NEWSLETTER OF THE INTERNATIONAL FINANCIAL REPORTING INTERPRETATIONS COMMITTEE

IASB IFRIC UPDATE

April 2003

The International Financial Reporting Interpretations Committee met on 1 and 2 April in London.

Agenda items

The IFRIC discussed the following agenda items:

Changes in decommissioning and similar liabilities

The IFRIC considered a revised draft Interpretation and discussed the following:

Accounting for the effect of changes in the discount rate and estimated cash flows

The IFRIC considered the following three approaches for accounting for the effect of changes in the discount rate and the estimated cash flows on a decommissioning liability:

(a) capitalising the part of the change that relates to current and future periods.

(b) capitalising only the part of a change in estimated cash flows that relates to current and future periods. The effect of a change in the discount rate would be recognised in current period profit or loss.

(c) recognising the effect of all changes in either the cash flows or the discount rate in current period profit or loss.

The IFRIC agreed that it preferred approach (a). This approach is consistent with its view that a change in the estimated cash flows represents a change in the cost of the related asset. It also treats all changes (whether to the cash flows or the discount rate) in the same way, which the IFRIC agreed is important given that some factors, eg inflation, can affect both the cash flows and the discount rate. However, the IFRIC also appreciated the argument for approach (b), namely that a change in the discount rate is an event of the present period, and agreed that it could also accept this approach. The IFRIC asked the staff to present its preferred approach (ie (a)) to the Board to ensure that it is acceptable to the Board.

Remeasuring a decommissioning liability for changes in the discount rate

The IFRIC noted that some constituents had questioned whether a decommissioning liability should be remeasured for changes in the discount rate. It noted that such remeasurement is required by IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. It agreed to add to the draft Interpretation's Basis for Conclusions, that paragraphs 36 and 47 of IAS 37 require that the measurement of the liability, both initially and subsequently, is the best estimate of the expenditure required to settle the present obligation at the balance sheet date and should reflect a current discount rate. Hence, when a change in estimated cash flows and/or the discount rate is material, the effect of the change should be recognised.

Transition

The IFRIC instructed the staff to include in the draft Interpretation an illustration and/or explanation of the mechanics of 'prospective' application for both first-time adopters and existing IFRS preparers.

Calculating the amount to be capitalised

The IFRIC tentatively agreed that the determination of how much of a change in a decommissioning liability should be capitalised should be done on a "systematic and rational basis". The IFRIC instructed the staff to include in the draft Interpretation an example of how to determine the amount.

Paragraph 20A of the Exposure Draft of Improvements to IAS 16 Property, Plant and Equipment

The IFRIC expressed support for a proposed revision of paragraph 20A of the Exposure Draft of Improvements to IAS 16 *Property, Plant and Equipment*. The revision would clarify that paragraph 20A applies only to the initial capitalisation of costs and not to subsequent changes in the estimated amount of those costs.

IAS 19 *Employee Benefits*: Multi-employer plan exemption

IAS 19 gives an exemption from defined benefit accounting for multi-employer plans when sufficient information is not available to use defined benefit accounting. The standard goes on to state that this may occur if:

(a) the entity does not have access to information about the plan that satisfies the requirements of the standard; or

(b) the plan exposes the participating entities to actuarial risks associated with the current and former employees of other entities, with the result that there is no consistent and reliable basis for allocating the obligation, plan assets and cost to individual entities participating in the plan.

A draft Interpretation giving guidance on what participants in multi-employer plans are expected to do in order to try to get the necessary information and to make a consistent and reliable allocation was sent to the IFRIC and the Board at the end of February. The IFRIC considered the comments received and a revised draft Interpretation.

The IFRIC asked the staff to revise the Interpretation further (a) to clarify when plans would meet the definition of a multi-employer plan, (b) to explain how defined benefit accounting should be applied by participants in multi-employer plans, and (c) in the light of (a) and (b), to include some discussion of when sufficient information may or may not be available. A revised Interpretation will be brought to the July meeting.

