NEWSLETTER OF THE INTERNATIONAL FINANCIAL REPORTING INTERPRETATIONS COMMITTEE

IASB

IFRIC UPDATE

April 2005

The International Financial Reporting Interpretations Committee met in London on 31 March and 1 April 2005, when it discussed:

- Service concession arrangements
- Impairment of an equity instrument
- IAS 32 – Convertible instruments denominated in a foreign currency
- Near-final IFRIC 6: Applying the Restatement Approach under IAS 29 *Financial Reporting in Hyperinflationary Economies* - Sweep issues
- IFRS 2 – Group and treasury share transactions
- Emission rights – consideration of an amendment to IAS 38
- IAS 11 *Construction Contracts*: Combining and Segmenting Contracts
- D9 *Employee Benefits with a Promised Return on Contributions or Notional Contributions*
- D10 *Waste Electrical and Electronic Equipment*
- D11 *Changes in Contributions to Employee Share Purchase Plans*
- Potential agenda items

Changes to the composition of the IFRIC

The meeting in March was the last meeting of the IFRIC that Kevin Stevenson would attend as IASB Director of Technical Activities. The acting Chairman, Gilbert Gélard and Mr Wright, on behalf of the members, thanked Mr Stevenson for his efforts in leading the IFRIC since its inception.

The acting Chairman welcomed Shunichi Toyoda to his first meeting of the IFRIC. He said that Mr Toyoda brought extensive experience from the Japanese business community and would be completing the remainder of the term of Junichi Akiyama, Professor of Accounting, Tama University, who recently retired from the IFRIC. The acting Chairman expressed the IFRIC's appreciation of Professor Akiyama's contribution to the IFRIC over his two terms of service. A note from Professor Akiyama was read to the IFRIC.

The acting Chairman also welcomed Allan Cook, former technical director of the UK Accounting Standards Board, who was observing his first meeting as IFRIC Co-ordinator (a newly established position).

The acting Chairman also thanked Rob Comerford for his contribution to the IFRIC over the past two years as an observer from the International Organization of Securities Commissions. Mr Comerford is to leave the SEC to join a firm.

Service concession arrangements

Website example

The staff reported that a group of constituents had prepared spreadsheets modelling the impact of the service concession proposals on an operator's results over the duration of a typical road concession. The staff was now discussing the models with the constituents and would post the examples to the IFRIC's Website as soon as possible.

Comment deadline

The staff reported that some constituents had expressed concerns that the period given for public comment on the draft Interpretations (61 days) was too short. Some constituents had observed that generic matters addressed in the drafts would have consequences for entities outside the concession industry. There were, for example, implications for all entities applying IAS 11 *Construction Contracts*. Entities outside the concession industry may not have been following the development of the proposals and may need more time to assess their consequences.

The staff noted that extending the comment period would set the project back by one or two months. The IFRIC would have only three meetings at which to discuss the comments and finalise the Interpretations if it was to meet its objective of issuing them during 2005. However, the project would equally be delayed if, as now seemed likely, a substantial number of constituents failed to meet the existing deadline for submitting comments.

The IFRIC accepted that constituents needed a longer comment period and voted to change the deadline from 3 May to 31 May. Members were, however, mindful that service concession operators needed the proposals to be finalised promptly. They directed the staff to encourage constituents to respond early if possible and to emphasise that, having extended the deadline, the IFRIC would have no leeway to consider late comments.

Impairment of an equity instrument

[Agenda Item 8]

The IFRIC discussed a request for guidance on how to determine whether under paragraph 61 of IAS 39 (as amended in March 2004) there has been a 'significant or prolonged decline in the fair value of an investment in an equity instrument below its cost' in the situation when an impairment loss has previously been recognised for an investment classified as available for sale.

(Continued)

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Impairment of an equity instrument *(Continued)*

The submission asked whether IAS 39 requires 'significant' to be evaluated in relation to the original cost of the instrument or the amount to which the instrument was written-down following recognition of a prior impairment loss recognised in profit or loss. The submission also asked whether in evaluating whether a subsequent decline in fair value is 'prolonged', the period of decline be considered in relation to the entire period for which the investment has been held or the period since the prior impairment loss was recognised in profit or loss. The submission also requested guidance as to whether IAS 39 allows an entity to segregate different loss events impacting an investment in a single equity instrument and evaluate the significance and duration of each event separately.

