

IFRS News

Shedding light on the IASB's activities*

IFRS News – Issue 55
September 2007

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Issue of the month

IFRIC releases new interpretations on customer loyalty plans and MFR

IFRIC 13 – Accounting for Customer Loyalty Programmes

Customer loyalty programmes are widespread – retailers, airlines, hotels, telecoms operators and similar businesses are all offering incentives to gain customer loyalty. There seem to be almost as many different accounting treatments as there are programmes. IFRIC 13, Customer Loyalty Programmes, was published to create consistency in accounting for customer loyalty plans. The interpretation is applicable to all entities that grant awards as part of a sales transaction (including awards that can be redeemed for goods or services not supplied by the entity).

Impact of the interpretation

When a customer buys goods or services and receives a loyalty incentive (an award credit), this is treated as a multiple element arrangement. Revenue earned by the seller under the transaction is consequently split between the elements – ie, between the goods or services and the award credit (at fair value). The revenue allocated to the award credit is deferred and only recognised when the award credit is used.

What does this mean to those who offer award credits? The seller determines a fair value for the award credit (which will generally be based on the fair value that the customer will receive) and then estimates the likely number of awards that will be redeemed. The fair value of revenue estimated in this way is deferred. The seller must maintain detailed customer data to estimate the expected levels of redemption, and keep that estimate up to date. Changes in the estimate of redemptions after award credits have been issued affect the rate at which the deferred revenue is recognised but do not alter the amount of deferred revenue.

The entity may be the principal in the scheme or it may be acting as an agent for the third party running the scheme. The entity is a principal when it has the obligation to satisfy the awards demanded by participants, and the accounting follows the model described above. The entity is an agent when it pays the third party for each award point, and the third party has the obligation to satisfy the awards requested. The entity acting as an agent recognises commission income, which:

- is the difference between the consideration allocated to the incentive and the amount payable to the third party supplying the incentive; and

- is deferred until the third party is obliged to supply the awards and is entitled to receive consideration for doing so.

What happens if the entity is going to make a loss? When an award credit is issued, it may reduce the margin that an entity will receive on a subsequent sale of the goods. However, provided this reduction in margin does not cause the entity to make a loss, the entity is not permitted to recognise a provision for the margin reduction. If there is expected to be a loss on sale of the later item using the award credits, the award credit arrangement is accounted for as an onerous contract and a provision is recognised.

IFRIC 13 is applicable for periods beginning on or after 1 July 2008, with early adoption permitted, although this must be disclosed. The long implementation date is to enable companies to collate the significant amounts of data required in order to assess the fair value of the incentive. Comparatives also need to be restated for the impact of IFRIC 13.

PwC's IFRS Retail & Consumer Industry Accounting Group have published an overview of IFRIC 13, including practical examples of the application of the interpretation in the retail and consumer sector. For more information, contact katie.woods@uk.pwc.com

IFRIC 14, IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

Defined benefit pension accounting, in general, is not a recommended activity for beginner accountants or the faint hearted. It is generally acknowledged to be a complex area of accounting, and specialist input is recommended. The application of the asset ceiling is possibly one of the most complex aspects of IAS 19. IFRIC 14 provides some clear principles in this area, but application is unlikely to be straightforward, as it links together the legal, actuarial and accounting issues.

The legal issues will often be different in each country, and an understanding of the employment law, the statutory protections afforded to pensioners and the rights and duties of pension trustees is crucial.

A pension asset can arise when a defined benefit pension plan has a surplus of plan assets over plan liabilities. IAS 19.58 requires the employer to consider the recoverability of any surplus; this is more than a mathematical exercise. There must be economic benefit available to the company, either through a reduction in future contributions or a refund. IFRIC 14, published in July, looks at this asset ceiling test and considers the interaction with any statutory, contractual or constructive obligation to make contributions to the plan. This obligation is described as a 'minimum funding requirement' (MFR).

Impact of the interpretation

The employer must have an unconditional right to a refund, either while the plan is ongoing or on a winding-up for a surplus to be available as refund. The winding-up might be by a gradual run-off – until all beneficiaries have been fully paid, or by a one-time liquidation of the plan. Rights to a refund are conditional if the governing body of the plan (trustees) or a regulator has the power to block a refund of surplus, or to use the surplus in other ways without needing the agreement of the employer.

