NEWSLETTER OF THE INTERNATIONAL FINANCIAL REPORTING INTERPRETATIONS COMMITTEE

IASB IFRIC UPDATE

May 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 8 May 2008, when it discussed:

- IFRIC D21 *Real Estate Sales*
- IFRIC D22 *Hedges of a Net Investment in a Foreign Operation*
- IFRS 2 *Share-based Payment* and IFRIC 11 *IFRS 2—Group and Treasury Share Transactions* – Group cash-settled share-based payment transactions
- Rate regulated liabilities
- IFRIC agenda decisions
- Tentative agenda decisions
- IFRIC work in progress

IFRIC D21 *Real Estate Sales*

The IFRIC completed its redeliberations of draft Interpretation D21 at this meeting.

The IFRIC considered the staff's proposals for drafting changes to D21 made in response to its redeliberations at its meetings in January and March 2008. When redeliberating the issue, the IFRIC asked the staff to clarify the interaction between IAS 11 *Construction Contracts* and IAS 18 *Revenue* using a flow chart. The IFRIC generally supported the flow chart and the analysis proposed by the staff. However, the IFRIC asked the staff to address some remaining outstanding issues such as clarifying 'real estate sale' and 'continuous transfer'.

Remaining outstanding issues

At this meeting, the staff presented a paper addressing issues in respect of:

- the scope of the Interpretation;
- the application of IAS 18;
- the identification of a component for the sale of land;
- disclosures;
- transition and effective date.

Clarification of the scope

D21 stated that 'this [draft] Interpretation shall be applied in accounting for revenue from the sale of real estate.' At this meeting, the IFRIC decided:

- to clarify that the Interpretation would apply to *agreements for the construction of real estate*. The primary issue of whether an agreement is within the scope of IAS 11 or IAS 18 arises only from agreements that include construction activities. To be consistent, the Interpretation will be renamed *Agreements for the Construction of Real Estate*.
- to replace both terms 'developers' and 'sellers' used in D21 by 'entities that undertake the construction of real estate'. In doing so, the intention is to focus on the entity that, directly or indirectly, undertakes construction activities and therefore would be affected by the Interpretation.

Application of IAS 18

The staff presented revised versions of the draft Interpretation, flow chart and illustrative examples that clarify that if the buyer has only limited ability to influence the design of the real estate an agreement may not meet the definition of a construction contract and would therefore be within the scope of IAS 18. In this case, the entity should determine whether the agreement is for the rendering of services or for the sale of goods:

- If the entity is not required to acquire and supply construction materials, the agreement may be only an agreement for the rendering of services in accordance with IAS 18, to which the criteria for recognition of revenue set out in paragraph 20 of IAS 18 apply;
- If the entity is required to provide services together with construction materials in order to perform its contractual obligation to deliver the real estate to the buyer, the agreement is an agreement for the sale of goods and the criteria for recognition of revenue set out in paragraph 14 of IAS 18 apply.

The IFRIC reaffirmed its view of how paragraph 14 of IAS 18 should be applied and identified two types of agreements for the sale of real estate:

(a) Agreements in which the entity transfers to the buyer control and the significant risks and rewards of ownership of the work in progress in its current state as construction progresses ('continuous transfer'). In this case, if all the criteria in paragraph 14 of IAS 18 are met continuously, an entity should recognise revenue on the same basis (by reference to the stage of completion).

(b) Agreements in which the entity transfers to the buyer control and the significant risks and rewards of ownership of the completed real estate in its entirety at a single point of time (eg at completion, upon or after delivery). In this case, the entity should recognise revenue only at that point, when all the criteria in paragraph 14 of IAS 18 are satisfied.

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The IFRIC also identified agreements for the delivery of multiple goods in which the entity transfers to the buyer control and the significant risks and rewards of ownership of each separately identifiable good at different points of time (eg at each delivery). The IFRIC concluded that such agreements are of type (b) above, ie they simply involve multiple deliveries. The control and risks and rewards of the work in process does not transfer to the buyer as construction progresses, only when each completed item is delivered. Therefore the use of the percentage of completion method would not be appropriate.

The IFRIC noted that agreements of type (a) above may not be frequently encountered. However, the IFRIC decided that the Interpretation should address the accounting for such agreements because some respondents to D21 identified agreements with these characteristics. The IFRIC also decided that application by analogy would be permitted in accordance with IAS 8.

Identification of a component for the sale of land

As discussed in paragraph 13 of IAS 18, the IFRIC concluded that the agreement should be analysed to determine any separately identifiable components. Depending on facts and circumstances, the entity may or may not conclude that a component for the sale of land is separately identifiable from the component for the construction of real estate.

