



IASB IFRIC UPDATE

No. 21 / July 2002

The International Financial Reporting Interpretations Committee met on 23 and 24 July in London, when it discussed:

- operating matters
- current agenda items
- new agenda items

Operating matters

The IFRIC discussed the following operating matters:

■ Mandate and Operating Procedures

The IFRIC discussed whether to retain both its Mandate and Operating Procedures (MOP) and its *Preface*, or to replace its *Preface* with the MOP. The IFRIC decided to replace the *Preface* with its MOP, with only one editorial change.

In addition, the IFRIC discussed suggestions made at the April meeting to revise its MOP regarding confidentiality, conflicts of interest, analogous circumstances, and Interpretations that conflict with IFRSs or the IASB *Framework*. The IFRIC agreed that the only change needed related to procedures for dealing with proposed Interpretations that could conflict with IFRSs or the *Framework*. Proposed amendments to the MOP will be communicated to the Board.

■ IFRIC Membership

The IFRIC also noted the conclusion of the IASB that, as a result of mergers or transfers, the IFRIC membership should not include more than one member from the same accounting firm.

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Agenda items

The IFRIC discussed the following agenda items:

■ Linkage of transactions

Entities sometimes enter into two or more transactions or contracts where the accounting treatment varies depending on whether the contracts are accounted for separately or together.

The IFRIC continued its previous discussion at the April meeting by considering a number of detailed examples that illustrate the issues involved. It noted that this issue could be viewed as the application of the

Framework's concept of substance over form to particular situations. It agreed the following points:

- It is necessary to consider all of the terms and conditions of an arrangement and their effect when determining the appropriate accounting treatment.
- If a right or obligation is non-substantive—ie it has no effect in practice, it should have no effect on the accounting treatment.
- When one contract (or feature of a contract) completely undoes another, the combination should be viewed as a nullity.
- The form of a transaction does not affect whether transactions should be linked or the consequent accounting treatment. Similarly, the fact that rights and obligations are contained in two or more contracts as opposed to one should not affect the accounting treatment.
- When a transaction is priced on off-market terms, this indicates that there is another feature or transaction that needs to be identified and that the transactions may need to be linked. However, it is not necessary that transactions are at off-market prices before linkage needs to be considered.
- When preparing consolidated accounts, transactions with different companies in the same group may need to be linked when accounting for the combination from the perspective of the group. This reflects the basic principle of consolidation that group financial statements reflect transactions entered into by the various members of the group as those of a single economic entity.
- When a Standard or Interpretation applies to two or more linked contracts *in their entirety*, that Standard or Interpretation should take precedence over the requirements set out above.

The IFRIC also discussed possible indicators and conditions for when transactions should be linked.

The IFRIC asked the staff to continue to work on the topic. The IFRIC also requested that the staff work with

the staff of the EITF, which is considering a similar issue, with a view to developing a common approach.

■ IAS 18 Revenue

The IFRIC discussed the following revenue recognition issues with a view of giving input into the Board's project on *Revenue—definition and recognition—and related aspects of liabilities*:

(a) Framework—earned vs liability definition

The IFRIC discussed identifying revenue on the basis of being earned versus applying the liability definition and recognition criteria in the *Framework*. For example, does 'unearned/deferred' revenue meet the *Framework's* liability definition and recognition criteria?

(b) Sale of goods—rights of return

The IFRIC discussed when an entity can reliably estimate returns, and how to determine whether (and to what extent) revenue should be recognised. In particular, it discussed the interaction of a right of return and the condition in IAS 18.14(a) for revenue recognition that: "the enterprise has transferred to the buyer the significant risks and rewards of ownership".

(c) Barter transactions

The IFRIC discussed IAS 18.12, which states: "When goods or services are exchanged or swapped for goods or services which are of a similar nature and value, the exchange is not regarded as a transaction which generates revenue." Specifically, it discussed whether it is appropriate not to recognise revenue in a barter transaction.

