NEWSLETTER OF THE INTERNATIONAL FINANCIAL REPORTING INTERPRETATIONS COMMITTEE

IASB

IFRIC UPDATE

May 2007

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 3 and 4 May 2007, when it discussed:

- D19 *IAS 19—The Asset Ceiling: Availability of Economic Benefits and Minimum Funding Requirements*
- D20 *Customer Loyalty Programmes*
- IAS 18 *Revenue*—Customer contributions
- IAS 18 *Revenue*—Guidance on identifying agency arrangements
- IAS 18 *Revenue*—Sales of real estate
- IAS 19 *Employee Benefits*—Timetable for IAS 19 issues
- IAS 21 *The Effects of Changes in Foreign Exchange Rates*—Hedging of a net investment in a foreign operation
- IAS 27 *Consolidated and Separate Financial Statements*—Demergers and other in-specie distributions
- IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*—Disclosures
- IFRIC agenda decisions
- Tentative agenda decisions

Changes to the Composition of the IFRIC

The chairman extended the thanks of the IASB and the IFRIC to four IFRIC members who are retiring following the May meeting - Jeannot Blanchet, Domingo Marchese, Mary Tokar and Ian Wright.

The chairman noted that new IFRIC members would be announced by the Trustees in due course.

D19 IAS 19—*The Asset Ceiling: Availability of Economic Benefits and Minimum Funding Requirements*

The IFRIC completed its redeliberation of draft Interpretation D19, considered a revised draft and, subject to drafting changes, directed the staff to present the revised draft to the Board. The final Interpretation will be presented to the Board for ratification at its meeting in June, with the intention that it will be issued in July and become effective for financial periods beginning on or after 1 January 2008.

The IFRIC decided:

- to clarify in the consensus that minimum funding requirements are requirements for an entity to fund a post-employment defined benefit or other long-term plan, but not to include any examples illustrating such requirements.
- that an entity should recognise an asset for a refund only if it has an unconditional right to that refund, but not to link this requirement for recognition to the treatment of contingent assets under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.
- that the assumptions underlying the calculation of the IAS 19 future service cost should be consistent with those underlying the defined benefit obligation at the balance sheet date. In addition, the entity should assume a stable workforce in the future unless the entity is demonstrably committed at the balance sheet date to make a reduction in the number of employees covered by the plan. In that case, the assumption about the workforce should be consistent with that reduction. An entity should not take into account projections of future reductions that it is not yet committed to.
- to state that an entity cannot recognise economic benefits from refunds, reductions in future contributions, or a combination of both based on assumptions that are mutually exclusive.

The IFRIC considered whether the changes from the draft Interpretation exposed for comment as D19 were such that re-exposure was needed in accordance with the IFRIC *Due Process Handbook*. The IFRIC concluded that they were not.

The IFRIC also decided that the Interpretation should be effective for reporting periods beginning on or after 1 January 2008.

D20 *Customer Loyalty Programmes*

The IFRIC completed its redeliberation of draft Interpretation D20 *Customer Loyalty Programmes*, considered a revised draft of the Interpretation and, subject to drafting changes, directed the staff to present the revised draft to the Board. The final Interpretation will be presented to the Board for ratification at its meeting in June, with the intention that it will be issued in July and become effective for financial periods beginning on or after 1 January 2008.

Before approving the Interpretation, the IFRIC reconsidered the proposal in D20 that revenue should be allocated between goods or services sold and the award credits by reference to their *relative* fair values. It decided that the Interpretation should require the revenue

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allocated to the award credits to be measured by reference to their fair values (rather than cost). However, the Interpretation should not preclude an allocation method in which the amount allocated to the award credits is equal to their fair value, with the residual consideration being allocated to the other goods and services. This latter method could be simpler to apply and be justified on practical and materiality grounds.

The IFRIC also considered aspects of the drafting of the revised Interpretation. It directed the staff:

- to express the revenue recognition requirements in more straightforward terms. If the entity supplies the awards itself, revenue should be recognised when award credits are redeemed and the entity fulfils its obligations to supply the awards. If a third party supplies the awards and the entity assesses that it has collected the consideration allocated to award credits as an agent for that third party, revenue should be recognised when the third party becomes obliged to supply the awards.
- to review the wording throughout the Interpretation to ensure that it does not imply that award credits need to be accounted for on an individual transaction-by-transaction basis. Varying degrees of aggregation by the accounting period in which such awards are generated may be appropriate depending on the circumstances.
- to explain in the Basis for Conclusions that the requirements have been worded to accommodate award credits granted by credit card providers. For some sales transactions in which award credits are granted, the credit card provider would receive consideration from an intermediate party (the retailer accepting payment by credit card), not the customer. Some of this consideration would be allocable to the award credits.
- to simplify the illustrative examples, and focus in particular on illustrating when revenue should be recognised if award credits are provided by third parties. The examples should apply whether or not the entity acts as an agent for the third parties and not focus on the presentation of that revenue.

