NEWSLETTER OF THE INTERNATIONAL FINANCIAL REPORTING INTERPRETATIONS COMMITTEE

IASB IFRIC UPDATE

March 2004

The International Financial Reporting Interpretations Committee met in London on 23 and 24 March 2004, when it discussed:

- Interpretation 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*
- Draft Interpretation D1 *Emission Rights*
- IAS 11: combining and segmenting construction contracts
- IAS 19: defined contribution pension plans with a guaranteed minimum return on contributions or notional contributions
- IAS 32: members' shares in co-operative entities
- IAS 39: transitional requirements of impairment for available-for-sale equity instruments
- Service concession arrangements

Discussion of the recognition and measurement of biological assets in accordance with IAS 41 *Agriculture* was deferred to the May 2004 meeting.

Changes in existing decommissioning, restoration and similar liabilities

The IFRIC discussed a final draft of IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities,* which reflected changes that had been recommended by the Board, including:

- the removal from its scope of obligations included in the cost of mineral rights and mineral reserves (reverting to the scope of the exposure draft, D2). The Board took the view that decommissioning obligations associated with the extraction of minerals are either a cost of the property, plant and equipment used to extract them, which would be accounted for under IAS 16 and thus within the original scope, or are a cost of the inventory produced, which would be accounted for under IAS 2. The IFRIC agreed and therefore reverted to the original scope (ie excluding mineral rights and mineral reserves).
- the addition of an exemption for first-time adopters under IFRS 1, who will now be able to use a simplified method instead of the full retrospection that would otherwise be required.
- further clarification of how the Interpretation is applied to revalued assets, which will involve changes being taken to equity where they are adjustments to the revaluation surplus recognised under IAS 16, and the addition of a required disclosure for any changes taken to equity.

It is expected that, subject to final approval, the Interpretation will be issued in April with an effective date three months from issue.

Emission rights

The IFRIC received an update on the Board's recent discussions relating to IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*. (IAS 20 is one of the references in Draft Interpretation D1 *Emission Rights*.) The IFRIC noted that the Board had tentatively decided to amend IAS 20 by adopting the accounting model for government grants contained in IAS 41 *Agriculture*. Currently, this model applies only to biological assets measured at fair value less estimated point-of-sale costs.

The IFRIC considered some preliminary views about how these proposed amendments might affect its consensus in D1, but noted that it would need to await the Board's conclusions on an amendment of IAS 20 before making any technical decisions.

IAS 11 *Construction Contracts* segmenting and combining construction contracts

The IFRIC considered a draft Interpretation that would provide additional guidance on when it would be appropriate to segment or combine construction contracts. The IFRIC is developing this guidance as part of the IASB's ongoing project to achieve convergence between accounting standards around the world. The IASB had asked the IFRIC to see whether the provision of guidance on segmenting and combining construction contracts could draw together the application of IAS 11 *Construction Contracts* and US guidance contained in AICPA Statement of Position 81-1 *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*.

IAS 11 currently requires segmenting of construction contracts when certain criteria are met, including that each asset has been subject to separate negotiation. In contrast, SOP 81-1 permits segmentation when either a primary set of criteria are met or, if those criteria are not met, all of a second set of criteria are met. The IFRIC asked the staff to

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Combining and segmenting construction contracts *(continued)*

explore making some of the latter criteria, ie those relating to the existence of objective external market evidence, more in the nature of requirements of IAS 11. It also asked the staff to evaluate whether other US criteria could be used as indicators of when segmentation should be required.

As regards combining contracts, the IFRIC tentatively agreed that the criteria in SOP 81-1 addressing the close inter-relationship of construction activities and their timing and location should be incorporated in the guidance on IAS 11. The staff was asked to explore whether some obligation to complete further stages of a construction activity was required if the contracts were to be combined.

The IFRIC agreed to include in the draft Interpretation guidance on the effect of options for the construction of an additional asset at the request of the customer or amendments to an existing contract. The IFRIC was of a view that IAS 11 paragraph 10 was sufficient, but agreed to add guidance on the accounting for options that did not meet the criteria in IAS 11 for recognition as a separate construction contract.

The IFRIC also considered the possible inter-relationship of proposals for segmenting and combining construction contracts on accounting for service and multiple element contracts. IAS 18 *Revenue* paragraph 21 states that the "requirements of [IAS 11] are generally applicable to the recognition of revenue and the associated expenses for a transaction involving the rendering of services." The IFRIC was concerned that any guidance on segmenting and combining construction contracts that it might issue on IAS 11 would become the guidance for service revenue recognition, including revenue arrangements with multiple elements. They also wished to understand the implications of such guidance for the topic of service concession. The staff agreed to develop examples of both construction and non-construction service contracts against which the IFRIC could test the impact of the proposed Interpretation.

