

*IFRIC Update is published as a convenience to the IASB's constituents. All conclusions reported are tentative and may be changed or modified at future IFRIC meetings.*

*Decisions become final only after the IFRIC has taken a formal vote on an Interpretation or Exposure Draft, which is confirmed by the IASB.*

The International Financial Reporting Interpretations Committee met in London on 2 and 3 March 2006, when it discussed:

- Service Concession Arrangements
- IAS 18 *Revenue* – Sales of Real Estate
- IAS 19 *Employee Benefits* – The Effect of a Minimum Funding Requirement on the Asset Ceiling
- IAS 32 *Financial Instruments: Presentation* – Classification of a Financial Instrument
- IFRS 1 *First-time Adoption of International Financial Reporting Standards* – Determination of the Carrying Amount of the Investment in a Subsidiary in the Separate Financial Statements of the Parent
- Customer Loyalty Programmes
- IAS 39 *Financial Instruments: Recognition and Measurement* – Aspects of Derecognition in the Context of Securitisation
- IAS 39 *Financial Instruments: Recognition and Measurement* – Whether Inflation Risks Qualify as Separable Components for Hedging Purposes
- IFRIC Relationship with National Standard-Setters and National Interpretative Groups
- IFRIC Agenda Decisions
- Tentative Agenda Decisions

## Service Concession Arrangements

The IFRIC discussed:

- D12 *Service Concession Arrangements – Determining the Accounting Model*
- The interaction of D12 with IFRIC 4 *Determining whether an Arrangement contains a Lease*
- An analysis of remaining comments received on the exposure drafts D12, D13 *Service Concession Arrangements – The Financial Asset Model* and D14 *Service Concession Arrangements – The Intangible Asset Model*.

### Determining the accounting model

The staff presented an analysis of the circumstances in which an operator's asset would meet the definition of a financial asset contained in IAS 32 *Financial Instruments: Presentation*.

In the light of comments received the staff proposed amending the criterion contained in paragraphs 10-13 of D12 to better reflect the definition of a financial asset in IAS 32: ie a financial asset exists when the operator has a contractual right to receive cash. The IFRIC clarified that the grantor does not need to pay the cash to the operator directly. With this change, the proposed amendment would better reflect the economic reality of concession arrangements: to the extent that the operator is remunerated for its construction services by obtaining a contractual right to receive cash from, or at the direction of, the grantor, the operator would recognise a financial asset and, to the extent that the operator receives only a licence to charge users, it would recognise an intangible asset. The IFRIC agreed that bifurcation of the operator's right to cash flows into a financial and an intangible asset may be necessary in certain circumstances and that the Interpretations should reflect this. Some IFRIC members expressed concern, that bifurcation of arrangements may create measurement issues.

In reaching the above decisions, the IFRIC discussed the nature and measurement of a commitment given by the grantor to ensure a specified amount of return to the operator for services provided. The IFRIC noted that the fair value of the commitment would vary according to the precise terms and circumstances of the contract. However, such a commitment did not qualify as a financial guarantee under IAS 39 (which would have required it to be measured at fair value). Rather, it was the means whereby the operator obtained a contractual right to receive cash from, or at the direction of, the grantor. The entire commitment should therefore be recognised as a financial asset.

The staff agreed to prepare a revised draft of D12 for consideration at the next IFRIC meeting.

### The interaction of D12 with IFRIC 4

The IFRIC considered the distinction between IFRIC 4 and D12 and whether the 'significant residual interest' criterion was a necessary part of the scope requirements in D12. The IFRIC agreed a consequential amendment to the scope of IFRIC 4 to specifically exclude arrangements falling within the scope of D12. In addition, it was agreed that the Basis for Conclusions of IFRIC 4 should be amended to explain why the scope exclusion was required.

Paragraph 5b of D12 sets a criterion for a concession arrangement to fall within the scope of D12-14 that the residual interest in the infrastructure should revert to the grantor at the end of the concession and that the residual interest should be significant.

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The IFRIC agreed that paragraph 5b of D12 should be amended. The condition that the residual interest should revert to the grantor would apply only if the residual interest is significant. The amendment results in 'whole of life' assets, (ie where an asset is used in a service concession arrangement for the whole of its useful life) falling within the scope of D12-14, rather than IFRIC 4.

The IFRIC requested the staff to consider further the meaning of 'significant' in relation to the residual interest, and the perceived inconsistency that the scope of the draft Interpretations excludes pre-existing assets of the operator while including pre-existing assets of the grantor.