The IFRIC decided not to include any specific disclosure requirements in the Interpretation. It decided that the requirements of IAS 1 *Presentation of Financial Statements* to disclose significant accounting policies and the key assumptions, estimates and judgements underlying them were sufficient.

The IFRIC reaffirmed its previous decision not to include specific transitional arrangements. As a result, the requirements of IAS 8 will be applicable—changes in accounting policy will be accounted for retrospectively except to the extent that retrospective application is impracticable. Reversing a previous tentative decision, the IFRIC decided not to include a statement in the Interpretation that if an entity had previously accrued the costs of supplying awards, it would be changing an accounting policy when it first applied the Interpretation. The IFRIC agreed with the staff view that, in straightforward cases, this conclusion would be obvious, whilst in more complex situations, the judgement would depend on the facts of the case.

The IFRIC decided that re-exposure of the draft Interpretation was not necessary. The overall approach and main requirements proposed by D20 had not changed. The most significant changes were the addition of illustrative examples and further guidance to clarify the requirements, which had been added at the request of commentators.

Finally the IFRIC discussed the effective date. It acknowledged that application of the Interpretation could require entities to undertake systems changes and took the view that the lead-in time should be longer than the usual 90 days. It therefore decided that the Interpretation should be effective for accounting periods beginning on or after 1 January 2008.

IAS 18 *Revenue*—Customer contributions

The IFRIC received a request for guidance on how an entity should account for contributions received from or on behalf of customers. Such contributions arise when the customer provides an infrastructure asset, or cash to fund the acquisition and/or construction of such an asset, in order to obtain an ongoing service or to secure the ongoing supply of goods from the entity. The submission asked for guidance on how the entity should account for the asset received.

The IFRIC noted that the issue was widespread in various industries, such as utilities and telecommunications, and that there was divergence in practice.

The IFRIC therefore agreed with the staff recommendation to take the issue on to its agenda.

The IFRIC noted that the issue could potentially apply to a diverse set of arrangements. If it were to consider all such arrangements, the scope of the project might be so wide as to make it unlikely that the IFRIC would be able to reach a consensus on a timely basis.

The IFRIC considered whether to limit the scope of this project to situations in which a physical asset was contributed by an entity other than the customer who would receive the ongoing service. However, the IFRIC rejected that proposal. Instead, the IFRIC decided first to consider situations in which the entity received a contribution of property, plant and equipment. If it reaches a consensus on this issue, the IFRIC will consider whether its conclusions could be applied to other situations, including those in which cash is received for the acquisition and/or construction of an asset.

The IFRIC also discussed its approach to the project. It concluded that it should consider whether the arrangement conveys a right to use an asset as described in IFRIC 4 *Determining whether an Arrangement contains a Lease*. Assuming that rights have been transferred, the IFRIC will consider whether the transfer was an exchange transaction and whether the asset received should be recognised at cost (which could be nil) or fair value. Only after having concluded on those issues will the IFRIC consider the accounting for any resulting credit.

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IAS 18 *Revenue*—Guidance on identifying agency arrangements

This issue concerns determining whether an entity is acting as principal or agent, and the effect of this on the reporting of revenue. At its meeting in July 2006, the IFRIC decided to take the issue on to its agenda but asked the staff to give the project a lower priority than other projects.

At this meeting, the staff asked IFRIC members whether they were aware of such diversity in practice that an Interpretation was needed. Some IFRIC members noted an indicator of diversity was that some national standard-setters and audit firms had issued guidance. Those IFRIC members supported issuing an Interpretation as it would reduce diversity and give useful guidance for preparers of financial statements. One IFRIC member pointed out that EITF 99-19 *Reporting Revenue Gross as a Principal versus Net as an Agent* provides useful indicators that include responsibility for fulfilment, in addition to indicators on risk and rewards. Another IFRIC member was not in favour of issuing an Interpretation because providing a list of indicators would not reduce diversity. This member believed that apparent differences in financial reporting actually reflect differences in circumstances that vary from industry to industry and from jurisdiction to jurisdiction.

