



# On the Horizon for IFRS

August 20, 2008

## **IFRIC issues July 2008 meeting highlights**

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## IFRIC issues July 2008 meeting highlights

*All decisions reached at IFRIC meetings are tentative and may be changed or modified at future meetings. Committee decisions become final only after completion of a formal vote on an Interpretation or Draft Interpretation, which is confirmed by the IASB.*

The International Financial Reporting Interpretations Committee has issued the July 2008 [IFRIC Update](#), which summarizes the Committee's meeting in London on July 10-11, 2008. Highlights of the meeting are discussed below.

### **IFRIC discusses Draft Interpretation on distributions of non-cash assets to owners**

The IFRIC discussed a summary of the comment letters received on Draft Interpretation D23, *Distributions of Non-cash Assets to Owners* (the draft interpretation or D23).

### Continuance of the project

Most of the respondents supported the IFRIC's conclusion that it should develop an interpretation on distributions of non-cash assets to owners and agreed with the IFRIC's proposals. However, some of the respondents expressed a concern that the scope of the project was too narrow. The IFRIC decided to continue the project without changing the scope for the following reasons:

- Because guidance for the accounting for the distribution of non-cash assets to owners in their capacity as owners is not contained in IFRS, there is diversity in practice.
- Transactions in which the shares of group entities are distributed to shareholders outside the group do not meet the definition of common control transactions in IFRS 3, *Business Combinations*, and would therefore be within the scope of the draft interpretation.

The IFRIC asked the staff to redraft D23 to clarify the scope.

### Measurement of the dividend payable

The IFRIC discussed whether the draft interpretation should indicate that all dividends payable should be measured in accordance with IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*. Although many respondents expressed a concern, it was not the intention of D23 to imply that the measurement attribute in IAS 37 should always be interpreted to be fair value (that issue is part of the IASB's project to amend IAS 37.) The IFRIC made a decision to revise the draft interpretation to require that the dividend payable be measured by reference to the fair value of the assets to be distributed. The draft interpretation would analyze the requirements of potentially relevant standards but would not link the conclusion to any individual standard.

### Recognition of a gain on settlement

The IFRIC decided not to adopt the alternative view included in paragraph BC44 of D23 with respect to the recognition of the gain on settlement directly in equity. However, the IFRIC directed the staff to provide in the final Basis for Conclusions additional rationale that the settlement gain should be included in profit or loss.

### Disclosure requirements

The IFRIC decided to proceed with the disclosure requirements proposed in paragraphs 13–15 of D23. No serious concerns were raised in the comment process.

### Application of IFRS 5, Non-current Assets Held for Sale and Discontinued Operations

The IFRIC made the following decisions:

- *Apply IFRS 5 to assets held for distribution to owners:* The IFRIC will recommend that the IASB amend IFRS 5 to make it applicable to such distributions.
- *Apply IFRS 5 at the commitment date at which time the assets must be available for immediate distribution in their present condition and the distribution must be highly probable:* A highly probable distribution must meet the same conditions as those for assets held for sale in IFRS 5.8 and .9. The probability of shareholders' approval (if required in the jurisdiction) should be considered as part of the assessment of whether the distribution is highly probable.

The IFRIC recognized 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 fair value.

As a result, the IFRIC asked the staff

- To consider whether it should recommend that the IASB amend IFRS 5 to require the assets to be distributed to be measured at fair value and, if so, when IFRS 5 should be applied
- To consider any potential implications or consequences of such a conclusion for other standards

#### When to recognize the dividend payable

The issue of when an entity should recognize a dividend payable liability is not addressed in D23, therefore, the IFRIC decided that the liability should be recognized when the declaration of the dividend is no longer at the discretion of the entity, as follows:

- When declaration of the dividend by management is approved by the shareholders, if the jurisdiction legally requires the approval by the shareholders, or
- When the dividend is declared by management, if the jurisdiction does not legally require the approval by the shareholders

See the [IFRIC project summary](#) for more information on this project.

