NEWSLETTER OF THE INTERNATIONAL FINANCIAL REPORTING INTERPRETATIONS COMMITTEE

IASB

IFRIC UPDATE

July 2008

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

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

The IFRIC met in London on 10 and 11 July 2008, when it discussed:

- IFRIC D23 *Distributions of Non–cash Assets to Owners*
- IFRIC D24 *Customer Contributions*
- *Group Cash-settled Share-based Payment Transactions* (Proposed amendments to IFRS 2 *Share-based Payment* and IFRIC 11 *IFRS 2—Group and Treasury Share Transactions*)
- Compliance costs for REACH
- Agenda decision
- Tentative agenda decisions
- Work in progress

IFRIC D23 *Distributions of Non-cash Assets to Owners*

The IFRIC considered comments received on Draft Interpretation D23, published for comment in January 2008. This meeting was the first redeliberation of D23.

Should the IFRIC continue this project?

Most respondents to D23 supported the IFRIC's conclusion that it should develop an interpretation on this issue and agreed with the IFRIC's proposals. However, some expressed serious general concerns and recommended that the IFRIC discontinue this project. In addition, some expressed concern about what they saw as the narrow scope of the project and suggested that it was not worth while for the IFRIC to develop an interpretation that would apply to only a limited number of transactions. The IFRIC decided to continue this project without changing its scope because:

- the accounting for the distribution of non-cash assets to owners in their capacity as owners is diverse because no IFRS guidance exists, and
- transactions in which the shares of group entities are distributed to shareholders outside the group do not meet the definition of common control transactions in IFRS 3 *Business Combinations* and would therefore be within the scope of the Interpretation. The IFRIC directed the staff to redraft the Interpretation to ensure that the scope is clear.

Measurement of the dividend payable and recognition of a gain on settlement

The IFRIC reconsidered whether the Interpretation should specify that all dividends payable should be measured in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The IFRIC noted that many respondents were concerned that D23 might imply that the measurement attribute in IAS 37 should always be interpreted to be fair value. This was not the intention of D23 as that question is part of the Board's project to amend IAS 37. Therefore, the IFRIC decided to modify the proposal in D23 to require the dividend payable to be measured by reference to the fair value of the assets to be distributed. The Interpretation would analyse the requirements of potentially relevant standards but would not link the conclusion to any individual standard.

Considering the comments received, the IFRIC decided not to adopt the alternative view set out in paragraph BC44 of D23 concerning the recognition of the gain on settlement directly in equity. However, the IFRIC directed the staff to provide in the final Basis for Conclusions further rationale for the conclusion that the settlement gain should be included in profit or loss.

Disclosure

The IFRIC did not identify any serious concerns about the disclosure requirements proposed in paragraphs 13–15 of D23 and decided to proceed with them.

Application of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

As a result of the comment letter analysis and its redeliberations, the IFRIC decided that:

- IFRS 5 should be applied to assets held for distribution to owners. The IFRIC would recommend to the Board that IFRS 5 should be amended to make it applicable to such distributions.
- IFRS 5 should be applied at the commitment date at which time the assets must be available for immediate distribution in their present condition and the distribution must be highly probable. For the distribution to be highly probable, it must meet the same conditions as for assets held for sale in paragraphs 8 and 9 of IFRS 5. The probability of shareholders' approval (if required in the jurisdiction) should be considered as part of the assessment of whether the distribution is highly probable.

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The IFRIC recognised respondents' concerns about the potential 'accounting mismatch' in equity resulting from measuring the assets to be distributed at carrying amount and measuring the dividend payable at fair value. Consequently, the IFRIC directed the staff to consider whether it should recommend that the Board amend IFRS 5 to require the assets to be distributed to be measured at fair value, and if so, when IFRS 5 should be applied. The staff were also asked to consider any potential implications or consequences of such a conclusion for other standards.

When to recognise the dividend payable

D23 does not address when an entity should recognise a liability for a dividend payable and some respondents asked the IFRIC to clarify this issue. The IFRIC decided that the liability to make the distribution should be recognised:

(a) when declaration of the dividend by management is approved by the shareholders, if the jurisdiction legally requires such approval and the declaration of the dividend is no longer at the discretion of the entity, or

(b) when the dividend is declared by management, if the jurisdiction does not legally require shareholders' approval and the declaration of the dividend is no longer at the discretion of the entity.

