NEWSLETTER OF THE INTERNATIONAL FINANCIAL REPORTING INTERPRETATIONS COMMITTEE

IASB IFRIC UPDATE

August 2002

The International Financial Reporting Interpretations Committee met on 28 and 29 August 2002 in London, when it discussed:

- operating matters
- agenda items.

Operating matters

The IFRIC considered a proposed rubric and structure for future Interpretations and agreed:

- to a revised rubric similar to the one proposed by the Board for IFRSs
- that IFRIC Interpretations should be numbered sequentially beginning with IFRIC Interpretation 1.

Regarding the body of future Interpretations, the IFRIC agreed that the format should be one that was as compatible as possible with that of the IFRS, so that text could be transferred easily into the IFRS at the earliest opportunity. This would mean that:

- the main principle(s) being interpreted should be clearly identified (in bold)
- in addition to the Interpretation, the answer should contain a robust basis for conclusions.

Agenda items

The IFRIC discussed the following agenda items:

IAS 19 *Employee Benefits* – the asset ceiling

IAS 19 includes a limit on the amount that can be recognised as an asset in respect of a surplus in a defined benefit plan (the asset ceiling). The IFRIC discussed the conceptual basis for the asset ceiling and its views will be provided to the Board as input into its convergence project on post-employment benefits. No further IFRIC discussions of this matter are planned.

The IFRIC also considered possible guidance on the asset ceiling as specified in IAS 19. It discussed whether refunds and reductions in future contributions should be regarded as available only if an entity has a right to them or it is probable that the entity would be given any necessary approval. The IFRIC noted the dilemma that the definition of an asset in the IASB *Framework for the Preparation and Presentation of Financial Statements* would require the entity to have control—ie for there to be to be a right—and that this would significantly restrict the asset that could be recognised in many jurisdictions.
In contrast, the discussion in the basis for conclusions to IAS 19 indicates that the asset ceiling would have an effect only in rare cases, implying that the intention was to recognise as an asset economic benefits to which the entity did not have an absolute right but which it is likely to obtain.

The IFRIC agreed that given this inconsistency between the *Framework* and the discussion in the Standard, and that the IASB would be considering the conceptual question of the asset ceiling soon, it should not issue any Interpretation on the existing requirement in IAS 19 at present, but rather that it should draw the issue to the attention of the Board.

Revenue: multiple element revenue arrangements

Multiple element revenue arrangements are arrangements offered by entities to customers that include the delivery or performance of multiple products, services, or rights. Multiple element arrangements can have fixed fees or a fixed fee coupled with a continuing payment stream (which can be fixed, variable or both). The delivery of products, the performance of services and the customer's use of an entity's asset may occur at different points in time and over different periods of time.

The IFRIC considered principles that should be used to identify the unit(s) of account in a multiple element revenue arrangement. The IFRIC discussed two accounting models being considered by the US Emerging Issues Task Force (EITF) in Issue No. 00-21 *Accounting for Revenue Arrangements with Multiple Deliverables*.

At the conclusion of its discussion, the IFRIC agreed to continue to follow the EITF's progress on Issue No. 00-21.

The IFRIC also agreed to proceed with its consideration of the following two revenue topics considered in its February 2002 meeting:

- loyalty programmes
- sales and specified trade-in rights.

The IFRIC will provide the background analysis of this issue to the Board for their project on *Revenue—definition and recognition—and related aspects of liabilities*.

Update on the work of other interpretive groups

The IFRIC discussed new projects being undertaken by interpretative committees of national standard-setters, and whether any of these projects might form suitable agenda items for the IFRIC. The IFRIC did not identify any new agenda items.

Rights of use

The IFRIC continued its discussion from the July meeting of when a right of use constitutes a lease transaction that should be accounted for in accordance with IAS 17 *Leases*, and considered a draft Interpretation.

(Continued…)

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The IFRIC saw particular problems in deciding when a right of use should be classified as an intangible, a derivative, a lease, or a service. Some members saw this issue as being exacerbated where the capacity of an asset was defined by reference to output or time. To resolve this dilemma it was agreed that in preparing an Interpretation the focus be placed upon distinguishing a lease from a service, using examples that were clearly distinguishable.

