

IFRS INTERPRETATIONS COMMITTEE - AGENDA DECISIONS (JANUARY AND MARCH 2018)

INTERNATIONAL FINANCIAL REPORTING BULLETIN 2018/01



Background

This Bulletin summarises issues that the IFRS Interpretations Committee (the Interpretations Committee) decided not to take onto its agenda at its January and March 2018 meetings, which were reported in its public newsletter (the IFRIC Update). Although these agenda decisions do not represent authoritative guidance issued by the International Accounting Standards Board (IASB), in practice they are regarded as being highly persuasive. All entities that report in accordance with IFRS need to be aware of these agenda decisions, and may need to modify their accounting approach. More detailed background about agenda decisions is set out below.

The Interpretations Committee is the interpretative body of the IASB. The role of the Interpretations Committee is to provide guidance on financial reporting issues which have been identified and which are not specifically addressed in IFRS, or where unsatisfactory or conflicting interpretations either have developed, or appear likely to develop.

Any party which has an interest in financial reporting is encouraged to submit issues to the Interpretations Committee when it is considered to be important that the issue is addressed by either the Interpretations Committee itself, or by the IASB. When issues are raised, the Interpretations Committee normally consults a range of other parties, including national accounting standard setting bodies, other organisations involved with accounting standard setting, and securities regulators.

At each of its meetings, the Interpretations Committee considers new issues that have been raised, and decides whether they should be added to its agenda. For those issues that are not added to the agenda, a tentative agenda decision is published in the IFRIC Update newsletter which is issued shortly after each of the Interpretations Committee's meetings. These tentative agenda decisions are open to public comment for a period of 60 days, after which point they are taken back to the Interpretations Committee for further consideration in the light of any comment letters which have been received and further analysis carried out by the Staff. The tentative agenda decision is then either confirmed and reported in the next IFRIC Update, subjected to further consideration by the Interpretations Committee or referred to the IASB.

Interpretations Committee agenda decisions do not represent authoritative guidance. However, they do set out the Interpretations Committee's rationale for not taking an issue onto its agenda (or referring it to the IASB). It is noted on the IFRS Foundation's website that they 'should be seen as helpful, informative and persuasive'. In practice, it is expected that entities reporting in accordance with IFRS will take account of and follow the agenda decisions and this is the approach which is followed by securities regulators worldwide.

STATUS

Final

EFFECTIVE DATE

Immediate

ACCOUNTING IMPACT

Clarification of IFRS requirements.
May lead to changes in practice.

Agenda decisions that were finalised

IFRS 9 & IAS 1	<i>Financial Instruments & Presentation of Financial Statements - Presentation of interest revenue for particular financial instruments</i>
IFRS 15	<i>Revenue from Contracts with Customers - Revenue Recognition in a Real Estate Contract that Includes the Transfer of Land</i>
IFRS 15	<i>Revenue from Contracts with Customers - Right to payment for performance to date</i>
IFRS 15	<i>Revenue from Contracts with Customers - Revenue recognition in a real estate contract</i>
IAS 28	<i>Investments in Associates and Joint ventures - Contributing property, plant and equipment to an associate</i>

Tentative agenda decisions

IAS 7	<i>Statement of Cash Flows - Classification of short-term loans and credit facilities</i>
IFRS 9	<i>Financial Instruments - Classification of a particular type of dual currency bond</i>
IFRS 9 & IAS 39	<i>Financial Instruments - Hedge accounting with load following swaps</i>

Agenda decisions that were finalised - Wide Application**IFRS 9 & IAS 1 *Financial Instruments and Presentation of Financial Statements - Presentation of Interest Revenue for Particular Financial Instruments***

The Interpretations Committee received a request concerning the consequential amendment that IFRS 9 made to paragraph 82(a) of IAS 1. This amendment requires an entity to present interest revenue calculated using the effective interest rate method separately from other sources of revenue. Specifically, the request asked whether that requirement prohibits an entity from presenting particular cash flows on derivatives that are not part of a designated and effective hedging relationship (for example, the accrued and realised cash flows on an interest rate swap) as 'interest revenue' in profit or loss, separately from other movements in fair value.

