NEWSLETTER OF THE INTERNATIONAL FINANCIAL REPORTING INTERPRETATIONS COMMITTEE

IASB IFRIC UPDATE

January 2007

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

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

The IFRIC met in London on 11 and 12 January 2007, when it discussed:

- Draft IFRIC Due Process Handbook
- D20 *Customer Loyalty Programmes*
- IAS 18 *Revenue*—Revenue Recognition in respect of Initial Fees
- IAS 19 *Employee Benefits*—Distinction between Curtailments and Negative Past Service Costs
- IAS 21 *The Effects of Changes in Foreign Exchange Rates*—The Hedge of a Net Investment in a Foreign Operation
- IAS 38 *Intangible Assets*—Advertising and Promotional Expenditure and Catalogues
- IAS 41 *Agriculture*—Recognition and Measurement of Biological Assets and Agricultural Produce in accordance with IAS 41
- IFRIC Agenda Decisions
- Tentative Agenda Decisions
- Update on Agenda Committee Business

Draft IFRIC Due Process Handbook

The IFRIC discussed the proposals for the IFRIC Due Process Handbook that the Chairman was to present to the Trustees the following week.

The IFRIC noted that the proposed Handbook contained no reference to an agenda committee nor to any requirement for special sessions of the IFRIC to discuss agenda setting. The Chairman explained that the intention was that recommendations for the agenda would be discussed by IFRIC members in public session on the day before a formal IFRIC meeting. There would be no requirement for a quorum, since business at those sessions would be limited to agreeing recommendations to be presented to the formal IFRIC meeting for decisions. It was not intended to increase the frequency of the present bi-monthly IFRIC meetings. In preparing papers for the agenda discussions, the staff would consult on an informal basis but there would be no requirement for an interim meeting of IFRIC members.

IFRIC members commented that the existence of the Agenda Committee had helped efficiency by assisting the staff in bringing well-structured proposals to the IFRIC. It was suggested that the Handbook might usefully incorporate a requirement that the staff should consult IFRIC members in drafting proposals for the agenda.

The IFRIC noted that decisions not to take an item onto the agenda would continue to be published in draft and in final form. They would continue to give reasons but would not be described as 'clarifications' because they were not authoritative. Nevertheless, they would carry weight as being the opinion of the IFRIC arrived at after a brief exposure for public comment. If the IFRIC could not agree on the reasons, it might be necessary to give no reasons.

D20 *Customer Loyalty Programmes*

The IFRIC considered comments received on Draft Interpretation D20 *Customer Loyalty Programmes*, which had been published for comment in September 2006. In particular, it considered comments on the overall approach and scope of the proposed Interpretation.

Overall approach

The IFRIC noted that the overwhelming majority of commentators agreed that there was a need for an Interpretation addressing 'points', 'air miles' and other award credits that entities grant to customers when they buy goods or services. However, opinion was divided on what the accounting treatment should be. Some commentators supported the D20 proposal that revenue should be allocated to the award credits and recognised only when the entity fulfilled its obligation to supply the awards. Others took the view that the entity should instead accrue the costs of supplying the awards, arguing in particular that:

- loyalty awards are in substance marketing expenses incurred to induce the initial sale. They should therefore be treated as costs associated with the sale of the goods or services, not separate components of the sale.

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- the fair value of the award credits cannot always be measured reliably. The proposed approach would be complex to implement and would not produce better quality or more useful information. The costs would exceed the benefits.

A third group thought that the accounting treatment should depend on the nature of the scheme. For example, revenue deferral would be appropriate if the entity supplied the awards itself in the course of its ordinary activities, whereas cost accrual would be appropriate if the awards were supplied by a third party.