### **Analysis of remaining comments**

The staff presented an analysis of remaining comments received on draft Interpretations D12-14. The IFRIC deferred consideration of two of the issues:

- the different treatments under the intangible asset and financial asset models of repairs and maintenance obligations; and
- the timing of recognition of an intangible asset, to allow the staff an opportunity to analyse the issues in the light of the IFRIC's decision described above to move the dividing line between the two models.

### *Allocation of contract revenue*

The IFRIC noted the comments received on the proposal in D13 to require allocation of revenue to the different activities of a service concession arrangement by reference to their fair values. The IFRIC noted that this issue had ramifications beyond service concessions arrangements and asked the staff to give priority to a separate project to analyse IAS 11 and IAS 18 to determine whether it is appropriate in an unsegmented contract to allocate different project margins to the different components.

### *Amortisation of an intangible asset*

The IFRIC noted that the Basis for Conclusions as currently drafted could result in creating the false impression that the IFRIC was prohibiting the use of unit-of-production amortisation for intangible assets recognised under D14. The IFRIC decided to amend the Basis for Conclusions to clarify that amortisation methods specified in IAS 38 would be acceptable for intangible assets recognised under D14, provided that the method used reflected the pattern in which the asset's future economic benefits are expected to be consumed by the entity. The IFRIC confirmed its earlier decision that use of interest methods of amortisation is prohibited under D14.

### *Effective date*

The IFRIC will consider the effective date of the Interpretations when it has completed its post-exposure deliberations.

## **IAS 18 Revenue – Sales of Real Estate**

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The IFRIC decided to take onto its agenda a project to clarify the requirements of IAS 18 *Revenue* for real estate sales in which an agreement for sale is reached before construction of buildings or other facilities is complete. The project was triggered by the apparently contradictory guidance set out in section 9 of the Appendix to IAS 18, which has been interpreted rather differently from the requirements of IAS 18. The IFRIC decided that the objectives of the project should be to:

- clarify the circumstances in which IAS 18 *Revenue* is applicable, ie to develop factors in determining whether real estate sales (before construction is complete) should be accounted for as a construction contract in accordance with IAS 11 *Construction Contracts* or as a sale of goods (and possibly provision of further services to complete the construction) in accordance with IAS 18 *Revenue*.
- reinforce and interpret the revenue recognition criteria in IAS 18. The Interpretation should include guidance on whether and, if so, when the transaction should be regarded as comprising two components:
  - (a) a sale of goods (the partially-constructed real estate); and
  - (b) rendering of further services (the remaining construction services required to complete the construction).
- eliminate potential confusion arising from the application of the guidance set out in Appendix to IAS 18, possibly by amending that Appendix (which does not form part of the Standard).

The IFRIC also considered whether the project should specify how revenue and expenses should be allocated to contracts for the sale of individual units within a multi-unit development. The method would depend on whether the contracts should be combined. Some IFRIC members thought that existing criteria for combining contracts were sufficiently clear and that, as the application would depend on the circumstances, little further generic guidance could be given. The IFRIC asked the staff to analyse the issue for further consideration at a future meeting.

The IFRIC noted that the output of this project could be an Interpretation and/or amendments to the real estate example set out in the Appendix to IAS 18. The IFRIC decided to wait until it had reached agreement on the nature and extent of the consensus before determining the format of its output.

The IFRIC asked the staff to research the issues on which the IFRIC is seeking a consensus and to present them for discussion at a future meeting.

## **IAS 19 *Employee Benefits* – The Effect of a Minimum Funding Requirement on the Asset Ceiling**

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The IFRIC continued its consideration of whether a statutory minimum funding requirement (MFR) affects the application of the asset ceiling requirements under IAS 19. The staff presented a draft Interpretation at the meeting.

The IFRIC reaffirmed the decisions made at previous meetings. In particular, the IFRIC confirmed that, if an entity has a statutory requirement to pay contributions to a plan that would exceed the amount of the defined benefit obligation measured under IAS 19 and the assets derived from those contributions would not be available to the entity (either as a refund of surplus or a reduction in future contributions), that requirement would give rise to an additional liability under IAS 19.

An IFRIC member suggested that the scope of the draft Interpretation should be changed to ‘funding requirements’ instead of ‘statutory minimum funding’ requirements. The IFRIC noted that such a change might extend the scope to unrelated issues and therefore agreed that the scope and title of the draft Interpretation should not be changed. However, the analysis may need to be applied to other circumstances by analogy.