In addition, the IFRIC agreed that it would consider adding some of the issues arising from this topic (for example, guarantees inherent in take-or-pay contracts, asset componentisation, the distinction between a lease and a derivative) to its agenda as separate items in the future.

Derivatives on interests in subsidiaries and associates

The IFRIC continued its discussion of the accounting for derivatives on interests in subsidiaries, associates and joint ventures.

It noted that the resolution of this issue is affected by the Board's decisions on its current project to improve International Accounting Standards (including the classification of minority interests as equity, and the proposed guidance on the classification of derivatives on own equity instruments as equity or assets/liabilities).

The IFRIC noted that applying those proposals would mean that changes in the fair value of derivatives on interests in subsidiaries would not be recognised in consolidated profit or loss (assuming the proposed conditions for equity classification in the exposure draft of proposed amendments to IAS 32 *Financial Instruments: Presentation and Disclosure* are met). Changes in the fair value of derivatives on interests in associates and joint ventures would be recognised.

However, the IFRIC was concerned about some of the implications of the Board's decisions and requested staff to convey those concerns to the Board. In particular, the IFRIC was concerned about shifts in value between the equity participants of a parent entity and those of subsidiaries, and about accounting for stepped acquisitions and disposals.

Transactions with owners and common control transactions

As a follow-up to its April meeting, the IFRIC continued its discussion of the accounting concepts and principles that should apply when accounting for transactions with owners and common control transactions.

The IFRIC discussed concepts and principles in order:

- to determine whether it could discern an approach for dealing with transactions with owners and common control transactions
- to provide input into the IASB's Accounting Concepts project dealing with refinement of the elements literature.

The paper illustrated the differences between an entity and a proprietorial outlook toward the various types of transactions with owners and used examples of various valuation bases. Subject to a correction of some of the proprietorial examples, the paper is to go forward as input for the Board's work on the definition and recognition of the elements.

Items not taken on the agenda

Listed below are decisions of IFRIC not requiring publication of an Interpretation. A comprehensive list of all the items the IFRIC has agreed not to require publication of an Interpretation can be found on the IASB's Website.

Income Taxes – Non-depreciable/depreciable assets

The main issue is whether the whole of an investment property held under a finance lease consisting of land and buildings that is accounted for using the fair value model in IAS 40 *Investment Property* is a "non-depreciable asset" under SIC-21 *Income Taxes – Recovery of Revalued Non-Depreciable Assets* paragraph 4 (with the consequence that any deferred tax asset or liability on it should be measured at the tax rate applicable on a sale of the property).

The IFRIC agreed not to require publication of an Interpretation on this issue because SIC–21, IAS 16 *Property, Plant and Equipment*, and IAS 12 *Income Taxes* provide adequate guidance.

Exchanges of businesses or other non-monetary assets for an interest in a subsidiary, joint venture or associates

The issue is whether exchanges of businesses or other non-monetary assets for an interest in the assets of a subsidiary, joint venture or associate:

- should be recognised in the consolidated financial statements at fair value as at the acquisition date, therefore recognising a gain (or loss) on 'sale' in the consolidated financial statements; or
- should be recognised in the consolidated financial statements at the pre-combination carrying amount, therefore reversing out of the consolidated financial statements the gain (or loss); or
- should be recognised in the consolidated financial statements at the pre-combination carrying amount to the extent of continued ownership interest in the business or non-monetary asset, therefore recognising a gain only for the minority interest portion in the consolidated financial statements.

The IFRIC agreed not to require publication of an Interpretation on this issue because the Board's intention is to deal with this issue (specifically exchanges of businesses or other non-monetary assets for an interest in a subsidiary) in the Board's Business Combinations Phase II project.

Pre-contract costs

Entities in some industries incur significant 'pre-contract' costs in bidding for and securing contracts to supply products or services. Examples are entities that supply property and services under service concessions, outsourcing, and similar arrangements. Where a bid is successful, the entity will often have incurred significant costs before the contract is signed.

The issue is when is it appropriate to recognise an asset (versus an expense) for pre-contract costs.

The IFRIC agreed that IAS 11 *Construction Contracts* paragraph 21 provides guidance regarding accounting for pre-contract costs relating to construction contracts and that this guidance can be used for analogous circumstances.

Although the IFRIC agreed not to require publication of an Interpretation on this issue, it noted that a great deal of care should be taken when determining whether pre-contract costs should be capitalised.

