NEWSLETTER OF THE INTERNATIONAL FINANCIAL REPORTING INTERPRETATIONS COMMITTEE

IASB IFRIC UPDATE

December 2005

The International Financial Reporting Interpretations Committee met in London on 1 December 2005, when it discussed:

- D16 *Scope of IFRS 2* – Proposal for a final Interpretation
- Interim Financial Reporting and Impairment of Goodwill and of Investments in Equity Instruments – Proposal for a draft Interpretation
- Tentative agenda decisions

D16 - *Scope of IFRS 2*

The IFRIC continued its discussion, begun at the November meeting, on finalising an Interpretation following review of comments on D16.

Scope of Interpretation

At the November meeting the IFRIC had decided that the scope of the Interpretation should be aligned more closely with that of IFRS 2. The scope of the Interpretation was therefore extended to include transactions in which equity instruments are granted by a shareholder rather than by the entity itself and transactions in which equity instruments of the entity's parent or another group entity are granted or liabilities are incurred based on these equity instruments.

At this meeting the IFRIC discussed how to ensure that the enlarged scope of the Interpretation would not be read as requiring an assessment of all transactions by shareholders. The IFRIC noted that the scope of the Interpretation does not include transactions with shareholders in their capacity as shareholders, which IFRS 2 itself excludes. The IFRIC also decided to clarify by way of an Illustrative Example that the Interpretation did not apply to transfers of equity instruments by a shareholder for nil consideration when there was no evidence to suggest that the entity either then or in the future would receive any benefit from the arrangement. Some respondents to the draft Interpretation asked whether D16 covers 'non-reciprocal' arrangements, such as charitable contributions. The IFRIC confirmed that it did.

Status of Interpretation

The IFRIC had considered at the November meeting whether the Interpretation represents an extension of the scope of IFRS 2 or whether it is a clarification of the Standard. At this meeting the IFRIC noted that when the Board developed IFRS 2, it concluded that the directors of an entity would expect to receive some goods or services in return for share-based payments (IFRS 2, Basis for Conclusions, paragraph BC37). Therefore, it is not necessary to identify specifically the goods or services received in return for the share-based payments in order to conclude that goods or services have been (or will be) received. Accordingly, the IFRIC confirmed that the Interpretation was a clarification of IFRS 2 and did not require an amendment to the Standard.

Measurement and Recognition

The IFRIC confirmed its decision at the November meeting that the Interpretation should require the entity to measure the unidentifiable goods or services received as the difference between the fair value of the share-based payment and the fair value of the identifiable goods or services received or receivable as measured at the grant date. For cash-settled transactions, the liability should be re-measured at each reporting date until it is settled. Recognition questions, on the other hand, should be determined by reference to the requirements of IFRS 2.

Next steps

The IFRIC asked the staff to amend the draft in the light of the discussion and to present it to the Board for approval to issue.

Interim Financial Reporting and Impairment of Goodwill and of Investments in Equity Instruments

At the November meeting, the IFRIC had decided that IAS 34 *Interim Financial Reporting* contains support for both a discrete period approach and an integral period approach with regard to the reversal of previously recognised impairment losses for goodwill and investments in equity instruments.

The IFRIC had decided that the specific guidance with regard to reversals of previously recognised impairment losses of goodwill in IAS 36 *Impairment of Assets* and investments in equity instruments in IAS 39 *Financial Instruments: Recognition and Measurement* should take precedence over the more general guidance in IAS 34.

At this meeting, the IFRIC discussed a draft Interpretation that had been prepared by the staff. The IFRIC decided to proceed with publication after making a number of drafting changes, including clarification of the scope of the draft Interpretation.

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Puts held by Minority Shareholders

The IFRIC deferred to a subsequent meeting discussion of a staff paper on the classification of puts held by minority shareholders, in order to allow the Agenda Committee an opportunity to formulate a recommendation on whether the subject should be taken onto the agenda.

Tentative agenda decisions

The IFRIC reviewed the following matters, which the Agenda Committee had recommended should not be placed on the IFRIC agenda. These tentative decisions, including where appropriate suggested reasons for not adding them to the IFRIC agenda, will be re-discussed at the March 2006 IFRIC meeting. Constituents who disagree with the proposed reasons, or believe that the explanations may contribute to divergent practices, are welcome to communicate those concerns by 20th January 2006, preferably by email to:

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or by post to:

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Communications will be placed on the public record unless confidentiality is requested by the writer.

Whether a New Entity that pays Cash can be identified as the Acquirer

The IFRIC considered an issue regarding whether a new entity formed to effect a business combination in which it pays cash as consideration for the business acquired could be identified as the acquirer.

IFRS 3.22 states that when a new entity is formed to issue equity instruments to effect a business combination, one of the combining entities that existed before the combination shall be identified as the acquirer on the basis of the evidence available.

[The IFRIC declined] to add this topic to the agenda on the basis that it is clear that IFRS 3.22 does not prohibit a newly formed entity that pays cash to effect a business combination from being identified as the acquirer.

'Transitory' common control

The IFRIC considered an issue regarding whether a reorganisation involving the formation of a new entity to facilitate the sale of part of an organisation is a business combination within the scope of IFRS 3.

IFRS 3 does not apply to business combinations in which all the combining entities or businesses are under common control both before and after the combination, unless that control is transitory. It was suggested to the IFRIC that, because control of the new entity is transitory, a combination involving that newly formed entity would be within the scope of IFRS 3.