#### IFRIC discusses Draft Interpretation on customer contributions

The IFRIC discussed a summary of the comment letters received on Draft Interpretation D24, *Customer Contributions* (the draft interpretation or D24). The draft interpretation proposes guidance on the accounting for customer contributions received by an access provider. Although most of the respondents agreed that an interpretation on customer contributions is necessary, they expressed various concerns. One of the main concerns was whether the entity receiving the customer contributions always has an obligation to provide

ongoing access to a supply of goods or services, and if such an obligation exists, when the revenue should be recognized.

The IFRIC discussed an example of a customer contribution for connection to a price-regulated network. In the example, a real estate developer contributes an electricity substation to the utility company operating the electricity network and, either by law or regulation, the utility company has an obligation to provide ongoing access to the electricity network to all connected customers at the same price, regardless of whether they have contributed an asset. Once a customer is connected, the utility company provides ongoing access to its network and charges the customer a quarterly fee for that access, regardless of whether the customer purchases its electricity from the utility company or another company.

The IFRIC concluded that in the specific facts and circumstances of the example, the ongoing performance obligation is an executory contract and should be accounted for only if the contract is onerous. There was general support for the staff's conclusion that the ongoing obligation to provide access arises from the terms of the operating license rather than from the contribution. If the contributing party received some exclusive right, such as reduced pricing, the obligation to provide access might in that case arise from the contribution, which could affect the period over which revenue would be recognized. The IFRIC asked the staff to prepare additional examples that would include different facts and circumstances (e.g., in a non-regulated environment or circumstances in which IFRIC 4, *Determining whether an Arrangement contains a Lease*, might apply).

Some IFRIC members questioned whether, in accordance with paragraph 13 of IAS 18, *Revenue*, connection services would be identified as a separate

component from the ongoing service of providing access to the network. Accordingly, the IFRIC asked the staff to

- Develop IAS 18 indicators to identify whether a performance obligation arising from a customer contribution exists
- Prepare additional examples
- Carry forward the proposals in D24 with respect to recognition and measurement of the contributed asset

See the [IFRIC project summary](#) for more information on this project.

#### **Proposed amendments discussed for group cash-settled share-based payment transactions**

At the May 2008 IFRIC meeting, the staff had presented a summary of the comment letters received on the exposure draft, *Group Cash-settled Share-based Payment Transactions*, which includes proposed amendments to IFRS 2, *Share-based Payment*, and IFRIC 11, *IFRS 2 – Group and Treasury Share Transactions*. At the July 2008 IFRIC meeting, the scope and measurement proposals were redeliberated and the staff presented papers on alternatives for the main areas of concern raised in the comment letters for these proposals.

The IFRIC agreed that the exposure draft did not completely achieve its objective on the issue of how to include in the scope of IFRS 2 share-based payment transactions involving group entities (including shareholders) in which the settling entity may not be the entity receiving goods and services. The Committee decided to recommend that the IASB amend certain defined terms in IFRS 2.3 to clarify that

- The *receiving entity* should account for the goods and services received in accordance with IFRS 2.

- The *settling entity* should account for the settlement in accordance with IFRS 2.

The IFRIC recommended that the IASB should consider amending IFRS 2 to add the general principles developed by the staff rather than continuing to develop specific guidance case by case. Those principles address the accounting by the receiving entity, the settling entity, and the consolidated entity. The principles overcome the potential inconsistency with the Framework that results from relying on the recognition and measurement basis of another entity within a group, and allows for similar accounting for transactions of similar economic substance.

The IFRIC reconsidered the classification and measurement proposal for the separate financial statements of the entity receiving goods and services when a share-based payment transaction is settled by another group entity or its shareholder and decided to recommend that the classification and measurement of the share-based payment transaction by the receiving entity and the settling entity would not necessarily be the same, depending upon the circumstances, as follows:

- *Receiving entity*: When the receiving entity does not have any obligation to settle the share-based payment transaction, it would measure the goods and services received in accordance with the requirements for equity-settled transactions. Accordingly, only changes in estimates associated with vesting conditions (performance conditions) other than a market condition would be reflected. The receiving entity would recognize in equity an equivalent contribution from its shareholder or parent, irrespective of how the expense is calculated by the party with the obligation to settle the share-based payment transaction.

- *Settling entity:* The financial statements of the group and the settling entity would reflect the appropriate IFRS 2 measurement on the basis of the actual settlement by the group settling entity.