The IFRIC asked the staff to analyse existing guidance, including that issued by the audit firms, to determine whether such guidance was consistent and could be used to help to assess the level of diversity in practice.

IAS 18 *Revenue*—Sales of real estate

The IFRIC considered a revised version of a draft Interpretation on real estate sales. It approved the draft Interpretation for release for public comment, subject to drafting changes.

The draft Interpretation would apply to all real estate sales. However, the consensus focuses on transactions in which agreements for sale are reached before construction of the real estate is complete. Among other issues, it addresses the applicable accounting standard. It provides guidance on determining whether the sale agreement is:

- a construction contract within the scope of IAS 11 *Construction Contracts*, or
- an agreement for the sale of goods within the scope of IAS 18 *Revenue*.

Before approving the draft Interpretation, the IFRIC considered revised text for this guidance. It confirmed its previous decision that the guidance should identify features that, individually or in combination, indicate whether an agreement is for the provision of construction services to the buyer's specifications (a construction contract) or the sale of goods.

The IFRIC considered proposals that the features of a construction contract would include:

(a) the buyer being able to specify the major structural elements of the design of the real estate and/or specify major structural changes while construction was in progress (whether it exercises that ability or not);

(b) the buyer obtaining control and the significant risks and rewards of ownership of the work in progress as construction progresses.

It also considered proposals that indications of (b) could include:

- that work in progress takes place on land that is already owned or leased by the buyer
- the buyer having the right to take over the work in progress during construction, eg to engage a different contractor
- in the event of the agreement being terminated before construction is complete, the buyer retaining the work in progress and the seller having the right to be paid for work done.

The IFRIC agreed with these proposals but asked the staff to revise the drafting:

- to avoid any impression that all of the above features would need to be present for a sale agreement to be classified as a construction contract—either (a) or (b) above might on its own be sufficient basis for a judgement that the agreement is for construction services rather than the sale of goods;
- to express the indicators in terms of the seller's, rather than the buyer's, rights and position; and
- to note that the references to work in progress are to the work in progress in its current state and condition.

The IFRIC also approved the rest of the draft Interpretation, subject to drafting changes. The next step will be to inform the Board that the IFRIC has reached a consensus.

Provided that the Board does not object, the draft Interpretation is expected to be released for public comment by the end of June.

IAS 19 *Employee Benefits*—Timetable for IAS 19 issues

The IFRIC was provided with possible timetables indicating when the IAS 19 issues that have been raised might be presented to the IFRIC. Since none of these issues is within the scope of the Board's pensions project, the IFRIC expressed concern at the time expected to take to cover the issues and the degree of priority attributed to some of them. The Director of Technical Activities noted that the issues would be dealt with as staff resources allowed and that the relative priorities would be assessed.

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IAS 21 *The Effects of Changes in Foreign Exchange Rates*—Hedging of a net investment in a foreign operation

The IFRIC agreed to publish a draft Interpretation on the accounting for a hedge of a net investment in a foreign operation (net investment) in consolidated financial statements. The main issues addressed in the draft Interpretation relate to which net investment risk is eligible to be hedged and where within the group a hedging instrument can be held.

The IFRIC decided that when testing effectiveness in the hedge of a net investment, the implementation guidance in IAS 39 *Financial Instruments: Recognition and Measurement* (answer to Question F.2.14) can be applied. A hedging instrument can be held anywhere in the group: the functional currency of the entity holding the instrument is irrelevant. Accordingly, the foreign exchange gain or loss on the hedging instrument that is recorded in profit or loss, and the foreign exchange gain or loss recorded in equity on consolidation of that instrument, taken together, must be expected to offset the hedged risk in a hedge of a net investment. As the IFRIC previously decided, the hedged risk is the exchange gain or loss recognised in equity arising from the difference between the functional currency of the net investment and the functional currency of the parent hedging its net investment.

The IFRIC decided that an entity can hedge up to the carrying amount of its net investment. Thus, an entity is not required to look through its directly held net investment to assess the portion of its exposure that arises from the functional currencies of any lower level net investments.

The IFRIC decided that any Interpretation issued should be applied prospectively, rather than requiring an entity to apply it from the start of the earliest period for which comparative information under IFRSs is presented.

