

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 Exposure Draft, which is confirmed by the IASB.

The International Financial Reporting Interpretations Committee met in London on 12 and 13 January 2006, when it discussed:

- D15 *Reassessment of Embedded Derivatives* – Proposal for a final Interpretation;
- Service Concessions;
- Customer Loyalty Programmes;
- One tentative and one final agenda decision;
- Proposals for an IFRIC Handbook;
- Hedging Inflation Risk.

It was announced that IFRIC 8 *Scope of IFRS 2* and D18 *Interim Financial Reporting and Impairment* had been published on 12 January.

D15 – Reassessment of Embedded Derivatives

Staff of the German Standard Setter presented the draft of a final Interpretation reflecting amendments requested at the November IFRIC meeting. The IFRIC decided that the Interpretation should not address the accounting in a business combination for the acquiree's contracts containing embedded derivatives.

IFRIC members confirmed that, contrary to a suggestion in the draft presented to the meeting, all embedded derivatives meeting the requirements of paragraph 11 of IAS 39 must be separated from the host contract when the entity first becomes a party to the contract. Provided that point was clear, the IFRIC decided that the Interpretation did not need to refer to non-financial contracts that ceased to meet the conditions for

special treatment under paragraphs 5-7 of IAS 39. Modifying slightly a decision at the November meeting, the IFRIC decided that the explanation of a change of 'commercial substance' in the terms of a contract should use the language of paragraph 11A of IAS 39, rather than text from IASs 16 and 38. IFRIC members further observed that the exercise of an embedded option did not constitute a change in the terms, since the option was in the contract from inception and should be considered in the initial estimate of expected cash flows. The IFRIC decided that certain paragraphs of the Basis for Conclusions of the Draft Interpretation should be deleted to avoid repetition or unnecessary explanation.

Next steps

The IFRIC asked the staff to amend the draft in the light of the discussion and to present it to the Board for approval to issue.

Service Concession Arrangements

At this meeting the IFRIC discussed a project plan and the recognition of construction revenue under D14 *Service Concession Arrangements – The Intangible Asset Model*.

Project plan

The staff outlined a proposed plan that identified the key milestones and timing to get to publication of final Interpretations by the third quarter of 2006, assuming that re-exposure is not required. The IFRIC noted the plan, while observing that the timing might be optimistic. IFRIC will address whether re-exposure is necessary once it completes its redeliberations.

The IFRIC considered the extent to which a final Interpretation should address arrangements that had been excluded from the scope of D12 *Service Concession Arrangements – Determining the accounting model*. The staff referred to the frequent criticism by respondents to D12 that the proposals ignored many arrangements that were found in practice,

in particular, when the operator was either a lessee or, conversely, held the infrastructure as its property, plant and equipment under IAS 16. The IFRIC decided that the scope of the project should not be expanded but that the Basis for Conclusions should mention the spectrum of arrangements from lessee through service provider to owner, explaining that the Interpretations dealt with the middle group, which was the area that IFRIC believed most needed interpretive guidance. For arrangements that fell outside the scope of the Interpretations, references could be made to relevant Standards (eg IAS 16 *Property, Plant and Equipment*, IAS 17 *Leases*), though without giving guidance on their application. If such guidance proved to be needed, a separate project could be undertaken at a later date.

The IFRIC also identified two issues to be addressed in further redeliberations: whole of life arrangements and holistic versus component accounting for arrangements.

Recognition of construction revenue under the intangible asset model

The IFRIC noted that one aspect of D14 that caused concern amongst respondents was the revenue recognition profile under the intangible asset model. Over the course of the contract, the revenue recognised by the operator would exceed the total amount of cash flows from the contract. In the light of the comments received the IFRIC had directed staff to research the matter further.

The IFRIC noted that, at some point, the construction activity gives rise to an intangible asset in the books of the operator. The IFRIC discussed three alternatives as to how transformation

Copyright © IFRIC Update is published after every IFRIC meeting by the IASCF, Publications Department, 30 Cannon Street, London, EC4M 6XH United Kingdom

Tel: +44 (0)20 7332 2730

Fax: +44 (0)20 7332 2749

Website: www.iasb.org

Email: publications@iasb.org

ISSN 1477-206X

from construction asset to intangible asset might be recognised:

- View 1: revenue and, when applicable, profit is recognised on an exchange transaction, whereby construction services are exchanged for an intangible asset;
- View 2: no revenue is recognised, however profit is recognised on an exchange transaction; and
- View 3: construction costs incurred are capitalised directly into the cost of an intangible asset and no exchange transaction is accounted for.

Some IFRIC members re-iterated their discomfort with the ‘double’ recognition of revenue under View 1. One further possibility suggested was that, instead of a restriction on recognition of construction revenue, the subsequent revenue from users of the infrastructure should be restricted to that part which paid for the operation of the infrastructure. IFRIC decided to proceed with View 1 as proposed in D14. Revenue and, when applicable, profit should be recognised on the construction phase of the arrangement, when the requirements of IAS 11 are met.