The Interpretations Committee noted that amortised cost accounting, including interest revenue calculated using the effective interest method and credit losses calculated using the expected credit loss impairment model, is only applied to financial assets that are subsequently measured at either amortised cost or fair value through other comprehensive income. It is not applied to financial assets that are subsequently measured at fair value through profit or loss.

Therefore, the Interpretations Committee decided that the requirement in paragraph 82(a) of IAS 1 does not apply to derivatives or other financial assets that are subsequently measured at fair value through profit or loss. It only applies to those assets that are measured at amortised cost or fair value through other comprehensive income (subject to any effect of a qualifying hedging relationship applying the hedge accounting requirements in IFRS 9 or IAS 39).

IFRS 15 *Revenue from Contracts with Customers - Revenue Recognition in a Real Estate Contract that Includes the Transfer of Land*

The Interpretations Committee received a request to clarify how an entity accounts for the sale of land and a building to be constructed on the land. Specifically, the request asked whether (a) the sale of land and construction represents one or two performance obligations and (b) for each performance obligation whether revenue is recognised at a point in time or over time.

In the fact pattern described in the request, the contract includes the following features:

- The entity and the customer enter into a non-cancellable contract for the sale of a building yet to be constructed by the entity.
- At contract inception, the entity irrevocably transfers to the customer legal title to the land on which the entity will construct the building. The contract specifies a price for the land, which the customer pays on signing the contract.
- The entity and the customer agree upon the structural design and specification of the building before the contract is signed. As the building is being constructed:
 - if the customer requests changes to the structural design or specification, the entity prices the proposed changes based on a methodology specified in the contract; the customer then decides whether to proceed with the changes. The entity can reject the customer's request for changes only for a limited number of reasons, such as when the change would breach planning permission.
 - the entity can request changes to the structural design or specification only if not doing so would lead to an unreasonable increase in costs or delay to construction. The customer must approve those changes.
- The customer is required to make milestone payments throughout the construction period. However, these

payments do not necessarily correspond to the amount of work completed to date.

Issue 1: What are the performance obligations in the contract?

An entity identifies performance obligations by applying paragraphs 22-30 of IFRS 15. A performance obligation is a good or service (or bundle of goods or services) that is distinct, or a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

Paragraph 27 of IFRS 15 specifies that a good or service promised to a customer is distinct if:

- a) the customer can benefit from the good or service on its own or together with other resources readily available to the customer (i.e. the good or service is capable of being distinct); and
- b) the entity's promise to transfer the good or service is separately identifiable from other promises in the contract (i.e. the promise to transfer the good or service is distinct within the context of the contract).

The Interpretations Committee noted that the assessment of these criteria requires judgement.

In a contract for the transfer of an area of land and of an entire building to be constructed on the land, the Interpretations Committee concluded that land and the building are each capable of being distinct and therefore the condition in paragraph 27(a) of IFRS 15 is met. This is because the customer could hire another developer to construct a building were the land to have been purchased on its own. In reaching this conclusion, the Interpretations Committee noted that Paragraph BC100 explains that an entity disregards any contractual limitations that might preclude the customer from appointing a different contractor to carry out the construction.

The Interpretations Committee then considered the criterion in paragraph 27(b), noting that its underlying objective (explained in paragraph 29) is to consider whether the nature of the entity's promise is to transfer the land and building individually or, instead, to transfer a combined item to which the land and buildings are inputs. The Interpretations Committee noted paragraphs BC 105, BC116J and BC 116K, which explain that the notion of whether two or more promises are distinct within the context of a contract is influenced by whether the risk an entity assumes to fulfil one obligation is separable from the risk relating to others. This requires an assessment of the level of integration, interrelation or interdependence among the promises. Rather than considering whether one item by its nature, depends on the other, it is necessary to evaluate whether there is a transformative relationship between two promises in the process of fulfilling a contract.