The IFRIC was asked to reconsider whether the calculation of the asset available as a reduction in future contributions should take into account, in determining the future contribution reduction available, future changes in the size and demographics of the workforce consistent with the management’s most recent budgets/forecasts. The staff noted that the CICA 3461 (the Canadian pensions accounting standard) states that when an entity has existing plans to make significant reductions in its workforce, the entity reflects these planned reductions in the number of employees used to compute the expected future benefit amount.

The IFRIC noted its previous conclusion that actuarial assumptions, including demographic assumptions, used in computing the net plan asset available should be consistent with the assumptions made to compute the benefit obligation at the balance sheet date. The IFRIC also noted that, if the entity makes significant reductions in its workforce, that would give rise to a curtailment under IAS 19. Under IAS 19, the impact of curtailments is not anticipated before they occur. Therefore, the IFRIC decided that, consistent with other IAS 19 requirements, no allowance should be made for future changes in the size and demographics of the workforce.

The staff discussed possible transition requirements and agreed to bring a paper to support its proposal to the next meeting.

The IFRIC suggested changes to the wording of the draft Interpretation in order to make it easier to understand. An IFRIC observer suggested that the deferred tax model might provide a useful analogy to explain that financial statements present liabilities and assets recognised for accounting purposes rather than assessments by statutory authorities.

The IFRIC also asked that the terminology used make a clearer distinction between funding issues and accounting issues.

The IFRIC asked the staff to prepare a revised draft of the Interpretation for discussion at the next meeting.

## **IAS 32 *Financial Instruments: Presentation* – Classification of a Financial Instrument**

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In response to a submission for a possible agenda item, the IFRIC discussed the role of contractual and economic obligations in the classification of two different financial instruments under IAS 32.

The IFRIC agreed that IAS 32 is clear that a contractual financial obligation was necessary in order that a financial instrument be classified as a liability (ignoring the classification of financial instruments that may or will be settled in the issuer’s own equity instruments). Such a contractual obligation could be explicitly established or could be indirectly established. However, the obligation must be established through the terms and conditions of the financial instrument.

It was agreed that IAS 32 is clear that economic compulsion, by itself, would not result in a financial instrument being classified as a liability.

The IFRIC also discussed the role of ‘substance’ in the classification of financial instruments. It noted that IAS 32 restricted the role of ‘substance’ to consideration of the contractual terms of an instrument, and that anything outside the contractual terms was not considered for the purpose of assessing whether an instrument should be classified as a liability under IAS 32.

The IFRIC also agreed that an obligation to settle an instrument arising solely on an uncertain liquidation does not, by itself, result in that instrument being classified as a liability. Furthermore, the IFRIC agreed that IAS 32 was clear that the relative subordination on liquidation of a financial instrument was not relevant to the classification decision under IAS 32.

It was agreed that the classification of the two instruments included in the original submission to the IFRIC was clear under IAS 32.

The first instrument included in the submission was an irredeemable, callable financial instrument with dividends payable only if dividends are paid on the ordinary shares of the issuer (which themselves are payable at the discretion of the issuer). This instrument included a ‘step-up’ dividend clause that would increase the dividend at a pre-determined date in the future unless the instrument had previously been called by the issuer, and it ranked in liquidation before an instrument classified as a liability. The IFRIC agreed that this instrument included no contractual obligation ever to pay the dividends or to call the instrument and that therefore it should be classified as equity under IAS 32.

The second instrument included in the submission was an irredeemable, callable financial instrument (the ‘base’

instrument) with dividends that must be paid if interest was paid on another (the 'linked') instrument. The issuer must pay the interest on the linked instrument. The IFRIC agreed that the linkage to the linked instrument, on which interest is contractually obliged to be paid, creates a contractual obligation to pay dividends on the base instrument. The IFRIC therefore agreed that, under IAS 32, the base instrument should be classified as a liability.

The IFRIC decided that, since the Standard is clear, it would not expect diversity in practice and would not take this item onto its agenda. The IFRIC requested the staff to draft reasons for not adding this submission to its agenda.

## **IFRS 1 *First-time Adoption of International Financial Reporting Standards* – Determination of the Carrying Amount of the Investment in a Subsidiary in the Separate Financial Statements of the Parent**

The staff reported on two issues that had arisen in connection with the carrying amount of the investments in subsidiaries in the first IFRS separate financial statements of a parent entity:

- how the carrying amount of the investments in subsidiaries should be measured at the time when the parent entity first adopts IFRSs; and
- how the post acquisition profits of subsidiaries should be determined. Post acquisition profits are treated as revenue when received subsequently by the parent.

