value of the initial interest at the date of obtaining control of the subsidiary and its original consideration meets the definitions of income or expenses in the *Conceptual Framework for Financial Reporting* because a step acquisition transaction is a significant change in the nature of, and economic circumstances surrounding, that investment. Accordingly, applying paragraph 88 of PAS 1, the entity recognizes this difference in profit or loss, regardless of whether, before obtaining control, the entity had presented subsequent changes in fair value of the initial interest in profit or loss or other comprehensive income.

The election in paragraph 4.1.4 of PFRS 9 to present changes in other comprehensive income applies only to 'subsequent changes in fair value'. This difference does not arise from a change in the fair value of the instrument—the entity ceases to apply PFRS 9 and immediately applies PAS 27 so no fair value change has occurred. Consequently, the entity presents the difference in profit or loss.

No PFRS Standard requires or permits the presentation of any difference between the cost of an investment retained and its fair value other than in profit or loss. There is also no basis to recognize the difference in equity because the difference does not result from a transaction with owners in their capacity as owners.



PAS 28, *Investment in Associates and Joint Ventures*

PAS 28 – Impairment of investments in associates in separate financial statements

Issue

Should an entity apply the provisions of PAS 36, *Impairment of Assets*, or PFRS 9, *Financial Instruments*, to test its investments in subsidiaries, joint ventures, and associates carried at cost or using the equity method for impairment in its separate financial statements?

Background

According to paragraph 10 of PAS 27, *Consolidated Financial Statements*, an entity, in its separate financial statements, shall account for investments in subsidiaries, joint ventures and associates either at cost, in accordance with PFRS 9, *Financial Instruments*; or using the equity method as described in PAS 28, *Investments in Associates and Joint Ventures*.

According to paragraphs 4 and 5 of PAS 36 and paragraph 2.1 of PFRS 9, investments in subsidiaries, joint ventures, and associates that are not accounted for in accordance with PFRS 9 are within the scope of PAS 36 for impairment purposes.

Consensus

In its separate financial statements, an entity should apply the provisions of PAS 36 to test for impairment its investments in subsidiaries, joint ventures, and associates that are carried at cost or using the equity method in accordance with paragraphs 10(a) and 10(c) of PAS 27.



PAS 32, *Financial Instruments: Presentation*

PAS 32 – Accounting for a financial instrument that is mandatorily convertible into a variable number of shares subject to a cap and a floor

Issue

How should an entity classify a financial instrument that is mandatorily convertible into a variable number of shares subject to a cap and a floor in accordance with PAS 32, *Financial Instruments: Presentation*, and PAS 39, *Financial Instruments: Recognition and Measurement*, or PFRS 9, *Financial Instruments*?

Background

The financial instrument has a stated maturity date and, at maturity, the issuer must deliver a variable number of its own equity instruments to equal a fixed cash amount – subject to a cap and a floor, which limit and guarantee, respectively, the number of equity instruments to be delivered.

Consensus

The issuer's obligation to deliver a variable number of the entity's own equity instruments is a non-derivative that meets the definition of a financial liability in paragraph 11(b)(i) of PAS 32 in its entirety.

Paragraph 11(b)(i) of the definition of a liability does not have any limits or thresholds regarding the degree of variability that is required. Therefore, the contractual substance of the instrument is a single obligation to deliver a variable number of equity instruments at maturity, with the variation based on the value of those equity instruments. Such a single obligation to deliver a variable number of own equity instruments cannot be subdivided into components for the purposes of evaluating whether the instrument contains a component that meets the definition of equity. Even though the number of equity instruments to be delivered is limited and guaranteed by the cap and the floor, the overall number of equity instruments that the issuer is obliged to deliver is not fixed and therefore the entire obligation meets the definition of a financial liability.

Furthermore, the cap and the floor are embedded derivative features whose values change in response to the price of the issuer's equity share. Therefore, assuming that the issuer has not elected to designate the entire instrument under the fair value option, the issuer must separate those features and account for the embedded derivative features separately from the host liability contract at fair value through profit or loss in accordance with PAS 39 or PFRS 9.



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PAS 32 – A financial instrument that is mandatorily convertible into a variable number of shares (subject to a cap and a floor) but gives the issuer the option to settle by delivering the maximum (fixed) number of shares

Issue

How should an issuer assess the substance of a particular early settlement option included in a financial instrument in accordance with PAS 32, *Financial Instruments: Presentation*?