In the context of a contract for the sale of land and construction services, and drawing on two of the three examples of factors in paragraph 29 of IFRS 15, the Interpretations Committee observed that it is necessary to consider if:

- the entity provides a significant service of integrating the land and building into a combined output. This might be the case if there is a transformative relationship between the transfer of land and the construction of the building in the process of fulfilling the contract or if the entity's performance in constructing the building would have been any different if it had not transferred the land, and vice versa. Although there is a functional relationship between the land and the building (the building cannot exist without the land because its foundations will be built into the land) this does not necessarily mean the risks to which the entity is exposed in transferring the land to the customer are inseparable from the risks of constructing the building.
- the land and building are highly interdependent or interrelated. For example, would the entity be able to fulfil its promise to transfer the land even if the customer purchased the construction services from another developer, and would the entity be able to fulfil its

promise to construct the building had the customer purchased the land from another party?

The Interpretations Committee concluded that the promise to transfer land would be distinct in the context of the contract, and therefore the criterion in paragraph 27(b) would be met, if the entity concluded that:

- its performance in constructing the building would be the same regardless of whether it had transferred the land;
- it would be able to fulfil its promise to construct the building even if the customer had purchased the land from another party; and
- it would be able to fulfil its promise to transfer the land even if the customer had purchased the construction services from other providers.

The Interpretations Committee also observed that paragraph BC116N notes that the factors in paragraph 29 are not intended to be a series of criteria that are evaluated independently from the 'separately identifiable' principle in paragraph 27. In some cases, one or more of the factors in paragraph 29 may be less relevant in the context of the overall objective of the principle.

Issue 2: Should revenue be recognised at a point in time or over time?

Paragraph 35 sets out three circumstances when revenue should be recognised over time:

- a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs;
- b) the entity's performance creates or enhances an asset (for example work-in-progress) that the customer controls as the asset is created or enhanced; or
- c) the entity's performance does not create an asset with alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

Regarding the promise to transfer the land, the land is not consumed immediately (hence the criterion in paragraph 35(a) is not met), and the entity's performance does not create or enhance the land (hence the criteria in paragraphs 35(b) and 35(c) are not met). Therefore, assuming the entity concludes that the sale of land is a separate performance obligation, revenue from the transfer of land is recognised at a point in time.

Regarding the construction services, the Interpretations Committee concluded that the criterion in paragraph 35(b) is met because the customer has the ability to:

- direct the use of the building as it is being constructed through its control of the previously transferred land, by being able to change the structural design and specification of the building as it is constructed. The customer is also able to prevent others from directing the use of the building; and
- obtain substantially all of the remaining economic benefits from the building as a result of signing the contract because the entity cannot redirect the building for another use or to another entity.

It was also noted that, in paragraph BC129, the Board observed that 'in the case of a construction contract in which the entity is building on the customer's land, the customer generally controls any work in progress arising from the entity's performance.'

IFRS 15 Revenue from Contracts with Customers - Right to payment for performance to date

The Interpretations Committee received a request relating to the sale of a residential unit in a multi-unit complex. Specifically it was asked to clarify whether, in a specified fact pattern, the vendor has an enforceable right to payment for performance completed to date resulting in revenue being recognised over time in accordance with paragraph 35(c) of IFRS 15.

Relevant facts to the analysis are:

- the contract is for the sale of a real estate unit in a residential multi-unit complex, with the contract entered into before the unit is constructed
- the customer pays 10% of the purchase price for the real estate unit at contract inception, and pays the remainder of the purchase price to the entity after construction is complete.
- the customer has the right to cancel the contract at any time before construction is complete. If the customer cancels the contract the vendor is legally required to make reasonable efforts to resell the real estate unit to a third party. On resale, the vendor enters into a new contract with the third party, i.e. the original contract is not novated to the third party. If the resale price to be obtained from the third party is less than the original purchase price (plus selling costs), the original customer is legally obliged to pay the difference to the vendor.

The Interpretations Committee observed that, based on the fact pattern, the nature of the payment from the customer to which the entity has a right under the contract is a payment for the difference between the resale price and the original purchase price (i.e. compensation for loss of profit).

The Interpretations Committee also observed the following requirements of IFRS 15:

- Paragraph 37 states that to have an enforceable right to payment, an entity must be entitled at all times throughout the duration of the contract to an amount that compensates it for performance to date if the contract is terminated for reasons other than the vendor's failure to perform as promised; and
- Paragraph B9 states that an amount that would compensate an entity for performance completed to date would be an amount that approximates the selling price of the goods / services transferred to date. Therefore, a right to compensation for loss of profit would not constitute an enforceable right to payment for performance completed to date.

