NEWSLETTER OF THE INTERNATIONAL FINANCIAL REPORTING INTERPRETATIONS COMMITTEE

IASB IFRIC UPDATE

July 2004

The International Financial Reporting Interpretations Committee met in London on 29 July 2004, when it discussed:

- SIC-12: Scope exclusion for employee benefit trusts
- IAS 37: Constitution of an obligating event by future market share
- IFRIC D5: Comment letter analysis
- Service concession arrangements

The meeting lacked the quorum necessary for decisions to be made. However, the staff used the meeting to test various conclusions in advance of the meeting in September 2004.

SIC-12: Scope exclusion for employee benefit trusts

IFRIC members continued their discussion of employee benefit trusts relating to share-based payment arrangements. In June, the IFRIC published for public comment a Draft Amendment D7 *Scope of SIC-12*, proposing amendments to the scope of SIC-12 *Consolidation—Special Purpose Entities*, including a proposal to remove the scope exclusion for equity compensation plans. At this meeting, IFRIC members discussed various issues relating to accounting for employee benefit trusts in the sponsoring entity's consolidated and separate financial statements. No decisions were reached. The IFRIC will continue its discussions at its October meeting, after considering comments received on D7.

IAS 37: Constitution of an obligating event by future market share

IFRIC members discussed a draft Interpretation concerning liabilities arising from market share. The draft Interpretation provides guidance on the requirements in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* relating to the constitution of an obligating event. The draft proposes that if an obligation for the cost of waste management arises from participation of the producer in the future, ie future market share, the obligating event is the future participation in the market and not the date when the products are put on the market.

The constitution of an obligating event has been raised in conjunction with the EU Directive 2002/96/EC on Waste Electrical and Electronic Equipment (WE&EE). It regulates the collection, treatment, recovery and environmentally sound disposal of waste equipment. The Directive entered into force on 13 February 2003.

IFRIC members gave drafting advice to the Accounting Interpretation Committee of the German Accounting Standards Committee. An updated version will be circulated to the IFRIC members in due course. A revised draft will be discussed by the IFRIC in September 2004.

IFRIC D5: *Applying IAS 29* Financial Reporting in Hyperinflationary Economies *for the First Time*

IFRIC members began a consideration of comments received in response to Draft Interpretation D5 *Applying IAS 29* Financial Reporting in Hyperinflationary Economies *for the First Time*, published in March 2004. The IFRIC has received 30 comment letters from constituents. (D5 and the comment letters are available on the IASB's Website, www.iasb.org.) At this meeting, IFRIC members primarily focused on:

- the proposal to clarify that in the first year an entity identifies the existence of hyperinflation it should apply IAS 29 as if it always had applied the Standard
- the proposed measurement of opening deferred tax items in an entity's restated financial statements
- the Illustrative Example.

IFRIC members observed that several respondents disagreed or expressed concerns with the restatement approach in D5 (and IAS 29). Many of those respondents did not believe that restating financial information provides useful information; others cited costs versus benefits as their primary objection. As an alternative to the restatement approach some respondents proposed that D5 should permit entities an option to choose between either restatement of the financial statements or application of a 'stable/hard currency approach' (the latter as under US GAAP). Others suggested that D5 should be amended to require an entity to restate its financial statements for the effect of inflation from the beginning of the year the entity identifies the existence of hyperinflation and not, as D5 proposed, from the date of acquisition of its non-monetary assets.

IFRIC members present noted that D5 was intended to clarify how to implement the restatement approach required by IAS 29 and that the IFRIC was not permitted to amend the Standard to remove any requirements. The issues raised by respondents would require an

(continued)

IFRIC Update is published immediately after every IFRIC meeting by the International Accounting Standards Board, 30 Cannon Street, London EC4M 6XH, United Kingdom.

Tel: +44 (0)20 7246 6410
Fax: +44 (0)20 7246 6411

IASB Publications Department, 30 Cannon Street, London EC4M 6XH, United Kingdom.

