NEWSLETTER OF THE INTERNATIONAL FINANCIAL REPORTING INTERPRETATIONS COMMITTEE

IASB IFRIC UPDATE

November 2005

The International Financial Reporting Interpretations Committee met in London on 1 and 2 November 2005, when it discussed:

- Service Concession arrangements
- IFRIC Review of Operations
- D15 *Reassessment of Embedded Derivatives*
- IFRS 2 D16 – *Scope of IFRS 2 Share-based Payment*
- IFRS 2 D17 – *Group and Treasury Share transactions*
- Customer Loyalty Programmes
- IAS 19 – D9 *Plans* – Oral report on meeting with actuaries
- Applying the Restatement Approach under IAS 29 *Financial Reporting in Hyperinflationary Economics* – a further amendment
- IAS 34 – Interaction with IAS 36 and IAS39
- Other Matters
- IFRIC agenda decisions
- Tentative agenda decisions

Service Concession Arrangements

At this meeting the IFRIC:

- Discussed a staff summary of existing IFRSs that may be applicable to service concession arrangements;
- reviewed an outline prepared by the staff situating concessions in the context of other arrangements ranging from sub-contracted services to divested assets;
- noted draft decision trees prepared by the staff illustrating how Interpretations on concessions might cross-refer to existing IFRSs governing arrangements not specifically addressed within the Interpretations; and
- directed the staff to prepare a project summary on concessions to be posted to the IASB Website.

The IFRIC noted that IFRSs applied to concession arrangements notwithstanding the absence of specific Interpretations on the recognition and measurement of such arrangements. Existing policies would, therefore, have to be assessed using the hierarchy in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and some changes from previous GAAP may be required as part of an entity's first-time adoption of IFRSs. Members noted that, if entities wished to make further change to existing practices, they could, for example, follow the draft guidance in D12-14, except in relation to transition arrangements, as the transition proposals in D12 - D14 offered relief from full retrospective application.

Members noted that the draft contextual outline identified the applicable IFRSs that might apply to arrangements that fell within the scope of SIC-29 *Disclosure – Service Concession Arrangements* but outside the scope of the draft Interpretations.

Staff was directed to prepare a project summary to be posted to the IASB's Website to (a) summarise the tentative decisions reached as the project developed and (b) inform constituents of the work currently under way. The project summary could include revised versions of the contextual outline and draft decision trees presented by the staff at the meeting.

IFRIC Review of Operations

The Director of Technical Activities presented an analysis of the 33 comment letters received following exposure of the Trustees' consultative document IFRIC – Review of Operations in April 2005. She invited IFRIC members to give their views on the issues raised, which were to be discussed by the Trustees at their meeting two weeks later.

Constitutional change

The consultative document had proposed a change to the Constitution reducing the IFRIC quorum from nine to eight for not more than three consecutive meetings if there was a vacancy on the Committee. IFRIC agreed that the change, which was generally supported in the comment letters, should be proposed to the Trustees.

The agenda setting process

A discussion took place on the role of the Agenda Committee. IFRIC members not currently participating in the Agenda Committee meetings believed that that committee was functioning as intended: it provided an initial assessment of potential agenda items and did not itself seek to resolve the technical issues in items brought to the IFRIC; all IFRIC members received Agenda Committee papers and minutes and were at liberty to attend, subject to a limit on numbers to ensure that the total attendance did not constitute an IFRIC quorum. IFRIC members did not favour holding Agenda Committee meetings in public nor publishing information immediately following its meetings, since to do so could create the misleading impression that technical issues had been decided. They noted that the recommendations of the Agenda Committee were brought to the IFRIC in public session for debate and discussion and published in IFRIC *Update*.

[Continued…]

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IFRIC Review of Operations *[…Continued]*

Criteria for adding an item to the agenda

IFRIC members made various suggestions, in response to comments received, on the wording of the criteria in the IFRIC *Preface* for deciding whether or not to accept potential IFRIC agenda items. One was that the criteria should explicitly state that an item should not be taken on if current IFRSs are clear and only one answer is possible. Another suggestion was to clarify that an item would not necessarily be rejected if a current Board project on the same subject was not going to be applied retrospectively. The difficulty, however, was to know in advance what the outcome of a Board project might be, since transition issues normally were addressed only at the end of a project.