The IFRIC noted that IAS 39 referred to original cost on initial recognition and did not permit a prior impairment to establish a deemed cost, and noted that IAS 39 Implementation Guidance E.4.9 requires further declines in value after an impairment loss is recognised in profit or loss to be recognised immediately in profit or loss. Therefore, for an equity instrument for which a prior impairment loss has been recognised, 'significant' should be evaluated against the original cost at initial recognition and 'prolonged' should be evaluated against the period in which the fair value of the investment has been below original cost at initial recognition.

The IFRIC was of the view that IAS 39 is clear on these points when all of the evidence in IAS 39 and the implementation guidance is viewed together. The IFRIC decided that it would not take this submission onto its agenda and will discuss a draft reason for rejection at the next IFRIC meeting.

The IFRIC asked the staff to develop a proposal for consideration by the agenda committee regarding the meaning of the requirement to assess assets for impairment 'at each balance sheet date'. IFRIC members noted that this wording raises questions about the interaction of IAS 34 *Interim Financial Reporting* with IAS 39 and IAS 36 *Impairment of Assets*.

Convertible instruments denominated in a foreign currency

[Agenda Item 9]

The IFRIC discussed a request for guidance on the classification of the written option in a convertible bond denominated in a foreign currency (a currency other than the functional currency of the entity issuing the bond) ie a written option to exchange a fixed number of its own equity instruments for a fixed amount of cash that is denominated in a foreign currency. The IFRIC noted that although the issue has been raised in the context of a convertible bond it applies equally to freestanding instruments, ie to all contracts entered into by an entity to exchange a fixed number of its own equity instruments for a fixed amount of cash that is denominated in a foreign currency. The IFRIC also noted that the question of determining classification of such instruments as liabilities or equity depends upon whether a fixed amount of a foreign currency represents a fixed amount of cash or other financial asset.

The IFRIC noted that although this matter is not directly addressed in IAS 32, it is clear that when the question is considered in conjunction with guidance in other Standards, particularly IAS 39 *Financial Instruments: Recognition and Measurement*, any obligation denominated in a foreign currency represents a variable amount of cash. This is evidenced by the fact that IAS 39 allows cash flow hedge accounting for transactions denominated in a foreign currency because such transactions expose the entity to variability in cash flows.

Consequently, the IFRIC noted that contracts that will be settled by an entity by delivering a fixed number of its own equity instruments in exchange for a fixed amount of foreign currency should be classified as liabilities. The IFRIC decided that it would not take this submission onto its agenda and will discuss a draft reason for rejection at the next IFRIC meeting.

However IFRIC members also noted that the resulting accounting of reporting such contracts at fair value through profit or loss resulted in reporting gains and losses on what is arguably own equity in profit and loss, along with gains and losses arising from changes in foreign exchange rates. IFRIC was advised that the Board was considering similar issues in its project on equity instruments that are puttable at fair value of the residual interest of the issuer . In view of this, and also at the request of the IASB Strategy Committee, the IFRIC decided to explore possible amendments to the Standard and seek to develop a proposed amendment, if possible, that it could recommend to the Board to address the issue.

Near-final IFRIC 6: Applying the Restatement Approach under IAS 29 *Financial Reporting in Hyperinflationary Economies* - Sweep issues

[Agenda Item 5]

At this meeting, the IFRIC considered editorial matters, including some suggested wording from a Board member.

Applying the requirements of IAS 29

The draft Interpretation proposed that in the reporting period in which an entity identifies the existence of hyperinflation in the economy of its functional currency the entity should apply IAS 29 as if it had always applied the Standard. The IFRIC observed that an entity continuously applies IAS 29 to determine whether it operates in a hyperinflationary economy. The IFRIC therefore agreed to edit the wording to make it clear that if an entity identifies the existence of hyperinflation on the basis of the criteria in IAS 29 it applies the requirements of the Standard as if the economy had always been hyperinflationary.