The IFRIC considered the arguments made by those opposing the D20 approach. It decided to retain the overall approach but amend the draft Interpretation where possible to address some of the commentators' comments:

- by explaining more fully in the Basis for Conclusions the factors that distinguish award credits within the scope of the Interpretation from marketing expenses. Marketing expenses are incurred independently of a sales transaction, to secure that transaction. Award credits are part of the sales transaction itself: customers have paid consideration and there is an outstanding obligation.
- by clarifying in the Consensus (perhaps including an illustrative example) the accounting consequences if the entity immediately lays off the obligation to a third party. The entity would immediately recognise the revenue associated with the award credits and the amount payable to the third party (whether the revenue and amounts payable would be recognised gross or net would depend on whether the entity was acting as agent or principal, which would be discussed at a future meeting).
- by addressing cost/benefit issues in the Basis for Conclusions. Members acknowledged that there might be system costs, but noted that most of the variables that have to be estimated to measure the amount of revenue to allocate to award credits (eg timing of redemption, forfeiture rates etc) also have to be estimated to measure the future cost of fulfilling the obligation. They also noted that the benefits of the D20 approach include enhanced comparability—entities will measure customer loyalty performance obligations on the same basis as other performance obligations.

Scope

The IFRIC noted that the Interpretation was being regarded as applying more widely than intended. It decided to reword the scope paragraph (and perhaps also the title) to clarify that the Interpretation applies only to award credits that are granted to customers as part of a sales transaction, and not to other types of loyalty scheme. It does not apply to any incentives offered to potential customers in the absence of a sale.

The IFRIC also considered suggestions that the scope of the draft Interpretation should be expanded to address award credits that entities sell separately, either to their own customers or those of other vendors. It decided not to expand the scope to include such transactions. The reason was that the purpose of the Interpretation is to clarify that award credits granted with the sale of other goods or services are separately identifiable components of the sale. This issue does not arise if award credits are sold separately.

Next steps

The IFRIC will consider at a future meeting comments on the way in which D20 applies the separate component approach (eg how consideration is allocated between components and when it is recognised as revenue). Transitional arrangements and the effective date also remain to be considered.

IAS 18 *Revenue*—Revenue Recognition in respect of Initial Fees

The IFRIC considered a draft rationale for linking the upfront fee received by a fund management group from an investor with the ongoing fee received by the fund management group from a fund, for the purposes of applying the revenue recognition criteria in IAS 18. Some commentators had contended that, in this situation, the upfront and ongoing fees arose from contracts with different parties.

The IFRIC noted that IAS 18 paragraph 13 states that 'the recognition criteria [in IAS 18] are applied to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole.'

The IFRIC considered an example of a fund with an upfront fee of 5 per cent and an ongoing fee of 1 per cent. Units in the fund may be sold by an adviser from an in-house sales department of the same group as the fund manager or by a separate financial adviser. If they are sold by a separate financial adviser, that adviser will retain the 5 per cent upfront fee.

Some members of the IFRIC viewed the fact that the upfront fee is the same, regardless of whether it is retained by a separate financial adviser (which is independent of the group that includes the fund manager and therefore has no further involvement with the transaction) or by an adviser from an in-house sales department of the same group as the fund manager, as evidence that upfront services were delivered and that the fair value of those services can be measured reliably.

Other members observed that the upfront activities undertaken by an in-house sales department (which advises investors on which in-house fund to acquire) and upfront activities undertaken by a separate financial adviser (which may advise on a much wider investment decision) are not necessarily comparable. In their view it does not follow that there is evidence that an upfront service is provided by an in-house sales department or that the consideration received in respect of any services provided by such a source can be measured with reference to services provided by a separate financial adviser.

The IFRIC agreed that:

- fees may be recognised as revenue only to the extent that services have been provided
- whilst the proportion of costs incurred in delivering services may be used to estimate the stage of completion

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of the transaction, incurring costs does not by itself imply that a service has been provided

- the receipt of a non refundable initial fee does not, in itself, give evidence that an upfront service has been provided or that the fair value of the consideration paid in respect of any upfront services is equal to the initial fee received
- to the extent that:
  - an initial service can be shown to have been provided to a customer,
  - the fair value of the consideration received in respect of that service can be measured reliably and
  - the conditions for the recognition of revenue in IAS 18 have been met,

  upfront and ongoing fees may be recognised as revenue in line with the provision of services to the customer.

