NEWSLETTER OF THE INTERNATIONAL FINANCIAL REPORTING INTERPRETATIONS COMMITTEE

IASB IFRIC UPDATE

July 2007

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 12 July 2007, when it discussed:

- IAS 18 *Revenue*—Customer contributions
- IAS 27 *Consolidated and Separate Financial Statements*—Demergers and other in-specie distributions
- IAS 39 *Financial Instruments: Recognition and Measurement*—paragraph AG33(d)(iii)
- IAS 39 *Financial Instruments: Recognition and Measurement*—Scope of paragraph 11A
- IFRS 2 *Share-based Payment*—Group cash-settled share-based payment transactions
- IFRIC agenda decisions
- Tentative agenda decisions

Changes to the composition of the IFRIC

The chairman welcomed four new members of the IFRIC:

- Guido Fladt, senior partner responsible for international accounting in the PricewaterhouseCoopers National Office in Germany;
- Bernd Hacker, head of Standard Setter Liaison and Financial Instruments Accounting Policies at Siemens in Germany;
- Darrel Scott , Head of Group Finance, FirstRand Banking Group, South Africa; and
- Andrew Vials, senior partner responsible for the UK Department of Professional Practice, Accounting and Reporting at KPMG.

The chairman also welcomed new Board member, Zhang Wei-Guo, who was observing the meeting, noting that he brought to the Board a regulator's experience from his immediately preceding post as Chief Accountant and Director General of the Department of International Affairs of the China Securities Regulatory Commission.

IAS 18 *Revenue*—Customer Contributions

At its meeting in May 2007 the IFRIC took a project on to its agenda to develop guidance on the accounting by a service provider for the receipt of customer contributions. Such contributions arise in situations in which customers provide an asset to a service provider that is then used to deliver an ongoing service to customers.

The IFRIC discussed whether such a contribution met the criteria for recognition as an asset by the service provider. It concluded that, in some situations, the contributed asset would meet the criteria for recognition by the service provider.

The IFRIC then considered whether the ongoing service arrangement included a lease of the asset back to the customer. It concluded that in some situations IFRIC 4 *Determining whether an Arrangement contains a Lease* would apply and the ongoing service arrangement would include a leaseback of the asset to the contributor.

The IFRIC asked the staff to prepare a paper for the next meeting explaining how an entity would assess control over the asset, whether such an asset had been transferred as a result of a contribution and if the asset had then been leased back. The paper should also explain the implications of concluding that a leaseback had occurred.

The IFRIC then considered whether it was appropriate to account for customer contributions by applying IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* by analogy. The IFRIC noted that there were significant differences between government grants and customer contributions including that customer contributions are provided as part of trading relationships. The IFRIC concluded that it was not appropriate to account for customer contributions using IAS 20 by analogy.

The IFRIC discussed whether a contributed asset should be recognised initially at fair value or at cost. The IFRIC noted that paragraph 24 of IAS 16 *Property, Plant and Equipment* states that the cost of an item of property, plant and equipment that is acquired in exchange for a non-monetary asset is measured at fair value. The IFRIC believed that in a commercial transaction the contributed asset would be provided in exchange for another asset. That asset might take the form of an access right, an executory contract, or a right to future services. The IFRIC therefore concluded that a contributed asset should be measured initially at fair value in accordance with IAS 16.

The IFRIC also considered how an entity should account for the credit that arises as a result of recognising a contributed asset at its fair value. The IFRIC concluded that the credit does not arise from an equity contribution nor does it represent a reduction in the carrying value of an asset. Instead, it concluded that the credit relates to an income transaction.

Copyright © IFRIC *Update* is published after every IFRIC meeting by the IASC Foundation, 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

The service provider would need to assess whether the contribution resulted in any ongoing obligation to the customer. If so, this obligation should be recognised in the balance sheet and the contribution should be recognised in income over the periods in which the obligation is satisfied. The IFRIC noted that, in some cases, the credit would be recognised in income over the period of an ongoing service. In others it would be recognised in income immediately after the receipt of the asset. The IFRIC asked the staff to prepare a paper for the next meeting considering indicators that should be taken into account in determining how and when the credit should be recognised in income.

The IFRIC noted that the scope of the work on the project so far had been limited to the contribution of existing property, plant and equipment. The IFRIC directed the staff to develop a separate paper for the next meeting considering how this scope might be expanded to include contributions of cash to fund the construction of the asset.

