



The International Financial Reporting Interpretations Committee met in London on 1 and 2 September 2005, when it discussed:

- Service concession arrangements
- Employee Benefits – Minimum funding requirements and the asset ceiling
- Tentative agenda decisions

Opening remarks

The Chairman announced the publication of IFRIC 6 *Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment* and commented that the Interpretation addressed only historical waste from private households. If evidence emerged that the Interpretation was not being correctly applied, the IFRIC might have to take further action.

Service concession arrangements

IFRIC members considered a staff analysis of comments received on the three draft Interpretations:

- D12 *Service Concession Arrangements – Determining the Accounting Model*
- D13 *Service Concession Arrangements – The Financial Asset Model*
- D14 *Service Concession Arrangements – The Intangible Asset Model*

The draft Interpretations and comment letters are available at www.iasb.org.

The discussion focused on the scope of the draft Interpretations. Revenue recognition under the intangible asset model also was discussed briefly. The IFRIC intends to discuss at future meetings the remaining points raised by respondents.

Scope

D12 stated that the draft Interpretations applied to service concession

arrangements if (in summary):

- the grantor controlled the services that the operator must provide with the infrastructure;
- the grantor controlled the residual interest in the infrastructure at the end of the concession, and the residual interest would be significant; and
- the infrastructure was either (a) constructed or acquired for the purpose of the concession, or (b) existing infrastructure of the grantor, made available to the operator for the duration of the concession.

Several commentators criticised the proposals for their narrow scope and for not specifying the accounting treatment required when the above criteria were not met. In their view the scope exclusions limited the usefulness of the guidance. In addition, many expressed confusion over certain aspects of the proposals.

The IFRIC considered each of the main categories of concern raised by commentators.

(i) *Scope exclusion - grantor accounting*

Paragraph 7 of D12 states that the draft Interpretation does not specify the accounting by grantors. The IFRIC noted that several respondents had requested that the Interpretations specify the accounting by grantors. One of the reasons for the request to broaden the scope was that, while D12 purports not to deal with the accounting by grantors, it does consider a grantor's involvement in the service concession arrangement.

The IFRIC noted that in many cases the grantor is a government body, and providing accounting interpretations for government bodies is not the primary focus of the IFRIC. For that reason, D12 dealt only with the operator's accounting. In the light of the comments, the IFRIC agreed that the Interpretation should explain better the reasons for the scope restriction. The Basis for Conclusions should be strengthened to clarify that the Interpretations do not provide guidance on how any other party might account for the infrastructure,

noting that in many cases the government will control the physical asset, but that the resulting accounting had not been considered explicitly by the IFRIC.

(ii) *Scope exclusion - existing assets of the operator*

Paragraph 6 of D12 states that the draft Interpretation does not specify the accounting for the infrastructure that the operator held and recognised as its property, plant and equipment before entering into the concession arrangement.

The IFRIC noted that many respondents had challenged the reason noted in the Basis for Conclusions, ie that it would be unusual for such assets to be significant to the arrangement as a whole. The IFRIC acknowledged that the current wording in the Basis for Conclusions was unclear and clarification was required. The IFRIC decided that it should explain better the reasons for the scope restriction - the draft Interpretations had concentrated on situations for which existing accounting standards did not give a clear answer. The service concession arrangement may convey a right of use of existing assets of the operator to the grantor, in which case the operator would apply the derecognition requirements of IFRSs (eg IAS 16, IAS 17 and IFRIC 4) to determine whether it should derecognise its existing assets. The IFRIC decided to

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Service concession arrangements

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include in the final Interpretations signposts to the standards that the IFRIC expected would apply most often.

(iii) Scope exclusion – private-to-private service concession arrangements

Some respondents suggested the scope should be extended to include private-to-private service concession arrangements. The IFRIC noted that addressing the accounting for such arrangements was not the purpose of the project, and that to add this to the scope would require consideration of a wide range of fact patterns the IFRIC had not considered previously. The IFRIC decided that the scope should not be extended to require application of the Interpretation to private-to-private arrangements. However, IFRIC would not preclude application of the Interpretation by analogy to a private-to-private arrangement. The IFRIC noted that application by analogy could be appropriate under the hierarchy in IAS 8 when no standards applied directly. Some members asked for clarification on how the principles of D12 might be applied by analogy to private-to-private arrangements. Staff was directed to develop examples to test the scope proposals in D12 on this point.

