NEWSLETTER OF THE INTERNATIONAL FINANCIAL REPORTING INTERPRETATIONS COMMITTEE

IASB IFRIC UPDATE

November 2006

IFRIC Update *is published as a convenience to the IASB's constituents. All conclusions reported are tentative and may be changed or modified at future IFRIC meetings.*

Decisions become final only after the IFRIC has taken a formal vote on an Interpretation or Draft Interpretation, which is confirmed by the IASB.

The International Financial Reporting Interpretations Committee met in London on 1–3 November 2006, when it discussed:

- Comments received on the draft IFRIC Due Process Handbook
- IAS 18 *Revenue* – Real estate sales
- IAS 18 *Revenue* – Revenue recognition in respect of initial fees
- IAS 19 *Employee Benefits* – Update on employee benefit issues
- IAS 19 *Employee Benefits* – 'Special wages tax'
- IAS 21 *The Effects of Changes in Foreign Exchange Rates* – Hedging a net investment
- IAS 38 *Intangible Assets* – The treatment of catalogues and other advertising costs
- IAS 39 *Financial Instruments: Recognition and Measurement* – Indexation on own EBITDA or own revenue
- IAS 41 *Agriculture* – Recognition and measurement of biological assets and agricultural produce in accordance with IAS 41
- Demergers and other in specie distributions
- D9: *Employee Benefits with a Promised Return on Contributions or Notional Contributions*
- IFRIC agenda decisions
- Tentative agenda decisions

Introductory remarks

The Chairman welcomed new Board member, Mr Philippe Danjou, as an observer to the meeting, noting that he brought a regulator's experience from his immediately preceding post as Chief Accountant of the French Autorité des Marchés Financiers.

The Chairman announced that IFRIC 11 *IFRS 2—Group and Treasury Share Transactions* was issued on 2 November.

The Chairman reported on various IFRIC matters that had been discussed by the Board:

- Service Concessions: The Board was pleased with the IFRIC's work but, in view of the complexity of the project, also wanted to provide an opportunity for interested parties to express their views on the near-final draft at a public meeting. The meeting would be held in London on 13 November and it was hoped that the Board would then be in a position to approve the Interpretation at its November meeting. The effective date would be decided at that time.
- Contingent Rentals: The Board had discussed a proposed amendment to IAS 17 *Leases* to clarify that contingent rentals under an operating lease are to be recognised as they arise. The amendment would be made as part of the Annual Improvements process.
- Identification of portions in hedging instruments: The Board had discussed this issue, which originated in a request to the IFRIC to issue guidance on whether inflation could be designated as a portion of an interest-bearing asset or liability for the purposes of hedge accounting. It had asked for further research by the staff.
- Investment Property under Construction: The Board tentatively decided to amend IAS 40 *Investment Property* and IAS 16 *Property, Plant and Equipment* to include investment property under construction within the scope of IAS 40 instead of IAS 16. The amendment would be made as part of the Annual Improvements process.

Comments received on the draft IFRIC Due Process Handbook

The IFRIC considered an analysis of the forty-two comment letters received by the Trustees in response to their invitation for comments on the Draft IFRIC Due Process Handbook. (See the IASB Website under Current Projects/IFRIC Due Process.) Discussion focused on the process for accepting items onto the IFRIC agenda and the status and communication of agenda decisions.

The IFRIC agreed the need for a process to assist the staff in making recommendations to the IFRIC about which issues to add to its agenda. This might be undertaken by a working group of IFRIC members available from time to time, but does not require a formally constituted Agenda Committee. The process involves consideration of whether the issue raised is a substantive interpretative issue (as opposed to a request for application guidance), with a properly defined scope, and meets the tests for significance in the IFRIC agenda criteria. The working group would also be expected to provide relevant and practical input for the staff on current accounting practice. The staff would then recommend to the IFRIC whether to add an item to its agenda. The working group would have no fixed membership. It would comprise all members of the IFRIC participating in the meeting (in person or by telephone), subject to the number of IFRIC participants not exceeding eight (so as to be less than the IFRIC quorum of nine), together with Board, IOSCO and EC

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observers and the staff. The IFRIC suggested that increasing the size of the IFRIC to include more preparers might increase the possibility of at least some preparer members of the IFRIC being available to participate in each agenda working group meeting. The staff recommended that the meetings should be conducted in private in order to preserve a clear distinction between the role of the working group, to assist the staff in researching and presenting an issue for the IFRIC, and the role of the IFRIC as a decision taking body. IFRIC members asked that the Trustees should leave this matter to be determined by the IFRIC.

The IFRIC agreed that the transparency of the process could be improved. The IFRIC noted that since the Draft Due Process Handbook was published transparency had been improved by the provision of an oral report by the IFRIC Co-ordinator at each IFRIC meeting on the matters currently being considered by the Agenda Committee. The IFRIC suggested that in addition to that report, the IFRIC could publish on the IASB Website a list of the issues that the staff have under consideration for the IFRIC agenda but which have not yet been discussed by the full IFRIC.

The IFRIC acknowledged the comments of constituents about the status of agenda decisions. The IFRIC noted that the only documents that have ‘authoritative’ status are Standards and Interpretations approved by the Board. While agenda decisions do not have authoritative status, the IFRIC considers that agenda decisions should continue to provide more than a bald statement that the IFRIC was not adding an item to its agenda, because they help to inform constituents’ understanding of IFRSs.

The IFRIC considered a suggestion for a separate level of guidance between an Interpretation and an agenda decision, but decided that this was not necessary, as the guidance would not have authoritative status.

The IFRIC confirmed its earlier decision not to monitor national interpretations of IFRSs but expressed its desire to continue to work with national standard-setters and national interpretative groups.

The staff will be preparing revisions to the IFRIC Due Process Handbook for consideration and approval by the Trustees.

IAS 18 *Revenue* – Real estate sales

The IFRIC continued discussion of its project on recognising revenue from real estate sales. The project addresses situations in which an agreement for sale is reached before construction of the real estate is complete. At its September meeting the IFRIC had reached tentative conclusions about the applicable accounting standard (IAS 11 *Construction Contracts* or IAS 18 *Revenue*) and how IAS 18 should be applied to those contracts that were determined not to be ‘construction contracts’ within IAS 11.

At this meeting, it decided to proceed with a draft Interpretation that would interpret the definition of a construction contract in IAS 11 and supersede existing guidance on applying IAS 18 to real estate sales (Example 9 in the Appendix to IAS 18).