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IAS 19 *Employee Benefits*: Plans that would be defined contribution plans but for the existence of a minimum return guarantee

The IFRIC has been considering how to account for a plan that would be a defined contribution plan but for the existence of a minimum return guarantee. The terms of the plan are that a contribution is made each year based on the employee's current salary and the employee receives a benefit (a lump sum or an annuity) equal to the contributions paid into the plan plus the return generated on the assets acquired. The employer guarantees a minimum return on the assets over the period to when the benefit is paid.

At the February meeting, the IFRIC agreed to develop an Interpretation that would state that such plans are defined benefit plans under IAS 19 and would explain clearly how the defined benefit methodology in IAS 19 should be applied to such plans.

The IFRIC considered a draft of such an Interpretation. It noted that there might be divergence from US GAAP on such plans as it was not completely clear whether they would be classified as defined benefit or defined contribution under US GAAP. It also noted that the EITF was considering 'cash balance plans' which are similar to the plans in question except that any return generated by plan assets in excess of that guaranteed does not accrue to the employees. If the EITF concludes that such plans are defined benefit plans under US GAAP, a major issue to be considered by the EITF is the allocation of benefits to accounting periods, an issue that also is covered by the draft IFRIC Interpretation.

The IFRIC agreed that the question of the allocation of benefits to periods of service is a wider issue that is not unique to the kinds of plan discussed in the draft Interpretation. It agreed that this issue should be removed from the present draft and addressed in a separate Interpretation, preferably in conjunction with the EITF.

The draft Interpretation further proposed that in applying defined benefit accounting to the liability that arose because of the guaranteed return, any additional amounts accruing to the employees because of excess returns above the guaranteed return should be accounted for only when they actually arose. The IFRIC expressed support for the result achieved by this approach. However, it was concerned that not projecting forward the additional liability based on a best estimate of the expected return on assets was not consistent with the requirements of IAS 19. It agreed that the approach would better be described as an application of defined benefit accounting to the element of the plan that causes the plan to be defined benefit and defined contribution accounting to the element that is defined contribution in nature.

A revised Interpretation will be brought to the July meeting.

Decommissioning and environmental rehabilitation funds

The IFRIC continued its discussion from the November meeting on decommissioning and environmental rehabilitation funds. In particular, the IFRIC discussed accounting for the right to receive reimbursement from a fund.

The IFRIC discussed whether the right to receive a *cash* reimbursement from a fund is a financial asset within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* and, if so, how it would be classified. In particular, it discussed possible classifications as an originated loan (possibly with an embedded derivative if the fund invests in, eg equities) or as an available-for-sale asset.

The IFRIC also noted that not all rights to reimbursements will fall within the scope of IAS 39. In particular, if a right to reimbursement in cash arose as a result of regulation rather than from contract, it would not fall within the scope of IAS 39. Similarly, if the right was to reimbursement in services rather than in cash, it would not fall within the scope of IAS 39. This could result in economically similar rights to reimbursements being accounted for differently. The IFRIC expressed concern about this effect and concluded that it would be best if all rights to reimbursement from a decommissioning fund (whether arising from contract or from regulation, and whether reimbursement is in cash or services) were accounted for in the same way. The IFRIC also agreed that the most appropriate accounting would be to measure the right to reimbursement at fair value and report changes in fair value in the income statement. However, the IFRIC doubted whether such an approach would be consistent with existing GAAP.

The IFRIC also discussed the interaction of IAS 39 and IAS 37 in the context of a right to reimbursement. It noted that IAS 37, paragraph 1 has a scope exclusion for items covered by another standard, which would apply to any items that fall within the scope of IAS 39. It discussed whether IAS 39 might be amended to exclude rights to reimbursement from its scope, with the result that such rights would then fall within the scope of IAS 37. It noted that if such a change were made, this would leave the IFRIC free to provide guidance on the measurement of a right to reimbursement since IAS 37 is silent on this matter. The IFRIC also noted that, if such a change were made, care would need to be taken to ensure it did not have unexpected or broader consequences.

The IFRIC directed the staff to raise these concerns about current GAAP with the Board and, in particular, to explore with the Board whether the right to receive reimbursement in cash from a fund could be excluded from the scope of IAS 39.