One comment letter had asked for an appeals process when a request for an agenda item was refused. IFRIC believed that affected parties already had sufficient opportunity to raise their case through the exposure of tentative agenda decisions in IFRIC *Update*. Comment letters received in that period were made available to IFRIC members and, the IFRIC decided, would in future be posted to the IASB Website, unless the writer requested anonymity.

Dissemination of IFRIC agenda papers

Some IFRIC members asked for public circulation of all IFRIC papers in order to enlarge and improve their own consultation processes preparatory to an IFRIC meeting. They noted that, if Observer Notes were meant to be useful consultation documents, they would have to be made available at the same time as full papers rather than just prior to IFRIC meetings. Other members preferred to retain the existing system, whereby IFRIC papers were confidential but Observer Notes containing most of the material, including any recommendations, were generally made available shortly before the meeting. The Chairman acknowledged that members needed an ability to consult on the same confidential basis as applied to themselves. However, that was not the same as making papers publicly available, which could be counter-productive and would slow down the production of papers because of extra review procedures that would be required for publication.

Development of an IFRIC Handbook

IFRIC members supported the development of an IFRIC Handbook, with corresponding amendments to the IFRIC Preface to reflect current IFRIC operating procedures. The staff will prepare a draft for discussion by the IFRIC.

Other matters

Some IFRIC members were reluctant to state any target for the number of Interpretations to be issued in a typical year. Their preference would be that the IFRIC should aim to issue the minimum number necessary and should stress that its role was to provide high-level guidance on issues of principle rather than to engage in detailed application guidance.

A Board observer warned against explicit statements that the IFRIC was not an 'urgent issues group'. Members agreed that they in no way wished to suggest that they did not need to deal with issues expeditiously or that issues they dealt with were not urgent. However, the point needed to be made that in a conflict between speed of decision and due process, the latter should prevail.

D15 *Reassessment of Embedded Derivatives*

Staff of the German Accounting Standard Setter presented an analysis of issues arising from the 30 comment letters received on D15.

The draft Interpretation had proposed to clarify that the assessment under IAS 39 of when an embedded derivative is to be separated from its host contract is made when the entity first becomes a party to the contract and is not reassessed unless there is a change in the terms of the contract, in which case it is required; also, that the assessment by first-time adopters should be made on the basis of conditions that existed when the entity first became a party to the contract.

The IFRIC noted that several comment letters suggested that the IFRIC should comment on assessment, from a group perspective, of contracts with embedded derivatives when those contracts are held by an entity acquired in a business combination. A related question raised was whether it is possible to designate, at the effective date of a business combination, such acquired contracts as at fair value through profit or loss under the fair value option in IAS 39, and what the interaction of this election might be with the requirement for separation of embedded derivatives.

The IFRIC decided not to expand the scope of D15 to cover these issues but rather to refer these questions to the IFRIC Agenda Committee, in order that a recommendation might be developed that would consider among other things whether the issues are likely to be addressed by the Board in its current Business Combinations project.

The IFRIC also discussed how to clarify its decision to exclude from the scope of D15 contracts to satisfy the entity's expected purchase, sale or usage requirements. The wording should not imply that those contracts were outside the scope of IAS 39 – merely that IAS 39 dealt with them differently from other contracts containing embedded derivatives. IFRIC members believed that, if a contract for an entity's expected purchase, sale or usage requirements ceased to be held for that purpose, then it should be assessed at that point to determine whether any embedded derivative needed to be separated out.

Some respondents pointed out that 'a change in the terms of the contract' could apply either to the host instrument, the embedded derivative or both. The IFRIC agreed and, further, asked the staff to clarify 'a change in the terms' by reference to changes in future cash flows, using language consistent with that used in IASs 16, 38 and 39 to explain the notion of 'commercial substance'.

The IFRIC decided that the Interpretation should not address measurement issues resulting from a reassessment.

In response to comment letters received, the IFRIC confirmed its view that changes in market conditions should not cause a reassessment. In particular, it decided to clarify that a contract that contained a market-related contingency should not be reassessed for changes in the market.

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IFRS 2 D16 – *Scope of IFRS 2 Share-based Payment*

The Staff presented a comment analysis of the responses to D16 – Scope of IFRS 2, issued in May 2005. D16 proposed to clarify that share based payment transactions in which the entity cannot specifically identify some or all of the goods or services received nevertheless may fall within the scope of IFRS 2.

Thirty-nine comment letters were received. The majority of respondents were supportive of the principle of expensing the cost of equity instruments issued by an entity in return for goods or services received even when some or all of those goods or services are not identifiable.

