NEWSLETTER OF THE INTERNATIONAL FINANCIAL REPORTING INTERPRETATIONS COMMITTEE

IASB IFRIC UPDATE

November 2008

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 IFRIC met in London on 6 November 2008, when it discussed:

- IFRIC D24 *Customer Contributions*
- Compliance costs for REACH
- Customer-related intangible assets
- IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*—Voluntary prepaid contributions under a minimum funding requirement
- Agenda decisions
- Tentative agenda decisions
- Work in progress

IFRIC D24 *Customer Contributions*

The IFRIC completed its redeliberations of draft Interpretation D24 at this meeting. The IFRIC considered a revised draft Interpretation, basis for conclusions and illustrative examples prepared by the staff that took into account the IFRIC's tentative views reached at its meetings in July and September 2008. This draft was posted on the IASB's Website in the Observer Notes for the meeting.

Title of the Interpretation

The IFRIC noted that, in some jurisdictions, the term 'contribution' implies a non-reciprocal transfer rather than an exchange transaction. In addition, IFRIC members noted that this term might be difficult to translate into some languages. For these reasons, the IFRIC decided to use the term 'transfer' instead of 'contribution' and to rename the Interpretation IFRIC X *Transfers of Assets from Customers*.

Who controls the asset?

The IFRIC noted that D24 envisaged several steps to determine whether an asset should be recognised, including the consideration of IFRIC 4 *Determining whether an Arrangement contains a Lease* and IAS 17 *Leases*. In its redeliberations, the IFRIC decided to simplify the requirements and the focus on who controls the asset. At this meeting, the IFRIC decided that this guidance should be based solely on the definition of an asset set out in the *Framework*. The IFRIC supported the following wording proposed by the staff:

When an entity receives a transfer from a customer in the form of an item of property, plant and equipment, it should assess whether the transferred item meets the definition of an asset set out in the *Framework*. Paragraph 49(a) of the *Framework* states that 'an asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.' In most circumstances, the entity obtains the right of ownership of the transferred item of property, plant and equipment. However, in determining the existence of an asset, the right of ownership is not essential. Therefore, if the customer continues to control the transferred item, the asset definition would not be met despite the transfer.

The entity that controls the transferred item of property, plant and equipment can generally deal with the transferred item as it pleases. For example, the entity having control of an asset can exchange it for other assets, employ it to produce goods or services, charge a price for others to use it, use it to settle liabilities, hold it, or distribute it to owners.

The IFRIC concluded that this guidance was clearer than the proposals in D24 and asked the staff to amend the revised draft Interpretation accordingly.

Revenue recognition

The IFRIC considered the guidance included in the revised draft Interpretation to help identify whether one or two services are provided in exchange for the transferred item of property, plant and equipment in accordance with paragraph 13 of IAS 18 *Revenue*. The IFRIC generally supported the staff's proposals but asked the staff to delete two indicators:

- The IFRIC concluded that the fact that the connection service could be sold separately is not a relevant indicator that this service is a component of the transaction because services can generally be sold separately.
- The IFRIC concluded that the fact that customers have the ability to choose to receive goods or services from suppliers other than the entity is not a relevant indicator that the provision of ongoing access to a supply of goods or services arises from the terms of the entity's operating license or other regulation rather than from the arrangement.

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IFRIC D24 *Customer Contributions* (contd)

Other clarifications

The IFRIC asked the staff to clarify the definition of a customer and the nature of the various services that might be provided by multiple parties to the arrangement. For example:

- Customers may choose to receive electricity from a supplier other than the network company responsible for its transmission. In this case, it should be clear that the Interpretation applies to the network transmission company that receives the property, plant and equipment from the customer and that the service received is the use of the network to access the supply of electricity.
- An electricity substation may be transferred by a property developer in relation to a number of residential units it is constructing. In this case, it is the homeowners that will eventually use the network to access the supply and use the electricity, although they did not initially transfer the substation. The Interpretation would clarify that the property developer would be the 'customer' transferring the asset for the purposes of the Interpretation.

These different circumstances should also be clarified in the examples.

Vote to confirm consensus

The IFRIC considered whether the changes from the draft Interpretation exposed for comment as D24 were such that re-exposure was required in accordance with the IFRIC *Due Process Handbook*. The IFRIC made changes to D24 to address the concerns expressed by respondents, including some utility companies, that an entity receiving a transfer of an asset from a customer does not *always* have an obligation to provide ongoing access to a supply of goods or services as a result of the transfer. However, the IFRIC acknowledged that the changes made to D24 in respect of revenue recognition were significant. Consequently, the IFRIC decided that the near-final draft of the Interpretation should be posted on the Website for a longer than normal period to give those constituents who wished to do so the opportunity to comment on it. At its meeting in January 2009 the IFRIC will consider any comments received before it submits the Interpretation to the Board for ratification at the Board's meeting in January.