Tel: +44 (0)20 7246 6410
Fax: +44 (0)20 7332 2749
Email: publications@iasb.org
Web: www.iasb.org

ISSN 1477-206X

amendment to the Standard itself, which would need direct action by the IASB.

IFRIC members discussed how the IFRIC might proceed with the Interpretation in the light of the concerns of respondents. In view of the comments received, there was support for asking the IASB whether it would be prepared to consider a limited amendment of IAS 29. A possible approach would be to require an entity in a hyperinflationary economy to restate its financial statements by the change in a general price index from the beginning of the year the entity identifies the existence of hyperinflation. It was also noted that more fundamental amendments to IAS 29 suggested by some respondents should be made as part of an IASB project, rather than considered by the IFRIC.

In relation to the proposed measurement of opening deferred tax items in an entity's restated financial statements, the majority of respondents agreed with the proposed approach. It was noted, though, that some respondents disagreed with the view expressed in the Basis for Conclusions that deferred tax items are neither monetary nor non-monetary in nature. Some respondents believed (consistently with some IFRIC members' view) that IAS 21 *The Effects of Changes in Foreign Exchange Rates* would treat such items are monetary. IFRIC members present confirmed the proposed treatment of opening deferred tax items but agreed in principle to modify its reasoning in the Basis for Conclusions.

Some respondents also noted that D5 proposed that an adjustment of deferred tax items should be recognised as a single (tax) line item in the income statement, although part of such an adjustment refers to a monetary loss on the entity's tax bases. They believed that a portion of adjustments related to deferred tax items should be reflected as part of the net monetary gain or loss. IFRIC members present supported that view.

Respondents' views on the Illustrative Example were divided. Though several found the example useful, others found it either too simplified (does not address the more difficult issues arising when an entity restates its financial statements) or too complicated (further explanation needed). Others expressed the view that it should be limited to illustrate the restatement of deferred tax items only. IFRIC members present considered the different views and asked the staff to limit the example to the restatement of deferred tax items.

The IFRIC will continue it deliberations on D5 when the IASB has considered whether it would approve a limited amendment to IAS 29.

Service concession arrangements

IFRIC members discussed a set of preliminary draft Interpretations prepared by the staff:

- D10A *Service Concession Arrangements – Determining the Accounting Model*
- D10B *Service Concession Arrangements – The Receivable Model*
- D10C *Service Concession Arrangements – The Intangible Asset Model*

The discussion focused mainly on the first of the draft Interpretations, but also discussed briefly the issue of revenue recognition under the intangible asset model. It is intended that further discussion of the draft Interpretations will take place at the IFRIC's September 2004 meeting.

The flow chart (Figure 1) sets out the framework proposed in the first of these draft Interpretations, as amended to reflect recommendations made at the meeting. As can be seen from the flow chart, a new terminology has been adopted. The party that grants the concession is called the grantor (formerly the concession provider, CP), and the party that operates the concession is called the operator (formerly the concession operator, CO).

The first part of the flow chart, down to and including the box "The infrastructure items are assets of the grantor", deals with the question of which party should recognise the infrastructure as its own. IFRIC members present agreed that this is the first question that must be answered before deciding on the accounting model, and broadly agreed with the approach set out in the flow chart, which is based on the following analysis:

- Previously existing infrastructure assets of either the operator or the grantor should continue to be recognised by that party unless derecognition is appropriate under IAS 16 *Property, Plant and Equipment*. In this regard, IAS 16 specifies that an entity applies the criteria in IAS 18 *Revenue*, and also that IAS 17 *Leases* applies to a sale and leaseback.
- However, in accounting for infrastructure constructed or acquired for the purpose of the concession, existing accounting standards contain little guidance on which party should first recognise the infrastructure as its own and thereafter consider whether the derecognition requirements have been met. IFRIC members agreed that this determination should be based on who controls the right to use the infrastructure, and that control may be separated from ownership.

