NEWSLETTER OF THE INTERNATIONAL FINANCIAL REPORTING INTERPRETATIONS COMMITTEE

IASB IFRIC UPDATE

October 2004

The International Financial Reporting Interpretations Committee met in London on 7 and 8 October 2004, when the principal matters it discussed were:

- D1 *Emission Rights*
- D3 *Determining whether an Arrangement contains a Lease*
- D6 *Multi-employer Plans*
- D7 *Scope of SIC-12*
- D8 *Members' Shares in Co-operative Entities*
- IAS 1 application issues
- Service concession arrangements
- Waste electrical and electronic equipment

D1 *Emission Rights*

The IFRIC confirmed its tentative decision to issue an Interpretation based on the consensus in draft Interpretation D1 *Emission Rights*.

The IFRIC made two amendments to its draft consensus.

- In D1, the IFRIC proposed that allowances should not be amortised but should be tested for impairment in accordance with IAS 36 *Impairment of Assets*. Although the IFRIC maintained its view that conceptually allowances should not be amortised, it concluded that this treatment would not always be consistent with the requirements of IAS 38 *Intangible Assets*. Therefore, the IFRIC decided that it could not specify that allowances should not be amortised in all circumstances. However, the IFRIC also decided to highlight that if the allowances were traded in an active market (as defined in IAS 38) no amortisation would be required.
- In D1, the IFRIC proposed that the cash penalty that would be incurred if a participant failed to deliver sufficient allowances to cover its actual emissions should be taken into account in measuring the provision for the obligation to deliver allowances. The IFRIC noted that it would be unusual for a cap and trade scheme to allow a participant to satisfy its environmental obligation with a cash payment and therefore concluded that the penalty should be treated separately from the obligation to deliver allowances. It noted that the penalty would be within the scope of IAS 37 but decided that there was no need to provide specific guidance on this point.

Subject to a final review of the drafting by IFRIC members and approval by the IASB, the Interpretation is expected to be issued in November with an effective date of 1 March 2005 (with early adoption encouraged).

IFRIC members acknowledged the concerns of respondents about the mixed measurement model that would arise. The IFRIC also confirmed that, subject to identifying a satisfactory way of distinguishing allowances from other intangible assets, it would encourage the IASB to amend IAS 38 as soon as possible to permit allowances traded in an active market to be measured at fair value with changes in value recognised in profit or loss.

D3 *Determining whether an Arrangement contains a Lease*

The IFRIC voted to issue a final Interpretation. As reported in earlier *IFRIC Updates*, the final consensus will be based on the US Interpretation EITF 01-8 *Determining Whether an Arrangement Contains a Lease*.

Subject to a final review of the drafting by IFRIC members and approval by the IASB, the Interpretation is expected to be issued in November with an effective date of 1 January 2006 (with early adoption encouraged).

D6 *Multi-employer Plans*

The IFRIC considered the responses to D6 *Multi-employer Plans*. The IFRIC noted the concerns expressed in the responses on the general lack of availability of information about multi-employer plans and questions about the relevance of the information that would be generated by allocating elements of plans on the basis of current data, such as current contributions, percentage of payroll or head count.

The IFRIC agreed that, in the light of the arguments put forward about the potential lack of utility of the amounts that would be generated, it should not proceed with D6 as currently drafted. However, it noted that IAS 19 requires an allocation to be made when the information can be obtained and a reliable basis of allocation determined. IFRIC members observed that the Board was addressing a similar issue with respect to group benefit plans and that the issue of how to generate relevant information arose in that context also.

- The IFRIC considered a staff recommendation that, given the weight of evidence from the responses, about whether the IFRIC should recommend the IASB to amend IAS 19 to give a

(continued)

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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

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D6 *Multi-employer Plans* (continued)

blanket exemption from defined benefit accounting to all participants in a multi-employer plan. IFRIC members were equally divided on this issue.

The IFRIC agreed instead to send a report to the IASB noting the following:

- the responses to D6 raised substantive problems relating to the availability of information about the plan as a whole,
- the basis on which to make a reliable allocation of the plan, and
- the usefulness of the information given by defined benefit accounting allocated on the basis of current data, such as current contributions, percentage of payroll or head count

- the IFRIC believes that the latter two issues apply equally to allocating group plans in the separate or individual financial statements of group entities as to multi-employer plans
- the IFRIC considered and rejected (by a blocking minority) recommending to the IASB that it should amend IAS 19 to give a blanket exemption from defined benefit accounting to participants in multi-employer plans.