(iv) Amend the significant residual interest criterion

The IFRIC noted that many commentators did not understand why the IFRIC excluded from the scope service concession arrangements for which no significant residual interest exists (“Whole-of-life” arrangements). They considered a return of the significant residual interest to the grantor useful as an indicator of control of the infrastructure, but inappropriate as a determining factor. Many questioned the validity of the assumption that infrastructure without a significant residual interest would preclude control by the grantor.

The IFRIC considered these comments and noted that one reason for including this requirement was to differentiate between regulated industries and service concession arrangements. The IFRIC believed that some criterion relating to the residual interest was required, because the concept of a public service obligation was not in itself robust enough to form the basis for the scope. However, the IFRIC noted that the treatment of arrangements in which the infrastructure will be subject to the service concession arrangement for the whole of its expected life was unclear, as was the treatment of infrastructure subject to renewal options. The IFRIC also decided that the meaning of the term ‘infrastructure’ should be clarified.

Staff was directed to prepare an analysis of the residual interest criterion for consideration at the next meeting. That analysis should include consideration of the nature of the asset that exists at the end of the arrangement.

(v) Clarify the requirements for control of usage

The IFRIC considered whether the ‘control’ requirement in paragraph 5(b) of D12 should be amended. Many commentators had expressed confusion over the extent of regulation that would be needed for an arrangement to be within the scope of the draft Interpretations: in particular in relation to the regulation of the price, whether price regulation at a detailed level was required or price caps were sufficient evidence of control. For example, a grantor could

set a fixed price that the operator must charge, or it could set a maximum price.

The IFRIC commented that the extent of control over pricing and usage may vary, and that the Interpretation’s scope should extend beyond contracts for which the grantor controls almost every aspect. The IFRIC decided that the requirements should be clarified.

Staff was directed to consider this matter as part of the analysis for consideration at the next meeting.

(vi) Reconcile the scope of D12 to IFRIC 4 and SIC 29

The IFRIC considered whether the ‘control’ requirement articulated in paragraph 5(b) of D12 should be reconciled to the definition of ‘control of use’ in IFRIC 4, as many commentators believed that the two documents were inconsistent with one another. The IFRIC decided that the Basis for Conclusions should explain that in developing the requirements the IFRIC considered the requirements of IFRIC 4 and believed that, in service concession arrangements within the scope of the draft Interpretations, a right of use was not conveyed to the operator.

The IFRIC considered another proposal that the scope of SIC-29 should be amended so that it was the same as the draft Interpretations. The IFRIC decided that this was inappropriate. SIC-29 contained disclosure requirements for entities entering into a wide range of service concession arrangements. There was no reason why those disclosure requirements should be restricted to the narrower range of arrangements covered by the recognition and measurement requirements of D12-D14.

(vii) Clarify the application of the requirements to partly regulated assets

The IFRIC considered a concern that the draft Interpretations did not specify the accounting when a piece of infrastructure is used partly for regulated purposes and partly for non-regulated purposes and the non-regulated use is not physically separable and capable of being operated independently. This might arise if, for example, non-regulated use is permitted for a specified portion of capacity. The IFRIC considered the guidance that had been proposed at the December 2004 meeting (that such a piece of infrastructure might be a jointly-controlled asset) and determined that a more detailed analysis was required. Staff was directed to prepare the analysis, which should include consideration of whether a single contract would be required to be accounted for partly under one model and partly under another.

(viii) Clarify the meaning of ‘public service obligation’

The IFRIC considered the need to improve the language of paragraph 2 of D12 to clarify when a public service obligation arises. IFRIC decided that the draft Interpretation should be amended to clarify what is meant by ‘public service obligation.’ The requirement is that the infrastructure be available for public use. It is irrelevant whether the public chooses to use the infrastructure or is required to do so. When the infrastructure is not available for the public to use (for example, an information technology outsourcing arrangement for a government department), a public service obligation does not exist and the arrangement is not within

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Service concession arrangements

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the scope of the Interpretations. It was acknowledged that public service obligations may vary from country to country.