Some respondents also requested further clarification of the scope and the Basis for Conclusions. The IFRIC asked the staff to revise the wording of the Consensus and Basis for Conclusions of the draft Interpretation to reflect the IFRIC's response to constituents' concerns. However, the IFRIC also noted that, given the general agreement with the principle expressed in D16, a re-exposure of a revised draft Interpretation for comment would not be necessary.

The key changes to D16 agreed by the IFRIC are set out below.

Scope of Interpretation

Some respondents noted that paragraph 6 of D16 refers only to grants made by the entity of its own instruments, and is therefore not consistent with the scope of IFRS 2.

The IFRIC agreed that the scope of the draft Interpretation should include transactions in which the transfer is made by one or more shareholders rather than only the transfers made by the entity itself. It should also include transactions in which the transfer is of equity instruments of another group entity or based on the value of the equity instruments of another group entity (for cash-settled transactions). The IFRIC noted that the precise wording of the scope of D16 would differ slightly from that of IFRS 2 to allow for the fact that unidentifiable goods or services are now included explicitly in the scope.

Scope of IFRS 2

Some respondents asked whether the additional benefits received in the Illustrative Example (e.g. enhanced corporate image) would qualify as a good or service under IFRS 2 and whether they should be treated as an asset or as an expense.

The IFRIC confirmed that the unidentifiable good or service should be treated as an expense in accordance with paragraph 8 of IFRS 2 and will consider in a subsequent meeting whether D16 represents an extension of the scope of IFRS 2 or whether it is a clarification of the scope of the Standard.

The rebuttable presumption in paragraph 13 of IFRS 2

Some respondents asked whether D16 was intended to imply that the presumption in paragraph 13 of the standard (that the fair value of goods or services received in non-employee transactions could be reliably measured) must be rebutted whenever the draft Interpretation is applied.

The IFRIC noted that the rebuttable presumption in paragraph 13 of IFRS 2 is applicable to identifiable goods or services received only. It does not apply to unidentifiable goods or services. A statement in respect of this will be added to the Basis for Conclusions.

Non-reciprocal arrangements

Some respondents also asked whether D16 covers 'non-reciprocal' arrangements. The IFRIC noted that D16 states that *if the identifiable consideration received (if any) appears to be less than the fair value of the equity instruments granted or liability incurred, typically this circumstance indicates that other consideration (ie goods or services) has been (or will be) received.* Therefore, a transaction would fall outside the scope of D16 only when there is no indication that some other consideration has been received.

Comparison of values of equity instruments issued and goods or services received

Some respondents commented that the wording of D16 could suggest that the entity would need to compare the fair value of the equity instrument granted with the fair value of identifiable goods or services received for all non-employee goods or services received.

The IFRIC confirmed that this was not its intention. The IFRIC discussed how to clarify this either in the Consensus or the Basis for Conclusions.

Measurement date

Some respondents asked for further guidance on determining the measurement date in respect of a D16 type transaction.

IFRS 2 defines the measurement date for transactions with parties other than employees as the date at which the entity receives the goods or services. However, it may be difficult to determine the date at which any unidentifiable consideration has been (or will be) received. IFRIC members favoured using the grant date of the equity instrument as the measurement date for the unidentifiable goods or services received.

It followed that the comparison of the value of equity instruments issued with the value of any identifiable goods or services received would be made at the grant date. However, the value of any identifiable goods or services received should be measured in accordance with IFRS 2. The IFRIC also noted that, when the share-based payment is cash-settled, the entity would need to remeasure the fair value of the unidentifiable goods or services received at each reporting date until the liability is settled.

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IFRS 2 – D17 – *Group and Treasury Share transactions*

The Staff presented a comment analysis of the responses to D17, which clarified the classification of group and treasury transactions as equity or cash settled. In particular, D17 proposed the following classification in the subsidiary's separate financial statements:

- When an entity grants to its employees rights to equity instruments of the entity, and either chooses or is required to buy those equity instruments from another party, the transaction with the employees shall be accounted for as equity-settled
- When an entity's employees are granted rights to equity instruments of the entity, either by the entity itself or by its shareholder, and the shareholder provides the equity instruments, the transaction with the employees shall be accounted for as equity-settled.
- When a parent entity grants rights to its equity instruments direct to a subsidiary entity's employees, the transaction with the employees shall be accounted for as equity-settled.
- When a subsidiary entity grants to its employees rights to equity instruments of its parent, the transaction with the employees shall be accounted for as cash-settled.