Subject to drafting changes, the IFRIC directed the staff to obtain clearance from the Board to the publication of the draft Interpretation for public comment.

IAS 27 *Consolidated and Separate Financial Statements*—Demergers and other in-specie distributions

The IFRIC had received a request for guidance on how an entity should account for demergers and other in-specie distributions in its financial statements. The submission focused on situations in which an entity distributes an ownership interest in a subsidiary to its shareholders and consequently loses control over that subsidiary.

At its meeting in November 2006 the IFRIC noted that accounting by an entity for the loss of control of its subsidiary was being considered as part of the redeliberations on Business Combinations phase II. The IFRIC therefore decided that it could not start any interpretative project until the decisions on loss of control in Business Combinations phase II had been finalised.

At its meeting in March 2007 the Board finalised its decisions on accounting for the loss of control of a subsidiary but decided not to address the measurement basis of distributions to owners in phase II of the Business Combinations project.

Therefore, at this meeting the IFRIC considered how the issue should be progressed. The IFRIC noted that the issue was widespread and that significant diversity in practice existed with the assets or businesses distributed being measured by some entities at their carrying amounts and by others at fair value. Those that used fair value recognised the difference between the carrying amount and fair value either in profit or loss or directly in equity.

The IFRIC concluded that the issue should be taken on to its agenda but believed it was crucial to ensure that the project's scope was sufficiently narrow to be capable of interpretation. Some IFRIC members suggested that one possibility could be to focus on distributions of assets to equity participants (ie non-reciprocal transfers of assets to equity participants). In addition, they believed that the assets distributed should not be restricted to ownership interests in subsidiaries.

The IFRIC asked the staff to prepare a paper considering the possible scope of this interpretative project for the next IFRIC meeting.

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*—Disclosures

The IFRIC received a request to clarify whether the disclosure requirements of IFRS 7 *Financial Instruments: Disclosures* and IAS 19 *Employee Benefits*, in the absence of specific exclusion, would apply to non-current assets (or disposal groups) classified as held for sale or discontinued operations under IFRS 5.

At this meeting, the staff presented a paper with two alternative views:

- View A: IFRS 5 specifies all the disclosures required in respect of non-current assets classified as held for sale or discontinued operations, together with the requirement of IAS 33 *Earnings per Share* paragraph 68 to disclose the amount per share for discontinued operations.
- View B: Disclosures required by IFRSs, whose scope does not exclude non-current assets classified as held for sale or discontinued operations, continue to apply to non-current assets classified as held for sale or discontinued operations.

Some IFRIC members supported view B as the only logical outcome. They were concerned, for example, that under view A a liability arising from employee benefits (IAS 19) that is part of a disposal group would continue to be measured according to IAS 19 but the disclosures of IAS 19 would not be provided. Some IFRIC members believed that this issue should be clarified by the Board. A Board member suggested that because IFRS 5 is converged with SFAS 144 the staff should discuss this issue with the FASB staff to be

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aware of practice in the US and to ensure that convergence would be maintained. IFRIC members were asked to provide the staff with information to assess whether there is diversity in practice.

The IFRIC deferred to a future meeting its decision whether this issue should be taken on to its agenda.

IFRIC agenda decisions

The following explanations are published for information only and do not change existing IFRS requirements. IFRIC agenda decisions are not Interpretations. *Interpretations of the IFRIC 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.*

IFRS 3 *Business Combinations*—Reassessments on a business combination

The IFRIC was asked to provide guidance on whether, and in what circumstances, a business combination triggers reassessment of the acquiree's classification or designation of assets, liabilities, equity and relationships acquired in a business combination. Reassessment issues include, for instance, whether embedded derivatives should be separated from the host contract, the continuation or de-designation of hedge relationships and the classification of leases as operating or finance leases.

At its meeting in February 2007, the Board decided that the issue should be dealt with in Business Combinations phase II.

Given that decision, the IFRIC decided not to take this item on to its agenda.

IAS 1 *Presentation of Financial Statements*/IAS 39 *Financial Instruments: Recognition and Measurement*—Current or non-current presentation of derivatives classified as 'held for trading' under IAS 39

The IFRIC was asked to provide guidance on whether derivatives that are classified as held for trading in accordance with IAS 39 should be presented as current or non-current in the balance sheet. Such derivatives may be settled more than one year after the balance sheet date.