Recognition of revenue and profit or loss under the intangible asset model

The IFRIC briefly considered respondents' comments on the proposed requirements relating to recognition of construction revenue under the intangible asset model (D14).

Paragraphs 7-8 of the draft Interpretation D14 proposed that revenue should be recognised in respect of the construction services provided by the operator and that the revenue be measured in accordance with paragraph 12 of IAS 18. The effect was that under the intangible asset model the construction was viewed as a barter transaction giving rise to revenue. Revenue was also recognised on the subsequent use of the infrastructure. BC12 of D14 sets out a detailed example demonstrating the consequences of these requirements, noting in particular that total revenue exceeds total cash inflows by the amount of the barter revenue.

The IFRIC noted that respondents' views differed on the proposal to recognise revenue on the exchange of the infrastructure. Some, including nearly all operator respondents, supported the proposal that the exchange was a barter transaction. Several of these commented that the proposal to recognise construction revenue on the exchange of the infrastructure reflects the economic reality of service concessions arrangements. A majority of respondents did not support the proposal; many of these criticised the double recognition of revenue and believed that the result had a negative impact on the usefulness of financial statements. They argued that the exchange transaction has no commercial substance as required under paragraphs 45-47 of IAS 38 and paragraphs 24-25 of IAS 16. Some respondents suggested that the 'acquired intangible asset' alternative dismissed in D14 better reflected the substance of the exchange of construction services for a licence in a service concession arrangement; in their view, the construction costs represented payments to acquire an intangible asset rather than costs incurred in respect of revenue-generating construction services.

In the light of these comments the IFRIC considered a staff analysis of revenue recognition under the intangible asset model. The staff proposed that the IFRIC should revise the intangible asset model to require that no revenue be recognised on the exchange of constructed infrastructure for an intangible asset giving the right to operate that same infrastructure to generate future cash flows. The proposal was based on IAS 18.12's prohibition on recognition of revenue on an exchange of similar assets and IAS 16.25's prohibition on recognising a gain on an exchange without commercial substance.

IFRIC members raised a number of queries on the staff proposal. One member expressed concern about the implications of the proposal for the financial asset model, under which construction revenue is recognised in accordance with IAS 11, as the two models would then have even more divergent accounting for the construction phase. Some members noted the practical difficulties of applying

the staff proposal to arrangements that had elements of both the financial and the intangible asset models. Another member questioned whether non-recognition of construction revenue under the intangible asset model must mean non-recognition of profit or loss on construction. One member noted that the staff's proposal that under the intangible asset model the exchange between grantor and operator lacked commercial substance appeared inconsistent with the fundamental approach underpinning the draft Interpretations ie, that the grantor controls the infrastructure and the operator has right of access only. Some members argued that the risk and timing of cash flows between the construction and the operation phases were very different. In support of the staff proposal one member stated that, the arrangement should be considered as a single investment project; the right to operate could not be divorced from construction of the infrastructure.

Staff was directed to establish the broader implications that its proposal not to recognise construction revenue under the intangible asset model would have on the financial asset model and the proposal in D12 that the operator has right of access only. That analysis should also consider the recognition of revenue and profit or loss separately.

IAS 19 Employee benefits – Minimum Funding Requirements and the asset ceiling

The IFRIC continued from the June meeting its discussion of the extent to which a minimum funding requirement (MFR) imposed by government or a regulatory body might restrict recognition of a net asset that otherwise would be recognised under IAS 19 in respect of the surplus in a plan. An ancillary question considered at the meeting was whether the existence of an MFR could transform an IAS 19 surplus into a liability or increase an IAS 19 liability in respect of a deficit in the plan.

The IFRIC noted that an MFR affected cash flows between an entity and its benefit plan rather than directly reducing an asset or creating a liability. However, legislation in a given jurisdiction or the terms of the plan might constrain the ability of the entity to benefit from funds that it had transferred into plan assets, even if those funds exceeded the amount required to settle the liabilities of the plan as computed under IAS 19. In those circumstances, any excess of the net plan asset computed under IAS 19 over the level of surplus required under the MFR might not be available to the entity.