Consequently, the Interpretations Committee concluded that the criteria in paragraph 35(c) for recognising revenue over time were not met.

IFRS 15 Revenue from Contracts with Customers - Revenue recognition in a real estate contract

The Interpretations Committee received a request to clarify whether revenue from the sale of a residential unit in a multi-unit complex (real estate unit) should be recognised over time as construction progresses.

Paragraph 35 of IFRS 15 specifies that an entity transfers control of a good or service over time, and therefore recognises revenue over time when one or more of three criteria are met. The assessment in any particular circumstance requires an analysis of the rights and obligations created by the contract, taking into account the legal environment within which the contract is enforceable. The conclusion will, therefore, ultimately depend on the particular facts and circumstances that apply to the contract.

In the fact pattern considered by the Interpretations Committee, the contract for the real estate unit includes the following features:

- (i) The real estate developer (entity) and the customer enter into a contract for the sale of a real estate unit in a residential multi-unit complex before the entity begins construction.
- (ii) The entity's obligation under the contract is to construct and deliver the completed real estate unit as specified in the contract, i.e. it cannot change or substitute the specified unit in the contract. The entity retains legal title to the real estate unit (and any land attributed to it) until

the customer has paid the purchase price after construction is complete.

- (iii) The customer pays a portion of the purchase price for the real estate unit as it is constructed, and pays the remainder (a majority) after construction is complete.
- (iv) The contract gives the customer an undivided interest in the land and the multi-unit complex under construction. The customer cannot cancel the contract, except as noted in (vii) below, nor can it change the structural design of the unit. The customer can resell or pledge its right to the undivided interest in land and the complex as it is being constructed, subject to the entity performing a credit risk analysis of the new buyer of the right.
- (v) The customer, and the other customers who have agreed to buy units, have the right to together decide to change the structural design and negotiate such change with the entity
- (vi) If the entity is in breach of its obligations under the contract, the customer and other customers have the right to together decide to replace the entity or otherwise stop the construction of the complex construction of the complex.
- (vii) Although the contract is irrevocable, the courts have accepted requests to cancel contracts in specific circumstances, for example when it has been proven that the customer is not financially able to fulfil the terms of the contract, e.g. if the customer becomes unemployed or has a major illness that affects their ability to work. In these situations, the contract has been cancelled and the customer has received most, but not all, of the payments it has already made to the entity. The remainder has been retained by the entity as a termination penalty.

Applying these facts to the three circumstances in paragraph 35 of IFRS 15 when revenue should be recognised over time, the Interpretations Committee concluded as follows.

- The customer does not simultaneously receive and consume the benefits of the real estate unit during its construction. Therefore the condition for recognising revenue over time, as specified in paragraph 35(a) of IFRS 15, is not met.
- Paragraph 35(b) of IFRS 15 requires revenue to be recognised over time if control of the real estate unit passes to the customer during construction. In order to decide if this applies, it is necessary to assess whether the customer has the ability to direct the use of, and obtain substantially all the remaining benefits from, the partly-constructed real estate unit. Paragraph BC129 explains that this criterion was included 'to address situations in which an entity's performance creates or enhances an asset that the customer clearly controls as the asset is created or enhanced'. In this case the Interpretations Committee observed that:
 - although the customer can resell or pledge the its contractual right to the undivided interest in the land and multi-unit complex, it is unable to sell or pledge the real estate unit itself before construction is complete;
 - the customer has no ability change the structural design of the retail unit as it is being constructed, nor can it use the part-constructed real estate unit in any other way. The customer's right together with other customers to decide to change the structural design does not provide the customer with the ability to direct the use of the retail unit because the agreement of other customers is needed to negotiate any changes.
 - the customer's right (together with other customers) to replace the entity, only in the event of the entity's failure to perform as promised, is protective in nature and is not indicative of control; and
 - the customer's exposure to changes in the market value of the real estate unit may indicate that the customer has the ability to obtain substantially all of the remaining benefits from the real estate unit. However,

it does not give the customer the ability to direct the use of the unit as it is constructed.

