**PROFESSIONAL REGULATORY BOARD OF ACCOUNTANCY**
Resolution No. 27
Series of 2018

**WHEREAS,** the Financial Reporting Standards Council (FRSC) has approved and submitted hereunder pronouncements to the Board for approval;

1. PIC Q&A No. 2016-03 *Accounting for Common Areas and the Related Subsequent Costs by Condominium Corporations.*
2. PIC Q&A No. 2017-04 *PAS 24 – Related party relationships between parents, subsidiary, associate and non-controlling shareholder.*
3. PIC Q&A No. 2017-05 *PFRS 7- Frequently asked questions on the disclosure requirements of financial instruments under PFRS 7, Financial Instruments; Disclosures*
4. PIC Q&A No. 2017-07 *PFRS 10- Accounting for reciprocal holdings in associates and joint ventures.*
5. PIC Q&A No. 2017-08 *PFRS 10- Requirement to prepare consolidated financial statements where an entity disposes of its single investment in a subsidiary, associate or joint venture.*
6. PIC Q&A No. 2017-09 *PAS 17 and Philippine Interpretation SIC-15 – Accounting for payments between and among lessors and lessees.*
7. PIC Q&A No. 2017-10 *PAS 40- Separation of property and classification as investment property.*
8. PIC Q&A No. 2017-11 *PFRS 10 and PAS 32- Translation costs incurred to acquire outstanding non-controlling interest or to sell non-controlling interest without a loss of control.*
9. PIC Q&A No. 2017-12 *Subsequent treatment of equity component arising from intercompany loans.*

**WHEREAS,** after study and review of the provisions of the above-stated pronouncements as adopted by the FRSC, the Board finds them to be well-taken and instructive for compliance by practicing Certified Public Accountants;

**WHEREFORE,** the Board **RESOLVES**, as it is hereby **RESOLVED,** to adopt the above-stated pronouncements as part of the Philippine Accounting Standards.

**RESOLVED FURTHER,** that this Resolution and the above-stated pronouncements shall take effect after fifteen (15) days following its full and complete publication in the Official Gazette or in any newspaper of general circulation in the Philippines.

Done in the City of Manila, this 18th day of May, 2018.

**JOEL L. TAN-TORRES**
Chairman

**GLORIA T. BAYSA**
Vice-Chairperson

**ARLYN S. VILLANUEVA**
Member

**SAMUEL B. PADILLA**
Member

**GERVACIO I. PIATOR**
Member

**THELMA S. CIUDADANO**
Member

**MARKO ROMEO L. FUENTES**
Member

**ATTESTED:**

**ATTY. LOVELIKA T. BAUTISTA**
Chief
Secretariat to the Professional Regulatory Boards

DATE OF PUBLICATION IN THE OFFICIAL GAZETTE : AUGUST 13, 2018
DATE OF EFFECTIVITY : AUGUST 29, 2018

**APPROVED:**

**TEOFILO S. PILANDO, JR.**
Chairman

**YOLANDA D. REYES**
Commissioner

**JOSE Y. CUETO, JR.**
Commissioner

O-CH/O-COI/O-COII/PRB-ACC/D-LGL/D-SPRB
TSP//YDR/JYC/JLT/ERII/LTB/gnet

October 16, 2017

**Hon. Teofilo S. Pilando, Jr.**
Chairman
Professional Regulation Commission
P. Paredes Street corner N. Reyes Street
Sampaloc, Manila

Dear Chairman Pilando:

The Financial Reporting Standards Council (FRSC) has approved the issuance of the following PIC Q&As:

- PIC Q&A No. 2016-03 *Accounting for Common Areas and the Related Subsequent Costs by Condominium Corporations*
- PIC Q&A No. 2017-04 *PAS 24 - Related party relationships between parents, subsidiary, associate and non-controlling shareholder*
- PIC Q&A No. 2017-05 *PFRS 7 – Frequently asked questions on the disclosure requirements of financial instruments under PFRS 7, Financial Instruments: Disclosures*
- PIC Q&A No. 2017-07 *PFRS 10 – Accounting for reciprocal holdings in associates and joint ventures*
- PIC Q&A No. 2017-08 *PFRS 10 – Requirement to prepare consolidated financial statements where an entity disposes of its single investment in a subsidiary, associate or joint venture*
- PIC Q&A No. 2017-09 *PAS 17 and Philippine Interpretation SIC-15 - Accounting for payments between and among lessors and lessees*
- PIC Q&A No. 2017-10 *PAS 40 - Separation of property and classification as investment property*
- PIC Q&A No. 2017-11 *PFRS 10 and PAS 32 - Transaction costs incurred to acquire outstanding non-controlling interest or to sell non-controlling interest without a loss of control*
- PIC Q&A No. 2017-12 *Subsequent treatment of equity component arising from intercompany loans*

We are submitting the aforementioned pronouncements for approval through the Board of Accountancy.

Thank you for your continued cooperation in this effort to establish financial reporting standards in the Philippines.

Very truly yours,

**David L. Balangue**
Chairman

PHILIPPINE INTERPRETATIONS COMMITTEE (PIC)
QUESTIONS AND ANSWERS (Q&As)

Q&A No. 2016-03

Accounting for Common Areas and the Related Subsequent Costs by Condominium Corporations

This PIC Q&A deals with the accounting for common areas (including land) that were constructed before the creation of the Condominium Corporation and the accounting treatment for subsequent costs related to common areas incurred by the Condominium Corporation.

Background

Section 2 of R.A. 4726 *The Condominium Act* defines a "condominium" as *an interest in real property consisting of separate interest in a unit in a residential, industrial or commercial building and an undivided interest in common, directly or indirectly, in the land on which it is located and in other common areas of the building.* A condominium may include, in addition, a separate interest in other portions of such real property.

Title to the common areas, including the land, or the appurtenant interests in such areas, may be held by a Condominium Corporation in which the holders of separate interest shall automatically be members or shareholders, to the exclusion of others, in proportion to the appurtenant interest of their respective units in the common areas. Whenever the common areas in a condominium projects are held by a condominium corporation, such corporation shall constitute the management body of the project. The corporate purposes of such a corporation shall be limited to the holding of the common areas.

In current practice, the ownership of the land is not transferred to the Condominium Corporation. The Transfer Certificate of Title (TCT) is cancelled by the Registry of Deeds and they annotate the master deeds of restrictions and separate Condominium Certificate of Titles (CCTs) are issued in replacement of the TCT. The individual CCT shall be issued in the name of the original developer and then subsequently transferred to their buyers. The land description is no longer indicated in the Deed of Sale or CCT of the buyer but the project name and the master deed with declaration of restrictions and the unit number is always stated.

For purposes of paying real property tax, a separate tax declaration is issued and the Condominium Corporation pays based on the assessed value or special assessment. Depending on the policy of the Board of the Condominium Corporation, this may form part of the association dues which is being paid by the unit owners on a monthly basis. Further, as part of the Condominium Corporation's management of the common areas (including the land), it incurs major expenditures, the costs of which are collected from the unit owners through special assessment. This special assessment is being collected in advance from the unit owners and subsequently disbursed and paid to the suppliers as the major expenditures progress.

In practice, the accounting for land and other common areas is not consistent among Condominium Corporations. Some do not record the land and other common areas, while others record these based on cost or appraised value.

Another issue related to accounting for land and other common areas is the accounting for special assessments. Special assessments are made by Condominium Corporations in order to finance specific projects.

The accounting for special assessments and the related expenditures differs among Condominium Corporations. Some Condominium Corporations recognize these as revenues while others treat these assessments as liability or equity.

