NEWSLETTER OF THE INTERNATIONAL FINANCIAL REPORTING INTERPRETATIONS COMMITTEE

IASB IFRIC UPDATE

September 2008

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 4 and 5 September 2008, when it discussed:

- IFRIC D23 *Distributions of Non–cash Assets to Owners*
- IFRIC D24 *Customer Contributions*
- Customer-related intangible assets
- Regulatory assets and liabilities
- Agenda decisions
- Tentative agenda decisions
- Work in progress

IFRIC D23 *Distributions of Non-cash Assets to Owners*

The IFRIC completed its redeliberation of draft Interpretation D23 at this meeting.

The IFRIC approved the staff's proposed drafting changes to D23 developed in response to its redeliberations at the meeting in July 2008 as well as those changes proposed in response to the minor issues discussed in this meeting. The main changes relate to:

- clarifying the scope of the Interpretation with respect to common control transactions
- specifying the measurement of the dividend payable without attributing the requirement to a particular standard and therefore also modifying the disclosure requirements
- providing additional rationale for the conclusion that the settlement gain should be included in profit or loss
- adding guidance on when to recognise the dividend payable
- adding the proposed amendments to IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

The IFRIC recognised respondents' concerns about the potential 'accounting mismatch' in equity resulting from measuring the assets to be distributed at their carrying amount and measuring the dividend payable at the fair value of the assets to be distributed. Consequently, the IFRIC considered whether it should recommend that the Board amend IFRS 5 to require the assets to be distributed to be measured at fair value.

The IFRIC did not identify any IFRS literature that would support an upward remeasurement of the assets solely on the basis of a commitment to distribute them. The IFRIC noted that such a change would result in an inconsistency within IFRS 5 between assets held for sale and those held for distribution. The IFRIC also noted this 'mismatch' would arise only in the normally short period between when the dividend payable is recognised and when it is settled. Therefore, the IFRIC decided not to recommend that the Board amend IFRS 5 in this regard.

The IFRIC considered whether the changes from the draft Interpretation exposed for comment as D23 were such that re-exposure was needed in accordance with the IFRIC *Due Process Handbook*. The IFRIC concluded they were not.

Finally, the IFRIC voted and confirmed the consensus. Subject to drafting changes to be confirmed by circulation of a revised draft, the IFRIC directed the staff to present the final Interpretation to the Board for approval. The staff expect the final Interpretation to become effective for distributions recognised in annual periods beginning on or after three months after it is issued.

IFRIC D24 *Customer Contributions*

At its meeting in July 2008 the IFRIC discussed an example of a customer contribution made in return for connection to a price-regulated network. The IFRIC generally supported the staff's conclusion on revenue recognition but asked the staff to broaden the issue and develop indicators based on IAS 18 *Revenue*.

At this meeting, the IFRIC discussed the staff's analysis and rationale for a revised draft Interpretation and two illustrative examples.

Whose asset is it?

The staff reminded the IFRIC of the different steps that D24 envisaged to determine whether an asset should be recognised, including the consideration of IFRIC 4 *Determining whether an Arrangement contains a Lease* and IAS 17 *Leases*. The staff pointed out that, although respondents to D24 generally did not object to the proposals, they believed that D24 was unduly complex and difficult to understand and apply. For this reason, the staff suggested simplifying D24 and addressing the issue of who controls the asset by giving guidance based on the *Framework* and existing IFRSs. In doing so, readers of the Interpretation would not need to refer to other IFRSs.

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IFRIC D24 *Customer Contributions* (contd)

The IFRIC generally agreed with the staff's conclusion that an approach with a clear focus on who controls the asset is easier to understand than the step-by-step approach in D24. However, the IFRIC asked the staff to identify whether other indicators should be added to the revised draft. In addition the staff was asked to ensure that the guidance developed in the Interpretation is consistent with guidance on similar issues in IFRSs, particularly in situations in which the arrangements between the parties identify who controls the asset only for a portion of its useful life.

How should the credit be accounted for?

When an entity concludes that it should recognise the contributed asset because it controls that asset, the second issue is how the resulting credit should be accounted for.

At its meeting in July 2008 the IFRIC discussed an example of a customer contribution for connection to a price-regulated network. On the specific facts of the example, the IFRIC reached the tentative view that the ongoing obligation to provide access arises from the terms of the operating licence, not from the contribution. In other words, if no performance obligation remains after the connection has been established, revenue should be recognised when the connection is made.

At this meeting, the staff presented a revised draft Interpretation incorporating indicators based on IAS 18 to help identify the goods or services to be provided in exchange for the customer contribution:

- some features indicate that there may be only one service delivered: connection to the network in a rate-regulated environment or ongoing services provided at a reduced rate in an outsourcing arrangement;
- other features indicate that there may be two services delivered: the initial connection to the network and the service to provide ongoing access to a supply of goods or services.

The IFRIC supported the approach the staff had developed, which was based on identifying the different components of a single transaction in accordance with IAS 18. The IFRIC took the view that developing indicators to help such identification would be useful. The IFRIC asked the staff to refine the wording of the proposed indicators, add references in the illustrative examples to the revised draft Interpretation and develop an example of a customer contribution arising in an outsourcing arrangement.