IAS 27 *Consolidated and Separate Financial Statements*—Demergers and other in-specie distributions

At its meeting in May 2007 the IFRIC decided to take on to its agenda a project to develop guidance on how an entity should account for demergers and other in-specie distributions.

At this meeting, the IFRIC discussed the scope of the project. The IFRIC tentatively agreed that the project should:

- define in-specie distributions as unconditional non-reciprocal transfers of assets by an entity to its equity holders acting in their capacity as equity holders;
- address all non-cash distributions; and
- focus on the financial statements of the entity that makes the distribution.

In addition, the IFRIC had a preliminary discussion of how non-cash distributions should be accounted for by the entity that makes distributions.

The IFRIC asked the staff to develop a further paper, focusing on:

- how a distribution to equity holders and the corresponding obligation should be measured at the date the distribution is declared; and
- when an entity makes a distribution to its equity holders, how the assets distributed should be derecognised, based on existing IFRSs, and how any difference between the carrying amount of the obligation (ie dividend payable) and the carrying amounts of the assets distributed should be accounted for. Regarding the latter point, the IFRIC asked the staff to consider whether the difference meets the definitions of income and expense set out in the *Framework*.

IAS 39 *Financial Instruments: Recognition and Measurement*—paragraph AG33(d)(iii)

In the May 2007 IFRIC *Update* the IFRIC published its tentative agenda decision regarding the application of the requirement in paragraph AG 33(d)(iii) of IAS 39. The issue particularly relates to assessing the economic environment in which the transaction takes place in the context of determining whether a currency is commonly used in contracts to buy or sell non-financial items.

The IFRIC considered the responses to the tentative agenda decision. Some respondents noted that many different interpretations of an economic environment existed in practice. Those respondents suggested that the IFRIC should refer the issue to the Board for clarification.

In the light of the issues raised by respondents, the IFRIC agreed that the staff needed additional time to analyse those issues further to be in a position to recommend any action to the IFRIC. Therefore the IFRIC deferred to a future meeting its decision on whether to confirm the tentative agenda decision.

IAS 39 *Financial Instruments: Recognition and Measurement*—Scope of paragraph 11A

In the May 2007 IFRIC *Update* the IFRIC published its tentative agenda decision regarding the application of paragraph 11A of IAS 39. The issue relates to whether the fair value option set out in that paragraph can be applied to all contractual arrangements with one or more embedded derivatives, including contractual arrangements with hosts outside the scope of IAS 39.

In the light of the issues raised by respondents (in particular the fact that some respondents found the wording of IAS 39 confusing), the IFRIC agreed that the staff needed additional time to analyse those issues further to be in a position to recommend any action to the IFRIC. Therefore the IFRIC deferred to a future meeting its decision on whether to confirm the tentative agenda decision.

Copyright © 2007 International Accounting Standards Committee Foundation

IFRS 2 *Share-based Payment*—Group cash-settled share-based payment transactions

The IFRIC received a request for guidance on how the following two cash-settled share-based payment schemes should be accounted for in the financial statements of an entity that receives services from its employees:

- Scheme 1 – The employees will receive cash payments that are linked to the price of the equity instruments of the entity; and
- Scheme 2 – The employees will receive cash payments that are linked to the price of the equity instruments of the parent of the entity.

Under both schemes, the parent (not the entity) is obliged to make the required cash payments to the employees. The IFRIC discussed the issues in the following two respects:

- whether Scheme 1 and Scheme 2 should be within the scope of IFRS 2; and
- how Scheme 1 and Scheme 2 should be accounted for in the financial statements of the entity.

In the staff's view, scheme 1 would be within the scope of IFRS 2 in accordance with paragraph 6 of IFRIC 8. However, the IFRIC noted that, in the financial statements of the entity, neither scheme meets the definition of either a cash-settled share-based payment transaction or an equity-settled share-based payment transaction. Because both schemes are cash-settled and share-based, the IFRIC believed that both schemes should be within the scope of IFRS 2. Consequently, the services received from the employees should be measured based on the requirements applicable to cash-settled share-based payment transactions in accordance with IFRS 2.

The IFRIC tentatively decided to draw the issues to the attention of the Board and not to take them on to its own agenda. The IFRIC asked the staff to bring back to the September 2007 IFRIC meeting a text of a tentative agenda decision as well as a draft of potential amendments to IFRS 2 (particularly paragraph 3) and consequential amendments to IFRIC 11.