Background

The instrument has a stated maturity date and at maturity, the issuer must deliver a variable number of its own equity instruments to equal a fixed cash amount, subject to a cap and a floor. The cap and the floor limit and guarantee, respectively, the number of equity instruments to be delivered. The issuer is required to pay interest at a fixed rate.

The issuer has the contractual right to settle the instrument at any time before maturity. If the issuer chooses to exercise that early settlement option, it must:

- a) deliver the maximum number of equity instruments specified in the contract; and
- b) pay in cash all of the interest that would have been payable if the instrument had remained outstanding until its maturity date.

Consensus

The definitions of financial asset, financial liability and equity instrument in PAS 32 are based on the financial instrument's contractual rights and contractual obligations. However, paragraph 15 of PAS 32 requires the issuer of a financial instrument to classify the instrument in accordance with the substance of the contractual arrangement. Consequently, if a contractual term of a financial instrument lacks substance, that contractual term would be excluded from the classification assessment of the instrument.

The issuer cannot assume that a financial instrument (or its components) meets the definition of an equity instrument simply because the issuer has the contractual right to settle the financial instrument by delivering a fixed number of its own equity instruments.

Judgment will be required to determine whether the issuer's early settlement option is substantive and thus should be considered in determining how to classify the instrument. If the early settlement option is not substantive, that term would not be considered in determining the classification of the financial instrument.

The guidance in paragraph 20(b) of PAS 32 is relevant because it provides an example of a situation in which one of an instrument's settlement alternatives is excluded from the classification assessment. Specifically, the example in that paragraph describes an instrument that the issuer will settle by delivering either cash or its own shares and states that one of the settlement alternatives should be excluded from the classification assessment in some circumstances.



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To determine whether the early settlement option is substantive, the issuer will need to understand whether there are actual economic or other business reasons that the issuer would exercise the option. In making that assessment, the issuer could consider, along with other factors, whether the instrument would have been priced differently if the issuer's early settlement option had not been included in the contractual terms.

Factors such as the term of the instrument, the width of the range between the cap and the floor, the issuer's share price and the volatility of the share price could be relevant to the assessment of whether the issuer's early settlement option is substantive. For example, the early settlement option may be less likely to have substance – especially if the instrument is short-lived – if the range between the cap and the floor is wide and the current share price would equate to the delivery of a number of shares that is close to the floor (i.e., the minimum). That is because the issuer may have to deliver significantly more shares to settle early than it may otherwise be obliged to deliver at maturity.

PAS 32 – Classification of financial instruments that give the issuer the contractual right to choose the form of settlement

Issue

How should financial instruments that give the issuer the contractual right to choose the form of settlement be classified in accordance with PAS 32, *Financial Instruments: Presentation*?

Background

This Q&A clarifies how an issuer would classify three financial instruments in accordance with PAS 32. None of the financial instruments had a maturity date but each gave the holder the contractual right to redeem at any time. The holder's redemption right was described differently for each of the three financial instruments; however in each case the issuer had the contractual right to choose to settle the instrument in cash or a fixed number of its own equity instruments if the holder exercised its redemption right. The issuer was not required to pay dividends on the three instruments but could choose to do so at its discretion.

Paragraph 15 of PAS 32 requires the issuer of a financial instrument to classify the instrument in accordance with the substance of the contractual arrangement. Consequently, the issuer cannot achieve different classification results for financial instruments with the same contractual substance simply by describing the contractual arrangements differently.

Paragraph 11 of PAS 32 sets out the definitions of both a financial liability and an equity instrument. Paragraph 16 describes in more detail the circumstances in which a financial instrument meets the definition of an equity instrument.

Consensus

A non-derivative financial instrument that gives the issuer the contractual right to choose to settle in cash or a fixed number of its own equity instruments meets the definition of an equity instrument in PAS 32 as long as the instrument does not establish an obligation to deliver cash (or another financial asset) indirectly through its terms and conditions.

Paragraph 20(b) of PAS 32 provides the example that an indirect contractual obligation



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would be established if a financial instrument provides that on settlement the entity will deliver either cash or its own equity instruments whose value is determined to exceed substantially the value of the cash.

Financial instruments, in particular those that are more structured or complex, require careful analysis to determine whether they contain equity and non-equity components that must be accounted for separately in accordance with PAS 32.

If the issuer has a contractual obligation to deliver cash, that obligation meets the definition of a financial liability.



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PAS 34, *Interim Financial Reporting*

PAS 34 – Condensed statement of cash flows

Issue

How should an entity apply the requirements of PAS 34, *Interim Financial Reporting*, regarding the presentation and content of the condensed statement of cash flows in the interim financial statements?