The IFRIC noted that a wide range of business models utilising initial and ongoing fees exists in different markets. The services provided and the revenue that may be recognised in each situation depend on the facts and circumstances relevant to each model.

The IFRIC could not agree on further principles by which it would determine the extent to which an upfront service had been provided by an in-house sales department or whether the consideration for that service could be measured reliably. The IFRIC had debated those issues over three consecutive meetings without agreement and took the view that it was unlikely within a reasonable time frame to reach a consensus on further principles for determining the extent to which an upfront service had been provided. It therefore decided to remove the item from its agenda.

IAS 19 *Employee Benefits*—Distinction between Curtailments and Negative Past Service Costs

The IFRIC considered how to distinguish between plan amendments that are curtailments and those that are negative past service costs in IAS 19. The IFRIC noted that a lack of clarity in IAS 19 had resulted in diverse practices.

The IFRIC noted that the Board's project on IAS 19 is not intended to address the issue. However, decisions in that project might result in both curtailments and negative past service costs being accounted for in the same way, thus eliminating the need to distinguish between them. There might be little benefit in the IFRIC addressing this issue if the Board's project would result in a further change to the accounting for post-employment benefits shortly after any Interpretation could be finalised.

The IFRIC decided to explore whether it should recommend the Board to address this issue through its annual improvements process. Staff recommendations on possible amendments to IAS 19 will be considered at a future IFRIC meeting.

IAS 21 *The Effects of Changes in Foreign Exchange Rates*—The Hedge of a Net Investment in a Foreign Operation

The IFRIC discussed accounting for a hedge of a net investment in a foreign operation in group financial statements in accordance with IAS 21 *The Effects of Changes in Foreign Exchange Rates* and IAS 39 *Financial Instruments: Recognition and Measurement*. The main issues raised in this project are: what is an acceptable hedged risk, and in which group entities can the hedging instrument be held?

The IFRIC decided that an Interpretation on the mechanics of consolidation would not resolve the issues raised in the project. Nevertheless, the IFRIC should address whether an entity can hedge its presentation currency. Members believed that a hedged risk should represent an economic exposure, which can arise only between functional currencies. Hedges of an elective presentation currency would be prohibited if an Interpretation followed that logic. One approach proposed was that at the consolidated level the hedgeable risk created by a net investment was limited to that between the functional currency of the net investment and that of the group parent. The staff were asked to investigate that view, as well as an alternative whereby a hedgeable risk could be identified in respect of the economic exposure between the functional currency of a net investment and that of the group parent or any intermediate parent.

The IFRIC noted that the answer to Question F 2.14 in the Implementation Guidance with IAS 39 states that, in relation to an example of a swap contract undertaken as a cash flow hedge, IAS 39 does not require the operating unit that is exposed to the risk being hedged to be a party to the hedging instrument. However, further investigation was necessary to consider whether that approach was applicable to other forms of hedging contract and to hedges of net investments.

Lastly, the IFRIC briefly discussed US GAAP and agreed to undertake further analysis. A view was expressed that, in some respects at least, the differently stated US requirements might achieve a similar result in practice to the principles being sought by the IFRIC.

IAS 38 *Intangible Assets*—Advertising and Promotional Expenditure and Catalogues

At its meeting in November 2006, the IFRIC asked the staff to consider whether paragraph 69 of IAS 38 could be amended to require the costs of advertising and promotional activities to be recognised as an expense when the advertising or promotion was distributed to customers rather than when the expenditures were incurred.

At this meeting, the IFRIC considered draft changes that could be made to IAS 38 paragraph 69 and the implications of making such changes for other types of expenditure including start-up costs, training costs, and costs associated with reorganising or restructuring an entity.

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The IFRIC concluded that the implications of such a change might not be acceptable. For example, many members were uncomfortable with a change to the standard that would defer the recognition of start-up costs until a start-up occurred.