The IFRIC considered text for the draft Interpretation, focusing in particular on the circumstances in which a sale agreement would meet the definition of a construction contract and hence be within the scope of IAS 11. It considered a proposal to describe a construction contract as one that required the seller to provide construction services, and discussed whether those services should be described as being provided ‘to the buyer’s specifications’ or ‘in accordance with the buyer’s directions’. It considered suggestions that:

- construction contracts could additionally be described as contracts in which there is a continuous transfer of risks and rewards of ownership of the property in its current state and condition;
- one indicator that a contract is a construction contract is that the buyer has specified the original design, not just chosen from a range of designs or specifications offered by the seller. In such circumstances, the construction services are clearly being provided to the buyer’s specifications;
- a typical pre-completion agreement for the sale of a unit (eg apartment or retail unit) within a multiple-unit development is not a construction contract. However, there may be some circumstances in which an agreement for the sale of real estate after construction has commenced could include a construction contract—even though the original design was not specified by the buyer. An example might be a transaction in which an investor buys a whole development in its current partially completed state and engages the seller to provide construction services to complete the development. The draft Interpretation should either accommodate such transactions, or be restricted in scope—addressing only the initial sale of individual units within a development, rather than changes in ownership of the development as a whole.

The IFRIC directed the staff to analyse these suggestions further and draft text for discussion at a future meeting. It also asked the staff to consider whether any of the existing text constituted application guidance, which should appear in a separate section from the core consensus material.

The IFRIC noted that the matters that it had considered in its project did not include all of the matters that are at present addressed in Example 9 of the Appendix to IAS 18—the guidance developed so far would replace only the first paragraph of the Example. If the Interpretation were to supersede the whole of Example 9, the IFRIC would need to consider whether it should also bring forward or replace the second and third paragraphs of the Example. The IFRIC decided to return to this question at a later date, when other aspects of the draft Interpretation had been settled.

Finally, the IFRIC noted that, in view of the long-term nature of some real estate development projects, it should consider whether to propose specific transitional arrangements. It directed the staff to analyse the options for discussion at a future meeting.

IAS 18 *Revenue* – Revenue recognition in respect of initial fees

The IFRIC continued its deliberations on the recognition of revenue in respect of upfront fees. The IFRIC:

- agreed that revenue should be recognised only when a service of value to the customer is provided. In this connection, the IFRIC reaffirmed its decision that, in the absence of evidence that a service has been provided, upfront investment advice given by a fund manager does not represent a valuable service to a customer in situations in which the customer does not have to pay for that advice unless it is acted upon.
- reaffirmed its view that the credit which arises on the balance sheet as a result of the deferral of the recognition of revenue in respect of upfront fees represents amounts received from customers in advance of the provision of services and is not a liability in respect of the future cost of providing those services.
- agreed that the timing of the recognition of revenue should be based upon the entity's perspective of when services are provided, but that the allocation of revenue across multiple elements in a service contract should be based upon the fair value of the services provided to the customer rather than the cost of those services to the provider.
- noted that it would be appropriate to account on a portfolio basis.
- agreed that the draft Interpretation should apply to all arrangements in which an entity receives a non-refundable upfront fee in advance of providing an ongoing service.
- discussed transitional arrangements for the draft Interpretation and agreed that any Interpretation developed should require retrospective application.
- agreed that it should propose changes to examples 14(b)(iii) and 17 in the Appendix to IAS 18 to conform them with these conclusions.

The IFRIC also discussed the legal structure used by fund managers whereby the fund manager's sales division provides upfront services to an investor and the fund manager's investment division provides ongoing services to a fund. In this situation, the upfront and ongoing contracts have different counterparties. The IFRIC asked the staff to prepare a draft rationale explaining why these two agreements should be considered together for the recognition of revenue.

The IFRIC asked the staff to prepare a draft Interpretation reflecting its discussions to be presented to the IFRIC at its meeting in January 2007.

IAS 19 *Employee Benefits* – Update on employee benefit issues

The IFRIC reviewed a status report on the outstanding IAS 19 issues that had come before it or been raised with the IFRIC staff.

In the light of the IASB's decision to include in its Post-employment Benefits project the treatment of cash balance and similar plans and the distinction between defined benefit and defined contribution plans (see separate report in this issue), the IFRIC agreed to remove those two topics from its agenda.

The IFRIC agreed that a summary of the other outstanding issues (mainly items raised informally with the staff or identified by the staff when examining comment letters) should be considered by the IFRIC Agenda Committee in accordance with the IFRIC's normal agenda process. After consultation with the Agenda Committee, the staff will develop recommendations for the IFRIC on each of these items.

The issues are:

- issues related to the non-consolidation model and definition of plan assets
- pension promises based on performance hurdles
- changes to a plan caused by government
- treatment of employee contributions
- treatment of death-in-service and other risk benefits
- distinction between curtailments and negative past service costs.

IAS 19 *Employee Benefits* – 'Special wages tax'

The IFRIC considered the issue of how to account for taxes payable by an entity on contributions to a defined benefit plan or on the recognition of an expense for pension costs. The IFRIC asked the staff to develop a paper for the Agenda Committee on the nature of the taxes (whether they were income taxes or other taxes on the entity or taxes paid by the entity on behalf of employees) and whether the scope of IAS 19 was employee benefits or the cost of employee benefits.

IAS 21 *The Effects of Changes in Foreign Exchange Rates* – Hedging a net investment

The IFRIC discussed whether to undertake a project to develop guidance on the accounting for a hedge of a net investment in a foreign operation in group financial statements. The IFRIC considered:

- whether IAS 21 *The Effects of Changes in Foreign Exchange Rates* presumes certain mechanics of consolidation (ie either consolidation of each individual subsidiary directly to the ultimate parent or a step-by-step series of subconsolidations by immediate parent entities up to the final consolidation at the ultimate parent level) and the impact of this on the accounting for a hedge of a net investment;

- what the hedged risk is in a hedge of a net investment—the risk between the functional currency of the net investment and that of its (immediate, intermediate or ultimate) parent or the risk between the functional currency of the net investment and the presentation currency of the group;
- where the hedging instrument can be held within a group—whether it needs to be held by the (immediate, intermediate or ultimate) parent or whether it can be held by any entity within the group.

IFRIC members noted that IAS 21 did not presume any particular mechanics of consolidation and asked the staff to consider whether clarifying this point would resolve most of the diversity occurring in practice. Initial thoughts were that such clarification would not suffice to resolve the issues raised and further guidance would be needed.

The IFRIC decided to take the topic onto its agenda and asked the staff to analyse:

- the scope of the project;
- identification of a net investment and the hedgeable risk attaching to it;
- what instruments could be used for hedging a net investment and whether their location within the group was relevant;
- assessment of hedge effectiveness; and
- the implications of the project for convergence with US GAAP.