The IFRIC noted that one example proposed by the staff that would accompany, but not be part of, the Interpretation was illustrating a case of segmentation. The IFRIC also noted in the staff's paper a case in which the land was not identified as a separate component and asked the staff to include such an example in the Basis for Conclusions.

Disclosures

The IFRIC noted that, for agreements accounted for under paragraph 14 of IAS 18 that have 'continuous transfer', the entity that undertakes the construction of real estate should disclose information about its accounting policies, significant judgements and major sources of estimation uncertainty in accordance with IAS 1 *Presentation of Financial Statements*.

The IFRIC decided that the Interpretation should require specific disclosures similar to those of paragraphs 39 and 40 of IAS 11 for such agreements to satisfy the requirements of IAS 1.

Vote to confirm consensus

The IFRIC concluded that the revised draft Interpretation together with the flow chart and the illustrative examples clarifies the definition of a construction contract, and the articulation between IAS 11 and IAS 18, and provides guidance on how to account for revenue when the agreement for the construction of real estate falls within the scope of IAS 18.

The IFRIC considered whether the changes from the draft Interpretation exposed for comment as D21 were such that re-exposure was needed in accordance with the IFRIC *Due Process Handbook*. The IFRIC believed that it had addressed the main concerns expressed by respondents to D21 about some aspects of the proposals or the possible application by analogy with industries other than real estate. The IFRIC therefore concluded that re-exposure would not result in the identification of new issues and was not necessary.

The IFRIC also believed that the main expected change in practice would be a shift from recognition of revenue using the percentage of completion method to recognition of revenue at a single point of time (eg at completion, upon or after delivery). Affected agreements would be mainly those accounted for in accordance with IAS 11 that do not meet the definition of a construction contract as interpreted by the IFRIC and do not result in a 'continuous transfer'.

The IFRIC therefore concluded that a six-month lead time for implementation would be sufficient and decided to recommend that the Interpretation should be effective for accounting periods beginning on or after 1 January 2009 with retrospective application.

Finally, the IFRIC voted and confirmed the consensus. Subject to drafting changes, the IFRIC directed the staff to present the final Interpretation to the Board for ratification at its meeting in June, with the expectation that it will be issued by the end of that month.

IFRIC D22 *Hedges of a Net Investment in a Foreign Operation*

The IFRIC completed its redeliberations of draft Interpretation D22 at this meeting.

The IFRIC considered the staff's proposals for drafting changes to D22 made in response to its redeliberations in the meetings in January and March. The main changes include:

- clarifying the amount reclassified to profit or loss from the foreign currency translation reserve in the consolidated financial statements of the parent (in respect of both the hedging instrument and the net investment in that foreign operation) when a foreign operation that was hedged is disposed of.
- clarifying the transitional requirements.
- replacing all the illustrative examples with an appendix of application guidance.

In particular, the IFRIC discussed the wording of the Interpretation and the application guidance in connection with the designation of the hedged risk and the designation of hedges of more than one foreign operation. Also, some IFRIC members proposed that the staff should include a numerical example illustrating the accounting for the disposal of a foreign operation. The staff will consider whether a simple example should be included in the final draft. The IFRIC approved the staff's proposals for drafting changes, including other minor changes.

The IFRIC considered whether the changes from the draft Interpretation exposed for comment as D22 were such that re-exposure was needed in accordance with the IFRIC *Due Process Handbook*. The IFRIC concluded that they were not.

Finally, the IFRIC voted and confirmed the consensus. Subject to drafting changes, the IFRIC directed the staff to present the final Interpretation to the Board for ratification at its meeting in June. The staff expect that the final Interpretation will be issued in June and will become effective for financial periods beginning on or after 1 October 2008.

IFRS 2 *Share-based Payment* and IFRIC 11 *IFRS 2 Group and Treasury Share Transactions* – Group cash-settled share-based payment transactions

The staff presented a preliminary analysis of the comments received on the Exposure Draft published by the Board in December 2007. The Exposure Draft addressed the accounting in the stand-alone financial statements of the entity that receives goods and services from its suppliers, including employees, for certain share-based arrangements that are cash-settled when the entity itself does not have any obligation to make the required payments to its suppliers.

The staff presented a summary of the comments made in the 44 letters received. The summary identified the main areas of concern about the proposed scope and measurement the staff believed should be reconsidered before finalising the amendments. Many respondents acknowledged that the principal objective of the proposals was to align the accounting for share-based transactions of similar economic substance, no matter whether they are equity-settled or cash-settled, and to remove structuring incentives. However, many respondents either expressed concern about the scope, or disagreed with some aspects of the measurement proposal. Some questioned some of the bases for the consensus reached.