The IFRIC members acknowledged that, in general, the *Framework* is based on the notion that revenue recognition is driven by the recognition of assets and liabilities (the 'balance sheet approach'), whereas the existing IAS 18 is generally based on the earning process as a driver of revenue.

The IFRIC members expressed differing views regarding the above issues, which signalled the need for these issues to be considered as part of the IASB's broader project.

The IFRIC agreed to continue the revenue recognition discussion at its next meeting. It is expected that the analyses will then be provided to the Board as input for the newly adopted project on revenue and related liabilities.

■ IAS 32 Financial Instruments: Disclosure and Presentation

(a) Economic compulsion

The IFRIC considered the principles that underlie the classification of certain financial instruments as debt or equity and, in particular, the guidance in paragraph 22 of IAS 32. The IFRIC agreed that an instrument whose legal form does not give rise to an obligation

might implicitly obligate (ie 'economically compel') an entity due to the way its terms and conditions operate. The IFRIC tentatively agreed on the principles that underlie this notion.

(b) Discretionary dividends

This item also considers the classification of certain financial instruments as debt or equity, but in consolidated financial statements. One particular example is an instrument that is issued by a subsidiary where additional terms (eg a guarantee) are agreed between the holders and the parent and/or a fellow subsidiary. The IFRIC agreed that any such additional terms should be considered when determining whether the consolidated group lacks discretion over distributions and/or redemption and hence has a liability.

The conclusions reached by the IFRIC on both of these issues will be passed to the Board as input into its project on Improvements to IAS 32.

■ Rights of use

The IFRIC considered when a right of use constitutes a lease transaction that should be accounted for in accordance with IAS 17 *Leases*. This was a subset of matters discussed when considering indefeasible rights of use at an earlier meeting. The IFRIC discussed some of the issues that this question raises, namely:

- whether the asset in the arrangement would need to be explicitly specified or whether, for example in a service agreement, an asset might be implicitly specified;
- whether the right to use the asset would need to be an exclusive right; and
- whether the asset could be a component of a larger asset.

The IFRIC agreed that it should address these matters and develop guidance to assist in determining whether a particular transaction falls within the scope of IAS 17. It did not reach decisions on the above issues, and agreed to continue discussion at a later meeting.

New agenda items

The IFRIC discussed the following new agenda items:

■ Emission rights

Several governments either have, or are in the process of developing, schemes to encourage reduced emissions of pollutants, in particular of greenhouse gases. The IFRIC discussed a scheme that is based on a 'cap and trade' model whereby participants are allocated emission rights or 'allowances' equal to a 'cap' (ie target level of emissions) and are permitted to trade those allowances. The IFRIC agreed with the Agenda Committee's recommendation that it add the accounting for emission

rights to its agenda.

The IFRIC had an initial discussion of the main features of such a scheme and the accounting issues that arise. The discussion was mainly educational and no decisions were reached. The IFRIC agreed to continue its discussion at a future meeting.

■ **Derivatives on interests in subsidiaries, associates and joint ventures**

An entity that has a subsidiary, joint venture or associate may enter into a contract (eg a forward, or a put or call option) either to buy some of the shares in the investee that it does not already own or, alternatively, to sell some of its present holding.

The IFRIC agreed with the Agenda Committee's recommendation that it add the treatment of such derivatives to its agenda.

The IFRIC noted that the resolution of this issue is affected by the Board's decisions on:

- whether transactions between a majority holder of an interest in a subsidiary and the minority interest give rise to gains and losses; and
- the classification of contracts on an entity's own equity. This is being addressed in improvements to IAS 32 *Financial Instruments: Presentation and Disclosure*.

The IFRIC agreed to consult the Board on these matters, and also on whether the issue is best addressed by the IFRIC developing an Interpretation or by the Board when finalising the proposed improvements to IAS 32.

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.