NEWSLETTER OF THE INTERNATIONAL FINANCIAL REPORTING INTERPRETATIONS COMMITTEE

IASB IFRIC UPDATE

November 2004

The International Financial Reporting Interpretations Committee met in London on 4 and 5 November 2004, when the principal matters it discussed were:

- D8 *Members' Shares in Co-operative Entities*
- IFRS 2: scope
- IFRS 2: Changes in contributions to ESPPs
- IFRS 2: Treasury share transactions and group transactions
- Service concession arrangements
- Waste electrical and electronic equipment

D8 *Members' Shares in Co-operative Entities*

At its last meeting and after considering the comments received on D8 *Members' Shares in Co-operative Entities*, the IFRIC tentatively agreed to proceed to a final Interpretation based on the approach in D8. At this meeting, the IFRIC considered the following issues arising from the comment letters on D8:

(a) The title and scope of the Interpretation.

(b) Clarification of the application of the prohibition on redemption.

(c) Subsequent measurement of the liability for redemption of members' shares.

(d) The distinction in D8 between a 'reclassification' and an 'extinguishment' and the proposal that no gain or loss should be recognised on a reclassification.

(e) Use of the portfolio approach.

(f) Transition.

The IFRIC decided:

(a) to amend the title of D8 to *Members' Shares in Co-operative Entities and Similar Instruments* to reflect that its scope is wider than only members' shares in co-operatives.

(b) to clarify the application of the prohibition on redemption. Restrictions—such as conditions relating to available cash, reserves, liquidity, distributable profits etc—that can prevent redemption only if certain conditions are met (or not met) are conditional restrictions that do not result in equity classification. On the other hand, restrictions that unconditionally prevent redemption result in equity classification.

(c) not to provide additional guidance on subsequent measurement of the financial liability for the redemption of members' shares, given that the focus of the Interpretation is classification rather than measurement and that there is a need to finalise the Interpretation as soon as possible. The Agenda Committee would consider whether this issue should be the subject of a future Interpretation.

(d) to remove the distinction in D8 between a 'reclassification' and an 'extinguishment'. The IFRIC decided not to address in this Interpretation when a gain or loss should be recognised on a transfer between liabilities and equity, given that the focus of the Interpretation is classification rather than measurement and that there is a need to finalise the Interpretation as soon as possible. However, the Agenda Committee would consider this issue (in conjunction with subsequent measurement of the financial liability for the redemption) to determine whether it should be the subject of a future Interpretation.

(e) to amend the discussion in the Basis for Conclusions for use of the portfolio approach to classification by reference to the accounting for a contract to purchase an entity's own shares as illustrated in paragraph 23 of IAS 32.

(f) not to alter the transition provisions proposed in D8.

The IFRIC also decided to add a reminder to the Basis for Conclusions that entities whose members' shares are not equity may use the presentation formats included in paragraphs IE32 and IE33 of the illustrative examples to IAS 32.

Lastly, the IFRIC agreed to clarify that an entity assesses the classification of members shares and similar instruments as liabilities or equity on the basis of local laws, regulations and its governing charter in effect at the date of classification. Accordingly, an entity does not take into account expected future amendments to local laws, regulations or its governing charter.

The IFRIC approved publication of the Interpretation. The Board will consider the Interpretation at its meeting in November 2004. The IFRIC intends to publish the Interpretation by the end of 2004.

Service concessions

The IFRIC re-debated two matters on which it reached tentative conclusions at previous meetings:

(a) the circumstances in which the operator had a financial (as opposed to intangible) asset; and

(b) the circumstances in which a financial asset could not be classified as a loan or receivable.

The IFRIC considered concerns that the proposals previously agreed upon would lead to concession assets being classified as financial assets and loans and receivables in circumstances that might not strictly meet the criteria in IAS 32

(continued)

IFRIC Update is published immediately after every IFRIC meeting by the International Accounting Standards Board, 30 Cannon Street, London EC4M 6XH, United Kingdom.

Tel: +44 (0)20 7246 6410
Fax: +44 (0)20 7246 6411

IASB Publications Department, 30 Cannon Street, London EC4M 6XH, United Kingdom.

Tel: +44 (0)20 7246 6410
Fax: +44 (0)20 7332 2749
Email: publications@iasb.org
Web: www.iasb.org

ISSN 1477-206X

Service concessions *(continued)*

Financial Instruments: Disclosure and Presentation and IAS 39 *Financial Instruments: Recognition and Measurement*.