Therefore the condition for recognising revenue over time, as specified in paragraph 35(b) of IFRS 15, is not met.

- The third criterion in paragraph 35(c) was developed for recognising revenue over time because in some cases it may be unclear whether the asset that is created or enhanced is controlled by the customer (see paragraph BC131 and BC143). Paragraph 35(c) requires revenue to be recognised over time if the asset created by the entity's performance does not have an alternative use to the entity, and the entity has an enforceable right to payment for performance completed to date. In this case, the entity cannot change or substitute the real estate unit specified in the contract with the customer, and therefore the customer could enforce its right to the unit if the entity sought to direct the asset for another use. Consequently, the contractual restriction is substantive and the real estate unit does not have an alternative use. Therefore one of the two conditions specified in paragraph 35(c) of IFRS 15 necessary for recognising revenue over time is met. However, the entity does not have an enforceable right to payment for performance completed to date (the second necessary condition specified in paragraph 35(c) of IFRS 15). This is because there is legal precedent indicating the entity is not entitled to an amount that at least compensates it for performance completed to date in the event of cancellation for reasons other than the entity's failure to perform (see paragraph 37). In the event of the courts accepting requests to cancel contracts, the entity is entitled only to a termination penalty that does not compensate it for performance completed to date (see paragraph B12). The Interpretations Committee observed that, although it is not necessary to carry out an exhaustive search for evidence, it would be inappropriate either to ignore evidence of relevant legal precedent, or to anticipate evidence that may or may not become available in future. It was also noted that the assessment of enforceable rights is based on their existence and enforceability. The likelihood that a right (including a right to terminate) will be enforced or exercised is not relevant to this assessment. In this case, the Interpretations Committee concluded that the conditions in paragraph 35(c) are not met.

Based on the fact pattern described, therefore, the Committee observed that none of the three criteria set out in paragraph 35 of IFRS 15 apply and that the entity should recognise revenue at a point in time by applying paragraph 38 of IFRS 15.

Agenda decisions that were finalised - Narrow Application

IAS 28 Investments in Associates and Joint ventures - Contributing property, plant and equipment to an associate

The Interpretations Committee received a request about how an entity accounts for a transaction in which it contributes property, plant and equipment (PPE) to a newly-formed associate. The request asked:

- whether IFRS standards provide a general exception or exemption from applying the requirements in a particular standard to common control transactions (Question A);
- whether an investor recognises any gain or loss on contributing PPE to an associate to the extent of other investors' interests in the associate (Question B); and
- how an investor determines the gain or loss on contributing PPE to the associate and whether cost of its resulting interest should be based on the fair value of the PPE contributed or the fair value of the acquired interest (Question C).

Question A

The Interpretations Committee observed that paragraph 7 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires an entity to apply an IFRS Standard to a transaction when that Standard applies specifically to the transaction. Therefore, unless a Standard specifically excludes common control transactions from its scope, an entity should apply the applicable requirements in the Standard to common control transactions.

Question B

Paragraph 28 of IAS 28 requires an entity to recognise gains and losses from transactions with associates only to the extent of unrelated investors' interests. The Interpretations Committee observed that the term 'unrelated investors' refers to investors other than the entity (including its consolidated subsidiaries) and does not mean the opposite of 'related' as used in the definition of a related party in IAS 24 *Related Party Disclosures*.

Accordingly, the Interpretations Committee concluded that an entity recognises any gain or loss on contributing PPE to an associate to the extent of other investors' interests in the associate.

Question C

The Interpretations Committee:

- noted that this question is only relevant if it is determined that the fair value of PPE contributed differs from the fair value of the equity interest in the associate received in exchange. If there is initially any indication that the fair values differ, the investor should first assess the reasons for the difference and review the procedures and assumptions it has used to determine fair value;
- observed that an entity is required to recognise a gain or loss on contributing PPE, and a carrying amount for the investment in the associate, based on the fair value of the PPE contributed (unless the transaction provides objective evidence that the entity's interest in the associate might be impaired, in which case it considers the impairment requirements in IAS 36 *Impairment of Assets*); and
- noted that if it is determined that the fair value of the PPE is more than the fair value of the acquired interest in the associate, this would provide objective evidence that the entity's interest in the associate might be impaired.