The staff recommended that the Board be requested to make amendments to IFRS 1 to give relief to parent entities in measuring the carrying amounts of the investments in subsidiaries in their first IFRS separate financial statements. The IFRIC supported the staff recommendation.

## **Customer Loyalty Programmes**

The IFRIC continued its deliberations on accounting by vendors for customer loyalty rewards, ie rights to additional goods or services granted to customers as a reward for past purchases.

The IFRIC first considered whether the rewards should be treated as:

- (a) a separate component of a multiple-element sales transaction. Some of the sales proceeds received for the past sale would be allocated to the rewards and recognised as revenue only when the rewards were delivered; or
- (b) an expense still to be incurred in respect of the past sale. All of the sales proceeds would be recognised as revenue at the point of the initial sale, and provision would be

made for the cost of supplying the rewards and charged as an expense alongside the initial sale; or

- (c) either (a) or (b) depending on the circumstances.

IFRIC members held different views. Some took the view that the substance was the same whatever the form of the rewards. Members favouring approach (a), the multiple-element sale transaction, argued that loyalty rewards were similar to 'buy-one-get-one-free' offers. Since revenue is measured at the fair value of the consideration received or receivable, then revenue is allocated to the two separate components. Delivery of the first item does not give rise to all the revenue being recognised. However, they cautioned that the multiple-element approach should not be taken to an extreme – loyalty rewards should be identified as separate components only if significant. Members favouring approach (b), the future expense, regarded it as simpler and more reliable and thought that users' needs would not be served better by approach (a). Members who favoured approach (c) believed that the choice between (a) and (b) should depend on the circumstances, eg whether the additional goods and services would be provided by the entity or a third party; or whether the additional goods and services were items that were otherwise sold by the entity.

The IFRIC then considered how IAS 18 *Revenue* would apply if rewards were accounted for as a separate component of a multiple-element sales transaction. It decided that:

- the entity should estimate the fair value of the customer consideration received for the loyalty rewards. Various factors could be relevant to the estimate: eg the market selling price for the goods and services offered as rewards; the likelihood that the customer would meet any further qualifying conditions and claim the rewards; and any further consideration that the customer would have to pay for the goods or services claimed. The time value of money would be taken into account if material.
- on the basis of this estimate, the total consideration receivable from the customer would be divided between the original goods and services sold and the rights to loyalty rewards. The revenue recognition criteria in IAS 18 would be applied to each component separately, ie the revenue attributed to the loyalty rewards would be deferred until the rewards had been delivered.
- the time at which income was recognised, and the way in which it was classified and presented, might depend on whether the entity supplied the rewards itself or granted the customers rights to claim goods and services from a third party supplier. (The definition of 'revenue' and requirements of IAS 18 needed to be considered further on this point.)
- when the revenue relating to the loyalty rewards was recognised, any further costs to be incurred in respect of the loyalty rewards would also be recognised.

To focus the IFRIC's discussion at the next meeting, the Chairman directed the staff to prepare a draft Interpretation supporting a consensus that all rights to loyalty rewards should be treated as a separate component of a multiple-element sales transaction, if material. The Interpretation should direct readers to the relevant paragraphs of existing

IFRSs and not try to provide exhaustive guidance on accounting for customer loyalty programmes.

The IFRIC members requested that the staff ensure that the analysis of the requirements of IAS 18 addressed both sales of goods and rendering of services; and consider further the implications of customer loyalty programmes that gave customers rights to claim goods and services from a third party supplier.

## **IAS 39 *Financial Instruments: Recognition and Measurement* – Aspects of Derecognition in the Context of Securitisation**

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The IFRIC discussed two related issues that had been submitted in connection with the derecognition requirements of IAS 39. The issues address how best to make operational the requirements of IAS 39 (summarized in the flowchart in IAS 39 AG 36). Analysis of the issues will be discussed at future meetings.

The first issue was how the derecognition provisions of IAS 39 should be applied to groups of financial assets. The staff noted that, in practice, entities may transfer groups of financial assets which comprise non-derivative financial assets and derivatives. The staff noted that the key issue in this question was whether one derecognition test should be applied to such groups of financial assets, or whether separate derecognition tests should be applied (even though economically such groups of financial assets may be viewed as a single unit and cash flows from the financial instruments are grouped together).