The IFRIC decided to recommend that the IASB should not amend IFRS 2 to address how to account for an intragroup reimbursement arrangement for group share-based payment transactions. This is consistent with the conclusions reached by the IFRIC and the IASB when IFRIC 11 was finalized.

The IFRIC asked the staff to prepare a summary of the discussions and decisions reached for the IASB.

See the [IFRIC project summary](#) for more information on this project.

#### **Compliance costs for REACH discussed**

The IFRIC received a request to provide guidance on the treatment of costs incurred to comply with the European Regulation (the Regulation) concerning the Registration, Evaluation, Authorization and Restriction of Chemicals (REACH), which became effective on June 1, 2007. Different types of costs have been incurred with respect to the Regulation resulting in diversity in practice in the accounting for these costs and in the development of the related accounting policies. The Regulation impacts entities in the chemical industry. Some companies believe these costs do not meet the definition of an asset in the Framework, while others believe they represent intangible assets, and still others believe they should be capitalized as part of the chemicals produced. Costs in Europe are expected to run in the billions of euros. This issue may also affect non-EU companies that have operations in Europe and use IFRS in their home jurisdictions.

The IFRIC indicated that other jurisdictions in addition to Europe had developed or were in the process of developing regulations relating to similar

environmental issues. The staff was asked to analyze this issue on the basis of general principles and to work with other interpretative bodies whose entities might be affected by the Regulation or similar requirements.

The IFRIC had recommended and the Committee agreed that this issue should tentatively be added to the agenda.

#### **Agenda decisions**

*IFRIC agenda decisions are not Interpretations, which are determined only after deliberation and due process, including a formal vote. IFRIC Interpretations become final only when approved by the IASB.*

At the May 2008 meeting, the IFRIC had tentatively decided not to add an issue to the agenda at that time and to reconsider it at the July 2008 meeting. The Committee discussed the issue at the July 2008 meeting.

#### **IAS 39, Financial Instruments: Recognition and Measurement – Applying the effective interest rate method**

The Committee was asked to provide guidance on the application of the effective interest rate method to a financial instrument with cash flows that are linked to changes in an inflation index. Three possible approaches were discussed:

- *Paragraph AG7 of IAS 39:* applies to floating rate financial instruments whose estimated cash flows are revised to reflect movements in market rates of interest thus altering the effective interest rate
- *Paragraph AG8 of IAS 39:* applies to changes in estimated future cash flows other than those that are addressed in AG7 thus altering the carrying amount of the instrument

- *Provisions of IAS 29, Financial Reporting in Hyperinflationary Economies*: applies only to the financial statements of an entity whose functional currency is the currency of a hyperinflationary economy

The Committee confirmed its tentative decision in May 2008 to not add the issue to its agenda since application guidance already exists in paragraphs AG6–AG8 of IAS 39 and judgment is required in applying paragraphs AG7 and AG8 to this issue. However, the Committee referred the issue to the IASB with a recommendation that the application guidance should be clarified or expanded.

#### **Tentative agenda decisions**

After reviewing the following issues, the Committee tentatively decided not to add them to the agenda at this time. The issues will be reconsidered at the September 2008 meeting.

#### **IAS 17, Leases – Time pattern of the user's benefit**

The Committee received a request for guidance on alternatives to straight-line recognition of lease expense. IAS 17.34 states 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 Committee indicated that guidance had previously been requested on this issue and had not been added to the agenda for the following reasons:

- IAS 16, *Property, Plant and Equipment*, and IAS 38, *Intangible Assets*, require an entity to recognize 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”

- IAS 17, in contrast, refers to the time pattern of the user's benefit. Based upon the existing IFRS guidance, any alternative to the straight-line method of recognizing operating lease expense must reflect the time pattern of the use of the leased property rather than the amount of use or other factor related to economic benefits.

The Committee decided not to add this issue to the agenda since it did not expect significant diversity in practice.