For all three questions, the Interpretations Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to account for the contribution of PPE to an associate. Consequently, it decided not to add this matter to its standard-setting agenda.

The Interpretations Committee also noted that the Board has a research project on Business Combinations under Common Control (BCUCC). Although transactions involving the contribution of PPE to a newly formed associate in return for shares in the associate are outside the scope of that project, it was noted that the Board will consider the interaction with other transactions under common control.

Tentative agenda decisions - Wide Application

IAS 7 Statement of Cash Flows - Classification of short-term loans and credit facilities

The Interpretations Committee received a request asking about the types of borrowings an entity includes in its statement of cash flows as a component of cash and cash equivalents. In the fact pattern described in the request:

- The entity has short-term loans and credit facilities (short-term arrangements) that have a short contractual notice period (e.g. 14 days);
- the entity uses the short-term arrangements for cash management; and
- the balance of the short-term arrangements does not often fluctuate from being negative to positive.

The Committee observed that:

- applying paragraph 8 of IAS 7, an entity generally considers bank borrowings to be financing activities. An entity, however, includes a bank borrowing as a component of cash and cash equivalents only in the particular circumstances described in paragraph 8 of IAS 7, i.e. the banking arrangement is a bank overdraft that is both repayable on demand, and forms an integral part of the entity's cash management.
- cash management includes managing cash and cash equivalents for the purpose of meeting short-term cash commitments rather than for investment or other purposes (paragraphs 7 and 9 of IAS 7). Assessing whether a banking arrangement is an integral part of an entity's cash management is a matter of facts and circumstances.
- if the balance of a banking arrangement does not often fluctuate from being negative to positive, then this indicates that the arrangement does not form an integral part of the entity's cash management and, instead, represents a form of financing.

In the fact pattern described in the request, the Interpretations Committee concluded that the entity does not include the short-term arrangements as components of cash and cash equivalents because they are not repayable on demand. Additionally, the short-term arrangements are a form of financing rather than an integral part of the entity's cash management because the balance does not often fluctuate from being negative to positive.

The Committee also noted that paragraphs 45 and 46 of IAS 7 require an entity to:

- disclose the components of cash and cash equivalents and present a reconciliation of the amounts in its statement of cash flows with the equivalent items reported in its statement of financial position; and
- disclose the policy which it adopts in determining the composition of cash and cash equivalents.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to assess whether to include in its statement of cash flows the short-term arrangements described in the request as components of cash and cash equivalents. Therefore, it tentatively decided not to add this matter to its standard-setting agenda.

Tentative agenda decisions - Narrow Application

IFRS 9 Financial Instruments - Classification of a particular type of dual currency bond

The Interpretations Committee received a request about how a holder would classify a 'dual currency bond' with a par amount denominated in one currency and fixed interest coupon payments denominated in another currency. The fixed interest payments are paid annually and the par amount is repaid at a stated maturity date. The submitter asked whether such a financial instrument has contractual cash flows that are solely payments of principal and interest on the principal amount outstanding applying paragraphs 4.1.2(b) and 4.1.2A(b) of IFRS 9.


On the basis of the responses to outreach performed on the request, the Interpretations Committee observed that the financial instrument described in the request is not common. Therefore, the Committee has not obtained evidence that the matter has widespread effect. Consequently, it tentatively decided not to add this matter to its standard-setting agenda.

IFRS 9 & IAS 39 Financial Instruments - Hedge accounting with load following swaps

The Interpretations Committee received a request about how an entity applies the requirement that a forecast transaction in a hedging relationship must be highly probable when the notional amount of the derivative designated as a hedging instrument ('Load

Following Swap') varies depending on the outcome of the hedged item. In addition, the request asked whether, when assessing or measuring hedge effectiveness, the hedged item must be fixed (in volume terms) at the inception of the hedging relationship, and whether the answers to these questions depend on whether the entity applies IAS 39 or IFRS 9.

On the basis of the responses to outreach performed on the request, the Committee observed that the financial instrument described in the request is not common. Therefore, the Committee has not obtained evidence that the matter has widespread effect. Consequently, the Committee tentatively decided not to add this matter to its standard-setting agenda.



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