It decided to change the proposals in the draft interpretations to narrow the circumstances in which financial assets would be recognised. But it also decided to explain within the Basis for Conclusions arguments that might support a wider interpretation of the definition in IAS 32, and invite comments on those arguments. It further agreed to reword the guidance on when a financial asset would not be eligible to be classified as a loan or receivable to remove any potential inconsistency with IAS 39.

Liabilities arising from participating in a specific market—waste electrical and electronic equipment

The IFRIC considered and approved final editorial changes to a draft Interpretation *Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment*. The IFRIC expects to publish the Draft Interpretation for public comment later in November or early December 2004.

IFRS 2: Scope of IFRS 2

IFRIC members began discussing questions about the scope of IFRS 2 *Share-based Payment*. The questions are whether, or in what circumstances, IFRS 2 applies to transactions in which an entity issues equity instruments and the cash consideration received (if any) is less than the fair value of those equity instruments. IFRIC members tentatively agreed to develop a draft Interpretation. IFRIC members will continue their discussions at a future meeting.

IFRS 2: Changes in Contributions to ESPPs

IFRIC members began discussing the issue of accounting for changes in employee contributions to an employee share purchase plan (ESPP), in particular, the effect of an employee ceasing to make contributions into the plan, or redirecting those contributions into another plan.

IFRIC members tentatively agreed to develop a draft Interpretation and discussed a preliminary draft prepared by the staff. IFRIC members requested the staff to amend the preliminary draft for discussion at the meeting in December 2004.

IFRS 2: Treasury share transactions and group transactions

IFRIC members began discussing issues relating to accounting for share-based payment arrangements in which:

(a) the entity grants options to its employees and chooses or is required to purchase its own shares upon exercise of the options by its employees, and

(b) a subsidiary's employees are granted rights to shares of the parent.

In the latter situation, the issues relate to the accounting treatment in the separate financial statements of the subsidiary and its parent.

IFRIC members discussed a series of examples prepared by the staff. IFRIC members tentatively agreed to develop a draft Interpretation covering at least some of the issues raised in those examples. IFRIC members raised further points that they requested the staff to explore. IFRIC members will continue their discussion of the topic at a future meeting.

Activities of other interpretative bodies

The IFRIC discussed new projects being undertaken by other interpretative committees and national standard-setters, and whether these projects might form necessary agenda items for the IFRIC.

An IOSCO Observer provided an overview of SEC Staff Accounting Bulletin (SAB) 106, which addresses a mismatch between Statement of Financial Accounting Standard 143 *Accounting for Asset Retirement Obligations* and the full cost method used by some oil and gas producing companies. The representative also outlined the SEC staff belief that residual (as opposed to direct) methods of determining the fair value of an intangible asset are not acceptable under SFAS 141 *Business Combinations*.

The Committee discussed proposed FASB Staff Position 03-1-a which would clarify the operation of EITF 03-1 *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. An SEC representative noted that an upcoming AICPA/SEC Conference would involve discussion of this issue, including the consistency of EITF 03-1 and IAS 39 *Financial Instruments: Recognition and Measurement*. The IFRIC requested the staff to prepare a paper on this topic for consideration at a future meeting.

The IFRIC discussed EITF Issue No. 04-8 *The Effect of Contingently Convertible Debt on Diluted Earnings per Share*. The draft Abstract reflects the EITF's tentative conclusion that contingently convertible debt instruments (Co-Cos) should be included in diluted earnings per share, regardless of whether any contingent features have been met. The IFRIC Chairman noted that the Board will be asked to discuss this matter at a future meeting.

Items not taken to the IFRIC agenda

The IFRIC discussed the Agenda Committee's recommendations on whether the following issues should be added to the agenda. The tentative decisions of the IFRIC outlined below are expected to be ratified by the IFRIC at the December meeting.

IAS 2 *Inventories*: Discounts and rebates

The IFRIC considered three related questions on the application of IAS 2 *Inventories* that had been referred to it by the Urgent Issues Group (UIG) of the Australian Accounting Standards Board:

(a) whether discounts received for prompt settlement of invoices should be deducted from the cost of inventories or recognised as financing income.

(b) whether all other rebates should be deducted from the cost of inventories. The alternative would be to treat some rebates as revenue or a reduction in promotional expenses.