If the effect of an MFR is to require an additional liability to be recognised, rather than to restrict the recognition of a net plan asset, the question arises whether the liability should be recognised under IAS 19 or IAS 37. Some would claim that IAS 37 is the more relevant Standard because the liability results from the effects of a statutory requirement rather than the plan rules. Against this, the IFRIC noted that, although the additional liability is caused by a statutory requirement, it is the interaction of that requirement with the legislation or rules governing the plan that creates the liability. Accordingly, IAS 19 appears to be the relevant Standard.

The IFRIC did not discuss in detail the recognition and measurement of an additional liability but assumed for the purposes of this meeting that these would be similar to the procedures applied in determining whether recognition of a plan asset should be restricted.

IAS 19 specifies two ways in which future economic benefits may be available to an entity from a net asset recognised for the plan: a refund or a reduction in future contributions. The questions therefore are:

- when are refunds and reductions in contributions 'available'; and
- how does a statutory minimum funding requirement affect their availability?

Availability of refunds and contribution reductions

The IFRIC agreed that a refund of plan assets or a reduction in future contributions may be considered available even if it cannot be obtained (realised) at the balance sheet date.

Impact of the MFR on the availability of a refund

In determining the impact of the MFR on the recognition of a net plan asset under IAS 19.58, the IFRIC agreed that the

asset available as a refund should be recognised to the extent that:

- a. in the jurisdiction of the plan in question and under the terms of the plan, any surplus existing on the settlement of the entire plan (wind-up) will revert to the entity. The IFRIC believed that, to the extent that an asset is recognised on this assumption, that fact should be disclosed in the financial statements. The staff noted that if wind-up of a plan would require incurring costs that have not been recognised, then the net asset available on wind-up should be calculated net of such costs. Staff commented that costs associated with settlement may be so prohibitive that the entire surplus may be utilised in the process and therefore a plan with an apparent surplus may not be able to recover any of it on wind-up.
- b. in the jurisdiction of the plan in question and under the terms of the plan, in a gradual run-down of the plan (ie a gradual expiry of the plan liabilities as members leave the plan, to the point where there are no members in the plan), any surplus in the plan at the end of its life, if not before, will revert to the entity. The IFRIC believed that, to the extent that an asset is recognised on this assumption, that fact should be disclosed in the financial statements. The staff noted that this approach differs from the approach in (a) above in that additional costs that would be triggered only by a settlement are not precipitated. This approach is merely a way of demonstrating that current MFR restrictions do not prevent the IAS 19 surplus from being recoverable at the end of the life of the plan. In such circumstances the entire surplus at the balance sheet date would be available.

The IFRIC considered that future changes in the MFR should not be taken into account when determining the amount of an asset that might be available as a refund.

Impact of the MFR on reduction in future contributions

The IFRIC noted that an entity would have to consider whether a net plan asset could be realised through reductions in future contributions only if the net plan asset could not be realised through a refund upon wind-up or on a gradual run-down of a plan.

In respect of the availability of an asset as a reduction in future contributions, the IFRIC agreed that the recognition of the available asset should be limited to the present value, assuming a stable active plan membership, of :

- the gross service cost (ie the liability expected to arise from future service in each year by current and future plan members) less both
- the future employee contributions and
- the entity's contribution requirement under the MFR.

The IFRIC agreed that the future contribution requirements under the MFR should be based on the MFR requirements at the balance sheet date. The IFRIC noted that, in applying current MFR regulations, changes in future periods in the contributions required under those regulations should be reflected. For example, the MFR may set out possible or

scheduled changes in contribution levels that relate to the entity's current obligation.

The IFRIC noted that the projection of future service cost and MFR contribution requirements in this calculation is designed to establish the extent to which an existing net plan asset can be recognised currently, on the basis that it will be available to avoid the need for contributions that would otherwise be required in the future. Accordingly, while an excess in aggregate of future service cost over MFR contribution requirements validates recognition of an asset, a shortfall does not denote a present liability. Nevertheless, within the projection, a shortfall in one year is offset against an excess in another year, in order that the aggregate of all years will evidence the entity's ability to benefit from its existing net plan asset.

The IFRIC rejected the suggestion that the entity should make allowance for any unrecognised future changes in the size and demographics of the workforce consistent with the management's budgets/forecasts in determining the future contribution reduction available. The IFRIC concluded that actuarial assumptions, including demographic assumptions, used in computing the net plan asset available via reductions in future contributions should be consistent with the assumptions made to compute the benefit obligation at the balance sheet date.

