IFRS in Focus

IASB publishes package of narrow-scope amendments to IFRS Standards

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This *IFRS in Focus* addresses the recent package of narrow-scope amendments to IFRS Standards that has been published by the International Accounting Standards Board (IASB). The individual amendments are:

- *Reference to the Conceptual Framework,* which amends IFRS 3 *Business Combinations*
- *Property, Plant and Equipment—Proceeds before Intended Use,* which amends IAS 16 *Property, Plant and Equipment*
- *Onerous Contracts—Cost of Fulfilling a Contract,* which amends IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
- *Annual Improvements to IFRS Standards 2018–2020*

- The IASB has issued a package of narrow-scope amendments to IFRS Standards.
- The amendments to IFRS 3:
  - Update IFRS 3 so that it refers to the 2018 *Conceptual Framework* instead of the 1989 *Framework;*
  - Add to IFRS 3 a requirement that, for transactions and other events within the scope of IAS 37 or IFRIC 21, an acquirer applies IAS 37 or IFRIC 21 (instead of the *Conceptual Framework*) to identify the liabilities it has assumed in a business combination; and
  - Add to IFRS 3 an explicit statement that an acquirer does not recognise contingent assets acquired in a business combination.
- The amendments to IAS 16 prohibit deducting from the cost of an item of property, plant and equipment any proceeds from selling items produced while bringing that asset to the location and condition necessary for it to be capable of operating in the manner intended by management. Instead, an entity recognises the proceeds from selling such items, and the cost of producing those items, in profit or loss.
- The amendments to IAS 37 specify that the 'cost of fulfilling' a contract comprises the 'costs that relate directly to the contract'. Costs that relate directly to a contract can either be incremental costs of fulfilling that contract or an allocation of other costs that relate directly to fulfilling contracts.
- The annual improvements package includes the following minor amendments:
  - Subsidiary as a First-time Adopter (Amendment to IFRS 1)
  - Fees in the '10 per cent' Test for Derecognition of Financial Liabilities (Amendment to IFRS 9)
  - Lease Incentives (Amendment to Illustrative Example 13 of IFRS 16)
  - Taxation in Fair Value Measurements (Amendment to IAS 41)
- All amendments are effective for annual periods beginning on or after 1 January 2022, except for the amendment to IFRS 16 for which no effective date is stated as it regards only an illustrative example.

Reference to the Conceptual Framework (Amendments to IFRS 3)

Background

In 2018, the IASB issued a revised *Conceptual Framework* and most references to the *Framework* included in IFRS Standards were updated to the 2018 *Conceptual Framework* at that time. However, one paragraph of IFRS 3 continued to refer to the 1989 *Framework*, as updating this paragraph could have caused conflicts for entities applying IFRS 3.

Potential conflicts occur as the definition of assets and liabilities in the 2018 *Conceptual Framework* differ from those in the 1989 *Framework* potentially leading to day 2 gains or losses post-acquisition for some balances recognised.

In the ED, the IASB identified three possible amendments to IFRS 3 that would update IFRS 3 without significantly changing its requirements. These amendments have now been finalised.

The amendments

The amendments update IFRS 3 so that it refers to the 2018 *Conceptual Framework* instead of the 1989 *Framework.* They also add to IFRS 3 a requirement that, for obligations within the scope of IAS 37, an acquirer applies IAS 37 to determine whether at the acquisition date a present obligation exists as a result of past events. For a levy that would be within the scope of IFRIC 21 *Levies*, the acquirer applies IFRIC 21 to determine whether the obligating event that gives rise to a liability to pay the levy has occurred by the acquisition date.

Finally, the IASB adds to IFRS 3 an explicit statement that an acquirer does not recognise contingent assets acquired in a business combination.

Observation

Even without the amendment, IFRS 3 prohibits the recognition of contingent assets acquired in a business combination. This prohibition can be inferred from the recognition principle and is confirmed in the Basis for Conclusions to IFRS 3. However, it was not stated explicitly in IFRS 3 itself. To change this, the IASB added a paragraph to IFRS 3 to make its requirements for contingent assets explicit and clarify that replacing the reference to the *Framework* does not change them.

Effective date

The amendments are effective for business combinations for which the date of acquisition is on or after the beginning of the first annual period beginning on or after 1 January 2022. Early application is permitted if an entity also applies all other updated references (published together with the updated *Conceptual Framework)* at the same time or earlier.

