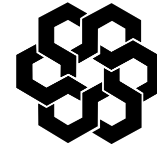

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International Accounting Standards Board

This observer note is provided as a convenience to observers at IFRIC meetings, to assist them in following the IFRIC's discussion. Views expressed in this document are identified by the staff as a basis for the discussion at the IFRIC meeting. This document does not represent an official position of the IFRIC. Decisions of the IFRIC are determined only after extensive deliberation and due process. IFRIC positions are set out in Interpretations.

Note: The observer note is based on the staff paper prepared for the IFRIC. Paragraph numbers correspond to paragraph numbers used in the IFRIC paper. However, because the observer note is less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

IFRIC meeting: **March 2008, London**
Project: **IAS 37 – Provisions, Contingent Liabilities and Contingent Assets - Deposits on returnable containers (Agenda Paper 4A)**

Background

1. At its meeting in November 2007, the IFRIC discussed a request for guidance to be issued on the accounting for the obligation to refund deposits on returnable containers. In some industries, entities that distribute their products in returnable containers collect a deposit for each container delivered and have an obligation to refund this deposit when containers are returned by the customer. The issue is whether the obligation should be accounted for in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*.

2. In the November 2007 IFRIC Update, the IFRIC published a tentative agenda decision proposing not to add the item to its agenda on the basis that divergence in this area was not expected to be significant.

3. After that meeting, the IFRIC received two comment letters. Both respondents agreed that the IFRIC should not add the issue to its agenda. However, one respondent did not agree with the rationale for that conclusion. This respondent argued that, when the containers are not sold to the customer (and derecognised

by the entity) and remain the assets of the entity, the obligation to refund the deposit is not an executory contract but a financial liability within the scope of IAS 39.

4. At its January 2008 meeting, whilst the IFRIC did not change its decision not to add the issue to its agenda, it did not agree on wording for that decision. The IFRIC therefore asked the staff to present a paper to the next meeting with amended wording for its agenda decision.

Staff analysis

5. The staff undertook further analysis and discussed the issue with the Financial Instruments team. It appears that there are two circumstances:

   - the container is sold to the customer together with the product and is derecognised by the entity;
   - the container remains the property of the entity that distributes the product.

The container is sold and derecognised

6. When the container is sold to the customer together with the product, the distributor loses control over the container that is derecognised through the sale transaction. The deposit paid by the customer is refundable if the container is returned. The value of the deposit usually represents a small portion of the value of the container or the product. In these circumstances, only a few containers are returned and deposits claimed.

7. The staff's view is that the obligation to refund the deposit for any returned containers is an exchange transaction of cash (the deposit) for the containers (non-financial assets). Whether that exchange transaction occurs is at the option of the customer. Because the transaction involves the exchange of a non-financial item, it does not meet the definition of a financial instrument in accordance with IAS 32 and therefore is not within the scope of IAS 39.

8. The types of containers described in paragraphs 6 and 7 are often single use containers or containers that must be processed before reuse, like glass bottles or aluminium cans. However, in the staff's view there are multiple use containers for which a similar conclusion is appropriate.

9. In many cases, containers may be purchased and used several times over a number of periods. Entities generally include these containers as part of PP&E and depreciate them over their expected useful lives. When the value of the individual container is not large, the containers are recognised in groups and are not tracked individually. In accordance with IAS 16, the depreciation methodology would take into account not only the physical life of the containers but the entity's best estimate of the number that will actually be returned to be reused.

10. In the staff's view, the depreciation of containers recognised as PP&E is equivalent to the expensing of containers that are treated as single use packaging supplies. Both accounting procedures result in the derecognition of the containers as sales are made to customers. The only difference is the timing of the derecognition.

11. Consequently, the staff concludes that in both cases the return of the containers is part of the sale transaction and its cost should be recognised in accordance with IAS 18 paragraph 19. That estimate of returns would be consistent with the estimate included in the determination of the depreciation of the containers.

The container is not sold

12. In some circumstances, the container clearly remains the property of the entity that distributes the product (the distributor). This would be the case for instance when the container is used for transporting medical or dangerous products. The deposit's value is relatively important compared to the value of the product (and sometimes higher). The containers are still the property of the distributor that keeps control of and tracks them individually. The deposit may represent a high amount in order to ensure the container will be returned. Alternatively, the cost of disposing of the container may be significant, providing an incentive for the customer to return it even though the refund amount is relatively small. In some cases, the distributor may be legally responsible for ensuring the safe disposal of each container.

13. Such containers are also likely to be multi-use containers and to be capitalised as PP&E and depreciated over their useful lives. However, in these cases the staff

believe that it is clear that the only item sold to the customer is the product; the customer's only asset with respect to the container is its right to the deposit.

14. When the containers are not part of the sale transaction, the staff's view is that the obligation to refund the deposit meets the definition of a financial liability in accordance with IAS 32 and is measured in accordance with IAS 39. In particular, paragraph 49 of IAS 39 states that 'the fair value of a financial liability with a demand feature (eg a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.'

Staff recommendation

15. The staff redrafted the wording of the decision the IFRIC tentatively made not to add the item to its agenda. The wording set out in the appendix to this paper now addresses the two different circumstances (with track changes).

16. Questions to the IFRIC: do you agree with the amended wording set out in the appendix to this paper?

[Appendix omitted from observer note].