The pension plan accounting is not affected by IFRIC 14 if any surplus left in the plan on a gradual winding-up would be available to the employer unconditionally. The employer recognises the surplus as a prepayment, subject to any adjustment for unrecognised actuarial gains/losses and past service costs, irrespective of why it has arisen.

The employer needs to determine the economic benefit available from a contribution reduction. The value of a contribution reduction, absent an MFR, is presumed to be the present value of the service cost (IAS 19 cost to the

employer of benefits accruing in the future) over the shorter of 'the expected life of the plan and the expected life of the entity'.

Any MFR must be split between contributions for past and future service. The value of a contribution reduction is the present value of the difference between the service cost and the MFR contributions required for future service (allowing for any reduction in respect of an MFR surplus), again looking forward over the expected life of the plan or the entity.

Any IAS 19 surplus that exceeds the economic benefit available, whether as a contribution reduction or a refund, is an irrecoverable surplus. It is not recognised as an asset. However, it may be a contingent asset, which would have to be disclosed if an inflow of economic benefit is probable.

An MFR deficit (ie, MFR contributions due in respect of past service), may be an onerous contract. Normally an employer paying contributions to the plan is exchanging one form of asset, cash, for another, plan assets. However, if the contributions create or increase an irrecoverable surplus, the employer does not receive full value for the contributions. An obligation to pay contributions that will not be recoverable is therefore an onerous contract. The impact is recognised when the obligation arises, not when the cash is paid.

An MFR in a plan with irrecoverable surpluses can significantly complicate the IAS 19 accounting. Consider a plan that recognises actuarial gains and losses immediately, and currently has a deficit of 100. It has an MFR contribution due in respect of past service of 120. Will the 20 of surplus after payment of the MFR be available or not? If the plan does not allow unconditional refunds of surplus and the MFR means that no contribution reduction is available, the 20 would not be recoverable. Therefore the employer would have to recognise an additional liability of 20, thus increasing the balance sheet liability to 120.

This additional expense of 20 would be recognised in the same way as actuarial gains and losses. Any adjustments arising from the MFR implications of IFRIC 14 are recognised in the SoRIE (if the employer has adopted the SoRIE approach for actuarial gains and losses) or in the income statement (if the entity is applying the corridor and spreading approach).

IFRIC 14 is applicable for annual periods beginning on or after 1 January 2008, with earlier adoption permitted. Companies are encouraged to start looking at these issues sooner rather than later if they have funded post-employment benefit plans with surpluses, or MFRs that may create surpluses, even if there is no intention to early adopt IFRIC 14.

Explanations for diagram A

1. This means that no third party, such as a regulator, has the ability to intervene in the run-off of the plan. Also, the trustees or pension members cannot have any onerous powers, such as the ability to terminate the plan.
2. No third-party consent is required before the employer can take the surplus. For example, if the trustees' consent to the transfer of the surplus to the employer is required or any surplus would be given to charity, this criterion is not met.

Explanations for diagram B

1. Some of the surplus may be earmarked for use by other parties. For example, the trustees may have the ability to use 40% of the fund for discretionary benefits. If this is the case, the surplus should be reduced by the amount that is set aside. The remainder (or the whole of the amount if none is set aside) can be assessed to determine if it is recoverable through a refund or a reduction in future contributions.

A refund, for example, may be available between the current date and the expected end of the plan life. This refund should be determined taking into account settlement costs. The surplus that is available as a reduction in future contributions is the IAS 19 service cost less minimum funding requirement service cost (subject to a minimum of zero) plus any surplus on the minimum funding requirement at the reporting date.

2. A company may have an obligation under the minimum funding requirements to pay contributions to cover an existing shortfall on the minimum funding basis at the reporting date. The amount of contributions that the employer will not be able to access as refund in the future is recognised as an additional liability. The present value of the future shortfall contributions is calculated. If this amount takes the IAS 19 surplus over the asset limit calculated under note 1 above, it is reflected as an additional liability.
3. Calculate as in note 2 above.