The IFRIC therefore tentatively agreed that it would not pursue that amendment to paragraph 69 of IAS 38. The IFRIC noted that, if it did not pursue any changes, then divergence was likely to continue to exist around the wording of paragraph 70 of IAS 38 and the treatment of prepayments, and it asked the staff to develop amendments to paragraphs 68-70 of IAS 38 to clarify that advertising costs may be deferred until they are consumed.

The IFRIC also discussed mail order catalogues. The IFRIC reaffirmed its view that such catalogues are forms of advertising. In the course of its discussion, the IFRIC considered whether to develop an Interpretation specific to direct-response advertising, mirroring US GAAP SOP 93-7. The IFRIC concluded that the scope of such an Interpretation would be too narrow and therefore decided against this approach.

IAS 41 *Agriculture*—Recognition and Measurement of Biological Assets and Agricultural Produce in accordance with IAS 41

The IFRIC continued its discussion about the prohibition on taking into account 'increases in value arising from additional biological transformation' in paragraph 21 of IAS 41. The IFRIC also discussed the potential impact of the Board project on fair value measurement and concluded that there would be substantial benefits from complementary amendments to IAS 41. The IFRIC agreed that the staff should propose to the Board that IAS 41 should be amended to remove the prohibition in paragraph 21on taking into account 'additional biological transformation' when estimating fair value using discounted cash flows and to clarify that biological transformation was not limited to physical growth. In making this recommendation, the IFRIC agreed that the proposed amendment should:

- retain the fair value objective when measuring the present value of expected net cashflows at the beginning of paragraph 21
- ensure that the revised paragraph 21 continues to make clear that fair value is measured in relation to the asset's current location and condition
- amend paragraph 17 to make clear that, if an active market is used to estimate the fair value of an asset, it should be an active market for the asset in its current location and condition
- make clear that a market for a dead asset (for example a scrap, pulp, or damaged goods market) is not an active market for a growing crop
- make clear that future risks should be factored into the cash flow projections or discount rates but not both.

In drafting the amendment, the IFRIC stressed that it was necessary to consider any changes to paragraph 21 in the context of paragraphs 17–20. For example, a paragraph 21 discounted cash flow model will not be used when a relevant active market exists for a biological asset as the asset can be valued with reference to that market using paragraph 17.

IFRIC Agenda Decisions

The following explanations are published for information only and do not change existing IFRS requirements. IFRIC agenda decisions are not Interpretations. *Interpretations of the IFRIC are determined only after extensive deliberation and due process, including a formal vote. IFRIC Interpretations become final only when approved by nine of the fourteen members of the IASB.*

IAS 39 *Financial Instruments: Recognition and Measurement*—Definition of a derivative: Indexation on own EBITDA or own revenue

In July 2006 the IFRIC published a tentative agenda decision that explained why it had decided not to issue guidance on whether a contract that is indexed to an entity's own revenue or own earnings before interest, tax, depreciation and amortisation (EDITDA) is (or might contain) a derivative.

The tentative agenda decision addressed two issues:

- whether the exclusion from the definition of a derivative of contracts linked to non-financial variables that are specific to a party to the contract applies only to insurance contracts
- whether EBITDA or revenue is a financial or non-financial variable.

The tentative agenda decision concluded that:

- the exclusion from the definition of a derivative of contracts linked to non-financial variables that are specific to a party to the contract is not restricted to insurance contracts, on the basis of the current drafting of the standard; and
- although IAS 39 is unclear whether revenue or EBITDA is a financial or non-financial variable, the IFRIC would not take this issue onto its agenda because it was unlikely to reach a consensus on a timely basis.

At the January 2007 meeting, the IFRIC decided to withdraw the tentative agenda decision.

Having reconsidered the issue, the IFRIC noted that taking no action would allow continued significant diversity in practice regarding how financial and non-financial variables were determined.

Consequently, the IFRIC directed the staff to refer the issue to the Board. The IFRIC recommended that the Board should amend IAS 39 (possibly as part of the annual improvements process) to limit to insurance contracts the exclusion from the definition of a derivative of contracts linked to non-financial variables that are specific to a party to the contract.