The IFRIC decided that the Interpretation should be applied prospectively to transfers of assets from customers received on or after three months from the date of publication of the final Interpretation. Finally, the IFRIC voted and confirmed the consensus subject to its final review of drafting changes.

Compliance costs for REACH

The IFRIC received a request to add an issue to its agenda to provide guidance on the treatment of costs incurred to comply with the requirements of the European Regulation concerning the Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH). At its meeting in July 2008, the IFRIC agreed with the staff's recommendation that it should tentatively add this issue to its agenda.

In July, the IFRIC noted that jurisdictions other than Europe had developed or were in the process of developing regulations relating to similar environmental issues. Consequently, the IFRIC recommended that the staff should analyse the issue on the basis of general principles rather than the specifics of any particular legislation.

At this meeting the IFRIC considered whether this issue meets the criteria for being added to the IFRIC agenda. For that purpose, the IFRIC considered:

- key features of REACH;
- accounting standards and practices; and
- accounting issues and alternative views under IFRSs.

The IFRIC did not decide whether to add this issue to its agenda. The IFRIC directed the staff to identify the rights an entity acquires under REACH and the characteristics of REACH compliance costs that require an Interpretation. This information will permit the IFRIC to determine whether it can specify an appropriate scope for this project and therefore whether it should be added to the agenda.

Customer-related intangible assets

The IFRIC received a request to add an item to its agenda to provide guidance on the circumstances in which a non-contractual customer relationship arises in a business combination. IFRS 3 *Business Combinations* (as revised in 2008) requires an acquirer to recognise the identifiable intangible assets of the acquiree separately from goodwill. An intangible asset is identifiable if it meets either the contractual-legal criterion or the separable criterion in IAS 38 *Intangible Assets*. Contractual customer relationships are always recognised separately from goodwill as they meet the contractual-legal criterion. However, non-contractual customer relationships are recognised separately from goodwill only if they meet the separable criterion.

The IFRIC noted that the IFRS Glossary defines the term 'contract'. Paragraphs B31—B40 in the application guidance of IFRS 3 provide guidance on the recognition of intangible assets and the different criteria related to whether they are established based on a contract. The IFRIC also noted that paragraph IE28 in the illustrative examples accompanying IFRS 3 provides indicators for identifying the existence of a customer relationship between an entity and its customer and states that a customer relationship 'may also arise through means other than contracts, such as through regular contact by sales or service representatives.'

The IFRIC concluded that how the relationship is established helps to identify whether a customer relationship exists but should not be the primary basis for determining whether the acquirer recognises an intangible asset. The IFRIC noted that the criteria in paragraph IE28 might be more relevant. The existence of contractual relationships and information about a customer's prior purchases would be important inputs in valuing a customer relationship intangible asset but should not determine whether it is recognised.

In the light of the explicit guidance in IFRS 3, the IFRIC decided that developing an Interpretation reflecting its conclusion is not possible. Noting widespread confusion in practice on this issue, the IFRIC decided that it could be best resolved by referring it to the IASB and the FASB with a recommendation to review and amend IFRS 3 by:

- removing the distinction between 'contractual' and 'non-contractual' customer-related intangible assets recognised in a business combination; and
- reviewing the indicators that identify the existence of a customer relationship in paragraph IE28 of IFRS 3 and including them in the standard.

IFRIC 14 *IAS 19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*—Voluntary prepaid contributions under a minimum funding requirement

As a result of comment letters received on the issue related to IFRIC 14 (discussed in Agenda Decisions below), the IFRIC noted that there are other requirements in IFRIC 14 that cause difficulties. These requirements may produce unintended consequences in some circumstances in the treatment of voluntary prepaid contributions under a minimum funding requirement. Paragraph 22 of IFRIC 14 requires an entity to include particular expected cash outflows in the assessment of whether there is an asset at the reporting date. In some cases, the inclusion of these cash flows implies there is a liability at the reporting date when there is not. The IFRIC decided to add this issue to its agenda. As a result of this project, the IFRIC expects to propose amendments to the wording of paragraph 22 of IFRIC 14.

IFRIC agenda decisions

The following explanation is published for information only and does not change existing IFRS requirements. *IFRIC agenda decisions are not Interpretations. IFRIC Interpretations 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 39 *Financial Instruments: Recognition and Measurement*—Valuation of restricted securities

The IFRIC received a request for guidance on whether a discount must be applied to the quoted market price when establishing the fair value of a security quoted in an active market when there is a contractual, governmental or other legally enforceable restriction that prevents the sale of the security for a specified period. Guidance was requested only in situations in which the restriction applied to the current holder of the security and would not transfer to another entity.