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Transition

The IFRIC decided to delete the reference to the accounting for changes in accounting policy under IAS 8. It was concluded that no transitional provisions would be necessary because the Interpretation, in itself, would require retrospective application unless certain exemptions in IAS 29 apply.

Accounting under US GAAP

The IFRIC observed that US GAAP addresses the accounting for hyperinflation in (a) the financial statements of an entity operating in a hyperinflationary economy and whose financial statements are intended for users in the United States, and (b) the financial statements of a foreign entity. The IFRIC agreed to edit the reference to the accounting for hyperinflation under US GAAP in the Basis for Conclusions.

One IFRIC member asked staff to clarify whether treating the tax base of an asset as a monetary item would produce a meaningful recorded monetary loss. The restatement of an entity's monetary, comparative figures was mentioned as an example. Based on this staff analysis the IFRIC would decide whether further deliberation is necessary.

The edited document will be circulated to Board members to ensure nothing has altered their decision to approve its publication.

IFRS 2 – Group and treasury share transactions

[Agenda Item 10]

The IFRIC considered a revised draft of a draft Interpretation on the classification of share-based payment arrangements under IFRS 2 *Share-based Payment* in which:

- an entity grants to its employees rights to equity instruments of the entity, and either chooses or is required to buy those equity instruments (eg treasury shares) from another party, which it then transfers to its employees.
- an entity's employees are granted rights to equity instruments of the entity, and a shareholder provides the equity instruments needed to settle the share-based payment arrangement.
- a subsidiary's employees are granted rights to equity instruments of the parent or another group entity.

The revised draft reflects the conclusions reached by the IFRIC at its February meeting. (For more information, refer to the March/April Observer Notes on the IASB Website.)

The IFRIC voted unanimously in favour of publishing the draft Interpretation, subject to some drafting changes to incorporate points raised during the meeting and the usual Board process. The IFRIC asked the staff to include an Invitation to Comment as to whether IFRIC's focus on the legal obligation of the subsidiary is appropriate.

Scope of IFRS 2

[Agenda Item 11]

The IFRIC considered a revised draft of a draft Interpretation on the scope of IFRS 2 *Share-based Payment*. The IFRIC had concluded at an earlier meeting that the scope of IFRS 2 is not limited to transactions in which the entity can specifically identify the goods or services received. The IFRIC concluded that, in the absence of specifically identifiable goods or services, other circumstances may indicate that goods or services have been (or will be) received, in which case IFRS 2 applies. In particular, if the identifiable consideration received (if any) appears to be less than the fair value of the equity instruments granted or liability incurred, then typically this circumstance indicates that other consideration (ie goods or services) has been (or will be) received.

The IFRIC voted unanimously in favour of publishing the draft Interpretation, subject to some drafting changes to incorporate points raised during the meeting, editorial review and the usual Board process.

Emission rights – consideration of an amendment to IAS 38

[Agenda Item 3]

The IFRIC considered a preliminary draft of a proposed amendment to IAS 38 *Intangible Assets*. The objective of the proposed amendment is to require a narrowly specified subset of intangible assets (including emission allowances traded in an active market as defined in IAS 38) to be measured after initial recognition at fair value with the gains or losses arising from changes in the fair value recognised in profit or loss. (The draft amendment was included in the observer note for the meeting available on the IASB's Website www.iasb.org)

For emission allowances that are traded in an active market, the proposed amendment would amend the accounting in IFRIC 3 *Emission Rights* and result in the allowances and the emission liability (ie the provision recognised as the entity produces emissions) being measured on a consistent basis, by reference to the fair value of the allowances. Furthermore, changes in the value of the allowances and emission liability would both be recognised in profit or loss.

The IFRIC tentatively confirmed the overall approach in the preliminary draft. In particular, it confirmed its tentative conclusion at the February meeting that fair value measurement through profit or loss should apply only to a narrowly specified subset of intangible assets rather than any intangible asset whose fair value can be determined by reference to an active market. The IFRIC asked the staff to focus the drafting on the ultimate value of the allowance deriving from its use to settle a specific type of liability. It also tentatively decided that fair value measurement through profit or loss should be mandatory for this subset of intangible assets. However, the IFRIC will reconsider whether fair value measurement through profit or loss should be optional or mandatory once it has finalised the criteria for specifying the subset.