IAS 39 sets out requirements on the recognition and measurement of financial instruments. It does not address how financial instruments should be presented in the balance sheet. Consequently, some believed that the held-for-trading classification under IAS 39 is solely for measurement purposes.

IAS 1 paragraphs 51-62 set out requirements for the presentation of an asset or a liability as current or non-current in the balance sheet. IAS 1 paragraph 56 states that information about the liquidity and solvency of an entity is useful for users of the financial statements.

In the light of the above requirements, the IFRIC decided not to take the issue on to its agenda. However, it noted that some believe that IAS 1 paragraph 62 could be read as implying that financial liabilities that are classified as held for trading in accordance with IAS 39 are required to be presented as current. Therefore, the IFRIC directed the staff to recommend to the Board an amendment to IAS 1 paragraph 62 to remove that implication.

IAS 16 *Property, Plant and Equipment*—Sale of assets held for rental

The IFRIC was asked to provide guidance on the accounting for sales of assets held for rental. Some entities sell assets after renting them out to third parties. In such circumstances, it appears that the asset is manufactured or acquired with a dual intention, to rent it out and to sell it. The issue is whether the sale of such an asset should be presented gross (revenue and costs of sales) or net (gain or loss) in the income statement.

The IFRIC noted that IAS 16 paragraph 68 states that gains arising from derecognition of an item of property, plant and equipment shall not be classified as revenue. Also, when the asset is classified as held for sale under IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, IFRS 5 paragraph 24 refers to the derecognition requirements of paragraphs 67-72 of IAS 16, thereby confirming that gains should not be classified as revenue. However, some believed that, in some limited circumstances, reporting gross revenue in the income statement would be consistent with the *Framework* paragraph 72, with IAS 18 *Revenue*, IAS 2 *Inventories*, and IAS 40 *Investment Properties* and with the prohibition on offsets in IAS 1 *Presentation of Financial Statements*.

For this reason, the IFRIC decided to draw the issue to the attention of the Board and not to take the item on to its own agenda.

IAS 19 *Employee Benefits*—Curtailments and negative past service costs

The IFRIC was asked whether plan amendments that reduce benefits should be accounted for as curtailments or as negative past service costs. The submission noted that materially divergent practice could result because of the different recognition requirements for curtailments and negative past service cost.

The IFRIC noted that the Basis for Conclusions on IAS 19 indicates that IASC was aware of the ambiguity in distinguishing between negative past service costs and curtailments, but decided that the issue arose too rarely to justify the complexity that a more detailed requirement would produce. However, since the issue was becoming more prevalent and divergent practices were developing, the IFRIC believed that the issue should be addressed.

The IFRIC observed that there would be limited benefit in taking this issue on to its agenda because the Board was currently engaged in a post-employment benefits project. The IFRIC therefore decided not to take the issue on to its agenda, but to refer it to the Board for consideration.

Tentative agenda decisions

The IFRIC reviewed the following matters and tentatively decided that they should not be taken onto the IFRIC agenda. These tentative decisions, including, where appropriate recommended reasons for not taking the item onto the IFRIC agenda, will be re-discussed at the IFRIC meeting in July 2007. Constituents who disagree with the proposed reasons, or believe that the explanations may contribute to divergent practices, are welcome to communicate those concerns by 30 June 2007, preferably by email to: ifric@iasb.org or by post to:

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

IAS 12 *Income Taxes*—Deferred tax arising from unremitted foreign earnings

The IFRIC was asked to provide guidance on whether entities should recognise a deferred tax liability in respect of temporary differences arising because foreign income is not taxable unless remitted to the entity's home jurisdiction. The foreign income in question did not arise in a foreign subsidiary, branch, associate or joint venture.

The submission referred to paragraph 39 of IAS 12 and noted that, if the foreign income arose in a foreign subsidiary, branch, associate or interest in a joint venture and met the conditions in IAS 12 paragraph 39(a) and (b), no deferred tax liability would be recognised.

The IFRIC noted that the Board was considering the recognition of deferred tax liabilities for temporary differences relating to investments in subsidiaries, branches, associates and joint ventures as part of its Income Taxes project. As part of this project, the Board has tentatively decided to eliminate the notion of 'branches' from IAS 12 and to amend the wording for the exception for subsidiaries. The IASB Income Taxes project team has been informed of the issue raised with the IFRIC.

Since the issue is being addressed by a Board project which is expected to be completed in the near future, the IFRIC [decided] not to add the issue to its agenda.