Background

There are divergent views on the presentation and content of the condensed statement of cash flows. One view is that an entity should present a detailed structure of the condensed statement of cash flows showing cash flows by nature. Another view is that an entity may present a three-line condensed statement of cash flows showing only a total for each of operating, investing and financing cash flow activities.

A condensed statement of cash flows is one of the primary statements that is included as part of an interim financial report as prescribed by paragraph 8 of PAS 34. Paragraph 10 of PAS 34 specifies that each of the condensed statements shall include, at a minimum, each of the headings and subtotals that were included in the most recent annual financial statements. Paragraph 10 of PAS 34 also requires additional line items to be included if their omission would make the interim financial statements misleading.

In an interim financial report:

- a) an entity shall include an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period. Information disclosed in relation to those events and transactions shall update the relevant information presented in the most recent annual financial report (see paragraph 15 of PAS 34).
- b) the overriding goal is to ensure that an interim financial report includes all information that is relevant to understanding an entity's financial position and performance during the interim period (see paragraph 25 of PAS 34). The Interpretations Committee further noted that in accordance with paragraph 1.20 of the *Conceptual Framework*, information about cash flows helps users to understand a reporting entity's operations, evaluate its financing and investing activities, assess its liquidity or solvency and interpret other information about financial performance.

Consensus

To meet the requirements in paragraphs 10, 15 and 25 of PAS 34, a condensed statement of cash flows should include all information that is relevant in understanding the entity's ability to generate cash flows and the entity's needs to utilize those cash flows. A three-line presentation alone would not meet the requirements in PAS 34.



PAS 38, *Intangible Assets*

PAS 38 - Goods acquired for promotional activities

Issue

How does an entity account for the goods it distributes as part of its promotional activities?

Background

A pharmaceutical entity acquires goods (such as refrigerators, air conditioners and watches) to distribute to doctors as part of its promotional activities. The entity and the doctors do not enter into agreements that create enforceable rights and obligations in relation to those goods.

Consensus

Paragraph 5 of PAS 38 states that PAS 38 applies to expenditure on advertising activities. Accordingly, if an entity acquires goods solely to be used to undertake advertising or promotional activities, it applies the requirements in paragraph 69 of PAS 38. Paragraph 69 requires an entity to recognize expenditure on such goods as an expense when the entity has a right to access those goods. Paragraph 69A of PAS 38 states that an entity has a right to access goods when it owns them. The entity, therefore, recognizes expenditure on those goods as an expense when it owns the goods, or otherwise has a right to access them regardless of when it distributes the goods.

The rationale for treating such goods as an expense under paragraph 69 of PAS 38 is that goods acquired to be used to undertake advertising and promotional activities have no other purpose than to undertake those activities. In other words, the only benefit of those goods for the entity is to develop or create brands or customer relationships, which in turn generate revenues. However, applying PAS 38, the entity does not recognize internally generated brands or customer relationships as assets.



PAS 41, *Agriculture*

PAS 41 – Biological assets growing on bearer plants

Issue

When can an entity rebut the fair value presumption in paragraph 30 of PAS 41?

Consensus

Paragraph 30 of PAS 41 contains a presumption that fair value can be measured reliably for a biological asset. However, that presumption can be rebutted only on initial recognition for a biological asset for which quoted market prices are not available and for which alternative fair value measurements are determined to be clearly unreliable. Paragraph 30 of PAS 41 says that once the fair value of such a biological asset becomes reliably measurable, an entity measures it at its fair value less costs to sell.

The reference to 'clearly unreliable' in paragraph 30 of PAS 41 indicates that, to rebut the presumption, an entity must demonstrate that any fair value measurement is clearly unreliable. Paragraph BC4C of IAS 41 suggests that, when developing the amendments to IAS 41 on bearer plants, it was expected that the fair value measurements of produce growing on bearer plants might be clearly unreliable when an entity encounters significant practical difficulties. However, the converse is not necessarily true — i.e., if an entity encounters significant practical difficulties, this does not necessarily mean that any fair value measurement of produce is clearly unreliable.

In this situation, the entity should consider whether the measurement is clearly unreliable before rebutting the fair value presumption in PAS 41.

PAS 41 – Subsequent Expenditure on Biological Assets

Issue

How should an entity account for costs related to the biological transformation (subsequent expenditure) of biological assets measured at fair value less costs to sell applying PAS 41, *Agriculture*?