IFRIC D24 *Customer Contributions*

The IFRIC considered comments received on Draft Interpretation D24, published for comment in January 2008. The staff presented a paper summarising the comments received. Most respondents supported the IFRIC's conclusion that it should develop an interpretation on this issue. However, many raised revenue recognition issues and asked the IFRIC for clarifications. Some, including utility companies, pointed out that, for example, when a utility company is required by law or regulation to provide access to a supply of a commodity to all customers at the same price, the access provider may not have any further obligation once connection to the service has been made. Some respondents believed that an obligation to provide ongoing services to the customer who contributed the asset exists only if the customer obtains in exchange some exclusive right of access to goods or services, eg at a reduced price.

The IFRIC discussed an example of a customer contribution for connection to a price-regulated network based on the background of the initial submission to the IFRIC and existing guidance issued by a national interpretative group. In the example, an electricity substation is contributed by a real estate developer to the utility company operating the electricity network. Either by law or regulation, the utility company has an ongoing obligation to provide access to the electricity network to all connected customers at the same price, regardless of whether they have contributed an asset. Once a customer is connected, the utility company provides ongoing access to its network and charges the customer a quarterly fee for that access. The customer is free to purchase electricity from providers other than the utility but must use the utility's network to receive it.

The IFRIC generally supported the staff's conclusion that, in the specific facts of the example, the ongoing obligation to provide access arises from the terms of the operating licence not from the contribution. The IFRIC concluded that in these circumstances the ongoing performance obligation is an executory contract and should not be accounted for, unless it is onerous.

However, some IFRIC members pointed out that the example prepared by the staff was very narrow and asked the staff to develop additional examples with different facts and circumstances (eg in a non-regulated environment or circumstances in which IFRIC 4 *Determining whether an Arrangement contains a Lease* might apply). Some IFRIC members also questioned whether, in accordance with paragraph 13 of IAS 18 *Revenue*, connection services would be identified as a separate component from the ongoing service of providing access to the network.

For discussion at the next meeting, the IFRIC directed the staff to develop indicators based on IAS 18 to help identify whether a performance obligation arising from a customer contribution exists, to prepare additional examples, and to carry forward the proposals in D24 in respect of recognition and measurement of the contributed asset.

Group Cash-settled Share-based Payment Transactions (Proposed amendments to IFRS 2 *Share-based Payment* and IFRIC 11 IFRS 2—*Group and Treasury Share Transactions*)

At the IFRIC meeting in May 2008, the staff presented a summary of comments received on the exposure draft (ED). The IFRIC agreed to reconsider the significant points raised by respondents before making its recommendations to the Board. Because IFRS 2 is being amended by this project, the Board decided at its meeting in May 2008 that the amendments should also incorporate into IFRS 2 all the guidance currently found in the interpretations.

At this meeting, the IFRIC redeliberated the scope and measurement proposals in the ED. The staff presented papers considering alternatives to address the main areas of concern expressed by respondents about these proposals.

The ED considered how to include in the scope of IFRS 2 share-based payment transactions involving group entities (including shareholders) in which the settling entity may not be the entity receiving goods and services. The IFRIC agreed with respondents that the ED's proposals did not completely achieve its objective. Therefore, the IFRIC decided to recommend that the Board amend some defined terms and paragraph 3 of IFRS 2 to make it clear that:

- the receiving entity has to account for the goods and services received in accordance with IFRS 2; and
- the settling entity has to account for the settlement in accordance with IFRS 2.

The IFRIC also decided to recommend that the Board should consider amending IFRS 2 to add the general principles

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developed by the staff rather than continuing to develop specific guidance case by case.

The IFRIC reconsidered the classification and measurement proposed in the ED for the separate financial statements of the entity receiving goods and services when a *share-based payment* transaction will be settled by another group entity or its shareholder.