Property, Plant and Equipment—Proceeds before Intended Use (Amendments to IAS 16)

Background

IAS 16 specifies that directly attributable costs include the costs of testing whether an asset is functioning properly, after deducting the net proceeds from selling items produced while bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

Entities had applied the requirements in IAS 16 differently—some entities deducted only proceeds from selling items produced while testing, others deducted all sales proceeds until the asset is in the location and condition necessary for it to be capable of operating in the manner intended by management (i.e. available for use). For some entities, the proceeds deducted from the cost of an item of property, plant and equipment could be significant and could exceed the costs of testing.

The amendments

The IASB decided to amend IAS 16 to prohibit deducting from the cost of an item of property, plant and equipment any proceeds from selling items produced before that asset is available for use, i.e. proceeds while bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. Consequently, an entity recognises such sales proceeds and related costs in profit or loss. The entity measures the cost of those items in accordance with IAS 2 *Inventories.*

The IASB also decided to clarify the meaning of 'testing whether an asset is functioning properly'. IAS 16 now specifies this as assessing whether the technical and physical performance of the asset is such that it is capable of being used in the production or supply of goods or services, for rental to others, or for administrative purposes.

If not presented separately in the statement of comprehensive income, the financial statements shall disclose the amounts of proceeds and cost included in profit or loss that relate to items produced that are not an output of the entity's ordinary activities, and which line item(s) in the statement of comprehensive income include(s) such proceeds and cost.

Observation

The ED proposed no requirements on identifying and measuring costs, however the IASB agreed with comments that identifying costs could require extensive judgement, which in turn could result in differences in how entities identify and measure costs.

Consequently, the IASB decided to require entities to apply IAS 2 in identifying and measuring costs, because the requirements in IAS 2 set out a framework for identifying and measuring costs without being overly prescriptive and an entity would already be required to apply IAS 2 in identifying and measuring costs if the entity were to determine that the sale of items produced is an output of its ordinary activities.

Effective date and transition

The amendments are effective for annual periods beginning on or after 1 January 2022. Early application is permitted.

An entity applies the amendments retrospectively, but only to items of property, plant and equipment that are brought to the location and condition necessary for them to be capable of operating in the manner intended by management on or after the beginning of the earliest period presented in the financial statements in which the entity first applies the amendments. The entity shall recognise the cumulative effect of initially applying the amendments as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the beginning of that earliest period presented.

Onerous Contracts—Cost of Fulfilling a Contract (Amendments to IAS 37)

Background

IAS 37 does not give any guidance on which costs an entity considers in assessing whether a contract is onerous. For some contracts, differing interpretations of the onerous contract requirements in IAS 37 could have a material effect on entities that enter into those contracts.

The amendments

The IASB decided to amend IAS 37 by specifying that the 'cost of fulfilling' a contract comprises the 'costs that relate directly to the contract'. Costs that relate directly to a contract consist of both the incremental costs of fulfilling that contract (examples would be direct labour or materials) and an allocation of other costs that relate directly to fulfilling contracts (an example would be the allocation of the depreciation charge for an item of property, plant and equipment used in fulfilling the contract).

Observation

In the ED, the IASB proposed to include examples of costs that do and do not relate directly to a contract. These examples were based on IFRS 15 *Revenue from Contracts with Customers.*

For the final amendments, the IASB decided to replace the examples with a more general description of the types of costs that relate directly to a contract, i.e. the incremental costs of fulfilling the contract and an allocation of other costs that relate directly to fulfilling contracts. The IASB concluded that the more general description can be applied to all types of contract, rather than only contracts to provide goods or services, avoids questions about the implications of slight differences in the wording of examples in different IFRS Standards, and provides a framework within which an entity can apply judgement to determine whether to include or exclude a particular cost.

Effective date and transition requirements

The amendments are effective for annual periods beginning on or after 1 January 2022. Early application is permitted.

Entities apply the amendments to contracts for which the entity has not yet fulfilled all its obligations at the beginning of the annual reporting period in which the entity first applies the amendments. Comparatives are not restated. Instead, the entity shall recognise the cumulative effect of initially applying the amendments as an adjustment to the opening balance of retained earnings or other component of equity, as appropriate, at the date of initial application.