IAS 38 *Intangible Assets* – The treatment of catalogues and other advertising costs

At its September 2006 meeting, the IFRIC decided to add a project to its agenda addressing advertising and promotional expenditure. The project is to consider at what point an expense should be recognised in the situation where an entity undertakes activities to develop advertising or promotional material before the year-end but does not distribute the material to its customers until after the reporting date.

At this meeting, the IFRIC considered which IFRS should be applied to advertising and promotional expenditure. In some circumstances, entities routinely sell advertising and promotional materials, such as catalogues, to customers. In these limited situations, the IFRIC concluded that the advertising and promotional expenditure may be accounted for in accordance with IAS 2 *Inventories*. If this is the case, then the inventories should be carried at the lower of cost and net realisable value in accordance with IAS 2.

The IFRIC noted paragraph 5 of IAS 38, which states that IAS 38 'applies to, amongst other things, expenditure on advertising…', and agreed that advertising and promotional expenditure that did not meet the definition of inventory (because it was not routinely sold in the ordinary course of business) should be accounted for in accordance with that standard.

The IFRIC examined four different views as to the point at which advertising or promotional expenditure should be recognised as an expense under IAS 38:

- when the entity has an obligation to pay for the advertising or promotional activities;
- when the entity takes delivery of the advertising or promotional materials;
- when the entity delivers the advertising to its customers; or
- when the entity receives the benefit of its advertising by way of increased sales revenue.

The IFRIC considered paragraphs 68-70 of IAS 38, which discuss (amongst other things) the accounting for advertising and promotional activities. The IFRIC was unable to reach a consensus on which of the first three recognition points those paragraphs required. The IFRIC noted, however, that capitalising advertising and promotional costs and amortising them over the periods in which the entity expects to receive sales could not be supported under IAS 38.

The IFRIC agreed to recommend that the Board amend IAS 38 to clarify that advertising and promotional expenditure should be recognised as an expense when the advertising is conducted by the entity, ie distributed to its customers.

The IFRIC asked the staff to prepare a paper setting out the changes that need to be made to IAS 38 to clarify the treatment of advertising and promotional expenditure, together with the implications of making such changes.

IAS 39 *Financial Instruments: Recognition and Measurement* – Indexation on own EBITDA or own revenue

In July 2006, the IFRIC published a tentative agenda decision which explained why it had provisionally decided not to issue guidance on whether a contract that is indexed to an entity's own revenue or own earnings before interest, tax, depreciation and amortisation (EBITDA) is or contains a derivative.

Having reviewed the comment letters received in response to the tentative agenda decision, the IFRIC directed the staff to undertake further research on this issue before finalising its agenda item.

IAS 41 *Agriculture* – Recognition and measurement of biological assets and agricultural produce in accordance with IAS 41

Between September 2003 and May 2004 the IFRIC discussed two issues relating to the accounting for biological assets and agricultural produce in accordance with IAS 41.

The first issue related to how an entity should account for an obligation to replant a biological asset after harvest. The second related to how the exclusion from taking into account 'additional biological transformation' in paragraph 21 of IAS 41 should be interpreted.

As a result of those discussions, the IFRIC had agreed that:

- it would not address the question of how an obligation to replant a biological asset should be accounted for
- it would ask the Board to amend IAS 41 to remove the exclusion from taking into account 'additional biological transformation' and replace it with text stating that fair value should be measured with reference to an asset's 'highest and best use' in its 'most advantageous market'
- it would ask the Board to amend IAS 41 to include further guidance on how to measure fair value in the situation when no active market exists for an asset
- it would recommend to the Board that it amend IAS 41 to refer to 'costs of sale' rather than 'point-of-sale costs' to improve consistency with other standards.

At its November 2006 meeting, the IFRIC considered how best to proceed with this project.

The IFRIC confirmed that it would not seek to address the issue of how to account for an obligation to replant but instead directed the staff to ask the IAS 37 project team whether an example of an obligation to replant could be included within that standard. The IFRIC also agreed that the change of 'point-of-sale costs' to 'costs to sell' should be addressed by the Board's Annual Improvements project.

The IFRIC agreed that the exclusion from taking into account 'additional biological transformation' in paragraph 21 of IAS 41 gives rise to divergence, particularly where no active market (other than a scrap or pulp market) exists for immature biological assets. The IFRIC agreed that this divergence would not be wholly removed by removing the phrase 'additional biological transformation'. The IFRIC also agreed that it would be difficult to resolve the issue by interpretation if that wording remained in the standard. The IFRIC therefore asked the staff to develop a paper considering how best to resolve this divergence by issuing an Interpretation, amending IAS 41, or a combination of the two.

The IFRIC noted that the Board was currently undertaking a project to develop guidance on fair value measurement and therefore decided that it was not appropriate to recommend that the Board amend IAS 41 to include a further hierarchy on the measurement of fair value.

Demergers and other in specie distributions

The IFRIC received a request for guidance on the accounting for demergers and other in specie distributions in the financial statements of the entity making the distribution. The submission focused on situations in which an entity distributes its ownership interests in a subsidiary to its shareholders.

The IFRIC noted that IFRSs do not address the issue at present. The IFRIC acknowledged a need to address the issue because of the emergence of diversity in practice in respect of the basis on which in specie distributions should be recognised (ie at carrying amounts or at fair values).

The IFRIC noted that the accounting by an entity for the loss of control of its subsidiary as a result of a distribution to its shareholders of its shares in the subsidiary was being considered as part of the redeliberations on Business Combinations phase II. It was possible that in specie distributions generally would be considered in those redeliberations. The IFRIC agreed that it would like to undertake an interpretative project on in specie distributions. However, the IFRIC also agreed that a project could not be started until after the decisions in Business Combinations phase II on loss of control were finalised. The IFRIC will monitor the Board's deliberations and determine the scope of any such project, or whether a project is still required, once Business Combinations phase II has been completed.

Update on Agenda Committee business

The staff reported on issues with the Agenda Committee that had not yet reached the IFRIC agenda. Items that had been discussed at the November meeting were:

- IAS 17 *Leases*—Sale and leasebacks with repurchase agreements (this issue arose from the IFRIC's consideration of service concession arrangements)
- IAS 39 *Financial Instruments: Recognition and Measurement*—Interpretation of 'written option'
- IAS 39 *Financial Instruments: Recognition and Measurement*—Assessing hedge effectiveness of an interest rate swap in a cash flow hedge

In addition, an issue on IAS 16 *Property, Plant, and Equipment*—Sale of assets in a rental business had been discussed by the Agenda Committee in October but had not yet been presented to the IFRIC. Further research was currently being undertaken by the staff in this area and a paper is likely to be presented to the IFRIC at its meeting in January 2007.