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The IFRIC will consider a revised draft at its next meeting.

As a separate matter, the IFRIC considered further the suggestion by the Chair of EFRAG that emission allowances should be eligible to be designated as a hedge of forecast emissions. The suggestion would result in the gains and losses from remeasuring emission allowances that are designated as a hedge of highly probable forecast emissions initially being recognised in equity and subsequently transferred to profit and loss as those emissions occur. IFRIC members noted that this would require extending the limited extension in IAS 39 for use of non-derivatives as hedging instruments to include use of intangible assets measured at fair value. Members also noted that IAS 39 presently permits a non-derivative to be designated as a hedging instrument for a foreign currency exchange risk only. The IFRIC asked the staff to relay these concerns to the EFRAG staff, and ask the EFRAG staff to develop an analysis of this issue on behalf of the IFRIC for consideration at the IFRIC's next meeting.

The IFRIC noted that it had previously identified the issue of when to recognise receipt of emission allowances. The staff are to develop this issue for a future meeting.

IAS 11 *Construction Contracts*: Combining and Segmenting Contracts

[Agenda Item 7]

The IFRIC has been considering whether it could enhance convergence with US GAAP by adding guidance on the requirements in IAS 11 *Construction Contracts* on combining and segmenting contracts.

The prompt for this project came from the Board in May 2003, when it asked the IFRIC to consider the guidance for combining and segmenting contracts in AICPA SOP 81-1 *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* with a view to adding similar guidance to IAS 11. At its meeting in February 2005, the IFRIC agreed to communicate its conclusions to the Board before proceeding with its work on this project.

At the meeting in March 2005, the IFRIC considered a draft report to the Board. The report first explained the IFRIC's decision not to proceed with a draft Interpretation on combining and segmenting construction contracts. The IFRIC had concluded that the matter was not a priority for the IFRIC at this time:

- an IFRS preparer with a US listing should be able to get to the same answer under both frameworks, as the conditions for combining and segmenting under IFRS and US GAAP were not inconsistent, (US GAAP is elective whereas under IAS 11 contracts must be combined or segmented when certain conditions are met)
- IFRIC members were not aware of any significant divergence in practice.

These conclusions applied only to the matter of combining and segmenting construction contracts within the scope of SOP 81-1. The IFRIC directed the staff to add to the report its conclusion that full convergence of the conditions for combining and segmenting construction contracts could not be achieved through interpretation. The main obstacle was that paragraphs 40 and 41 of SOP 81-1 provided two routes to segmenting a construction contract, only one of which was available in IAS 11.

The draft report also discussed the interrelationship between the conditions for combining and segmenting construction contracts and the treatment of multiple-element arrangements. EITF Issue No. 00-21 *Revenue Arrangements with Multiple Deliverables* provides specific guidance on the treatment of such arrangements. The staff had concluded that IFRSs also provide guidance on their treatment and that, for a combined construction and service arrangement, an IFRS preparer with a US listing could get to the same accounting treatment under both frameworks (provided the outcome of the arrangement was not loss-making and could be estimated reliably). Some IFRIC members questioned those conclusions and agreed to send their comments on the draft report to staff.

Lastly, the draft report considered a fundamental difference between IAS 11 and SOP 81-1. The difference related to revenue recognition on construction contracts that involved different activities but did not meet the conditions in IAS 11 for segmentation. The IFRIC had observed that IAS 11 required gross recognition of revenue and costs (the 'gross approach'), while US GAAP required recognition of a percentage of expected contract profit (the 'net approach'). Arguably, the use of the gross approach (unlike the net approach) could result in the recognition of different profit margins on different activities within an unsegmented contract. The IFRIC concluded that it would progress this matter as a separate project and directed the staff to analyse the matter further and present it for consideration at a future Agenda Committee meeting.