Diagram A

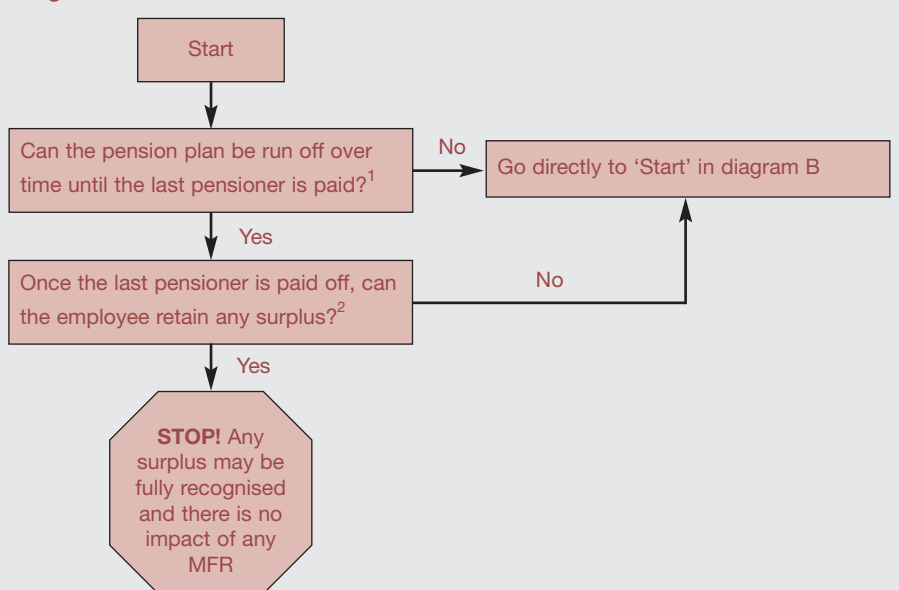
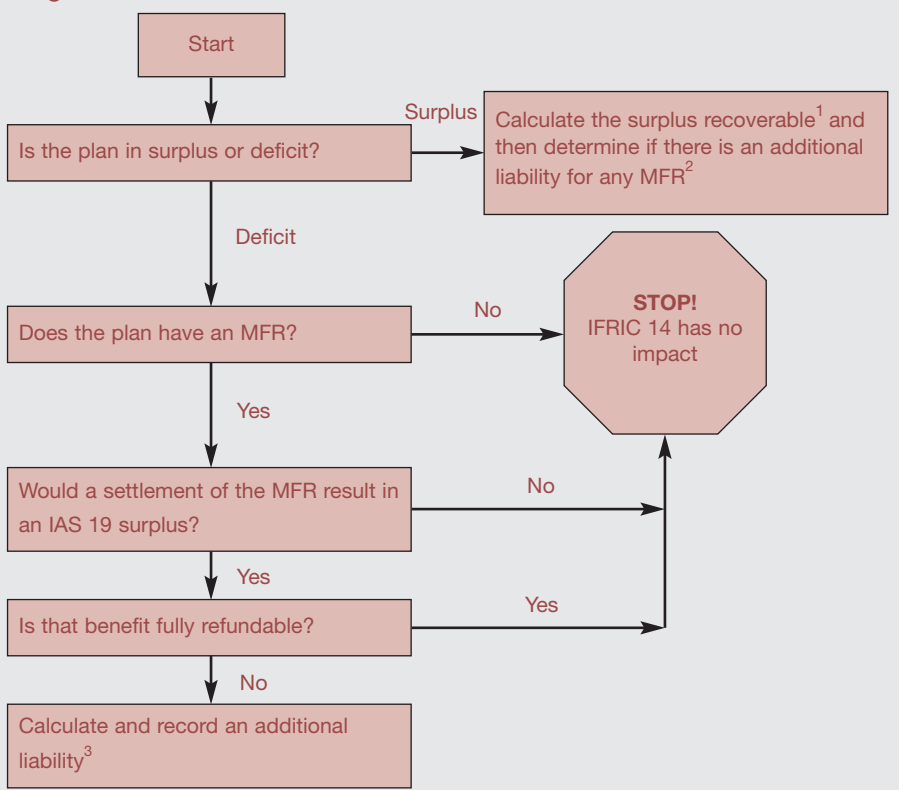


Diagram B



IFRIC issues draft interpretations on real estates sales and net investment hedges

D21, Real Estate Sales

IFRIC has issued draft interpretation D21, Real Estate Sales, to address diversity in practice in the treatment of real estate sales. The exposure draft, issued in July 2007, clarifies when a real estate contract is a construction contract as opposed to a contract for the sale of finished goods. It provides factors that indicate that a contract is for construction services, including:

- the ability of the buyer to specify major structural elements of the design; and
- transfer of control and risks and rewards of ownership as work progresses.

D21 also proposes that the revenue recognition criteria for sale of goods outlined in IAS 18 paragraph 14 must be met for the sale of completed or substantially completed real estate.