The IFRIC noted that any guidance it could provide would be in the nature of implementation guidance rather than an Interpretation. In its view, any additional guidance that is necessary should be provided by the Board in its project on fair value measurement.

The IFRIC therefore decided not to add this issue to its agenda.

IFRIC 14 IAS 19—*The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*—Stable workforce assumption

The IFRIC received a request to consider an issue arising from IFRIC 14. The issue relates to the economic benefit available in the form of reductions in future contributions when there is a minimum funding requirement. IFRIC 14 requires the economic benefit to be determined assuming a stable workforce in the future unless the entity is demonstrably committed at the end of the reporting period to make a reduction in the number of employees covered by the plan. The request noted that in some circumstances the assumption of a stable workforce may understate the economic benefits available to the entity as a reduction in future contributions. The request noted that contributions to a plan are recognised as an expense, not an asset, if they provide no economic benefits in accordance with IFRIC 14. Therefore, by choosing the timing and the level of such contributions, an entity can affect its reported earnings.

The IFRIC noted that the requirements of IFRIC 14 regarding the assumption of a stable workforce are explicit. The issue was discussed extensively during the development of IFRIC 14 and the request provides no new information to cause the IFRIC to reconsider its conclusion. The IFRIC therefore decided not to add this issue to its agenda.

Tentative agenda decisions

The IFRIC reviewed the following matters and tentatively decided that they should not be added to the IFRIC agenda. These tentative decisions, including recommended reasons for not adding the items to the IFRIC agenda, will be reconsidered at the IFRIC meeting in January 2009. Constituents who disagree with the proposed reasons, or believe that the explanations may contribute to divergent practices, are encouraged to communicate those concerns by 15 December 2008 by email to: ifric@iasb.org.

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

IAS 28 *Associates*—Potential effect of IFRS 3 *Business Combinations* (as revised in 2008) and IAS 27 *Consolidated and Separate Financial Statements* (as amended in 2008) on equity method accounting

The IFRIC staff noted that the FASB's Emerging Issues Task Force (EITF) recently added to its agenda, EITF Issue No. 08-6 *Equity Method Investment Accounting Considerations*. EITF 08-6 addresses several issues resulting from the recently concluded joint project by the IASB and FASB on accounting for business combinations and accounting and reporting for non-controlling interests that culminated in the issue of IFRS 3 (as revised in 2008) and IAS 27 (as amended in 2008) and SFAS 141(R) and SFAS 160.

EITF 08-6 addresses the following four issues:

1 How the initial carrying value of an equity method investment should be determined

2 How an impairment assessment of an underlying indefinite-lived intangible asset of an equity method investment should be performed

3 How an equity method investee's issue of shares should be accounted for

4 How to account for a change in an investment from the equity method to the cost method.

The IFRIC noted that IAS 28 *Investments in Associates* provides explicit guidance on issues 2 and 4. Therefore, the IFRIC does not expect divergence in practice and [decided] not to add these issues to its agenda. The IFRIC asked the staff to carry out additional research and analysis of issues 1 and 3 for consideration at a future IFRIC meeting.

IAS 32 *Financial Instruments: Presentation*—Classification of puttable and perpetual instruments

The IFRIC received a request for guidance on the application of paragraph 16A (c) of IAS 32, which states that 'All financial instruments in the class of instruments that is subordinate to all other classes of instruments have identical features. […]'. The request asked for guidance on the classification of an entity's puttable instruments that are subordinate to all other classes of instruments when the entity also has perpetual instruments that meet the definition of equity instruments in accordance with paragraphs 11 and 16 of IAS 32.

The IFRIC noted that a financial instrument is first classified as a liability or equity instrument in accordance with the general requirements of IAS 32. That classification is not affected by the existence of puttable instruments. As a second step, if a financial instrument meets the definition of a financial liability because it is puttable to the issuer, the entity considers the conditions in paragraphs 16A and 16B of IAS 32 to determine whether it should be classified as equity. Consequently, the IFRIC noted that IAS 32 does not preclude the existence of several classes of equity.

The IFRIC also noted that paragraph 16A(c) applies only to 'instruments in the class of instruments that is subordinate to all other classes of instruments'. Paragraph 16A(b) specifies that the level of an instrument's subordination is determined by its priority in liquidation. Accordingly, the existence of the puttable feature does not of itself imply that the puttable instruments are less subordinate than the perpetual instruments.

Given the requirements in IAS 32, the IFRIC did not expect significant diversity in practice to develop. Therefore the IFRIC [decided] not to add this issue to its agenda.

IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*/IAS 38 *Intangible Assets*—Regulatory assets and liabilities

The IFRIC received a request to consider whether regulated entities could or should recognise a liability (or an asset) as a result of rate regulation by regulatory bodies or governments.

