

The International Financial Reporting Interpretations Committee met in London on 2 and 3 September 2004, when the principal matters it discussed were:

- D1 *Emission Rights*
- D3 *Determining whether an Arrangement contains a Lease*
- D4 *Decommissioning, Restoration and Environmental Rehabilitation Funds*
- Service concession arrangements
- Waste electrical and electronic equipment

The contents of final Interpretations were established for D1, D3, D4 and a Draft Interpretation addressing waste electrical and electronic equipment. The contents of the Interpretation based on D4 and the Draft Interpretation were voted on. The Interpretations based in D1 and D3 will be voted on at the October 2004 meeting.

The IFRIC will consider three Draft Interpretations on service concession arrangements at the October meeting.

## **D1 Emission Rights**

The IFRIC exposed Draft Interpretation D1 *Emission Rights* in May 2003, and considered comment letters at its September and December 2003 meetings. At that time the IFRIC confirmed its view that D1 represented the most appropriate interpretation of current IFRSs. However, it tentatively decided that it would propose an amendment to IAS 38 *Intangible Assets* to require emission rights (allowances) traded in an active market to be measured at fair value with changes in value recognised in profit or loss. This proposal would have required re-exposure of the draft Interpretation. In addition, the Board requested that the IFRIC delay issuing the revised draft Interpretation until the Board had completed work on amending IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* (IAS 20 is one of the principal references for D1). In other words, the Board envisaged the IFRIC issuing a revised

draft Interpretation that reflected the amendments to IASs 20 and 38.

At this meeting, the IFRIC noted it was unlikely that the Board would issue a final amended IAS 20 for at least another year and hence that the IFRIC would be unable to finalise D1 until that time. Given that the EU Emissions Trading Scheme starts at the beginning of 2005, and given the potential for diversity of accounting for that scheme, the IFRIC reconsidered whether it should finalise its original proposals in D1.

The IFRIC acknowledged that finalising the original proposals in D1 would mean that if allowances were subsequently measured at fair value, changes in value above cost would be recognised in equity rather than in profit or loss. Nonetheless, most of the members present noted that the disadvantage of this treatment specified by the current IAS 38 would be outweighed by the benefits of providing timely accounting guidance that would promote consistent application of IFRSs. The IFRIC also noted that when the Board amended IAS 20, any required modifications to the Interpretation would be dealt with as a consequential amendment arising from the amended Standard.

Therefore, the view of the majority of IFRIC members present was that D1 should be finalised in substantially its present form and issued in the fourth quarter. The IFRIC will vote on the final Interpretation at its next meeting.

## **D3 Determining whether an Arrangement contains a Lease**

The IFRIC continued its consideration of comments received in response to the exposure of Draft Interpretation D3 *Determining whether an Arrangement contains a Lease* that was issued in January 2004. In particular, the IFRIC considered feedback from meetings that the staff had held recently with some preparer constituents.

The IFRIC confirmed its decision in June 2004 to adopt the wording in US GAAP (ie EITF 01-8 *Determining Whether an Arrangement Contains a Lease*) for determining whether an arrangement contains a lease. While some participants at the staff's meetings with preparers had, in some cases, highlighted difficulties in assessing whether their arrangements satisfied the criteria in the EITF approach, the IFRIC decided that none of these difficulties pointed to fundamental flaws or gave rise to insurmountable application problems.

The IFRIC decided to provide additional guidance in cases in which it is determined that an arrangement contains a finance lease but it is impracticable for the purchaser (lessee) to separate the payments for the lease element of the arrangement from other payments under the arrangement. In such cases the IFRIC decided that the purchaser should (a) recognise an asset and a liability at an amount equal to the fair value of the underlying asset and (b) subsequently reduce the liability as payments are made and impute a finance charge on the liability using the purchaser's incremental borrowing rate of interest.

Recognising the difficulty of making the assessment whether an arrangement contains a lease retrospectively, the IFRIC decided to modify the transition requirements proposed in D3. The IFRIC decided that both existing preparers as well as first-time adopters

*(continued)*

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### **D3 Determining whether an Arrangement contains a Lease (continued)**

should apply the Interpretation retrospectively, but should assess whether an arrangement contains a lease based on the facts and circumstances existing at the start of the earliest period for which comparative information is presented.