Issue 1

How should the Condominium Corporations account for the land and other common areas?

Consensus

Paragraph 4.37 of the Conceptual Framework discusses when an element (assets, liabilities, income, expenses) can be recognized in the financial statements. It indicated that "*Recognition is the process of incorporating in the balance sheet or income statement an item that meets the definition of an element and satisfies the criteria for recognition set out in paragraph 4.38. It involves the depiction of the item in words and by a monetary amount and the inclusion of that amount in the balance sheet or income statement totals. Items that satisfy the recognition criteria should be recognized in the balance sheet or income statement. The failure to recognize such items is not rectified by disclosure of the accounting policies used nor by notes or explanatory material.*"

Under paragraph 4.38, "*An item that meets the definition of an element should be recognized if:*

*(a) it is probable that any future economic benefit associated with the item will flow to or from the entity; and*

*(b) the item has a cost or value that can be measured with reliability.*"

Paragraph 4.4(a) of the Conceptual Framework defines an asset as "*a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.*" While PAS 16 *Property, Plant and Equipment* paragraph 6 defines Property, plant and equipment as: "*...tangible items that: (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and (b) are expected to be used during more than one period.*"

Paragraph 4.8 of the Conceptual Framework provides that: "*The future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity. The potential may be a productive one that is part of the operating activities of the entity. It may also take the form of convertibility into cash or cash equivalents or a capability to reduce cash outflows, such as when an alternative manufacturing process lowers the costs of production.*"

Paragraph 4.12 of the Conceptual Framework also states that "In determining the existence of an asset, the right of ownership is not essential; thus, for example, property held on a lease is an asset if the entity controls the benefits which are expected to flow from the property. Although the capacity of an entity to control benefits is usually the result of legal rights, an item may nonetheless satisfy the definition of an asset even when there is no legal control".

The definition of asset in the conceptual framework recognizes the fact that for an entity to recognize an asset, it must have control over the economic benefits expected to be derived from such asset. Control over an asset is the ability of the entity to direct the use of the asset so as to obtain economic benefits. An entity has the right to direct the use of an asset if the entity can direct how and for what purpose the asset is used.

The Condominium Corporation cannot direct how and for what purpose the land and other common areas will be used. The decision as to how and for what purpose these common areas will be used are made by the unit owners rather than the Condominium Corporation.

Furthermore, the ownership or the title over the common areas is not a requirement for an entity to recognize an asset; rather, as provided by paragraph 4.6 of the conceptual framework, "*in assessing whether an item meets the definition of an asset, liability or equity, attention needs to be given to its underlying substance and economic reality and not merely its legal form.*" Thus, regardless of whether the title of the land is transferred to the Condominium Corporation or not, this is not essential in the determination of whether the common areas (including the land) is to be recognized in the financial statements of the Condominium Corporation.

Accordingly, Condominium Corporations should not recognize the land and other common areas as assets in its financial statements.

Issue 2

How should the Condominium Corporations recognize the special assessments and the subsequent expenditures?

Consensus

Considering that the Condominium Corporation is a non-stock and non-profit entity, it shall need funds to sustain its operations. Thus, as time and in such manner as the Condominium Corporation Board may reasonably and necessarily determine, there shall be an assessment against each Unit owner proportionate to his or its appurtenant interest.

The Condominium Corporation Board, may from time to time, designate such amount or amounts to be collected from Unit owners as and by way of special assessment to cover such expenditures deemed necessary but is not considered in the regular assessment such as major building improvement projects approved by the Unit owners.

Revenue, as defined in PAS 18, *Revenue* paragraph 7, is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants.

Considering that the special assessment is collected for specific purpose and will only be spent on said purpose, there will be no gross inflow of economic benefits to the Condominium Corporation. Thus, such could not be recognized as revenue. However, since the Condominium Corporation received cash from the unit owners, it has the liability to ensure that said cash is intact and will be spent on the purpose it is collected. In this regard, a liability should be recognized in the books of the Corporation and once spent, said liability will be reversed. Any excess from the cash received from the unit owners against the amount spent for special assessments will be reversed to equity as it represents an increase in equity relating to contributions from the unit owners as equity participants.

To illustrate, journal entries are as follows:

*Dr. Cash.........................................P xxxx*

*Cr. Liabilities for Special Assessments.............P xxxx*

*To record receipts of cash from unit owners.*

*Dr. Liabilites for Special Assessments.....P xxxx*

*Cr. Cash.................................................P xxxx*

*To record actual expenditures for special assessments.*

In case of any excess assessment, the amount will be recognized directly to equity. However, in cases where the excess assessment will be applied against future association dues, then said amount will be amortized accordingly to revenue.

Transition and Effective Date

The consensus in this Q&A is effective for annual periods beginning on or after January 1, 2018 and should be applied retrospectively. Earlier application is permitted.

Date approved by PIC: August 31, 2016

PIC Members

Wilson P. Tan, Chairman

Zaldy D. Aguirre

Jerome Antonio B. Constantino

Emmanuel Y. Artiza

Sharon G. Dayoan

Clark Joseph L. Babor

Ferdinand George G. Florendo

Wilfredo A. Baltazar

Jose Emmanuel U. Hilado

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Lyn I. Javier

Rosario S. Bernaldo

Ma. Concepcion Y. Lupisan

Maria Isabel E. Comedia

Normita L. Villaruz

Date approved by FRSC: October 11, 2017

PHILIPPINE INTERPRETATIONS COMMITTEE (PIC)
QUESTIONS AND ANSWERS (Q&As)

## Q&A No. 2017-04

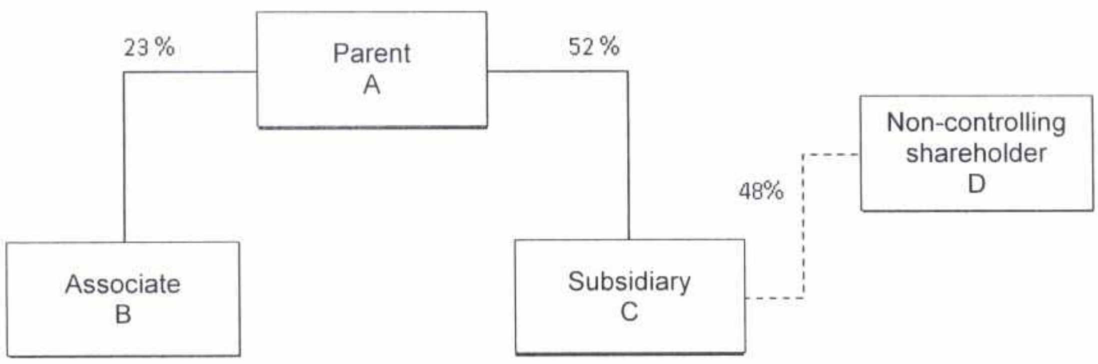
## PAS 24 - Related party relationships between parents, subsidiary, associate and non-controlling shareholder

### Issues

The ownership structure of a reporting group as per below fact pattern may give rise to various related party relationships.

1. Is entity B a related party of entity A in A's consolidated financial statements?
2. Is entity B a related party of entity C in C's separate financial statements?
3. Is entity D a related party of entity A in A's separate financial statements?
4. Is entity D a related party of entity A in A's consolidated financial statements?

### Fact Pattern




### Consensus

1. Yes, entity B is a related party of A in the consolidated financial statements of A.

2. Yes, entity B is a related party of C in the separate financial statements of C.

3. No, entity D is not a related party of A in the separate financial statements of A.

4. Entity D would not normally be a related party of A in the consolidated financial statements of A. However, since D and C are related parties, depending on the relative size of C within A's group, D might have significant influence over A's group.