These criteria are proposed to be applied to the real estate itself, in its current state, and not to the buyer's right to acquire fully constructed real estate.

Revenue recognition would be deferred until completion of construction and transfer of risks, rewards and control in situations where completed or substantially completed real estate units are sold.

Comments are due by 5 October 2007; a final standard is expected some time in 2008.

D22, Hedges of a Net Investment in a Foreign Operation

Since the Improvements project, the Board has continued to make changes to foreign currency and financial instruments standards. Exposure draft D22 was issued in July 2007 relating to

net investment hedges. If adopted the interpretation will:

- disqualify presentation currency risk as a risk that can be hedged. The draft interpretation clarifies that only risk associated with functional currencies can be hedged;
- allow a parent company to hedge a net investment in an indirect subsidiary. The draft interpretation clarifies that an entity can hedge a net investment in an indirect foreign subsidiary where there are intervening subsidiaries with different functional currencies; and
- allow a hedging instrument to be held anywhere within a consolidated group, regardless of the functional currency of the entity holding the hedging instrument.

Comments are due by 19 October; a final standard is expected some time in 2008.



Perspective of new IFRIC member

Guido Fladt, new IFRIC member and head of the IFRS technical function in PwC Germany, talks to IFRS News about his views on, and expectations for, the committee.

What skills do you bring to your role on IFRIC?

IFRIC members are selected based on specific skills, as laid down in the IFRIC Due Process Handbook, which particularly includes an awareness of current accounting issues and the technical ability to solve them. As a technical partner, I am continuously concerned with accounting issues that have practical relevance for our clients, and my job has always been to come up

with solutions. As a member of PwC's Global Accounting Consulting Services network, I not only deal with German problems but also with international ones. So based on my technical experience and my affiliation to our IFRS network, I think that I meet the required skills.

What do you want to accomplish during your tenure on IFRIC?

IFRIC members are appointed for a three-year term, which might be

renewed for another three years. During this term, I would like to contribute to the process of IFRIC addressing issues of widespread practical relevance that can be resolved efficiently – ie, on a timely basis.

Are there any areas in particular you would like to see addressed?

One particular area, where I have seen divergence in practice and which in my mind is of huge relevance, is the

consolidation of so-called special purpose entities. In general, I think that SIC-12 gives the right answer, but there ought to be some more specific guidance without going as far as a rules-based interpretation. The IASB will address this issue in its consolidation project, and we will have to wait and see what the outcome will be. Another area where I see the need for further interpretation is assets held for sale and discontinued operations.

Should the IFRIC do more interpretations or fewer?

Right now, IFRIC meets six times a year. All debates have to take place during these six two-day public meetings. Hence there is a natural restriction to the number of interpretations that IFRIC can do. In addition, you need to look at each issue very thoroughly to avoid having to readdress an interpretation after it has been published. So, I think that IFRIC should be able to publish between four and six interpretations annually, which on average is pretty much the number they have issued so far. You must bear in mind that IFRIC is not supposed to act as an urgent issues group.

How effectively do the members work together?

What I have seen during my first meetings is that all the members work very effectively together. The members come from a variety of backgrounds and bring different knowledge and experiences to the table. The discussions are very intensive and you have to concentrate closely during the whole meeting. What I see as of great importance for an effective and efficient meeting is the co-ordination and leadership by the IFRIC chairman. I was impressed by the way Bob Garnett achieves this.

Does IFRIC have adequate staff resources?

You probably can never have enough

staff. I was introduced to the IFRIC staff members, who are highly qualified professionals. But I can imagine that they would not object to having additional support.

Does this affect IFRIC's ability to serve constituents' interests?

My understanding is that at the moment the backlog of submissions is not very high. But this might change and, since emerging issues should be resolved in good time, it might be necessary to step up IFRIC's resources in the future.

I hope that, in five years time, the IASB will have dealt with most of the basic issues that they have on their agenda, like revenue recognition, the distinction between liabilities and equity and so on. Then we would really have a stable platform.

Who do you most admire on IFRIC or in standard setting generally, and why?

There is no specific person that I admire most. If you would ask me what the most important attributes of a person involved in standard setting are, I would probably say to be always consistent in developing standards and interpretations, to be aware that accounting is not an exact science where there is always only one correct answer, and to be thick-skinned.

Why is a thick skin an advantage?

You cannot please everyone. So, I expect that whatever conclusion is reached at IFRIC, there will always be constituents, like preparers or auditors, who will criticise what IFRIC has decided. It would

not be good for one's health to take this criticism to heart.