Lastly, the IFRIC decided to delay the effective date to 1 January 2006.

The IFRIC concluded that re-exposure was not necessary and will vote on the final Interpretation at its next meeting.

## **D4 Decommissioning, Restoration and Environmental Rehabilitation Funds**

The IFRIC agreed:

- to confirm the approach exposed in D4 namely:
  - rights to reimbursement in services are economically similar to rights to reimbursement in cash
  - both of these rights should be accounted for in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and an amendment to IAS 39 *Financial Instruments: Recognition and Measurement* should be made to achieve this
  - in the absence of guidance on measurement in IAS 37, the IFRIC should give guidance that both types of reimbursement rights are measured at fair value through profit and loss.
- to provide clarification that a residual interest in a fund, such as a contractual right to distributions once all the decommissioning has been completed or on winding up of the fund, may be a financial instrument within the scope of IAS 39
- to provide discussion in the Basis for Conclusions that the IFRIC had explored constituents views on the ‘asset cap’ in paragraph 53 of IAS 37 and concluded that in the case of an asset for the reimbursement right the asset cap should apply
- that it was not necessary to re-expose its conclusions for public comment.

The principles of the final Interpretation were voted on and agreed. Subject to a review of the drafting by IFRIC members and the Board’s approval, the Interpretation will be published without further discussion at a meeting.

## **Service concession arrangements**

The IFRIC discussed three preliminary draft Interpretations on service concession arrangements:

- *Service Concession Arrangements—Determining the Accounting Model*
- *Service Concession Arrangements—The Receivable Model*
- *Service Concession Arrangements—The Intangible Asset Model*

In July, IFRIC members present had tentatively agreed that the grantor should be considered to control a property, even if it is owned by the operator, if the grantor (including parties related to it) both:

- (a) controls or regulates what services the operator must provide using the property, to whom it must provide them, and at what price; and
- (b) will control, through ownership, beneficial entitlement or otherwise, the residual interest in the property at the end of the concession, and the residual interest is significant.

The IFRIC confirmed this decision, subject to changing “will control” in condition (b) to “controls”, so as to clarify that control through an option (which is not certain to be exercised) meets this condition.

The IFRIC also agreed that this control test should form part of the scope of the interpretations. The scope should be restricted to the accounting by the operator, when the above conditions were met. This would allow the interpretations to be simplified because the operating lease model would not now apply to arrangements within their scope.

In July, IFRIC members present had proposed that the scope should be limited to public-to-private infrastructure service concessions, but that they should not prohibit a wider application. At this meeting, the IFRIC refined this proposal, agreeing that the scope should be limited to arrangements having the characteristics of infrastructure service concessions—the most significant characteristic being that the grantor is obliged to keep the infrastructure, or its output, available to the public because of the nature of the services involved, regardless of who operates it.

### **Application of the control conditions**

The IFRIC discussed the extent to which the control conditions should be applied in a ‘holistic’ way, to the infrastructure as a whole, or separately to each item of infrastructure.

The first issue considered was when a part of an item of infrastructure, such as the roof of a building or the top layer of a road, will be replaced during the life of the concession. The IFRIC agreed that the conditions should be applied to the item as a whole, so that condition (b) (see above) will be met if the item as a whole (including any replacement part) has a significant residual value at the end of the concession, and this is controlled by the grantor.

The second issue considered was whether a holistic approach should be applied when the infrastructure includes physically separate items that were replaced during the life of a concession. The staff proposed that, if the items did not generate income separately from the infrastructure as a whole, a holistic approach should be applied so that condition (b) would be met if the infrastructure as a whole had a significant residual value, which was controlled by the grantor. In these circumstances, if condition (a) was also met, the staff argued that the operator, on behalf of the grantor who was the true controller, was managing the infrastructure as a whole. Although some IFRIC members agreed with this point of view, others argued that, under IAS 16 *Property, Plant and Equipment*, control should be considered separately for these items. This could lead to any newly constructed items being treated as assets of the

operator, if they were to be replaced over the life of the concession, unless (under Draft IFRIC Interpretation D3) there was a finance lease of those items from the operator to the grantor.