#### **IAS 18, Revenue – Accounting for trailing commissions**

The Committee received a request to provide guidance on the accounting by a financial adviser for ongoing commission arrangements (trailing commissions). The issue specifically relates to the accounting treatment where the contractual obligation for the payment/receipt of the commission is not linked to the performance of any future service by the financial adviser (for example, when a financial adviser directs its client's funds to an investment manager's product.) In this type of arrangement, the financial adviser would receive both an initial commission for the placement of the business with the investment manager and an ongoing (trailing) commission, provided that the client's funds remain invested in the product for a specified time.

The IFRIC noted that many industries have similar arrangements and that practice is diverse, since it is difficult to determine whether the entity is required to provide any future service to be entitled to receive the commission and because different views exist with respect to the relevant IFRS.

The IFRIC decided not to add this issue to the agenda for the following reasons:

- A consensus would not likely be reached on a timely basis due to the complexity of the issues and the pervasive effect of any conclusions reached.
- The IASB is considering the issues in its revenue recognition and liabilities projects.

#### IAS 32, Financial Instruments: Presentation – Transaction costs to be deducted from equity

The Committee received a request to provide guidance on

- The extent of transaction costs to be accounted for as a deduction from equity in accordance with IAS 32.37, as follows:  
The transaction costs of an equity transaction are accounted for as a deduction from equity (net of any related income tax benefit) to the extent they are incremental costs directly attributable to the equity transaction that otherwise would have been avoided.
- The allocation of transaction costs that relate jointly to more than one transaction in accordance with IAS 32.38, as follows:  
Transaction costs that relate jointly to more than one transaction (for example, costs of a concurrent offering of some shares and a stock exchange listing of other shares) are allocated to those transactions using a basis of allocation that is rational and consistent with similar transactions.

The issues relate specifically to the meaning of the terms *incremental* and *directly attributable*. The Committee indicated that IAS 32 provides the following:

- Only incremental costs directly attributable to issuing new equity instruments or acquiring previously outstanding equity instruments would be related to an equity transaction.
- Transaction costs related to other activities undertaken at the same time (e.g., becoming a public company or acquiring an exchange listing) are not costs incurred in issuing or acquiring its own equity instruments.

Based upon the existing IFRS guidance, the Committee decided not to add this issue to the agenda. The IFRIC noted that the terms *incremental* and *directly attributable* are used with similar but not identical meanings in many of the IFRS and therefore recommended that the IASB develop common definitions for both terms and add them to the Glossary as part of the annual improvements project.

#### Work in progress

The Committee reviewed a summary of the remaining outstanding issues, as follows:

- IFRIC 15, *Arrangements for the Construction of Real Estate*, and IFRIC 16, *Hedges of a Net Investment in a Foreign Operation*, were approved by the IASB at its June 2008 meeting and the final interpretations have been recently issued.
- The issue regarding how expenditures on unrecognized assets should be classified in the statement of cash flows has been included by the IASB in the annual improvements project.
- Research is continuing on the rate regulated liabilities issue that the IFRIC discussed at the May 2008 meeting.
- An agenda issue relating to derecognition is not yet active.

### **Future Committee meeting**

The next Committee meeting is September 4-5, 2008.

### IFRS reference materials

#### **IASB**

##### IASB projects, meetings, and effective dates

See the [IASB website](#) for information on projects, meetings, and effective dates.

##### International Financial Reporting Standards 2008 Bound Volume

The IASB issued its *International Financial Reporting Standards* (IFRSs) 2008 Bound Volume. The 2008 edition includes the latest version of IFRSs and IASs, as well as IFRIC and SIC Interpretations as approved for issue by the IASB at January 1, 2008. The 2008 bound volume may be purchased through the [IASB website](#).

##### Revised reference guide by the IASB and IASC Foundation

The IASB and the IASC Foundation issued a [revised reference guide](#), *IASB and the IASC Foundation: Who we are and what we do*.

#### **AICPA**

##### AICPA launches a new IFRS website

The AICPA recently launched a new IFRS website at [www.ifrs.com](http://www.ifrs.com). The website includes informational videos, explanatory material about IFRS, training programs, and links to various resources. Included on the new website are the following documents:

- [International Financial Reporting Standards \(IFRS\) - An AICPA Backgrounder](#)
- [IFRS Questions and Answers](#)
- [IFRS Primer for Audit Committees](#)