The second issue was whether certain transfers of financial assets, as detailed below, should fall within paragraph 18(a) or paragraph 18(b) of IAS 39. IAS 39 differentiates two types of transfers: transfers of contractual rights to cash flows are set out in paragraph 18(a); and transfers in which the entity retains the contractual rights to cash flows and assumes a contractual obligation to pay cash flows to a recipient are set out in paragraph 18(b). If the transfer falls within paragraph 18(b), all of the ‘pass through’ conditions set out in paragraph 19 must be met. The transfers at issue include those where an entity can contractually agree to pass on cash flows without notifying the debtor; and those in which an entity may transfer contractual rights to cash flows subject to certain conditions, eg (i) conditions relating to the existence and legal status of the asset at the time of the transfer, (ii) conditions relating to the performance of the asset after the time of transfer, and (iii) offset agreements. The question arose whether, in these cases, the ‘pass through’ provisions set out in paragraph 19 should be applied.

The IFRIC noted that there was divergence in practice and that the issues were related. Consequently, it concluded that the issues should be addressed in one Interpretation.

## **IAS 39 *Financial Instruments: Recognition and Measurement* – Whether Inflation Risks Qualify as Separable Components for Hedging Purposes**

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The IFRIC discussed whether inflation qualifies as a risk associated with a portion of the fair value or cash flows of an interest bearing financial asset or an interest bearing financial liability in accordance with paragraph 81 of IAS 39.

In analysing this issue a key question is whether the guidance about portions of non-financial assets set out in AG 100 of IAS 39 is relevant to the identification of portions in financial assets and financial liabilities. AG 100 states that changes in the price of a portion of a non-financial asset generally do not have a *predictable, separately measurable* economic effect on the price of the overall non-financial asset or non-financial liability in a manner which is comparable to the effect of a change in market interest rates on the price of a bond.

While the IFRIC agreed that the guidance in IAS 39 AG 100 may be relevant to the identification of portions in financial assets and liabilities, there was debate as to whether or not this paragraph permitted the designation of inflation risk as a hedgeable portion of the fair value or cash flows of an interest bearing financial asset or liability.

The IFRIC members noted that the IFRIC received a number of submissions in a short period of time in connection with the meaning of ‘portion’ set out in IAS 39. The IFRIC, therefore, asked the staff to perform analysis to identify under what circumstances portions could or could not qualify for hedging purposes in accordance with IAS 39, based on the current requirements of IAS 39.

## **IFRIC Relationship with National Standard-Setters and National Interpretative Groups**

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The Director of Technical Activities presented a paper on IFRIC’s relationship with national standard setters (NSSs) and national interpretative groups (NIGs). She explained that the IASB and the IFRIC could not prevent NSSs or NIGs from issuing their own interpretations, as long as they considered it was appropriate to do so.

She said that there were a number of resources through which requests could be raised with the IFRIC for Interpretations. According to the Draft Statement of Best Practice, NSSs are encouraged to request the IFRIC to address issues that require Interpretations. In addition, in accordance with the Preface to International Financial Reporting Interpretations, IFRIC members and observers have the primary responsibility for identifying issues to be considered by the IFRIC and drawing the staff’s attention to any situations where they find that a proposed interpretation by an NSS or NIG is potentially divergent.

Due to the widespread adoption of IFRSs worldwide, the staff thinks that it would not be feasible to monitor the work of every NSS or NIG. Instead, the staff recommended that IFRIC continue to support NSSs or NIGs bringing issues to the IFRIC for consideration in the usual manner through the IFRIC due process. In addition, IFRIC members and observers would be encouraged to bring to its attention issues where there appears to be inappropriate interpretation developing in a national jurisdiction or where a proposed EITF interpretation or FASB Staff Position (FSP) of a converged standard is divergent. The IFRIC should not 'endorse' or 'frank' interpretations issued by others. The IFRIC Due Process Handbook should deal with the relationship with NSSs and NIGs.

Some IFRIC members expressed concern that, if the IFRIC did not monitor the interpretations issued by NSSs or NIGs, local interpretations would emerge that were inconsistent with IFRSs. They pointed out that not all interpretations issued by NSSs or NIGs were confined to domestic issues. On the other hand, some IFRIC members commented that the staff would face an overwhelming workload if required to undertake comprehensive monitoring of interpretations by NSSs or NIGs. The IFRIC agreed that it would be difficult to endorse interpretations issued by NSSs or NIGs worldwide.