Are you there to represent the firm or as an individual?

As an IFRIC member, I am not a representative of the PwC network. I have to form my own view independently, which might then deviate from the firm's view. Nevertheless, it is expected that I use the resources of the firm's network to identify issues that should be submitted to IFRIC for an interpretation, or to gather information that helps me to form my own view. On the other hand, I am not relying only on the firm as a source of information but, for example, also on the German Institute of Chartered Accountants and the Accounting Standards Committee of Germany.

What area of accounting are you most interested in?

I was always a generalist and tried to cover all areas of accounting (with the exception of agriculture, I have to admit). Within PwC's Global Accounting Consulting Services group, I recently changed from the Financial Instruments to the Business Combinations Team. Therefore, I am mostly interested in transactions that involve different aspects of accounting, like for instance a business combination with puttable minorities and a replacement of share-based payment awards.

How do you think the IFRS landscape will look in five years time?

I hope that, in five years time, the IASB will have dealt with most of the basic issues that they have on their agenda, like revenue recognition, the distinction between liabilities and equity and so on. Then we would really have a stable platform.

IFRIC members		
Member	Position	Term ends
Bob Garnett, chairman	Appointed to the IASB in January 2001. Previously technical director at the South African Institute of Chartered Accountants; partner in Arthur Andersen's financial consulting practice in Johannesburg; head of investment management operations of Southern African venture capital group; member of the Investment Analysts Society of Southern Africa; general manager of Finansbank; executive vice-president, finance, for Anglo American; member of the South African Accounting Practices Board; committee member on IASC's project on extractive industries.	N/A
Philip D Ameen	Vice president and comptroller of General Electric; member of the FASB's task force on business combinations; chairman of the Financial Executives Institute's Committee on Corporate Reporting.	2008
Michael E Bradbury	Professor of accounting in the faculty of business at Unitec, Auckland, New Zealand. Member of the Financial Reporting Standards Board of New Zealand.	2008
Claudio De Conto	General manager, administration and control, Pirelli, Milan.	2008
Guido Fladt	Head of the technical IFRS function in PwC, Germany; member of the committee at the Institute of Certified Public Accountants in Germany (IDW) providing guidance on the application of IFRS; chairman of the IDW Committee on Financial Instruments.	2010
Bernd Hacker	Head of Standard Setter Liaison and Financial Instruments Accounting Policies at Siemens in Germany;	2010
Sara York Kenny	Principal Accounting Policy Advisor at the International Finance Corporation, World Bank Group, responsible for the development and maintenance of its US GAAP and IFRS accounting policies; member of the IASB and FASB's Joint International Group on Financial Statement Presentation.	2009
Jean-Louis Lebrun	Partner and IFRS international technical leader at Mazars; member of EFRAG working party on concessions; member of EFRAG committee that sets accounting; member of IFAC's transnational audit committee	2008
Takatsugu Ochi	General Manager of the Planning and Administration Department, Financial Resources Management Group, Sumitomo Corporation, Japan, responsible for the company's internal control system; member of the International Issues Standing Committee and Technical Committee for Amendment of Company Law at the Accounting Standards Board of Japan	2009
Ruth Picker	Senior Partner in Ernst & Young's Technical Consulting Group, Global IFRS; member of E&Y's Global International Financial Reporting Standards Policy Committee; lecturer and Task Force member for the Securities Institute of Australia; member of the Editorial Board of the Australian Accounting Review; member of the Industry Advisory Committee for the Melbourne Centre for Financial Studies.	2009
Darrel Scott	Head of Group Finance, FirstRand Banking Group in South Africa;	2010
Andrew Vials	KPMG partner in charge of the UK firm's Department of Professional Practice, Accounting and Reporting.	2010
Ken Wild	National director of assurance and advisory services at Deloitte Touche Tohmatsu, UK; DTT's global IFRS leader; member of the Financial Reporting Advisory Board of the UK Government Treasury; member of the Technical Committee of the 100 Group of Finance Directors.	2009
Observers	International Organization of Securities Commissions (IOSCO); European Commission	
Key ■ Auditor ■ Preparer ■ Standard setter/academic		



For further help, please contact:

Head of the IFRS Conversion Team – Yves Vandenplas: Tel. +32 2 710 4029; yves.vandenplas@pwc.be

Patrice Schumesch: Tel. +32 2 710 4028; patrice.schumesch@pwc.be