Customer Loyalty Programmes

The IFRIC continued its discussion begun at the November 2005 meeting on the basis of a paper prepared by staff of the French Standard Setter. The staff were asked to bring back a paper with further discussion of the two main issues:

- the dividing line determining when to use paragraph 13 of IAS 18 *Revenue*, dealing with multiple element sales, and when paragraph 19, dealing with provisions for remaining costs;
- the basis for recognising revenue on services to be supplied by third parties.

IFRIC members concluded that customer loyalty programmes should be characterised, for accounting purposes, principally by the rights which they granted to customers as a reward for past purchases.

The IFRIC had been asked for guidance on whether the resulting customer relationship constituted an intangible asset. Most members believed that such questions should not be brought into the scope of this project, as they are addressed in IAS 38 *Intangible Assets*, which set a high hurdle for recognition.

Other scope issues debated were: money-off vouchers freely distributed; volume rebates; and rights granted to a customer to obtain free or discounted goods or services from a third party. It was decided that inclusion of the first two issues would expand the scope unduly; freely distributed vouchers did not involve a current sale and volume rebates might not have all of the same characteristics as a more specific loyalty scheme. One member asked for the decision on volume rebates to be considered further by the staff, since their effects seemed very close to the effects of multiple element sales. In respect of the third issue it was decided that the scope should be sufficiently broad to include all revenue transactions that provide for additional goods or services to be supplied, whether by the entity or a third party. That

would provide a basis for considering the nature of the entity’s commitment and whether accounting for the initial sale should differ depending on whether the commitment would be met by the entity itself or by a third party. It also raised questions over the circumstances in which the customer’s dealings with the third party would represent a subsequent sale by the entity or an agency activity.

In discussing references to ‘constructive obligations’ the IFRIC concluded that it would not seek to address whether non-contractual but long-standing practices create constructive obligations equivalent to loyalty programmes. However, it should deal explicitly with customer rights that accrued under a programme up to the threshold at which a formal entitlement is obtained. The IFRIC asked the staff to address whether plan terms with a threshold achieved in multiple transactions are a recognition or measurement issue.

The IFRIC decided that a draft Interpretation should not address measurement issues in detail but it should note that IAS 18 requires revenue to be recognised at the fair value of the consideration received. When customer loyalty rights granted are accounted for under paragraph 13 of IAS 18, the fair value of the consideration should be apportioned between the current sale and the rights to future goods or services. The IFRIC noted that the measurement of the fair value of the consideration received for those rights should reflect the expected percentage of rights that lapse unexercised. The IFRIC deferred for future consideration what differences might result from recognition of customer loyalty rights under paragraph 19 of IAS 18 rather than paragraph 13 and also what to do if the relevant paragraph were determined by the customer’s own choice of the benefits he or she would receive.

The IFRIC asked that the staff paper for the next meeting should include analysis of these issues.

Postponement of discussions regarding potential agenda items

The IFRIC postponed to a later meeting discussions of staff papers on two issues: the classification of undated debt instruments/preferred shares; and puts held by minority interests.

IFRIC agenda decision

The following explanation is published for information only and does not change existing IFRS requirements. Interpretations of the IFRIC are determined only after extensive deliberation and due process, including a formal vote by written ballot. IFRIC Interpretations become final only when approved by nine of the fourteen members of the IASB.

A historical record of these decisions can be found on the IASB website.

IFRS 6 Exploration for and Evaluation of Mineral Resources – Application of the ‘full-cost’ method

The IFRIC was asked to clarify the effect of the limited scope of IFRS 6 on exploration and evaluation (E&E)

activities. The IFRIC was asked if this limited scope (a) reflected the Board's intention to impose limits on current national GAAP practices only in respect of activities conducted in the E&E phase, while permitting industry practices in other extractive industry areas (eg, development and exploitation) to continue unchanged, or (b) whether the IASB focused only on E&E activities because it was the only area for which the IASB was willing to grant some relief from the hierarchy for selection of accounting policies in IAS 8. Under the latter view, the IAS 8 hierarchy would apply fully to an entity's selection of IFRS accounting policies for activities outside of the E&E phase. The submission identified some inconsistencies between current extractive industry full-cost accounting practices in respect of development and exploitation activities but questioned whether the IASB intended to require change from current practices in these areas in advance of a comprehensive extractive industry project.

The IFRIC noted that the effect of the limited scope of IFRS 6 was to grant relief only to policies in respect of E&E activities, and that this relief did not extend to activities before or after the E&E phase. The Basis for Conclusions on IFRS 6 includes the Board's intention of limiting the need for entities to change their existing accounting policies for E&E activities. The IFRIC believed it was clear that the scope of IFRS 6 consistently limited the relief from the hierarchy to policies applied to E&E activities and that there was no basis for interpreting IFRS 6 as granting any additional relief in areas outside its scope. Therefore, the IFRIC believed that diversity in practice should not become established and decided not to add the issue to its agenda.

Tentative agenda decision

The IFRIC reviewed the following matter, which the Agenda Committee had recommended should not be placed on the IFRIC agenda. This tentative decision, including where appropriate suggested reasons for not adding it to the IFRIC agenda, will be re-discussed at the March 2006 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 26 February 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.