**Basis for Consensus**

Paragraph 9 of PAS 24, *Related Party Disclosures*, defines those related party relationships that are required to be disclosed in financial statements. Paragraph 10 of PAS 24 also requires that the substance of relationships between entities is also to be considered in identifying possible related party relationships.

***Scenario 1***

B is related to A in A's consolidated financial statements because B is an associate of A (as stated in paragraph 9(b)(ii) of PAS 24).

***Scenario 2***

Because B is a related party of A, B is also a related party to all members in the same group as A. Therefore, B is a related party of subsidiary C in the separate financial statements of C (as stated in paragraph 9(b)(ii) of PAS 24).

***Scenario 3***

No, entity D is not a related party to A in the separate financial statements of A as it does not have significant influence over A.

***Scenario 4***

Entity D has significant influence over C in the group and hence any transactions between D and C are disclosed in C's separate financial statements as related party transactions. This does not mean D is automatically a related party of A. However, consideration should be given to the level of influence held by the NCI shareholder on the total group (i.e. amount of influence of NCI shareholders on C and weighting of C in total group). If the level of influence on A is considered material, it may be decision-useful information to users of the group financial statements if transactions between C and D (as related party transactions) were disclosed in entity A's consolidated financial statements.

**Relevant Guidance**

Paragraph 9 of PAS 24 defines a related party as:

"A related party is a person or entity that is related to the entity that is preparing its financial statements (in this Standard referred to as the 'reporting entity').

(a) A person or a close member of that person's family is related to reporting entity if that person:

 (i) has control or joint control over the reporting entity;

 (ii) has significant influence over the reporting entity; or

 (iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.

(b) An entity is related to a reporting entity if any of the following conditions applies:

 (i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).

 (ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).

 (iii) Both entities are joint ventures of the same third party.

 (iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.

 (v) The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.

(vi) The entity is controlled or jointly controlled by a person identified in (a).

(vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management

(viii) The entity, or any member of a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting entity.

Paragraph 3 of PAS 28, *Investments in Associates and Joint Ventures* defines significant influence as:

"the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control over those policies."

Paragraph 10 of PAS 24 indicates:

"In considering each possible related party relationship, attention is directed to the **substance** of the relationship and not merely the legal form." [Emphasis added]

Paragraph 9 of PAS 1 defines the purpose of financial statements as:

"Financial statements are a structured representation of the financial position and financial performance of an entity. **The objective of financial statements is to provide information** about the financial position, financial performance and cash flows of an entity **that is useful to a wide range of users in making economic decisions**. Financial statements also show the results of the management's stewardship of the resources entrusted to it. ..." [Emphasis added]

**Effective Date**

The consensus in this Q&A is effective from the date of approval by the FRSC.

Date approved by PIC: June 28, 2017

PIC Members

Wilson P. Tan, Chairman

| | |
|---|---|
| Emmanuel Y. Artiza | Sharon G. Dayoan |
| Clark Joseph L. Babor | Zaldy D. Aguirre |
| Wilfredo A. Baltazar | Ferdinand George A. Florendo |
| Gloria T. Baysa | Jose Emmanuel U. Hilado |
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| Maria Isabel E. Comedia | Ma. Concepcion Y. Lupisan |
| Jerome Antonio B. Constantino | Normita L. Villaruz |

Date approved by FRSC: OCT 1 1 2017

PHILIPPINE INTERPRETATIONS COMMITTEE (PIC)
QUESTIONS AND ANSWERS (Q&As)

## Q&A No. 2017-05

**PFRS 7 – Frequently asked questions on the disclosure requirements of financial instruments under PFRS 7, *Financial Instruments: Disclosures***

### Background

PFRS 7 applies to all entities that hold financial instruments. However, the extent of disclosure required depends on the extent of the entity's use of financial instruments and its exposure to risk.

The disclosure requirements of the PFRS are intended to: (1) provide information that will enhance the understanding of the significance of financial instruments to a company's financial position, performance, and cash flows; and (2) assist in evaluating the risks associated with these instruments, including how the entity manages those risks. PFRS 7 must be applied for accounting periods beginning on or after January 1, 2007.

### Issues

Applying PFRS 7 gives rise to a number of application issues. Below are the frequently asked questions on the disclosure requirements of financial instruments under PFRS 7.

### Liquidity Risk

1. In the maturity analysis of gross undiscounted cash flows of financial liabilities, how are coupon payments from interest-bearing borrowings presented?

2. Are companies required to show a reconciliation of amounts presented in the maturity analysis and in the statement of financial position?

3. In practice, most companies manage liquidity risk based not on the remaining contractual maturities but on expected maturities. How should companies disclose this?

4. What should the company include in the maturity analysis of financial assets in its liquidity risk disclosure, if such analysis is necessary to evaluate the nature and extent of liquidity risk?

5. For floating-rate financial liabilities, what rates should be used in calculating its interest cash flows in the maturity analysis?

**Market Risk**

1. What should be the basis of the company in preparing the basic sensitivity analysis?

2. In disclosing the sensitivity analysis, what is the time frame over which the company should make its analysis?

3. Should the disclosure about sensitivity analysis be based on a pre-tax or post-tax basis?

4. What foreign currency risk impacts should be captured in the market risk disclosure?

5. Are commodity contracts that are not within the scope of PAS 39 because they are normal sale or purchase contracts be included in the market risk sensitivity analyses?

**Credit Risk**

1. PFRS 7 requires analysis of the age of financial assets that are past due but not impaired. What amounts should be shown in such analysis?

2. Should "cash on hand" be included under the disclosures on credit risk?

3. Where should the disclosure on concentration of credit risk be based?

## Fair Value

1. Are over-the-counter (OTC) derivative contracts classified as Level 1 measurement in the fair value hierarchy?

2. In the fair value hierarchy disclosure, how should an instrument measured at fair value be categorized?

3. An instrument for which there is currently no active market and the entity used a valuation model. A significant input to the model is a credit spread based on historical default statistics and credit rating assigned by an agency to the instrument. Under what level should we classify the instrument under the fair value hierarchy table and why?

4. The entity uses a model to calculate the fair value of the loan/debt instrument. The model uses discounted cash flows based on the risk-free rate plus a credit spread. Under what level will the loan/debt instrument fall under the fair value hierarchy?

## Other Disclosures

1. Is it possible to include interest expense on short positions (financial liability held for trading) in net gains or net losses on financial liabilities at fair value through profit or loss (FVPL)?

2. If financial liabilities that are not at fair value through profit and loss are used to finance a portfolio of trading financial assets (for example, trading debt securities), can the interest expense (funding costs) on such liabilities be included in net gains or net losses on financial assets or financial liabilities at fair value through profit or loss (FVPL)?

**Consensus**

**Liquidity Risk**

1. Companies are not required to show interest cash flows separately from principal cash flows in the analysis, although some do.

2. No, but companies may opt to present such reconciliation.

3. In PFRS 7.39, companies are required to disclose a maturity analysis of their financial liabilities showing the undiscounted cash flows based on the remaining contractual maturities. Companies may wish to provide a separate maturity analysis based on expected maturity dates. However, such an analysis will not remove the need to produce the required contractual maturity analysis.

4. Only those financial assets the company holds for managing liquidity risk (e.g., financial assets that are readily saleable or expected to generate cash inflows to meet cash outflows on financial liabilities). (PFRS 7.B11E)

5. The standard requires the amounts included in the analysis to be based on conditions at year-end. For floating-rate borrowings, one should look to the spot rates at year-end, although a degree of sophistication may be introduced by using year-end forward rates.