If an ongoing service is part of the arrangement, the staff raised the issue of determining the period over which revenue should be recognised. The IFRIC concluded that that period should generally be determined by the terms of the arrangement with the customer but agreed that if the arrangement did not specify a term, the revenue should be recognised over a period no longer than the useful economic life of the contributed asset used to provide the ongoing service.

At the IFRIC's meeting in November 2008 the staff will present a revised draft of the Interpretation that takes into account the IFRIC's tentative views and that includes a basis for conclusions and illustrative examples.

Customer-related intangible assets

The IFRIC received a request to add an item to its agenda to provide guidance on the circumstances in which a non-contractual customer relationship arises in a business combination. IFRS 3 *Business Combinations* (as revised in 2008) requires an acquirer to recognise the identifiable intangible assets of the acquiree separately from goodwill. An intangible asset is identifiable if it meets either the contractual-legal criterion or the separable criterion in IAS 38 *Intangible Assets*.

Customer-related intangible assets may be either contractual or non-contractual. Contractual customer relationships are always recognised separately from goodwill as they meet the contractual-legal criterion. However, non-contractual customer relationships are recognised separately from goodwill only if they meet the separable criterion. Consequently, determining whether a relationship is contractual is critical to identifying and measuring both separately recognised customer relationship intangible assets and goodwill, and different conclusions could result in substantially different accounting outcomes.

The staff's survey of IFRIC members indicated that diversity exists in practice regarding which customer relationships have a contractual basis and which are non-contractual. In addition, valuation experts may be taking different views, which could also be contributing to diversity in this area.

The IFRIC agreed with the staff's recommendation that the issue should be added to its agenda and with the staff's view that the outcome of this project would not necessarily be an Interpretation. Because IFRS 3 was the result of a joint project with the US Financial Accounting Standards Board (FASB), the staff will liaise with a member of the FASB staff. They will also consider the deliberations of appraisal/valuation professional organisations in developing a more complete project proposal for presentation at the IFRIC's meeting in November 2008.

Regulatory assets and liabilities

In January 2008 the IFRIC received a request to consider whether regulated entities could or should recognise a liability (or an asset) as a result of price regulation by regulatory bodies or governments. A project plan was presented and approved at the IFRIC's meeting in May.

At this meeting, the IFRIC considered the background information accumulated as a result of the staff's research work. The IFRIC was asked whether there was additional information or analysis that it would like developed as a basis for it to assess the issue in relation to the agenda criteria at a future meeting. IFRIC members identified several matters they believed warranted further analysis and discussion in the paper. The discussion was educational and no decisions were made. The staff expect to present a paper supporting their recommendation on whether the IFRIC should add the issue to its agenda at the November 2008 meeting.

IFRIC agenda decisions

The following explanation is published for information only and does not change existing IFRS requirements. *IFRIC agenda decisions are not Interpretations. IFRIC Interpretations 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 17 *Leases*—Time pattern of the user's benefit

The IFRIC received a request for guidance on the application of paragraphs 33 and 34 of IAS 17, which state that 'For operating leases, lease payments (excluding costs for services such as insurance and maintenance) are recognised as an expense on a straight-line basis unless another systematic basis is representative of the time pattern of the user's benefit, even if the payments are not on that basis.' The request asked for guidance on what alternatives to straight-line recognition of lease expense might be appropriate.

The IFRIC noted that guidance had previously been requested on this issue, and for the reasons elaborated on below, had not been added to the agenda.

The IFRIC noted that IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* require an entity to recognise the use of productive assets using the method that best reflects 'the pattern in which the asset's *future economic benefits* are expected to be consumed by the entity' (emphasis added). In contrast, IAS 17 refers to the *time pattern* of the user's benefit. Therefore, any alternative to the straight-line recognition of lease expense under an operating lease must reflect the time pattern of the use of the leased asset.

The IFRIC also noted that it did not expect significant diversity in practice regarding the application of this requirement.

The IFRIC therefore decided not to add this issue to its agenda.

IAS 18 *Revenue*/IAS 39 *Financial Instruments: Recognition and Measurement*—Accounting for trailing commissions

The IFRIC received a request for guidance on how an entity should account for ongoing commission arrangements, referred to as trailing commissions, in the particular circumstances where the contractual obligation for the payment/receipt of the commission is not linked to the performance of any future service.

An example of the type of arrangement in question is when a financial adviser directs its client's funds to an investment manager's product. The adviser receives an initial commission for the placement of the business with the investment manager and a further ongoing (trailing) commission provided that the client remains invested in the product for a specified time. The issue focuses on the accounting treatment by the financial adviser to the client.

The IFRIC noted that similar arrangements are present in many industries. Consequently, the issue is widespread. In addition, the IFRIC is aware that practice in this area is diverse. Diversity arises in part because of difficulty in determining, considering all relevant circumstances including the terms of the contractual arrangement, whether the entity is required to provide any future service to be entitled to receive the commission. Diversity also arises because IAS 18 and IAS 39 have different recognition criteria and views differ on whether IAS 18 or IAS 39 is the relevant standard.