## IFRIC Agenda Decisions

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*The following explanation is published for information only and does not change existing IFRS requirements.*

*Interpretations of the IFRIC are determined only after extensive deliberation and due process, including a formal vote. IFRIC Interpretations become final only when approved by nine of the fourteen members of the IASB.*

### **Whether a New Entity that pays Cash can be identified as the Acquirer**

The IFRIC considered an issue regarding whether a new entity formed to effect a business combination in which it pays cash as consideration for the business acquired could be identified as the acquirer.

IFRS 3.22 states that when a new entity is formed to issue equity instruments to effect a business combination, one of the combining entities that existed before the combination shall be identified as the acquirer on the basis of the evidence available.

The IFRIC decided that, as it is clear that IFRS 3.22 does not prohibit a newly formed entity that pays cash to effect a business combination from being identified as the acquirer, it would not expect diversity in practice and would not take this item onto its agenda.

### **'Transitory' Common Control**

The IFRIC considered an issue regarding whether a reorganisation involving the formation of a new entity to facilitate the sale of part of an organisation is a business combination within the scope of IFRS 3.

IFRS 3 does not apply to business combinations in which all the combining entities or businesses are under common control both before and after the combination, unless that

control is transitory. It was suggested to the IFRIC that, because control of the new entity is transitory, a combination involving that newly formed entity would be within the scope of IFRS 3.

IFRS 3.22 states that when an entity is formed to issue equity instruments to effect a business combination, one of the combining entities that existed before the combination must be identified as the acquirer on the basis of the evidence available. The IFRIC noted that, to be consistent, the question of whether the entities or businesses are under common control applies to the combining entities that existed before the combination, excluding the newly formed entity. Accordingly, the IFRIC decided not to add this topic to its agenda.

The IFRIC also considered a request for guidance on how to apply IFRS 3 to reorganisations in which control remains within the original group. The IFRIC decided not to add this topic to the agenda, since it was unlikely that it would reach agreement in a reasonable period, in the light of existing diversity in practice and the explicit exclusion of common control transactions from the scope of IFRS 3.

### **Leases of Land that do not transfer Title to the Lessee**

The IFRIC considered a comment letter that it had received in response to the publication of its draft reasons for not taking this issue on its agenda. The correspondent argued that a finance lease treatment should be afforded to leases exceeding 500 years. The IFRIC rejected this approach based on the current text of the standard. However, in response to comments from a number of IFRIC members, the IFRIC agreed to recommend to the IASB that the special provisions related to the transfer of title on a lease of land should be deleted from IAS 17. The IFRIC confirmed the following text, previously published, of its reasons for not taking this item onto its agenda.

The IFRIC considered whether long leases of land would represent a situation when a lease of land would not *normally* be classified as an operating lease even though title does not transfer to the lessee. IAS 17 states at paragraph 14 that a characteristic of land is that it normally has an indefinite economic life. If title is not expected to pass to the lessee by the end of the lease term, then the lessee *normally* does not receive substantially all of the risks and rewards incidental to ownership, in which case the lease will be an operating lease. Even when the land has an indefinite economic life, paragraph 15 states that 'the land element is *normally* classified as an operating lease unless title is expected to pass to the lessee by the end of the lease term.....' [emphasis added].

The IFRIC noted that leases of land with an indefinite economic life, under which title is not expected to pass to the lessee by the end of the lease term, were classified as operating leases before an amendment to IAS 17 was made in respect of IAS 40 *Investment Properties*. Specifically, IAS 17 was amended to state that in leases of land that do not transfer title, lessees *normally* do not receive substantially all the risks and rewards incidental to ownership.

Some have understood the introduction of the word 'normally' as implying that a long lease of land in which title would not transfer to the lessee would henceforth be treated as a finance lease, since the time value of money would reduce the residual value to a negligible amount. The IFRIC noted that, as summarised in paragraph BC 8, the Board considered but rejected that approach in relation to the classification of leases of land and buildings, because 'it would conflict with the criteria for lease classification in the Standard, which are based on the extent to which the risks and rewards incidental to ownership of a leased asset lie with the lessor or the lessee'. The Board also made clear that it had not made any fundamental changes to the Standard.