**Market Risk**

1. The basic sensitivity analysis should be prepared on the basis of financial instruments held at the reporting date. Therefore, an entity does not need to forecast the financial instruments that will be held over the next year, nor does it have to work out what financial instruments it held during the previous year. A reasonably possible change in relevant market risk variables should be applied to determine the theoretical impact on profit or loss and equity, and it is this impact that should be disclosed. A reasonably possible change should not include remote or worst case scenarios or stress tests. (PFRS 7.B19)

2. The Application Guidance of the Standard makes it clear that the sensitivity analysis should show the effects of changes that are reasonably possible

over the period until the company will next present its risk disclosures. (PFRS 7.B19)

3. The disclosure may be on either a pre-tax or a post-tax basis. This is a policy choice to be made and applied consistently, and disclosed in the financial statements.

4. PFRS 7 is clear that the foreign currency risk impacts that should be captured are those arising from monetary items denominated in a currency that is different from the functional currency of the entity holding them. Therefore, it should not capture sensitivity from translating the results and assets of foreign operations, although there is nothing wrong with showing these as additional information. (PFRS 7.B23)

5. They should not be included, although there is nothing wrong with showing additional information about them on a voluntary basis or to comply with the disclosure requirements of other standards. For VaR-type disclosures it will depend on whether the analysis used by management to manage risk includes those contracts. (PFRS 7.5)

**Credit Risk**

1. The whole amount of the financial assets that are past due but not impaired. As the requirement is worded, the whole of a loan needs to be shown as past due even if only a single interest payment is past due.

2. No, since there is no more credit risk for cash the company holds.

3. PFRS 7 requires disclosure of all risk concentrations to which an entity is exposed in relation to financial instruments, based on financial instruments that have similar characteristics such as geographical area, currency, industry, market, and type of counterparty. (PFRS 7.B8)

**Fair Value**

1. An OTC derivative contract is a unique bilateral contract between two counterparties for which quoted prices are not continuously available. Given their nature, OTC derivative contracts are not normally classified as Level 1 measurements in the fair value hierarchy disclosures. Depending on the

observability of the inputs used, the instrument would either be classified as Level 2 or Level 3 measurements.

2. The disclosure on fair value hierarchy focuses on the inputs used in valuation techniques rather than the valuation techniques themselves. The level in the fair value hierarchy shall be based on the lowest level input that is significant to the fair value measurement in its entirety. For this purpose, the word "significant" refers to what is significant to the valuation of the instrument in its entirety.

3. Credit spreads are not normally evidence of market transactions thus the instrument will be classified under Level 3.

4. If the credit spread is considered significant, the conclusion is Level 3. However, if the credit spread is insignificant, then the conclusion could be Level 2.

**Other Disclosures**

1. Yes. Interest expense on short positions should be presented in a manner consistent with the treatment of interest expense on long positions, included in either interest expense or in gains and losses on financial instruments at fair value through profit or loss as appropriate. There should be consistent application from period to period and the company should disclose its accounting policy.

2. No. The interest expense incurred on such liabilities, although such liabilities may be used to fund the company's trading portfolio, is not considered to arise directly from the company's trading activities and should be included in interest expense. If, however, the financial liability funding the trading assets is designated as held for trading, it would be appropriate to include the interest expense in net gains or net losses on financial assets or financial liabilities at fair value through profit or loss.

Date approved by PIC: June 28, 2017

PIC Members

Wilson P. Tan, Chairman

| | |
|---|---|
| Emmanuel Y. Artiza | Sharon G. Dayoan |
| Clark Joseph L. Babor | Zaldy D. Aguirre |
| Wilfredo A. Baltazar | Ferdinand George A. Florendo |
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| Rosario S. Bernaldo | Lyn I. Javier |
| Maria Isabel E. Comedia | Ma. Concepcion Y. Lupisan |
| Jerome Antonio B. Constantino | Normita L. Villaruz |

Date approved by FRSC: OCT 11, 2017

## PHILIPPINE INTERPRETATIONS COMMITTEE (PIC)
## QUESTIONS AND ANSWERS (Q&As)

**Q&A No. 2017-07**

PFRS 10 – Accounting for reciprocal holdings in associates and joint ventures

### Issues

1. How does an entity account for reciprocal holdings in associates in accordance with paragraph 27 of PAS 28, *Investments in Associates and Joint Ventures*?

2. Does an entity adjust earnings per share calculation for the cross holdings?

### Background

Entity A has a 20%-owned associate, Entity B.

Entity B, in turn, has a 20% ownership in Entity A, where Entity B exercises significant influence. Entity B accounts for Entity A as an associate.

Both Entity A's and Entity B's share capital is 100,000 shares at Php1 unit each.

Entity A's profit, excluding its share in Entity B, is Php100; Entity B's profit, excluding its share in Entity A, is also Php100.

Taxation is ignored and there are no dividends.

Thus, the economic reality that Entity A's profit (a) is dependent on Entity B's profit (b) and vice versa is solved by simultaneous equations as follows:

$$a = \text{Php}100 + 0.2b$$

$$b = \text{Php}100 + 0.2a$$

Therefore, solving the simultaneous equation results in:

$a = \text{Php}125$ and $b = \text{Php}125$

**Consensus**

1. In applying Paragraph 27 of PAS 28, Entity A should recognize its share of Entity B's profits, including Entity B's share in the profits of Entity A. However, in the case of reciprocal holdings, this approach results in a portion of Entity A's profits being double-counted. Therefore, the net approach, which simply accounts for 20% of the associate's profit (before the reciprocal profit is added), is more appropriate in this case. In this fact pattern, the net approach results in Entity A and Entity B both recognizing profit in the amount of Php120. The difference of Php5 represents the equity effect of the reciprocal holdings and therefore, is not recognized in profit.

   This view is supported by the fact that the equity method of accounting employs consolidation-type procedures such as the elimination of unrealized profits. Under paragraph B86(c) of PFRS 10, income arising on an investment held by a subsidiary in its parent company is eliminated. Therefore, in applying consolidation procedures in equity accounting, income arising from the associate's investment in its investor is also eliminated.

2. The number of ordinary shares on issue is adjusted for the same reasons that profit is determined using the net approach – namely, that the equity method is required to be applied using consolidation procedures and this includes the elimination of intragroup balances such as the associate's investment in the investor.

   Therefore, in calculating earnings per share, the weighted-average number of ordinary shares is reduced by the amount of the effective cross-holding. In the fact pattern, Entity A's and Entity B's ordinary shares are reduced by 4,000 (100,000 times 20% of the 20%) to 96,000 for the purpose of the earnings per share calculation. This adjustment reduces the entity's equity balance and its investment in the associate by its effective 4% interest in its own shares.

   It should be noted, however, that the associate is not part of the group and therefore, the shares held in the investor are not 'treasury shares' as defined. This consensus, however, does not rely on viewing the associate's holding as treasury shares. Rather, it relies on the fact that paragraph 26 of PAS 28 states that many of the procedures that are appropriate for the application of the equity method are similar to the consolidation procedures described in PFRS 10. If a subsidiary holds shares in its parent company, these are eliminated under B86(c) of PFRS 10. The same procedure should, therefore, apply to equity accounting. This will result in a similar treatment of treasury shares that are eliminated from equity and, accordingly, excluded in determining earnings per share.