Many respondents disagreed with some aspects of the proposals on the grounds that the substance of the transaction in paragraphs (c) and (d) above is the same and therefore should receive the same accounting treatment.

Some IFRIC members believed that this issue relates to the lack of a higher principle concerning the representation of group transactions in a subsidiary's separate financial statements and the group financial statements. They thought that, until such time as the Board addressed that general issue, there would be little benefit in the IFRIC's continuing with D17.

Other members saw merit in developing an Interpretation as a narrow issue within the terms of D17. A first point to be made was that, if a subsidiary made grants of its parent's shares or rights to those shares without involving the parent, then that transaction would be 'cash-settled'. Some members commented that any grant by a subsidiary of rights to its parent's shares must be cash-settled since those shares were the subsidiary's assets and not its equity.

Members who believed that the D17 issue raised more fundamental questions regarding accounting in the separate financial statements of members of a group pointed out that a parent might grant shares or options to an employee who transferred between various subsidiaries; in such cases, they believed, the most relevant accounting was that each subsidiary should bear an allocation of the group cost, which would not necessarily equal the amount that would result from applying IFRS 2 to that subsidiary as a free-standing entity.

The IFRIC requested that the staff include a consideration of these issues in the subsequent paper. The IFRIC will consider at that point whether it should continue with D17.

Customer Loyalty Programmes

Staff from the French Standard Setter (CNC) presented an issues paper on Customer Loyalty Programmes. The CNC had been asked to resolve an issue in this field and had approached the IFRIC for an Interpretation. The IFRIC had asked the CNC to undertake further research on its behalf.

The IFRIC noted that the Board has a current project on Revenue which ultimately should cover the matters raised in the issues paper but which is not expected to reach an early conclusion.

Scope

The issues paper explained that not all customer incentive arrangements fell within its definition of customer loyalty programmes. The paper addressed only programmes in which the benefit offered to the customer derived from a past transaction. The IFRIC acknowledged that precise identification of such circumstances could be difficult in some cases.

Allocation of revenue v recognition of expense

Depending on the substance of the arrangement, customer loyalty programmes fall under one of two paragraphs in IAS 18 *Revenue*. Paragraph 13 states that 'in certain circumstances it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction'. As an example it cites a sale with an identifiable amount for subsequent servicing; in such a case, it says, the servicing amount should be deferred and recognised as revenue in the period when the service is performed. By contrast, paragraph 19 notes that 'expenses, including warranties and other costs to be incurred after the shipment of goods can normally be estimated reliably when the other conditions for recognition of revenue have been satisfied'. This implies that the full revenue is recognised at the time of sale with recognition of a liability for any accompanying commitments.

Some IFRIC members believed this was the crucial issue for interpretation. Others thought that it would be very difficult on the basis of existing Standards to develop general guidance for choosing between paragraphs 13 and 19. They believed the key issue, which could be usefully addressed by the IFRIC in a reasonable time period, was measurement of the amount that was deferred under paragraph 13. On this issue the question was whether the deferred amount had to be measured in accordance with IAS 18 or IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. They inclined to the view that use of IAS 37 for measurement was not obligatory for a transaction within the scope of paragraph 13, since IAS 18 applied the principle that revenue should be recognised at the fair value of the consideration received. In many cases, fair value would provide a sound basis for allocation of revenue between the components of a single transaction. However, when the customer had to perform in some way to obtain the promised benefit, for example by making a significant additional purchase, the fair value of the customer benefit awarded would have to take account of the probability of the customer performing.

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The issues paper asked at what point revenue should be recognised if IAS 37 applied. One possibility was to recognise the full revenue at the time of sale, as under paragraph 19 of IAS 18; another was to defer the revenue related to the unfulfilled obligation and recognise it as the obligation was discharged.

If IAS 37 applied, the question arose how the liability should be measured. The IFRIC agreed that an Interpretation should address whether and, if so, when IAS 37 applied but should not attempt to develop the measurement requirements of IAS 37.

Other points

The IFRIC suggested that an Interpretation should refer incidentally to IAS 39 *Financial Instruments: Recognition and Measurement* in respect of any embedded derivatives in the transactions covered. Similarly, it should refer to IAS 38 *Intangible Assets* in respect of any intangibles.