(c) whether volume rebates should be recognised only when threshold volumes are achieved, or proportionately where achievement is assessed as probable.

On (a), the IFRIC tentatively agreed that settlement discounts should be deducted from the cost of inventories. Because the requirements under IFRSs were sufficiently clear, the IFRIC tentatively agreed that the matter should not be added to the agenda.

On (b), the IFRIC tentatively agreed that IAS 2 requires only those rebates and discounts that have been received as a reduction in the purchase price of inventories to be taken into consideration in the measurement of the cost of the inventories. Rebates that specifically and genuinely refund selling expenses would not be deducted from the costs of inventories. Because the requirements under IFRSs were sufficiently clear, the IFRIC tentatively agreed that the matter should not be added to the agenda.

On (c), the IFRIC tentatively agreed that there was insufficient evidence of diversity in practice to warrant the matter being added to the agenda.

IAS 11 *Construction Contracts* and IAS 18 *Revenue*: Pre-completion contracts for the sale of residential development properties

The IFRIC considered a question on the application of IAS 11 *Construction Contracts* and IAS 18 *Revenue* that had been referred to it by the UIG. The UIG was concerned that its Abstract 53 *Pre-completion Contracts for the Sale of Residential Development Properties* might not comply with IFRSs.

The IFRIC tentatively agreed that pre-completion contracts might not meet the definition of construction contracts set out in IAS 11 because the contracts in question are not specifically negotiated for the construction of residential units. Rather, they are agreements for the purchase and sale of such units. In addition, when pre-completion contracts did not meet the definition, the guidance in IAS 18 would prohibit revenue recognition before legal title is transferred, if the risks and rewards of ownership did not pass to the buyer before then.

The IFRIC tentatively agreed that the issue should not be added to the agenda. The IFRIC noted that the definition of a construction contract in IAS 11 was sufficiently clear on this matter; it did not include typical pre-completion contracts and further guidance was not required. The IFRIC also has a project on its agenda seeking to clarify the criteria for combining and segmenting contracts. The features of pre-completion contracts that might have a relevance to the criteria for combining contracts could be considered as part of that project. The Board is also undertaking a project on revenue recognition, which will address revenue recognition on real estate transactions. The IFRIC agreed that, in the meantime, the guidance in the Appendix to IAS 18 is sufficient to prevent premature recognition of revenue on pre-completion contracts.

IAS 16 *Property, Plant and Equipment* and IAS 17 *Leases*: Depreciation of assets leased under operating leases

The Agenda Committee considered whether interest methods of depreciation were permissible under IFRSs. Use of such methods would permit an entity to depreciate an asset that is not a receivable in much the same way as if it were a receivable, with the result that the depreciated amount of the asset reflects the present value of future net cash flow expected from it. The Committee recommended that this topic should not be added to the IFRIC's agenda.

The IFRIC noted that, while deliberating certain issues related to service concessions, it had considered whether it would be appropriate to use an interest method of depreciation. In that discussion, it concluded that using an interest method of depreciation was not appropriate. The IFRIC concluded that there was nothing unique about assets leased under operating leases in service concessions that would cause it to reach a different conclusion about the use of interest methods of depreciation. It noted that the Basis for Conclusions in the future Interpretations on service concessions would include a discussion of its conclusions on interest methods of depreciation.

IAS 38 *Intangible Assets*: Subscriber acquisition costs

The IFRIC considered a question on the application of IAS 38 *Intangible Assets* that had been referred to it by the UIG. The UIG was concerned that its Abstract 42 *Subscriber Acquisition Costs in the Telecommunications Industry* might be inconsistent with IFRSs.

IFRIC members expressed concern that the issues raised in UIG 42 applied in a broad range of situations and were not limited to the telecommunications sector. If the IFRIC did add this topic to its agenda, there were concerns about whether IFRIC would be able to reach a consensus view on a timely basis. The IFRIC also noted that this issue was related to several Board projects. Accordingly, the IFRIC tentatively agreed not to add this issue to its agenda.

Future meetings and requests for Interpretations

The IFRIC's meetings for 2004 and 2005 are expected to take place in London, UK, as follows:

2 and 3 December 2004

2005

3 and 4 February 2005

31 March and 1 April 2005

2 and 3 June 2005

28 and 29 July 2005

1 and 2 September 2005

3 and 4 November 2005

1 and 2 December 2005

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.