IFRIC agenda decisions

The following explanations are published for information only and do not change existing IFRS requirements. IFRIC agenda decisions are not Interpretations. *Interpretations of the IFRIC 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 12 *Income Taxes* - Deferred tax arising from unremitted foreign earnings

The IFRIC was asked to provide guidance on whether entities should recognise a deferred tax liability in respect of temporary differences arising because foreign income is not taxable unless remitted to the entity's home jurisdiction. The foreign income in question did not arise in a foreign subsidiary, associate or joint venture.

The submission referred to paragraph 39 of IAS 12 and noted that, if the foreign income arose in a foreign subsidiary, *branch*, associate or interest in a joint venture and met the conditions in IAS 12 paragraph 39(a) and (b), no deferred tax liability would be recognised. The submission noted that IAS 12 does not include a definition of a *branch*. It therefore asked for guidance as to what constituted a branch. Even if the income did not arise in a branch, the submission asked for clarity as to whether the exception in paragraph 39 could be applied to other similar foreign income by analogy.

The IFRIC noted that the Board was considering the recognition of deferred tax liabilities for temporary differences relating to investments in subsidiaries, *branches*, associates and joint ventures as part of its Income Taxes project. As part of this project, the Board has tentatively decided to eliminate the notion of 'branches' from IAS 12 and to amend the wording for the exception for subsidiaries to restrict its application. The project team has been informed of the issue raised with the IFRIC.

Since the issue is being addressed by a Board project that is expected to be completed in the near future, the IFRIC decided not to add the issue to its agenda.

IAS 39 *Financial Instruments: Recognition and Measurement*—Gaming transactions

The IFRIC considered a submission relating to the accounting for wagers received by a gaming institution.

The IFRIC noted the definitions of financial assets and financial liabilities in IAS 32 *Financial Instruments: Presentation*, and the application guidance in paragraph AG8 of IAS 32. It noted that when a gaming institution takes a position against a customer, the resulting unsettled wager is a financial instrument that is likely to meet the definition of a derivative financial instrument and should be accounted for under IAS 39.

In other situations, a gaming institution does not take positions against customers but instead provides services to manage the organisation of games between two or more gaming parties. The gaming institution earns a commission for such services regardless of the outcome of the wager. The IFRIC noted that such a commission was likely to meet the definition of revenue and would be recognised when the conditions in IAS 18 *Revenue* were met.

Copyright © 2007 International Accounting Standards Committee Foundation

The IFRIC did not consider that there was widespread divergence in practice in this area and therefore decided not to take the issue on to its agenda.

IAS 39 *Financial Instruments: Recognition and Measurement*—Hedging multiple risks with a single derivative hedging instrument

The IFRIC was asked to provide guidance on how an entity should apply the requirements of paragraph 76(b) of IAS 39 to demonstrate hedge effectiveness when it designates a single derivative hedging instrument as a hedge of more than one type of risk.

The answer to Question F.1.13 of the Guidance on Implementing IAS 39 requires an entity to assess the hedge effectiveness of each different risk position separately. In order to satisfy this requirement, IG F.1.13 imputed equal and opposite functional currency legs, which did not exist in the contractual terms of the derivative hedging instrument, as a basis to split the fair value of the derivative hedging instrument into multiple components. In addition, IG F.1.12 permits an entity to designate a derivative simultaneously as a hedging instrument in both a cash flow hedge and a fair value hedge. The submission asked whether the approach set out in IG F.1.13 can be extended to other circumstances.

The IFRIC noted that, although IG F.1.12 and IG F.1.13 allow an entity to impute a notional leg as a means of splitting the fair value of a derivative hedging instrument into multiple components for assessing hedge effectiveness, the split should not result in the *recognition* of cash flows that do not exist in the contractual terms of a financial instrument (see Question C.1 of the Guidance on Implementing IAS 39).

In addition, the IFRIC noted that IAS 39 requires an entity to document, at the inception of the hedge, how it will assess hedge effectiveness. IAS 39 requires the entity to apply the chosen method consistently over the life of the hedging relationship.

The IFRIC noted that the issue concerned how to assess hedge effectiveness. Therefore, the IFRIC decided not to take the issue on to the agenda because any guidance developed would be more in the nature of application guidance than an interpretation.