At its meeting in November 2008 the IFRIC considered detailed background information, an analysis of the issue and an assessment of the issue against its agenda criteria. The IFRIC noted that:

- rate regulation is widespread and significantly affects the economic environment of regulated entities;
- divergence does not seem to be significant in practice;
- resolving the issue would require interpreting the definitions of assets and liabilities set out in the *Framework* and their interaction with one or more IFRSs;
- although the issue is not specifically being considered in an active Board project, it relates to more than one active Board project.

The IFRIC concluded that the agenda criteria were not met, mainly because divergence in practice does not seem to be significant. Therefore, the IFRIC [decided] not to add the issue to its agenda.

IAS 39 *Financial Instruments: Recognition and Measurement*—Derecognition

The IFRIC was asked:

1 how the derecognition tests in IAS 39 should be applied to groups of financial assets, in particular, when a group of financial assets should be considered similar; and

2 when the pass through tests in IAS 39 should be applied to a transfer of a financial asset.

At its meeting in July 2006 the IFRIC decided to refer these issues to the Board for clarification. The Board discussed the issues at its meeting in September 2006 and its observations were communicated to the IFRIC at its meeting in November 2006. The IFRIC decided not to add the issue to the agenda. A tentative decision was published in the November 2006 IFRIC *Update*.

At its meeting in January 2007 the IFRIC decided to add a limited scope project on derecognition to its agenda. However, the project has been inactive awaiting the availability of staff resources.

Subsequently, the Board has accelerated its project to develop a replacement for the sections of IAS 39 that would have been interpreted by this IFRIC issue. The Board expects to issue a new standard on this topic no later than 2010.

Therefore the IFRIC [decided] to remove this issue from its agenda.

IAS 39 *Financial Instruments: Recognition and Measurement*—Fair value measurements of financial instruments in inactive markets: determining the discount rate

The IFRIC received a submission containing a proposal on how a discount rate should be determined when fair value is established using a valuation technique. The submission noted that both the credit spread and liquidity spread components of the discount rate might not be observable in inactive markets. The submission suggested that, in such circumstances, the liquidity spread should not exceed that of a non-tradable loan or receivable which is comparable to the security being measured, that a model-based valuation should aim to calculate the value of a financial instrument that market participants would agree on if they were acting in a rational manner and that market behaviour that is clearly not indicative of fair value should be eliminated from the valuation.

The IFRIC noted that using a discounted cash flow model in measuring fair value might be appropriate if there is no active market. However, the IFRIC also noted that IAS 39 states that the objective of using a valuation technique is to establish what the fair value (ie the transaction price in an arms' length exchange motivated by normal business considerations) would have been on the measurement date. To meet that measurement objective, a valuation technique incorporates all factors that market participants would consider in setting a price and is consistent with accepted economic methodologies for pricing financial instruments. Accordingly, the IFRIC concluded that any suggestion that a valuation technique should consider factors differently from the way a market participant would be expected to consider them so as to arrive at a price that is different from the price a market participant would determine would not be consistent with IAS 39.

The approach proposed in the submission suggests that certain factors should be adjusted away from a market participant's view. This would be inconsistent with both the objective of fair value measurement and the existing guidance in IAS 39.

The IFRIC also noted that any guidance it could provide would be in the nature of implementation guidance rather than an interpretation. In addition, the IASB had just published the report of its Expert Advisory Panel which explains how experts measure and disclose the fair values of financial instruments in inactive markets and a staff summary on the use of judgement to measure those values when markets are no longer active. In addition, the issue relates directly to subjects that will be discussed at the joint IASB/FASB round-table meetings to be held in November and December. In the IFRIC's view, the issue should be included for discussion at the joint round tables and any amended guidance that is necessary should be provided as a result of the Board's joint activities with the FASB and its fair value measurement project.

Therefore the IFRIC [decided] not to add this issue to its agenda.

IFRIC work in progress

The IFRIC reviewed a summary of outstanding issues. The IFRIC noted that all requests received were either discussed at this meeting or are being considered by the Board.

From July 2006, IFRIC meetings have been audiocast live via the Internet. Audio recordings are available to listen to via the Website and can be accessed via the IFRIC Projects included within the Current Projects area. 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:

- 8 and 9 January
- 5 and 6 March
- 7 and 8 May
- 9 and 10 July
- 3 and 4 September
- 5 and 6 November

In addition to the meetings listed above, the IFRIC may hold meetings for a preliminary discussion of some staff papers. Attendance by IFRIC members at these meetings is voluntary and no decisions on technical issues will be made. If the IFRIC holds a preliminary meeting, it will normally take place on the Wednesday afternoon before the IFRIC meeting.

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 http://www.iasb.org/About+Us/About+IFRIC/Propose+Agenda+Item.htm