**Relevant guidance**

Paragraph 27 of PAS 28 states:

"A group's share in an associate or a joint venture is the aggregate of the holdings in that associate or joint venture by the parent and its subsidiaries. The holdings of the group's other associates or joint ventures are ignored for this purpose. When an associate or a joint venture has subsidiaries, associates or joint ventures, the profit or loss, other comprehensive income and net assets taken into account in applying the equity method are recognized in the associate's or joint venture's financial statements (including the associate's or joint venture's share of the profit or loss, other comprehensive income and net assets of its associates and joint ventures), after any adjustments necessary to give effect to uniform accounting policies…"

Paragraph 26 of PAS 28 applies consolidation procedures to equity balances as follows:

"Many of the procedures that are appropriate for the application of the equity method are similar to the consolidation procedures described in PFRS 10. Furthermore, the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for the acquisition of an investment in an associate or a joint venture."

Paragraph B86 of PFRS 10 states:

"Consolidated financial statements:…(c) eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group (profits or losses resulting from intragroup transactions that are recognized in assets, such as inventory and fixed assets, are eliminated in full)."

**Effective Date**

The consensus in this Q&A is effective from the date of approval by the FRSC.

Date approved by PIC: June 28, 2017

**PIC Members**

**Wilson P. Yan, Chairman**

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Date approved by FRSC: OCT 11, 2017

**PHILIPPINE INTERPRETATIONS COMMITTEE (PIC)**
**QUESTIONS AND ANSWERS (Q&As)**

## Q&A No. 2017-08

PFRS 10 – Requirement to prepare consolidated financial statements where an entity disposes of its single investment in a subsidiary, associate or joint venture

### Issue

Is an entity required to prepare consolidated financial statements if during the year it disposes of its only subsidiary?

### Background

Parent Company A (the reporting entity) has an investment in one subsidiary that it consolidated in prior reporting periods. In the current reporting period, the entity disposed of the investment. As a result, at the end of the reporting period, there is no group. Parent Company A does not meet the exemption in PFRS 10, *Consolidated Financial Statements*, from preparing consolidated financial statements.

Parent Company A also issues separate financial statements prepared in accordance with PFRSs, where it accounts for its investment in the subsidiary at cost.

### Consensus

Parent Company A is required to present consolidated financial statements for the reporting period in which it has a subsidiary, regardless of whether or not it has any investments in subsidiaries at the end of the reporting period.

Although Parent Company A is not a parent at the end of the reporting period, it was a parent during the reporting period. Paragraph B88 of PFRS 10 requires the consolidated financial statements to include the income and expenses of a subsidiary up to the date on which the parent ceases to control the same subsidiary.

Paragraph B98 of PFRS 10 also requires the gain or loss from loss of control of a subsidiary to be calculated based on the difference between the proceeds and the carrying amounts of the assets and liabilities of the subsidiary at the date when control is lost. The carrying amount as of the date of disposal reflects the income and expense of the subsidiary during the reporting period. The gain or loss recognized on disposal in the consolidated financial statements is therefore generally different from the gain or loss in the separate financial statements of Parent Company A.

Paragraph OB12 of *The Conceptual Framework for Financial Reporting* states that the general purpose financial reports provide information about the effects of transactions and other events that changed a reporting entity's resources and claims.

A 'reporting entity' includes a group. The disposal of a subsidiary in any reporting period is usually a significant transaction by the group in that period and therefore the effects of that transaction on the financial position and performance of the group are relevant.

This same principle applies to investments in associates or joint ventures when these constitute the only investments in group entities, and these investments are sold during the period.

**Relevant guidance**

Paragraph B88 of PFRS 10 states:

"An entity includes the income and expenses of a subsidiary in the consolidated financial statements from the date it gains control until the date when the entity ceases to control the subsidiary. Income and expenses of the subsidiary are based on the amounts of the assets and liabilities recognized in the consolidated financial statements at the acquisition date…"

Paragraph B98 of PFRS 10 states:

"If a parent loses control of a subsidiary, it shall:

(a) derecognize:
  (i) the assets (including any goodwill) and liabilities of the subsidiary at their carrying amounts at the date when control is lost; and
  (ii) the carrying amount of any non-controlling interests in the former subsidiary at the date when control is lost (including any components of other comprehensive income attributable to them).

(b) recognize:
  (i) the fair value of the consideration received, if any, from the transaction, event or circumstances that resulted in the loss of control;
  (ii) …
  (iii) …

(c) …
(d) recognize any resulting difference as a gain or loss in profit or loss attributable to the parent.

Paragraph OB12 of *The Conceptual Framework for Financial Reporting* states that "General purpose financial reports provide information about the financial position of a reporting entity, which is information about the entity's economic resources and the claims against the reporting entity. Financial reports also provide information about the effects of transactions and other events that change a reporting entity's economic resources and claims. Both types of information provide useful input for decisions about providing resources to an entity."

**Effective Date**

The consensus in this Q&A is effective from the date of approval by the FRSC.

Date approved by PIC: June 28, 2017

**PIC Members**

**Wilson P. Tan, Chairman**

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Date approved by FRSC: OCT 11, 2017

PHILIPPINE INTERPRETATIONS COMMITTEE (PIC)
QUESTIONS AND ANSWERS (Q&As)

## Q&A No. 2017-09

### PAS 17 and Philippine Interpretation SIC-15 - Accounting for payments between and among lessors and lessees

### Issue

What is the accounting treatment, from both the lessor's and the lessee's perspective, in respect of payments made between and among lessors and lessees (both old tenants and new tenants)?

### Fact Pattern

1. Lessor pays:

    A. Old tenant to get out of a lease agreement as it intends to redevelop or renovate the property.

    B. Old tenant to get out of the lease agreement as the lessor intends to or has already re-let the same premises to a new tenant that will pay a significantly higher rent than the old tenant, or is of higher quality, or both.

    C. A new tenant in the form of an incentive to occupy the property.

    D. For alterations to the building specific to the new tenant, which the new tenant makes on its own behalf, that have no further value to the lessor after the completion of the lease period.

2. Old tenant pays:

    A. The lessor to enable the old tenant to vacate the leased premises early

    B. A new tenant to take over the lease

3. A new tenant pays:

    A. The lessor in order to secure the right to obtain a lease agreement

    B. An old tenant to buy out the lease agreement

**Consensus**

1. Lessor pays:

    A. Lessor: A payment to the old tenant must be expensed as incurred unless they meet the definition of construction costs under PAS 16, *Property, Plant and Equipment*. If a payment meets the definition of construction costs, it is capitalized as part of the associated property. For example, an entity that acquired a shopping mall and made payments to evict existing retail lessees in order to redevelop the property into an office building would capitalize the payments.

       Old tenant: The receipt is recognized as income immediately.

    B. Lessor: The payment is expensed.

       Old tenant: The receipt is recognized as income immediately.

    C. Lessor: The payment to the new tenant is a prepayment and amortized over the lease term on a straight-line basis under Philippine Interpretation SIC-15, *Operating Leases - Incentives*.

       New tenant: The receipt is recorded as a deferred lease incentive and amortized over the lease term on a straight-line basis under Philippine Interpretation SIC-15.

    D. Lessor: The payment is accounted for in the same manner as C above.

       New tenant: The tenant records the amount that it receives from the lessor as deferred lease incentive, which is amortized over the lease term under Philippine Interpretation SIC-15.

The costs incurred by the tenant for the alterations to the building are capitalized as leasehold improvement. The tenant must adopt an approach to depreciate its leasehold improvements over: (i) a period that is the shorter of the lease term or the asset's useful life, or (ii) the expected useful life of the leasehold improvement.

2. Old tenant pays:

   A. Old tenant: The payment is recognized as an expense immediately unless the payment was already stipulated in the contract and the probability criteria was previously met, in which case the liability would have accrued over the expected life of the contract.

      Lessor: The receipt is recognized as income immediately unless the payment was already stipulated in the contract and the probability criteria was previously met, in which case the financial asset would have accrued over the expected life of the contract.