D6 *Multi-employer plans*: State Plans

[Agenda Item 6]

The IFRIC considered the responses to the proposed amendments in D6 *Multi-employer plans* relating to state plans. The proposed amendments gave participants in a narrow group of state plans an absolute exemption from defined benefit accounting. The IFRIC decided not to proceed with the proposed amendments, in part because the responses indicated that some participants in such state plans were able to obtain the information necessary for defined benefit accounting and thus should do so. This means that the existing provisions of IAS 19 would continue to apply to state plans.

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D9 *Employee Benefits with a Promised Return on Contributions or Notional Contributions*

[Agenda Item 4]

The IFRIC considered the analysis of the comments received in response to D9 *Employee Benefits with a Promised Return on Contributions or Notional Contributions*.

The staff presented a paper that proposed to clarify the scope of D9 by including possible additional guidance on the distinction between defined benefit and defined contribution plans and constructive obligations. The paper also set out a proposed methodology for measuring the liability that was an amendment of the fixed/variable approach proposed in D9 to a deconstruction approach, under which three main components for measurement purposes would be identified: defined benefits, defined contributions and embedded guarantees/options.

The staff proposed this alternative approach to respond to comments that D9, as exposed, would limit development of best practice application of the projected unit credit method. Some respondents had noted that currently, practice is evolving to use valuation methods such as the Black-Scholes method to measure the value of guarantees. Respondents were concerned that the adoption of D9 would preclude methods other than a fixed/variable split. However, the staff noted that current actuarial practice is evolving and may not be using such valuation techniques in a consistent fashion. IFRIC members asked the staff to evaluate a possible amendment to the draft that would include two alternatives:

- use of the fixed / variable approach proposed in D9 or,
- inclusion of any embedded guarantees or options within the measurement of the defined benefit obligation as a whole.

IFRIC members rejected a proposal to split a defined benefit plan into a component accounted for as a defined contribution plan and a component accounted for as a defined benefit plan. They believed that this was not consistent with IAS 19.

The IFRIC will discuss the proposed measurement methods at the next meeting.

The IFRIC concluded that it might be useful for the distinction between defined benefit and defined contribution plans, as well as the additional guidance in respect of constructive obligations, to be debated in a separate session. The staff will produce a paper on those issues at the next meeting, and the IFRIC will assess the relative priority of this item compared with other IAS 19 proposed interpretive projects.

D10 *Waste Electrical and Electronic Equipment*

[Agenda Item 12]

The IFRIC considered the responses to D10 *Liabilities Arising from Participating in a Specific Market - Waste Electrical and Electronic Equipment* (WEEE). While almost all of the 22 respondents agreed with the draft Consensus, there were several suggestions to enlarge the scope of D10 and to clarify several issues in the Basis for Conclusions. The IFRIC decided not to expand the scope of D10 to address other issues raised by the EU directive on WEEE. Though the scope of D10 remains unchanged, the Basis will be revised to state explicitly that the IFRS hierarchy (as articulated within IAS 8) applies in situations that are not within the scope of D10. For example, if according to a national legislation 'new waste' from private households has to be (or can be) treated in a similar manner to historical waste, then D10 should be considered.

The IFRIC decided to amend the Basis to clarify certain issues. First, disclosure is encouraged of the potential impact of waste management responsibilities as set out in relevant national legislation. In addition, the concept of constructive obligation (discussed in paragraphs BC10 and BC11) is addressed in more depth. Finally, editorial changes were discussed to clarify that terms used in D10 - such as 'market share' or 'measurement period' - can be defined very differently in the applicable national legislation of each EU Member State. This, however, does not affect the Consensus of D10 but only affects the measurement of the liability, which is not within the scope of D10. The IFRIC voted to issue a final Interpretation but suggested wording changes especially to clarify how a liability accrues during a 'measurement period'. IFRIC suggested that the staff draw on the language in the proposed FASB Staff Position on the same issue (Proposed FSP 143-a). Subject to an editorial review of the drafting by IFRIC members and approval by the Board, the Interpretation is expected to be issued shortly after the next IASB meeting in April.

D11 *Changes in Contributions to Employee Share Purchase Plans*

[Agenda Item 13]

IFRIC Draft Interpretation D11 *Changes in Contributions to Employee Share Purchase Plans* was published in December 2004, with a request for comments by 1 March 2005.