No consensus was reached on this issue. However, the IFRIC noted that, over the life of a concession, replacement of significant items of newly constructed infrastructure would likely be less frequent. More often, the replacement of significant infrastructure items occurred when the operator inherited an ageing infrastructure from the grantor, which it was obliged to replace under the terms of the concession. In these circumstances, if condition (a) was met, the items contributed by the grantor would generally not be derecognised by the grantor under IAS 16, and so would not be assets of the operator, while condition (b) would be met for the replacement infrastructure if it would revert to the grantor with a significant residual value. Thus, the old and replacement infrastructure would be treated consistently.

The IFRIC also discussed the implications when the use of infrastructure was partly regulated in the manner described in condition (a) and partly unregulated. It noted that there were too many variables to give guidance on all possible situations, but agreed that:

- any infrastructure that was physically separable and capable of being operated independently should be analysed separately if it was used wholly for unregulated purposes. For example this might apply to a private wing of a hospital, where the grantor uses the remainder of the hospital to treat public patients.
- where purely ancillary activities (such as a hospital shop) were unregulated, the control tests should be applied as if those services did not exist, because their existence does not detract from the grantor's control of the relevant infrastructure (in cases where it has such control).

In either of these cases, there may be a lease from the grantor to the operator, which should be accounted for under IAS 17 *Leases*.

#### **Whether the receivable model or the intangible asset model should apply**

The staff proposed that the receivable model should apply, so that the asset resulting from construction services provided by the operator would be characterised as a receivable, whenever:

- the grantor (rather than users) has the primary responsibility to pay the operator for its services, including when those payments were contingent either on satisfactory performance of subsequent service or on the level of usage, or
- although the operator was entitled to be paid by users, the effect of the contractual arrangements was that the grantor retains substantially all of the demand risk (both upwards and downwards) associated with the service concession.

In any other case, the intangible asset model would apply.

The IFRIC tentatively agreed this proposal, subject to further consideration of whether the characterisation of the operator's asset would differ if the contract were segmented so that the provision of construction services was treated as a separate contract from the provision of other services, and to the matters described below.

If the grantor (rather than users) has the primary responsibility to pay the operator for its services, but those payments depend upon usage that was outside the grantor's control, the IFRIC noted that the operator's asset has many of the characteristics of an intangible asset such as a licence. However, a majority of the IFRIC tentatively agreed that the asset meets the definition of a financial asset under IAS 32 *Financial Instruments: Disclosure and Presentation* and should be accounted for as such. Under IAS 39 *Financial Instruments: Recognition and Measurement*, this asset would not be a receivable qualifying for amortised cost treatment, but would be accounted for as an available-for-sale asset, unless it was accounted for as at fair value through profit or loss.

The IFRIC did not discuss the treatment when payments by the grantor depend on usage that it can control.

#### **Applying the intangible asset model**

The IFRIC continued its discussion of the accounting when, under the intangible asset model, construction services were provided in exchange for the intangible asset, with reference to an example (which ignores interest).

Suppose that the operator builds a road at a cost of 100, its construction profit (if recognised) is 10, and total cash inflows over the life of the concession are 200. Under the receivable model, the operator would recognise construction revenue of 110 and a receivable of 110. Of the future cash inflows of 200, 110 would be treated as repaying the receivable, with the remaining 90 being recognised as revenue over the life of the concession. Total revenue would be 200.

By contrast, under the intangible asset model, the staff argued that it was necessary to recognise the exchange of construction services for the intangible asset, and that under IAS 18 *Revenue* this was an exchange on which both revenue and profit or loss would be recognised. As a result:

- the operator would recognise construction revenue of 110, an intangible of 110, and a construction profit of 10;
- over the life of the concession, the intangible asset of 110 would be amortised against revenues (which in this case would be from users) of 200. The net position is the same as in the receivable case, but total revenues would be 310 rather than 200.

The majority of the IFRIC strongly disliked this outcome. The IFRIC would have preferred total revenue to be 200 as under the receivable model, equalling the cash flows. It was concerned that similar arrangements could be accounted for very differently, depending on whether the receivable model or the intangible asset model applied. However, a majority of the IFRIC tentatively agreed that IAS 18 appeared to require this treatment. The IFRIC decided that the draft Interpretations should be prepared on this basis, but asked that their concerns should be brought to the attention of the Board.