Background

PAS 41 does not specify the accounting for subsequent expenditure for biological assets measured at fair value less costs to sell. Paragraph B62 of the Basis for Conclusions on



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PAS 41 explains that '...the Board decided not to explicitly prescribe the accounting for subsequent expenditure related to biological assets in the Standard, because it believes to do so is unnecessary with a fair value measurement approach'.

Consensus

Applying PAS 41, an entity either capitalizes subsequent expenditure or recognizes it as an expense when incurred. Capitalizing subsequent expenditure or recognizing it as an expense has no effect on the fair value measurement of biological assets nor does it have any effect on profit or loss; however, it affects the presentation of amounts in the statement of profit or loss.

In assessing how to present such subsequent expenditure in the statement of profit or loss, an entity would apply the requirements in paragraphs 81-105 of PAS 1, *Presentation of Financial Statements*. In particular, the entity would:

- a. applying paragraph 85, 'present additional line items (including by disaggregating the line items listed in paragraph 82), headings and subtotals in the statement(s) presenting profit or loss and other comprehensive income when such presentation is relevant to an understanding of the entity's financial performance'; and
- b. applying paragraph 99, present in the statement(s) presenting profit or loss and other comprehensive income or in the notes an analysis of expenses recognized in profit or loss using a classification based on either their nature or their function within the entity, whichever provides information that is reliable and more relevant.

Applying paragraph 13 of PAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, an entity would apply its accounting policy for subsequent expenditure consistently to each group of biological assets. An entity would also disclose the selected accounting policy applying paragraphs 117-124 of PAS 1 if that disclosure would assist users of financial statements in understanding how those transactions are reflected in reported financial performance.



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Philippine Interpretation IFRIC-14, PAS 19—*The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*

Philippine Interpretation IFRIC-14 and PAS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction

Issue

Should an entity assume continuation of a minimum funding requirement for contributions relating to future service?

Background

The issue relates to whether the future minimum funding requirement for contributions to a defined benefit plan to cover future service would apply for only the fixed period that had been agreed between the entity and the pension trustees or would also apply beyond that period. The conclusion on this issue could affect how the economic benefit available as a reduction in future contributions is determined, which could in turn affect the amount of the net defined benefit liability or asset to be recognized in the entity's statement of financial position.

In the circumstances described above, neither a plan wind-up nor a plan closure to future accrual has been decided upon at the end of the reporting period. In addition, a pension regulation or a contractual agreement, or both, specify that:

- a) the pension trustees are required to prepare, and from time to time review and if necessary revise, a statement of funding principles that documents the pension trustees' policy for ensuring that a required funding objective is met;
- b) the statement of funding principles sets out, among other things, the methods to be used to determine the assumptions that are used to calculate the liabilities that determine contributions to be paid;
- c) the pension trustees are required to prepare a schedule of contributions that is negotiated with the entity and that is consistent with the statement of funding principles;
- d) the amounts specified in the schedule of contributions must then be paid for a fixed period;
- e) the entity and the pension trustees are required to renew the schedule of contributions as the fixed period comes to an end if the plan is continued;
- f) the schedule of contributions does not need to be renewed if the plan is wound up; and
- g) the entity can decide to wind up or close the plan to future accrual, if this is agreed with the pension trustees.



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Consensus

The future minimum funding requirement for contributions to a defined benefit plan to cover future service would apply for the fixed period that had been agreed between the entity and the pension trustee and beyond that period.

It should be observed that although the level of contributions after the fixed period will be subject to future negotiations, if the plan continues after the fixed period, the entity must continue to make contributions for future service that are consistent with the statement of funding principles.

Paragraph 18 of Philippine Interpretation IFRIC-14 requires an entity to analyze its minimum funding requirements at a given date into the contributions that are required to cover:

- any existing shortfall for past service on the minimum funding basis; and
- future service.

Paragraph 19 of Philippine Interpretation IFRIC-14 explains that contributions to cover any existing shortfall for past service do not affect future contributions for future service.

Also, paragraph 23 of Philippine Interpretation IFRIC-14 requires an entity to determine whether contributions payable to cover an existing shortfall for past service will be available as a refund or reduction in future contributions.

It should be noted that the issue raised relates only to the minimum funding requirement for contributions to cover future service.