Finally, the IFRIC discussed whether the language currently in the draft Interpretation relating to silos should be retained. The IFRIC agreed that the issue of silos goes beyond decommissioning funds and should be covered more generally, perhaps in the Board's project on consolidation. The IFRIC concluded that silos were likely to be extremely rare for decommissioning funds and hence that all reference to silos should be deleted from the draft.

Deferred taxes in a hyperinflationary economy

The IFRIC discussed whether to take on to its agenda the issue of how an entity should calculate its comparative deferred tax figures (and hence the income statement change for the year) in the first year it identifies the existence of hyperinflation and applies IAS 29 *Financial Reporting in Hyperinflationary Economies*.

The following possible approaches were discussed:

(a) the deferred tax balance (in nominal value) is restated as either a monetary or a monetary item in accordance with the general approach in IAS 29.

(b) the deferred tax balance is remeasured based on the difference between the restated carrying amount of assets and liabilities and their tax bases.

(c) the deferred tax balance (in nominal value) is analysed into its underlying components (i) carrying amounts and (ii) tax bases. Each component is restated, after which the deferred tax item is derived from the temporary differences of the restated carrying amounts and the restated tax bases.

(d) the comparative deferred tax balance is neither restated nor remeasured (ie it remains unchanged compared with the financial statements of the previous reporting period).

The IFRIC noted that the Board is in the process of deciding whether it should take on to its agenda a general project on hyperinflation. In this connection, the Board is seeking the advice of jurisdictions that have experienced hyperinflation. The IFRIC noted, however, that in the meantime it might be useful for it to issue an Interpretation (or implementation guidance) on the issue described above.

The IFRIC asked the staff to prepare numerical examples for it to consider at a future meeting. It agreed that it would reconsider whether the issue should be taken on to the agenda after discussing these examples.

Emission rights

The IFRIC considered a pre-ballot draft Interpretation on emission rights.

The IFRIC noted that certain Board members had expressed serious reservations about the draft Interpretation, particularly in view of the Board's forthcoming project to amend IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*. However, the IFRIC confirmed its view that (a) guidance on this topic is needed urgently, and (b) the IFRIC does not have the power to overrule existing GAAP that is applicable (namely IAS 20, IAS 37, and IAS 38 *Intangible Assets*) nor to anticipate any changes to that GAAP.

The IFRIC therefore agreed to proceed with the draft Interpretation in substantially its present form. It did, however, amend two of its earlier decisions as follows:

(a) the draft Interpretation should require that the government grant, which arises when allowances are awarded for less than fair value, should be amortised to income over the compliance period on a systematic and rational basis. Subject to these limits, a particular amortisation method should not be specified.

(b) the draft Interpretation should refer to the existence of the Board's project to amend IAS 20, but should not contain any discussion of what the amendments might be nor of their possible effect on the consensus.

The IFRIC instructed the staff to prepare a ballot draft of the Interpretation.

Rights of use

The IFRIC continued its deliberations from its February meeting of its draft Interpretation *Determining whether an Agreement contains a Lease*.

The draft Interpretation stated that there are three elements that need to be present for an agreement to contain a lease:

(a) fulfilment of the agreement depends upon use of a specific item or items ('the asset');

(b) the purchaser controls the right to use the asset for a specific period of time; and

(c) the purchaser's obligation to make payments to the supplier under the agreement is for the time that the asset is made available rather than for actual use of the asset.

The IFRIC discussed the application of the second criterion to agreements in which purchasers have rights to acquire substantially all of the output produced by a specific asset. Although the draft Interpretation stated that such agreements give rise to a right of use, some IFRIC members disagreed with that conclusion for some output contracts. They believe that in some such circumstances purchasers do not control the right to use an asset, rather they have rights to output. They were therefore concerned that the Interpretation used the term 'control' inconsistently with other standards. In the light of this discussion the IFRIC agreed to explore whether the second criterion (the purchaser controls the right to use) is required or could be modified. The IFRIC also discussed the possibility of removing recognition and measurement issues from the project, thereby limiting the draft Interpretation to disclosure. However, the IFRIC agreed that some rights of use should be recognised and that an Interpretation that achieved this would be an improvement on present GAAP. It therefore agreed to continue with this project in its present form.