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IAS 39 *Financial Instruments: Recognition and Measurement*—Short Trading

The IFRIC received a submission regarding the accounting for short sales of securities when the terms of the short sales require delivery of the securities within the time frame established generally by regulation or convention in the marketplace concerned. A fixed price commitment between trade date and settlement date of a short sale contract meets the definition of a derivative according to IAS 39 paragraph 9. However, the submission noted that entities that enter into regular way purchase or sales of financial assets are allowed to choose trade date or settlement date accounting in accordance with IAS 39 paragraph 38. Therefore, the issue was whether short sales of securities should be eligible for the regular way exceptions (ie whether entities that enter into short sales are permitted to choose trade date or settlement date accounting).

The IFRIC noted that paragraphs AG55 and AG56 of IAS 39 address the recognition and derecognition of financial assets traded under regular way purchases and regular way sales of long positions. If the regular way exceptions are not applicable to short sales of securities, such short sales should be accounted for as derivatives and be measured at fair value with changes in fair value recognised in profit or loss.

The IFRIC received several comment letters explaining an interpretation of IAS 39 that is commonly used in practice. Under that interpretation, entities that enter into short sales of securities are allowed to choose trade date or settlement date accounting. Specifically, practice recognises the short sales as financial liabilities at fair value with changes in fair value recognised in profit or loss. Under the industry practice, the same profit or loss amount is recognised as would have been recognised if short sales of securities were accounted for as derivatives but the securities are presented differently on the balance sheet.

The IFRIC acknowledged that requiring entities to account for the short positions as derivatives may create considerable practical problems for their accounting systems and controls with little, if any, improvement to the quality of the financial information presented. For these reasons and because there is little diversity in practice, the IFRIC decided not to take the issue onto the agenda.

IAS 39 *Financial Instruments: Recognition and Measurement* and IAS 27 *Consolidated and Separate Financial Statements*—Financial Instruments puttable at an amount other than Fair Value

The IFRIC received a submission regarding the classification in the financial statements of the holders of financial instruments puttable at the option of the holders at an amount other than fair value (the puttable instruments). The submission noted that the issuer's contractual obligation to deliver cash requires the issuer to recognise financial liabilities in its financial statements in accordance with IAS 32 *Financial Instruments: Presentation*. The issues are:

- how the puttable instruments should be accounted for in the financial statements of the holders, in particular, whether the accounting for the instruments in the financial statements of the holders should be symmetrical with that in the financial statements of the issuer
- whether an entity that has control over an entity that has no equity instruments in issue is required to present consolidated financial statements in accordance with IAS 27 *Consolidated and Separate Financial Statements* as well as to recognise goodwill in accordance with IFRS 3 *Business Combinations*.

Regarding the first issue, the IFRIC noted that IAS 32 and IAS 39 do not directly address whether the accounting for financial instruments in the financial statements of the holders should be symmetrical with that in the financial statements of the issuer. However, the IFRIC noted that the issuer of a financial instrument is required to classify it in accordance with IAS 32, whereas the holder is required to classify and account for it in accordance with IAS 39.

The IFRIC noted that IAS 39 requires the holder to identify embedded derivatives of hybrid financial instruments. IAS 39 also requires the holder to account for the embedded derivatives separately if all the conditions in IAS 39 paragraph 11 are met. These requirements apply to the holder regardless of whether any embedded derivatives are accounted for separately in the financial statements of the issuer. In the light of the existing guidance in IAS 39, the IFRIC decided that the first issue should not be taken onto the agenda.

Regarding the second issue, the IFRIC noted that the control of a subsidiary, and the resulting requirement for a parent to present consolidated financial statements in accordance with IAS 27 (including the requirement to recognise goodwill in accordance with IFRS 3) does not necessarily depend on the parent's owning equity instruments of the subsidiary. The IFRIC, therefore, decided not to take the second issue onto the agenda.

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

In November 2006, the IFRIC published a tentative agenda decision not to provide guidance on a number of issues relating to the derecognition of financial assets.