Own shares that are held for trading purposes

Some companies, in particular financial institutions, may hold their own shares for trading purposes. For example, a financial institution may issue a bond whose principal amount varies with the movement in a share index (sometimes referred to as a 'index tracker bond'). In order to hedge the equity derivative that is embedded in the bond, it may purchase a portfolio of the shares contained in the relevant index and classify them as held for trading. If the financial institution is one of the companies in the index, the result will be that it holds its own shares for trading purposes.

The issue is whether an exception from SIC-16 *Share Capital – Reacquired Own Equity Instruments (Treasury Shares)* should be made for own shares that are held for trading purposes in order to allow them to be measured at fair value with changes in value being reported in the income statement.

The IFRIC agreed not to require publication of an Interpretation on this issue, and that IAS 39 *Financial Instruments: Recognition and Measurement* and SIC-16 are clear that:

- own shares should be treated as a deduction from equity in all circumstances
- they may not be classified as an asset that is held for trading
- no gain or loss is recognised in the income statement on such shares.

Reciprocal equity interests

When A owns an interest in B, and B concurrently owns an interest in A, those investments are known as reciprocal interests (or 'cross-holdings'). The issue is what is the accounting for reciprocal interests when Entity A and Entity B account for their investments in one another using the equity method as defined in IAS 28 *Accounting for Investments in Associates*.

The IFRIC agreed not to require publication of an Interpretation on this issue. IAS 28 paragraph 16 states, "Many of the procedures appropriate for the application of the equity method are similar to the consolidation procedures set out in IAS 27 *Consolidated Financial Statements and Accounting for Investments in Subsidiaries*". Like the consolidation procedures applied when a subsidiary is consolidated, the equity method requires reciprocal interests to be eliminated.

The IFRIC also agreed to provide examples of reciprocal interests to the Board as input into the IAS 28 Improvements project.

The effects of rights of veto on control

This issue relates to the effect of rights of veto given to a third party on the assessment of whether an owner of more than half of the voting rights in an enterprise has control.

The IFRIC agreed not to require publication of an Interpretation on this issue because the Board will be addressing this issue in the near future in its recently adopted project Consolidation and Special Purpose Entities.

Business combinations - the seller's contingent consideration

This issue considers the accounting for contingent consideration received by the seller in a business combination.

The IFRIC agreed not to require publication of an Interpretation on this issue for the following reasons: (i) it is not pervasive in practice; and (ii) the Board is currently looking at contingent consideration from the purchaser's perspective as part of its Business Combinations Phase II project.

The IFRIC noted that when accounting for contingent consideration received by the seller, one of the questions to consider is whether IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* or IAS 39 *Financial Instruments: Recognition and Measurement* applies.

In addition, the IFRIC agreed that the scope exclusion in IAS 39.1(g) should be clarified, ie the exclusion in IAS 39.1(g) applies to the purchaser (who would account for this transaction under IAS 22 *Business Combinations*) and not the seller. This decision will be communicated to the Board as part of the IAS 39 Improvements project.

Inventories - cash discounts

This issue considers how a purchaser of goods should account for cash discounts received.

The IFRIC agreed not to require publication of an Interpretation on this issue because IAS 2 *Inventories* paragraph 8 provides adequate guidance. Cash discounts received should be deducted from the cost of the goods purchased.

IAS 19 Employee Benefits - Classification of an insured plan

This issue relates to a particular insured plan found in Sweden. The IFRIC was asked to provide guidance on whether the particular plan is a defined benefit or a defined contribution plan under IAS 19 and, if it was thought to be a defined benefit plan, whether it would qualify for the exemptions from defined benefit plan accounting available under IAS 19 for some multi-employer plans.

The IFRIC agreed not to require publication of an Interpretation on this issue. IAS 19 is clear that the particular plan considered is a defined benefit plan. However, the IFRIC's Agenda Committee is looking at whether the general issue of the availability of the exemptions for multi-employer plans should be examined by the IFRIC.

Future meetings and requests for Interpretations

All meetings in 2002 are expected to be in London.

Meeting dates, tentative agenda and additional details about the next meeting will be posted to the IASB Website at www.iasb.org.uk before the meeting. Interested parties can also submit requests for Interpretations through the IASB Website.