## Waste electrical and electronic equipment

The IFRIC continued the discussions it had begun at its July 2004 meeting. The IFRIC agreed that the scope of the draft Interpretation should not be widened to include waste management cost of commercial users. The requirements and guidance contained in IAS 16 *Property, Plant and Equipment*, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, and IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* on when to recognise and how to measure the cost and how to account for the effect of changes in the measurement were considered to be adequate. The IFRIC noted that commercial users normally had an obligation arising from the passage of legislation requiring them to recycle historical waste electrical and electronic equipment. While providers of replacement equipment might assume this obligation, this could not be anticipated. The IFRIC agreed on the following changes to the draft text:

- the title should be amended to better reflect the issue
- no guidance was needed on measurement implications resulting from the cost allocation by market share
- the effective date should be set at three months after the Interpretation was finalised
- there was no need for specific transition requirements – therefore, the requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* should apply
- there was no specific implication for first-time adopters of IFRSs.

The IFRIC unanimously voted in favour of publishing the draft Interpretation as an exposure draft subject to editorial review by IFRIC members of drafting changes needed to incorporate points raised during the meeting and the normal Board process.

## Items not taken to the IFRIC agenda

The IFRIC ratified decisions at the July 2004 IFRIC meeting that the following issues should not be added to the IFRIC agenda (see *IFRIC Update*, July 2004 for further information on these issues):

- Estonian dividend tax – whether the tax on dividends under Estonian Income Tax Law should be recognised in profit or loss or directly in equity.
- Extended payment terms, eg such as six-month's interest-free credit
- Prompt settlement discounts

IFRIC members also discussed the following issues:

### **IAS 11 Construction Contracts: Project accounting—contractee's accounting**

The IFRIC was asked to consider providing guidance on the proper accounting by the contractee as a construction project develops from contract signature to completion. The IFRIC agreed not to add this topic to the agenda, as the issue was

one of application rather than principle. Also, there was no convincing evidence of widespread problems in practice.

### **IAS 24 Related Party Disclosures: Disclosure of emoluments to key management personnel**

Paragraph IN5 of IAS 24 (as revised in 2003) states that a main change in IAS 24 (2003) from the previous version (1994) was that “The Standard requires disclosure of the compensation of key management personnel”. The IFRIC was asked to consider whether, based on this introductory remark, it was possible to infer that IAS 24 (1994) did not require disclosure of compensation of key management personnel.

The IFRIC noted that the comments in the Introduction of IAS 24 (2003) were made to highlight explicitly that disclosure of key management personnel was required, given that the 2002 Exposure Draft had proposed eliminating this disclosure. This was not a change from the requirements of IAS 24 (1994). IAS 24 (1994) had no specific exemption for the disclosure on management compensation. Accordingly, IAS 24 (1994) required an entity to disclose key management personnel compensation, given they met the definition of a related party. No interpretation was considered necessary.

### **IAS 24: Interpretation of the term ‘information’ in IAS 24 paragraph 17**

The IFRIC was asked to supplement the minimum disclosures in paragraph 17 regarding “transactions and outstanding balances necessary for an understanding of the potential effect of [related party] relationships on the financial statements”. For example, it was suggested that an interpretation of paragraph 17 should specifically require disclosure of the purpose and economic substance of transactions, identity of related parties, extend of management involvement, special risks and the effect of such transactions on the financial statements.

The IFRIC agreed not to add this issue to its agenda, noting that the IASB, in its revisions to IAS 24 in 2003, debated the extent of specific minimum disclosure requirements and the suggested items were not included. The IFRIC did agree that, because of wider policy considerations, this issue might be appropriate for discussion at the Board and, perhaps, the Standards Advisory Council.

### **Future meetings and requests for Interpretations**

The IFRIC's meetings for 2004 and 2005 are expected to take place in London, UK, as follows:

- 7 and 8 October 2004
- 4 and 5 November 2004
- 2 and 3 December 2004
- 3 and 4 February 2005
- 31 March and 1 April 2005
- 2 and 3 June 2005
- 28 and 29 July 2005
- 1 and 2 September 2005
- 3 and 4 November 2005
- 1 and 2 December 2005

Meeting dates, tentative agendas and additional details about the next meeting will also be posted to the IASB Website at [www.iasb.org](http://www.iasb.org) before the meeting. Interested parties may also submit requests for Interpretations through the IASB Website.