In these cases, after considering comments made by respondents, the IFRIC decided to recommend that the classification and measurement of the share-based payment transaction by the receiving entity and settling entity should not necessarily be the same, dependent on the circumstances. When the receiving entity does not have any obligation to settle the share-based payment transaction, it should measure the goods and services received in accordance with the requirements for equity-settled transactions. Thus, only changes in estimates associated with vesting conditions (performance conditions) other than a market condition would be reflected. The receiving entity would recognise an equivalent contribution from its shareholder or parent in equity irrespective of how the expense is calculated by the party with the obligation to settle the shared-based payment transaction. The financial statements of the group and the settling entity will reflect the appropriate IFRS 2 measurement on the basis of the actual settlement by the group settling entity.

The IFRIC directed the staff to report a summary of its discussions to the Board along with the rationales underlying the recommended changes from the proposals in the ED.

Consistently with the conclusions reached by the IFRIC and the Board when finalising IFRIC 11, the IFRIC decided to recommend that the Board not amend IFRS 2 at this time to address how to account for an intragroup reimbursement arrangement for these group share-based payment transactions.

Compliance costs for REACH

The IFRIC received a request to add an issue to its agenda to provide guidance on the treatment of costs incurred to comply with the requirements of the European Regulation concerning the Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH). The Regulation came into force in part on 1 June 2007 and companies have begun to account for the first costs incurred to comply.

The submission noted that different types of costs are incurred as a result of the Regulation. It also noted that a variety of treatments for the costs has been observed in practice and that entities are beginning to develop accounting policies that include a mixture of the approaches observed.

The IFRIC agreed with the staff's recommendation that it should tentatively add this issue to its agenda. The IFRIC noted that jurisdictions other than Europe had developed or were in the process of developing regulations relating to similar environmental issues. Consequently, the IFRIC recommended that the staff should analyse the issue on the basis of general principles rather than the specifics of any particular legislation.

In addition, the IFRIC agreed with the staff's proposal that it would be helpful to work with other interpretative bodies whose entities might be affected by the Regulation or similar requirements.

IFRIC agenda decisions

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

Application of the effective interest rate method

The IFRIC was asked for guidance on the application of the effective interest rate method to a financial instrument whose cash flows are linked to changes in an inflation index. The submission suggested three possible approaches.

The IFRIC noted that paragraphs AG6–AG8 of IAS 39 *Financial Instruments: Recognition and Measurement* provide the relevant application guidance. Judgement is required to determine whether an instrument is a floating rate instrument within the scope of paragraph AG7 or an instrument within the scope of paragraph AG8.

In view of the existing application guidance in IAS 39, the IFRIC decided not to add this issue to its agenda. However, the IFRIC referred the issue to the Board with a recommendation that the Board should consider clarifying or expanding that application guidance.

Tentative agenda decisions

The IFRIC reviewed the following matters and tentatively decided that they should not be added to the IFRIC agenda. These tentative decisions, including recommended reasons for not adding the items to the IFRIC agenda, will be reconsidered at the IFRIC meeting in September 2008. Constituents who disagree with the proposed reasons, or believe that the explanations may contribute to divergent practices, are encouraged to communicate those concerns by 18 August 2008 by email to: ifric@iasb.org.

Communications will be placed on the public record unless the writer requests confidentiality, supported by good reason, such as commercial confidence.

IAS 17 *Leases* — Time pattern of the user's benefit

The IFRIC received a request for guidance on the application of paragraphs 33 and 34 of IAS 17, which state that 'For operating leases, lease payments (excluding costs for services such as insurance and maintenance) are recognised as an expense on a straight-line basis unless another systematic basis is representative of the time pattern of the user's benefit, even if the payments are not on that basis.' The request asked for guidance on what alternatives to straight-line recognition of lease expense might be appropriate.

The IFRIC noted that guidance had previously been requested on this issue, and for the reasons elaborated on below, had not been added to the agenda.

The IFRIC noted that IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* require an entity to recognise the use of productive assets using the method that best reflects 'the pattern in which the asset's *future economic benefits* are expected to be consumed by the entity' (emphasis added). In contrast, IAS 17 refers to the *time pattern* of the user's benefit. Therefore, any alternative to the straight-line recognition of lease expense under an operating lease must reflect the time pattern of the use of the leased property rather than the amount of use or other factor related to economic benefits.