Disclosure of cash flow effects

The IFRIC agreed that, if an MFR was expected to require cash outflows in excess of current service cost, entities should disclose the amounts and timing of such outflows.

Other Issues

A question was raised in respect of the definition of availability, in particular, whether the surplus in a closed plan of an entity could be used to offset the deficit in another plan of the entity. No consensus was reached on this point.

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 agenda decisions, including where appropriate suggested reasons for not adding them to the IFRIC agenda, will be discussed at the November IFRIC meeting. Care should be exercised in reading each of the suggested wordings, as they are no more than tentative until confirmed at the later meeting. References to the IFRIC deciding therefore are therefore placed in [square brackets], since it will be for the IFRIC to reject or accept that wording at its next meeting.

Constituents who disagree with the proposed reasons, or believe that the explanations may contribute to divergent practices, are welcome to relay these concerns by 19th October 2005, preferably by email to:

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First Floor, 30 Cannon Street, London
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email: ifric@iasb.org

IAS 17 Leases – time pattern of user's benefit from an operating lease

The IFRIC was asked to consider the income and expense recognition profile of an operating lease in which the annual payments rise by a fixed annual percentage over the life of the lease. The constituent asked whether it would be acceptable to recognise these increases in each accounting period when they are intended to compensate for expected annual inflation over the lease period. The constituent noted that IAS 17 requires contingent rentals to be recognised as they arise.

The IFRIC noted that the accounting under IAS 17 for operating leases does not incorporate adjustments to reflect the time value of money, for example by deferring a portion of a level payment to a later period. Rather, IAS 17 requires a straight-line pattern of recognition of income or expense from an operating lease unless another systematic basis is more representative of the time pattern of the user's benefit. The IFRIC noted that recognising income or expense from annual fixed inflators as they arise would not be consistent with the time pattern of the user's benefit. Accordingly, [the IFRIC decided] not to take this item onto its agenda as it did not expect significant diversity in practice to arise.

IAS 39 Financial Instruments: Recognition and Measurement – Retention of servicing rights

The IFRIC was asked to provide guidance on whether an arrangement under which an entity has transferred the contractual rights to receive the cash flows of a financial asset but continues to provide servicing on the transferred asset would fail the definition of a transfer of cash flows in terms of IAS 39 paragraph 18(a).

The IFRIC noted that paragraph 18(a) focuses on whether an entity transfers the contractual rights to receive the cash flows from a financial asset. The determination of whether the contractual rights to cash flows have been transferred is not affected by the transferor retaining the role of an agent to

administer collection and distribution of cash flows. Therefore, retention of servicing rights by the entity transferring the financial asset does not in itself cause the transfer to fail the requirements in paragraph 18 (a) of IAS 39. [The IFRIC decided] not to add the issue to its agenda as it did not expect significant diversity in practice to arise.

IAS 39 *Financial Instruments: Recognition and Measurement* – Revolving structures

The IFRIC discussed a request for guidance on whether ‘revolving’ structures would meet the pass-through requirements in paragraph 19(c) of IAS 39. In a revolving structure an entity collects cash flows on behalf of eventual recipients and uses the amounts collected to purchase new assets instead of remitting the cash to the eventual recipients. On maturity the principal amount is remitted to the eventual recipients from the cash flows arising from the reinvested assets.

The IFRIC noted that in order to meet the pass-through arrangement requirements in IAS 39 paragraph 19 (c) an entity is required to remit any cash flows it collects on behalf of eventual recipients without material delay. This paragraph also limits permissible reinvestments to items that qualify as cash or cash equivalents. Most revolving arrangements would involve a material delay before the original collection of cash is remitted. Furthermore, the nature of the new assets typically acquired means that most revolving arrangements involve reinvestment in assets that would not qualify as cash or cash equivalents. Therefore, it is clear that such structures would not meet the requirements in paragraph 19 (c) of IAS 39. Consequently, [the IFRIC decided] not to add the issue to its agenda as it did not expect significant diversity in practice to arise.

Future IFRIC meetings

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

2005

- 3 and 4 November
- 1 and 2 December

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. Interested parties may also submit requests for Interpretations through the IASB Website at www.iasb.org/about/ifric.asp