After considering the comment letters received on the tentative agenda decision, the IFRIC concluded that additional guidance is required in this area. The IFRIC therefore decided to withdraw the tentative agenda decision and add a project on derecognition to its agenda.

The IFRIC noted that any Interpretation in this area must have a tightly defined and limited scope, and directed the staff to carry out additional research to establish the questions that such an Interpretation should address.

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Tentative Agenda Decisions

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 taking them onto the IFRIC agenda, will be re-discussed at the March 2007 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 26 February 2007, preferably by email to: ifric@iasb.org or by post to:

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

IAS 17 *Leases*—Sale and Leasebacks with Repurchase Agreements

During the course of developing its Interpretation on service concession arrangements, the IFRIC tentatively concluded that a transaction that took the form of a sale and leaseback should not be accounted for as such if it incorporated a repurchase agreement. The reason was that the seller/lessee retained control of the asset by virtue of the repurchase agreement. Hence, the criteria for recognising a sale in paragraph 14 of IAS 18 *Revenue* would not be met.

However, at its meeting in May 2006 the IFRIC noted that this tentative conclusion would apply more widely than to service concession arrangements and that the matter should be the subject of a separate project.

At this meeting, the IFRIC considered whether the conditions for recognition of a sale in paragraph 14 of IAS 18 must be met before a transaction is accounted for as a sale and leaseback transaction under IAS 17. In particular, the IFRIC considered whether transactions that take the form of a sale and leaseback transaction should be accounted for as such when the seller/lessee retains effective control of the leased asset through a repurchase agreement or option.

The IFRIC noted that IAS 17, rather than IAS 18, provides the more specific guidance with respect to sale and leaseback transactions. Consequently, it is not necessary to apply the requirements of paragraph 14 of IAS 18 to sale and leaseback transactions within the scope of IAS 17.

However, the IFRIC also noted that IAS 17 applies only to transactions that convey a right to use an asset. SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease* and IFRIC 4 *Determining whether an Arrangement contains a Lease* provide guidance on when an arrangement conveys a right of use. If, applying the criteria in SIC-27 and IFRIC 4, an entity determines that an arrangement does not convey a right of use, the transaction is outside the scope of IAS 17 and the sale and leaseback accounting in IAS 17 should not be applied.

The IFRIC noted that significantly divergent interpretations do not exist in practice on this issue and that it would not expect such divergent interpretations to emerge. Consequently, the IFRIC [decided] not to take the issue onto its agenda.

IAS 19 *Employee Benefits*—Special Wages Tax

The IFRIC was asked to consider whether taxes related to defined benefits, for example taxes payable on contributions to a defined benefit plan or taxes payable on some other measure of the defined benefit, should be treated as part of the defined benefit obligation in accordance with IAS 19 *Employee Benefits*. The IFRIC noted the following:

- Taxes paid by a defined benefit plan are included in the definition in IAS 19 of the return on plan assets.
- Income taxes paid by the entity are accounted for in accordance with IAS 12.
- The scope of IAS 19 is not restricted to benefits paid to employees. It includes some costs of employee benefits that are not paid to employees.
- A wide variety of taxes on pension costs could exist worldwide, each specific to its own jurisdiction, and it is a matter of judgement whether they are income taxes within the scope of IAS 12, costs of employee benefits within the scope of IAS 19, or other costs within the scope of IAS 37.

Given the variety of tax arrangements, the IFRIC believed that guidance beyond the above observations could not be developed in a reasonable period of time.

The IFRIC therefore [decided] not to take the issue onto its agenda.

IAS 36 *Impairment of Assets*—Identifying Cash-generating Units in the Retail Industry

The IFRIC was asked to develop an Interpretation on whether a cash-generating unit (CGU) could combine more than one individual store location. The submitter developed possible considerations including shared infrastructures, marketing and pricing policies, and human resources.

The IFRIC noted that IAS 36 paragraph 6 (and supporting guidance in paragraph 68) requires identification of CGUs on the basis of independent cash inflows rather than independent net cash flows and so outflows such as shared infrastructure and marketing costs are not considered.