The Chairman said that the IFRIC would shortly be given an opportunity to consider whether to leave certain of these issues to be dealt with by the Board or to work in parallel with a Board project.

D9 *Employee Benefits with a Promised Return on Contributions or Notional Contributions*

IFRIC Draft Interpretation D9 *Employee Benefits with a Promised Return on Contributions or Notional Contributions* was published in July 2004. It addressed how IAS 19 *Employee Benefits* should be applied to plans with a promised return on actual or notional contributions. Such plans may provide for a guarantee of a fixed return, a benefit that depends on future asset returns or a combination of both and are sometimes referred to as cash balance plans.

The draft Interpretation proposed that such plans should be classified as defined benefit arrangements and, further, for plans with a combination of a guaranteed fixed return and a benefit that depends on future asset returns, the amount of the liability should be determined by analysing the benefits into a fixed component and a variable component. A defined benefit liability would be recognised in respect of the fixed component and an additional liability would be recognised to the extent that the liability in respect of the variable component exceeds the defined benefit liability at the balance sheet date.

Most respondents to the draft Interpretation agreed that the types of plans addressed in D9 should be treated as defined benefit arrangements. However there was some disagreement in respect of the proposed methodology. A significant number of constituents believed that the issues would be more appropriately addressed as an amendment to IAS 19 rather than as an Interpretation.

The IASB added a project on post-employment benefits to its agenda in 2006. Phase I of the project includes the accounting for intermediate risk plans (including cash balance plans) and the definition of defined benefit and defined contribution plans. Phase I is expected to result in a standard within four years.

In the light of the IASB's decision, the IFRIC agreed at this meeting to remove the project from its agenda. The IFRIC noted that the work it had completed would inform the Board's consideration of its project.

One matter identified in D9 concerning allocation of the effects of salary increases will be brought in due course to the Agenda Committee for consideration as a separate issue.

IFRIC agenda decisions

The following explanations are published for information only and do not change existing IFRS requirements. IFRIC agenda decisions are not Interpretations. *Interpretations of the IFRIC are determined only after extensive deliberation and due process, including a formal vote. IFRIC Interpretations become final only when approved by nine of the fourteen members of the IASB.*

IAS 1 *Presentation of Financial Statements* – Whether the liability component of a convertible instrument should be classified as current or non-current

The IFRIC was asked to consider a situation in which an entity issued convertible financial instruments that, in accordance with IAS 32 *Financial Instruments: Presentation*, were accounted for as two elements—an equity component (ie the holders' rights to convert the instruments into a fixed number of equity instruments of the issuer any time before the maturity date) and a liability component (ie the entity's obligation to deliver cash to holders at the maturity date, which was more than one year after the balance sheet date). The issue was whether the liability component should be presented as current or non-current on the face of the issuer's balance sheet.

The IFRIC observed that both IAS 1 *Presentation of Financial Statements* and the *Framework for the Preparation and Presentation of Financial Statements* state that information about the liquidity and solvency of an entity is useful to users. The IFRIC also noted that the definitions of liquidity and solvency refer to the availability of cash to the entity. On that basis, the IFRIC believed that the liability component should be classified as non-current.

On the other hand, the IFRIC noted that paragraph 60(d) of IAS 1 states that a liability should be classified as current if the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the balance sheet date. According to paragraph 62 of the *Framework*, conversion of an obligation into equity is considered as the settlement of a liability. In addition, according to the definition of a financial liability set out in paragraph 16 of IAS 32, a financial liability may be settled through the delivery of a variable number of the issuer's own equity instruments. Settlement of a liability is not confined to delivery of cash or other assets.

The IFRIC believed that the above IFRS requirements appeared to be in conflict. In addition, the IFRIC observed that practice, in determining whether the liability component was classified as current or non-current, focused on when the issuer was obliged to deliver cash or other assets.

The IFRIC received a comment letter, supporting an alternative rationale for the non-current classification of the liability component of a compound financial instrument. IAS 32 requires the equity and liability components of a compound financial instrument to be accounted for separately. Because IAS 1 addresses the presentation of liabilities (not equity), the comment letter suggested that the equity component should be ignored in determining whether the liability component should be presented as current or non-current in accordance with IAS 1.

The IFRIC decided that both rationales should be drawn to the attention of the Board with a request for clarification. The IFRIC decided not to take the issue onto its own agenda.

IAS 11 *Construction Contracts* – Allocation of profit in a single contract

The IFRIC considered an issue identified in its deliberations of service concession arrangements, namely whether it is appropriate in a single contract to determine different profit margins for the different components of the contract.

Whilst IAS 11 *Construction Contracts* has specific criteria for contract segmentation, the guidance on segmenting in IAS 18 *Revenue* is expressed only at a general level. The IFRIC noted that in IAS 18:

- paragraph 4 states that services directly related to construction contracts are not dealt with in IAS 18 but are dealt with in IAS 11
- paragraph 13 states that in certain circumstances, it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction.

The IFRIC noted that, whilst IAS 18 paragraph 21 refers to IAS 11, it does so only for the percentage of completion method for recognition of revenue and the associated expenses and does not refer to the combining, segmenting and disclosure requirements of IAS 11.

The IFRIC noted that, as part of its project on D20 *Customer Loyalty Programmes*, it had deliberated whether, in a single contract within the scope of IAS 18, it is appropriate to determine different profit margins for the different components of the contract. In D20, the IFRIC tentatively concluded that the requirements of IAS 18 paragraph 13 to account for separately identifiable components of a contract would require segmentation of contracts that have separately identifiable components potentially with different profit margins. D20 also proposes guidance on how to allocate the total contract revenue to the different components.

The IFRIC noted that, for a single contract for construction and other services not directly related to construction activities, IAS 18 paragraphs 4 and 13 require the contract to be separated into two components, a construction component within the scope of IAS 11 and a service component within the scope of IAS 18, in order to reflect the substance of the transaction. The IFRIC noted that the segmenting criteria of IAS 11 apply only to the progressive recognition of margin relating to the construction component and that the requirements of paragraph 13 of IAS 18 apply to the service component. The consequence is that different profit margins might be recognised on the different components of such a single contract.

The IFRIC decided that, in view of the existing guidance in IAS 18 and IAS 11 and because these issues are expected to be addressed in an Interpretation following from D20, it would not take this item onto its agenda.

IAS 16 *Property, Plant and Equipment* – Revaluation of investment properties under construction

The IFRIC discussed whether to take on a project to consider whether the revaluation model in IAS 16 is available for investment property under construction.