The IFRIC considered a summary of comments received. The staff reported that most respondents focused on the proposal that if an employee ceased to contribute to an ESPP, and as a consequence is no longer able to buy shares under the plan, then the entity should account for that event as a cancellation. Therefore, D11 proposed that the entity should recognise immediately the amount that otherwise would be recognised over the remainder of the vesting period.

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Many respondents disagreed with this proposed treatment. Of these, many argued that a requirement to contribute to an ESPP is a vesting condition; therefore, the cessation of contributions should be accounted for as a forfeiture (ie reversal of the expense recognised to date and no further expense). Of the remainder of respondents who disagreed, some supported the alternative treatment outlined in the Basis for Conclusions on D11 (paragraph BC10), ie the cessation of contributions has no accounting effect; instead the entity should continue to recognise the services received from that employee over the remainder of the vesting period. In addition, a few respondents argued that the entity should cease recognising an expense in respect of that employee, with no reversal of the previous expense. Some respondents arrived at a similar conclusion by arguing that the ESPP represents an arrangement that provides the employee with a choice of settlement in cash or equity.

After considering respondents' comments, the IFRIC reaffirmed its previous conclusion that the event should not be accounted for as a forfeiture. However, it did not reach a conclusion on whether the event should be:

- accounted for as a cancellation, in which case the entity would recognise immediately the amount that would otherwise be recognised over the remainder of the vesting period (the treatment proposed in D11), or
- disregarded, in which case the entity would continue to recognise the services received from that employee over the remainder of the vesting period (the alternative treatment outlined in the Basis for Conclusions).

Given that IFRIC members were unable to reach a consensus on this issue, the staff advised that they would recommend to the Board that IFRS 2 be amended. In particular, the staff would recommend that IFRS 2 be amended to clarify whether the requirements relating to cancellations apply to both cancellations by the entity and by the employee.

Potential agenda items

The following items and suggested reasons for not adding them to the IFRIC agenda will be discussed at the June IFRIC meeting. Care should be exercised in reading each of the suggested wordings, as they are expressed in the form recommended by the IFRIC Agenda Committee, which it would employ if it were IFRIC. Thus, when the wording states 'that the IFRIC decided…', it will be for the IFRIC to reject or accept that wording at its next meeting.

IAS 1 Comparatives for prospectuses

IAS 1 Normal operating cycle

IAS 7 Value Added tax

IAS 12 Carryforward of unused tax losses and tax credits

IAS 12 Non-amortisable intangible assets

IAS 12 Deferred tax relating to finance leases

IAS 17 Recognition of operating lease incentives under SIC-15

IAS 17 Finance subleases of finance leases

IAS 19 Determining the appropriate rate to discount post-employment benefit obligations

IAS 39 Accounting for securities sold but not yet purchased (short trading)

IAS 39 Hedge effectiveness tests – vacillations in effectiveness/timing of tests

IAS 1 Comparatives for prospectuses

The IFRIC considered whether to amend requirements relating to comparative information within IAS 1.36, because of perceived practical problems faced in complying with EU requirements relating to prospectuses.

The IFRIC took the view that the issue was largely a regulatory matter, and decided not to add the issue to its agenda.

IAS 1 Normal operating cycle

The IFRIC considered an issue regarding the classification of current and non-current assets by reference to an entity's normal operating cycle. It was asked whether the guidance in IAS 1.57(a) was applicable only if an entity had a predominant operating cycle. This is particularly relevant to the inventories of conglomerates which, on a narrow reading of the wording, might always have to refer to the twelve-month criterion in IAS 1.57(c), rather than the operating cycle criterion.

The IFRIC decided not to consider the question further because, in its view, it was clear that the wording should be read in both the singular and the plural and that it was the nature of inventories in relation to the operating cycle that was relevant to classification. Furthermore, if inventories of different cycles were held, and it was material to readers' understanding of an entity's financial position, then IAS 1's general requirement in IAS 1.71 already required disclosure of further information.