The IFRIC will consider any further action on multi-employer plans in the light of the IASB's reaction to this report and the IASB's discussion of the treatment of group plans in the separate or individual financial statements of group entities.

D7 *Scope of SIC-12*

The IFRIC considered comments received from respondents to Draft Amendment D7 *Scope of SIC-12*, published on 30 June 2004. The IFRIC voted unanimously to amend SIC-12:

- to remove the scope exclusion for equity compensation plans.
- to add a scope exclusion for other long-term employee benefit plans.

In other words, the IFRIC agreed that paragraph 6 of SIC-12 should be amended as follows (new text is underlined and deleted text is struck through).

> This Interpretation does not apply to post-employment benefit plans or ~~equity compensation plans~~ other long-term employee benefit plans.

The IFRIC Amendment to SIC-12 will be presented to the IASB for its approval.

D8 *Members' Shares in Co-operative Entities*

The IFRIC considered the main comments received on the draft interpretation D8 *Members' Shares in Co-operative Entities*. It noted that 96 comment letters had been received, with over 74 per cent of the respondents agreeing either fully or in part with the draft Interpretation.

The IFRIC also noted the following:

- Most respondents agreeing with the draft Interpretation did so unequivocally and were appreciative of the efforts taken by the IFRIC and the IASB to resolve the classification of members' shares in co-operative entities.
- Most of those who disagreed did so because local laws would have the effect that members' shares in co-operative entities in their jurisdiction would be classified as liabilities. This is because the boards of those entities do not have the unconditional right to refuse redemption.
- Some respondents, while supporting the proposed Interpretation, expressed reservations. The predominant reservation was that in some jurisdictions, co-operative entities would need to amend their governing charter in order to meet D8's conditions for equity classification. However, this poses difficulties given restrictions imposed by local legislation on such amendments.

The IFRIC tentatively agreed to retain the approach proposed in the draft Interpretation. It also agreed that the following issues raised by respondents should be addressed in finalising the draft Interpretation:

- reconsidering the title of D8 in order better to reflect its scope.
- clarifying the distinction between restrictions that prevent a liability from coming into existence and restrictions that prevent a liability from being settled.
- clarifying the accounting for a reclassification between liabilities and equities (or vice versa) when the amount of a prohibition against redemption changes, including reconsidering whether a gain or loss arises on such reclassifications.
- exploring alternative transition requirements.

The IFRIC also tentatively agreed not to address in more detail the measurement of liabilities and equity, given the IFRIC's aim of finalising the Interpretation as soon as possible.

The staff noted that they expect the IFRIC to have only one further discussion, at its November meeting, with the aim of finalising the Interpretation by the end of 2004.

IAS 1 application issues

Analysis of expenses by nature or function

The IFRIC discussed a potential agenda topic of whether to tighten the requirements in paragraph 88 of IAS 1 *Presentation of Financial Statements* for the presentation of an analysis of expenses by nature or function. The purpose of the clarification would be to remind constituents that *ad hoc* mixing of functional and natural classifications of expenses in the analysis is not permitted, and thus enhance the comparability of such analyses between entities.

IFRIC members were advised that there was some evidence that entities classify expenses on a functional basis but exclude certain 'unusual' expenses from the functional classifications to which they relate and present these items separately by nature. Examples are inventory write-downs, employee termination benefits and impairments of property, plant and equipment or intangible assets.

The IFRIC instructed the staff to write to the IASB to describe the issue and ask whether developing guidance on the application of IAS 1 would fall within the scope of the IASB's project on reporting comprehensive income.

Presentation of 'net finance costs'

The IFRIC discussed a potential agenda topic of whether it is acceptable to present a line item 'net finance costs' (or a similar term) on the face of the income statement without showing the finance costs and finance revenue composing it.

IFRIC members had an open discussion of the issue. They noted that paragraph 81 of IAS 1 requires the face of the income statement to include line items that present, *inter alia*, amounts for revenue and finance costs. IFRIC members agreed that:

- taken together, paragraphs 32 and 81 of IAS 1 preclude presenting 'net finance costs' (or a similar term) on the face of the income statement without showing the finance costs and finance revenue composing it; but
- this does not preclude presentation of finance revenue followed immediately by finance costs and a subtotal (eg 'net finance costs') on the face of the income statement.

The IFRIC agreed not to develop an Interpretation on this issue.

Service concession arrangements

The IFRIC continued its discussion of three draft Interpretations on service concession arrangements:

- Service Concession Arrangements – Determining the Accounting Model
- Service Concession Arrangements – The Financial Asset Model
- Service Concession Arrangements – The Intangible Asset Model

The IFRIC asked for a number of clarifications and minor amendments to be made, including expanding the basis for conclusions. It also asked the staff to prepare some worked examples of the application of the proposals, to confirm its understanding of them, and to consider further the accounting treatment under the financial asset model when payments by the grantor vary with usage.