The IFRIC also noted that it did not expect significant diversity in practice regarding the application of this requirement.

The IFRIC therefore [decided] not to add this issue to its agenda.

IAS 18 *Revenue* — Accounting for trailing commissions

The IFRIC received a request for guidance on how an entity should account for on-going commission arrangements, referred to as trailing commissions, in the particular circumstances where the contractual obligation for the payment/receipt of the commission is not linked to the performance of any future service.

An example of the type of arrangement in question is when a financial adviser directs its client's funds to an investment manager's product. The adviser receives an initial commission for the placement of the business with the investment manager and a further on going (trailing) commission provided that the client remains invested in the product for a specified time. The issue focuses on the accounting treatment by the financial adviser to the client.

The IFRIC noted that similar arrangements are present in many industries. Consequently, the issue is widespread. In addition, the IFRIC is aware that practice in this area is diverse, in part because of difficulty in determining whether the entity is required to provide any future service to be entitled to receive the commission and in part because of differences of views regarding the relevant standards.

Given the complexity of the issues and the pervasive effect of any conclusions reached, the IFRIC concluded that it would not be able to reach a consensus on a timely basis. The IFRIC also noted that the Board was considering these issues in its projects on revenue recognition and liabilities. Therefore, the IFRIC [decided] not to add this issue to its agenda.

IAS 32 *Financial Instruments: Presentation* — Transaction costs to be deducted from equity

The IFRIC received a request for guidance on the extent of transaction costs to be accounted for as a deduction from equity in accordance with paragraph 37 of IAS 32 and on how the requirements of IAS 32 paragraph 38 to allocate transaction costs that relate jointly to more than one transaction should be applied. This issue relates specifically to the meaning of the terms 'incremental' and 'directly attributable'.

The IFRIC noted that only incremental costs directly attributable to issuing new equity instruments or acquiring previously outstanding equity instruments would be related to an equity transaction in accordance with IAS 32. Costs related to other activities undertaken at the same time such as becoming a public company or acquiring an exchange listing are not costs incurred in issuing or acquiring its own equity instruments.

In view of the existing guidance, the IFRIC [decided] not to add this issue to its agenda.

However, the IFRIC also noted that the terms 'incremental' and 'directly attributable' are used with similar but not identical meanings in many Standards and Interpretations. The IFRIC recommended that common definitions should be developed for both terms and added to the Glossary as part of the Board's annual improvements project.

IFRIC work in progress

The IFRIC reviewed a summary of its outstanding issues. The staff noted that IFRIC 15 *Arrangements for the Construction of Real Estate* and IFRIC 16 *Hedges of a Net Investment in a Foreign Operation* had been approved by the Board in June and recently released. In addition, an item regarding how expenditure on unrecognised assets should be classified in the statement of cash flows that the IFRIC had referred to the Board had been included in the annual improvements project.

The IFRIC discussed eight issues at this meeting including three requests to add items to the agenda received after the last meeting. Two additional requests have been received and are being analysed by the staff in order to make a recommendation on whether the IFRIC should add the issues to its agenda. In addition, research is proceeding on the rate regulated liabilities issue that the IFRIC discussed in May. The final issue, relating to derecognition, is not active as it is still awaiting the allocation of staff resources.

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From July 2006, IFRIC meetings have been audiocast live via the Internet. Audio recordings are available to listen to via the Website and can be accessed via the IFRIC Projects included within the Current Projects area. Please visit the IASB Website at www.iasb.org for more information.

Future IFRIC meetings

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

2008

- 4 and 5 September
- 6 and 7 November

2009

- 8 and 9 January
- 5 and 6 March
- 7 and 8 May
- 9 and 10 July
- 3 and 4 September
- 5 and 6 November

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

Meeting dates, tentative agendas and additional details about the next meeting will also be posted to the IASB Website at www.iasb.org before the meeting. Instructions for submitting requests for Interpretations are given on the IASB Website at http://www.iasb.org/About+Us/About+IFRIC/Propose+Agenda+Item.htm

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