Annual Improvements 2018-2020

The IASB has issued *Annual Improvements* to *IFRS Standards 2018–2020*. The pronouncement contains amendments to four IFRS Standards as result of the IASB's annual improvements project.

Subsidiary as a First-time Adopter (Amendment to IFRS 1)
Paragraph D16(a) of IFRS 1 *First-time Adoption of International Financial Reporting Standards* allows subsidiaries that become a first-time adopter later than its parent to measure its assets and liabilities at the carrying amounts that would be included in the parent's consolidated financial statements.

The amendment extends this relief to the cumulative translation differences for all foreign operations. For those, the subsidiary that uses the exemption in IFRS 1:D16(a) can now also elect to measure cumulative translation differences for all foreign operations at the carrying amount that would be included in the parent's consolidated financial statements, based on the parent's date of transition to IFRS Standards, if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary. A similar election is available to an associate or joint venture that uses the exemption in IFRS 1:D16(a).

The amendment is effective for annual periods beginning on or after 1 January 2022. Earlier application is permitted.

Observation
The ED proposed that entities that apply IFRS 1:D16(a) would be *required* to use the extended relief now introduced by the amendment. However, responses to the ED revealed that entities could in some situations find it burdensome to measure cumulative translation differences using the amount reported by the parent. The IASB therefore decided to permit, but not require, a subsidiary applying IFRS 1:D16(a) to use that exemption for cumulative translation differences.

Fees in the '10 per cent' Test for Derecognition of Financial Liabilities (Amendment to IFRS 9)
IFRS 9 *Financial Instruments* requires an entity to derecognise a financial liability and recognise a new financial liability when there is an exchange between an existing borrower and the lender of debt instruments with substantially different terms (including a substantial modification of the terms of an existing financial liability or part of it).

The terms are substantially different if the discounted present value of the remaining cash flows under the new terms are at least 10 per cent different from the discounted present value of the remaining cash flows of the original financial liability ('10 per cent' test).

The amendment clarifies which fees an entity includes when it applies the '10 per cent' test in assessing whether to derecognise a financial liability. An entity includes only fees paid or received between the entity (the borrower) and the lender, including fees paid or received by either the entity or the lender on the other's behalf.

The amendment is effective for annual periods beginning on or after 1 January 2022. Earlier application is permitted. The amendment is applied prospectively to modifications and exchanges that occur on or after the date the entity first applies the amendment.

Lease Incentives (Amendment to IFRS 16)
Illustrative Example 13 of IFRS 16 *Leases* includes as part of the fact pattern a reimbursement relating to leasehold improvements. The example does not explain clearly enough the conclusion as to whether the reimbursement would meet the definition of a lease incentive in IFRS 16.

To resolve any potential confusion regarding the treatment of lease incentives, the amendment now removes the illustration of the reimbursement of leasehold improvements.

As the amendment to IFRS 16 only regards an illustrative example, no effective date is stated.

Taxation in Fair Value Measurements (Amendment to IAS 41)
In 2008, the IASB removed from IAS 41 *Agriculture* the requirement to use a pre-tax discount rate when measuring fair value. However, at that time, it did not remove from IAS 41:22 the requirement to use pre-tax cash flows when measuring fair value.

To resolve this conflict, the IASB now removed the requirement in IAS 41 for entities to exclude cash flows for taxation when measuring fair value. This aligns the fair value measurement in IAS 41 with the requirements of IFRS 13 *Fair Value Measurement* to use internally consistent cash flows and discount rates and enables preparers to determine whether to use pre-tax or post-tax cash flows and discount rates for the most appropriate fair value measurement.

The amendment is effective for annual periods beginning on or after 1 January 2022. Earlier application is permitted. The amendment is applied prospectively, i.e. for fair value measurements on or after the date an entity initially applies the amendment.

Further information
If you have any questions about the package of narrow-scope amendments please speak to your usual Deloitte contact or get in touch with a contact identified in this *IFRS in Focus*.

The Deloitte Accounting Research Tool (DART) is a comprehensive online library of accounting and financial disclosures literature. iGAAP on DART allows access to the full IFRS Standards, linking to and from:

- Deloitte's authoritative, up-to-date, iGAAP manuals which provide guidance for reporting under IFRS Standards; and
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