Control

As regards control, IFRIC members supported further development of the draft Interpretations assuming that the grantor should be considered to control the property, even if the operator holds legal title, if the grantor both:

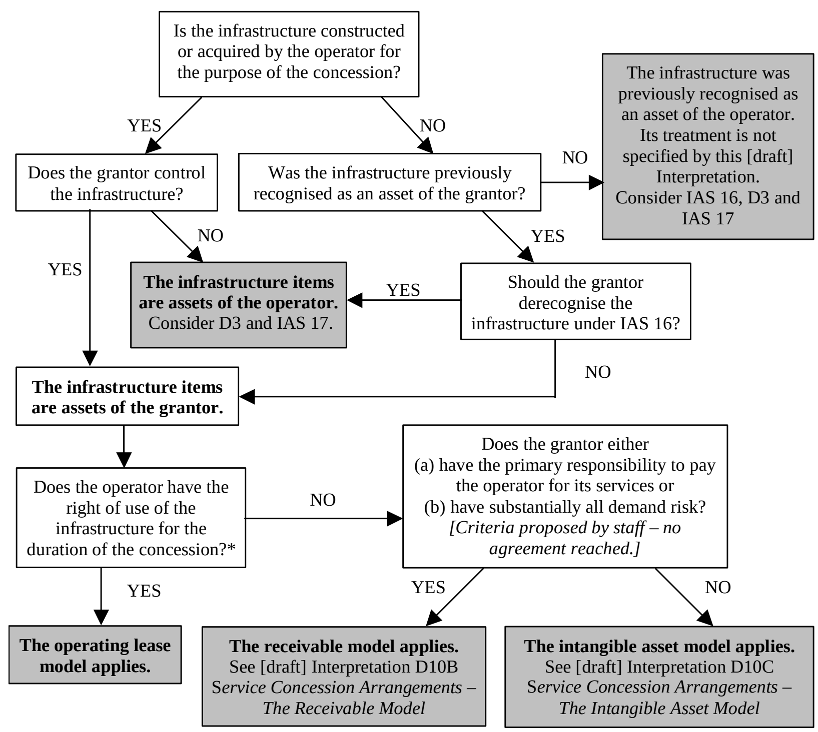
(a) controls or regulates what services the operator must provide using the property, to whom it must provide them, and at what price; and

(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.

IFRIC members noted that the reversionary feature described in condition (b) often is present in service concessions. The meeting discussed, but did not reach agreement on:

- whether condition (b) would be met if the operator must replace an infrastructure asset that is used up in the service concession, and the grantor has the residual interest in the replacement.
- to what extent the conditions should be applied in a holistic way, to the infrastructure as a whole, or separately to its components.

Figure 1 - Proposed accounting framework for service concession arrangements



* The operator will not have the right of use if the grantor controls or regulates what services the operator must provide using the property, to whom it must provide them,

Previously existing infrastructure assets

With respect to the derecognition of previously existing infrastructure assets of either the operator or the grantor, IFRIC members noted that existing IFRSs address derecognition and rights of use, therefore the IFRIC did not need to address this issue. IFRIC members also noted that in May 2004, the IFRIC had tentatively agreed to publish a draft Interpretation requiring that no sale should be recognised in a sale and leaseback containing a repurchase agreement (including an option), if the seller retains significant risks or rewards under the repurchase agreement, or any other linked transaction that has a similar effect, on the grounds that a sale containing such a repurchase agreement is not a sale under IAS 18.

Scope

IFRIC members present agreed in principle that the scope of the exposure drafts should be limited to public-to-private infrastructure service concessions, but that they should not prohibit a wider application. There should be a specific invitation to comment on whether the scope should be extended to cover other kinds of arrangement, including those wholly within the private sector. IFRIC members expressed a desire to consider whether application of the draft Interpretations under D10A, D10B and D10C to a private-to-private arrangement would result in any inconsistencies. During the exposure period, the IFRIC should consider further the implications of so doing.

The remainder of the flow chart is concerned with establishing which accounting model should apply when the infrastructure is recognised as an asset of the grantor – ie how the operator's asset resulting from the provision of initial construction or other services should be characterised.