The IFRIC will consider a revised draft Interpretation at its next meeting.

IAS 19 *Employee Benefits*: Plans with a guaranteed minimum return on contributions or notional contributions

At the February 2004 meeting the IFRIC had approved for publication a draft Interpretation on plans with a guaranteed minimum return on contributions or notional contributions. The Board subsequently reviewed the draft for clearance and discussed it at its March 2004 meeting, in particular the application of the deferred recognition options in IAS 19 to the variable element liability. The staff gave an oral report of the Board's discussion, noting that the Board did not object to the publication of the draft Interpretation. The staff also noted that the Board had made some suggestions to make the draft Interpretation easier to understand. The IFRIC agreed that:

(a) the issues should be reworded to clarify that the draft Interpretation covered:
   - (i) the treatment of a fixed guarantee
   - (ii) the treatment of a benefit that depends on future asset returns and
   - (iii) the treatment of a plan that combines (i) and (ii).

(b) the example should be simplified and additional footnotes explaining the calculations should be given.

(c) the Basis for Conclusions should clarify that the requirements for the application of the deferred recognition options for the variable element liability gave the same result for a variable element liability arising from plan assets and for a variable element liability arising from notional assets.

IAS 39 *Financial Instruments*: transitional requirements on impairment of available-for-sale equity instruments

The IFRIC considered:

- whether there are circumstances in which IAS 39 *Financial Instruments: Recognition and Measurement* (as revised in 2003) would require recognition of an impairment loss that the previous version of IAS 39 would not have required to be recognised; and
- if so, whether the loss should be recognised as a transitional adjustment to opening retained earnings.

The IFRIC was of a view that the words "a significant or prolonged decline in fair value of an investment in an equity instrument below its cost is also objective evidence of impairment" in IAS 39 paragraph 61 was an unequivocal trigger for the measurement requirement in IAS 39 paragraphs 67 and 68.

In addition, the IFRIC noted that paragraph 104 requires that the new standard be applied retrospectively to all periods presented, except as specified in certain paragraphs. The issue did not relate to one of those paragraphs, thus the IFRIC decided that it was clear that retrospective application of the standard was required.

Members' shares in co-operative entities

The IFRIC continued its discussions on questions that have been raised about whether members' shares in co-operative entities should be classified as debt or equity. The IFRIC confirmed the tentative decisions made at its previous meeting and considered a draft Interpretation based on these decisions.

The IFRIC agreed that the Interpretation should be made less industry-specific. Rather, the Interpretation will focus on the effect on classification as liabilities or equity of particular contract features. The IFRIC directed the staff to redraft the draft Interpretation by providing additional guidance:

- to clarify that shares of co-operative entities are equity instruments if the entity has the unconditional right to refuse to redeem the shares, or if the entity has the obligation to refuse to redeem the shares.
- to confirm in the Interpretation that no distinction need be made between obligations to refuse to redeem the shares that arise from an external authority (eg national law) or as a result of provisions in the entity's governing document.
- to state that reclassification of shares between liabilities and equity does not result in gains or losses in the income statement.
- to discuss in greater detail the effects of, and basis for, considering the classification of the shares on a portfolio basis.
- to conform the transition requirements in the Interpretation to those in IAS 32 (as revised in December 2003), but to provide a discussion in the Basis for Conclusions on the effect of transition provisions on entities that may be unable to change their governing charter so that members' shares are classified as equity until some time in 2005.
- to expand the examples to include the example of an entity that is required to redeem shares only if a new member can be found to replace the departing member.

The IFRIC also considered, but rejected, the alternative views raised by the European Association of Co-operative Banks that:

- members' shares with mandatory redemption features should be reported as equity until a member has requested redemption, at which time the shares would be reclassified as a liability.
- alternatively, the classification of members' shares should incorporate the probability that members will request redemption.

Service concession arrangements

The IFRIC discussed what issues would need to be addressed before staff could prepare a draft interpretation. Staff noted that any Interpretation would need to address both service concessions involving the finance and construction of new infrastructure, and those using existing infrastructure. In each case it would need to address both contracts in which the concession provided pays for the services and those in which the users pay for them.