IAS 7 Value Added Tax

The IFRIC considered a suggestion that it should add to its agenda a project to clarify whether cash flows reported in accordance with IAS 7 *Cash Flow Statements* should be measured inclusive or exclusive of value added tax (VAT). There was evidence that different practices would emerge, the differences being most marked for entities that adopt the direct method of reporting cash flows.

The IFRIC decided not to develop an Interpretation on this topic since the present requirement of IAS 7 was clear. The direct method requires disclosure of 'gross cash receipts and gross cash payments'. No exception is given to permit VAT receipts and payments to be reported on a net basis. Therefore, VAT receipts should be reported separately from VAT payments (whether included within the receipts or payments to which the VAT relates or as a separate amount).

In the longer term, the treatment of VAT could be considered in the review of IAS 7 that forms part of the Board's project on performance reporting.

IAS 12 Carryforward of unused tax losses and tax credits

The IFRIC considered whether to provide guidance on how to apply the probability criterion for the recognition of deferred tax assets arising from the carryforward of unused tax losses and unused tax credits, and in particular whether the criterion should be applied to the amount of unused tax

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losses or unused tax credits taken as a whole or to portions of the total amount.

The IFRIC decided not to develop any guidance because, in practice, the criterion is generally applied to portions of the total amount. The IFRIC was not aware of much diversity in practice.

IAS 12 Non-amortisable intangible assets

The IFRIC considered whether to develop guidance on various issues arising from the application of IAS 12 to non-amortised intangible assets, including the question of what tax rate should be applied to calculate deferred tax on intangible assets that are no longer to be amortised because of changes to accounting standards. In this regard, the IFRIC also considered the relevance of SIC-21 *Income Taxes – Recovery of Revalued Non-Depreciable Assets*.

The IFRIC agreed not to develop any guidance because the issues fell within the scope of the Board's short-term convergence project with the FASB. An exposure draft was expected later this year.

In response to concerns that the IAS 8 hierarchy requires an analogy to be made to the requirements of SIC-21 in all situations involving assets measured at fair value, the IFRIC noted that SIC-21 has a limited scope and does not address this particular issue.

IAS 12 Deferred tax relating to finance leases

The IFRIC considered the treatment of deferred tax relating to assets and liabilities arising from finance leases.

The IFRIC noted that initial recognition exemption applies to each separate recognised element in the balance sheet, and no deferred tax asset or liability should be recognised on the temporary difference existing on the initial recognition of assets and liabilities arising from finance leases or subsequently.

The IFRIC took the view that IAS 12.16 is clear that all deferred tax assets and liabilities must be recognised unless they fall within an exemption specified by paragraph 15 or 24. The inception of a finance lease is clearly the initial recognition of an asset that does not arise from a business combination and does not affect profit or loss at the time of recognition. Accordingly the exemption applies and there can be no recognition of a deferred tax asset or deferred tax liability.

The IFRIC decided not to develop any guidance because the issue fell directly within the scope of the Board's short-term convergence project with the FASB on income taxes. An exposure draft is expected later this year.[1]

IAS 17 Recognition of operating lease incentives under SIC-15

The IFRIC considered the appropriate period over which to recognise an incentive for an operating lease, when an incentive is provided and the lease contains a clause that requires rents to be repriced to market rates.

Two possible approaches for the period over which to recognise the incentive:

- recognise the incentive over the full term of the operating lease
- recognise the incentive over the shorter of the lease term and a period ending on a date from which it is expected that the prevailing market rentals will be payable.

The IFRIC noted that SIC-15.5 states:

> 'the lessee shall recognise the aggregate benefit of incentives as a reduction of rental expense over the lease term, on a straight-line basis unless another systematic basis is representative of the time pattern of the lessee's benefit from the use of the leased asset.'

The IFRIC took the view that the wording of SIC 15.5 is clear and did not accept an argument that the lease expense of a lessee after an operating lease re-priced to market ought to be comparable with the lease expense of an entity entering into a new lease at that same time at market rates. Nor did the IFRIC believe that the repricing itself would be reflective of a change in the time patterns referred to in SIC 15.5.

The IFRIC decided not undertake a project to modify SIC 15.