Operating lease model

The operating lease model would apply if the operator has an operating lease of the infrastructure from the grantor. This requires the operator to have the right of use of the infrastructure. Under this model, the operator's asset would be an operating lease prepayment.

IFRIC members noted that if the grantor has the control described in condition (a) (ie it controls or regulates what services the operator must provide using the property, to whom it must provide them, and at what price), the operator does not have the right of use of the grantor's infrastructure but only the right of access to the infrastructure to provide the specified services on the specified terms. The operating lease model will not apply in such cases.

Receivable model *vs* intangible asset model

For most public-to-private infrastructure service concessions, it will be necessary to decide between the receivable model and the intangible asset model: is the operator's asset a receivable, or an intangible asset?

Staff proposed that the receivable model should apply whenever:

- the grantor has the primary responsibility to pay the operator for its services. This would apply even if payments by the grantor depended on usage, or
- although the operator is entitled to be paid by users, the effect of the contractual arrangements is that the grantor retains substantially all of the demand risk associated with the service concession.

IFRIC members did not discuss the second of these two cases, and reached no conclusion on the first. A wide range of views was expressed, and the staff was asked to do further research on the issues. One issue to be addressed is whether the applicability of the intangible model depended in part on whether the construction phase would be segmented from the operating phase under IASs 18 and 11 *Construction Contracts*.

Applying the intangible asset model

IFRIC members continued a consideration of an analysis of revenue and profit or loss recognition under the intangible asset model.

Under IAS 18, when goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction that generates revenue. The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred.

The staff argued that this requires revenue and profit or loss to be recognised on the exchange. Although some IFRIC members agreed, others disagreed with the recognition of construction revenue and profit, for various reasons.

The aspect of the issue discussed was whether or not the transaction involves an exchange. If there were no exchange, the intangible asset would be recognised at the cost of the services provided, and no revenue would be recognised. IFRIC members also noted that IAS 16 and IAS 38 *Intangible Assets* discuss exchange transactions that result in recognition of gain or loss but not revenue and questioned whether acquisition of an intangible asset (eg a licence) would fall into this category.

The staff proposed that there is an exchange of the construction services for the intangible asset, because the operator is building an asset for the grantor. The intangible asset is the consideration received in exchange for those services. There would only not be an exchange if the operator were building the asset for itself. Some IFRIC members are not convinced that this is so, and argue for various reasons that the cost of the construction services rendered should be accumulated as the cost of the intangible asset. No conclusion was reached.

Items not taken to the IFRIC agenda

IFRIC members reached a tentative decision that the following matters should not be added to its agenda. These decisions are expected to be ratified at the September 2004 meeting.

Estonian dividend tax

IFRIC members considered whether the tax on dividends under Estonian Income Tax Law should be recognised:

(a) in profit or loss, in accordance with paragraphs 52A and 52B of IAS 12 *Income Taxes*; or

(b) directly in equity, in accordance with paragraph 65A of IAS 12.

IFRIC members expressed concern about taking onto its agenda a request to interpret a specific tax system, particularly as the features of the Estonian tax system are not widespread or pervasive throughout the world. IFRIC members also noted that the Board of the IASC discussed the Estonian tax system during deliberations of amendments to IAS 12 in 2000.

Extended payment terms

IFRIC members considered the accounting for extended payment terms, such as six-month's interest-free credit. IFRIC members were of the opinion that the accounting treatment was clear. IFRIC members agreed that IAS 39 *Financial Instruments: Recognition and Measurement* applies to the receivable in such circumstances, and that the effect of the time value of money should be reflected when this is material (IAS 39 paragraphs AG69-AG82). IFRIC members noted that the wording of IAS 18 *Revenue* paragraph 11 lacked clarity and needed to be improved.

Prompt settlement discounts

IFRIC members agreed that prompt settlement discounts should be estimated at the time of sale, and presented as a reduction of revenues. IFRIC members agreed that it should not provide guidance on making such estimates.

Future meetings and requests for Interpretations

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

2 and 3 September 2004
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 before the meeting. Interested parties may also submit requests for Interpretations through the IASB Website.