The IFRIC noted that since IAS 40 was written, the use of fair values in accounting has become more widespread. At the same time, valuation techniques have become more robust. The IFRIC therefore considered that the requirement that investment property under construction be accounted for under IAS 16 might no longer be necessary, and agreed to ask the Board whether it would consider amending IAS 40 to state that investment property under construction should be accounted for under that standard.

As reported in the October 2006 IASB *Update*, the Board agreed that, as part of its Annual Improvements project, it would propose amending IAS 16 and IAS 40 to state that investment property under construction should be accounted for under IAS 40. Since the issue was being resolved by the Board, the IFRIC decided not to take the issue onto its agenda.

IAS 32 *Financial Instruments: Presentation* – Changes in the contractual terms of an existing equity instrument resulting in it being reclassified to financial liability

The IFRIC was asked to consider a situation in which an amendment to the contractual terms of an equity instrument resulted in the instrument being classified as a financial liability of the issuer. Two issues were discussed: (i) on what basis the financial liability should be measured at the date when the terms were changed and (ii) how any difference between the carrying amount of the previously recognised equity instrument and the amount of the financial liability recognised at the date when the terms were changed should be accounted for.

The IFRIC noted that at the time when the contractual terms were changed, a financial liability was initially recognised, and, furthermore, that a financial liability on initial recognition is measured at its fair value in accordance with paragraph 43 of IAS 39 *Financial Instruments: Recognition and Measurement*. The IFRIC observed that Example 3 of IFRIC 2 *Members' Shares in Co-operative Entities and Similar Instruments* deals with a similar situation. In that example, at the time when the financial liabilities are recognised, when the terms are changed, they are recognised at their fair value.

The IFRIC observed that the change in the terms of the instrument gave rise to derecognition of the original equity instrument. The IFRIC noted that paragraph 33 of IAS 32 *Financial Instruments: Presentation* states that no gain or loss shall be recognised in profit or loss on the purchase, sale, issue or cancellation of an entity's own equity instruments. The IFRIC, therefore, believed that, at the time when the terms were changed, the difference between the carrying amount of the equity instrument and the fair value of the newly recognised financial liability should be recognised in equity.

The IFRIC believed that the requirements of IFRS, taken as a whole, were sufficiently clear and that the issue was not expected to have widespread relevance in practice. The IFRIC, therefore, decided that the issue should not be taken onto the agenda.

IAS 32 *Financial Instruments: Presentation* – Classification of a financial instrument as liability or equity

At its meeting in March 2006, the IFRIC discussed a submission for a possible agenda item relating to the role of contractual obligations and economic compulsion in the classification of financial instruments. At that meeting and the following meeting in May, the IFRIC agreed not to take the item onto the agenda but did not agree on reasons to be given for that decision.

At the IFRIC meeting in July, the Chairman reported the Board's discussions on the issue at its meeting in June 2006.

As stated in the June 2006 IASB *Update*,

> The Board discussed whether so-called economic compulsion should affect the classification of a financial instrument (or a component of a financial instrument) under IAS 32 *Financial Instruments: Presentation*. This issue had previously been debated at the IFRIC meetings in March and May 2006.
>
> For a financial instrument (or a component of a financial instrument) to be classified as a financial liability under IAS 32, the issuer must have a contractual obligation either:
>
> - to deliver cash or another financial asset to the holder of the instrument, or
> - to exchange financial assets or financial liabilities with the holder under conditions that are potentially unfavourable to the issuer.
>
> (Different requirements apply to financial instruments that may or will be settled in the issuer's own equity instruments.) The Board confirmed that such a contractual obligation could be established explicitly or indirectly, but it must be established through the terms and conditions of the instrument. Thus, by itself, economic compulsion would not result in a financial instrument being classified as a liability under IAS 32.
>
> The Board also stressed that IAS 32 requires an assessment of the substance of the contractual arrangement. It does not, however, require or permit factors not within the contractual arrangement to be taken into consideration in classifying a financial instrument.

In view of the Board's discussion, the IFRIC believed that it could not achieve anything substantial by adding the issue onto the agenda. Instead, the IFRIC agreed to draw the Board's attention to comments raised by constituents and to ask the Board whether anything could be done to achieve even greater clarity on this point.

IAS 32 *Financial Instruments: Presentation* – Foreign currency instruments exchangeable into equity instruments of the parent entity of the issuer

At its meeting in April 2005, the IFRIC concluded that derivative contracts that may be settled by an entity by delivering a fixed number of its own equity instruments in exchange for a fixed amount of foreign currency are financial liabilities. At the same time, the IFRIC recommended that the issue should be referred to the Board. However, the Board, in September 2005, decided not to proceed with any amendments to IAS 32 *Financial Instruments: Presentation* in connection with convertible instruments issued by an entity in a currency other than the functional currency of the entity.

Subsequently, the IFRIC was asked to consider a question relating to the issue by a subsidiary of financial instruments that provide holders with the rights to exchange the financial instruments into a fixed number of equity instruments of the parent at a fixed amount of currency. Variants considered were that the amount of currency is fixed if it is denominated in (i) the functional currency of the issuer of the exchangeable financial instruments or (ii) the functional currency of the issuer of the equity instruments. The question was whether the conversion options embedded in the exchangeable financial instruments should be classified as equity in the consolidated financial statements of the parent in accordance with IAS 32 *Financial Instruments: Presentation*.

The IFRIC noted that a group does not have a functional currency. It therefore discussed whether it should add a project to its agenda to address which functional currency should be the reference point in determining whether or not the embedded conversion options are equity instruments.

The IFRIC believed that the question was sufficiently narrow that it is not expected to have widespread relevance in practice. The IFRIC, therefore, decided not to take the matter onto the agenda.

IAS 32 *Financial Instruments: Presentation* – Puts and forwards held by minority interests

The IFRIC considered a request for clarification of the accounting when a parent entity has entered into a forward to acquire the shares held by the [non-controlling] minority interest in a subsidiary or the holder of the [non-controlling] minority interest can put its shares to the parent entity.

Paragraph 23 of IAS 32 states that a parent must recognise a financial liability when it has an obligation to pay cash in the future to purchase the minority's shares, even if the payment of that cash is conditional on the option being exercised by the holder. After initial recognition any liability to which IFRS 3 is not being applied will be accounted for in accordance with IAS 39. The parent will reclassify the liability to equity if a put expires unexercised.

The IFRIC agreed that there is likely to be divergence in practice in how the related equity is classified. However, the IFRIC did not believe that it could reach a consensus on this matter on a timely basis. Accordingly, the IFRIC decided not to add this item to its agenda.

IAS 38 *Intangible Assets* – Classification and accounting for SIM cards

The IFRIC received a request for an Interpretation as to whether a mobile phone operator should account for a Subscriber Identity Module (or 'SIM card') as an intangible asset in accordance with IAS 38 or as inventory in accordance with IAS 2.