IAS 17 Finance subleases of finance leases

The IFRIC considered a suggestion that IAS 17 needed interpretation when assets obtained under finance leases (eg, from manufacturers) are in turn leased immediately by intermediaries, in finance leases, to end users. This was because there was a possibility of the intermediaries treating the assets as inventory when received from the manufacturer followed by a sale to the end user.

The IFRIC took the view that this issue was covered adequately by IAS 17's guidance for finance leases (both for the intermediary in its capacity as a lessee and a lessor and for the end user as a lessee) and by the derecognition requirements of IAS 39 (paragraphs 39-42) as they apply to the finance lease liabilities of the intermediary. The IFRIC did not agree with the treatment that had been suggested.

IAS 19 Determining the appropriate rate to discount post-employment benefit obligations

The IFRIC considered the following question relating to paragraph 78 of IAS 19. If there is no deep market in high quality corporate bonds in a country, may the discount rate for a post-employment benefit obligation be determined by reference to a synthetically constructed equivalent instead of using the yield on government bonds?

Paragraph 78 of IAS 19 states that:

> 'The rate used to discount post-employment benefit obligations (both funded and unfunded) shall be determined by reference to market yields at the balance sheet date on high quality corporate bonds. *In countries where there is no deep market in such bonds, the market yields (at the balance sheet date) on government bonds shall be used…*' [Emphasis added]

[1] Although this is the wording submitted to the IFRIC, the IFRIC Agenda Committee has recommended that the IASB staff reconsider the matter and bring it to the next meeting. This may well cause the above wording to change, as may other potential agenda items discussed in this IFRIC*Update*.

The IFRIC took the view that paragraph 78 is clear that a synthetically constructed equivalent to a high quality corporate bond by reference to the bond market in another country may not be used to determine the discount rate.

The IFRIC observed that the reference to ‘in a country’ could be reasonably read as including high quality corporate bonds that are available in a regional market to which the entity has access, provided that the currency of the regional market and the country were the same (eg the Euro). This would not apply if the country currency differed from that of the regional market

IAS 39 Accounting for securities sold but not yet purchased (short trading)

The IFRIC considered an issue arising from the effect of applying IAS 39 that, in the case of ‘short sales’ that give rise to financial liabilities, an entity is not permitted a choice of applying trade date or settlement date accounting, but must apply the recognition and derecognition requirements in paragraphs 14–42 of IAS 39.

It had been suggested that because of these requirements, differences in the sequence of buy and sell transactions in the same financial asset can result in different accounting treatments. When an entity first enters into a contract to buy an asset (a ‘long position’) and then enters into a contract to sell the same asset, the entity applies trade date or settlement date accounting consistently to both trades in accordance with its chosen accounting policy. When an entity first enters into a contract to sell an asset (a ‘short position’) and then enters into a contract to buy the same asset, the entity cannot recognise the sale before it is settled (but must recognise a liability for a short position in the meantime), while recognising on trade date the purchase of an asset (if that is its chosen policy). Consequently an entity could be required to monitor its long or short position in every security that it trades in order to determine which accounting it is permitted to follow.

The IFRIC noted that possible solutions would all require a change to IAS 39, which would require that the Board and not the IFRIC. The IFRIC also noted that the issue involves a difference between IFRSs and US GAAP. Accordingly, the IFRIC decided not to add the topic to its agenda, but to recommend the Board consider the issue as a part of its project on convergence with US GAAP.

IAS 39 Hedge effectiveness tests – vacillations in effectiveness/timing of tests

The IFRIC considered whether under IAS 39 an entity that designates a hedging instrument in a hedge that fails the retrospective effectiveness test can subsequently redesignate the hedging instrument in a hedge of the same financial asset or liability and obtain hedge accounting for a subsequent period in which the hedge is effective.

The IFRIC noted that the Standard did not preclude redesignation of the hedging instrument in a hedge of the same financial asset or liability in a subsequent period provided the hedge meets the hedge accounting requirements in IAS 39. It concluded that although the issue had practical relevance the issue did not involve significantly divergent interpretations. Accordingly, the IFRIC decided not to add the topic to its agenda.

Future meetings and requests for Interpretations

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

- 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.

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