The IFRIC also instructed the staff:

(a) to ensure that agreements that allow suppliers to substitute assets do not fall outside the scope of the Interpretation;

(b) to articulate more clearly in the Interpretation that the asset is the right to use rather than the underlying asset;

(c) to reconsider the issue of when an agreement should be reassessed;

(d) to provide more guidance on how the phrase 'substantially all' should be applied at the inception of the agreement.

The IFRIC also agreed that it should consider adding to its agenda in due course a project on disclosure of executory contracts.

The IFRIC will continue its deliberations at its next meeting.

Liaison update

The IFRIC discussed new projects being undertaken by interpretive 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 among these projects.

Items not taken on to the agenda

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

Non-monetary exchanges of assets

The IFRIC considered an example of a transaction involving exchanges of non-monetary assets in which Company A exchanges its 13 per cent interest in Company B for a 13 per cent interest in Company C, where C's only asset is its 100 per cent holding in B. As a result, A's holding in B is held in a different legal form (ie via an intermediate holding company with no other activities), rather than held directly. The issue is whether the exchange of A's interest in B for the 13 per cent interest in C would result in derecognition of the investment in B with any gain or loss reported in profit or loss and recognition of a new investment in C.

The IFRIC agreed not to publish an Interpretation on this issue because the example is relatively narrow. However, the IFRIC agreed to consider including this example in its future guidance on reporting linked transactions.

IAS 21 *The Effects of Changes in Foreign Exchange Rates* – Exchange rate for remeasuring foreign currency transactions and translation of foreign operations

The issue is which exchange rate an entity should use for remeasuring foreign currency transactions and translation of foreign operations if more than one exchange rate is available.

The IFRIC noted that the improved IAS 21, paragraph 24, states that "When several exchange rates are available, the rate to be used is that at which the future cash flows represented by the transaction or balance could have been settled if those cash flows had occurred at the measurement date." The IFRIC agreed that the guidance in the improved IAS 21 is satisfactory and decided not to take the issue on to its agenda.

Equity method application

The main issue was whether the presumption in the Exposure Draft to improve IAS 28 *Accounting for Investments in Associates* that an investor has 'significant influence' over the operations of an investee if it holds directly or indirectly through subsidiaries, 20 per cent or more of the voting power of the investee, was met in examples that were divided into two main categories:

(a) when the investor has a subsidiary that is less than wholly owned, and the subsidiary holds 20 per cent of the voting power of the investee.

(b) when the investor holds 20 per cent or more of the voting power of the investee through associates or joint ventures (rather than subsidiaries).

It was agreed that, in the examples that fell under (a) above, the presumption was met. In the examples that fell under (b) above, it was agreed that, in one case, the conclusion that equity accounting would be applied was based on the mechanics of equity accounting rather than using the 20 per cent presumption, and in another case, it was unclear whether the presumption was met.

Therefore, the IFRIC agreed to pass this issue to the Improvements project to clarify the wording in IAS 28.

Classification of treasury shares in the consolidated cash flow statement

Four scenarios were considered concerning the classification of treasury shares in the consolidated cash flow statement, under IAS 7 *Cash Flow Statements*:

(a) a subsidiary purchases (sells) shares of its parent.

(b) the parent entity purchases (sells) shares of its subsidiary from (to) minority interest holders.

(c) the subsidiary issues shares to minority interest holders.

(d) the subsidiary purchases its own shares from minority interest holders.

While the conclusions drawn were consistent with the current accounting for transactions with minority interest holders, the IFRIC noted that this accounting would probably change, given the Board's tentative decision that transactions between majority and minority interest holders are equity transactions.

Therefore, the IFRIC agreed that the issue should be passed to the Business Combinations Phase II project for consideration of consequential amendments to IAS 7.

Reciprocal interests

This issue addressed the accounting of a parent's (or investor's) shares that are held by a subsidiary (or associate).

The IFRIC decided to wait until the amendments to improve IAS 27 *Consolidated Financial Statements and Accounting for Investments in Subsidiaries* are finalised from the Business Combinations Phase II project before considering whether to take this issue on to the agenda.

Future meetings and requests for Interpretations

The IFRIC's meetings for the remainder of 2003 are expected to take place in London, UK, as follows:

1 and 2 July

30 and 31 July

30 September and 1 October

2 and 3 December

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