The IFRIC noted that the accounting for SIM cards before their delivery to customers or after connecting these customers to the network using such SIM cards was unlikely to be of practical or widespread relevance as the amounts involved were unlikely to be significant.

The IFRIC also noted that the accounting for SIM cards that had been delivered to customers is part of the question of which costs incurred by a mobile phone operator entering into a contract with a customer qualify for recognition as subscriber acquisition costs. The IFRIC had previously considered the treatment of subscriber acquisition costs in the telecommunications industry and, in March 2006, declined to take the issue onto its agenda.

The IFRIC therefore considered that the question of how SIM cards should be accounted for was a part of the issue that it had declined to take onto its agenda in March 2006. The IFRIC reaffirmed its March 2006 decision that the issue should not be taken onto its agenda.

IAS 38 *Intangible Assets* – Adoption of IAS 38 (revised 2004)

In December 2003 consequential amendments were made to IAS 38 *Intangible Assets* arising from the improvements to

IAS 16 *Property, Plant and Equipment*. These amendments did not change the transitional provisions in IAS 38. In March 2004, further amendments to IAS 38 were made, as a consequence of the issue of IFRS 3 *Business Combinations*. These later amendments changed the transitional provisions in IAS 38 to require prospective application. Both the December 2003 and March 2004 amendments became effective for annual periods beginning on or after 1 January 2005.

The IFRIC received a request for guidance on whether the December 2003 consequential amendments should be applied retrospectively or prospectively if an entity adopted the March 2004 version of IAS 38 early.

Whilst the IFRIC agreed that divergence might have arisen in the way that the two sets of amendments to IAS 38 were adopted in 2004, it believed that the issue was not widespread and that further diversity was unlikely to develop in the future. The IFRIC therefore decided not to take the issue onto its agenda.

IAS 39 *Financial Instruments: Recognition and Measurement* – Valuation of electricity derivatives

The IFRIC received a request for guidance on the treatment of certain principal-to-principal derivatives designed to fix the price of a supply of electricity by linking it with a transaction to buy or sell the electricity through an intermediary. In a related agenda decision published in IFRIC *Update* for August 2005, the IFRIC noted that such derivatives did not fall under the exemption from IAS 39 for contracts for the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements. The question therefore arose whether such contracts fell under the exception from valuation in IAS 39 for derivatives linked to unquoted equity instruments and, if not, how they should be valued. Valuation issues included the facts that the derivative had a variable notional amount and that the term of the derivative might extend well beyond the period for which there were any observable market data.

The IFRIC noted that the only exception in IAS 39 from the requirement to fair value derivatives after initial recognition is given in paragraph 46(c), amplified by paragraphs AG80 and AG81, and that it was not appropriate to extend this exemption to the derivatives considered in this request. The IFRIC noted further that IAS 39 contains general principles on how to measure fair value. The IFRIC decided that it should not seek to develop more detailed guidance on this topic, since the subject was too specific.

IAS 39 *Financial Instruments: Recognition and Measurement* – Testing of hedge effectiveness on a cumulative basis

The IFRIC was asked to consider a situation in which an entity uses regression analysis to assess both retrospective and prospective effectiveness. In measuring hedge effectiveness at the initial stage of the hedging relationship, the entity finds that the actual dollar-to-dollar comparison of the changes in the fair value or cash flows of the hedged item that are attributable to the hedged risk and the changes in the fair value or cash flows of the hedging instrument was outside a range of 80-125 per cent. The issue was whether such a result meant that the entity failed to qualify for hedge accounting in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*.

The IFRIC noted that IAS 39 distinguishes the requirement to perform periodic hedge effectiveness tests from the requirement to measure and recognise hedge effectiveness and ineffectiveness. The IFRIC noted that measurement of hedge effectiveness and ineffectiveness requires the comparison of the actual gains or losses on the hedging items and those on the hedged instruments.

However, the IFRIC observed that IAS 39 does not specify a single method for assessing retrospective and prospective hedge effectiveness. Paragraph 88 of IAS 39 requires that an entity should document the method for assessing hedge effectiveness at inception of the hedging relationship and apply the same method consistently over the life of the hedging relationship. The entity should use the documented method to perform the tests. The IFRIC believed that the fact that the dollar-to-dollar comparison of the changes in the fair value or cash flows of the hedged items and the changes in the fair value or cash flows of the hedging instrument falls outside a range of 80-125 per cent does not necessarily result in the entity failing to qualify for hedge accounting, provided that the dollar-to-dollar comparison is not the method documented at inception of the hedge for assessing hedge effectiveness. The IFRIC also noted that, regardless of how hedge effectiveness is assessed, IAS 39 requires any hedge ineffectiveness to be recognised in profit or loss.

The IFRIC noted that specifying how to apply a particular method for assessing hedge effectiveness would require development of application guidance (rather than an Interpretation). The IFRIC, therefore, decided not to take the issue onto the agenda.

IFRS 2 *Share-based Payment* – Fair value measurement of post-vesting transfer restrictions

The IFRIC was asked whether the estimated value of shares issued only to employees and subject to post-vesting restrictions could be based on an approach that would look solely or primarily to an actual or synthetic market that consisted only of transactions between an entity and its employees and in which prices, for example, reflected an employee's personal borrowing rate. The IFRIC was asked whether this approach was consistent with the requirements under IFRS 2.

The IFRIC noted the requirements in paragraph B3 of Appendix B to IFRS 2, which states that, 'if the shares are subject to restrictions on transfer after vesting date, that factor shall be taken into account, but only to the extent that the post-vesting restrictions affect the price that a knowledgeable, willing market participant would pay for that share. For example, if the shares are actively traded in a deep and liquid market, post-vesting transfer restrictions may have little, if any, effect on the price that a knowledgeable, willing market participant would pay for those shares.'

Paragraph BC168 of the Basis for Conclusions on IFRS 2 notes that 'the objective is to estimate the fair value of the share option, not the value from the employee's perspective.' Furthermore, paragraph B10 of Appendix B to IFRS 2 states that 'factors that affect the value of the option from the individual employee's perspective only are not relevant to estimating the price that would be set by a knowledgeable, willing market participant.'

The IFRIC noted that these paragraphs require consideration of actual or hypothetical transactions, not only with employees, but rather with all actual or potential market participants willing to invest in restricted shares that had been or might be offered to them.

The IFRIC believed that the issue was not expected to create significant divergence in practice and that the requirements of IFRS 2 were clear. The IFRIC, therefore, decided not to take the issue onto the agenda.