IAS 19 – D9 *Plans* – Oral report on meeting with actuaries

The Staff reported on a meeting held with a group of actuarial consultants (the Group) on the staff's proposed approach for D9 plans (plans with a promised return on actual or notional contributions).

The staff's approach distinguished between three possible components of a D9 plan: a defined contribution (DC) component, in which the liability is equal to a definable set of assets; a defined benefit plan, in which the liability is defined independently of the assets; and an embedded guarantee. The staff's approach would value each component in accordance with its effect on the entity's risk.

The Group confirmed that there is a wide range of plans that fall within the scope of D9, particularly in Belgium, the Netherlands, Switzerland, the US and, increasingly, in the UK. In addition, there is a gradual trend globally away from pure defined benefit arrangements and pure defined contribution arrangements to the type of hybrid plan that falls within the scope of D9. Further, the value of the embedded guarantee in some plans is significant.

The Group noted that in some cases separate valuation of each component would give a better representation of economic reality. It cautioned, however, that, given the current level of expertise in this area, it would be difficult to obtain widespread application of a fair value approach to measuring the embedded guarantee within all benefit promises. It was suggested that the use of additional disclosures or an explicit materiality test might be more appropriate. It also noted that such an approach could raise potential conflicts with the current measurement requirements of IAS 19.

Finally, the Group commented that there were larger issues in IAS 19 to be addressed, including the treatment of gains and losses, and that the staff's proposed approach should be considered along with those issues as part of a comprehensive project on pensions, preferably as part of a convergence project with the FASB.

The IFRIC will consider at a subsequent meeting whether it would like to continue with D9 as proposed, issue a revised exposure draft, refer the project to the Board for immediate deliberation or refer the project to the Board as part of a potential pensions convergence project.

Applying the Restatement Approach under IAS 29 *Financial Reporting in Hyperinflationary Economics* – a further amendment

The IFRIC decided to amend the Consensus paragraph of the draft Interpretation to align its wording more closely with the requirements of IAS 29. The amendment related to non-monetary items in an entity's opening balance sheet that had been revalued or impaired at some time prior to that date. For such items, the restatement necessary to reflect inflation up to the closing balance sheet date should commence from the date at which the items had last been revalued or impaired rather than the date at which assets had been acquired or liabilities incurred. The staff was authorised to finalise the wording and present the amendment to the Board for approval.

IAS 34 – Interaction with IAS 36 and IAS 39

The IFRIC discussed the interaction of IAS 34 *Interim Financial Reporting* with the impairment requirements for goodwill in IAS 36 *Impairment of Assets* and investments in equity instruments under IAS 39 *Financial Instruments: Recognition and Measurement.*

IAS 36 and IAS 39 prohibit the reversal through profit or loss of previously recognised impairment losses for goodwill and investments in equity instruments classified as available for sale.

IAS 34 requires that the same accounting policies should be applied in the interim financial statements as are applied in the annual financial statements (a 'discrete period' approach). However, the standard also requires that measurements for interim reporting should be made on a year-to-date basis, so that the frequency of an entity's reporting does not affect the measurement of its annual results (an 'integral period' approach).

The IFRIC therefore considered whether IAS 34 requires that an impairment loss recognised in one interim period should be reversed in a subsequent interim period, should circumstances justify a different answer by the end of a subsequent interim period; alternatively, whether IAS 34 requires that an impairment loss for which reversal generally is prohibited should never be reversed in a subsequent interim period.

The IFRIC concluded that IAS 34 supports both the discrete period approach and the integral period approach with regard to the reversal of previously recognised impairment losses for goodwill and investments in equity instruments classified as available for sale. However, the IFRIC tended to the view

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that the specific guidance with regard to reversals of previously recognised impairment losses of goodwill in IAS 36 and investments in equity instruments in IAS 39 should take precedence over the more general guidance in IAS 34.

The IFRIC therefore decided to proceed with a draft Interpretation with respect to impairment of goodwill and investments in equity instruments. The IFRIC also requested that the Board consider whether IAS 34 should be amended to clarify this issue. IFRIC members and observers remarked that there were a number of other issues on which clarification would be welcome if IAS 34 were to be amended. However, the proposed Interpretation would not attempt to embrace these.

Other Matters

The IFRIC considered an issue proposed by a constituent as a potential agenda item concerning the eligibility of expected inflation as a portion of nominal interest rates. No agenda decision was reached. The IFRIC asked the staff to obtain further input from the constituent on the proposal.