IAS 39 *Financial Instruments: Recognition and Measurement*—Gaming Transactions

The IFRIC considered a submission relating to the accounting for wagers received by a gaming institution.

The IFRIC noted the definitions of financial assets and financial liabilities in IAS 32 *Financial Instruments: Presentation*, and the application guidance in paragraph AG8 of IAS 32. It noted that when a gaming institution takes a position against a customer, the resulting unsettled wager is likely to meet the definition of a derivative financial instrument that should be accounted for under IAS 39.

In other situations, a gaming institution does not take a position against a customer but instead provides services to manage the organisation of games between two or more gaming parties. In such situations, the gaming institution earns a commission regardless of the outcome of the wager. The IFRIC noted that such a commission was likely to meet the definition of revenue and would be recognised when the conditions in IAS 18 *Revenue* were met.

The IFRIC did not consider that there was widespread divergence in practice in this area and therefore [decided] not to take the issue on to its agenda.

IAS 39 *Financial Instruments: Recognition and Measurement*—Hedging future cashflows with purchased options

The IFRIC was asked how effectiveness should be assessed when an option, in its entirety, is designated as a hedging instrument to hedge variability in future cash flows in a cash flow hedge. All changes in the fair value of the option (including changes in the time value component) are considered in assessing and measuring hedge effectiveness.

The requests suggested the following approach to assessing and measuring hedge effectiveness. An entity could compare all changes in the fair value of the purchased option with changes in the fair value of a hypothetical written option that has the same maturity date and notional amount as the hedged item. The requests noted that such an approach would minimise or eliminate hedge ineffectiveness when the terms of the purchased option and the hypothetical written option perfectly matched. The IFRIC was asked whether IAS 39 allows such an approach.

The IFRIC noted that the following questions have to be considered in addressing the issue:

(a) whether a hedged item used for assessing and measuring hedge effectiveness should be the same as that designated at inception of the hedge; and

(b) what items are eligible for designation as hedged items at inception of the hedge.

Regarding question (a), IAS 39 requires the hedged item used for assessing and measuring hedge effectiveness to be the same as that designated at the inception of the hedge (see IAS 39 paragraph 88).

Regarding question (b), IAS 39 does not allow derivatives to be designated as hedged items subject to one exception, namely a purchased option in a fair value hedge (see the answer to Question F.2.1 of the Guidance on Implementing IAS 39). Therefore, the IFRIC noted that a (hypothetical or actual) written option cannot be designated as a hedged item under IAS 39.

Moreover, the IFRIC noted that the approach suggested in the requests would effectively result in considering the time value component of an option (that does not exist in the hedged item) in determining changes in the fair value of the hedged item for assessing and measuring hedge effectiveness.

In view of the above requirements, the IFRIC noted the approach suggested in the requests is not allowed under IAS 39. Therefore, the IFRIC [decided] not to take the issue on to its agenda.

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IAS 39 *Financial Instruments: Recognition and Measurement*—Hedging multiple risks with a single derivative hedging instrument

The IFRIC was asked to provide guidance on how to apply paragraph 76(b) of IAS 39. One of the conditions for an entity to designate a single derivative hedging instrument as a hedge of more than one type of risk is that the entity has to demonstrate hedge effectiveness (see IAS 39 paragraph 76(b)).

The answer to Question F.1.13 of the Guidance on Implementing IAS 39 requires an entity to assess hedge effectiveness of each different risk position separately. The IFRIC noted, in IG F.1.13, that an imputed functional currency leg, that did not exist in the contractual terms of the derivative hedging instrument, was created as a base to split the fair value of the derivative hedging instrument into multiple components for assessing hedge effectiveness of each risk position separately. The submission asked whether the approach set out in IG F.1.13 can be extended to other circumstances.

The IFRIC noted that IG F.1.13 requires hedge effectiveness of each risk position to be considered separately. To do so, an entity has to impute a notional leg to split the fair value of a derivative hedging instrument into multiple components for assessing hedge effectiveness of each separate risk position. In addition, the IFRIC noted that IG F.1.12 permits an entity to designate a derivative simultaneously as a hedging instrument in both a cash flow hedge and a fair value hedge.

The IFRIC noted that the illustrative examples in the IG consider all changes in the fair value of the entire derivative hedging instrument. In addition, the IFRIC noted that C.1 of the Guidance on Implementing IAS 39 does not allow notional cash flows that do not exist in the contractual terms of a financial instrument to be recognised. In view of this requirement, the imputation of a notional leg for assessing and measuring hedge effectiveness should not result in any notional cash flows that do not exist in the contractual terms of the derivative hedging instrument being recognised.