Given the complexity of the issues and the pervasive effect of any conclusions reached, the IFRIC concluded that it would not be able to reach a consensus on a timely basis. The IFRIC also noted that the Board was considering these issues in its projects on revenue recognition and liabilities. The IFRIC therefore decided not to add this issue to its agenda.

IAS 32 *Financial Instruments: Presentation*—Transaction costs to be deducted from equity

The IFRIC received a request for guidance on the extent of transaction costs to be accounted for as a deduction from equity in accordance with IAS 32 paragraph 37 and on how the requirements of IAS 32 paragraph 38 to allocate transaction costs that relate jointly to one or more transaction should be applied. This issue relates specifically to the meaning of the terms 'incremental' and 'directly attributable'.

The IFRIC noted that only incremental costs directly attributable to issuing new equity instruments or acquiring previously outstanding equity instruments are related to an equity transaction in accordance with IAS 32. The IFRIC also noted that judgement will be required to determine which costs are related solely to other activities undertaken at the same time as issuing equity, such as becoming a public company or acquiring an exchange listing, and which are costs that relate jointly to both activities that must be allocated in accordance with paragraph 38.

In view of the existing guidance, the IFRIC decided not to add this issue to its agenda.

However, the IFRIC also noted that the terms 'incremental' and 'directly attributable' are used with similar but not identical meanings in many Standards and Interpretations. The IFRIC recommended that common definitions should be developed for both terms and added to the Glossary as part of the Board's annual improvements project.

Tentative agenda decisions

The IFRIC reviewed the following matters and tentatively decided that they should not be added to the IFRIC agenda. These tentative decisions, including recommended reasons for not adding the items to the IFRIC agenda, will be reconsidered at the IFRIC meeting in November 2008. Constituents who disagree with the proposed reasons, or believe that the explanations may contribute to divergent practices, are encouraged to communicate those concerns by 13 October 2008 by email to: ifric@iasb.org.

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

IAS 39 *Financial Instruments: Recognition and Measurement*—Valuation of restricted securities

The IFRIC received a request for guidance on whether a discount must be applied to the quoted market price when establishing the fair value of a security quoted in an active market when there is a contractual, governmental or other legally enforceable restriction that prevents the sale of the security for a specified period. Guidance was requested only in situations in which the restriction applied to the current holder of the security and would not transfer to another entity.

The IFRIC noted that any guidance it could provide would be in the nature of implementation guidance rather than an interpretation. In its view, any additional guidance that is necessary should be provided by the Board in its project on fair value measurement.

The IFRIC therefore [decided] not to add this issue to its agenda.

IFRIC 14 *IAS 19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*—Stable workforce assumption

The IFRIC received a request to address an issue arising from IFRIC 14. The issue relates to the economic benefit available in the form of reductions in future contributions when there is a minimum funding requirement. IFRIC 14 requires the economic benefit to be determined assuming a stable workforce in the future unless the entity is demonstrably committed at the end of the reporting period to make a reduction in the number of employees covered by the plan. The request asserted that in some circumstances the assumption of a stable workforce may understate the economic benefits available to the entity as a reduction in future contributions. The request noted that contributions to a plan are recognised as an expense, not an asset, if they provide no economic benefits in accordance with IFRIC 14. Therefore, by choosing the timing and the level of such contributions, an entity can affect its reported earnings.

The IFRIC noted that the requirements of IFRIC 14 regarding the assumption of a stable workforce are clear. The issue was discussed extensively during the development of IFRIC 14 and the request provides no new information to cause the IFRIC to reconsider it.

The effect of the timing of voluntary contributions described in the request is an inherent part of the limit on the asset that can be recognised in respect of a surplus in accordance with IAS 19.

The IFRIC therefore [decided] not to add this issue to its agenda.

IFRIC work in progress

The IFRIC reviewed a summary of its outstanding issues. The IFRIC discussed nine issues at this meeting including two requests to add items to the agenda received after the last meeting. No additional requests have been received.

Work will begin shortly on the issue related to compliance costs for the European Regulation concerning Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH) with the assistance of other interpretive bodies that have indicated an interest in participating in the project. The Board will consider the IFRIC's recommendations on group cash-settled share-based payment transactions at its September meeting and the staff expect to take recommendations on the application of the effective interest rate method to the Board in October. On the final issue in the summary, relating to derecognition, the IFRIC agreed with a staff proposal that it should consider removing the issue from its agenda given the acceleration of the Board's project. The staff will prepare a recommendation for the IFRIC to consider at its November meeting.

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:

2008

- 6 and 7 November

2009

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

In addition to the meetings listed above, the IFRIC may hold meetings for a preliminary discussion of some staff papers. Attendance by IFRIC members at these meetings is voluntary and no decisions on technical issues will be made. If the IFRIC holds a preliminary meeting, it will normally take place on the Wednesday afternoon before the IFRIC meeting.

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