IAS 27 Consolidated and Separate Financial Statements – Separate financial statements issued before consolidated financial statements

The IFRIC was asked to consider whether separate financial statements issued before consolidated financial statements could be considered to comply with IFRSs.

The IFRIC noted that IAS 27 requires that separate financial statements should identify the financial statements prepared in accordance with paragraph 9 of IAS 27 to which they relate (the consolidated financial statements), unless one of the exemptions provided by paragraph 10 is applicable.

The IFRIC decided that, since the Standard is clear, it would not expect diversity in practice and would not take this item onto its agenda.

Proposal for an IFRIC Due Process Handbook

The Director of Technical Activities presented a draft of an IFRIC Due Process Handbook, which was to be proposed to the Trustees at their March 2006 meeting for approval for issue for public comment. It was intended that, when finalised, the Handbook would replace most of the existing *Preface to International Financial Reporting Interpretations*, the remainder of which would be combined with the existing *Preface to International Financial Reporting Standards*.

The IFRIC discussion focused on:

- the criteria for adding an issue to the IFRIC agenda;
- whether the Agenda Committee should meet in public; and
- other matters.

Agenda criteria

The draft Handbook added to the existing criteria for taking an issue onto the agenda (listed in paragraph 27 of the IFRIC Preface) an explicit statement that an issue would not be taken on if the IFRSs are clear, with the result that divergent interpretations are not expected in practice. The IFRIC welcomed an explicit statement to that effect. Among other suggestions by individual members were: that an Interpretation would assist convergence with one or more National Standards; and that financial reporting would be improved through the elimination of diverse reporting methods. On reflection, members considered that convergence might be a result of their work but was an objective for the Board rather than for the IFRIC. Members agreed that the remaining suggestions should be considered in the redrafting.

It was agreed that any one of the listed criteria might suffice to cause an issue to be accepted or declined as an agenda item.

Whether the Agenda Committee should meet in public

A number of comment letters received on IFRIC's Review of Operations had raised questions regarding whether the IFRIC Agenda Committee should meet in public. The issue was therefore being raised with the IFRIC. 'Meeting in public' would mean only that members of the public might attend Agenda Committee meetings; it would not be accompanied by publication of Observer Notes or minutes of the discussions.

IFRIC members were divided in their views. It was recognised that there was an important distinction between

the role of the Agenda Committee, which was to assist the staff in their initial preparation of a paper for the IFRIC leading to a *recommendation* on whether or not to place items on the agenda, and the role of the IFRIC, which was to *evaluate issues and take decisions* on the content of the agenda and on the technical issues. Some IFRIC members thought that requiring the Agenda Committee to meet in public would tend to blur the distinction of roles between the Agenda Committee and the full IFRIC and put pressure on all IFRIC members to attend Agenda Committee meetings. That would place an additional burden on some members with a particular disadvantage for those residing outside the UK.

Other members commented that holding Agenda Committee meetings in public would help to dispel concerns that technical decisions were being taken behind closed doors. They noted that, inevitably, the process of assisting the staff to understand issues that have been raised involves discussion of technical matters. However, it is clear that decisions are taken only at full meetings of the IFRIC in public. Those IFRIC members who attended Agenda Committee meetings voluntarily said that they felt they benefited from hearing that committee's discussions and would like to find some way of extending such benefits to the whole of the IFRIC.

Concluding the debate, the Chairman said that he would propose to the Trustees that the present arrangements should continue but that consideration should be given to ways of improving the communication to the IFRIC of the detail discussed in the Agenda Committee.

Other matters

The draft Handbook contained text (based on paragraphs 42 and 43 of the IFRIC Preface) carrying forward the existing policy regarding liaison with and monitoring of National Standard Setters and National Interpretive Groups. IFRIC members were reluctant to see these go forward before they had had an opportunity to review that policy in the light of current developments. It was suggested that the Handbook should at least mention their concerns and say that the policy is to be reviewed. The Chairman said that it might be possible to bring a paper on the subject to the IFRIC in March, to allow IFRIC members the opportunity for discussion ahead of the Trustees' meeting.

IFRIC members made various drafting suggestions, which the Director of Technical Activities undertook to reflect in a redraft to be circulated for members' comment before being submitted to the Board and then to the Trustees.

Hedging Inflation Risk

IFRIC members received a presentation by staff from Morgan Stanley and Barclays Capital on the workings of the inflation markets. The presentation was designed to assist the IFRIC in considering whether to add an interpretive project addressing whether inflation risk qualifies as a separate component for hedging purposes under IAS 39 *Financial Instruments: Recognition and Measurement*. The session was educational; no decisions were taken.

Future IFRIC meetings

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

2006

- 2 and 3 March
- 11 and 12 May
- 6 and 7 July
- 7 and 8 September
- 2 and 3 November

Meeting dates, tentative agendas and additional details about the next meeting will also be posted to the IASB Website at www.iasb.org before the meeting. Instructions for submitting requests for Interpretations are given on the IASB Website at www.iasb.org/about/ifric.asp