Furthermore, the IFRIC noted that IAS 39 requires an entity to document, at inception of the hedge, how it will assess hedge effectiveness. IAS 39 requires the entity to apply the chosen method consistently over the life of the hedging relationship.

The IFRIC noted that the issue concerned how to demonstrate hedge effectiveness. Therefore, the IFRIC [decided] not to take the issue on to the agenda because any guidance developed on this issue would be more in the nature of application guidance than an interpretation.

IAS 39 *Financial Instruments: Recognition and Measurement*—Scope of paragraph 11A

The IFRIC was asked whether the fair value option available in paragraph 11A of IAS 39 can be applied to all contractual arrangements with one or more embedded derivatives, including contractual arrangements that contain hosts outside the scope of IAS 39.

The scope of IAS 39 is set out in paragraphs 2-7 of the Standard. When a financial instrument contains one or more embedded derivatives, the conditions set out in IAS 39 paragraph 11A must be met in order to designate the financial instrument as at fair value through profit or loss in accordance with IAS 39 paragraph 9.

The IFRIC noted that the scope of paragraph 11A of IAS 39 should be consistent with the overall scope of IAS 39 set out in paragraphs 2-7. Consequently, the fair value option available in paragraph 11A of IAS 39 is not applicable to contracts that are outside the scope of IAS 39.

In the light of the above requirements, the IFRIC [did not expect] significant diversity in practice. The IFRIC therefore [decided] not to take the issue on to its agenda.

IAS 39 *Financial Instruments: Recognition and Measurement*—paragraph AG33(d)(iii)

The IFRIC was asked about the application of paragraph AG33(d)(iii) of IAS 39, particularly, what the economic environment is in determining whether a currency is commonly used in contracts to buy or sell non-financial items.

The IFRIC noted that paragraph AG33(d)(iii) requires an entity:

- to identify where the transaction takes place; and
- to identify currencies that are commonly used in the economic environment in which the transaction takes place.

The IFRIC [decided] not to take the issue on to its agenda because any guidance developed would be more in the nature of application guidance than an interpretation.

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*—Plan to sell the controlling interest in a subsidiary

The IFRIC was asked to provide guidance on applying IFRS 5 when an entity is committed to a plan to sell the controlling interest in a subsidiary. The request considered situations in which the entity retained a non-controlling interest in its former subsidiary, taking the form of either an investment in an associate, an investment in a joint venture or a financial asset. The submitter raised four issues relating to the consolidated financial statements of the entity:

- What triggers classification of the subsidiary's assets and liabilities as held for sale under IFRS 5?
- When classification as held for sale is required, should all the subsidiary's assets and liabilities be classified as held for sale or only the portion to be sold?
- Is classification as discontinued operations relevant when the entity plans to retain a significant influence over its former subsidiary after the sale?
- After the sale, how should the remaining non-controlling equity investment be measured?

In considering the first two issues, the IFRIC noted that paragraph 6 of IFRS 5 states: 'An entity shall classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered <u>principally</u> through a sale transaction rather than through continuing use' [emphasis added]. The IFRIC [decided] to recommend to the Board that IFRS 5 be amended to clarify whether the criteria for classification as held for sale are met for all a subsidiary's assets and liabilities when the parent is committed to a plan

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that involves loss of control over the subsidiary. The IFRIC believed that having a plan involving loss of control over a subsidiary should trigger classification as held for sale of all those assets and liabilities.

On the third issue, the IFRIC noted that a disposal group classified as held for sale will also be a discontinued operation if the criteria of paragraph 32 of IFRS 5 are met. The IFRIC also noted that IFRS/US GAAP differences are likely to arise until a common definition of discontinued operations is adopted with a consistent approach to continuing involvement. Because the IFRIC did not expect divergence to emerge in practice, it [decided] not to address the issue.

The IFRIC noted that the last issue is being considered in the Board's joint project on Business Combinations and, therefore, [decided] not to address that issue.

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:

2007

- 12 and 13 July
- 6 and 7 September
- 1 and 2 November

2008

- 10 and 11 January
- 6 and 7 March
- 8 and 9 May
- 10 and 11 July
- 4 and 5 September
- 6 and 7 November

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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