Subject to the above, the IFRIC substantially agreed the proposals, and agreed to proceed to a vote on the draft Interpretations at its next meeting.

Waste electrical and electronic equipment

The IFRIC discussed its editorial comments on a draft Interpretation on waste electrical and electronic equipment, which was approved in September 2004.

The IFRIC requested a few minor amendments to be made, including expanding the basis for conclusions for certain issues of concern to IFRIC members. The draft Interpretation, *Liabilities Arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment*, will be published after clearance by the IASB.

Activities of other interpretative bodies

The IFRIC discussed new projects being undertaken by interpretative committees and national standard-setters, and whether these projects might form necessary agenda items for the IFRIC. The IFRIC did not identify any new agenda items among these projects.

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 a share price-related contingent feature had been met. An IOSCO representative updated the IFRIC on the EITF's redeliberations in the light of comment letters received on the issue.

The IFRIC expressed concern that the interpretation would undermine the convergence achieved between IAS 33 and SFAS 128 *Earnings per Share*. An IFRIC member suggested that any differing treatment of Co-Cos might be justified by discrepancies in the debt/equity models under US GAAP and IFRSs. The recommendation of the IFRIC Agenda Committee, that the IASB should consider the issue (rather than the IFRIC), will be considered at the November IFRIC meeting.

Items not taken to the IFRIC agenda

The IFRIC agreed with the Agenda Committee's recommendations that the following issues should not be added to the Agenda.

Transition issues under IFRS 1

The IFRIC considered two issues regarding first-time adoption of IFRSs. The first issue was whether the 'impracticability' exception under IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* should also apply to first time adopters. The IFRIC agreed that there were potential issues, especially with respect to 'old' items, such as property, plant and equipment. However, those issues could usually be resolved by using one of the transition options available in IFRS 1.

The second issue was whether a specific exception should be granted to first-time adopters to permit entities to translate all assets and liabilities at the transition date exchange rate rather than applying the functional currency approach in IAS 21 *The Effects of Changes in Foreign Exchange Rates*. The IFRIC agreed that the position under IFRS 1 and IAS 21 was clear, and that there was no scope for an Interpretation on this topic that would provide any relief.

Impairment – Accounting for incurred losses in under IAS 39

The IFRIC considered whether under IAS 39 *Financial Instruments: Recognition and Measurement* an entity should recognise an impairment on a group of loans if its loss expectation at initial recognition of the loans had not changed, but the entity could estimate reliably, based on past history, that loss events occurred after initial recognition, but before the reporting date.

The IFRIC agreed that the interpretation of the Standard was clear and that an entity should recognise such an incurred impairment loss that is supported by objective evidence, which might not have been reported before the entity's reporting date. However, an impairment loss could not be recognised if relevant events had not been recognised. The IFRIC recommended that the IASCF education team should consider this issue for possible inclusion in educational material.

Effective interest rate

The IFRIC considered whether future credit losses should be included in determining effective interest rates. The IFRIC agreed that IFRSs were clear on this issue. Paragraph 9 of IAS 39 states that when calculating effective interest rate an entity shall not consider future credit losses. Also, IAS 39 Implementation Guidance issue B26 provides further guidance on the matter.

Commodity price risk hedging

The IFRIC considered whether under IAS 39 a non-financial instrument can be separated into price risk components, with the component that relates to an efficient, liquid and regulated commodity exchange being designated as the hedged item (rather than the price risk of the entire non-financial item).

The IFRIC agreed that IAS 39 paragraphs 82 and AG100 provide clear guidance on the matter. The IFRIC also noted that to allow separation of a non-financial asset into price risk components with the separate components being designated as the hedged item would require an amendment to IAS 39 rather than an Interpretation.

Single instrument designated as a hedge of more than one type of risk

The IFRIC considered whether, when a single hedging instrument is designated as a hedge of more than one type of risk, the effectiveness test can be carried out for the total hedged position, which incorporates all risks identified, if these risks are inextricably linked in the hedging instrument.

The IFRIC agreed that IAS 39 was clear on the matter. The Standard does not require separate effectiveness testing when a single hedging instrument is designated as a hedge of more than one type of risk. The IFRIC also noted that the issue is neither widespread nor pervasive at present.

Future meetings and requests for Interpretations

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

4 and 5 November 2004

2 and 3 December 2004

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.