IFRS 2 *Share-based Payment* – Incremental fair value to employees as a result of unexpected capital restructurings

The IFRIC was asked to consider a situation in which the fair value of the equity instruments granted to the employees of an entity increased after the sponsoring entity undertook a capital restructuring that was not anticipated at the date of grant of the equity instruments. The original share-based payment plan contained neither specific nor more general requirements for adjustments to the grant in the event of a capital restructuring. As a result, the equity instruments previously granted to the employees became more valuable as a consequence of the restructuring. The issue was whether the incremental value should be accounted for in the same way as a modification to the terms and conditions of the plan in accordance with IFRS 2 *Share-based Payment*.

The IFRIC believed that the specific case presented was not a normal commercial occurrence and was unlikely to have widespread significance. The IFRIC, therefore, decided not to take the issue onto the agenda.

IFRS 2 *Share-based Payment* – Employee benefit trusts in the separate financial statements of the sponsor

The IFRIC discussed the application to separate financial statements of an issue that had been submitted in connection with the amendment of SIC-12 *Consolidation—Special Purpose Entities* to include within its scope special purpose entities established in connection with equity compensation plans. The issue related to an employee benefit trust (or similar entity) that has been set up by a sponsoring entity specifically to facilitate the transfer of its equity instruments to its employees under a share-based payment arrangement. The trust holds shares of the sponsoring entity that are acquired by the trust from the sponsoring entity or from the market. Acquisition of those shares is funded either by the sponsoring entity or by a bank loan, usually guaranteed by the sponsoring entity. In most circumstances, the sponsoring entity controls the employee benefit trust. In some circumstances, the sponsoring entity may also have a direct control of the shares held by the trust. The issue is whether guidance should be developed on the accounting treatment for the sponsor's equity instruments held by the employee benefit trust in the sponsor's separate financial statements.

The IFRIC discussed whether the employee benefit trust should be treated as an extension of the sponsoring entity, such as a branch, or as a separate entity. The IFRIC noted that the notion of 'entity' is defined neither in the *Framework* nor in IAS 27 *Consolidated and Separate Financial Statements*. The IFRIC then discussed whether the sponsoring entity should, in its separate financial statements, account for the net investment according to IAS 27 or rather for the rights and obligations arising from the assets and liabilities of the trust. The IFRIC noted that, in some circumstances, the sponsoring entity may have direct control of the shares held by the trust. The IFRIC also noted that the guidance included in the Framework and IAS 27 does not address the accounting for the shares held by the trust in the sponsor's separate financial statements.

The IFRIC concluded that it could not reach a consensus on this matter on a timely basis, given the different types of trusts and trust arrangements that exist. The IFRIC noted that this issue related to two active projects of the IASB: the Conceptual Framework and the revision of IAS 27 *Consolidated and Separate Financial Statements* in the course of the Consolidation project. For these reasons, the IFRIC decided not to take the issue onto its agenda.

IFRS 3 *Business Combinations* – Are puts or forwards received by minority interests in a business combination contingent consideration?

The IFRIC considered a request for an interpretation of whether a put or forward entered into by a parent entity, as part of a business combination, to acquire the shares held by the [non-controlling] minority interest was contingent or deferred consideration.

The accounting for these arrangements, including the circumstances considered by the IFRIC, was being considered by the Board as part of the current redeliberations on the proposed revised IFRS 3 *Business Combinations*. The IFRIC expected that the revised IFRS 3 would assist in clarifying whether this type of arrangement includes a component of contingent consideration. The IFRIC therefore believed that it could not develop guidance more quickly than it was likely to be developed in the Business Combinations project and decided not to take a project on this issue onto its agenda.

IFRS 7 *Financial Instruments: Disclosures* – Presentation of 'net finance costs' on the face of the income statement

At its meeting in October 2004, the IFRIC noted that, taken together, paragraphs 32 and 81 of IAS 1 *Presentation of Financial Statements* preclude the presentation of 'net finance costs' on the face of the income statement unless finance costs and finance revenue are also shown on the face of that statement. IFRS 7 *Financial Instruments: Disclosures* was issued in 2005. Paragraph IG13 of IFRS 7 states that 'The total interest income and total interest expense disclosed in accordance with paragraph 20(b) is a component of the finance costs, which paragraph 81(b) of IAS 1 requires to be presented separately on the face of the income statement. The line item for finance costs may also include amounts that arise on non-financial assets or non-financial liabilities.'

The IFRIC was asked whether the IFRIC's October 2004 analysis regarding presenting 'net finance costs' on the face of the income statement was still valid in the light of paragraph IG13 of IFRS 7.

The IFRIC believed that its analysis in October 2004 was still valid. Consequently, the IFRIC decided not to take the issue onto the agenda.

The IFRIC believed that the words in paragraph IG13 of IFRS 7 might result in confusion. It therefore decided to recommend to the Board that the paragraph should be amended.

SIC-12 *Consolidation—Special Purpose Entities* – Relinquishment of Control

The IFRIC considered an issue concerning the relative weight to be given to the various indicators in paragraph 10 of SIC-12 *Consolidation—Special Purpose Entities* in determining who should consolidate a special purpose entity (SPE). The issue focused on a situation in which all the decisions necessary for the ongoing activities of the SPE had been predetermined by its creator and in which the majority of the 'equity interest tranche' had been transferred to a third party. The question was whether in such a situation the benefits and risks factors specified in paragraph 10(c) and (d) of SIC-12 took precedence over the factors in paragraph 10(a) (activities of the SPE conducted in accordance with specific business needs of one party) and paragraph 10(b) (one party has decision-making powers or has delegated them by setting up an 'autopilot' mechanism).

The IFRIC noted that, under IAS 27 *Consolidated and Separate Financial Statements*, control, which is the basis for consolidation, has two components: power to govern and rights to obtain benefits.

The IFRIC noted that the factors set out in paragraph 10 of SIC-12 are indicators only and not necessarily conclusive. The IFRIC believed that this approach was deliberate, in acknowledgement of the fact that circumstances vary case by case. In the IFRIC's view, SIC-12 requires that the party having control over an SPE should be determined through the exercise of judgement and skill in each case, after taking into account all relevant factors. For this reason, the IFRIC decided not to take the issue onto the agenda.

Tentative agenda decisions

The IFRIC reviewed the following matters, which the Agenda Committee had recommended should not be taken onto the IFRIC agenda. These tentative decisions, including, where appropriate, recommended reasons for not taking them onto the IFRIC agenda, will be re-discussed at the January 2007 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 15 December 2006, preferably by email to: ifric@iasb.org or by post to:

International Financial Reporting Interpretations Committee
First Floor, 30 Cannon Street
London EC4M 6XH
United Kingdom

Communications will be placed on the public record unless confidentiality is requested by the writer, supported by good reason, such as commercial confidence.