   B. Old tenant: The payment is recognized as an expense immediately.

      New tenant: The receipt is recognized as income immediately, unless the payment was made to compensate the new tenant for above market rentals, in which case the receipt is recognized over the lease term.

3. A new tenant pays:

   A. New tenant: The payment is recognized as a prepayment (under PAS 17, *Leases*) and amortized over the lease term on a straight-line basis.

      Lessor: The receipt is recognized as deferred revenue (under PAS 17) and amortized over the lease term on a straight-line basis.

   B. Old tenant: The receipt is recognized as a gain immediately.

      New tenant: The payment is recognized as an intangible asset (under PAS 38, *Intangible Assets*) with a finite economic life. Since the payment does not directly relate to the lease, it is not accounted for under PAS 17.

*Accounting treatment of payments made between lessors and lessees (both old tenants and new tenants)*

The following matrix shows possible business transactions between lessor and lessees on an arm's length basis.

| | **Treatment in the financial statements of** | | |
|---|---|---|---|
| **Transaction** | **Lessor** | **Old tenant** | **New tenant** |
| Lessor pays old lessee – lessor intends to renovate the building<br><br>(fact pattern 1A) | (i) Expense immediately if the payment does not meet the definition of construction costs in PAS 16.<br>(ii) Capitalize as part of the carrying amount of the leased asset if the payment meets the definition of construction costs in PAS 16. | Recognize as income immediately | |
| Lessor pays old tenant – new lease with higher quality tenant<br><br>(fact pattern 1B) | Expense immediately | Recognize as income immediately | |
| Lessor pays new tenant – an incentive to occupy<br><br>(fact pattern 1C) | Recognize a prepayment and amortize this over the lease term on a straight-line basis under | | Recognize deferred lease incentive and amortize over the lease term on a straight-line basis under Philippine |

| Transaction | Treatment in the financial statements of | | |
|---|---|---|---|
| | Lessor | Old tenant | New tenant |
| | Philippine Interpretation SIC-15 | | Interpretation SIC-15 |
| Lessor pays new tenant – building alterations specific to the lessee with no further value to lessor<br><br>(fact pattern 1D) | Recognize a prepayment and amortize over the lease term on a straight-line basis under Philippine Interpretation SIC-15 | | (i) Record amount received from lessor as deferred lease incentive, and amortize it over the lease term on a straight line basis in accordance with Philippine Interpretation SIC-15<br>(ii) Capitalize costs incurred by the tenant for alterations to the building as leasehold improvement |
| Old tenant pays lessor to vacate the leased premises early<br><br>(fact pattern 2A) | Recognize as income immediately, unless it was within the original contract and probability criteria previously met (if so, it would have been accrued over the lease term) | Recognize as expense immediately unless it was within the original contract and probability criteria previously met (if so, it would have been accrued over the lease term) | |
| Old tenant pays new tenant to take over the lease<br><br>(fact pattern 2B) | | Recognize as an expense immediately | Recognize as income immediately (consistent with the payment from the old tenant to the lessor) unless it is to compensate for above |

| Transaction | Treatment in the financial statements of | | |
|---|---|---|---|
| | Lessor | Old tenant | New tenant |
| | | | market rentals, in which case it is deferred and amortized over the lease term |
| New tenant pays lessor to secure the right to obtain a lease agreement<br><br>(fact pattern 3A) | Recognize as deferred revenue under PAS 17 and amortize over the lease term on a straight line basis | | Recognize as a prepayment under PAS 17 and amortize over the lease term on a straight-line basis |
| New tenant pays old tenant to buy out the lease agreement<br><br>(fact pattern 3B) | | Recognize as a gain immediately | Recognize as an intangible asset (under PAS 38) with a finite economic life |

**Basis for Consensus**

PAS 17 deals with costs incurred by a lessor in relation to a lease and payments between lessees and lessors on recognition of a lease. Philippine Interpretation SIC-15 deals with how incentives in operating leases should be accounted for both by lessors and lessees. However, PAS 17 and Philippine Interpretation SIC-15 do not deal with payments for terminating leases or payments between a lessee and a third party.

1. Lessor pays:

   A. Lessor: If the payment meets the definition of construction costs of an item of property, plant and equipment contained in paragraph 6 of PAS 16, it must be capitalized. If not, the payment is expensed, as it does not meet the definition of an asset in PAS 16 or PAS 38.

      Old tenant: As there is no further performance obligation, the receipt is income.

B. Lessor: A payment by a lessor to a lessee to terminate the lease in order to re-let it to another tenant does not meet the definition of initial direct cost for arranging a new lease (paragraph 52 of PAS 17). This is because this cost is incurred in relation to the lease with the old tenant, and is not directly related to the new lease, even if the new lease has been entered into. Therefore, the payment is expensed immediately.

   Old tenant: Similar to the conclusion in 1A). Since the lessee has no future performance obligations, the receipt is recognized by the lessee as income.

C. Lessor: A payment by a lessor to a new tenant to occupy the property is an integral part of the net consideration agreed for the use of the leased asset. Under paragraph 3 of Philippine Interpretation SIC-15 this is an incentive. Therefore, the lessor accounts for the payment as a prepayment that is amortized over the lease term on a straight line basis.

   New tenant: For the same reasons, the new tenant recognizes the payment as deferred revenue and amortizes it over the lease term on a straight line basis, as a reduction to the rental costs.

D. Lessor: A payment by the lessor to a lessee to reimburse the lessee for the costs of leasehold improvements to the building at the direction of the lessee is accounted for by the lessor in the same manner and for the same reasons as C above.

   Lessee: The amount received from the lessor will be deferred and amortized over the lease term in accordance with paragraph 5 of Philippine Interpretation SIC-15. The costs incurred by the tenant for the alterations to the building meet the capital expenditure criteria in PAS 16 and are capitalized.

2. Old tenant pays:

   A. A payment made by the lessee to the lessor to get out of a lease agreement does not meet the relevant definitions in PAS 16 or PAS 38 and is not accounted for under PAS 17 since there is no longer a lease in existence. It is therefore expensed.

Similarly, from the lessor's perspective, income is recorded in the same manner.

However, if the payment to the lessor to vacate the premises was already stipulated in the original lease contract and the payment was assessed as probable during the life of the contract, both the lessee and lessor would have accrued this over the lease term in accordance with the principles established in PAS 17.

B. A payment made by an existing tenant to a new tenant to take over the lease does not meet the definition of an asset under PAS 16 or PAS 38 and is not accounted for under PAS 17 since there is no longer a lease in existence. It should therefore be expensed.

   The new tenant recognizes the receipt as income at the inception of the lease, unless the payment was made to compensate the new tenant for paying above-market rentals (similar in nature to an incentive to enter into the lease). In the case of the latter, the receipt is deferred and amortized over the period of the lease.

3. A new tenant pays:

   A. A payment made by a new tenant to the lessor in connection with a lease arrangement is accounted for under PAS 17 and therefore accounted for as a prepayment and amortized over the lease term by the new tenant.

      Similarly this is treated by the lessor as revenue received in advance and amortized over the lease term.

   B. A payment made by a new tenant to an old tenant to buy out the old tenant's lease (with a third party lessor), is not directly related to the new tenant's lease (i.e., the agreement between the new tenant and the third party lessor). Therefore it cannot be accounted for under PAS 17.

      The payment will generally meet the definition of an intangible asset in paragraph 8 of PAS 38, and therefore is amortized over the useful life – being the term of the lease. However, if this definition is not met due to other conditions and circumstances in the arrangement, the payment is recognized as an expense in the period in which it is incurred.