After considering the significant points raised in the comment letters, the IFRIC agreed with the staff's analysis of the main issues to be redeliberated, which are:

- the scope for these arrangements with similar substance should be set out more clearly and consistently among IFRSs;
- the amended scope for these arrangements should be consistent with the definitions of share-based payments in IFRS 2;
- the classification and measurement for these arrangements as cash-settled transactions by the entity when it does not have any obligation;
- the attribution of the parent's liability and remeasurement by the subsidiary in the absence of existing concepts in IFRSs and the risk of unintended analogy for other transactions.

The IFRIC also approved the proposed project timetable for redeliberations.

Rate regulated 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. The staff were aware that another group was intending to request an Interpretation with the same or similar scope and had been awaiting receipt of that request.

In the interim, the staff had undertaken preliminary research and developed a project plan for making a recommendation to IFRIC on an agenda decision. The IFRIC discussed and approved the staff's project plan. In accordance with that plan, the IFRIC will consider the scope of the issue and whether the issue should be added to the IFRIC's agenda at its meeting in July 2008.

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 37 *Provisions, Contingent Liabilities and Contingent Assets* —Deposits on returnable containers

The IFRIC was asked to provide guidance on the accounting for the obligation to refund deposits on returnable containers. In some industries, entities that distribute their products in returnable containers collect a deposit for each container delivered and have an obligation to refund this deposit when containers are returned by the customer. The issue is whether the obligation should be accounted for in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*.

The IFRIC noted that paragraph 11 of IAS 32 *Financial Instruments: Presentation* defines a financial instrument as 'any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.' Following delivery of the containers to its customers, the seller has an obligation only to refund the deposit for any returned containers.

In circumstances in which the containers are derecognised as part of the sale transaction, the obligation is an exchange of cash (the deposit) for the containers (non-financial assets). Whether that exchange transaction occurs is at the option of the customer. Because the transaction involves the exchange of a non-financial item, it does not meet the definition of a financial instrument in accordance with IAS 32.

In contrast, when the containers are not derecognised as part of the sale transaction, the customer's only asset is its right to the refund. In such circumstances, the obligation meets the definition of a financial instrument in accordance with IAS 32 and is therefore within the scope of IAS 39.
In particular, paragraph 49 of IAS 39 states that 'the fair value of a financial liability with a demand feature (eg a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.'

The IFRIC concluded that divergence in this area was unlikely to be significant and therefore decided not to add this issue to its agenda.

IAS 19 *Employee Benefits*—Settlements

The IFRIC received a request to clarify whether some payments of benefits under a defined benefit plan are settlements as defined in IAS 19. The payments in question arise when an existing plan gives plan members the option to choose to receive a lump sum payment at retirement instead of ongoing payments.

The IFRIC noted that events that are covered by the actuarial assumptions underlying the measurement of the defined benefit obligation are not treated as settlements under IAS 19. The IFRIC decided not to add the issue to its agenda because there was little diversity in practice.

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 July 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 16 June 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.

Application of the effective interest rate method

The IFRIC was asked for guidance on the application of the effective interest rate method to a financial instrument whose cash flows are linked to changes in an inflation index. The submission suggested three possible approaches.
The IFRIC noted that paragraphs AG6–AG8 of IAS 39 provide the relevant application guidance. Judgement is required to determine whether an instrument is a floating rate instrument within the scope of paragraph AG7 or an instrument within the scope of paragraph AG8.
In view of the existing application guidance in IAS 39, the IFRIC [decided] not to add this issue to its agenda.

IFRIC work in progress

The IFRIC reviewed a summary of its outstanding issues. The staff noted that six topics had been discussed at the meeting. The staff expect that an analysis of the comments received on D23 *Non-cash Asset Distributions to Owners* and D24 *Customer Contributions* will be presented at the July meeting and redeliberations will also begin then. An item regarding how expenditure on unrecognised assets should be classified in the statement of cash flows that the IFRIC recommended the Board to include in its annual improvements project was awaiting a Board decision. One new request for interpretation, regarding the accounting for trailing commissions, has been received and is being analysed by staff in order to make a recommendation on whether the IFRIC should add the issue to its agenda. The final issue, relating to derecognition, is not active as it is still awaiting the allocation of staff resources.

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

- 10 and 11 July
- 4 and 5 September
- 6 and 7 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