IAS 39 *Financial Instruments: Recognition and Measurement* – Short trading

The IFRIC received a submission regarding the accounting for short sales of financial assets when the terms of the short sale require delivery of the financial assets within the time frame established generally by regulation or convention in the marketplace concerned. The submission noted that entities that enter into regular way purchases or sales are allowed to choose trade date or settlement date accounting in accordance with paragraph 38 of IAS 39 *Financial Instruments: Recognition and Measurement*. Therefore, the issue was how short sales should be accounted for in accordance with IAS 39, in particular, whether entities that enter into short sales are permitted to choose trade date or settlement date accounting.

The IFRIC noted that paragraphs AG 55 and AG 56 of IAS 39 address the recognition and derecognition of financial assets traded under regular way purchases and regular way sales of long positions. The IFRIC noted that a fixed price commitment between trade date and settlement date of a short sale contract meets the definition of a derivative (see IAS 39 paragraph 9). [The IFRIC, therefore, believed] that the relevant requirements in IAS 39 are that short sale contracts should be recognised and accounted for as derivatives and are not eligible for the special accounting exemptions given to regular way purchases and sales. Accordingly, [the IFRIC decided] not to take the issue onto the agenda.

IAS 39 *Financial Instruments: Recognition and Measurement* – Financial instruments puttable at an amount other than fair value

The IFRIC received a submission regarding the classification in the financial statements of the holders of financial instruments puttable at the option of the holders at an amount other than fair value (the puttable instruments). The submission noted that the issuer's contractual obligation to deliver cash requires the issuer to recognise financial liabilities in its financial statements in accordance with IAS 32 *Financial Instruments: Presentation*. The issues are:

- how the puttable instruments should be accounted for in the financial statements of the holders, in particular, whether the accounting for the instruments in the financial statements of the holders should be symmetrical with that in the financial statements of the issuer; and
- whether an entity that has control over another entity (that has no equity instruments in issue) is required to present consolidated financial statements in accordance with IAS 27 *Consolidated and Separate Financial Statements* as well as to recognise goodwill in accordance with IFRS 3 *Business Combinations*.

Regarding the first issue, the IFRIC noted that IAS 32 and IAS 39 do not directly address whether the accounting for financial instruments in the financial statements of the holders should be symmetrical with that in the financial statements of the issuer. However, the IFRIC noted that the issuer of a financial instrument is required to classify it in accordance with IAS 32, whereas the holder is required to classify and account for it in accordance with IAS 39.

The IFRIC noted that IAS 39 requires the holder to identify embedded derivatives of hybrid financial instruments. IAS 39 also requires the holder to account for the embedded derivatives separately if all the conditions in IAS 39 paragraph 11 are met. These requirements apply to the holder regardless of whether any embedded derivatives are separately accounted for in the financial statements of the issuer. In the light of the existing guidance in IAS 39, the IFRIC [decided] that the first issue should not be taken onto the agenda.

Regarding the second issue, the IFRIC noted that the control of a subsidiary, and the resulting requirement for a parent to present consolidated financial statements in accordance with IAS 27 (including the requirement to recognise goodwill in accordance with IFRS 3) does not necessarily depend on the parent's owning equity instruments of the subsidiary. The IFRIC, therefore, [decided] not to take the second issue onto the agenda.

IAS 39 *Financial Instruments: Recognition and Measurement* – Derecognition of financial assets

The IFRIC had previously discussed two issues relating to the derecognition requirements of IAS 39, namely (a) when financial assets are considered to be similar for the purposes of the derecognition tests, and (b) when the pass through tests in paragraph 19 of IAS 39 should be applied.

At its meeting in July the IFRIC directed the staff to seek the views of the Board on these two issues. In particular, the Board was asked to clarify whether the wording of IAS 39 reflected the Board's intentions. The Board discussed these issues at its meeting in September (as noted in IASB *Update*).

At this IFRIC meeting, the staff reported the views of the Board.

The views of the Board regarding whether financial assets should be considered similar for the purposes of the derecognition tests were the following:

- Derivative and non-derivative instruments are not 'similar'. For example, if an entity enters into an arrangement to pass the cash flows from both a mortgage and a mortgage guarantee to a third party, the mortgage and the guarantee cannot be considered similar.
- If two assets are not similar, the pass-through tests in IAS 39 when relevant must be applied to the two assets separately. Therefore, in the previous example, the pass-through tests should be applied separately to the mortgage and the mortgage guarantee. One of the pass-through tests required by IAS 39 is to consider whether the transferor has <u>any</u> obligation to pay amounts to the eventual recipients if it does not collect equivalent amounts from the asset being considered for derecognition. When assessing whether any such obligation exists for the mortgage, the entity must consider the possible effects of a default on the mortgage. The fact that, in the event of a default on the mortgage, the transferor is required to pay over the receipts from the guarantee to the eventual recipients does not cause the mortgages to fail the pass-through tests as the obligation to pay over receipts from the guarantee arises from the transfer of the guarantee not from a default on the mortgages. However, if the transferor is required to pay over amounts to eventual recipients in the event of a default on the *guarantee*, such an obligation is considered to be the result of a default on the mortgage, and would therefore result in the mortgage failing the pass-through tests.
- Derivative instruments can be either assets or liabilities. Consequently, a derivative such as an interest rate swap that is transferred as part of a derecognition transaction must pass both the asset and the liability derecognition tests.

The views of the Board regarding when the pass through tests in paragraph 19 of IAS 39 should be applied were:

- If an entity transfers the contractual rights to receive the cash flows from an asset, the pass-through tests need not be applied. An entity transfers the contractual rights to receive the cash flows from an asset (as set out in paragraph 18(a) of IAS 39) when it transfers legal ownership to the asset or rights equivalent to legal ownership. This may be the case when an entity transfers specifically identified cash flows from an asset in accordance with paragraph 16 of IAS 39.
- Conditions attached to the transfer of asset, for example representations and warranties regarding the existence of that asset, do not necessarily affect whether the entity has transferred the contractual rights to receive cash flows but they may affect the assessment of risks and rewards.

The IFRIC considered the Board's views and discussed whether to take these issues on to its agenda. In the light of the Board's views, the IFRIC [decided] not to take these issues on to its agenda.

From July 2006, IFRIC meetings have been audio cast live via the Internet and are made available on the IASB Website for six months after the meeting. Please visit the IASB Website at www.iasb.org for more information.

Future IFRIC meetings

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

2007

- 11 and 12 January
- 8 and 9 March
- 3 and 4 May
- 12 and 13 July
- 6 and 7 September
- 1 and 2 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