The IFRIC agreed that the following issues should be addressed:

- When should the concession operator recognise existing and/ or new infrastructure assets as its own?
- If the concession operator does not recognise the existing and/ or new infrastructure assets as its own, what is the nature of any assets that it should recognise? In particular, should an intangible asset similar to a licence be recognised?
- How revenues and costs should be recognised by the concession operator, including whether construction should be segmented from other services provided under the contract. The IFRIC also wished to address how IAS 11 *Construction Contracts* would be applied to the contract as a whole if the contract were not segmented into construction and operation phases.
- How should the finance costs of such contracts be accounted for? In particular, when and under what conditions should finance costs be capitalised as part of the construction and/ or operations phases?
- How should obligations to return assets at the end of the contract be accounted for?

The IFRIC considered some examples prepared by staff analysing the accounting treatment when construction is, and is not, segmented from other services. The IFRIC asked for further examples to be developed to clarify whether or not the effect of including finance costs in contract costs is significantly different depending on whether or not construction is segmented from other services. The IFRIC also asked staff to consider the implications of its tentative decisions on combining and segmenting construction contracts for determining whether or not service concession contracts should be segmented.

The IFRIC discussed the circumstances in which the concession operator should recognise an asset for the right of recovery of finance or other costs, with particular reference to the requirements of FAS 71 *Accounting for the Effects of Certain Types of Regulation* and Spanish generally accepted accounting principles. Both sets of GAAP provide for the recognition of such assets by regulated entities, subject to certain conditions. The IFRIC did not object to material being developed from a review of such material, but objected to the creation of a new category of asset. No asset should be recognised that does not already qualify for recognition under the IASB *Framework* and relevant existing standards such as IAS 11 *Construction Contracts*, IAS 16 *Property, Plant and Equipment*, IAS 18 *Revenue* or IAS 38 *Intangible Assets*.

The IFRIC discussed the depreciation methods that might be applied to tangible or intangible assets recognised in service concession arrangements. It agreed that:

- interest methods of depreciation are not appropriate. This should be noted in the Basis for Conclusions of any Interpretation.
- The Interpretation should otherwise be silent on deprecation methods. The IFRIC noted that the units of production method, which is specifically mentioned in IAS 16, could be appropriate for property, plant and equipment. However, the IFRIC also noted that IAS 38 states that there will rarely, if ever, be persuasive evidence to support an amortisation method for intangible assets that results in a lower amount of accumulated amortisation than under the straight-line method.

Items not taken to the IFRIC agenda

The IFRIC noted the Report of the Agenda Committee and agreed with the Committee's recommendations not to take the following items to its agenda:

- *Consumption of inventories by a service organisation* The issue related to the consumption of inventories by a public sector service entity, in particular the assessment of net realisable value when the inventory is consumed as part of the service rendered.

  The IFRIC noted that the same issues existed for commercial entities. The IFRIC concluded that this matter was one of assessing the recoverability of an asset without a direct cash flow. The IFRIC decided not to add this issue onto the agenda.

- *Conflict between scope and definitions in IAS 26 Accounting and Reporting by Retirement Benefit Plans* The issue concerns whether IAS 26 applies to plans other than those sponsored by employers. IAS 26 paragraph 9 states that "Some retirement benefit plans have sponsors other than employers; this Standard also applies to the reports of such plans." However, IAS 26 paragraph 8 defines "Retirement benefit plans" as "arrangements whereby an entity provides benefits for its employees on or after termination of service…" [emphasis added].

  The IFRIC agreed that the wording of IAS 26 could be improved, but noted that the intention of the Standard (as expressed in paragraph 9) was clear. On balance, the Committee did not think that this was a priority issue referred the issue to the IASB to be addressed via editorial changes when IAS 26 was addressed.

- *Impairment of undeveloped reserves* The issue concerned whether the assessment of the recoverable amount for an extractive entity's cash-generating unit (or site) that has begun production should include the expected cash inflows from, and necessarily incurred cash outflows (capital expenditure) planned, in order to continue developing the site in order to access undeveloped reserves / resources over its life.

  With respect to value in use, the IFRIC concluded that the issue was based on a narrow reading of IAS 36 *Impairment of Assets* paragraphs 32-35 that was not supported by IFRIC members. In addition, the staff noted that the Board intended to clarify the determination of "net selling price" in the Basis of Conclusions on IAS 36. For these reasons, the IFRIC agreed not to add this issue onto the agenda.

Future meetings and requests for Interpretations

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

4 and 5 May 2004

3 and 4 June 2004

29 and 30 July 2004

7 and 8 October 2004

2 and 3 December 2004

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.