IFRS 3.22 states that when an entity is formed to issue equity instruments to effect a business combination, one of the combining entities that existed before the combination must be identified as the acquirer on the basis of the evidence available. The IFRIC noted that, to be consistent, the question of whether the entities or businesses are under common control applies to the combining entities that existed before the combination, excluding the newly formed entity. Accordingly, [the IFRIC decided] not to add this topic to its agenda.

The IFRIC also considered a request for guidance on how to apply IFRS 3 to reorganisations in which control remains within the original group. [The IFRIC declined] to add this topic to the agenda, on the basis that it is unlikely that the IFRIC would reach agreement in a reasonable period, in the light of existing diversity in practice and the explicit exclusion of common control transactions from the scope of IFRS 3.

Leases of Land that do not transfer Title to the Lessee

The IFRIC was asked whether long leases of land would represent a situation when a lease of land would not *normally* be classified as an operating lease even though title does not transfer to the lessee. IAS 17 states at paragraph 14 that a characteristic of land is that it normally has an indefinite economic life. If title is not expected to pass to the lessee by the end of the lease term, then the lessee *normally* does not receive substantially all of the risks and rewards incidental to ownership, in which case the lease will be an operating lease. Even when the land has an indefinite economic life, paragraph 15 states that 'the land element is *normally* classified as an operating lease unless title is expected to pass to the lessee by the end of the lease term……' [emphasis added].

The IFRIC noted that leases of land with an indefinite economic life, under which title is not expected to pass to the lessee by the end of the lease term, were classified as operating leases before an amendment to IAS 17 was made in respect of IAS 40 *Investment Properties*. Specifically, IAS 17 was amended to state that in leases of land that do not transfer title, lessees *normally* do not receive substantially all the risks and rewards incidental to ownership.

Some have understood the introduction of the word 'normally' as implying that a long lease of land in which title would not transfer to the lessee would henceforth be treated as a finance lease, since the time value of money would reduce the residual value to a negligible amount. The IFRIC noted that, as summarised in paragraph BC 8, the Board considered but rejected that approach in relation to the classification of leases of land and buildings, because 'it would conflict with the criteria for lease classification in the Standard, which are based on the extent to which the risks and rewards incidental to ownership of a leased asset lie with the lessor or the lessee'. The Board also made clear that it had not made any fundamental changes to the Standard.

The IFRIC noted that one example of a lease classification affected by the introduction of the word 'normally' was a lease of land in which the lessor had agreed to pay the lessee the fair value of the property at the end of the lease period. In such circumstances, significant risks and rewards associated with the land at the end of the lease term would have been transferred to the lessee despite there being no transfer of title. Consequently a lease of land, irrespective of the lease term, is classified as an operating lease unless title is expected to pass to the lessee or significant risks and rewards associated with the land at the end of the lease term pass to the lessee.

[The IFRIC decided] not to add this item to its agenda as, although leases of land that do not transfer title are widespread, the IFRIC has not observed, and does not expect, significant diversity in practice to arise.

IAS 12 *Income Taxes* - Scope

The IFRIC has considered a request to give guidance on which taxes are within the scope of IAS 12. The IFRIC noted that IAS 12 applies to income taxes, which are defined as taxes that are based on *taxable profit*. That implies that (i) not all taxes are within the scope of IAS 12 but (ii) because taxable profit is not the same as accounting profit, taxes do not need to be based on a figure that is exactly accounting profit to be within the scope. The latter point is also implied by the requirement in IAS 12 to disclose an explanation of the relationship between tax expense and accounting profit. The IFRIC further noted that the term 'taxable profit' implies a notion of a net rather than gross amount. Finally, the IFRIC observed that any taxes that are not in the scope of IAS 12 are in the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

However, the IFRIC also noted the variety of taxes that exist world-wide and the need for judgement in determining whether some taxes are income taxes. The IFRIC therefore believed that guidance beyond the observations noted above could not be developed in a reasonable period of time and [decided] not to take a project on this issue onto its agenda.

Subscriber Acquisition Costs in the Telecommunications Industry

The IFRIC was asked how a provider of telecommunications services should account for telephone handsets it provides free of charge or at a reduced price to customers who subscribe to service contracts. The question was whether:

a. the contracts should be treated as comprising two separately identifiable components, ie the sale of a telephone and the rendering of telecommunication services, as discussed in paragraph 13 of IAS 18 *Revenue*. Revenue would be attributed to each component; or

b. the telephones should be treated as a cost of acquiring the new customer, with no revenue being attributed to them.

The IFRIC acknowledged that the question is of widespread relevance, both across the telecommunications industry and, more generally, in other sectors. IAS 18 does not give guidance on what it means by 'separately identifiable components' and practices diverge.

However, the IFRIC noted that the terms of subscriber contracts vary widely. Any guidance on accounting for discounted handsets would need to be principles-based to accommodate the diverse range of contract terms that arise in practice. The IASB is at present developing principles for identifying separable components within revenue contracts. In these circumstances, the IFRIC does not believe it could reach a consensus view on a timely basis. [The IFRIC therefore decided] not to take the topic onto its agenda.

Correction: Page 2

This version of IFRIC Update incorporates the correction made 16 December 2005, to the final sentence of the first paragraph of the item **Leases of Land that do not transfer Title to the Lessee**.

Future IFRIC meetings

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

2006

- 12 and 13 January
- 2 and 3 March
- 11 and 12 May
- 6 and 7 July
- 7 and 8 September
- 2 and 3 November

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. Instructions for submitting requests for Interpretations are given on the IASB Website at www.iasb.org/about/ifric.asp