The IFRIC considered a staff paper analysing possible ways of responding to an issue regarding the treatment of certain leases of land that do not transfer title to the lessee. The IFRIC indicated that it did not favour taking the item onto its agenda but deferred taking a decision until the following meeting, in order to provide the staff an opportunity to propose appropriate wording for the decision and its rationale

IFRIC agenda decisions

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

A historical record of these decisions can be found on the IASB website.

IFRS 4 ***Insurance Contracts*** **- Discretionary participation features in insurance contracts or financial liabilities**

The IFRIC received a request for interpretative guidance on:

- the definition of a discretionary participation feature (DPF) in IFRS 4 Insurance Contracts
- the interaction of the liability adequacy test (paragraphs 15-19 of IFRS 4) with the minimum measurement of the guaranteed element of a financial liability containing a DPF (paragraph 35(b) of IFRS 4)

The IFRIC was informed of concerns that key disclosures regarding these features are required only in respect of items regarded as DPF. Consequently, a narrow interpretation of DPF would fail to ensure clear and comprehensive disclosure about contracts that include these features. The IFRIC noted that disclosure is particularly important in this area, given the potential for a wide range of treatments until the IASB completes phase II of the project on insurance contracts.

The IFRIC noted that IFRS 4 requires an insurer to disclose information that identifies and explains the amounts in its financial statements arising from insurance contracts (paragraph 36) and information that helps users to understand the amount, timing and uncertainty of future cash flows from insurance contracts (paragraph 38).

The IFRIC also noted that the Guidance on Implementing IFRS 4 was designed to help entities to develop disclosures about insurance contracts that contain a DPF.

The IFRIC decided not to add this topic to the agenda, because it involves some of the most difficult questions that the IASB will need to resolve in phase II of its project on insurance contracts. The fact that, in developing IFRS 4, the IASB chose to defer such questions to phase II limits the scope for reducing diversity through an Interpretation.

IAS 12 Income Taxes - Single asset entities

The IFRIC considered the application of IAS 12 to single asset entities, and whether the expected manner of recovery of the asset should in any circumstances reflect disposal of the entity rather than the asset.

The IFRIC decided not to take this item onto its agenda because the issue falls directly within the scope of the IASB's short-term convergence project on income taxes with the FASB. An exposure draft is expected in 2006.

IAS 32 ***Financial Instruments: Disclosure and Presentation*** **- Employee long service leave**

The IFRIC considered whether a liability for long service leave falls within IAS 19 or whether it is a financial liability within the scope of IAS 32.

The IFRIC noted that IAS 19 indicates that employee benefit plans include a wide range of formal and informal arrangements. It is therefore clear that the exclusion of employee benefit plans from IAS 32 includes all employee benefits covered by IAS 19.

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.

IFRS 2 ***Share-based Payment*** **- Employee share loan plans**

The IFRIC was asked to consider the accounting treatment of employee share loan plans. Under many such plans, employee share purchases are facilitated by means of a loan from the issuer with recourse only to the shares. The IFRIC was asked whether the loan should be considered part of the potential share-based payment, with the entire arrangement treated as an option, or whether the loan should be accounted for separately as a financial asset.

The IFRIC noted that the issue of shares using the proceeds of a loan made by the share issuer, when the loan is recourse only to the shares, would be treated as an option grant in which options were exercised on the date or dates when the loan was repaid. The IFRIC decided it would not expect diversity in practice and would not take this item onto its agenda.

IAS 17 ***Leases*** **- Time pattern of user's benefit from an operating lease**

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The IFRIC was asked to consider the income and expense recognition profile of an operating lease in which the annual payments rise by a fixed annual percentage over the life of the lease. The constituent asked whether it would be acceptable to recognise these increases in each accounting period when they are intended to compensate for expected annual inflation over the lease period.

The IFRIC noted that the accounting under IAS 17 for operating leases does not incorporate adjustments to reflect the time value of money, for example by deferring a portion of a level payment to a later period. Rather, IAS 17 requires a straight-line pattern of recognition of income or expense from an operating lease unless another systematic basis is more representative of the time pattern of the user's benefit. The IFRIC noted that recognising income or expense from annual fixed inflators as they arise would not be consistent with the time pattern of the user's benefit. Accordingly, the IFRIC decided not to take this item onto its agenda as it did not expect significant diversity in practice to arise.