From the perspective of the old tenant, the receipt is treated as a gain immediately and any remaining balances of the lease are removed and netted off with the amounts received to calculate any resulting gain.

**Effective Date**

The consensus in this Q&A is effective from the date of approval by the FRSC.

Date approved by PIC: June 24, 2017

**PIC Members**

**Wilson P. Tan, Chairman**

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Date approved by FRSC: OCT 11, 2017

**PHILIPPINE INTERPRETATIONS COMMITTEE (PIC)**
**QUESTIONS AND ANSWERS (Q&As)**

**Q&A No. 2017-10**

## PAS 40 - Separation of property and classification as investment property

### Issues

1. How should paragraph 10 of PAS 40, *Investment Property* "... could be sold separately..." interpreted?
2. If separation does not occur prior to the sale of property/assignment of a lease, does this prevent a portion of a property that otherwise meets the definition of investment property in PAS 40 being so treated?
3. Does the intention to lease, or the action of leasing, out a portion of a property under an operating rather than a finance lease prohibit the application of PAS 40?

### Fact Pattern

***Scenario 1***

A property is used partly to derive rental income and partly as owner-occupied property. For example, in an office tower, one could sub-divide the floors and sell individual portions. Similarly with industrial/commercial property, an owner could sub-divide and subsequently sell some portions and retain others for own use.

***Scenario 2***

Properties that are physically sub-divided into different portions (for example different floors) are registered as one single property with the Land or Property registry, and need to be legally sub-divided before a portion can be disposed of. Often, these legal proceedings are undertaken only at the point of sale of that portion of, or the assignment of a lease on that portion of, the property concerned. At the end of the reporting period, the legal sub-division has not occurred.

***Scenario 3***

Portions of a property are leased out under operating leases.

## Consensus

### *Scenario 1*

To separately account for the portions of a property (part as an investment property and part as property, plant and equipment), the property must be in a state and condition to enable it to be disposed of separately at the end of the reporting period.

### *Scenario 2*

The fact that a property could be divided in future periods if the owner so chose is insufficient to conclude that the portions can be accounted for separately. If the property requires sub-division before the portions could be disposed of separately, then those parts are not accounted for separately until such sub-division occurs.

It seems clear that 'separately' needs to be assessed both in terms of the 'physical' separation (e.g., mezzanine floors and partitioning walls) of the property and to 'legal' separation (e.g., legally defined property boundaries and/or registered separately).

Judgement is required to determine whether the legal separation is a substantive requirement that will restrict it being currently separable or whether it is a non-substantive requirement where it is currently separable.

### *Scenario 3*

The intention to lease out a portion of a property, or the action of leasing out a portion of a property, under an operating lease does not prohibit the application of PAS 40 to that portion. However further assessment of the facts and circumstances are needed.

## Basis for Consensus

### *Scenario 1*

If a literal interpretation of paragraph 10 of PAS 40 were applied, almost any portions or element of property would be capable of separate classification and, arguably, the restriction in paragraph 10 of PAS 40 would be mostly irrelevant.

Paragraph 5 of PAS 40 defines investment property as:

"property (land or a building-or part of a building-or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for:

(a) use in the production or supply of goods or services or for administrative purposes; or

(b) sale in the ordinary course of business."

Further, paragraph 10 of PAS 40 states:

"Some properties comprise a portion that is held to earn rentals or for capital appreciation and another portion that is held for use in the production or supply of goods or services or for administrative purposes. If these portions could be sold separately (or leased out separately under a finance lease), an entity accounts for the portions separately. If the portions could not be sold separately, the property is investment property only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes."

***Scenario 2***

For the requirements in paragraph 10 of PAS 40 to be relevant to the decision to separately classify portions of a property, it is believed that the interpretation of 'could be sold separately' must be assessed by reference to the asset's present state and condition. Consequently, if the property requires sub-division before the portions could be disposed of separately, then those parts are not accounted for as separate portions until such sub-division occurs.

If the entity owning the property could not be prevented from legally sub-dividing the property then the property is already in a condition to be sold separately and this would not prevent the portion of the property concerned being accounted for as investment property.

This would be case where, for example: the process of sub-dividing the property was entirely within the control of the entity and did not require permission from a third party (which would include the relevant authorities); or if permission from a third party was required, this was no more than a formality.

Conversely, if the entity was required to obtain the permission of third parties before legally sub-dividing the property, and such permission could be withheld, the portions of the property concerned are not accounted for separately until such sub-division occurs.

Therefore, if the portion of the property concerned otherwise meets the definition of investment property at the end of the reporting period, judgment is required to assess the legal position of the property in determining whether it is appropriate to account for a portion separately under PAS 40.

***Scenario 3***

Paragraph 10 of PAS 40 states that if portions could be

"...sold separately (or leased out separately under a finance lease)..."

they are accounted for separately. An intention to lease, or the action of leasing out a portion of a property under an operating lease is prima facie evidence that, if it so wished, the entity could also lease out the property under a finance lease – the difference between the two commonly being just the length of the lease.

If, however, there is evidence that the property could not be leased out under a finance lease, then PAS 40 could not be applied to that portion.

**Effective Date**

The consensus in this Q&A is effective from the date of approval by the FRSC.

Date approved by PIC: June 28, 2017

**PIC Members**

**Wilson P. Tan, Chairman**

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Date approved by FRSC: OCT 11, 2017

PHILIPPINE INTERPRETATIONS COMMITTEE (PIC)
QUESTIONS AND ANSWERS (Q&As)

Q&A No. 2017-11

**PFRS 10 and PAS 32 - Transaction costs incurred to acquire outstanding non-controlling interest or to sell non-controlling interest without a loss of control**

**Issue**

How does a parent account for transaction costs incurred to acquire outstanding non-controlling interest (NCI) in a subsidiary, or transaction costs incurred to sell non-controlling interest in a subsidiary without loss of control, in the consolidated financial statements of the parent?

**Background**

***Scenario 1***

Entity A (reporting entity) acquired a 70% controlling interest in Subsidiary B in 20X1.

In 20X8, Entity A acquires the remaining 30% interest in Subsidiary B. In this transaction, Entity A incurred directly attributable incremental transaction costs of ₱500. (Consideration for the remaining 30% interest acquired by Entity A may be settled by a cash payment or by the issue of shares of Entity A)

***Scenario 2***

Entity A (reporting entity) acquired a 100% controlling interest in Subsidiary B in 20X1.

In 20X8, Entity A sells a 30% interest in Subsidiary B without losing control. In this transaction, Entity A incurred directly attributable incremental transaction costs of ₱300.

In both scenarios, the entity has a December year-end.

The effect of taxation is not considered as this is covered by PAS 12, *Income Taxes*.

**Consensus**

Any directly attributable incremental transaction costs incurred to acquire outstanding non-controlling interest in a subsidiary or to sell non-controlling interest in a subsidiary without loss of control are deducted from equity. This is regardless of whether the consideration is in cash or shares. The transaction costs in Scenario 1 of ₱500 and in Scenario 2 of ₱300 are deducted directly from equity.

PFRSs do not specify where to allocate the costs in equity – in particular, whether to the parent (who incurred the costs) or to the non-controlling interest (whose equity was issued/repurchased). Therefore, Entity A may choose where to allocate the costs within equity, based on the facts and circumstances surrounding the change in ownership, and any legal requirements.

Regardless to which account in equity the charge is allocated, the amount is not reclassified to profit or loss in future periods. Consequently, if the costs are allocated to NCI, this amount must be separately tracked. Therefore, if Subsidiary B is later sold in a separate transaction (i.e., loss of control), the transaction costs previously recognized directly in equity to acquire or sell the non-controlling interest are not reclassified from equity to profit and loss, because they do not represent components of other comprehensive income.