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*—Plan to sell the controlling interest in a subsidiary

The IFRIC was asked to provide guidance on applying IFRS 5 when an entity is committed to a plan to sell the controlling interest in a subsidiary. The request considered situations in which the entity retained a non-controlling interest in its former subsidiary, taking the form of either an investment in an associate, an investment in a joint venture or a financial asset. The submitter raised four issues relating to the consolidated financial statements of the entity:

- What triggers classification of the subsidiary's assets and liabilities as held for sale under IFRS 5?
- When classification as held for sale is required, should all the subsidiary's assets and liabilities be classified as held for sale or only the portion to be sold?
- Is classification as a discontinued operation relevant when the entity plans to retain significant influence over its former subsidiary after the sale?
- After the sale, how should the remaining non-controlling equity investment be measured?

In considering the first two issues, the IFRIC noted that paragraph 6 of IFRS 5 states: 'An entity shall classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered *principally* through a sale transaction rather than through continuing use' [emphasis added]. The IFRIC decided to recommend to the Board that it amend IFRS 5 to clarify whether the criteria for classification as held for sale are met for all of a subsidiary's assets and liabilities when the parent is committed to a plan that involves loss of control over the subsidiary. The IFRIC believed that IFRS 5 should be amended to clarify that having a plan that meets the conditions in IFRS 5 involving loss of control over a subsidiary should trigger classification as held for sale of all the subsidiary's assets and liabilities.

On the third issue, the IFRIC noted that a disposal group classified as held for sale will also be a discontinued operation if the criteria of paragraph 32 of IFRS 5 are met. Because the IFRIC did not expect divergence to emerge in practice, it decided not to address the issue. The IFRIC also noted that IFRS/US GAAP differences are likely to arise until a common definition of discontinued operations is adopted with a consistent approach to continuing involvement (as discussed in BC70 of IFRS 5).

The IFRIC noted that the last issue is being considered in the Board's joint project on business combinations and, therefore, decided not to address that issue.

Tentative agenda decisions

The IFRIC reviewed the following matters and tentatively decided that they should not be taken on to the IFRIC agenda. These tentative decisions, including, when appropriate recommended reasons for not taking the item on to the IFRIC agenda, will be reconsidered at the IFRIC meeting in September 2007. Constituents who disagree with the proposed reasons, or believe that the explanations may contribute to divergent practices, are welcome to communicate those concerns by 24 August 2007, 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 the writer requests confidentiality, supported by good reason, such as commercial confidence.

IAS 18 *Revenue Recognition* - Guidance on identifying agency relationships

The IFRIC received a request for an interpretation of how IAS 18 *Revenue* paragraph 8 should be applied to situations in which an entity employs another entity to meet the requirements of a customer under a sales contract. The request questioned whether there is a need for more general interpretative guidance in this area.

Copyright © 2007 International Accounting Standards Committee Foundation

The IFRIC noted that IAS 18 specifies the accounting for agency relationships. Paragraph 8 states that 'in an agency relationship, the gross inflows of economic benefits include amounts collected on behalf of the principal and which do not result in increases in equity for the entity. The amounts collected on behalf of the principal are not revenue. Instead, revenue is the amount of commission.' Paragraphs 6 and 18(d) of the Appendix to IAS 18 refer to the substance of the transaction to identify whether the entity is acting as agent or principal.

The IFRIC acknowledged that no detailed guidance was given in IFRSs on identifying agency relationships. However, the IFRIC believed that:

- determining whether an entity is acting as an agent depends on facts and circumstances and that judgement is required;
- any guidance beyond that given in IAS 18 would be more in the nature of implementation guidance than an Interpretation.

For these reasons the IFRIC [decided] not to develop an Interpretation and to remove this item from its agenda. In doing so, the IFRIC noted that this issue has widespread and practical relevance and that some constituents might not be aware of the existing guidance that has been issued in some jurisdictions.

For these reasons, the IFRIC asked the staff to develop guidance that might be recommended to the Board for inclusion in the Appendix to IAS 18.

IAS 19 *Employee Benefits* - Post-employment benefits—Benefit allocation for defined benefit plans

IAS 19 requires entities to attribute the benefit in defined benefit plans to periods of service in accordance with the benefit formula, unless the benefit formula would result in a materially higher level of benefit allocated to future years. In that case, the entity allocates the benefit on a straight-line basis (paragraph 67 of IAS 19). The IFRIC had previously considered whether entities should take into account expected increases in salary in determining whether a benefit formula expressed in terms of current salary allocates a materially higher level of benefit in later years.