Note: In reaching the above decision, IFRIC members considered the comment letters received on the draft published in September Update but confirmed that these did not alter their view of the requirements of IAS 17.

IFRS 39 *Financial Instruments: Recognition and Measurement* - Retention of servicing rights

The IFRIC was asked to provide guidance on whether an arrangement under which an entity has transferred the contractual rights to receive the cash flows of a financial asset but continues to provide servicing on the transferred asset would fail the definition of a transfer of cash flows in terms of IAS 39 paragraph 18(a).

The IFRIC noted that paragraph 18(a) focuses on whether an entity transfers the contractual rights to receive the cash flows from a financial asset. The determination of whether the contractual rights to cash flows have been transferred is not affected by the transferor retaining the role of an agent to administer collection and distribution of cash flows. Therefore, retention of servicing rights by the entity transferring the financial asset does not in itself cause the transfer to fail the requirements in paragraph 18 (a) of IAS 39. The IFRIC decided not to add the issue to its agenda as it did not expect significant diversity in practice to arise.

IFRS 39 *Financial Instruments: Recognition and Measurement* - Revolving structures

The IFRIC discussed a request for guidance on whether 'revolving' structures would meet the pass-through requirements in paragraph 19(c) of IAS 39. In a revolving structure an entity collects cash flows on behalf of eventual recipients and uses the amounts collected to purchase new assets instead of remitting the cash to the eventual recipients. On maturity the principal amount is remitted to the eventual recipients from the cash flows arising from the reinvested assets.

The IFRIC noted that in order to meet the pass-through arrangement requirements in IAS 39 paragraph 19 (c) an entity is required to remit any cash flows it collects on behalf of eventual recipients without material delay. This paragraph also limits permissible reinvestments to items that qualify as cash or cash equivalents. Most revolving arrangements would involve a material delay before the original collection of cash is remitted. Furthermore, the nature of the new assets typically acquired means that most revolving arrangements involve reinvestment in assets that would not qualify as cash or cash equivalents. Therefore, it is clear that such structures would not meet the requirements in paragraph 19 (c) of IAS 39. Consequently, the IFRIC decided not to add the issue to its agenda as it did not expect significant diversity in practice to arise.

Tentative agenda decisions

The IFRIC reviewed the following matters, which the Agenda Committee had recommended should not be placed on the IFRIC agenda. These tentative decisions, including where appropriate suggested reasons for not adding them to the IFRIC agenda, will be re-discussed at the January 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 2nd January 2006, preferably by email to:

ifric@iasb.org

or by post to:

International Financial Reporting Interpretations Committee
First Floor, 30 Cannon Street
London EC4M 6XH England.

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

Scope of IFRS 6 *Exploration for and Evaluation of Mineral resources*

The IFRIC was asked to clarify the effect of the limited scope of IFRS 6 on exploration and evaluation (E&E) activities. The IFRIC was asked if this limited scope (a) reflected the Board's intention to impose limits on current national GAAP practices only in respect of activities conducted in the E&E phase, while permitting industry practices in other extractive industry areas (eg, development and exploitation) to continue unchanged, or (b) whether the IASB focused only on E&E activities because it was the only area for which the IASB was willing to grant some relief from the hierarchy for selection of accounting policies in IAS 8. Under the latter view, the IAS 8 hierarchy would apply fully to an entity's selection of IFRS accounting policies for activities outside of the E&E phase. The submission identified some inconsistencies between current extractive industry full-cost accounting practices in respect of development and exploitation activities but questioned whether the IASB intended to require change from current practices in these areas in advance of a comprehensive extractive industry project.

The IFRIC noted that the effect of the limited scope of IFRS 6 was to grant relief only to policies in respect of E&E activities, and that this relief did not extend to activities before or after the E&E phase. The Basis for Conclusions on IFRS 6 includes the Board's intention of limiting the need

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for entities to change their existing accounting policies for E&E activities. The IFRIC believed it was clear that the scope of IFRS 6 consistently limited the relief from the hierarchy to policies applied to E&E activities and that there was no basis for interpreting IFRS 6 as granting any additional relief in areas outside its scope. Therefore, the IFRIC believed that diversity in practice should not become established and [decided] not to add the issue to its agenda.

Future IFRIC meetings

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

2005

- 1 and 2 December

2006

- 12 and 13 January
- 2 and 3 March
- 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 before the meeting. Interested parties may also submit requests for Interpretations through the IASB Website at www.iasb.org/about/ifric.asp

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