The IFRIC noted that one example of a lease classification affected by the introduction of the word 'normally' was a lease of land in which the lessor had agreed to pay the lessee the fair value of the property at the end of the lease period. In such circumstances, significant risks and rewards associated with the land at the end of the lease term would have been transferred to the lessee despite there being no transfer of title. Consequently a lease of land, irrespective of the lease term, is classified as an operating lease unless title is expected to pass to the lessee or significant risks and rewards associated with the land at the end of the lease term pass to the lessee.

The IFRIC decided not to add this item to its agenda as, although leases of land that do not transfer title are widespread, the IFRIC has not observed, and does not expect, significant diversity in practice.

### **IAS 12 Income Taxes – Scope**

The IFRIC considered whether to give guidance on which taxes are within the scope of IAS 12. The IFRIC noted that IAS 12 applies to income taxes, which are defined as taxes that are based on *taxable profit*. That implies that (i) not all taxes are within the scope of IAS 12 but (ii) because taxable profit is not the same as accounting profit, taxes do not need to be based on a figure that is exactly accounting profit to be within the scope. The latter point is also implied by the requirement in IAS 12 to disclose an explanation of the relationship between tax expense and accounting profit. The IFRIC further noted that the term 'taxable profit' implies a notion of a net rather than gross amount. Finally, the IFRIC observed that any taxes that are not in the scope of IAS 12 are in the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

However, the IFRIC also noted the variety of taxes that exist world-wide and the need for judgement in determining whether some taxes are income taxes. The IFRIC therefore believed that guidance beyond the observations noted above could not be developed in a reasonable period of time and decided not to take a project on this issue onto its agenda.

### **Subscriber Acquisition Costs in the Telecommunications Industry**

The IFRIC considered how a provider of telecommunications services should account for telephone handsets it provides free of charge or at a reduced price to customers who subscribe to service contracts. The question was whether:

- the contracts should be treated as comprising two separately identifiable components, i.e. the sale of a telephone and the rendering of telecommunication services, as discussed in paragraph 13 of IAS 18 *Revenue*. Revenue would be attributed to each component; or
- the telephones should be treated as a cost of acquiring the new customer, with no revenue being attributed to them.

The IFRIC acknowledged that the question is of widespread relevance, both across the telecommunications industry and, more generally, in other sectors. IAS 18 does not give guidance on what it means by 'separately identifiable components' and practices diverge.

However, the IFRIC noted that the terms of subscriber contracts vary widely. Any guidance on accounting for discounted handsets would need to be principles-based to accommodate the diverse range of contract terms that arise in practice. The IASB is at present developing principles for identifying separable components within revenue contracts. In these circumstances, the IFRIC does not believe it could reach a consensus on a timely basis. The IFRIC, therefore, decided not to take the topic onto its agenda.

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

The IFRIC considered a comment letter that had been received objecting to the draft reasons for not taking this onto IFRIC's agenda. The comment letter argued that it is possible to interpret IAS 27 as permitting separate accounts to be published when there is a reasonable expectation that consolidated accounts will be published shortly. IFRIC members rejected this approach based on the current text of the standard and reaffirmed the following text, previously published, of its reasons for not taking the item onto its agenda.

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

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

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

## Tentative Agenda Decisions

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*The IFRIC reviewed the following matters, which the Agenda Committee had recommended should not be taken onto the IFRIC agenda. These tentative decisions, including where appropriate recommended reasons for not adding it to the IFRIC agenda, will be re-discussed at the May 2006 IFRIC meeting. Constituents who disagree with the proposed reasons, or believe that the explanations may contribute to divergent practices, are welcome to communicate those concerns by 24 April 2006, preferably by email to: [ifric@iasb.org](mailto:ifric@iasb.org) or by post to:*

*International Financial Reporting Interpretations Committee  
First Floor, 30 Cannon Street  
London EC4M 6XH  
United Kingdom*

*Communications will be placed on the public record unless confidentiality is requested by the writer.*

### **IFRS 2 Share-based Payment – Scope of IFRS 2: Share plans with cash alternatives at the discretion of the entity**

The IFRIC considered whether an employee share plan in which the employer had the choice of settlement in cash or in shares, and the amount of the settlement did not vary with changes in the share price of the entity should be treated as a share-based payment transaction within the scope of IFRS 2 *Share-based Payment*.

The IFRIC noted that IFRS 2 defines a share-based payment transaction as a transaction in which the entity receives goods or services as consideration for equity instruments of the entity or amounts that are based on the price of equity instruments of the entity.