Although PFRS 10, *Consolidated Financial Statements*, is clear that changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (i.e., transactions with owners in their capacity as owners) it does not specifically address how to account for related transaction costs.

Nevertheless, the entity accounts for transaction costs as a deduction from equity because there is clear guidance elsewhere in PFRSs regarding the treatment of such costs.

**Relevant guidance**

Paragraph 35 of PAS 32, *Financial Instruments: Presentation*, states that "transaction costs of an equity transaction shall be accounted for as a deduction from equity."

Paragraphs 106 and 109 of PAS 1, *Presentation of Financial Statements*, are clear that for transactions with owners in their capacity as owners the related transactions costs are presented within equity separately from profit and loss or other comprehensive income.

This conclusion also applies if the parent issues equity to acquire non-controlling interest. Although there is no change in total consolidated equity, there are two transactions – an issue of new equity and a repurchase of existing equity. The entity accounts for transaction costs on the two elements in the same manner as if they had occurred separately.

In the absence of specific guidance, the entity may allocate costs within equity as appropriate and considering any legal requirements.

The guidance in paragraph 37 of PAS 32 is also applied in determining which costs qualify as transaction costs, i.e., only those "incremental costs directly attributable to the equity transaction that otherwise would have been avoided".

Since the transaction costs do not qualify as a component of other comprehensive income as defined in paragraph 7 of PAS 1, they are not reclassified from equity to profit or loss when the parent loses control over the subsidiary.

Paragraph 106 of PAS 1 states:

"An entity shall present a statement of changes in equity as required by paragraph 10. The statement of changes in equity includes the following information:

...

(d) for each component of equity ...

(i) profit or loss;

(ii) other comprehensive income; and

(iii) transactions with owners in their capacity as owners, showing separately contributions by and distributions to owners and changes in ownership interests in subsidiaries that do not result in a loss of control."

Paragraph 109 of PAS 1 states:

" ... Except for changes resulting from transactions with owners in their capacity as owners (such as equity contributions, reacquisitions of the entity's own equity instruments and dividends) and transaction costs directly related to such transactions, the overall change in equity during a period represents the total amount of income and expense, including gains and losses, generated by the entity's activities during that period."

Paragraph 23 of PFRS 10 states:

"Changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (i.e., transactions with owners in their capacity as owners)."

Paragraph B96 of PFRS 10 states:

"When the proportion of the equity held by non-controlling interests changes, an entity shall adjust the carrying amounts of the controlling and non-controlling interests to reflect the changes in their relative interests in the subsidiary. The entity shall recognize directly in equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the parent."

Paragraph 35 of PAS 32 states:

"... Transaction costs of an equity transaction shall be accounted for as a deduction from equity."

Paragraph 37 of PAS 32 states:

" ... The transaction costs of an equity transaction are accounted for as a deduction from equity to the extent they are incremental costs directly attributable to the equity transaction that otherwise would have been avoided."

**Effective Date**

The consensus in this Q&A is effective from the date of approval by the FRSC.

Date approved by PIC: June 28, 2017

**PIC Members**

**Wilson P. Tan, Chairman**

| | |
|---|---|
| **Emmanuel Y. Artiza** | **Sharon G. Dayoan** |
| **Clark Joseph L. Babor** | **Zaldy D. Aguirre** |
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| **Jerome Antonio B. Constantino** | **Normita L. Villaruz** |

Date approved by FRSC: OCT 11 2017

**PHILIPPINE INTERPRETATIONS COMMITTEE (PIC)**
**QUESTIONS AND ANSWERS (Q&As)**

**Q&A No. 2017-12**

**Subsequent Treatment of Equity Component Arising from Intercompany Loans**

**Issue**

How should a Subsidiary account for the Equity component arising from its borrowings from the Parent Company subsequent to initial recognition?

**Background**

PIC Q&A No. 2011-03, *Accounting for Inter-company Loans,* provides guidance on how the Parent Company and the Subsidiary will account for intercompany borrowings. Under such PIC Q&A, the Subsidiary recognizes the loan from the Parent Company at fair value. The difference between the fair value and the face amount of the loan (the 'Day 1' difference) shall be recorded as a component of equity (i.e., equity contribution by the parent). However, the PIC Q&A provides no guidance on how to account for such component of equity subsequent to initial recognition.

**Relevant guidance**

Paragraph 10(a) of PAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors* indicates that in the absence of a PFRS that specifically applies to a transaction, other event or condition, management shall use its judgment in developing and applying an accounting policy that results in information that is relevant to the economic decision-making needs of users.

Paragraph 11 of PAS 8 provides that in making the judgment, management shall refer to, and consider the applicability of, the following sources in descending order:

(a) the requirements in PFRSs dealing with similar and related issues; and
(b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework.

Paragraph 41 of PAS 16, *Property, Plant and Equipment* states that:

"The revaluation surplus included in equity in respect of an item of property, plant and equipment may be transferred directly to retained earnings when the asset is derecognized. This may involve transferring the whole of the surplus when the asset is retired or disposed of. However, some of the surplus may be transferred as the asset is used by an entity. In such a case, the amount of the surplus transferred would be the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost. Transfers from revaluation surplus to retained earnings are not made through profit or loss."

**Consensus**

Taking into consideration the nature of the transaction, it is presumed that the "equity contribution" recognized in the books of the subsidiary is equivalent to additional paid-in capital (APIC).

On the other hand, since there is no specific accounting standard that deals with the subsequent treatment of "equity contribution" recognized in the books of the subsidiary, paragraph 11 of PAS 8 states that, in making the judgment required by paragraph 10 of PAS 8, management can refer to, and consider the applicability of the requirements in PFRSs dealing with similar and related issues. The Subsidiary can analogize the provisions of paragraph 41 of PAS 16 which states that revaluation surplus included in equity in respect of an item of property, plant and equipment may be transferred directly to retained earnings when the asset is derecognized or as used by the entity (i.e., through depreciation and amortization). Applying the guidance of PAS 16, as the Subsidiary amortizes the "Day 1" difference using the effective interest method, an equivalent amount may be adjusted from the "Equity reserve" account to retained earnings.

Accordingly, the Subsidiary has an accounting policy choice to apply the following:

- **Option 1 (Preferred view)** – The equity component arising from the difference between the fair value and face value of the loan is initially recognized as "Equity reserve". Subsequently, the said adjustment will be closed to APIC upon settlement of the loan. This option entails a one-time charge to APIC without any future reclassification to retained earnings.

- **Option 2** – the equity component arising from the difference between the fair value and face value of the loan is also initially recognized as "Equity reserve", similar to Option 1. Subsequently, as the "Day 1" difference is amortized using the effective interest method through profit or loss, an amount equivalent to the amortization for the period is transferred from "Equity reserve" to retained earnings.

If Option 2 is applied, the entity needs to disclose this accounting policy in its financial statements. Otherwise, it will be assumed that Option 1 is applied.

The policy adopted by a subsidiary shall be applied consistently for similar transactions.

It should be emphasized that the above guidance is applicable only in the preparation of separate/standalone financial statements of the subsidiary. On consolidation, intercompany loans will be eliminated, including any discount or premium (and the effect of unwinding thereof) arising from any 'Day 1' difference.

**Transition and Effective Date**

The consensus in this Q&A is effective from the date of the approval by the FRSC. It shall be applied retrospectively.

Date approved by PIC: July 26, 2017

**PIC Members**

**Wilson P. Tan, Chairman**

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Date approved by FRSC: October 11, 2017