The IFRIC considered this issue as part of its deliberations leading to Draft IFRIC Interpretation D9 *Employee Benefits with a Promised Return on Contributions or Notional Contributions*. However, the IFRIC suspended work on this project until it could see what implications might be drawn from the Board's deliberations in its project on post-employment benefits.

The IFRIC noted that the Board will not address this issue for all defined benefit plans in phase 1 of its project on post-employment benefits. However, the IFRIC noted that it would be difficult to address this issue while the Board had an ongoing project that addressed the issue for some defined benefit plans. The IFRIC [decided] to remove this issue from its agenda.

IAS 39 *Financial Instruments: Recognition and Measurement*—Hedging future cash flows with purchased options

This is a re-exposure of reasons for the IFRIC not taking this item on to its agenda, first published in the May 2007 IFRIC Update.

In the May 2007 IFRIC *Update*, the IFRIC mentioned that, on the basis of the requirements in IAS 39, the approach for assessing hedge effectiveness suggested in the requests is not allowed under IAS 39. At this meeting, the IFRIC reviewed its tentative agenda decision and did not change its view. However, the IFRIC changed its reasons for not taking the issue on to its agenda because (i) some respondents to the tentative agenda decision identified other similar approaches they believed were allowed, (ii) some respondents thought the wording of the tentative agenda decision was interpretative, and (iii) the IFRIC was advised that the Board would specifically clarify the issue in its upcoming exposure draft on what risks and portions can be designated as hedged risks and hedged items respectively. The exposure draft is expected to be published by the end of the third quarter this year.

The revised tentative agenda decision is as follows:

The IFRIC received requests relating to a situation in which an entity designates an option, in its entirety, as a hedging instrument to hedge a one-sided variability in future cash flows in a cash flow hedge. All changes in the fair value of the option (including changes in the time value component) are considered in assessing and measuring hedge effectiveness.

The requests suggested the following approach to assessing and measuring hedge effectiveness. An entity could compare all changes in the fair value of the purchased option with changes in the fair value of a hypothetical written option that has the same maturity date and notional amount as the hedged item. The requests noted that such an approach would minimise or eliminate hedge ineffectiveness when the terms of the purchased option and the hypothetical written option perfectly matched. The IFRIC was asked whether IAS 39 allows such an approach.

The IFRIC noted that some respondents to its tentative agenda decision believed that the issue was complex and that there was diversity in practice regarding whether the approach suggested or other similar approaches are allowed under IAS 39.

However, the IFRIC [decided] not to take the issue on to its agenda because the Board has recently decided to propose an amendment to IAS 39 to clarify what risks and cash flows can be designated as hedged risks and hedged portions of risks for hedge accounting purposes. The IFRIC noted that the Board's project will specifically address the issue discussed in this agenda decision.

Copyright © 2007 International Accounting Standards Committee Foundation

IFRS 5 - ***Non-current Assets Held for Sale and Discontinued Operations*** **- Disclosures**

The IFRIC received a request to clarify whether the disclosure requirements of other standards such as IFRS 7 *Financial Instruments*: *Disclosures* and IAS 19 *Employee Benefits*, in the absence of specific exclusion, would apply to non-current assets (or disposal groups) classified as held for sale or discontinued operations in accordance with IFRS 5. At the May 2007 IFRIC meeting, the staff presented a paper with two alternative views:

- view A: IFRS 5 specifies the disclosures required in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations, together with the requirement of IAS 33 *Earnings per Share* paragraph 68 to disclose the amount per share for discontinued operations. Disclosures required by other standards do not apply to such assets (or disposal groups);
- view B: disclosures required by IFRSs, whose scope does not exclude non-current assets (or disposal groups) classified as held for sale or discontinued operations, continue to apply to such assets (or disposal groups).

The IFRIC believed that this issue could be resolved efficiently through an amendment to IFRS 5 and [decided] to draw the issue to the attention of the Board rather than taking the item on to its own agenda. The IFRIC also believed that such an amendment should generally reflect view A, but believed that other disclosures about such assets (or disposal groups) may also be necessary to comply with the general requirements of IAS 1 *Presentation of Financial Statements*.

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:

2007

- 6 and 7 September
- 1 and 2 November

2008

- 10 and 11 January
- 6 and 7 March
- 8 and 9 May
- 10 and 11 July
- 4 and 5 September
- 6 and 7 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

Copyright © 2007 International Accounting Standards Committee Foundation