IFRIC further noted that the definition of a share-based payment transaction does not require the exposure of the entity to be linked to movements in the share price of the entity. Moreover, it is clear that IFRS 2 contemplates share-based payment transactions in which the terms of the arrangement provide the entity with a choice of settlement, since they are specifically addressed in paragraphs 41 – 43 of IFRS 2. [The IFRIC, therefore, believed] that, although the amount of the settlement did not vary with changes in the share price of the entity, such share plans are share-based payment transactions in accordance with IFRS 2 since the consideration may be equity instruments of the entity.

[The IFRIC also believed] that, even in the extreme circumstances in which the entity was given a choice of settlement and the value of the shares that would be delivered was a fixed monetary amount, those share plans were still within the scope of IFRS 2.

[The IFRIC believed] that, since the requirements of IFRS 2 are clear, the issue is not expected to create significant divergence in practice. [The IFRIC, therefore, decided] not to take the issue onto the agenda.

### **IFRS 2 Share-based Payment – Share plans with cash alternatives at the discretion of employees: grant date and vesting periods**

The IFRIC considered an employee share plan in which employees were provided a choice to have cash at one date or shares at a later date. At the date the transactions were entered into, the parties involved understood the terms and conditions of the plans including the formula that would be used to determine the amount of cash to be paid to each individual employee (or the number of shares to be delivered to each individual employee) but the exact amount of cash or number of shares would only be known at a future date. The IFRIC was asked to confirm the grant date and vesting period for such share plans.

The IFRIC noted that IFRS 2 defines grant date as the date when there is a shared understanding of the terms and conditions. Moreover, IFRS 2 does not require grant date to be the date when the exact amount of cash to be paid (or the exact number of shares to be delivered) is known to the parties involved.

The IFRIC further noted that share-based payment transactions with cash alternatives at the discretion of the counterparty are addressed in paragraphs 34 - 40 of IFRS 2. Paragraph 35 of IFRS 2 states that, if an entity has granted the counterparty the right to choose whether a share-based payment transaction is settled in cash or by issuing equity instruments, the entity has granted a compound financial instrument, which includes a debt component (ie the counterparty's right to demand cash payment) and an equity component (ie the counterparty's right to demand settlement in equity instruments). Paragraph 38 of IFRS 2 states that the entity shall account separately for goods or services received or acquired in respect of each component of the compound financial instrument. [The IFRIC, therefore, believed] that the vesting period of the equity component and that of the debt component should be determined separately and the vesting period of each component may be different.

[The IFRIC believed] that, since "grant date" is defined in IFRS 2 and the requirements set out in paragraphs 34 - 40 of IFRS 2 are clear, the issues are not expected to create significant divergence in practice. [The IFRIC, therefore, decided] that the issues should not be taken onto the agenda.

### **IFRS 2 Share-based Payment – Fair value measurement of a post-vesting transfer restriction**

The IFRIC received a request in connection with employee share purchase plans in which employees can buy shares of the employing entity at a discount to the market price but are not permitted to sell those shares for a certain period beyond vesting date. The issue was whether the value of such post-vesting restrictions could be based on the "opportunity cost" borne by employees, determined based on a two-stage approach which assumed that employees would (1) sell forward the shares that cannot be disposed of within the restriction period and (2) buy the same number of freely traded shares with a personal unsecured loan. The value of the forward sale (step 1) would reflect a market participant's perspective, while the cost of the loan (step 2) would reflect an employee specific rate. The IFRIC was asked whether this approach is consistent with the requirements under IFRS 2.



The IFRIC noted the requirements in paragraph B3 of Appendix B to IFRS 2, which states that, “if the shares are subject to restrictions on transfer after vesting date, that factor shall be taken into account, but only to the extent that the post-vesting restrictions affect the price that a knowledgeable, willing market participant would pay for that share. For example, if the shares are actively traded in a deep and liquid market, post-vesting transfer restrictions may have little, if any, effect on the price that a knowledgeable, willing market participant would pay for those shares.” Entity-specific and employee-specific assumptions are not relevant in determining the value of such post-vesting transfer restrictions. Therefore, [the IFRIC did not believe that] the approach mentioned in the request was consistent with the requirements under IFRS 2.

[The IFRIC believed] that, since the requirements of IFRS 2 are clear, the issue was not expected to create significant divergence in practice. [The IFRIC therefore decided] not to take the issue onto the agenda.

### **Future IFRIC meetings**

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

#### **2006**

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

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