The IFRIC determined that developing guidance beyond that already given in IAS 36 on whether cash inflows are largely independent would be more in the nature of application guidance and therefore [decided] not to take this item onto its agenda.

IAS 39 *Financial Instruments: Recognition and Measurement*—Written Options in Retail Energy Contracts

The IFRIC received a request to provide an Interpretation on what is meant by ‘written option’ within the context of paragraph 7 of IAS 39.

Under paragraph 7 of IAS 39 a written option to buy or sell a non-financial item that can be net settled (as defined in paragraph 5) cannot be considered to have been entered into for the purpose of meeting the reporting entity’s normal purchase, sale and usage requirements. The application of this paragraph is illustrated in the current guidance.

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The submission was primarily concerned with the accounting for energy supply contracts to retail customers.

Analysis of such contracts suggests that in many situations they do not meet the net settlement criteria laid out in paragraphs 5 and 6 of IAS 39. If this is the case, such contracts would not be considered to be within the scope of IAS 39.

In the light of this analysis, the IFRIC expected little divergence in practice and therefore [decided] not to take the item onto the agenda.

IAS 39 Financial Instruments: Recognition and Measurement—Assessing Hedge Effectiveness of an Interest Rate Swap in a Cash Flow Hedge

The IFRIC was asked whether, when an entity designates an interest rate swap as a hedging instrument in a cash flow hedge, the entity is allowed to consider only the undiscounted changes in cash flows of the hedging instrument and the hedged item in assessing hedge effectiveness for hedge qualification purposes.

The IFRIC noted that when an interest rate swap is designated as a hedging instrument, a reason for ineffectiveness is the mismatch of the timing of interest payments or receipts of the swap and the hedged item. To take into account the timing of cash flows from interest payments or receipts in assessing hedge effectiveness, entities need also to take into account the time value of money.

IAS 39 states that ineffectiveness arises when the principal terms of the hedged item do not match perfectly with those of the hedging instrument (see paragraph AG108 of IAS 39). In addition, IAS 39 paragraph 74 does not allow the bifurcation of the fair value of a derivative hedging instrument for hedge designation purposes, unless the derivative hedging instrument is an option or a forward contract. The IFRIC observed that a consequence of a comparison between changes in undiscounted cash flows of an interest rate swap and changes in undiscounted cash flows of the hedged item for assessing hedge effectiveness is that only a portion of the movements in fair value of the swap is taken into account.

In the light of the above requirements in IFRSs, the IFRIC did not expect significant diversity in practice in the application of those requirements. [The IFRIC, therefore, decided] not to take the issue onto the agenda.

Update on Agenda Committee business

The staff reported on issues with the Agenda Committee that had not yet reached the IFRIC agenda. Items that had been discussed at the meeting in January were:

- IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*—Plans to sell the controlling interest in a subsidiary
- IAS 16 *Property, Plant and Equipment*—Sale of assets in a rental business.

In addition the following issues that had been discussed at the Agenda Committee's meeting in December had not yet reached the IFRIC agenda:

- IAS 1 *Presentation of Financial Statements*—Current or non-current presentation of derivatives not designated as hedging instruments in effective hedges
- IAS 18 *Revenue*—Customer contributions to a service entity's asset.

The staff were undertaking further research into these issues and papers were likely to be presented to the IFRIC at its meeting in March 2007.

From July 2006, IFRIC meetings have been audiocast live via the Internet. Audio recordings are available to listen to via the Website and can be accessed via the IFRIC Projects included within the Current Projects area. Please visit the IASB Website at www.iasb.org for more information.

Future IFRIC meetings

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

2007

- 8 and 9 March
- 3 and 4 May
- 12 and 13 July
- 6 and 7 September
- 1 and 2 November

Meeting dates, tentative agendas and additional details about the next meeting will also be posted to the IASB Website at www.iasb.org before the meeting. Instructions for submitting requests for Interpretations are given on the IASB Website at http://www.iasb.org/About+Us/About+IFRIC/Propose+Agenda+Item.htm

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