In the circumstances described, the pension trustees determine some or all of the factors (or funding principles) establishing the minimum funding basis (as that term is used in Philippine Interpretation IFRIC-14) and record them in the statement of funding principles. Accordingly, when the entity estimates the future minimum funding requirement contributions, it should (i) include the amounts in the schedule of contributions for the fixed period specified by the schedule; and (ii) beyond that period, make an estimate that assumes a continuation of those factors establishing the minimum funding basis as determined by the pension trustees. This is because:

- paragraphs 21 and BC30 of Philippine Interpretation IFRIC-14 explain that an entity's estimate of future minimum funding requirement contributions shall not include the effect of expected changes in the terms and conditions of the minimum funding basis that are not substantively enacted or contractually agreed at the end of the reporting period; and
- in the circumstances described, those factors establishing the minimum funding basis that are determined by the pension trustees and recorded in the statement of funding principles are equivalent to a legal requirement or contractual agreement. Accordingly, the estimate of future minimum funding requirement contributions for



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future service should not assume any changes to those factors if such changes require future negotiations with the pension trustees.

Further, for any factors affecting the estimation of future minimum funding requirements that are not determined by the trustees (for example, the remaining life of the plan is not specified by the existing funding principles), the assumptions used to estimate future minimum funding requirement contributions for future service beyond the fixed period must be consistent with those used for determining future service costs. This is because paragraphs 17 and 21 of Philippine Interpretation IFRIC-14 require an entity to use assumptions that are consistent with those used to determine the defined benefit obligation and with the situation that exists at the end of the reporting period.



Philippine Interpretation IFRIC-21, *Levies*

Philippine Interpretation IFRIC-21 – Identification of a present obligation to pay a levy that is subject to a pro rata activity threshold as well as an annual activity threshold

Issue

How should the requirements in paragraph 8 of Philippine Interpretation IFRIC-21, *Levies*, be interpreted in identifying an obligating event for a levy?

Background

Philippine Interpretation IFRIC-21, which is effective for annual periods beginning on or after January 1, 2014, was adopted in June 2013. It provides an interpretation of the requirements in PAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, for the recognition of liabilities for obligations to pay levies that are within the scope of Philippine Interpretation IFRIC-21.

There are tax regimes in which an obligation to pay a levy arises as a result of activity during a period but is not payable until a minimum activity threshold, as identified by the legislation, is reached. The threshold is set as an annual threshold, but this threshold is reduced, pro rata to the number of days in the year that the entity participated in the relevant activity, if its participation in the activity started or stopped during the course of the year.

Paragraph 8 of Philippine Interpretation IFRIC-21 provides that the obligating event that gives rise to a liability to pay a levy is the activity that triggers the payment of the levy, as identified by the legislation. For example, if the activity that triggers the payment of the levy is the generation of revenue in the current period and the calculation of that levy is based on the revenue that was generated in a previous period, the obligating event for that levy is the generation of revenue in the current period. The generation of revenue in the previous period is necessary, but not sufficient, to create a present obligation.

This Q&A deals with how the thresholds stated in the legislation should be taken into consideration when deciding “the activity that triggers the payment of the levy” in paragraph 8 of Philippine Interpretation IFRIC-21.

Consensus

In the circumstance described above, the payment of the levy is triggered by the reaching of the annual threshold as identified by the legislation.

The entity would be subject to a threshold that is lower than the threshold that applies at the end of the annual assessment period if, and only if, the entity stops the relevant activity before the end of the annual assessment period.

Accordingly, in the light of the guidance in paragraph 12 of Philippine Interpretation IFRIC-21, the obligating event for the levy is the reaching of the threshold that applies at the end of the annual assessment period.



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It should be noted that there is a distinction between a levy with an annual threshold that is reduced pro rata when a specified condition is met and a levy for which an obligating event occurs progressively over a period of time as described in paragraph 11 of Philippine Interpretation IFRIC-21; until the specified condition is met, the pro rata reduction in the threshold does not apply.

Philippine Interpretation IFRIC-21 – Levies raised on production property, plant and equipment

Issue

Should levies raised on production property, plant and equipment (PPE) be classified as:

1. an administrative cost to be recognized as an expense as it is incurred; or
2. a fixed production overhead to be recognized as part of the cost of the entity's inventory in accordance with PAS 2, *Inventories*?

Consensus

Paragraph 3 of Philippine Interpretation IFRIC-21 states that the Interpretation does not provide guidance on accounting for the costs arising from recognizing a levy. Philippine Interpretation IFRIC-21 notes that entities should apply other Standards to decide whether the recognition of an obligation for a levy gives rise to an asset or to an expense.